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Weekly Fixed Income Commentary

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Treasury yields rise after another Fed rate hike

U.S. Treasury yields rose after the hawkish U.S. Federal Reserve meeting. Yields were also pressured higher by reports that China may modify and eventually end its Covid-zero policy of lockdowns, boosting demand for commodities and increasing inflation expectations.

HIGHLIGHTS

- **Senior loans led gains, while agencies, investment grade corporates, MBS, emerging markets and preferreds also experienced positive excess returns.**
- **Treasuries, convertibles and high yield corporates offered negative returns.**
- **Municipal bond yields declined. New issue supply was muted at $2.8B, with outflows of -$2.4B. This week's new issuance should rise to $4.5B.**

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Watchlist

- *10-year Treasury yields rose last week.*
- *Spread assets were mixed amid poor risk sentiment.*
- *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 have risen this year, but the pace of long-term increases should remain relatively modest.

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.

HIGH YIELD CORPORATES SHOW ROBUST NEW ISSUANCE

U.S. Treasury yields rose last week, with the front-end moving higher after the U.S. Federal Reserve hiked rates by 75 basis points (bps), as expected, and Chair Powell delivered a hawkish press conference. The two-year yield ended 24 bps higher and the 10-year yield rose 15 bps. Yields were also pressured higher by reports that China is considering modifying and eventually ending its Covid-zero policy of lockdowns, boosting demand for commodities and increasing inflation expectations.

Investment grade corporate bond yields rose, pressuring returns. The asset class retreated -0.91% for the week as the overall yield level returned to above 6%. However, spreads tightened, helping the asset class outperform versus similar-duration Treasuries by 44 bps. The primary calendar continued at its recent relatively lethargic pace, with only $12 billion of new deals pricing, less than the nearly $20 billion expected. That helped keep demand strong, with new issue concessions down to 7.8 bps on average, the first single-digit concession in five weeks.

High yield corporates also weakened, returning -1.23% for the week and lagging similar-duration Treasuries by -59 bps. The asset class saw a robust week of new issuance, with $5 billion pricing, while inflows returned strongly as well, with $4.3 billion entering the asset class. Even though loan funds experienced an outflow of -$54 million, they outperformed substantially, returning 0.43%, to partially retrace underperformance over the last few weeks.

Emerging markets were mixed, as spreads tightened across both sovereigns and corporates in hard currencies. The asset class as a whole returned -0.30% for the week, but surpassed similar-duration Treasuries by 60 bps. High yield names outperformed. However, local markets lagged, as the dollar continued to strengthen after the hawkish Fed meeting. There was no new issuance across the space, as issuers are reportedly waiting until after the latest string of central bank meetings before coming to market.

HIGH YIELD MUNICIPALS OUTPERFORM HIGH GRADES

Municipal bond yields ended the week lower. Short-term rates declined by 1 basis point and long-term yields were 6 basis points lower.

Municipal bonds continue to be well bid. The market saw outflows for the 13th consecutive week, but selling is due primarily to investors harvesting tax losses. Also, much of the redemption proceeds are remaining in the tax-exempt space. Last week, municipal exchange-traded funds saw $737 million in positive flows. Tax-exempt money market funds also saw $3.4 billion in positive flows. These two data points, plus an outsized amount of individual bonds purchased by individual investors, continue to keep a stable bid in the tax-exempt market. Nevertheless, we are optimistic that 2023 will be constructive for tax-exempt bonds.

The City and County of Denver, Colorado, issued $1.1 billion of airport system revenue bonds, both AMT and non AMT bonds (rated Aa3/AA-). The deal was priced to sell and was well received. Underwriters were able to lower yields across the entire deal upon final pricing.

The high yield municipal market continues to resist higher yields, outperforming high grade munis and U.S. Treasury bonds last week. A meaningful decrease of new issuance is helping the market absorb secondary supply that continues to materialize to meet persistent fund outflows. After mixed performance in October, high yield municipal bond yields are helping to form some market stability. We believe structural features like sinking funds and shorter average lives on deeply discounted bonds are being overlooked and represent significant value.

High yield muni bond yields are helping to form some market stability.

In focus

The Fed forges ahead

As expected, the Fed approved a 75 bps increase in its policy rate for a fourth consecutive meeting, to a range of 3.75% to 4.00%. The Fed decided a hike of this magnitude was needed to combat still-hot inflation, which remains well above its 2% target.

In its policy statement, the central bank indicated it would “take into account the cumulative tightening” implemented so far, in addition to “the lags with which monetary policy affects economic activity and inflation.” This should allow officials to monitor how their hawkish moves have slowed the economy. To date, the interest-rate-sensitive housing market has felt the most pain from the Fed’s actions due to soaring mortgage costs.

Chair Jerome Powell suggested that policymakers would entertain the possibility of a smaller rate hike at the next meeting on December 14 “or the one after that.” However, he tempered those remarks by warning that the Fed might ultimately have to lift rates to a higher level than previously expected and keep them there for quite some time.

Recent public comments from the Fed have emphasized lower inflation as a condition for large rate hikes to cease, implying a pivot towards stable, let alone easier, policy is not around the corner. Yet trends in many of the drivers of rising prices — lower rent and declining wages, for example — provide reasons for optimism that inflation should moderate in the near term.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	October 2022	Year-to-date
2-year	4.66	0.24	0.20	3.93
5-year	4.33	0.15	0.14	3.07
10-year	4.16	0.14	0.22	2.65
30-year	4.25	0.11	0.39	2.35

Source: Bloomberg L.P., 04 Nov 2022. **Past performance does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	October 2022	Year-to-date
2-year	3.17	-0.01	0.08	2.93
5-year	3.22	-0.02	0.10	2.63
10-year	3.36	-0.05	0.06	2.33
30-year	4.08	-0.06	0.18	2.59

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

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	81
30-year AAA Municipal vs Treasury	96
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters, 04 Nov 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	October 2022	Year-to-date
Municipal	4.18	–	6.40	0.42	-0.83	-12.58
High yield municipal	6.26	240[1]	8.16	0.12	-2.05	-17.66
Short duration high yield municipal[2]	5.97	270	4.50	0.12	-0.81	-8.25
Taxable municipal	5.61	125[3]	8.08	-1.09	-2.49	-21.71
U.S. aggregate bond	5.10	60[3]	6.17	-0.78	-1.30	-16.02
U.S. Treasury	4.51	–	6.00	-0.91	-1.39	-14.81
U.S. government related	5.14	62[3]	5.13	-0.70	-0.96	-13.90
U.S. corporate investment grade	5.99	152[3]	6.95	-0.59	-1.03	-19.80
U.S. mortgage-backed securities	5.13	64[3]	6.08	-0.78	-1.42	-14.95
U.S. commercial mortgage-backed securities	5.76	130[3]	4.62	-0.73	-1.60	-13.57
U.S. asset-backed securities	5.63	96[3]	2.76	-0.46	-0.83	-6.16
Preferred securities	7.84	288[3]	5.20	-0.75	-2.35	-17.49
High yield 2% issuer capped	9.21	463[3]	4.03	-1.23	2.60	-13.23
Senior loans[4]	11.19	649	0.25	0.43	0.85	-2.19
Global emerging markets	8.53	404[3]	5.88	-0.30	-0.88	-21.22
Global aggregate (unhedged)	3.89	60[3]	6.73	-0.94	-0.69	-20.69

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, 04 Nov 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, 04 Nov 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 02 Nov 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.

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