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Weekly Fixed Income Commentary

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COVID-19 concerns push Treasury yields lower

U.S. Treasury yields fell slightly last week as attention centered on the risks of another wave of COVID-19 infections. Economic data showed further expansion, albeit at a slower pace.

HIGHLIGHTS

- **Investment grade corporates, mortgage-backed securities and convertibles all generated positive total and excess returns.**
- **Lower-quality sectors, like high yield corporates and senior loans, lagged somewhat.**
- **Municipal bond yields remained range bound. New issue supply was $10.7B, with flows of $1.7B. This week's new issue supply should be $9.2B ($1.6B taxable).**

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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
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Watchlist

- *Treasury yields declined slightly last week, but we continue to anticipate 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 continue to focus 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, with second quarter GDP growth reaching close to 10%.

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 also 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

- Policymakers become cautious and remove accommodation too early.
- 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.

SENIOR LOANS SEE FIRST OUTFLOWS SINCE JANUARY

U.S. Treasury yields fell only -1 basis point (bps) last week after a volatile start. Early in the week, concerns about the Delta variant of COVID-19 sparked risk-off sentiment, but these concerns ultimately moderated. Even though the Delta variant appears more transmissible and has led to upticks in new case growth, it has not resulted in increased fatalities. Meanwhile, economic data pointed to further economic expansion, with greater global synchronization, but a slightly decelerating overall pace.

Investment grade corporates outperformed, gaining 0.24% in total returns and outperforming similar-duration Treasuries by 7 bps. Spreads were well-supported by continued demand from non-U.S. accounts, especially in Asia. Supply was relatively muted, with only $10 billion pricing versus expectations for $20 to $25 billion. However, retail outflows of -$1.2 billion were the first since November 2020. With rates low and investors searching for yield, the technical backdrop will likely remain supportive moving forward.

High yield corporates traded close to flat last week, with total returns of 0.07%. Under the surface, there was an up-in-quality rotation, with BB-rated credits returning 0.13%, versus -0.09% for CCC-rated credits. The index rebounded after a soft start to the week, helped by the stabilization in rates and equities. Loans performed similarly, with total returns of -0.06% and higher-rated companies outperforming. Both asset classes saw retail outflows, with loans registering their first outflow since January. This generated some concern that ETFs could become forced-sellers in the weeks ahead, but the large reservoir of open CLO warehouses are likely prepared to step in as buyers if levels become more attractive.

Emerging markets lagged again, with total returns of -0.08% and underperformance versus similar-duration Treasuries of -28 bps. Global developed markets performed well, with yields on 10-year German bunds declining -7 bps to a new five-month low of -0.42%, after the European Central Bank formally changed its policy framework. It will now treat 2% inflation as a symmetrical target, allowing for overshoots, rather than treating it as a ceiling. The rally in core European bond markets helped other European yields to decline as well, including emerging markets.

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MUNICIPAL BOND YIELDS REMAIN RANGE BOUND

Municipal bond yields remained range bound last week, while Treasury yields rallied. Both markets closed the week with firm tones.

The bond market is trying to tell us something. The 10-year Treasury yield hit a low of 1.18% last week. We haven't seen this level since February 2021, when recovery from the pandemic was just beginning and very few people had been vaccinated. However, although the economy continues to recover and millions have been vaccinated, these low yields suggest that the recovery may be stalling. Fortunately yields increased slightly by week's end, suggesting that the rally was overblown. Range-bound municipal yields make sense, as tax-exempt yields remain very low on an absolute level. In general, we expect this trend to continue for both Treasuries and tax-exempt municipals.

Pennsylvania Turnpike Commission issued $394 million revenue bonds (rated A3/A). The deal was priced to sell and was well received. The deal included a 30-year bond with a 3% coupon issued with a yield of 2.18%. Those bonds traded in the secondary market at a premium of 2.15%.

The positive high yield municipal market performance trend continues, as both technical and fundamental forces support improving valuations. Investors added another $500 million in flows last week, during a typically slow point in the summer.

Investment grade corporate supply was relatively muted, with only $10 billion pricing last week.

In focus

EM debt offers opportunity amid volatility

Emerging markets (EM) debt has stumbled recently along with other higher-spread, fixed income asset classes. Risk-off sentiment has been driven by worries about the global economic recovery, particularly amid the spread of COVID-19 variants. Idiosyncratic events (e.g., protests in South Africa, credit concerns regarding Chinese property developers) have added to the uncertainty.

Within EM, returns for local markets have been the most challenged, as U.S. dollar strengthening has hampered currency appreciation in those markets.

Despite volatile performance, investor demand for EM debt has remained robust thanks to attractive yields. Net EM fund flows of $141 billion year to date put 2021 on track to outpace 2017's $179 billion — the highest total over the past five years.

Recent EM spread widening has created buying opportunities, with favorable entry points for both investment grade and high yield EM segments. Meanwhile, a more stable U.S. Treasury market going forward should allow for renewed EM spread compression — including between high yield and investment grade debt, which provided a tailwind for high yield EM assets during the first part of 2021.

Lastly, while we still see value in EM corporates, falling rates have shifted our preference to sovereign securities, where valuations appear a bit more attractive.

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U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.20	-0.02	-0.05	0.08
5-year	0.71	-0.06	-0.18	0.35
10-year	1.28	-0.01	-0.19	0.36
30-year	1.92	0.00	-0.17	0.27

Source: Bloomberg L.P., 23 Jul 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	-0.03	-0.08	-0.06
5-year	0.37	-0.03	-0.12	0.15
10-year	0.83	-0.01	-0.16	0.12
30-year	1.36	0.01	-0.14	-0.03

Source: Bloomberg L.P., 23 Jul 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	64
30-year AAA Municipal vs Treasury	71
High Yield Municipal vs High Yield Corporate	76

Source: Bloomberg L.P., Thompson Reuters, 23 Jul 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	0.88	–	5.01	0.09	0.79	1.86
High Yield Municipal	2.93	177[1]	5.57	0.22	1.11	7.30
Short Duration High Yield Municipal[2]	2.41	183	3.32	0.02	1.28	1.59
Taxable Municipal	2.06	75[3]	9.66	0.11	1.28	1.59
U.S. Aggregate Bond	1.39	35[3]	6.59	0.19	0.87	-0.75
U.S. Treasury	0.84	–	7.12	0.19	1.09	-1.52
U.S. Government Related	1.23	40[3]	6.09	0.07	0.72	-0.48
U.S. Corporate Investment Grade	1.97	86[3]	8.79	0.24	1.01	-0.27
U.S. Mortgage-Backed Securities	1.66	31[3]	3.97	0.18	0.48	-0.29
U.S. Commercial Mortgage-Backed Securities	1.38	61[3]	5.19	0.14	0.74	0.24
U.S. Asset-Backed Securities	0.47	26[3]	2.09	0.05	0.15	0.33
Preferred Securities	2.64	165[3]	4.67	-0.10	0.10	2.92
High Yield 2% Issuer Capped	3.86	290[3]	3.84	0.07	0.32	3.95
Senior Loans[4]	4.77	446	0.25	-0.06	0.09	3.57
Global Emerging Markets	3.85	286[3]	7.01	-0.08	0.38	-0.22
Global Aggregate (unhedged)	1.01	34[3]	7.56	0.08	0.71	-2.52

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, 23 Jul 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, 23 Jul 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 21 Jul 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

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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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