nuveen
A TIAA Company

Weekly Fixed Income Commentary

13 December 2021

Treasury yields rise as markets await the Fed

The U.S. Treasury yield curve steepened and spread sectors rallied strongly last week, as fears over the COVID-19 Omicron variant eased and inflation data came in-line with expectations. The Federal Reserve holds its last meeting of 2021 on Wednesday, where we expect the central bank to continue accelerating its tapering program.

HIGHLIGHTS

- **Total returns were negative for Treasuries and longer-duration asset classes like investment grade corporates, taxable municipals, agencies, and mortgage-backed securities.**
- **High yield, emerging markets and preferreds all performed very strongly, and excess returns were high in investment grade corporates, agencies and MBS.**
- **Municipal bond yields ended the week relatively unchanged. New issue supply was outsized at $17.6B, with flows of $804M. This week's new issue supply is ample at $8.5B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *10-year Treasury yields rose last week, and we anticipate higher rates over the medium term.*
- *Spread assets rallied substantially as risk sentiment rebounded strongly.*
- *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 affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- Further complications with the COVID-19 vaccine rollout, as well as multiple variants.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

SENIOR LOAN PRICES SNAP HIGHER

U.S. Treasury yields rose last week, with the 10-year yield ending 14 basis points (bps) higher at 1.48%. The curve also steepened somewhat, as two-year yields rose 7 bps. The biggest data release was Friday's CPI report, which showed a 0.8% month-over-month increase in prices. This takes the year-over-year rate to 6.8%, the highest since 1982. Nevertheless, that level was in-line with expectations, and the details of the report showed inflationary pressures narrowing, as measures which remove outliers, like the trimmed-mean and median CPI, both fell for the month. We expect inflation to moderate more substantially next year, but the Federal Reserve will likely continue to remove accommodation in the near term, starting with an acceleration the pace of tapering at its meeting this week.

Investment grade corporates weakened with the move in rates, returning -0.95%, but spreads tightened and the asset class outperformed similar-duration Treasuries by 33 bps. Supply was slightly larger than expected at around $40 billion, but most banks now expect supply to be very limited for the rest of the year. That will provide the market with positive technicals, though this will likely be offset somewhat by soft retail flows, with another outflow of $855 million last week.

High yield corporates had a fantastic week, with prices moving sharply higher despite the selloff in rates. The asset class returned 0.65% and outperformed similar-duration Treasuries by 109 bps. Supply was relatively muted at less than $10 billion and, as in the high grade market, it is expected to remain low for the rest of the year. Loans also saw prices snap higher, returning 0.28% for the week; that was the strongest weekly performance since April. Flows stabilized in both markets, with high yield seeing an inflow of $1.3 billion and loans seeing a small outflow of -$50 million. Given the move higher in rates, retail flows are likely to return to the loan asset class moving forward.

Emerging markets also rallied, returning 0.38% and outperforming similar-duration Treasuries by 121 bps. There was notable compression between high yield and investment grade segments, after the former had underperformed over recent weeks. With the bear steepening in Treasuries, investors looked to add hard currency exposure in emerging markets, especially in higher-yielding sovereign names. Russia and Ukraine notably lagged the rally, as geopolitical fears linger over both countries.

MUNICIPALS WAIT FOR BILLIONS TO BE REINVESTED AFTER JANUARY 1

Municipal bond yields remained relatively unchanged again last week, while Treasury bonds gave back a portion of the recent rally.

Friday's monthly Consumer Price Index at 6.8% makes inflation concerns very real. While Treasury bonds sold off somewhat, fixed income in general was stable. One reason for this muted reaction may be that Fed Chairman Powell has acknowledged inflation is a problem and the Fed is soon expected to begin to implement tighter monetary policies. Municipal bond yields remain well bid. January 1 coupon payments represent billions of dollars waiting to be reinvested.

Golden State Tobacco Securitization Corporation issued $1.3 billion capital appreciation bonds (unrated). The deal and was well received. For example, bonds due in June 2066 were issued at a yield of 3.75%. Those same bonds traded in the secondary market at a yield of 3.5%, or 25 bps richer. This shows that the market has a continued appetite for high yield tax-exempt bonds. The deal also included senior taxable bonds rated investment grade.

The sheer number of high yield municipal new issue deals is preventing credit spreads from tightening despite strong demand. Another 30 new deals are expected this week, when fund flows last week totaled $702 million. High yield municipal credit spreads have widened slightly, in part because of supply pressure. But mainly because idiosyncratic spread widening in recently issued California Essential Housing Bonds and the housing sector is now contributing materially to index averages. Golden State Tobacco refunding bonds are trading 25 bps tighter than final pricing, providing 3% returns for initial buyers and demonstrating that excess returns are being driven by credit selection even within highly sought after specialty state bonds.

High yield corporate prices moved higher, despite the selloff in rates.

In focus

Credit-sensitive assets present opportunity

Ahead of potential Federal Reserve rate hikes in 2022, fixed income investors continue to reposition their portfolios, which may involve adding credit-sensitive assets to drive income. Two popular areas allowing investors to take on credit risk include high yield corporates and senior corporate loans.

Senior loans in particular have floating-rate coupon structures and, as a result, even less interest rate sensitivity than high yield bonds.

The good news is that the economic growth leading to a potentially more hawkish Fed has allowed below-investment-grade issuers of loans and high yield to improve their fundamental positions. Revenues and earnings continue to strengthen, and leverage is declining while cash flow coverage increases. Even margins have remained fairly resilient, despite the fear that inflationary pressures could make issuers less profitable.

The capital markets enter their holiday period next week, but in 2022 the new issue market should allow companies ready access to capital. All of these factors should help keep default and credit losses in check for the foreseeable future and make credit risk an important part of asset allocation.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.66	0.07	0.09	0.53
5-year	1.25	0.12	0.09	0.89
10-year	1.49	0.14	0.04	0.57
30-year	1.88	0.21	0.09	0.23

Source: Bloomberg L.P., 10 Dec 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	0.01	0.11
5-year	0.60	0.00	0.01	0.38
10-year	1.03	0.00	0.00	0.32
30-year	1.48	0.00	0.00	0.09

Source: Bloomberg L.P., 10 Dec 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	70
30-year AAA Municipal vs Treasury	79
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 10 Dec 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	1.12	–	5.07	-0.02	0.05	1.40
High Yield Municipal	3.09	180[1]	6.33	0.04	0.11	7.60
Short Duration High Yield Municipal[2]	2.67	180	3.60	0.04	0.08	5.86
Taxable Municipal	2.30	75[3]	9.58	-1.26	-0.72	1.12
U.S. Aggregate Bond	1.76	38[3]	6.83	-0.72	-0.39	-1.67
U.S. Treasury	1.23	–	7.22	-0.97	-0.57	-2.38
U.S. Government Related	1.63	44[3]	6.15	-0.49	-0.16	-1.32
U.S. Corporate Investment Grade	2.35	96[3]	8.73	-0.95	-0.35	-1.31
U.S. Mortgage-Backed Securities	1.99	33[3]	4.79	-0.21	-0.23	-1.18
U.S. Commercial Mortgage-Backed Securities	1.87	68[3]	5.09	-0.45	-0.30	-1.31
U.S. Asset-Backed Securities	1.08	37[3]	2.34	-0.13	-0.18	-0.36
Preferred Securities	3.45	192[3]	4.76	0.24	0.44	2.36
High Yield 2% Issuer Capped	4.48	303[3]	3.93	0.65	1.06	4.42
Senior Loans[4]	5.27	441	0.25	0.28	0.36	5.12
Global Emerging Markets	4.47	315[3]	7.09	0.38	1.09	-1.54
Global Aggregate (unhedged)	1.27	37[3]	7.65	-0.17	0.16	-4.42

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, 10 Dec 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, 10 Dec 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 03 Dec 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 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-1953249PR-W1221P