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Weekly Fixed Income Commentary

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Cautious sentiment pushes Treasury yields lower

U.S Treasury yields declined last week, led by longer maturities. Negative market sentiment was prompted by rising numbers of COVID-19 cases in Europe and decreasing expectations for an agreement on U.S. fiscal stimulus. The Federal Reserve (Fed) continues to reinforce a policy of low interest rates for at least several years.

HIGHLIGHTS

- **Mortgage-backed, asset-backed and commercial mortgage-backed securities eked out positive total returns.**
- **Municipal bond prices remained essentially unchanged again last week.**
- **The global aggregate and emerging markets indexes fared poorly.**

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INVESTOR CAUTION LEADS TREASURY YIELDS LOWER

U.S. Treasury yields fell last week, as risk sentiment eroded and investors embraced their relative safety. Longer maturities led the move lower, but the declines were relatively muted across the curve as record-low yields left little room to fall further.[1] The week began with a negative tone due to rising COVID-19 cases in Europe and falling expectations for additional U.S. fiscal stimulus. Despite the negative risk sentiment and more than $150 billion in Treasury supply, rates consistently closed within 1 basis point (bps) of their opening level throughout the rest of the week.[1]

The Fed reinforced the outlook conveyed in its summary of economic projections, which showed inflation and interest rate policy remaining at current levels for several years. Inflation expectations reacted negatively, with the TIPS break-even rates falling each day.[1] The 10-year break-even rate had climbed steadily after cratering in March and reached a 12-month high at the end of August.

The cautious market tone weighed heavily on the non-Treasury taxable sectors. Only taxable municipals outperformed Treasuries, and most sectors suffered a negative weekly total return.[1] The securitized sectors (mortgage-backed, asset-backed and commercial mortgage-backed) were the only others to eke out positive total returns.[1] In the U.S., high yield corporates fell the most, followed by preferred securities, then investment grade corporates and senior loans, which declined a similar amount. The global markets fared poorly as well, with both the global aggregate and emerging markets indexes falling more than 1%.[1]

Municipal yields remain low on an absolute and relative basis.

THE BACKDROP FOR MUNICIPALS IS ATTRACTIVE

Municipal bond prices remained essentially unchanged again last week.[1] New issue supply totaled $10 billion and was priced to sell.[2] Fund flows were positive for the 20th consecutive week at $499 million.[3] This week's new issue supply is expected to be $9.9 billion ($5.9 billion taxable).[2] According to Municipal Market Analytics, the market has sustained 18 straight sessions of mostly unadjusted benchmarks, the longest streak of such unprecedented low volatility since 1988.

The municipal market continues to have a strong tone. The Fed stated that rates will stay low until the U.S. economy recovers from the pandemic. Municipal yields remain low on an absolute and relative basis. In fact, some tax-exempt municipals are trading at cheaper yields than their taxable counterparts, such as those issued by the University of California and New York State Personal Income Tax (PIT) bonds. This dislocation should maintain an attractive backdrop for municipals for the foreseeable future.

Texas Water Development Board issued $628 million water revenue bonds (rated AAA).[4] The deal was well received. In the secondary market, the 25-year bond with a 4% coupon traded at 1.79%, compared to an original yield of 1.84%. This makes sense, considering the 30-year Treasury bond is only trading yielding 1.45%. Tax-exempt municipal bonds are a bargain.

High yield municipal yields continued to decline last week, after a surge of issuance, which we believe is a sign of a well-placed recovery trend.[1,2] This trend is even more impressive heading into the end of the year, when investors typically expect weaker performance due to adverse technical factors. Tobacco securitization refunding continues, with Michigan announcing a deal for one of the market's largest and remaining issuances.[4] These refunding deals make tobacco bonds less available, presenting outsized reinvestment risk for portfolios concentrated in these securities.

HIGH YIELD CORPORATE BONDS TURN NEGATIVE FOR THE YEAR

High yield corporates suffered their worst weekly return since late April and slipped back into negative territory for the year for the first time since the end of July.[1] Spreads increased by 47 bps during the week, to 538 bps.[1] High yield bond funds reported outflows of $4.2 billion, the largest withdrawal of the quarter.[3] Supply remained heavy, with last week's record new issuance of $25 billion bringing September's total to nearly $50 billion.[2]

Investment grade corporate bonds snapped a three-week winning streak, but still fared better than their high yield counterparts.[1] Volatility picked up during the week amid an increase in COVID-19 cases, heightened U.S. election uncertainty and lack of progress on fiscal stimulus negotiations. Investment grade spreads widened by 12 bps, finishing above 200 bps for the first time since mid-July.[1] It was a busy week in terms of new issuance, with nearly $36 billion and 22 deals brought to market.[2]

Investment grade corporates fared better than their high yield counterparts.

Emerging markets (EM) debt traded poorly last week, in tandem with other risk assets.[1] Within EM, corporate bonds held up relatively better than sovereign issues, while local-currency markets were particularly hard hit as the week's flight to safety boosted the U.S. dollar. Despite posting their largest weekly loss since March, EM debt remains positive for the quarter and the year to date.[1]

In focus

Corporate credit has proved resilient

Below-investment-grade corporate debt, such as senior loans and high yield bonds, has experienced volatility alongside equities, as expected given their high correlations. However, corporate credit has historically also shown more resilience to the downside relative to stocks. This relationship has played out once again in recent weeks.

While the S&P 500 Index lost -7.79% from 2 September to 25 September, senior loans are slightly positive over the same time frame at +0.27%, despite some recent weakness.[1] High yield bonds, with less seniority and security relative to their senior loan counterparts, were down a little over -2.00%, which still compares favorably to the S&P.[1]

The recent high yield weakness is at least partly technical in nature. Waning demand from mutual funds and ETFs, along with a heavy new issue calendar, are main factors behind the recent price action. In fact, the higher quality assets within high yield (such as those rated BB) have underperformed in recent weeks despite falling volatility in the interest rate market. This move demonstrates that price action is being driven heavily by technicals instead of increasing worries over credit fundamentals.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.13	-0.01	0.00	-1.44
5-year	0.27	-0.02	0.00	-1.42
10-year	0.66	-0.04	-0.05	-1.26
30-year	1.40	-0.05	-0.07	-0.99

Source: Bloomberg L.P. As of 25 Sep 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	0.13	0.00	-0.03	-0.91
5-year	0.24	0.00	-0.02	-0.85
10-year	0.83	-0.01	0.02	-0.61
30-year	1.58	0.00	0.02	-0.51

Source: Bloomberg L.P. As of 25 Sep 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	126
30-year AAA Municipal vs Treasury	113
High Yield Municipal vs High Yield Corporate	75

Source: Bloomberg L.P., Thompson Reuters. As of 25 Sep 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	–	5.41	0.02	0.08	3.39
High Yield Municipal	4.51	314[5]	8.97	0.07	0.20	0.47
Short Duration High Yield Municipal[6]	4.23	375	4.23	0.04	0.21	0.58
Taxable Municipal	2.19	139[7]	10.07	0.38	0.79	9.39
U.S. Aggregate Bond	1.18	62[7]	6.14	-0.09	-0.02	6.83
U.S. Treasury	0.48	–	7.27	0.26	0.31	9.09
U.S. Government Related	1.12	68[7]	5.97	-0.14	-0.08	4.97
U.S. Corporate Investment Grade	2.03	140[7]	8.69	-0.69	-0.33	6.59
U.S. Mortgage-Backed Securities	1.30	65[7]	2.12	0.06	-0.17	3.55
U.S. Commercial Mortgage-Backed Securities	1.43	107[7]	5.30	0.01	0.38	7.02
U.S. Asset-Backed Securities	0.55	42[7]	2.12	0.02	0.11	4.13
Preferred Securities	3.22	241[7]	4.21	-0.99	-0.95	2.13
High Yield 2% Issuer Capped	6.03	538[7]	3.82	-1.52	-1.74	-0.15
Senior Loans[8]	6.03	580	0.25	-0.67	0.60	-0.91
Global Emerging Markets	4.10	354[7]	6.72	-1.27	-1.32	1.88
Global Aggregate (unhedged)	0.90	51[7]	7.38	-1.02	-0.71	5.35

5 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **6** 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. **7** Option-adjusted spread to Treasuries. **8** 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 25 Sep 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, 25 Sep 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 23 Sep 2020.

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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