nuveen
A TIAA Company

Weekly Fixed Income Commentary

13 June 2022

Treasury yields rise on strong inflation data

U.S. Treasury yields jumped last week, led by a dramatic spike in short-term rates, pulling total returns into negative territory. A surprisingly strong CPI report pushed credit spreads wider. All eyes are on the U.S. Federal Reserve as it meets this week.

HIGHLIGHTS

- **Total returns came in negative across all fixed income sectors.**
- **A negative risk sentiment weighed on non-Treasury sectors, and credit spreads widened.**
- **Municipal bond yields sold off. New issue supply was muted at $5.3B, with outflows of -$2.1B. This week's new issue supply is $3.4B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *10-year Treasury yields rose, and we expect modest rate increases this year.*
- *Credit sectors delivered weak relative performance.*
- *Net-negative supply should provide some support to municipal bonds.*

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.

HIGH YIELD CORPORATES LANGUISH

Treasury yields rose last week led by a dramatic spike in short-term rates. Yields jumped on Friday after a stronger-than-expected consumer price report caused investors to increase expectations for Fed rate hikes. Market-based expectations for the year-end fed funds policy rate increased more than 32 bps on Friday, and now reflect a policy rate of nearly 3.25% by December 2022. Longer-maturity Treasury yields had already risen by Friday, as they followed European rates higher early in the week. The yield curve flattened, as the 2-year Treasury yield increased a remarkable 41 bps while the 10- and 30-year maturities rose 22 and 11 bps, respectively.

Investment grade corporates struggled as yields rose and spreads widened. Spreads were subdued early in the week, despite heavy new issuance of $30 billion compressed into the first half of the week. However, the tone softened into Friday's CPI release. The sector's total return was negative at -1.79%, and underperformed similar-duration Treasuries by -43 bps. Year-to-date issuance totals about $680 billion, and fund outflows continued for the 15th consecutive week.

High yield corporates languished under a general risk-off broader market tone as recession fears grew. Retail and food/beverage were the hardest hit sectors, as investors worked to reduce inflation-linked credits. High yield posted a negative weekly total return of -2.32% and lagged similar-duration Treasuries by more than -121 bps. The new issue market has picked up materially from May. About $2.35 billion priced last week, bringing the June total to $8 billion, compared to $4 billion for the month of May. The loan market also ended the week on a softer tone, with a modestly negative total return of -0.02%. In the first sizable new issue week since mid-April, five new deals priced totaling more than $8 billion.

Emerging markets bonds declined across the board. High yield bore the brunt of the pain, as spreads moved wider. The global EM index fell -1.74% for the week and underperformed similar-duration Treasuries by more than -36 bps. EM local markets were under pressure by the increase in core rates and U.S. dollar strength, which pushed yields much higher across most local markets.

MUNICIPAL BOND YIELDS SHOULD REMAIN RANGE BOUND

Municipal bond yields sold off by week's end. Although short term rates remained unchanged, 30-year yields rose 29 bps by week's end. The new issue calendar was muted, and dealers struggled to get deals done. Fund flows turned negative once again. This week's new issue calendar will have to be priced cheap to pique investor interest.

Investors are again concerned that the Fed is behind the curve. The market continues to discount the Fed's lack of resolve, so Treasury rates may continue to experience volatility.

The municipal bond sell off makes sense, given that Treasury yields rose so dramatically. However, tax-exempt bonds are no longer cheap relative to Treasuries. Thus, deals will need to be attractively priced to lure buyers. We believe municipal yields should remain range bound for the summer with less supply and money returning to the market via reinvestment.

The state of Maryland issued $262 million general obligation bonds (rated Aaa/AAA) on Wednesday. Large balances remained in the deal by the end of the day. The deal included 5% bonds due in 2033 that came at a yield of 2.63%, then traded later in the week at 2.72%. This deal reflects how interest rates in general continued to sell off all week.

High yield municipal bonds outperformed last week, with fixed income markets hyper focused on inflation and the Fed meeting. High yield municipal credit spreads contracted by 13 bps. Interest rate anxiety caused AAA-rated muni yields to increase 29 bps on the long-end of the curve, while high yield muni yields increased 15 bps on average. High yield flows were flat last week. We are tracking at least 14 new issue deals this week. Demand remains strong, bolstered by a surge of inflows on top of heavy June/July cash flows.

Tax-exempt municipal bonds are no longer cheap relative to Treasuries, so deals will need to be attractively priced to lure buyers.

In focus

Investment grade corporate issuance cools

After a solid start to the year, investment grade corporate issuance slowed in May.

Supply slightly exceeded 2021 year-to-date volume through April, as issuers pulled forward deals in anticipation of higher rates and more volatile Treasury rates and corporate spreads. Gross supply of $125 billion was expected in May, but volatility pared that total back to $90 billion, making it the quietest May since 2014. As a result, year-to-date supply through May has declined 6% versus 2021 levels.

The drop in supply has provided strong technical support for the investment grade corporate market. Market strength was previously met with a headwind of heavy supply, but that was not the case in May. As a result, investment grade corporates delivered the strongest relative performance of all taxable fixed income sectors.

Looking ahead, issuance is expected to slow through the remainder of June as companies enter earnings black-out periods. The slower pace will likely continue through the summer, when issuance calendars tend to be lighter. Issuance should pick up again in the fall, but we expect total gross supply to end the year lower than last year.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	3.07	0.41	0.51	2.33
5-year	3.26	0.32	0.44	2.00
10-year	3.16	0.22	0.31	1.65
30-year	3.20	0.11	0.15	1.29

Source: Bloomberg L.P., 10 Jun 2022. **Past performance does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.75	0.00	-0.08	1.51
5-year	2.05	0.04	-0.06	1.46
10-year	2.58	0.15	-0.03	1.55
30-year	3.07	0.29	-0.04	1.58

Source: Bloomberg L.P., 10 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	96
High Yield Municipal vs High Yield Corporate	65

Source: Bloomberg L.P., Thompson Reuters, 10 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.01	–	6.64	-1.00	-0.81	-8.22
High yield municipal	5.07	214[1]	10.08	-1.36	-1.32	-10.06
Short duration high yield municipal[2]	4.67	233	4.28	-0.60	-0.58	-4.79
Taxable municipal	4.39	112[3]	9.31	-1.15	-1.16	-14.79
U.S. aggregate bond	3.77	49[3]	6.49	-1.52	-1.90	-10.65
U.S. Treasury	3.20	–	6.44	-1.27	-1.67	-9.87
U.S. government related	3.72	54[3]	5.54	-1.25	-1.57	-9.44
U.S. corporate investment grade	4.61	136[3]	7.66	-1.79	-2.21	-13.86
U.S. mortgage-backed securities	3.81	40[3]	5.91	-1.72	-2.06	-9.20
U.S. commercial mortgage-backed securities	4.20	99[3]	4.84	-1.24	-1.66	-9.11
U.S. asset-backed securities	3.84	77[3]	2.27	-0.69	-0.91	-4.20
Preferred securities	6.05	246[3]	5.08	-1.53	-1.71	-11.62
High yield 2% issuer capped	7.80	439[3]	4.24	-2.32	-2.72	-10.49
Senior loans[4]	8.88	552	0.25	-0.02	0.49	-1.96
Global emerging markets	6.69	348[3]	6.42	-1.74	-2.01	-14.91
Global aggregate (unhedged)	2.93	51[3]	7.06	-2.26	-2.88	-13.62

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, 10 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, 10 Jun 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 08 Jun 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.

Important information 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-2241665PG-W0622P