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Weekly Fixed Income Commentary

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Treasury yields rise amid risk-on sentiment

U.S. Treasury yields rose across the yield curve last week, led by longer maturities. Investors saw renewed potential for a fiscal stimulus package, as well as the possibility of a Democratic sweep of the White House and Senate. Risk assets rallied as a result.

HIGHLIGHTS

- **High yield corporates enjoyed the strongest returns, followed by emerging markets.**
- **Municipal bond yields sold off, following Treasury yields.**
- **Preferred securities, senior loans and investment grade corporates solidly outperformed similar-duration Treasuries.**

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TREASURY YIELDS RISE ON FISCAL STIMULUS HOPES

U.S. Treasury yields finished last week higher across the curve, led by longer maturities. Markets were entirely focused on the chaotic negotiations for an additional fiscal stimulus spending package. Political negotiations continued in hopes of passing a stimulus bill before the election. However, markets began looking beyond the election and pricing in a potential Democratic sweep of both the White House and the Senate. Expectations reflect that such an outcome would lead to a larger stimulus bill being passed early next year. As a result, risk assets rallied and longer-maturity Treasury yields rose. Higher long rates and a steeper yield curve reflect both an increase in economic growth fueled by the fiscal stimulus, as well as increased Treasury supply to fund the spending.

Fiscal stimulus hopes fostered a strong risk-on sentiment. In fact, while Treasury returns fell, most sectors delivered positive weekly total returns. Only taxable municipals underperformed Treasuries. High yield corporates enjoyed the strongest returns, followed by emerging markets. The other credit sectors also outperformed, with preferred securities, senior loans and investment grade corporates posting positive total returns and solidly outperforming similar-duration Treasuries. The higher quality sectors experienced softer returns, with commercial mortgage-backed securities enduring the worst relative performance after taxable municipals. The global aggregate index joined emerging markets in outperforming the U.S. markets, based on strong returns in the European region.

OUTSIZED ISSUANCE BOOSTS MUNICIPAL BOND YIELDS

Municipal bond yields sold off last week, following Treasury yields. New issue supply of $15.7 billion was priced to sell and well received. Fund flows were positive at $1.7 billion, after one week of negative flows. New issuance is expected to be outsized this week at $15.9 billion ($5.6 taxable).

Municipal yields rose last week primarily for two reasons: continued chatter from Washington, D.C. about additional stimulus and a robust municipal new issue calendar. We expect the outsized new issue pattern to continue for the remainder of the year. And demand for tax-exempt bonds remains strong, as yields are greater than U.S. Treasuries and institutional investors own a tremendous amount of short-term securities. The steep yield curve means new issue supply will continue to be well received, and managers will sell short-term holdings to pay for new (longer) purchases.

The City of New York issued $1 billion general obligation bonds (rated Aa2/AA). The 20-year bond was issued with a with a 4% coupon at a yield of 2.48%. The same bond traded in the secondary market at 2.42%. This deal illustrates the continued demand for tax-exempt bonds, especially in a high-tax state like New York.

High yield municipal bond yields held relatively steady last week against pressure from heightened new issuance volume and increasing Treasury yields. Yields increased just 3 basis points (bps) on average, compared to 9 bps for AAA-rated 20-year bonds. Fund flows snapped back to positive territory with inflows of $349 million. New issuance is expected to be lighter this week in the number of deals, but all eyes will be on the first attempt to bring a $3.2 billion deal for Brightline West.

Municipal fund flows were positive at $1.7 billion, after one week of negative flows.

HIGH YIELD CORPORATES AND EM DEBT POST BEST WEEKLY RETURNS SINCE JULY

High yield corporate bonds outperformed all fixed income sectors last week, recording their largest gain in nearly three months. High yield benefited from the week's strong risk-on tone in equity markets, which lifted the S&P 500 Index by nearly 4%. Spreads tightened by 41 bps, and fund flows (+$4 billion) turned positive after two weeks of outflows. In the primary market, new high yield issuance totaled $8 billion, most of it refinancing activity.

Emerging markets (EM) debt fired on all cylinders, generating its highest one-week return since late July. Results were positive across sovereign, corporate and local-currency segments on optimism that large-scale U.S. stimulus was still on the table. EM spreads narrowed by 19 bps for the week, and inflows into EM funds accelerated to $1.7 billion. Local EM currencies were buoyed by the prospect of a weaker U.S. dollar in the event of a Biden victory in November.

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Investment grade credit was marginally positive for the second week in a row. Although spreads tightened by 8 bps and fund inflows (+$8.7 billion) reached a six-week high, the higher quality and longer duration of investment grade corporates tempered their performance given last week's increased risk appetites and yield-curve steepening. The asset class has not generated a weekly return of 1% or higher since late May.

In focus

Fed policies boost the MBS market

The Federal Reserve (Fed) has responded quickly and aggressively to economic and fixed income market stresses triggered by the coronavirus pandemic. Two elements have significantly impacted the housing and mortgage markets: cutting policy rates to zero and buying mortgage-backed securities (MBS).

The Fed began cutting policy rates in mid-2019, dropping them to zero in March 2020. This action, coupled with expanded U.S. Treasury purchases, helped drive mortgage rates to all-time lows in August. Record low mortgage rates have supported home prices, spurred sales activity and fueled loan refinancing. The rate of home price appreciation has been trending higher after a brief pause, and home sales activity has jumped to the highest level since December 2006. Loan refinancing has reached 40% annualized rates for government loans, which had been as low as 10% as recently as early 2019.

The Fed began buying MBS in March, to help stabilize deteriorating financial market conditions and add liquidity. Since then, it has purchased more than $1 trillion in MBS and has grown its net holdings by $600 billion. As a result, the MBS sector has produced stable returns throughout the year, as well as some of the best year-to-date returns relative to Treasuries of any fixed income sector.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.16	0.02	0.03	-1.42
5-year	0.34	0.05	0.06	-1.35
10-year	0.78	0.07	0.09	-1.14
30-year	1.57	0.09	0.12	-0.82

Source: Bloomberg L.P. As of 09 Oct 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	0.15	0.02	-0.02	-0.89
5-year	0.29	0.03	-0.03	-0.80
10-year	0.95	0.07	-0.08	-0.49
30-year	1.73	0.10	-0.11	-0.36

Source: Bloomberg L.P. As of 09 Oct 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	120
30-year AAA Municipal vs Treasury	109
High Yield Municipal vs High Yield Corporate	87

Source: Bloomberg L.P., Thompson Reuters. As of 09 Oct 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	1.41	–	5.61	-0.33	-0.42	2.90
High Yield Municipal	4.61	310[1]	9.32	-0.18	-0.29	0.07
Short Duration High Yield Municipal[2]	4.23	365	4.19	-0.07	-0.03	0.56
Taxable Municipal	2.32	140[3]	10.09	-0.75	-0.83	8.06
U.S. Aggregate Bond	1.21	56[3]	6.16	-0.17	-0.22	6.55
U.S. Treasury	0.55	–	7.26	-0.50	-0.64	8.20
U.S. Government Related	1.16	64[3]	6.00	-0.02	-0.07	4.88
U.S. Corporate Investment Grade	2.00	126[3]	8.71	0.12	0.13	6.78
U.S. Mortgage-Backed Securities	1.31	56[3]	2.23	-0.05	-0.04	3.58
U.S. Commercial Mortgage-Backed Securities	1.48	104[3]	5.29	-0.23	-0.23	6.74
U.S. Asset-Backed Securities	0.57	41[3]	2.14	-0.03	-0.03	4.11
Preferred Securities	2.86	210[3]	4.20	0.45	1.02	3.33
High Yield 2% Issuer Capped	5.33	470[3]	3.63	1.19	1.35	1.93
Senior Loans[4]	5.89	563	0.25	0.45	0.45	-0.38
Global Emerging Markets	3.94	329[3]	6.79	1.00	0.98	2.93
Global Aggregate (unhedged)	0.91	47[3]	7.40	0.34	0.35	6.10

1 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **2** 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. **3** Option-adjusted spread to Treasuries. **4** 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 09 Oct 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.

Performance: Bloomberg, L.P. **Issuance:** The Bond Buyer, 09 Oct 2020. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 07 Oct 2020. **Mortgages:** Mortgage Bankers Association, National Association of Realtors, U.S. Census Bureau, Bloomberg and the New York Federal Reserve.

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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A word on risk

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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