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Weekly Fixed Income Commentary

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Treasury yields rise as central banks remain hawkish

U.S. Treasury yields rose as U.S. Federal Reserve rhetoric continued to indicate further tightening. Fed officials signaled another large rate hike for the September meeting.

HIGHLIGHTS

- **High yield corporates, convertibles, loans and emerging markets all enjoyed positive returns.**
- **Core fixed income asset classes broadly had negative returns amid the rise in rates, including Treasuries, agencies, MBS, investment grade corporates and taxable munis.**
- **Municipal bond yields increased across the curve. New issue supply was $6.4B, with outflows of -$1.1B. This week's new issue supply should be $8.8.**

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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
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Watchlist

- *10-year Treasury yields moved higher last week.*
- *Spread assets rallied despite outflows and heavy supply.*
- *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.

DESPITE OUTFLOWS, HIGH YIELD CORPORATES AND LOANS PERFORM

U.S. Treasury yields rose again last week, as the focus remains on hawkish central bank policy. The European Central Bank hiked rates 75 basis points (bps) as expected. Fed Chair Powell also emphasized his commitment to inflation-fighting and signaled another large rate hike for the September meeting in a speech last week. Two-year Treasury yields rose 17 bps in response, while 10-year yields rose 12 bps. The rate increase was partially driven by rates hedging, as investment grade corporate issuance significantly exceeded expectations. On the data front, Purchasing Managers' Indexes were broadly mixed, showing fresh weakness in Europe but stability in the U.S.

Investment grade corporates weakened alongside the rise in rates, returning -0.42% for the week. However, the asset class outperformed similar-duration Treasuries by 36 bps. That performance was notable, given a larger-than-expected deluge of new issuance, totaling $52.5 billion from 34 issuers. Concessions were elevated but not outsized, at around 7 bps. At the same time, the asset class saw outflows of -$863 million.

High yield corporates gained, returning 1.31% for the week and beating similar-duration Treasuries by 179 bps. The asset class saw much less new supply than investment grade markets, with only one deal pricing last week. In loans, three deals priced, and the forward calendar remains heavy. Outflows continued to be elevated, with -$2.3 billion leaving high yield funds and -$770 million leaving loans. The former now takes the three-week total to almost -$12 billion, or 5% of total assets under management. Nevertheless, both asset classes continue to perform well. Loans returned 0.14% for the week.

Emerging markets also rallied, returning 0.18% and outperforming similar-duration Treasuries by 82 bps. The renewed primary market activity was again a theme, with two new deals in Asia pricing with concessions between 10 and 20 bps. Outflows continued, totaling -$1.4 billion from emerging market funds. A factor in EM's relative underperformance was the stronger dollar, which touched multi-decade highs versus both the euro and yen.

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MUNI BOND ISSUANCE SHOULD REMAIN OUTSIZED

Municipal bond yields rose across most of the curve last week. Short-term rates were unchanged and the long end closed 9 bps higher.

Fed Chair Powell reiterated that the Fed will continue raising short-term rates to control inflation "until the job is done." Fixed income markets saw higher yields on the news, although the overall tone remains constructive.

We have not seen such robust yields for more than a decade. The U.S. Treasury curve is inverted, suggesting progress in curbing inflation. Many investors appear to want to lock in long yields, as they think yields will be lower in 2023.

Municipal bonds are seeing strong demand. Despite negative fund flows, individual investors are looking to lock in attractive tax-exempt yields on individual bonds. We expect this trend to continue. The new issue calendar should continue to be outsized and priced to sell. Institutional investors should also continue to show strong demand for tax-exempt bonds as they rebalance portfolios back to stated mandates.

The state of California issued $2.3 billion general obligation bonds (rated Aa2/AA-). The deal was priced to sell and was well received. Many maturities traded at a premium in the secondary market.

High yield municipal yields increased roughly 17 bps last week, driven by a new burst of outflows. Outflows now appear to be subsiding, and the market ended the week with new found firmness. High yield outperformed high grades, and credit spreads tightened. However, municipal-to-Treasury ratios widened to more than 100%, impacting all muni valuations. The high yield muni credit spread curve is inverted by more than 50 bps. This week brings more supply after a light calendar last week.

The stronger dollar touched multi-decade highs versus both the euro and yen.

In focus

Supply improves muni valuations

Municipal bond issuance is picking up, as usual, as the calendar turns to fall. Total issuance remains down about 12% year to date, mainly due to a nearly 50% decrease in refunding. Despite a significant increase in borrowing costs, new project issuance has actually increased 11% year-over-year.

Although higher borrowing costs have disrupted some parts of the market, larger issuance size has become more common. In fact, 28 deals of more than $1 billion have been priced this year, the most on record. Two deals of more than a billion dollars each came last week, and another Texas Water Board deal is expected to top the billion-dollar mark.

Supply typically increases during the fall months, with issuers looking to complete deals before the holidays. This trend has historically led to muted returns, meaning more attractive valuations and entry points for municipals.

This is illustrated by municipal-to-Treasury ratios generally moving higher from summer richness toward cheaper valuations. Municipal-to-Treasury ratios are currently 70% in 5 years, 82% in 10 years and 101% in 30 years, suggesting that the additional supply is already leading to municipals looking more attractive.

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U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	3.56	0.17	0.06	2.83
5-year	3.44	0.14	0.08	2.17
10-year	3.31	0.12	0.12	1.80
30-year	3.45	0.10	0.16	1.55

Source: Bloomberg L.P., 09 Sep 2022. **Past performance does not predict or guarantee future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	2.31	0.00	0.03	2.07
5-year	2.40	0.05	0.08	1.81
10-year	2.74	0.07	0.15	1.71
30-year	3.50	0.09	0.21	2.01

Source: Bloomberg L.P., 09 Sep 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	101
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 09 Sep 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	Month-to-date	Year-to-date
Municipal	3.44	–	7.06	-0.37	-0.90	-9.45
High yield municipal	5.52	219[1]	10.56	-0.77	-1.63	-11.97
Short duration high yield municipal[2]	5.27	274	4.28	-0.45	-0.85	-5.46
Taxable municipal	4.66	115[3]	9.27	-0.82	-1.10	-15.78
U.S. aggregate bond	4.11	53[3]	6.38	-0.70	-0.91	-11.56
U.S. Treasury	3.55	–	6.32	-0.66	-0.85	-10.74
U.S. government related	4.11	57[3]	5.40	-0.34	-0.54	-10.06
U.S. corporate investment grade	4.95	141[3]	7.42	-0.42	-0.87	-14.95
U.S. mortgage-backed securities	4.15	48[3]	5.90	-1.07	-1.13	-10.10
U.S. commercial mortgage-backed securities	4.52	101[3]	4.76	-0.44	-0.42	-9.37
U.S. asset-backed securities	4.19	57[3]	2.20	-0.23	-0.06	-4.00
Preferred securities	6.45	240[3]	5.05	-0.12	-0.39	-11.76
High yield 2% issuer capped	8.22	450[3]	4.05	1.31	1.13	-10.21
Senior loans[4]	9.42	574	0.25	0.14	-0.07	-1.24
Global emerging markets	7.12	360[3]	6.27	0.18	-0.32	-16.12
Global aggregate (unhedged)	3.22	55[3]	6.91	-0.78	-1.17	-16.54

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, 09 Sep 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, 09 Sep 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 02 Sep 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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