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Weekly Fixed Income Commentary

22 February 2021

Treasury yields rise on promising economic data

U.S. Treasury yields rose and the yield curve steepened, as economic data came in stronger than expected. Spreads in non-Treasury sectors generally tightened, though emerging markets spreads widened amid brief dollar strength. Loan funds saw a sixth consecutive weekly inflow, as the combination of better growth and higher rates boosted demand for floating-rate and lower-quality investments. Municipal yields sold off, reflecting good news.

HIGHLIGHTS

- **Senior loans have the highest 2021 returns so far, followed by high yield corporates and asset-backed securities.**
- **We see buying opportunities within municipal bonds.**
- **Global markets outperformed U.S. markets, but also experienced negative weekly total returns.**

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TREASURY YIELDS CONTINUE TO RISE

Longer maturity U.S. Treasury yields continued to climb last week, while shorter maturities remained firmly anchored. Stronger-than-expected economic data pushed 10- and 30-year Treasury yields above their March 2020 peaks for the first time since the pandemic. Interestingly, last week's rate jump was not accompanied by rising inflation expectations. In fact, implied inflation expectations actually fell, as the 10-year TIPS breakeven rate declined by more than 7 basis points (bps). The market struggled to absorb the $27 billion 20-year Treasury auction, which suffered from weak investor demand. However, this appeared to have little impact on rates, as it occurred on the only day of the week when yields finished lower.

The Fed minutes noted that inflation was likely to increase above 2% "for a brief period in the spring as the unusually low monthly observations from last spring roll out of the 12-month calculation." We don't expect to see a shift in Fed policy as a result.

All sectors except senior loans endured negative total returns last week. Senior loans continue to enjoy strong demand, as investors turn to floating-rate instruments for relative protection against rising rates. The sector has the highest total return in 2021, followed by high yield corporates and asset-backed securities, which are the only other non-municipal sectors with positive returns for the year. Tightening spreads helped high yield and investment grade corporates outperform similar-duration Treasuries, although both posted negative total returns. Global markets outperformed U.S. markets, but also experienced negative weekly total returns.

The selloff in municipal yields was a function of good news.

MUNICIPAL BONDS REPRESENT A BUYING OPPORTUNITY

Municipal bond yields rose last week. New issuance was light at only $5.2 billion due to the holiday-shortened week. Underwriters had trouble selling some deals, which were cheapened to clear the market. Fund inflows remain robust at $1.9 billion. The new issue calendar is expected to tick up this week to $9.7 billion ($2.7 taxable).

The selloff in municipal yields was a function of good news. The U.S. is making progress against COVID-19, meaning society may return to normal sometime in the not-too-distant future. This normalcy would suggest that rates should rise as the economy begins to rebuild. Also, the Biden administration is proposing a $1.9 trillion fiscal stimulus package, which represents a major boost to the economy.

Metropolitan government of Nashville and Davidson Co., TN, issued $551 million GO improvement bonds (rated Aa2/AA). The deal was not well received, and underwriters chose to cut bonds to where institutional investors would take notice. For example, a 2036 maturity came with a 1.75% coupon at an original yield of 1.71%. There was no interest at that level, but those bonds were eventually sold at a yield of 1.81%. Thus, the underwriter pared a loss in a new position and an institutional investor invested the money at an adjusted level.

High yield municipal bonds outperformed U.S. Treasuries and high grade municipal bonds last week, as yields retraced higher. High yield municipal yields increased 8 bps on average, compared to 18 bps for AAA-rated municipals and 13 bps for Treasuries. Average high yield municipal credit spreads contracted by 10 bps. Inflows totaled $578 million, taking year-to-date totals to $5.1 billion. We are tracking at least eight new issue deals this week across the charter school, land secured, hospital, senior living and industrial development sectors. Illinois Governor Pritzker's proposed budget plan, if enacted, would likely be enough to forestall any downgrades in the short-term, but does not address long-term structural imbalances.

EMERGING MARKETS DEBT SEES WEEKLY OUTFLOWS FOR THE FIRST TIME IN SIX MONTHS

Emerging markets (EM) debt posted a loss for the second week in a row, suffering its worst return since early January. EM fund flows (-$540 million) turned negative for the first time since September, in part reflecting investor anxiety over rising rates and a return of the reflation trade. The week was also characterized by light trading volumes, thin liquidity and subdued issuance, particularly in Asia, where many investors were on the sidelines for the Lunar New Year.

High yield corporate bonds trended sideways last week, landing in marginally negative territory but ahead of most other sectors. Lower-rated (CCC) bonds fared slightly better than B and BB issues. Overall spreads tightened by 4 bps, and the average yield hovered just north of the all-time low (3.96%) it recorded the prior week. Demand slipped, as investors pulled $1.4 billion from high yield funds – the largest weekly outflow of the year.

Investment grade corporates continue to enjoy strong demand from investors.

Investment grade corporates endured their fifth consecutive week of losses. On a sector basis, airlines, leisure and select energy industries — all of which stand to benefit from broader economic reopening — were among the relative outperformers. Despite lagging all other fixed income categories this year, the asset class continues to enjoy strong demand from investors, attracting $5.5 billion of inflows last week. Primary supply remained light, as only 11 issuers came to market with $14.4 billion in new deals.

In focus

Preferreds and CoCos produce solid returns

Contingent capital securities (CoCos), $25 par and $1000 par preferred securities delivered returns in the 7% range in 2020. While those broader sub-sectors performed in line, securities with non-fixed-rate coupon structures underperformed.

These securities represent 21% of the U.S. $25 par market, and more than 90% of the $1000 par and CoCo markets.

Preferred and CoCo securities with non-fixed rate coupons typically have an initial coupon reset that coincides with the first call date. This tends to limit the security's duration and its duration extension as rates rise. Interest rates fell sharply last year, so the shorter-duration characteristics of these securities dragged down performance relative to fixed-rate coupon securities.

However, rates have increased since the fourth quarter, fueling outperformance by non-fixed rate coupons. Consequently, $1000 par securities and CoCos have also performed well, given the preponderance of non-fixed coupon structures in these sectors. If interest rates continue to rise, the coupon structure's shorter duration and limited extension profile will likely benefit its relative performance and total return potential.

We believe active managers are better able to capitalize on the structural protection of non-fixed rate securities by increasing exposure when rates are expected to rise.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.11	0.00	0.00	-0.01
5-year	0.58	0.09	0.16	0.22
10-year	1.34	0.13	0.27	0.42
30-year	2.14	0.12	0.30	0.49

Source: Bloomberg L.P. As of 19 Feb 2021. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.12	0.04	0.01	-0.02
5-year	0.35	0.15	0.13	0.13
10-year	0.87	0.18	0.15	0.16
30-year	1.52	0.18	0.14	0.13

Source: Bloomberg L.P. As of 19 Feb 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	65
30-year AAA Municipal vs Treasury	71
High Yield Municipal vs High Yield Corporate	88

Source: Bloomberg L.P., Thompson Reuters. As of 19 Feb 2021. 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	1.05	–	5.15	-0.77	-0.40	0.24
High Yield Municipal	3.51	218[1]	6.85	-0.49	0.19	2.28
Short Duration High Yield Municipal[2]	2.93	238	3.63	-0.17	0.40	2.06
Taxable Municipal	2.25	88[3]	9.82	-0.96	-1.44	-1.47
U.S. Aggregate Bond	1.33	33[3]	6.23	-0.57	-1.09	-1.80
U.S. Treasury	0.78	–	7.00	-0.75	-1.52	-2.46
U.S. Government Related	1.24	45[3]	6.09	-0.61	-0.89	-1.40
U.S. Corporate Investment Grade	1.97	89[3]	8.60	-0.70	-1.27	-2.53
U.S. Mortgage-Backed Securities	1.48	18[3]	2.97	-0.20	-0.38	-0.30
U.S. Commercial Mortgage-Backed Securities	1.43	73[3]	5.23	-0.48	-0.89	-0.92
U.S. Asset-Backed Securities	0.42	28[3]	2.08	-0.03	-0.08	0.06
Preferred Securities	3.19	215[3]	4.81	-0.48	-0.09	-0.84
High Yield 2% Issuer Capped	4.01	320[3]	3.71	-0.05	0.95	1.28
Senior Loans[4]	4.73	447	0.25	0.15	0.59	1.86
Global Emerging Markets	3.59	264[3]	6.82	-0.64	-0.40	-1.25
Global Aggregate (unhedged)	1.01	33[3]	7.35	-0.63	-1.07	-1.94

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 19 Feb 2021. **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, 19 Feb 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 17 Feb 2021.

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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GCM-1532971PG-W0221P