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Weekly Fixed Income Commentary

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Treasury yields increase slightly as the Fed keeps asset purchases steady

Most U.S. Treasury yields increased modestly last week, led by longer maturities. The Federal Reserve (Fed) disappointed investors, as it did not expand long-duration asset purchases as some had hoped. The week ended on a soft tone for risk assets.

HIGHLIGHTS

- **Preferred securities and senior loans enjoyed the best returns across U.S. markets, followed by high yield and investment grade corporates.**
- **Municipal bond yields remain range bound.**
- **The global aggregate sector delivered the highest total return, supported by Asia-Pacific.**

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FED MEETING HELPS PUSH TREASURY YIELDS SLIGHTLY HIGHER

U.S. Treasury yields closed modestly higher last week for most maturities.[1] The 30-year maturity range led the increase, while shorter maturities remained anchored.[1] The week began with a risk-friendly market sentiment, stoked by stronger-than-expected U.S. and Chinese economic data, that propelled rates higher. At its meeting on Wednesday, the Fed indicated it would likely leave rates near zero through at least 2023. However, longer-maturity Treasury yields rose after the meeting because the Fed did not expand long-duration asset purchases as some investors had hoped. Disappointment carried into the following days, and the week ended on a soft tone for risk assets. Treasury rates slipped lower as the recovery in employment data continued to slow, offsetting a portion of the week's increase.[1]

Most non-Treasury sectors posted slightly positive total returns for the week and outperformed the lagging Treasury market.[1] Credit sectors outperformed, with preferred securities and senior loans enjoying the best returns across U.S. markets, followed by high yield and investment grade corporates.[1] The taxable municipal sector's relatively long duration dragged down returns, joining mortgage-backed securities and government-related assets as the only U.S. sectors with negative total returns lower than Treasuries.[1] Emerging markets also struggled, enduring a negative weekly return lower than Treasuries.[1] The global aggregate sector delivered the highest total return, supported by the Asia-Pacific region.[1]

We expect the municipal market to remain range bound for the foreseeable future.

THE MUNICIPAL MARKET IS IN BALANCE

Municipal bond yields remained unchanged last week.[1] New issue supply of $9 billion was priced to sell and well received.[2] Fund flows were positive for the 19th consecutive week at $612 million.[3] This week's new issue supply should be robust at $ 12.9 billion ($3.5 billion taxable).[3]

It is no surprise that municipal yields remain range bound. The Fed asserted once again that interest rates will stay low for as long as it takes to get the U.S. economy running as it was before the pandemic. The municipal market appears balanced, with demand roughly even with new issue supply. We expect the municipal market to remain range bound for the foreseeable future, and we would consider any dips to be potential buying opportunities.

New York Metropolitan Transit Authority (MTA) issued $900 million of bonds in three tranches, and all were well received (rated A3/BBB+).[4] For example, a 30-year bond with a 4% coupon yielding 4.35% later traded in the secondary market at 4.21%. Although ridership is down severely at MTA, the system remains the lifeblood of the New York economy. Because of MTA's importance, investors are anticipating that the city, state and the federal governments will keep the system functioning and maintain its debt service.

High yield municipals continued to outperform high grades, and credit spreads contracted further as a result.[1] Fund flows returned to positive territory.[3] A flurry of high yield municipal deals are expected this week, with the largest being a $127 million Ziegler Senior Living deal in Florida.[4] We also expect tobacco deals for Sonoma and Merced counties in California. Last week, both Buckeye Tobacco and Puerto Rico COFINA underperformed, as the rally over the summer appears to be retracing. Puerto Rico Electric Power Authority (PREPA) will receive nearly $13 billion in federal aid for capital expenditures, which is a positive development for the existing restructuring plan to move forward.

SIDEWAYS TRADING, IDENTICAL RETURNS FOR HIGH YIELD AND INVESTMENT GRADE CREDIT

Investment grade corporate bonds posted a positive return for the third week in a row and 10 of the last 12.[1] The asset class traded in a tight range with relatively light secondary flows.[3] Spreads tightened by 3 basis points (bps), finishing the week at 128 bps – nearly 30 bps narrower than their 20-year average.[1] The energy sector recovered from the prior week's losses, as oil prices rebounded by 10%. Sector laggards included pharmaceuticals, utilities, banks and autos.[1] In the primary market, 33 issuers priced $31.8 billion worth of new deals.[2]

High yield corporates matched the modest return of their investment grade counterparts.[1] Most of the week's gain came from coupon income, while price action was slightly negative. Spreads narrowed by 6 bps, and fund flows (+$526 million) were positive for the ninth time in the past 11 weeks.[1,3] New issuance exceeded $25 billion, making last week the busiest primary market ever for high yield.[2] Over 80% of the volume represented refinancing activity from issuers taking advantage of the low-rate environment.

After several positive weeks, EM fund flows flattened, signaling diminished demand.

Emerging markets (EM) debt continued to struggle, lagging all other non-municipal fixed income categories.[1] Returns were negative for the second consecutive week and five of the last six. The soft tone reflected a weak macroeconomic backdrop, heavy primary supply and a mildly disappointing Fed meeting. After several positive weeks, EM fund flows flattened, signaling diminished demand.

In focus

The Fed keeps rates down, but ups its outlook

The Federal Reserve maintained its target fed funds rate at 0%-0.25% at the September meeting. But the U.S. economy is recovering at a pace that has surprised financial markets (and the Fed too, apparently). As a result, Chair Jerome Powell and his colleagues upwardly revised their projections for growth and employment.

The closely watched "dot plot" showed that among the 17 Fed officials who set monetary policy, only one anticipates a higher fed funds rate by 2022, and a large majority foresees no increase through 2023.

Regarding inflation, the Fed re-emphasized that it will encourage prices to increase at rates "moderately above" its 2% target "for some time." This strategy is designed to offset the extended period during which inflation has run well below 2%, including the early months of 2020, when the labor market was still strong.

At his post-meeting press conference, Powell again made it clear that more fiscal stimulus is needed – both today and in the future – because the U.S. continues to face long-term risks from the coronavirus crisis.

Until a reliable vaccine is widely available, which would provide a major economic boost, we don't believe significant increases in inflation or longer-term interest rates are imminent concerns. Therefore, we see little scope for major changes in the monetary policy approach for a year or two, and perhaps beyond.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.14	0.01	0.01	-1.43
5-year	0.28	0.03	0.02	-1.41
10-year	0.70	0.03	-0.01	-1.22
30-year	1.45	0.04	-0.02	-0.94

Source: Bloomberg L.P. As of 18 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	0.00	-0.03	-0.91
5-year	0.24	0.00	-0.02	-0.85
10-year	0.84	0.00	0.03	-0.60
30-year	1.58	0.00	0.02	-0.51

Source: Bloomberg L.P. As of 18 Sep 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	120
30-year AAA Municipal vs Treasury	109
High Yield Municipal vs High Yield Corporate	82

Source: Bloomberg L.P., Thompson Reuters. As of 18 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	1.31	–	5.39	0.08	0.06	3.37
High Yield Municipal	4.52	314[5]	8.84	0.11	0.13	0.40
Short Duration High Yield Municipal[6]	4.23	374	4.13	0.04	0.13	0.50
Taxable Municipal	2.22	139[7]	10.08	-0.29	0.41	8.98
U.S. Aggregate Bond	1.18	59[7]	6.17	-0.09	0.07	6.93
U.S. Treasury	0.50	–	7.26	-0.17	0.06	8.82
U.S. Government Related	1.12	66[7]	6.02	-0.11	0.06	5.12
U.S. Corporate Investment Grade	1.94	128[7]	8.73	0.10	0.36	7.33
U.S. Mortgage-Backed Securities	1.34	66[7]	2.15	-0.19	-0.23	3.49
U.S. Commercial Mortgage-Backed Securities	1.42	104[7]	5.31	0.05	0.38	7.02
U.S. Asset-Backed Securities	0.55	42[7]	2.14	0.03	0.09	4.10
Preferred Securities	3.01	221[7]	4.28	0.19	0.04	3.15
High Yield 2% Issuer Capped	5.53	491[7]	3.69	0.10	-0.22	1.39
Senior Loans[8]	5.76	553	0.25	0.19	1.28	-0.25
Global Emerging Markets	4.03	345[7]	6.75	-0.23	-0.05	3.19
Global Aggregate (unhedged)	0.90	49[7]	7.40	0.54	0.31	6.43

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 18 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, 18 Sep 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 16 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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