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Weekly Fixed Income Commentary

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Hawkish Fed rhetoric boosts Treasury yields

U.S. Treasury yields rose slightly last week. U.S. Federal Reserve Chair Powell signaled no urgency to continue hiking rates, while pushing back against market pricing for aggressive rate cuts next year. Nevertheless, spread sectors generally performed well.

HIGHLIGHTS

- **Total returns were negative across most asset classes, except investment grade corporates and senior loans.**
- **Excess returns were positive for investment grade and high yield corporates, ABS, preferreds and emerging markets.**
- **Municipal bond yields declined. New issue supply was $11.6 billion and fund flows were essentially neutral. This week's new issuance is estimated at $8B.**

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Watchlist

- *The 10-year U.S. Treasury yield increased, but we anticipate further declines in overall rates in the months ahead.*
- *Spread assets generally outperformed versus Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" rates remains as a theme, as central banks battle 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 business investment. This combination should keep corporate defaults low.

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 intensify: China, Russia, Turkey, Iran and Israel.

SENIOR LOANS CONTINUE TO OUTPACE TAXABLE FIXED INCOME

U.S. Treasury yields moved higher last week, with 10-year yields ending 8 basis points (bps) higher at 4.65%. The Treasury Department auction of 10- and 30-year bonds was met with tepid demand. In particular, the 30-year auction had a 5 bps tail, indicating the softest demand since 2021. Separately, Fed Chair Powell repeated his prior rhetoric. He signaled no urgency to hike rates again but kept the option open, while also pushing back against pricing for aggressive rate cuts next year. The market currently prices three full 25 bps rate cuts in 2024, down from four full cuts before Powell spoke. That move pushed front-end yields higher, with 2-year Treasury yields rising 22 bps.

Investment grade corporates traded flat, returning 0.01% for the week, but beating similar-duration Treasuries by 28 bps. Yields were flat overall, while spreads tightened marginally. New issuance exceeded expectations, with 31 issuers bringing almost $47 billion of new supply for the week. Demand was healthy, with concessions averaging around 6.5 bps, slightly lower than the year-to-date average of 8.5 bps. Meanwhile, inflows continued the prior week's rebound, with $4 billion entering the asset class.

High yield corporate performance was mixed, retreating -0.30% for the week but beating similar-duration Treasuries by 11 bps. Senior loans returned 0.32% and have now returned 10.63% for the year, continuing to outpace other major fixed income sectors. Both asset classes were aided by strong inflows, with $6.2 billion entering high yield funds and $687 million flowing into loan funds. As in investment grade markets, leveraged finance saw an uptick in new issuance, with $7.6 and $7.2 billion issued across high yield and senior loans, respectively. We expect that trend to moderate slightly, as most of the existing pipeline has already come to market.

Emerging markets were also mixed, returning -0.20% but beating similar-duration Treasuries by 10 bps. After the prior week's strong performance by high yield emerging markets, conditions normalized somewhat. High yield sovereign spreads widened 3 bps, while investment grade names tightened -2 bps. Outflows eased, with -$55 million exiting from hard currency funds, while local funds saw inflows of $173 million. New issuance also surged in emerging markets at $16.2 billion, with 75% coming from sovereigns. That was more supply in one week than in the entire month of October.

THE MUNICIPAL MARKET HAS RALLIED IN NOVEMBER

Municipal bond yields declined last week, and munis outperformed Treasuries. Weekly muni new issue supply was priced to sell and was well received. Fund flows were essentially neutral. This week's new issue calendar should also be priced to sell and well received.

Muni bonds have performed well over the last two weeks. The 30-year MMD benchmark rate started November at 4.67% and has declined 35 bps to close at 4.25% on Friday. While this has been an exceptional rally, we expect continued volatility. The industry has billions of dollars of tax losses to exercise, and the new issue market should be priced to sell. We believe muni bond yields should be lower by mid-2024. We would consider any potential selloff as a buying opportunity.

Salt River Project Agricultural Improvement and Power District, AZ, issued $650 million electric system revenue bonds (rated Aa1/AA+). The deal was priced to sell and well received. Long bonds were trading in the secondary market at a premium to where they were issued.

High yield muni yields have decreased 31 bps on average over the last two weeks. Higher beta and larger issuers like Puerto Rico and tobacco have driven the largest market-weighted index yields lower, while more idiosyncratic high yield positions still offer very attractive yields. We are tracking another week of heavier new issuance, with 21 deals offering $800 million in par value. This should provide a high degree of selectivity for those with the ability to research this large deal volume. High yield exchange-traded funds are seeing strong inflows, while mutual funds are experiencing a rush of tax-loss selling in the face of the market rally.

We believe municipal bond yields should be lower by mid-2024.

In focus

Consider munis for tax-exempt income

Municipal bond yields have increased between 50 and 70 bps across the curve in 2023, including climbing 35 to 75 bps since the end of June.

This trend has recently slowed, with yields declining between 12 and 37 bps so far in the fourth quarter.

Nevertheless, we believe municipal bond yields continue to offer an attractive entry point for investors looking to add tax-exempt income to a fixed income allocation.

Current muni bond yields are particularly appealing on a taxable-equivalent basis, an important factor to consider when comparing muni investments with taxable fixed income. Investors could potentially earn taxable-equivalent yields ranging from 4.31% to 5.41% on a 10-year AAA rated municipal bond; 5.32% to 6.67% in 20 years; and 5.69% to 7.13% in 30 years.*

These yields appear extremely attractive as tighter fiscal policy begins to impact economic activity, especially given that municipal bonds currently have strong fundamentals with relatively low historical default rates.

*Includes the 3.8% Medicare tax on investment income. The taxable-equivalent yield represents the yield that must be earned on a fully taxable investment to equal the yield on a municipal investment on an after-tax basis. With respect to investments that generate qualified dividend income that is taxable at a maximum rate of 20%, the taxable-equivalent yield is lower. The yields do not take into account certain items such as the effects of state and/or local income taxes, the federal alternative minimum tax or capital gains taxes. Income from municipal bonds could be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliance conduct of a bond issuer.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	5.06	0.22	-0.03	0.63
5-year	4.69	0.18	-0.17	0.68
10-year	4.65	0.08	-0.28	0.78
30-year	4.76	0.00	-0.33	0.80

Source: Bloomberg L.P., 10 Nov 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	3.29	-0.12	-0.38	0.69
5-year	3.12	-0.13	-0.39	0.60
10-year	3.20	-0.12	-0.41	0.57
30-year	4.22	-0.11	-0.35	0.64

Source: Bloomberg L.P.,10 Nov 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	69
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 10 Nov 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	4.12	–	6.37	0.80	2.66	0.38
High yield municipal	6.14	219[1]	7.72	0.99	3.62	1.96
Short duration high yield municipal[2]	5.97	282	4.35	0.34	0.00	2.68
Taxable municipal	5.64	87[3]	7.87	-0.06	2.34	1.12
U.S. aggregate bond	5.41	52[3]	6.16	-0.29	2.00	-0.82
U.S. Treasury	4.86	–	5.92	-0.30	1.56	-1.20
U.S. government related	5.37	49[3]	5.10	-0.34	1.28	0.65
U.S. corporate investment grade	6.07	122[3]	6.75	0.01	2.48	0.57
U.S. mortgage-backed securities	5.61	65[3]	6.37	-0.55	2.48	-1.91
U.S. commercial mortgage-backed securities	6.21	137[3]	4.33	-0.34	1.15	0.41
U.S. asset-backed securities	5.87	81[3]	2.59	-0.15	0.51	2.35
Preferred securities	7.86	252[3]	4.97	-0.20	3.24	2.79
High yield 2% issuer capped	8.93	392[3]	3.46	-0.30	2.15	6.87
Senior loans[4]	10.17	563	0.25	0.32	0.62	10.63
Global emerging markets	8.11	325[3]	5.81	-0.20	1.89	1.30
Global aggregate (unhedged)	4.20	50[3]	6.57	-0.44	1.76	-1.67

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 Nov 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, 10 Nov 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 08 Nov 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.

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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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