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Weekly Fixed Income Commentary

14 September 2020

Treasury yields decline as risk-off trade continues

U.S. Treasury yields fell in response to continued risk-off market sentiment.[1] Non-Treasury sector results ended mixed, led by taxable municipal bonds. Modestly stronger economic data and robust corporate bond issuance had little impact on Treasury rates, which closed the week lower across the curve.

HIGHLIGHTS

- **Taxable municipal bonds led returns, followed by commercial mortgage-backed, senior loans and investment grade corporates.**
- **The municipal market held steady, buoyed by a strong U.S. Treasury market.**
- **Emerging markets debt finished near the bottom of the pack amid mixed conditions.**

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RISK-OFF TONE PULLS TREASURY RATES LOWER

U.S. Treasury yields fell overall last week, in response to continuing risk-off market sentiment.[1] A weak 10-year Treasury auction helped push rates higher only on Wednesday, as the market struggled to digest the ever-increasing Treasury supply.[1] Yields declined again on Thursday, however, on the heels of a stronger 30-year auction and continued equity market weakness.[1] Modestly stronger economic data and robust corporate bond issuance had little impact on Treasury rates, which closed the week lower across the curve.[1] Declines were similar for all maturities longer than 3 years.[1]

Non-Treasury sectors saw mixed results, driven by the pervasive risk-averse sentiment fueled by equity volatility. Most sectors struggled to keep pace with strong Treasury returns. Despite weak relative performance, most sectors produced positive total returns as yields fell. The taxable municipal sector led returns and was the only sector to outperform Treasuries.[1] Commercial mortgage-backed, senior loans and investment grade corporates followed with solidly positive total returns.[1] High yield corporate performance was dragged down by the equity market selloff and endured a negative weekly total return, along with emerging markets and mortgage-backed securities.[1]

MUNICIPAL BONDS OFFER ATTRACTIVE RELATIVE VALUE

The municipal market held steady last week, buoyed by a strong U.S. Treasury market.[1] New issuance totaled only $7 billion in the holiday-shortened week.[2] It was priced to sell and well received. Fund flows were positive for the 18th straight week at $1 billion.[3] This week's new issuance should increase to $11 billion.[2]

Outsized new issue supply may challenge the municipal market this week, although it will be priced to sell and should be well received. We expect this environment to continue through year end: bonds priced to sell meeting strong demand, as investors hold plenty of cash on the sidelines.

The city of Charlotte, North Carolina, issued $333 million of water and sewer system revenue bonds (rated Aaa/AAA).[4] The deal was well received and yields were lowered upon final pricing. This deal illustrates the relative value in the municipal market. These 2020 tax-exempt bonds came at 0.89% in 2030. This is substantially cheaper than the U.S. Treasury 10-year bond, trading at 0.67% when the deal was issued. That means investors could buy AAA tax-exempt bonds for less than U.S. Treasuries.

High yield municipal yields remained unchanged last week, as the market continues to shrug off minor outflows.[1] This week brings just a few high yield municipal deals, aside from a slew of new senior living deals at a time when that sector is in distress. These deals will test investors' appetite and ultimately be a helpful price discovery for such projects. American Dream announced it will be opening on October 1 with support from the state of New Jersey.

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INVESTMENT GRADE CORPORATES ENJOY ANOTHER POSITIVE WEEK, BUT HIGH YIELD STRUGGLES

Investment grade corporate bonds were among the week's better relative performers, despite slightly wider spreads and a flood of new supply.[1,2] Forty issuers brought $64 billion in deals to market, making last week the seventh-busiest on record for primary investment grade issuance.[2] Financials accounted for the majority of this activity, followed by consumer cyclicals. Overall new-issue volume is 68% ahead of last year's pace.[2] On the demand side, fund flows were positive (+$4.4 billion) for the 23rd consecutive week.[3]

High yield corporates recorded a loss, hurt by their correlation to U.S. equities in a risk-off week that dragged the S&P 500 Index down by 2.5%.[1] Energy was the worst-performing high yield sector, as oil prices tumbled 6.5%.[1] Spreads widened by 8 bps, and high yield bond funds reported outflows (-$769 million) for only the second time in the past 10 weeks.[1,3] High yield remains a top-performing fixed income category in the third quarter, behind only preferred securities.

High yield corporates remain a top-performing fixed income category in the third quarter.

Emerging markets (EM) debt finished near the bottom of the pack amid mixed conditions for the asset class. Positive factors included net inflows (+$2 billion) into EM bond funds and an underlying "buy the dip" mentality.[3] These were countered by heavier-than-normal new supply (15 deals totaling +$12 billion) for a holiday-shortened week, a weaker macroeconomic backdrop in Asia and credit concerns in sub-Saharan Africa.[2]

In focus

Inflation steps back into the spotlight

Investors have renewed their focus on inflation since August, when the Federal Reserve (Fed) announced its flexible average inflation targeting approach. The new strategy would allow inflation to overshoot the Fed's target for some time to come.

The Fed's preferred inflation gauge, the core price index for personal consumption expenditures (PCE), fell below 1% in April, but has risen each month since then. However, broad inflation measures remain well below the Fed's target, and we don't think higher inflation will be a problem any time soon. In fact, the Fed's own projections show inflation running below target through at least the end of 2022.

Lack of wage growth is one key anchor keeping inflation in check. Wage pressure was low even as unemployment hit record lows earlier this year, and labor markets are now exhibiting considerably more slack.

Treasury Inflation Protected Securities (TIPS) breakeven spreads have mirrored the bounce in inflation data since March, remaining below long-term averages. Investor demand, as well as Fed buying, has helped buoy valuations. But we think this measure of relative value merits investment consideration, as general prudence dictates some portfolio defense against the adverse effects of rising prices over time.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.13	-0.02	0.00	-1.44
5-year	0.25	-0.05	-0.02	-1.44
10-year	0.67	-0.05	-0.04	-1.25
30-year	1.41	-0.06	-0.06	-0.98

Source: Bloomberg L.P. As of 11 Sep 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	0.13	-0.02	-0.03	-0.91
5-year	0.24	-0.02	-0.02	-0.85
10-year	0.84	0.01	0.03	-0.60
30-year	1.58	0.01	0.02	-0.51

Source: Bloomberg L.P. As of 11 Sep 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	125
30-year AAA Municipal vs Treasury	111
High Yield Municipal vs High Yield Corporate	81

Source: Bloomberg L.P., Thompson Reuters. As of 11 Sep 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	1.32	–	5.39	0.05	-0.02	3.28
High Yield Municipal	4.53	315[5]	8.90	0.06	0.02	0.29
Short Duration High Yield Municipal[6]	4.23	374	4.15	0.04	0.02	0.40
Taxable Municipal	2.19	138[7]	10.11	0.48	0.70	9.30
U.S. Aggregate Bond	1.14	58[7]	6.14	0.25	0.17	7.03
U.S. Treasury	0.48	–	7.32	0.40	0.23	9.00
U.S. Government Related	1.12	66[7]	6.06	0.18	0.17	5.24
U.S. Corporate Investment Grade	1.95	131[7]	8.72	0.30	0.26	7.22
U.S. Mortgage-Backed Securities	1.20	56[7]	1.98	-0.01	-0.03	3.69
U.S. Commercial Mortgage-Backed Securities	1.44	107[7]	5.32	0.38	0.32	6.96
U.S. Asset-Backed Securities	0.57	44[7]	2.11	0.07	0.06	4.07
Preferred Securities	3.10	228[7]	4.33	0.03	-0.15	2.96
High Yield 2% Issuer Capped	5.57	497[7]	3.66	-0.22	-0.32	1.28
Senior Loans[8]	5.83	559	0.25	0.32	0.97	-0.55
Global Emerging Markets	3.99	342[7]	6.79	-0.11	0.18	3.43
Global Aggregate (unhedged)	0.89	49[7]	7.38	0.13	-0.23	5.86

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 11 Sep 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, 11 Sep 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 09 Sep 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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