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Weekly Fixed Income Commentary

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Treasury yields decline as investors make peace with inflation data

U.S. Treasury yields fell despite strong inflation data, as investors increasingly gain comfort that the current rise in inflation data will end up being temporary rather than persistent. Spreads narrowed across fixed income markets and performance was strong.

HIGHLIGHTS

- **High yield and investment grade corporates, emerging markets, and preferred securities all performed well.**
- **Municipal bond yields declined. New issue supply was $11.2 billion, with flows of $2.5 billion. This week's new issue supply is expected to be outsized again at $12.2 billion.**
- **Structured investments lagged, with mortgage-backed securities underperforming similar-duration Treasuries.**

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Watchlist

- *Treasury yields fell last week, but we continue to anticipate further increases in the months ahead*
- *Spread assets were well-supported versus Treasuries, and strong growth should continue to support fundamentals moving forward*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. Investors remain focused on the eventual tapering of purchases, but we do not expect that to happen any time soon.

Unprecedented global fiscal stimulus should boost consumption and growth this year. First quarter GDP rose at a robust 6.4% pace.

Record supply of investment grade corporates has been followed by high levels of issuance from high yield, middle market loans and the broadly syndicated loan market. 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 appear particularly attractive. Essential service municipal credits also look compelling.

KEY RISKS

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

TAXABLE FIXED INCOME RALLIES ACROSS THE BOARD

U.S. Treasury yields declined further last week, with the 10-year falling below 1.50% for the first time since early March. Ultimately, 10-year yields ended -10 basis points (bps) lower at 1.45% and the entire curve flattened. The moves were somewhat puzzling since macroeconomic data was strong, especially the May inflation report. Consumer prices rose 0.6% month-over-month, taking the year-over-year figure to 5.0%. Core prices, excluding food and energy, were up strongly at 3.8% year-over-year, the fastest increase since 1992. Nevertheless, most of the inflation remains due to a) year-over-year comparisons, which are peaking and will become a headwind, and b) Covid reopening trends in sectors like used cars, which are unlikely to be sustained. The market is gaining comfort with the transitory inflation narrative, removing the inflation risk premium from prices and allowing yields to fall.

Investment grade corporates continued to benefit from the moves in Treasuries. Though spreads traded flat, yields fell -7 bps and the sector returned 0.87%, outperforming similar-duration Treasuries. That rally has taken quarter-to-date returns to 3.0%, erasing almost two-thirds of the first quarter selloff. Amid the strong performance, investment grade corporates saw strong inflows at $5.7 billion, the most in six weeks, including a strong influx from Asia.

High yield corporates performed equally well, returning 0.50% and outperforming similar-duration Treasuries. Despite low yields and a heavy supply calendar, the market continues to grind tighter, with spreads narrowing across ratings buckets. The lowest-rated segment continues to lead the rally, with CCCs gaining 0.75% for the week. The loan market performed similarly, with prices rising and higher-risk names outperforming. Demand remains strong with $925 million in inflows, the most in six weeks, with reports suggesting robust CLO creation is in the pipeline.

Emerging markets rallied, returning 0.75% for the week and outperforming similar-duration Treasuries. The asset class saw strong inflows of over $2 billion. Bonds in several eastern European countries rallied on reduced inflation concerns. There were pockets of underperformance, e.g. El Salvador saw yields widen 70 to 100 bps after the country announced its intentions to accept Bitcoin as legal tender and to withdraw from a regional anti-corruption accord, both of which may put IMF financing at risk.

MUNICIPALS ARE RICHEST TO TREASURIES ON RECORD

Municipal bond yields declined last week, following a strong rally in the Treasury market.

The Treasury market experienced a short squeeze last week, where investors sell what they don't own (selling "short") anticipating that they will buy it back later at a lower price. But bond prices jumped and short sellers were forced to pay higher prices to cover their short sales.

This temporary bump in fixed income should dissipate soon as investors take profits. However, we expect bond prices in general to remain stable. Tax-exempt municipal bond prices should especially remain well bid, as the $180 billion reinvestment money and the $30 billion in anticipated fund flows enter the market all summer. Also, keep in mind that municipal bonds are at the richest to Treasuries on record.

The state of Georgia issued $412 million tax-exempt GO bonds early in the week (rated Aaa/AAA). The deal traded substantially richer in the secondary market as government bonds rallied. Bonds with a 4% coupon due in 2035 were issued with a yield of 1.18% and traded in the secondary market at 1.09%.

High yield municipal bond yields decreased by 11 bps on average last week. Credit spreads are less than 200 bps, and we expect further compression ahead. Inflows totaled $814 million last week, and year-to-date flows of $12.6 billion mark a record pace. While new issue deal flow remains well above average, it cannot satisfy investor demand. Deals are routinely massively oversubscribed and market access to new issuance is becoming increasingly valuable. Nuveen's high yield municipal team is tracking at least 21 new issue deals for this week.

Despite low yields and a heavy supply calendar, high yield corporate spreads continue to narrow.

In focus

Senior loan demand continues

Senior loans are one of the few areas in fixed income that has benefited from the recent uptick in inflation. With their floating-rate coupon structure, loans have a limited duration profile and tend to outperform traditional fixed income during periods of rising rates.

Investors tend to flock to this asset class when rising rates become a concern, and 2021 has been no exception. Loans mutual funds and ETFs have seen 22 consecutive weeks of inflows, totaling $24.4 billion year-to-date. The appetite for loans also remains strong institutionally, with the CLO market driving more than $70 billion of net demand this year. Performance has been resilient, as loan prices remain positive year-to-date, in addition to their coupon income.

The demand trend has continued in June, despite a rally in U.S. Treasuries. In fact, within the mutual fund and ETF markets where flows tend to be heavily influenced by sentiment around rates, inflows last week reached the highest levels since late April.

Senior loans may be a constructive part of a strategic allocation for investors positioning fixed income portfolios for economic growth with potential for continued interest rate volatility.

Data source: Morningstar, JPMorgan.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	0.00	0.01	0.03
5-year	0.74	-0.04	-0.06	0.38
10-year	1.45	-0.10	-0.14	0.54
30-year	2.14	-0.09	-0.14	0.49

Source: Bloomberg L.P., 11 Jun 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	0.08	-0.02	-0.02	-0.06
5-year	0.40	-0.04	-0.03	0.18
10-year	0.89	-0.07	-0.10	0.18
30-year	1.39	-0.09	-0.20	0.00

Source: Bloomberg L.P., 11 Jun 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	61
30-year AAA Municipal vs Treasury	65
High Yield Municipal vs High Yield Corporate	81

Source: Bloomberg L.P., Thompson Reuters, 11 Jun 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	0.92	–	5.02	0.45	0.66	1.45
High Yield Municipal	3.13	193[1]	5.82	0.59	0.99	5.83
Short Duration High Yield Municipal[2]	2.59	197	3.60	0.48	0.60	4.31
Taxable Municipal	2.19	74[3]	9.70	0.86	1.17	-0.20
U.S. Aggregate Bond	1.45	33[3]	6.57	0.47	0.60	-1.71
U.S. Treasury	0.89	–	7.05	0.48	0.61	-2.61
U.S. Government Related	1.31	43[3]	6.10	0.46	0.62	-1.17
U.S. Corporate Investment Grade	2.04	84[3]	8.70	0.87	1.10	-1.78
U.S. Mortgage-Backed Securities	1.71	25[3]	4.09	0.09	0.10	-0.63
U.S. Commercial Mortgage-Backed Securities	1.42	59[3]	5.21	0.34	0.47	-0.24
U.S. Asset-Backed Securities	0.42	25[3]	2.03	0.05	0.06	0.26
Preferred Securities	2.63	158[3]	4.65	0.31	0.72	2.17
High Yield 2% Issuer Capped	3.89	291[3]	3.85	0.50	0.77	3.04
Senior Loans[4]	4.69	442	0.25	0.18	0.25	3.32
Global Emerging Markets	3.74	267[3]	6.94	0.75	0.93	-0.38
Global Aggregate (unhedged)	1.08	33[3]	7.52	0.29	0.36	-2.19

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, 11 Jun 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, 11 Jun 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 09 Jun 2021. **Municipal reinvestment:** Bank of America.

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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