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Weekly Fixed Income Commentary

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Treasury yields decline and risk assets rally

Despite further positive economic data, technical dynamics turned more favorable and helped all major fixed income market segments to rally last week. 10-year U.S. Treasury yields fell -6 basis points and credit sectors generated positive total and excess returns versus similar-duration Treasuries.

HIGHLIGHTS

- **High yield, preferreds and structured products outperformed Treasuries. Loans posted strong returns and rallied to their highest dollar price of the year.**
- **Municipal bond yields also fell. New issue supply was $9.5 billion, with flows of $2.1 billion. This week's new issue supply is expected to be light at $7.8 billion ($3.3 billion taxable).**
- **Emerging markets gained amid a weaker dollar and robust inflows.**

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CIO of Global Fixed Income

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Watchlist

- *Treasury yields fell and all major fixed income market segments rallied amid robust inflows and softening inflation expectations*
- *Risk assets continued to perform well, boosted by the decline in rates and improving technical dynamics*
- *We still expect yields to rise over the medium term, as the growth and inflation outlook improves*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Unprecedented global fiscal stimulus will boost consumption and growth this year.

Zero/negative global interest rate policy remains a key market support, but investors are beginning to focus on the eventual normalization of policy.

Record supply of investment grade corporates has been followed by issuance from high yield, middle market loans, broadly syndicated loan market and certain COVID-exposed names/sectors. Taxable municipal supply continues to grow.

We favor a risk-on stance, focused on credits with durable free cash flow and solid balance sheets across a wide range of sectors. Mid-quality rating segments remain particularly attractive. Essential service municipal credits also look compelling.

KEY RISKS

- Further complications with the COVID-19 vaccine rollout.
- Inflation rises in a disorderly way, forcing premature policy tightening.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.
- Policymakers become cautious or run out of stimulus capacity.

LOANS PERFORM WELL WITH STRONG DEMAND

U.S. Treasury yields declined from their recent peaks, with the moves led by lower inflation rates, as oil prices retreated and technical dynamics became more supportive for fixed income markets. 10-year yields ended the week -6 basis points (bps) lower, with the intermediate part of the curve rallying even more, as 5-year yields dropped -11 bps. Despite the rally, global economic data was strong, with March PMIs signaling an even faster pace of expansion.

Investment grade credit spreads were flat and remain close to their recent lows, though they saw positive returns of 0.42% amid the rally in rates, as yields fell -7 bps. Technical dynamics were supportive, as overall supply came at the low end of expectations, at 16 deals for a total of $15.2 billion. Demand for those deals was strong, showing investor interest in credit areas remain high.

High yield corporates rallied throughout the week, boosted by the combination of better risk sentiment, the rally in rates and positive technicals. The asset class saw inflows of $3.81 billion, the biggest inflow of the year. All ratings segments rallied, with higher-rated BBs continuing their recent strong performance and returning 0.62%, versus 0.53% for high yield overall. Loans also performed well, with 0.33% in total returns, as the index rallied to its highest price level of the year. Loans also enjoyed strong technicals, with inflows of $1 billion, the thirteenth consecutive weekly inflow.

Emerging markets rallied, returning 0.48%, benefiting from the stability in U.S. rates and the softer dollar, which retreated -0.9% versus major currencies. The asset class also saw positive inflows of $1.6 billion into hard currency funds and $200 million into local markets. Supply was limited amid the holiday-shortened week in much of the world, providing an additional tailwind.

THE MUNICIPAL MARKET NEEDS MORE SUPPLY TO MEET DEMAND

Municipal bond yields fell last week, in conjunction with Treasury markets. Each market finished with a constructive tone.

The Federal Reserve remains resolute that inflation is not a concern. In its March meeting minutes just released, the Fed acknowledged pricing pressures in certain parts of the U.S. economy. But officials assert that the economy still is in a much-needed recovery mode. Until recovery is complete, inflation should not be a concern. We expect fixed income in general to remain range bound until data show *outsized* inflation pressures. Municipals are currently trading rich by historical measures: the 10-year AAA tax-exempt benchmark is 62% of the 10-year government bond.

The state of Louisiana issued $225 million of general obligation bonds (rated Aa3/NR). Some 5% coupon bonds of 2040 came at a yield of 1.63%. Those bonds traded in the secondary market at a yield of 1.50%. There is currently not enough new issuance to meet the strong demand for tax-exempt bonds.

High yield municipal yields declined by 12 bps on average last week. Fund flows totaled $821 million, bringing flows to $6.35 billion year to date. Credit spreads continued to contract versus AAA-rated municipals and Treasuries. This week's new issue calendar is expected to offer sizable deals in multi-family housing and charter schools. Land-secured deals are consistently being priced weekly in response to a very robust housing market. We expect credit spreads to continue contracting overall, particularly in select sectors and credits that still represent attractive relative value. This is mainly due to strong demand and below-average supply, improving fundamentals and minimal defaults.

High yield municipal credit spreads are expected to continue contracting overall.

In focus

Munis proved resilient in the first quarter

U.S. Treasury rates have been rising, but for positive reasons as the economy begins to reopen. This increase pushed total returns for high quality municipal bonds slightly negative in the first quarter, but munis still outperformed other fixed income asset classes.

High grade municipals are more sensitive to interest rates because they are more highly correlated to the AAA MMD curve and the Treasury markets. Although the municipal-to-Treasury ratio is declining, the 10-year ratio is now as low as 64%, and the 30-year ratio now sits at 73%. Both levels are meaningfully below their long-term historical averages.

Ratios are low for many reasons. Supply has been moderate. Credit fundamentals have proven resilient, with revenues outperforming expectations and defaults remaining low. Municipalities are receiving a large amount of federal government stimulus, further bolstering credit conditions. Demand for tax-exempt income remains high, and should grow with the increasing probability of some higher income tax rates in the coming year.

High yield municipals have benefited most from falling ratios and narrowing credit spreads. Even in a bear market for Treasuries, certain municipals – particularly high yield – have generated positive returns.

In summary, lower ratios, tighter spreads, solid liquidity and modest supply are helping the municipal bond market.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.16	-0.03	-0.01	0.03
5-year	0.86	-0.11	-0.08	0.50
10-year	1.66	-0.06	-0.08	0.74
30-year	2.33	-0.03	-0.08	0.69

Source: Bloomberg L.P. As of 09 Apr 2021. **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	-0.02	-0.01	-0.01
5-year	0.47	-0.05	-0.04	0.25
10-year	1.03	-0.08	-0.09	0.32
30-year	1.64	-0.09	-0.11	0.25

Source: Bloomberg L.P. As of 09 Apr 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	62
30-year AAA Municipal vs Treasury	70
High Yield Municipal vs High Yield Corporate	87

Source: Bloomberg L.P., Thompson Reuters. As of 09 Apr 2021. 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	1.10	–	5.18	0.38	0.47	0.11
High Yield Municipal	3.49	205[1]	6.93	0.78	0.92	3.05
Short Duration High Yield Municipal[2]	2.95	223	3.68	0.25	0.28	2.21
Taxable Municipal	2.41	77[3]	9.79	0.70	0.89	-2.61
U.S. Aggregate Bond	1.56	31[3]	6.43	0.40	0.49	-2.90
U.S. Treasury	0.97	–	6.87	0.39	0.45	-3.82
U.S. Government Related	1.43	44[3]	6.08	0.37	0.45	-2.42
U.S. Corporate Investment Grade	2.21	89[3]	8.56	0.42	0.77	-3.91
U.S. Mortgage-Backed Securities	1.75	11[3]	3.99	0.37	0.29	-0.81
U.S. Commercial Mortgage-Backed Securities	1.63	68[3]	5.21	0.61	0.53	-1.81
U.S. Asset-Backed Securities	0.55	34[3]	2.07	0.09	0.05	-0.11
Preferred Securities	2.62	148[3]	4.73	0.52	0.82	0.40
High Yield 2% Issuer Capped	4.03	293[3]	3.82	0.53	0.71	1.57
Senior Loans[4]	4.80	444	0.25	0.33	0.37	2.38
Global Emerging Markets	3.95	276[3]	6.80	0.48	0.64	-2.86
Global Aggregate (unhedged)	1.13	33[3]	7.45	0.60	0.69	-3.80

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 09 Apr 2021. **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, 09 Apr 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 07 Apr 2021.

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 professional 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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