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Weekly Fixed Income Commentary

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Investor optimism pushes Treasury yields higher

U.S. Treasury yields rose last week, as U.S. election results became clearer and Pfizer announced encouraging news about its COVID-19 vaccine trials. A somber mood later in the week offset a portion of the earlier increase, as virus cases rose across the globe and fears of increased lock-down measures intensified.

HIGHLIGHTS

- **Preferred securities enjoyed the best returns, followed by emerging markets, senior loans, taxable municipals and high yield corporates.**
- **Municipal bond prices finished slightly higher and high yield municipal bond demand accelerated.**
- **The global aggregate sector suffered the worst weekly total return.**

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OPTIMISM DRIVES TREASURY YIELDS HIGHER

Investor optimism pushed U.S. Treasury yields higher last week, as U.S. election results became clearer and Pfizer announced impressively effective COVID-19 vaccine trial news. By Tuesday, the positive market tone had driven long-maturity Treasury yields more than 13 basis points (bps) higher for the week. A soft 10-year auction on Tuesday helped solidify the boost and likely contributed to this maturity leading the week's rate increases. The 10-year Treasury yield closed higher than 90 bps early in the week for the first time since March. Markets struggled to absorb more than $122 billion in Treasury supply, which included a record-sized $27 billion 30-year auction. Investor enthusiasm was tempered on Thursday, weighed down by rising virus cases across the U.S. and the globe that stoked fears of increased lock-down measures. This somber mood resulted in falling rates, led by the 30-year. This move offset a significant portion of the earlier increase, although all maturities still finished the week with higher yields.

Broadly supportive market sentiment fueled outperformance across non-Treasury sectors. All U.S. sectors outperformed lagging Treasury returns, although some still posted negative total returns last week. Preferred securities enjoyed the best returns, followed by emerging markets, senior loans, taxable municipals and high yield corporates. All saw solidly positive weekly total returns. Investment grade corporates endured the lowest returns in the U.S. markets with a negative total return. The global aggregate sector suffered the worst weekly total return in fixed income. All regions posted negative total returns, with Asian markets falling the most.

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DEMAND FOR MUNICIPAL BONDS SHOULD CONTINUE

Municipal bond prices finished slightly higher last week. Fund flows turned positive once again, at $1.2 billion. This week's new issue calendar is expected to ramp up significantly to $11 billion ($3 billion taxable) and should be well received.

High grade municipals are no longer extremely cheap relative to Treasuries, as Treasury yields have risen slowly but steadily over the last few months. The 10-year yield hit a low of 55 basis points over the summer, but returned to 95 basis points this week. Meanwhile, municipal yields have remained relatively unchanged. Nevertheless, municipal bonds remain in high demand for their own intrinsic value: tax-exempt income. We expect demand for high grade municipals to continue, as taxes should rise under a Biden administration.

The city of Portland, Oregon, issued $239 million sewer system revenue bonds (rated Aa2/AA). The 10-year bond was priced at a yield of 0.95%, roughly equal to the 10-year Treasury yield last week. The spread between high grade tax-exempt yields and Treasury yields continues to narrow as Treasury yields rise.

High yield municipal bond demand has accelerated, with net fund flows of $526 million last week. Investors responded to optimistic vaccine progress and ultimately more confident expectations of a return to normal economic activity. Despite 10-year U.S. Treasury yields increasing 8 bps last week, high yield municipal yields decreased by 7 bps on average. Supply should remain light for the remainder of the year. Default rates remain low, contained to sectors already showing more pre-covid credit distress. Generally speaking, liquidity features supporting debt service in the instances of short-term revenue impairments should allow investors to avoid widespread defaults. However, we believe the current market offers ample opportunities for professional credit selection.

VACCINE NEWS GIVES A QUICK BOOST TO RISK ASSETS, BUT THE RESURGENT VIRUS WEIGHS

High yield corporates were positive for the second week in a row and six of the last seven. Spreads tightened by 7 bps, and fund inflows of $4.6 billion were the largest since June. Less encouraging was that all of last week's rise came on Monday, when risk assets jumped on news of a coronavirus vaccine breakthrough. High yield lost momentum as the week wore on, with investors focusing on rampant spikes in COVID-19 cases. By Friday's close, high yield had given back nearly half of Monday's gain.

Investment grade corporate bonds declined for the third time in the past four weeks. Unlike their high yield counterparts, which started strong and then tapered off, investment grade credits stumbled out of the gate but recouped some lost ground by the end of the week. Fund flows (+$3.4 billion) rebounded after turning negative the previous week. In the primary market, 18 issuers brought $42.9 billion in new supply, beating street estimates of $25 to $30 billion.

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Emerging markets (EM) debt finished near the top of the pack, boosted by the vaccine news and continuing optimism about U.S. election results. Technical factors were also positive, as inflows of $2.6 billion were met by relatively muted supply. The week's star EM performer was Turkey, where the government took steps signaling a potentially more orthodox approach to economic policy. The Turkish lira gained more than 10%, and local government bonds rallied.

In focus

Voters speak on issues affecting muni bonds

The November elections offered national, state and local races, as well as issues that help determine local budgets and affect tax-exempt bonds.

Illinois voters rejected implementing a graduated income tax rate structure, rather than the current flat tax set at 4.95%. The new structure would have helped offset COVID-19 revenue losses. Failure of the tax proposal alone won't cause an immediate rating downgrade to below investment grade, though the likelihood has increased. We expect the rating agencies will wait until January to take any action.

Arizona residents voted to permanently add a 3.5% surcharge on taxable income for high-wage earners. The estimated $940 million in revenue generated would go toward state education. This comes after the state made budget promises in 2018 that included a 20% pay raise for teachers by 2020. The state hopes the increase will attract teachers and resolve its persistent teacher shortage. Overall, we believe this is a credit positive for the state's school districts.

Nationally, Joe Biden proposed tax changes that could affect demand for municipal bonds, including increasing the maximum individual income tax rate and long-term capital gains rate for high-income tax-payers. House Democrats had proposed legislation that would again allow tax-exempt municipal bonds to be refunded with tax-exempt debt. However, a potentially divided Congress is unlikely to enact any major changes in the tax code in the first two years of the next administration.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	0.18	0.03	0.03	-1.39
5-year	0.41	0.05	0.02	-1.29
10-year	0.90	0.08	0.02	-1.02
30-year	1.65	0.05	-0.01	-0.74

Source: Bloomberg L.P. As of 13 Nov 2020. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	0.18	-0.01	-0.03	-0.86
5-year	0.26	-0.01	-0.04	-0.83
10-year	0.81	0.00	-0.12	-0.63
30-year	1.55	-0.01	-0.16	-0.54

Source: Bloomberg L.P. As of 13 Nov 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	91
30-year AAA Municipal vs Treasury	94
High Yield Municipal vs High Yield Corporate	88

Source: Bloomberg L.P., Thompson Reuters. As of 13 Nov 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	1.30	–	5.42	0.08	0.71	3.75
High Yield Municipal	4.40	307[1]	8.64	0.45	1.17	1.72
Short Duration High Yield Municipal[2]	4.09	360	4.04	0.31	0.34	1.44
Taxable Municipal	2.28	130[3]	10.05	0.70	1.16	8.54
U.S. Aggregate Bond	1.23	51[3]	6.22	-0.14	0.35	6.68
U.S. Treasury	0.61	–	7.29	-0.30	-0.07	7.80
U.S. Government Related	1.14	57[3]	5.99	0.10	0.65	5.20
U.S. Corporate Investment Grade	1.95	114[3]	8.77	-0.12	1.21	7.73
U.S. Mortgage-Backed Securities	1.33	51[3]	2.32	0.00	-0.01	3.57
U.S. Commercial Mortgage-Backed Securities	1.49	97[3]	5.29	0.03	0.31	6.82
U.S. Asset-Backed Securities	0.56	38[3]	2.12	-0.02	0.01	4.17
Preferred Securities	2.78	200[3]	4.32	0.95	1.94	4.93
High Yield 2% Issuer Capped	5.01	436[3]	3.63	0.49	2.60	3.70
Senior Loans[4]	5.65	538	0.25	0.74	1.48	0.81
Global Emerging Markets	3.82	310[3]	6.82	0.78	2.40	4.24
Global Aggregate (unhedged)	0.91	42[3]	7.41	-0.47	0.82	6.69

1 Yield difference between the Bloomberg Barclays 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. As of 13 Nov 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.

For more information, please visit nuveen.com.

Performance: Bloomberg, L.P. **Issuance:** The Bond Buyer, 13 Nov 2020. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 11 Nov 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.

Representative indexes: municipal: Bloomberg Barclays Municipal Index; **high yield municipal:** Bloomberg Barclays High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Barclays Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg Barclays U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg Barclays U.S. Treasury Index; **U.S. government related:** Bloomberg Barclays U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg Barclays U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg Barclays U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg Barclays CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Barclays Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg Barclays High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Barclays Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Barclays Global Aggregate Unhedged Index.

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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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