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Weekly Fixed Income Commentary

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Treasury yields rise as inflation creeps slightly higher

U.S. Treasury yields generally rose across the curve last week, led by the longer end of the curve. Multiple maturities hit their highest yields since late June/early July. Rates rose most aggressively mid-week in response to higher-than-expected inflation data. On Friday, maturities of 10 years and less declined as retail sales rose less than expected.

HIGHLIGHTS

- **Only the preferred and senior loan sectors posted positive returns.**
- **The high yield municipal bond market continues to benefit from strong technicals.**
- **Emerging markets debt posted negative total returns, but outperformed Treasuries.**

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TREASURY YIELD CURVE STEEPENS

U.S. Treasury yields rose across the curve last week, led by longer maturities.[1] The 20- and 30-year maturities rose about 20 basis points (bps), hitting their highest levels since late June/early July.[1] The 10-year yield also rose significantly, rising to its highest level since mid-June.[1] The move on the short-end of the curve was less pronounced, as these maturities tend to be anchored by monetary-policy expectations. Rates rose most aggressively mid-week in response to higher-than-expected inflation data. As the week closed, yields on maturities of 10 years or less declined as retail sales rose less than expected[1]

Rising U.S. Treasury yields resulted in negative total returns for most U.S. sectors last week.[1] Only the preferred and senior loan sectors posted positive total returns.[1] Relative returns were mixed, as only investment grade, high yield corporate and mortgage-backed securities underperformed similar-duration Treasuries.[1] Investment grade credit posted the weakest total and relative returns last week, but the sector maintains strong year-to-date total returns despite record levels of issuance.[1,3] The investment grade credit sector is expected to hit an annual issuance record later this month. Shifting to the global fixed income markets, the global aggregate and emerging markets sectors posted negative total returns, but both outperformed similar-duration Treasuries.[1]

Municipal bond yields experienced their first increase since late June, following the Treasury selloff.

RISING MUNICIPAL YIELDS FOLLOW TREASURIES

Municipal bond yields rose last week, following rising Treasury yields.[1] New issue supply of $11 billion was well received.[2] Fund flows were positive for the 14th consecutive week at $2.3 billion.[3] This week's new issuance is expected to be $14.2 billion ($5.2 billion taxable).[2]

The rise in municipal bond yields marks their first increase since late June. Weak demand for new Treasuries in last week's auction contributed to the selloff. While there is little value at these historically low yields on an absolute basis, municipal yields remain attractive relative to Treasuries. Strong demand for municipals should continue as yields remain lower for longer.

Los Angeles County Metropolitan Transportation Authority issued $1.3 billion sales tax revenue bonds (rated AA).[4] The bonds were well received and yields were lowered, reinforcing the relative attractiveness of tax-exempt municipal bonds. The 10-year bonds were priced at a yield of 0.77%, which is attractive compared with the 10-year Treasury bond yielding 0.60%.[1] This additional yield is especially attractive for California residents looking for tax-exempt income.

Technical strength continues to bolster the high yield municipal market. Supply continues to be limited, fund flows have re-accelerated and reinvestment flows should remain strong through mid-September. Nearly three-quarters of the monetary defaults in 2020 have been in the senior living sector. Bond security structures should prevent widespread monetary defaults, and investors should weigh levels of credit spreads versus the potential for more likely downgrades. High yield municipal credit spreads remain far above long-term averages, and we believe they could tighten significantly if widespread defaults fail to materialize.

INVESTMENT GRADE CREDIT FINDS ITSELF AT THE BOTTOM OF THE PACK

Investment grade corporate bonds landed in the basement, hurt by their longer average duration (8.72 years) in the face of last week's steepening yield curve.[1] Their -1.6% return was their worst one-week performance since the depths of the coronavirus-driven selloff in March.[1] The average yield on investment grade corporate bonds climbed 14 bps, to 1.96%, ending a recent trend of repeatedly hitting new lows.[1]

High yield corporates posted a loss after six consecutive weeks of gains.[1] Spreads gapped 19 bps wider, finishing at a two-week high just shy of 500 bps.[1] Net flows into high yield bond funds were -$471 million, marking the first weekly outflow since early July.[3] This declining demand was met by heavy supply (more than $19 billion in new issuance, the sixth-highest weekly volume on record).[2] Most of this month's high yield issuance has been related to refinancing.

Investment grade corporate bonds posted their worst one-week performance since March.

Emerging markets (EM) debt snapped a 15-week winning streak. Last week's loss was only the third negative return for the asset class since April and came despite modest spread tightening (-8 bps) and positive fund flows.[1,3] Within EM, sovereign and corporate debt underperformed local-currency issues. Among the currencies that fared well against the U.S. dollar were the Mexican peso, South African rand and Russian ruble.

In focus

EM debt has been performing well, but risks remain

Emerging markets (EM) debt has been among the top-performing fixed income sectors since bottoming in March during the worst of the coronavirus-driven meltdown. With risk back in fashion and the hunt for yield in full force, spreads on major EM debt indexes have retraced their widening from multi-year highs, now sitting at or below their long-term averages.

In our view, EM debt performance is likely to be supported in the near term by several factors: the global economic recovery, excess liquidity provided by major central banks and investors' willingness to deploy still-high levels of cash. But EM debt is not a monolithic asset class. Selectivity among sovereign, corporate and local-currency markets, as well as individual issuers, will be critical.

A main risk to this outlook is concern about the trajectory of COVID-19 cases, particularly in the U.S. and two large EM countries, Brazil and India. Although many EM economies rebounded in May and June, it's difficult to envision sustaining that momentum without a vaccine or treatment.

Rising U.S./China tensions are also on our radar. The Trump administration continues to blame China for the coronavirus outbreak, while China's diplomatic corps is becoming increasingly hawkish. Adding to the volatile mix are Beijing's crackdown on Hong Kong and uncertainty about the impact of U.S. elections in November.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	0.02	0.04	-1.43
5-year	0.30	0.06	0.09	-1.40
10-year	0.71	0.15	0.18	-1.21
30-year	1.45	0.21	0.25	-0.94

Source: Bloomberg L.P. As of 14 Aug 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.11	0.02	-0.02	-0.93
5-year	0.20	0.04	-0.03	-0.89
10-year	0.63	0.05	-0.02	-0.81
30-year	1.33	0.06	-0.04	-0.76

Source: Bloomberg L.P. As of 14 Aug 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	89
30-year AAA Municipal vs Treasury	92
High Yield Municipal vs High Yield Corporate	79

Source: Bloomberg L.P., Thompson Reuters. As of 14 Aug 2020. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	1.19	–	5.17	-0.31	0.16	3.96
High Yield Municipal	4.44	330[5]	8.13	-0.03	0.72	0.73
Short Duration High Yield Municipal[6]	4.14	374	3.99	0.09	0.48	0.25
Taxable Municipal	2.25	141[7]	10.07	-1.08	-1.01	8.68
U.S. Aggregate Bond	1.16	57[7]	6.12	-0.91	-0.80	6.85
U.S. Treasury	0.52	–	7.31	-1.03	-1.17	8.67
U.S. Government Related	1.14	66[7]	6.08	-0.70	-0.42	5.16
U.S. Corporate Investment Grade	1.96	128[7]	8.72	-1.58	-1.20	7.14
U.S. Mortgage-Backed Securities	1.20	54[7]	1.92	-0.14	0.00	3.68
U.S. Commercial Mortgage-Backed Securities	1.57	116[7]	5.33	-0.26	-0.36	6.08
U.S. Asset-Backed Securities	0.70	54[7]	2.12	-0.03	0.00	3.76
Preferred Securities	3.07	220[7]	4.27	0.48	0.85	2.18
High Yield 2% Issuer Capped	5.61	499[7]	3.69	-0.45	0.10	0.75
Senior Loans[8]	6.27	601	0.25	0.53	0.94	-2.05
Global Emerging Markets	4.15	355[7]	6.71	-0.35	0.63	3.33
Global Aggregate (unhedged)	0.90	49[7]	7.34	-0.58	-0.63	5.60

5 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **6** 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. **7** Option-adjusted spread to Treasuries. **8** 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. As of 14 Aug 2020. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. 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. All indexes are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 14 Aug 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 12 Aug 2020.

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.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays Taxable Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

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A word 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 advisor 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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