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Weekly Fixed Income Commentary

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Hawkish Fedspeak boosts Treasury yields

U.S. Treasury yields rose, led by shorter maturities. Hawkish commentary from U.S. Federal Reserve officials and strong economic data are causing expectations for interest rates to move higher.

HIGHLIGHTS

- **Total returns were positive for high yield corporates, emerging markets, loans, preferreds and convertibles.**
- **Total returns were negative for Treasuries, agencies, investment grade corporates, taxable munis, MBS, CMBS and ABS.**
- **Municipal bond yields rose slightly. New issue supply was $4.1B, with inflows of $1.1B. This week's new issue supply should be $6.6B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *10-year Treasury yields rose; we expect them to remain volatile and move modestly higher this year.*
- *Spread assets benefited from the improved economic growth outlook.*
- *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 remains 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

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

INVESTMENT GRADE CORPORATE NEW ISSUANCE REMAINS ACTIVE

Treasury yields increased last week, with the 10-year yield rising 18 basis points (bps). Two-year yields rose even more, up 34 bps. The sharp moves partially reversed July's strong rally, which was the biggest monthly drop in 10-year yields since spring 2020. The market had been incorporating expectations of a shallower Fed hiking cycle and a return to rate cuts in early 2023, but several Fed officials pushed back against that dynamic in speeches and interviews, causing expectations for future rates to move higher. Additionally, economic data was very strong. The July employment report showed a net gain of 528,000 new jobs and another acceleration in wages, which further exacerbated the move higher in rates.

Investment grade corporates weakened, in line with Treasuries, though spreads narrowed. The asset class returned -0.89% for the week, but outperformed similar-duration Treasuries by 5 bps. After the strong jobs report on Friday, yield surged higher on lower growth fears and higher expectations for Fed tightening. The primary market remained very active, with high-rated tech names dominating attention. Meta ($10 billion new issuance), Intel ($6 bn), and Apple ($5.5bn) led the way, with overall supply at $62 billion, roughly double the expected pace. New issue concessions remain wide at 11.6 bps.

High yield corporates continued to outperform, returning 0.66% for the week and beating similar-duration Treasuries by 157 bps. After touching 583 bps in early July, high yield spreads have now tightened -155 bps to trade at around 428 bps. The rally partially reflects technical dynamics, with the new issue calendar relatively dry and retail inflows continuing. Another $2.93 billion entered the asset class last week. Meanwhile, senior loans returned 0.76%, helped by both higher rates and the firmer economic outlook.

Emerging markets outperformed as well, gaining 0.37% but outpacing similar-duration Treasuries by 140 bps. Though the asset class weakened at the start of the week, with hawkish Fedspeak pushing the dollar higher, it rebounded through Friday. Industrial metals prices, which have been pressured lately on recession fears, bounced back late in the week, helped by the better economic data. Separately, the Bank of England hiked rates by 50 bps, contributing to the selloff in global rates.

HIGH YIELD MUNICIPAL INFLOWS CONTINUE

Muni yields rose slightly last week across the curve. Short-term rates increased 9 bps and long-term rates rose 2 bps.

Many investors believe the majority of inflation pressures are behind us, despite tough talk by several Fed officials after the last Fed rate hike. That may mean future Fed hikes will be lower than many currently fear. We agree that inflation fears should begin to cool, meaning Treasury bonds will likely remain well bid for the foreseeable future. Municipal bonds should also remain well bid as a supply/demand imbalance continues. Supply should remain light through Labor Day in the U.S., yet billions of dollars of reinvestment money remains to be redeployed. We believe munis also represent fair value at these levels.

The Georgia Ports Authority issued $757 million revenue bonds (rated Aa2/AA). The deal included 5% bonds due in 2042 priced at a yield of 3.24%. Those bonds traded in the secondary market at a yield of 3.33%. This reflects the selloff in fixed income due to the strong employment report published Friday morning.

High yield municipals enjoyed their fourth consecutive week of inflows at $860 million. High yield muni yields remained essentially unchanged, but key liquidity benchmarks like Puerto Rico and tobacco continued to grind tighter. The index returned 4% in July, while the tobacco sector returned 8.68%. Since the restructuring on 15 March, Puerto Rico general obligations bonds have returned -2.0%, very close to high yield muni index average returns. We are tracking at least 14 new issue deals this week, not counting deals that remain in day-to-day status from previous weeks.

Muni bonds should remain well bid as a supply/demand imbalance continues.

In focus

Corporate credit offers relative value

Valuations for the high yield corporate and senior loan markets have increased materially over the last several weeks. Spreads have tightened due to strong earnings, light new issuance, retail demand for high yield and institutional support for loans.

The risk and return tradeoff for corporate credit continues to look attractive relative to equities. But we encourage investors to be patient, as volatility in spreads and interest rates could persist given the uncertain economy.

While the loans and high yield markets generally move directionally with equities, they are currently trading at a material discount to par.

For investors looking for defensive equity exposure, credit may be worth considering. Going forward, we expect corporate credit to offer less potential downside risk compared to stocks, while also generating attractive current income. For floating-rate loans, that level of income could also rise if the Fed continues to raise rates while focusing on taming inflation. As many of these assets begin to migrate back to par, we believe they remain compelling investment opportunities.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	3.23	0.34	0.34	2.49
5-year	2.96	0.28	0.28	1.69
10-year	2.83	0.18	0.18	1.32
30-year	3.07	0.06	0.06	1.17

Source: Bloomberg L.P., 05 Aug 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	1.69	0.09	0.09	1.45
5-year	1.82	0.02	0.02	1.23
10-year	2.24	0.03	0.03	1.21
30-year	2.91	0.02	0.02	1.42

Source: Bloomberg L.P., 05 Aug 2022. **Past performance does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	79
30-year AAA Municipal vs Treasury	95
High Yield Municipal vs High Yield Corporate	66

Source: Bloomberg L.P., Thompson Reuters, 05 Aug 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	2.84	–	6.63	-0.12	-0.12	-6.69
High yield municipal	5.02	225[1]	10.09	-0.07	-0.07	-8.54
Short duration high yield municipal[2]	4.56	251	4.23	0.01	0.01	-3.51
Taxable municipal	4.28	123[3]	9.40	-1.07	-1.07	-13.25
U.S. aggregate bond	3.64	50[3]	6.47	-1.04	-1.04	-9.11
U.S. Treasury	3.12	–	6.56	-0.90	-0.90	-8.52
U.S. government related	3.72	61[3]	5.56	-0.72	-0.72	-8.34
U.S. corporate investment grade	4.51	141[3]	7.68	-0.89	-0.89	-12.40
U.S. mortgage-backed securities	3.60	35[3]	5.62	-1.42	-1.42	-7.18
U.S. commercial mortgage-backed securities	4.07	104[3]	4.84	-1.14	-1.14	-7.67
U.S. asset-backed securities	3.99	75[3]	2.21	-0.55	-0.55	-3.84
Preferred securities	5.63	201[3]	4.66	0.88	0.88	-8.54
High yield 2% issuer capped	7.62	430[3]	3.97	0.66	0.66	-8.52
Senior loans[4]	9.04	577	0.25	0.76	0.76	-1.92
Global emerging markets	6.90	382[3]	6.47	0.37	0.37	-15.08
Global aggregate (unhedged)	2.73	53[3]	7.10	-0.87	-0.87	-12.85

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, 05 Aug 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, 05 Aug 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 03 Aug 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.

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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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