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Weekly Fixed Income Commentary

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Long Treasury yields rise as the Fed adjusts its inflation strategy

The Federal Reserve (Fed) announced a shift in its approach to maintaining stable prices, now targeting an inflation rate that "averages 2 percent over time." Longer maturity Treasury yields rose on the news. Non-Treasury sectors generally fared well last week, with the exception of longer-duration assets.

HIGHLIGHTS

- **High yield corporates enjoyed outsized positive returns, outpacing all other sectors.**
- **High yield municipals outperformed high grades.**
- **Emerging markets debt markets declined for a third consecutive week.**

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FED STRATEGY CHANGES LIFT LONGER TREASURY YIELDS

30- and 10-year U.S. Treasury yields moved higher last week, while the 5-year yield remained nearly unchanged and the 2-year yield fell slightly.[1] All Treasury yields drifted higher to begin the week, propelled by optimism over U.S./China trade talks and progress developing a COVID-19 vaccine. Record-sized auctions earlier in the week were easily absorbed for 2-, 5- and 7-year Treasuries, keeping rates anchored for this maturity range. On Thursday, the Fed announced changes to its monetary policy strategy. Going forward, it will target an inflation rate that "averages 2 percent over time." Longer maturity Treasury yields moved higher as a result, as investors anticipated that the Fed will let inflation run higher for an extended period of time.[1] Treasury rates slipped lower on Friday, led by 2- to 5-year maturities, as investor demand picked up ahead of month-end.[1]

Non-Treasury sectors generally fared well last week, with the exception of longer-duration assets.[1] Several sectors produced positive returns, and most sectors outperformed the lagging Treasury market. High yield corporates enjoyed outsized positive returns, outpacing all other sectors.[1] Senior loans, preferred securities, mortgage-backed and asset-backed securities also delivered positive returns, although the total returns of the latter two were only slightly positive.[1] Returns on longer-duration sectors suffered due to rising yields on long maturity Treasuries, and taxable municipals and investment grade corporates experienced the lowest weekly total returns.[1] Non-U.S. returns were mixed, as emerging markets experienced negative returns while the global aggregate index eked out a slightly positive total return.[1]

After Labor Day, we expect the municipal new issue calendar to be robust and priced to sell through the end of the year.

MUNICIPAL NEW ISSUANCE SOON EXPECTED TO BE ROBUST

Municipal yields rose again last week, but the market maintains a solid tone.[1] New issue supply of approximately $10 billion was priced to sell and well received.[2] Fund flows were positive for the 16th consecutive week at $1 billion.[3] New issue supply should be $10.7 billion this week ($3.9 billion taxable).[2]

Municipal yields have risen for two consecutive weeks, coming off all-time lows.[1] It is not surprising that investors are being more selective at such low yields. After Labor Day, we expect the municipal new issue calendar to be robust and priced to sell through the end of the year. However, as we have been saying for quite some time, rates will remain lower for longer. Thus we would treat any municipal selloff as a potential buying opportunity.

New York City issued $1 billion tax-exempt general obligation bonds (rated Aa1/AA).[4] The 10-year bond was priced at a 1.45% yield, substantially cheaper than the 10-year U.S. Treasury bond at 0.74%. New York City is facing myriad issues due to the coronavirus pandemic. Nevertheless, the deal was well received by New York investors looking for tax-exempt income.

High yield municipals outperformed high grades last week.[1] New issuance is increasing, with several deals coming this week. They include a $1.3 billion deal for LaGuardia Airport Delta facilities, a $274 million deal for a new technology recycling plant in Ohio and a $141 million senior living project in Boca Raton, Florida.[4] High yield municipals saw their first outflows in 15 weeks, with a small outflow of -$15 million.[3] Municipal defaults remain minimal, at $2.3 billion, or 0.69% of the high yield municipal market, over the last 12 months. Compare this to corporate bond defaults of $76 billion, or 6.22% of the corporate high yield market.[5]

HIGH YIELD CORPORATE BONDS GAIN IN A RISK-ON WEEK

High yield corporates recorded their best total return in a month, performing in sympathy with U.S. equities amid last week's strong risk-on tone.[1] Spreads narrowed by 26 bps, ending the week at 476 bps — their tightest level since early August and far below their 20-year average of 530 bps.[1] Industry and sector results were almost universally positive, led by retail real estate investment trusts (REITs), airlines and leisure.[1]

Investment grade corporate bonds reversed course from the prior week's gain in what has been a weekly see-saw from positive to negative territory during August.[1] While investment grade credit spreads were flat to incrementally tighter for the week, the asset class was hurt by its long duration. The yield curve steepened, with 10- and 30-year Treasury rates closing at their highest levels since mid-June.[1] On a sector basis, railroads and utilities suffered the most, while airlines and lodging fared reasonably well.[1]

High yield corporate spreads narrowed to their tightest level since early August.

Emerging markets (EM) debt posted its third consecutive decline after a 15-week run of positive returns.[1] Last week's loss (-0.25%) was relatively modest, as fund inflows reflected continuing demand for EM debt and spreads tightened modestly.[1] Within EM segments, a weaker U.S. dollar bolstered local-currency issues, which outperformed sovereign and corporate bonds.

In focus

Corporate bond issuance is setting records

With all-time low yields, corporations are borrowing huge sums of money this year, to the tune of $1.5 trillion through July.[1] This already surpasses the previous full-year record for gross investment grade corporate bond supply set in 2017. We believe the 2020 total could reach nearly $1.7 trillion.

Even more impressive, issuance net of redeemed debt has exceeded $878 billion. Since 1993, the next highest yearly net issuance amount was $701 billion in 2009.[1]

This trend represents a significant change in the primary use of corporate proceeds. The percentage of issuance used to redeem outstanding debt has been steadily rising since 2013, until this year. For comparison, 73% of gross debt issued in 2019 was offset by redeemed debt, versus only 40% so far in 2020.[1]

We believe the current pace of corporate issuance will slow. Corporations have pulled much of the current supply forward from September and October to take advantage of falling Treasury yields that helped drive new issue bond coupons to all-time lows. We think a broad base of investors, including possibly the Federal Reserve, will easily absorb the remaining issuance. The Fed has only purchased about $12 billion in corporate bonds and exchange-traded funds, and has the capacity to buy an additional $738 billion.[1]

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.13	-0.02	0.02	-1.44
5-year	0.27	0.01	0.07	-1.42
10-year	0.72	0.09	0.20	-1.20
30-year	1.50	0.16	0.31	-0.89

Source: Bloomberg L.P. As of 28 Aug 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.16	0.02	0.03	-0.88
5-year	0.26	0.03	0.03	-0.83
10-year	0.81	0.08	0.16	-0.63
30-year	1.56	0.10	0.19	-0.53

Source: Bloomberg L.P. As of 28 Aug 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	109
30-year AAA Municipal vs Treasury	103
High Yield Municipal vs High Yield Corporate	85

Source: Bloomberg L.P., Thompson Reuters. As of 28 Aug 2020. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	1.31	–	5.33	-0.33	-0.48	3.30
High Yield Municipal	4.54	318[6]	8.79	-0.39	0.22	0.22
Short Duration High Yield Municipal[7]	4.11	363	3.97	-0.01	0.56	0.35
Taxable Municipal	2.27	141[8]	10.06	-1.10	-1.41	8.23
U.S. Aggregate Bond	1.18	57[8]	6.08	-0.51	-1.04	6.60
U.S. Treasury	0.51	–	7.19	-0.65	-1.38	8.44
U.S. Government Related	1.14	66[8]	5.99	-0.48	-0.71	4.86
U.S. Corporate Investment Grade	1.99	130[8]	8.63	-0.90	-1.79	6.50
U.S. Mortgage-Backed Securities	1.26	55[8]	2.06	0.06	0.05	3.74
U.S. Commercial Mortgage-Backed Securities	1.51	111[8]	5.31	-0.08	-0.04	6.42
U.S. Asset-Backed Securities	0.61	47[8]	2.12	0.04	0.21	3.97
Preferred Securities	2.78	198[8]	4.21	0.28	1.74	3.08
High Yield 2% Issuer Capped	5.37	476[8]	3.59	0.75	0.91	1.56
Senior Loans[9]	6.17	594	0.25	0.35	1.38	-1.63
Global Emerging Markets	4.17	357[8]	6.62	-0.25	0.35	3.04
Global Aggregate (unhedged)	0.91	48[8]	7.29	0.06	-0.35	5.90

6 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **7** Data is a subset of the S&P Short Duration Municipal Yield Index that is below investment grade/nonrated. Spread is the yield difference between this subset and the subset rated AAA. **8** Option-adjusted spread to Treasuries. **9** Spread refers to the 3-year discount margin. Duration is estimated based on the frequency of the reset date.

Source: Bloomberg L.P. and Credit Suisse. As of 28 Aug 2020. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. All index returns are shown in U.S. dollars. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer actually defaulting. **Effective duration** (expressed in years) measures the price sensitivity of a fixed-income investment to a change in interest rates, considering that expected cash flows will fluctuate as interest rates change. Index performance is shown for illustrative purposes only. Index returns include reinvestment of income and do not reflect investment advisory and other fees that would reduce performance in an actual client account. All indexes are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 28 Aug 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 26 Aug 2020. **5** J.P. Morgan.

Any reference to credit ratings refers to the highest rating given by one of the following national rating agencies: S&P, Moody's or Fitch. Credit ratings are subject to change. AAA, AA, A and BBB are investment grade ratings; BB, B, CCC, CC, C and D are below-investment grade ratings.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays Taxable Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

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Investing involves risk; principal loss is possible. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Preferred securities are subordinated to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments. The value of convertible securities may decline in response to such factors as rising interest rates and fluctuations in the market price of the underlying securities. Senior loans are subject to loan settlement risk due to the lack of established settlement standards or remedies for failure to settle. These investments are subject to credit risk and potentially limited liquidity, as well as interest rate risk, currency risk, prepayment and extension risk, and inflation risk

Investors should contact a tax advisor regarding the appropriateness of tax-exempt investments in their portfolio. If sold prior to maturity, municipal securities are subject to gain/losses based on the level of interest rates, market conditions and the credit quality of the issuer. Income may be subject to the alternative minimum tax (AMT) and/or state and local taxes, based on the state of residence. Income from municipal bonds held by a portfolio could be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

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