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Weekly Fixed Income Commentary

21 December 2020

Treasury yields rise on positive investor sentiment

U.S. Treasury yields closed higher last week, led by longer maturities. Investors were encouraged by positive news related to Brexit, coronavirus vaccines and U.S. fiscal relief efforts. The Federal Reserve (Fed) remained dovish at its December meeting, maintaining asset purchases at least at the current level for the foreseeable future.

HIGHLIGHTS

- **Preferred securities and emerging markets performed best, followed by high yield corporates and senior loans.**
- **Municipal bond prices continued to grind higher for yet another week.**
- **The global aggregate index posted a positive total return, based on strong returns in Europe.**

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TREASURY YIELDS RISE ON POSITIVE RISK SENTIMENT

All segments of the U.S. Treasury yield curve rose last week, led by longer maturities. Interest rates rose modestly but steadily throughout the week, driven mainly by investor sentiment rather than any fundamental developments. Positive news related to Brexit, coronavirus vaccine progress and fiscal relief efforts set a constructive tone, despite surging virus cases across the globe. The Fed meeting and disappointing economic data had little impact on interest rates.

The Fed continued with a dovish tone at its December meeting. It committed to maintain asset purchases at least at the current level "until substantial further progress" has been made toward achieving its dual mandate, effectively extending purchases well beyond their previously designated period of "the coming months." Treasury yields initially rose with the Fed announcement, but subsequently declined to finish the day nearly unchanged.

The positive risk tone buoyed non-Treasury sector returns last week. All credit sectors outpaced Treasuries and most experienced positive total returns despite rising yields. Preferred securities and emerging markets enjoyed the highest weekly returns. High yield corporates and senior loans followed closely behind with solidly positive total returns. Taxable municipals and investment grade corporates endured negative weekly returns, as both sectors were dragged down by long durations. However, both sectors have benefited from their relatively long durations, leading all sectors for 2020 with total returns above 9%. The global aggregate index posted a positive total return last week, based on strong returns in Europe.

Taxable municipals and investment grade corporates have benefited year-to-date from their relatively long durations.

MUNICIPAL BONDS END THE YEAR WITH A CONSTRUCTIVE TONE

Municipal bond prices continued to grind higher for yet another week. New issue supply of $9.2 billion was priced to sell and well received. Fund flows were positive at $915 million. This week's new issue supply is expected to be less than $1 billion due to the Christmas holiday.

Municipal bond prices are ending the year with a very constructive tone. High grade tax-exempt bonds have retraced all losses sustained since the coronavirus pandemic caused financial dislocations in March, mainly due to U.S. government policies. But challenges lie ahead, as some governors and mayors hint at additional lock downs. However, vaccines are being rolled out with good reviews so far. Hopefully a successful vaccine will enable the U.S. economy to fully recover. And it should be noted that the federal government – through various actions and programs – has committed to keeping the economy afloat.

The state of Connecticut issued $800 million general obligation bonds (rated A1/A). The deal was well received. Originally, the 3% bonds due in 2034 were priced at a yield of 1.70%. Those bonds traded in the secondary market at 1.58%.

As investor flows continue to build, high yield municipal performance continues to accelerate. The growing consensus is that 2021 will be a favorable year for this asset class that was severely punished in the spring, but has only partially recovered in 2020. The new issue calendar has come to a close for the year, and investors must now rely almost entirely on the secondary market until the supply machine starts back up. As a result, we expect credit spreads to continue tightening and outperformance trends to persist. For example, Buckeye Tobacco and Puerto Rico COFINA continue to tighten, and both Illinois GO and Chicago GO have accelerated tightening recently. Many sectors should benefit directly from elements of the latest federal stimulus bill, and many sectors can benefit indirectly from increased economic activity in general.

HIGH YIELD CORPORATE SPREADS AND AVERAGE YIELDS CONTINUE TO HEAD LOWER

High yield corporates were among last week's top performers. Spreads narrowed by 8 basis points (bps) on the week, to 377 bps — far tighter than their long-term average of 528 bps. Having posted positive returns for seven consecutive weeks and 11 of the last 12, high yield now leads all fixed income categories for the month and quarter. This outperformance has driven the average yield down to 4.40%, near its all-time low. Fund flows into high yield were negative (-$1.2 billion) for the second time in the past three weeks, perhaps in part because investors may be skeptical of finding value at these levels.

Investment grade corporate bonds realized a slight loss. Spread tightening (-5 bps) was not enough to offset the negative impact of long duration (8.8 years), as last week's rise in U.S. Treasury rates was more pronounced at the long end of the curve. The asset class was the week's second-worst performer in fixed income, with only Treasuries finishing lower. Investment grade corporates still lead the pack for the year, with returns exceeding 9%.

The average yield on high yield corporates is near its all-time low.

Emerging markets (EM) debt extended its string of weekly gains to seven. Within EM, sovereign bonds fared better than corporate credit, and local-currency issues handily outperformed those denominated in U.S. dollars. Spreads tightened by 10 bps overall. EM fund flows moderated but remained positive.

In focus

The Fed quietly caps a memorable year

Last week, the Fed clarified that its objective is not merely to provide emergency relief during the pandemic, but also to ensure that the U.S. economy returns to its former strength as quickly as possible after the crisis subsides. The Fed also upgraded its GDP forecasts for 2020 and 2021, despite some signs of economic weakening.

In its policy statement, the Fed adjusted its primary rationale for its current quantitative easing (QE) asset purchases. The program was launched in mid-March to help promote market liquidity in the early days of the coronavirus outbreak. The Fed will continue to purchase $120 billion of debt per month.

Now the Fed views QE as a means to promote continuing accommodative monetary policy. This subtle change likely indicates not only that QE will last well beyond the end of the COVID-19 crisis, but also that it will persist at least until (1) the U.S. is on track to achieving full employment or (2) inflation is primed to rise beyond the Fed's 2% target. The Fed doesn't believe inflation will average 2% until 2023, with interest rates expected to stay near zero at least through 2023.

Continued loose monetary policy, along with fiscal stimulus, should eventually help the economy run hotter, resulting in lower unemployment, higher labor force participation and rising wages for a broader cross-section of the workforce.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.12	0.00	-0.03	-1.45
5-year	0.38	0.02	0.02	-1.31
10-year	0.95	0.05	0.11	-0.97
30-year	1.69	0.06	0.12	-0.70

Source: Bloomberg L.P. As of 18 Dec 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	0.14	0.00	-0.01	-0.90
5-year	0.22	0.00	-0.01	-0.87
10-year	0.71	0.01	-0.01	-0.73
30-year	1.39	0.01	-0.02	-0.70

Source: Bloomberg L.P. As of 18 Dec 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	75
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	88

Source: Bloomberg L.P., Thompson Reuters. As of 18 Dec 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	1.08	–	5.20	0.12	0.49	5.08
High Yield Municipal	3.88	271[1]	7.25	0.28	1.53	4.53
Short Duration High Yield Municipal[2]	3.55	314	3.73	0.32	1.42	3.80
Taxable Municipal	2.15	113[3]	9.98	-0.14	0.59	9.97
U.S. Aggregate Bond	1.17	44[3]	6.24	-0.08	-0.22	7.12
U.S. Treasury	0.60	–	7.23	-0.35	-0.54	7.66
U.S. Government Related	1.09	52[3]	6.04	0.05	0.18	5.65
U.S. Corporate Investment Grade	1.82	100[3]	8.82	-0.02	-0.28	9.10
U.S. Mortgage-Backed Securities	1.29	41[3]	2.40	0.19	0.13	3.78
U.S. Commercial Mortgage-Backed Securities	1.31	81[3]	5.30	0.05	0.50	7.86
U.S. Asset-Backed Securities	0.47	34[3]	2.10	0.00	0.14	4.45
Preferred Securities	2.28	158[3]	4.22	0.49	1.25	7.31
High Yield 2% Issuer Capped	4.40	377[3]	3.64	0.33	1.30	6.43
Senior Loans[4]	5.13	489	0.25	0.30	1.10	2.57
Global Emerging Markets	3.53	281[3]	6.90	0.49	1.14	6.13
Global Aggregate (unhedged)	0.85	37[3]	7.46	0.32	0.98	8.80

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 18 Dec 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.

For more information, please visit nuveen.com.

Performance: Bloomberg, L.P. **Issuance:** The Bond Buyer, 18 Dec 2020. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 16 Dec 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.

Representative indexes: municipal: Bloomberg Barclays Municipal Index; **high yield municipal:** Bloomberg Barclays High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Barclays Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg Barclays U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg Barclays U.S. Treasury Index; **U.S. government related:** Bloomberg Barclays U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg Barclays U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg Barclays U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg Barclays CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Barclays Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg Barclays High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Barclays Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Barclays Global Aggregate Unhedged Index.

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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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