nuveen
A TIAA Company

Weekly Fixed Income Commentary

15 May 2023

Treasury yields rise, despite slowing inflation

U.S. Treasury yields rose despite improved U.S. inflation data, as expectations for more persistent inflation picked up. Both headline and core prices rose at the lowest rates since 2021. However, survey data showed a worrying increase in consumer inflation expectations.

HIGHLIGHTS

- **Treasuries, MBS, ABS, and investment grade and high yield corporates all had negative returns.**
- **Emerging markets, preferred securities and senior loans gained.**
- **Municipal bond yields remained essentially unchanged. New issue supply was $7.7B with outflows of -$102M. This week's new issuance is expected to be $8.5B.**

Anders Persson
CIO of Global Fixed Income

Daniel Close
Head of Municipals

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

Watchlist

- *U.S. Treasury yields rose slightly.*
- *Spread assets were mixed, despite the rise in rates.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" remains as a theme, as the Fed battles to control inflation. Higher interest rates are likely to cause additional volatility.

The underlying growth outlook remains healthy, thanks to strong consumer balance sheets and solid levels of businesses investment. This combination should keep corporate defaults low.

Treasury yields are likely to fall this year, and we expect the 10-year Treasury yield to end 2023 around 3.25%.

We favor selectively taking on risk in this environment of attractive prices and yields. Credit selection is key as we search for bonds with favorable income and solid fundamentals.

KEY RISKS

- Inflation fails to moderate as expected, weighing on asset prices.
- Policymakers tighten too rapidly, undermining the global economic expansion.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

INFLOWS CONTINUE FOR INVESTMENT GRADE CORPORATE BONDS

U.S. Treasury yields moved higher again last week, despite positive U.S. inflation data that showed a further slowdown in price pressures. Headline inflation moderated to 4.9% year-over-year, while core prices rose 5.5%. Both were the lowest rates of increases since 2021. However, survey data released on Friday showed a worrying increase in consumer inflation expectations, with the 5- to 10-year expectation rising to match a 12-year high of 3.2%. That caused Treasury yields to ultimately end higher for the week, with the 10-year yield closing up 3 basis points (bps) at 3.47% and the two-year yield rising 7 bps.

Investment grade corporates weakened alongside the rise in rates, returning -0.18% for the week but still outperforming similar-duration Treasuries by 4 bps. Regional banks continued to be pressured, with spreads widening another 15 to 100 bps; larger money center banks were flat. The asset class experienced an inflow of $2.7 billion, extending the current streak of inflows to seven weeks. Supply was relatively heavy, with $35 billion of new issuance, and demand for those deals was strong. New issue concessions averaged only around 7 bps. Another $35 billion of issuance is expected this week.

High yield corporates were mixed, returning -0.05% but beating similar-duration Treasuries by 6 bps. The asset class is still down for the month (-63 bps excess return) but up for the year (108 bps). Loan funds returned 0.02% and are now up 4.0% for the year. New issue supply has continued to pick up, with $3.1 billion and $5.0 billion of issuance across bond and loan spaces, respectively. In a possible sign of improved health, more deals are financing leveraged buyouts and merger/acquisition activity, rather than just refinancing.

Emerging markets gained, returning 0.08% and outpacing similar-duration Treasuries by 26 bps. The rally came despite a -$737 million outflow from hard currency funds. Local funds had robust inflows of $375 million, though the local market asset class returned -0.58% as the dollar gained late in the week after the high inflation expectation data. Focus for the EM asset class is now on elections in Turkey and, to a lesser extent, Thailand, where opposition parties may make electoral gains.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

MUNI BOND INVESTORS ENJOY HIGHER YIELDS AS THE FED BATTLES INFLATION

Municipal bond yields remained range bound last week. Fund flows were negative for the thirteenth consecutive week. However, municipal bond money market funds saw inflows of $1.9 billion, as investors capitalized on outsized short-term yields. This week's new issue supply must be priced to sell to pique investor demand.

The Fed continues its battle against inflation, but the inverted Treasury yield curve suggests that investors believe the U.S. Federal Reserve will prevail. In the meantime, muni bond yields have risen significantly since the depths of the pandemic. 1-year rates hit a low of 0.05% in April of 2021 and now sit almost 300 basis points higher at 2.97%. Similarly, the 10-year muni yield of 0.58% in August 2020 has risen 173 basis points to 2.31%. We expect rates to remain range bound as we enter the summer months, and munis should remain well bid. Historically high reinvestment money remains available, and it appears the new issue calendar will remain muted (versus 2022) for the year.

Dormitory Authority State of New York issued $1.08 billion school districts bonds (rated Aa3/NR). Underwriters struggled with the deal, and balances remained when it was finalized. The deal included 5% coupon bonds due in 2033 that came at a yield of 2.62%. This yield is approximately 76% of the 10-year Treasury bond yield.

High yield municipals saw positive fund flows last week, with demand firming just in time for the seasonal summer technical strength. U.S. Steel brought one of the largest high yield municipal new issue deals last week, and it was several times oversubscribed. Little new issuance is expected this week. The diligence of high yield muni investors will be tested, as access to supply is becoming increasingly valuable.

Municipal bond money market funds saw inflows of $1.9 billion, as investors capitalized on outsized short-term yields.

In focus

Municipal tailwinds expected in the summer

Municipal markets historically see net negative supply during the summer months, and this year's forecast is expected to be meaningful.

We are approaching historically large reinvestment months in May, June and July, when most municipal bonds mature and pay coupons. While not all money gets reinvested, most investors put a significant portion back into the municipal market. As such, there is a considerable increase in demand during these months.

At the same time, issuance is marking its slowest rate in five years, with supply about $100 billion below forecast. Low issuance plus seasonal demand should exacerbate this net negative supply dynamic, with projections at -$76 billion in June, July and August.[1]

Meanwhile, credit fundamentals remain strong. Municipalities have record levels of tax collections and cash on hand. Credit upgrades have been outpacing downgrades by nearly 3 to 1 based on full year 2022 data.

We believe this technical tailwind, combined with more supportive Fed policy, should lead to positive performance in the municipal market moving forward.

1 Bank of America Research.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	3.99	0.07	-0.02	-0.44
5-year	3.45	0.04	-0.04	-0.56
10-year	3.47	0.03	0.04	-0.41
30-year	3.79	0.04	0.12	-0.18

Source: Bloomberg L.P., 12 May 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.69	0.03	0.00	0.09
5-year	2.33	0.02	-0.05	-0.19
10-year	2.31	0.00	-0.04	-0.32
30-year	3.36	0.00	-0.03	-0.22

Source: Bloomberg L.P., 12 May 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	67
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	66

Source: Bloomberg L.P., Thompson Reuters, 12 May 2023. 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. **Performance data shown represents past performance and 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	3.35	–	6.07	0.05	0.40	2.96
High yield municipal	5.68	256[1]	7.60	0.25	0.41	3.75
Short duration high yield municipal[2]	5.29	304	3.88	0.19	0.41	3.07
Taxable municipal	4.73	105[3]	8.24	-0.22	-0.36	6.12
U.S. aggregate bond	4.37	59[3]	6.42	-0.23	-0.28	3.30
U.S. Treasury	3.76	–	6.34	-0.16	-0.10	3.45
U.S. government related	4.36	56[3]	5.39	-0.09	-0.01	3.69
U.S. corporate investment grade	5.19	145[3]	7.21	-0.18	-0.77	3.49
U.S. mortgage-backed securities	4.49	65[3]	6.19	-0.40	-0.20	2.85
U.S. commercial mortgage-backed securities	5.09	141[3]	4.54	-0.10	0.21	2.90
U.S. asset-backed securities	4.85	82[3]	2.86	-0.02	0.21	2.58
Preferred securities	7.66	304[3]	4.57	0.12	-3.17	-0.23
High yield 2% issuer capped	8.63	473[3]	3.62	-0.05	-0.43	4.16
Senior loans[4]	9.76	612	0.25	0.02	-0.08	4.00
Global emerging markets	7.32	359[3]	6.24	0.08	0.06	2.61
Global aggregate (unhedged)	3.50	55[3]	6.85	-0.46	-0.31	3.14

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, 12 May 2023. **Performance data shown represents past performance and 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, 12 May 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 10 May 2023.

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.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Performance data shown represents past performance and does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an 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.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE