nuveen
A TIAA Company

Weekly Fixed Income Commentary

18 April 2022

U.S. inflation miss leaves Treasury yields mixed

Long-end U.S. Treasury yields rose again, though front-end yields fell on softer-than-expected inflation numbers. The yield curve flattened as a result. Spread sectors were once again weaker.

HIGHLIGHTS

- **Treasuries, investment grade and high yield corporates, MBS, preferreds and emerging markets all weakened.**
- **CMBS was the only major asset class to outperform.**
- **Municipal bond yields ended higher. New issue supply was light at $5B, with outflows of -$4.1B. This week's new issue supply is $5B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields rose again, and we continue to expect rates to rise further this year.*
- *Spread sectors were weaker amid elevated uncertainty.*
- *Municipal bonds appear attractive vs. Treasuries.*

INVESTMENT VIEWS

Accommodative interest rate policy remains a key market support. While investors continue to focus on more hawkish Fed policy, overall rates are likely to remain relatively low even after several rate hikes.

The underlying growth outlook is healthy, as consumers have strong balance sheets, businesses are reinvesting and Covid recedes. This should keep defaults low.

Treasury yields are likely to rise this year, but we don't expect the 10-year Treasury yield to rise much above 3.00%.

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

- The Russia/Ukraine conflict continues to escalate.
- Inflation fails to decline as expected, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- COVID-19 cases increase, or new variants emerge.

SENIOR LOAN INFLOWS CONTINUE

Long-end Treasury yields continued to rise, with the 10-year up 12 basis points (bps) to 2.83%, the highest since 2018 and within 30 bps of the peak over the last decade. The curve flattened, with two-year yields falling -6 bps. Consumer price data showed a downside surprise to core inflation, at 0.3% month-over-month versus 0.5% expected. The data showed core prices rose 6.5% year-over-year and headline prices 8.5%, but this is likely the peak in year-over-year inflation, as comparisons should be a headwind moving forward. Separately, retail sales data met expectations for March, rising 0.5% with positive revisions to February's data as well, signaling continued strength in nominal consumer spending. The market went from pricing 228 bps of additional Fed rate hikes by year-end to a low of 200 bps after the inflation miss, then back up to 215 bps after the positive retail sales number.

Investment grade corporates weakened, as duration continued to underperform, returning -1.27% for the week and underperforming similar-duration Treasuries by -44 bps. Primary market activity slowed amid the holiday-shortened week, with 13 issuers bringing $19 billion of new supply. That was down -34% from the prior week. Investment grade corporate funds saw another large outflow of -$4.5 billion.

High yield corporates benefited from their shorter duration, but still had negative returns of -0.32% and underperformed similar-duration Treasuries by -26 bps. Only one deal totaling $585 million priced last week, as the primary market remains muted. The asset class also saw an abnormally large outflow of -$4.5 billion, the largest since March 2021, fully offsetting the prior two weeks of modest inflows. In contrast, loan funds saw another inflow of $1.1 billion, and the asset class was close to flat for the week, returning -0.01%.

Emerging markets also fell, returning -0.97% and underperforming similar-duration Treasuries by -47 bps. Russian hard currency bonds continued to be quoted in the mid-20s. Ratings agencies stated that if dollar payments are not made by May 4, the end of the current grace period, the country will be in default. Several central banks, including those in Israel, New Zealand, Canada and Korea, hiked policy rates amid the global trend toward monetary tightening. The European Central Bank did not formally change policy, but continued to signal the end of asset purchases to come next quarter and the first rate hike likely by year-end.

MUNICIPAL BOND SELLOFF REMAINS ORDERLY

Municipal bond yields ended last week higher, taking their cue from Treasuries, which also sold off.

The 10-year Treasury yield increased to 2.83%, the highest in 3 years. We believe the current high yield is justified, as last month's 8.5% inflation is the highest in 40 years. The Fed has to get tougher on inflation. Markets are expecting the Fed to raise short-term rates 50 basis points at the May meeting and to enact other aspects of quantitative tightening. We believe rates will continue to rise until the market is convinced the Fed is ahead of the curve to beat inflation.

The municipal market continues to sell off, but in an orderly fashion. Munis continue to be cheap relative to Treasuries, and yields are much cheaper now than they were at the beginning of the year. Institutional investors appear to be using this selloff to rebalance portfolios back to stated mandates. Munis remain well bid, a trend that should continue as long as Treasuries remain range bound.

Fairfax County, VA Industrial Development Authority issued $373 million revenue bonds for Inova Health system (rated Aa2/AA+). The deal was priced to sell and yields were lowered upon final pricing. For reference, the 10-year bond was priced at 5% in 2032 with a yield of 2.92%. This equals 104% of the 10-year Treasury bond, an example of the attractiveness of high grade tax-exempt bonds.

High yield municipals have not evaded the broader market downturn. But demand remains strong, with new deals being oversubscribed even as outflows continue. This shows the underlying credit strength within municipals, and further highlights that markets are being driven by interest rates rather than fundamentals. Municipals currently provide attractive relative value, particularly high yield municipals given their additional yield opportunities.

Munis remain well bid, a trend that should continue as long as Treasuries remain range bound.

In focus

A rough quarter creates opportunity

Three market drivers ruled the first quarter: The Fed, market volatility and inflation. Treasury yields rose sharply, negatively impacting all sectors. Where do we see opportunity going forward?

On the taxable side, we favor taking credit risk and minimizing duration risk given our forecast for peaking, but higher-than-average, inflation over the near-to-intermediate term, continued strong credit fundamentals and attractive valuations as a result of recent volatility. We see the best relative value opportunities in higher-quality below-investment-grade areas of the global fixed income markets. Specifically, we like broadly syndicated loans, BB-rated U.S. high yield corporates and preferred securities. Lastly, we see compelling opportunities in sovereign bonds in the Middle East and Latin America, and certain corporate industries such as pulp and paper and metals and mining.

The municipal market experienced its most challenging first quarter since 1980. But credit remains strong and technical factors are a tailwind. Defaults remain rare, and we've seen numerous high-profile upgrades in credit quality. We think it makes sense to take on credit risk in select lower-quality areas. Distressed sectors and turnaround credit stories, such as bonds from Chicago, Detroit and Puerto Rico, look compelling and offer attractive yields. More broadly, we have a favorable view of bonds backed by property taxes, and we see value in the energy and electric generation sectors.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	2.46	-0.06	0.12	1.72
5-year	2.79	0.03	0.33	1.52
10-year	2.83	0.12	0.49	1.32
30-year	2.92	0.20	0.47	1.01

Source: Bloomberg L.P., 15 Apr 2022. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.03	0.12	0.27	1.79
5-year	2.22	0.10	0.27	1.63
10-year	2.46	0.12	0.23	1.43
30-year	2.81	0.12	0.25	1.32

Source: Bloomberg L.P., 15 Apr 2022. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	87
30-year AAA Municipal vs Treasury	96
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters, 15 Apr 2022. 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	2.89	–	5.79	-0.54	-1.36	-7.51
High yield municipal	4.58	190[1]	8.53	-0.53	-1.58	-8.01
Short duration high yield municipal[2]	4.29	198	4.10	-0.38	-0.95	-4.16
Taxable municipal	3.93	102[3]	9.25	-1.10	-4.28	-12.21
U.S. aggregate bond	3.28	45[3]	6.57	-0.70	-2.77	-8.54
U.S. Treasury	2.71	–	6.57	-0.57	-2.49	-7.92
U.S. government related	3.20	50[3]	5.72	-0.49	-2.21	-7.49
U.S. corporate investment grade	4.02	121[3]	7.86	-1.27	-3.70	-11.11
U.S. mortgage-backed securities	3.42	35[3]	5.77	-0.48	-2.56	-7.40
U.S. commercial mortgage-backed securities	3.53	81[3]	4.90	-0.02	-1.44	-6.95
U.S. asset-backed securities	3.08	64[3]	2.29	0.10	-0.39	-3.25
Preferred securities	5.21	215[3]	5.19	-0.73	-2.13	-8.33
High yield 2% issuer capped	6.51	350[3]	4.13	-0.32	-1.80	-6.53
Senior loans[4]	7.21	440	0.25	-0.01	0.47	0.37
Global emerging markets	5.94	317[3]	6.69	-0.97	-2.31	-11.33
Global aggregate (unhedged)	2.41	44[3]	7.23	-0.93	-3.24	-9.20

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, 15 Apr 2022. **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, 15 Apr 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 13 Apr 2022.

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.

GWP-2128638PG-W0422P