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Weekly Fixed Income Commentary

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Strong economic data boost Treasury yields

U.S. Treasury yields rose last week, reversing recent declines and dragging down total returns. Stronger economic data supported forecasts for a more aggressive U.S. Federal Reserve tightening cycle. The month of May was stronger for fixed income in general.

HIGHLIGHTS

- **Total returns were negative for all taxable fixed income sectors, except senior loans.**
- **A positive risk sentiment largely supported non-Treasury sectors, which delivered strong relative performance.**
- **Municipal bond yields declined dramatically. New issue supply was $4.9B, with inflows of $1.2B. This week's new issue supply is $5.9B.**

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Watchlist

- *10-year Treasury yields rose, and we expect modest rate increases this year.*
- *Non-Treasury sectors delivered strong relative performance.*
- *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%.

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 LOANS SHOW POSITIVE PERFORMANCE

U.S. Treasury yields rose last week, led by the 5-year maturity range. Rates reversed their recent declines, as stronger economic data supported forecasts for a more aggressive Fed tightening cycle. However, the jump in yields was not enough to offset the previous three weeks of declines. Maturities of 10 years and shorter ended lower for the month of May. This helped the Treasury sector deliver its first positive monthly total return since November.

Investment grade corporates benefited from an overall constructive tone, but rising yields dragged on total returns. The sector posted a weekly return of -0.85%, but outperformed similar-duration Treasuries by 31 basis points (bps). Despite last week's decline, the sector produced its first positive month of the year in May, posting a total return of 0.93% and handily outpacing similar-duration Treasuries. Investors still appear to prefer higher-quality credits. Liquidity remains a challenge outside of new issuance, which was considerably lighter than expected in May.

High yield corporates followed investment grade, posting a negative total return of -0.34% last week and outperforming similar-duration Treasuries by 39 bps. Within high yield, bonds with longer duration and higher quality underperformed, while lower-quality CCC rated credits outperformed. High yield finished May with a modestly positive total return of 0.23% after jumping more than 3% in the final week, one of the strongest weeks in the last decade. Senior loans were the only sector showing a positive total return last week at 0.70%. However, the sector did not participate in the strong May monthly performance. It was one of the few sectors that declined during the month, at -2.51%.

Emerging markets similarly endured negative total returns of -0.43% for the week, but handily outperformed similar-duration Treasuries by 62 bps. Strong relative performance expanded beyond sovereign issues into high yield corporate bonds as well. Spreads in EM sovereigns tightened by 19 bps, offsetting a large portion of the rise in base yields. For May, the emerging markets sector fell slightly at -0.02% and underperformed similar-duration Treasuries by -38 bps.

MUNICIPAL BONDS FINISH MAY WITH A POSITIVE RETURN

Municipal bond yields declined dramatically last week. Short-term yields ended 10 bps lower and 30-year yields dropped 5 bps. Inflows totaled $1.2 billion, snapping 15 consecutive weeks of outflows, due to investor support following recent gains and outperformance relative to taxable bonds.

Municipal bonds have rallied 50 bps since their worst levels only a few weeks ago. Performance was so strong the final week of May that municipal bonds posted a positive return of 1.49% for the month. We expect this trend to continue for several reasons. Treasury yields appear range bound, and municipal bonds are relatively cheap versus Treasuries and on an absolute basis. Finally, and most important, supply and demand is expected to show a negative imbalance of -$33 billion for the summer. Reinvestment money is historically outsized during summer months, while new issuance is typically undersized.

Tampa, Florida, issued $298 million wastewater revenue bonds (rated Aaa/AAA). The deal was well received. For example, 5% coupon bonds with a 12-year maturity were priced with a yield of 2.60%.

High yield municipals also continued stabilizing last week, but the pace of performance leveled off after a rapid turnaround. Some high beta bonds are giving back some performance, as short-term trading accounts appear to be taking profits and bonds are transferring back into mutual fund ownership. Some bonds are up 40%+ since the turnaround on 18 May, so this is healthy for the market. Most of the market is still playing catch up, with average high yield municipal spreads roughly 25 bps wider since the turnaround. Summer is expected to produce significant net negative supply, fueled by heavy reinvestment, providing a strong technical backdrop to fuel a continued recovery and a fundamental realignment of relative valuations.

Municipal market inflows totaled $1.2 billion, snapping 15 consecutive weeks of outflows.

In focus

Muni bonds: an attractive entry point

Favorable bond valuations and higher yields, combined with strong credit fundamentals, are offering an attractive opportunity for municipal bonds.

Yields for 10-year AAA municipal bonds have more than doubled from one year ago, and it appears that U.S. Treasury yields may be settling into a new range. As such, municipal-to-Treasury ratios have risen sharply, with 30-year ratios reaching as high as 110%. Elevated ratios are often short-lived, but can offer compelling relative and absolute value. We have seen that rebound recently, with ratios now at approximately 90%. Municipal yields also dropped by almost 40 bps on average in May, suggesting that this window may be closing.

Credit fundamentals remain strong, with positive economic growth boosting tax revenues for municipalities to all-time highs. Rainy day funds and pension funding are at the healthiest levels in decades. High yield credit spreads have widened some after tightening significantly since the pandemic, after outflows created liquidity needs.

While there have been net outflows from municipal bonds funds, ETFs and a few state mutual funds have seen inflows since the beginning of the year. Inflows were a positive $1.2 billion last week, suggesting that investors are recognizing the opportunity.

U.S. Treasury market

Maturity	Yield	Change (%) Week	May 2022	Year-to-date
2-year	2.66	0.18	-0.16	1.92
5-year	2.94	0.22	-0.14	1.67
10-year	2.94	0.20	-0.09	1.43
30-year	3.09	0.12	0.05	1.19

Source: Bloomberg L.P., 03 Jun 2022. **Past performance does not predict or guarantee future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	May 2022	Year-to-date
2-year	1.75	-0.10	-0.39	1.51
5-year	2.01	-0.10	-0.40	1.42
10-year	2.43	-0.06	-0.38	1.40
30-year	2.78	-0.05	-0.36	1.29

Source: Bloomberg L.P., 03 Jun 2022. **Past performance does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	82
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 03 Jun 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 does not predict or guarantee future results.**

Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	May 2022	Year-to-date
Municipal	2.89	–	6.16	0.32	1.49	-7.30
High yield municipal	4.92	227[1]	9.52	0.21	1.10	-8.82
Short duration high yield municipal[2]	4.52	225	4.21	0.23	0.73	-4.22
Taxable municipal	4.21	117[3]	9.27	-0.85	-0.70	-13.81
U.S. aggregate bond	3.47	47[3]	6.56	-0.88	0.64	-9.28
U.S. Treasury	2.91	–	6.50	-0.97	0.18	-8.71
U.S. government related	3.43	55[3]	5.64	-0.65	0.57	-8.29
U.S. corporate investment grade	4.31	131[3]	7.80	-0.85	0.93	-12.30
U.S. mortgage-backed securities	3.52	33[3]	5.91	-0.84	1.11	-7.61
U.S. commercial mortgage-backed securities	3.90	100[3]	4.87	-0.76	0.21	-7.96
U.S. asset-backed securities	3.49	80[3]	2.28	-0.37	0.31	-3.54
Preferred securities	5.73	241[3]	5.06	-0.25	0.29	-10.25
High yield 2% issuer capped	7.22	409[3]	4.21	-0.34	0.23	-8.36
Senior loans[4]	8.48	548	0.25	0.70	-2.51	-1.94
Global emerging markets	6.37	342[3]	6.54	-0.43	-0.02	-13.41
Global aggregate (unhedged)	2.67	49[3]	7.15	-1.24	0.27	-11.62

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, 03 Jun 2022. **Past performance does not predict or guarantee 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, 03 Jun 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 01 Jun 2022.

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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.

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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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