nuveen
A TIAA Company

Weekly Fixed Income Commentary

22 November 2021

Treasury yields fall on new COVID-19 fears

U.S. Treasury yields fell modestly last week despite strong economic data, as concerns around COVID-19 resurfaced with reports of potential lockdowns in several European countries. Spread assets generally underperformed Treasuries.

HIGHLIGHTS

- **U.S. Treasuries, agencies, taxable municipals, and mortgage-backed securities rallied.**
- **Investment grade and high yield corporates, senior loans, emerging markets, preferreds and convertibles all weakened.**
- **Municipal bond prices ended the week slightly higher. New issue supply was $12.9B, with strong flows of $1.4B. This week's new issue supply is less than $1.0B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields fell last week, but we continue to anticipate higher rates into year-end*
- *Spread assets generally underperformed Treasuries, but we expect strong fundamentals to support credit market returns 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 tapering and an eventual increase in interest rates.

Unprecedented global fiscal stimulus should continue to boost consumption and growth into next year.

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 bonds also look compelling.

KEY RISKS

- Inflation rises in a disorderly way, negatively impacting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- Further complications with the COVID-19 vaccine rollout, as well as Delta or future variants.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

EMERGING MARKETS OUTPERFORM U.S. CORPORATES

U.S. Treasury yields fell modestly last week, with 10-year yields ending -2 basis points (bps) lower at 1.55%. The small rally came despite positive economic data, with retail sales for October showing continued strength in U.S. consumer demand. COVID-19 concerns resurfaced, with reports of potential lockdowns in several European countries, which sent 10-year German bund yields -8 bps lower on the week. Though we do not expect a return to 2020-type lockdowns, there is now increased risk of consumers and businesses retrenching somewhat over the winter months.

Investment grade corporates weakened, returning -0.03% but underperforming similar-duration Treasuries by -31 bps. The technical backdrop weakened, with overall supply vastly exceeding expectations on the week, at $56 billion of new issuance versus around $35 billion expected. More than half of that supply was in the long end, at 10+ years. Amid the supply deluge, concessions rose to 5 bps, but deals traded only around 1 bp tighter in the secondary market. At the same time, investment grade bonds saw a relatively modest inflow of $1.5 billion.

High yield corporates also traded lower, returning -0.38% and underperforming similar-duration Treasuries by -48 bps. Loans returned -0.05%. Both asset classes saw robust supply, with around $10 billion pricing in high yield and around $50 billion in loans. Demand was strong, with many deals tightening pricing, accelerating timing, or upsizing their amounts. There was some focus on a first and second lien loan deal brought to finance an LBO of a semiconductor company called Brooks Automation; the loans were indexed to SOFR instead of LIBOR and had no credit spread adjustment language. Instead, they simply tacked on an additional 10 bps of spread.

Emerging markets outperformed U.S. corporates, but still weakened. The asset class returned -0.01% on the week and underperformed similar-duration Treasuries by -16 bps. The market was pressured by another rise in the dollar, a drop in oil prices and renewed COVID-19 concerns in some counties. Idiosyncratic events also drove price action, such as Turkish government bonds weakening after the central bank surprisingly cut interest rates by 100 bps despite inflation running at almost 20% year-on-year. In China, there was further stability in the property sector, with investment grade names rallying further after their brief episode of weakness earlier this month.

MUNCIPAL BOND SHOULD REMAIN WELL BID

Municipal bond prices ended the week higher. The upcoming December 1 coupon payments should make secondary offerings look attractive.

Inflation continues to dominate the market discussions. Inflation had been dismissed as transitory until now, but the new buzz word for inflation is "sticky." We expect prices will remain range bound through the end of this calendar year, but in 2022 the Fed must show it is committed to snuffing out inflation. Otherwise, rates may begin to increase. We expect municipal bonds to remain well bid through the rest of this year. The market survived the outsized new issue supply, and now we await the December 1 and January 1 coupon payments.

The California Health Facilities Financing Authority issued $1 billion in bonds for Cedars-Sinai Health system (rated Aa3/AA-). The bonds were priced to sell and the deal was well received. For example, the 30-year bond with a 3% coupon was issued at a yield of 2.52%. That same bond traded in the secondary market at 2.31%. This shows the strong demand for higher-yielding tax-exempt bonds.

High yield municipal flows continued at a robust pace last week, creating a firm demand tone as U.S. Treasury volatility pushed and pulled between U.S. and global market forces. Demand is likely being strengthened by expectations of reinvestment demand from both Puerto Rico GO bonds and Golden State Tobacco refundings. This week should be rather quiet, but December is looking to be strong leading into a solid first quarter of 2022.

The technical backdrop weakened for investment grade corporates, with supply vastly exceeding expectations.

In focus

Puerto Rico re-emerges

Puerto Rico's emergence from bankruptcy appears to be finally be moving forward, despite a politically charged battle over pension cuts that threatened to delay the process in late October. Bankruptcy exit is expected by year-end, or early 2022.

Following a confirmation hearing, the bankruptcy court is expected to approve the proposed debt restructuring plan. The plan is based on consensually negotiated settlements and is supported by a majority of impaired creditors and bondholders. Most institutional bondholders and retail creditors voted for the plan, and the government has enacted legislation to authorize new, take-back obligations.

Puerto Rico's oversight board agreed to not cut current pension benefits in order to secure support from elected leaders. Currently defaulted bonds will be exchanged for $7.4 billion in new general obligation (GO) bonds, a $7.0 billion cash consideration and a proportional share of a new contingent value instrument (CVI), backed by excess sales tax collections. The new GO bonds will benefit from judicial validation and new guardrails limiting future debt issuances.

Post-restructuring, Puerto Rico's direct debt will be reduced to $7.4 billion from $34.3 billion, a 78.4% reduction. Debt service (inclusive of COFINA sales tax bonds restructured in 2019), will be reduced to $1.15 billion from $4.2 billion, a 73% reduction. Significant federal fiscal stimulus and disaster relief funding should bolster Puerto Rico's economy in the near-term.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.51	-0.01	0.01	0.39
5-year	1.22	0.00	0.04	0.86
10-year	1.55	-0.02	-0.01	0.63
30-year	1.91	-0.02	-0.02	0.27

Source: Bloomberg L.P., 19 Nov 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	0.25	0.01	0.00	0.11
5-year	0.61	0.00	-0.03	0.39
10-year	1.09	0.01	-0.12	0.38
30-year	1.54	0.01	-0.15	0.15

Source: Bloomberg L.P., 19 Nov 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	71
30-year AAA Municipal vs Treasury	81
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters, 19 Nov 2021. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg High Yield Municipal Index divided by the yield-to-worst for the Bloomberg 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	1.14	–	5.10	0.00	0.62	1.12
High Yield Municipal	3.09	175[1]	6.16	0.04	1.07	7.23
Short Duration High Yield Municipal[2]	2.66	175	3.60	0.00	0.54	5.49
Taxable Municipal	2.27	73[3]	9.60	0.24	0.25	1.14
U.S. Aggregate Bond	1.70	36[3]	6.79	0.09	-0.02	-1.60
U.S. Treasury	1.17	–	7.17	0.18	0.13	-2.44
U.S. Government Related	1.57	43[3]	6.14	0.10	0.04	-1.33
U.S. Corporate Investment Grade	2.28	92[3]	8.72	-0.03	-0.13	-1.15
U.S. Mortgage-Backed Securities	1.94	29[3]	4.70	0.08	-0.13	-0.99
U.S. Commercial Mortgage-Backed Securities	1.80	65[3]	5.08	0.08	-0.24	-1.15
U.S. Asset-Backed Securities	0.98	40[3]	2.33	0.02	-0.12	-0.23
Preferred Securities	3.28	182[3]	4.78	-0.29	-0.59	2.72
High Yield 2% Issuer Capped	4.43	303[3]	4.00	-0.38	-0.03	4.32
Senior Loans[4]	5.10	436	0.25	-0.05	0.19	5.10
Global Emerging Markets	4.37	308[3]	7.08	-0.01	-0.02	-1.57
Global Aggregate (unhedged)	1.25	36[3]	7.59	-0.11	-0.24	-4.53

1 Yield difference between the Bloomberg 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, 19 Nov 2021. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg. 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, 19 Nov 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 17 Nov 2021. **Puerto Rico:** ReOrg Research, Puerto Rico Fiscal Oversight and Management Board, 8th amended plan of adjustment.

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

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Past performance is no guarantee of future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

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.

Nuveen provides investment advisory solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.

GCM-1931443PG-W1121P