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Weekly Fixed Income Commentary

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Treasury yields rise again, with brightening economic outlook

U.S. Treasury yields rose again last week, though risk assets stabilized. Lower-rated credit outperformed and emerging markets saw renewed investor demand. Supply was heavy in many markets, causing some technical headwinds, but the medium-term technical backdrop remains supportive.

HIGHLIGHTS

- **Lower-quality sectors continued to outperform, to the benefit of leveraged loans and high yield corporates. Investment grade credit and government bonds weakened.**

- **Municipal bond prices rose. New issue supply was $9.5 billion, with positive flows of $1 billion. This week's new issue supply is expected to be $11.2 billion and should be well received.**

- **Emerging markets generally performed well, with sovereign spreads tightening. But we witnessed significant divergence within the asset class.**

Anders Persson
CIO of Global Fixed Income

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Watchlist

- *Treasury yields rose again as investors remain focused on the positive medium-term outlook.*
- *Fiscal policy has become more supportive, with the passage of the $1.9 trillion American Rescue Plan.*
- *Preferred securities and senior loans delivered positive weekly returns despite the rise in rates.*
- *High yield corporates saw large outflows last week, and heavy supply calendars provided a modest negative technical dynamic. High grade and high yield municipals saw inflows.*

INVESTMENT VIEWS

Unprecedented global fiscal stimulus will boost consumption and growth this year.

Zero/negative global interest rate policy remains a key market support, but investors are beginning to focus on the eventual normalization of policy.

Record supply of investment grade corporates has been followed by issuance from high yield, middle market loans, broadly syndicated loan market and certain COVID-exposed names/sectors. Taxable municipal supply continues to grow.

We favor a risk-on stance, focused on credits with durable free cash flow and solid balance sheets across a wide range of sectors. Mid-quality rating segments remain the most attractive. Essential service municipal credits also look compelling.

KEY RISKS

- Further complications with the COVID-19 vaccine rollout.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.
- Policymakers become cautious or run out of stimulus capacity.
- Inflation rises in a disorderly way, forcing premature policy tightening.

TAXABLE MARKETS DIGEST HEAVY SUPPLY

U.S. Treasury yields rose again last week, with the 10-year yield rising 6 basis points (bps) and the yield curve steepening. COVID-19 vaccinations picked up and the medium-term economic outlook continues to improve, though actual economic data last week was in line with expectations. Headline CPI inflation rose 1.7% year-over-year as expected, still short of the Federal Reserve's target, but is expected to rise substantially in the months ahead as the now-enacted $1.9 trillion fiscal stimulus begins to hit the economy. The Treasury auctioned $120 billion of notes and bonds, split between 3-, 10- and 30-year bonds, which were met with robust investor demand.

High grade corporate spreads widened slightly, as the market digested another heavy supply calendar. Overall, 19 deals priced, worth $54 billion, around 45% more than expected. The highlight was Verizon's 9-tranche, $25 billion offering, tied for the sixth largest ever, which met strong demand of $110 billion, a record amount. Investment grade spreads ultimately ended 2 bps wider.

Leveraged finance markets also saw healthy supply, with $20 and $17 billion announced in high yield and loans. Returns were near-flat in both markets, though lower-quality paper continued to outperform. In bonds, CCCs returned +0.47% compared to -0.05% for the overall market, while in loans, CCCs returned 0.34% versus 0.08% for the overall loan market.

Emerging markets performed well, with sovereign spreads tightening -6 bps after widening in each of the previous four weeks. There were some significant idiosyncratic stories driving divergence within the asset class. For example, Brazil's former President Lula had his corruption conviction annulled by a court, clearing the way for a potential future return to office, sparking Brazilian sovereign debt to widen 25 bps.

MUNICIPAL BOND PRICES CLOSE HIGHER

Broad fixed income markets are currently range bound. While U.S. Treasuries continued their selloff, municipal bond prices closed last week higher. However, municipal bond prices may sell off slightly in the near future. Currently, municipal tax-exempt bonds are expensive compared with taxable Treasury bonds. This normally results in tax-exempt bonds returning to fair value relative to Treasuries. However, we still don't see major inflation on the horizon and expect rates to remain lower for longer. We would consider any potential outsized selloff in municipals as a buying opportunity.

Virginia Public Building Authority issued $534 million revenue bonds (rated Aa1/AA+). The deal offered relatively cheap yields and was well received. 4% coupons due in 2034 came at a yield of 1.40%, then traded in the secondary market at 1.32%. Institutional investors saw this deal as a buying opportunity.

High yield municipal yields decreased again last week, despite upward pressure on U.S. Treasury yields. In a sharp turnaround, investors added $430 million in fund flows. The market enthusiastically embraced the unprecedented amount of federal stimulus funds on the way to support many municipal issuers across various sectors. The potential impact to creditor balance sheets cannot be overstated, putting to rest last spring's fears of widespread credit deterioration and ballooning defaults that the gripped the market. For example, Moody's upgraded Chicago Public Schools last week based on "very sizable infusion of federal funds from several rounds of pandemic aid." And we are expecting to see at least 16 new high yield municipal deals for this week.

Leveraged finance returns were nearly flat, though lower-quality paper continued to outperform.

In focus

High yield munis remain resilient

When we frequently discuss the resiliency of municipal bonds in the face of volatility, we generally focus on the market as a whole. But the high yield segment has shown particular resilience in the face of the coronavirus pandemic.

The municipal market returned 5.21% in 2020, despite an unprecedented shift in yields. Outflows of more than $42 billion in March flipped to positive inflows by May, and in November all the money had returned to the market.

Similarly, the high yield and short-duration high yield segments returned 4.89% and 4.08% in 2020, respectively. Investor confidence took slightly longer to return to the high yield market. Monthly flows turned positive in June, and flows remain approximately $3.25 billion short of pre-pandemic levels. Credit spreads compressed to 218 bps on Friday, after widening to 389 bps at the end of May 2020. The historic average is approximately 189 bps.

Shifting the focus to this year, the market remains sensitive to Fed announcements and current events, but overall there is still a lot of dispersion in the high yield market and plenty of room for excess returns as the economy further re-opens. Despite outflows in early March, buyer demand has remained strong, with oversubscribed new issue deals and many names firming up and trading lower. Credit spreads are still narrowing, and we expect high yield municipals to continue outperforming in 2021.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	0.01	0.02	0.03
5-year	0.84	0.04	0.11	0.48
10-year	1.63	0.06	0.22	0.71
30-year	2.38	0.08	0.23	0.73

Source: Bloomberg L.P. As of 12 Mar 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	0.09	-0.04	-0.10	-0.05
5-year	0.43	-0.05	-0.13	0.21
10-year	1.02	-0.09	-0.12	0.31
30-year	1.65	-0.11	-0.15	0.26

Source: Bloomberg L.P. As of 12 Mar 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	62
30-year AAA Municipal vs Treasury	69
High Yield Municipal vs High Yield Corporate	83

Source: Bloomberg L.P., Thompson Reuters. As of 12 Mar 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	1.14	–	5.24	0.42	0.72	-0.24
High Yield Municipal	3.63	218[1]	7.25	0.55	0.90	1.93
Short Duration High Yield Municipal[2]	3.05	238	3.71	0.23	0.35	1.70
Taxable Municipal	2.48	84[3]	9.79	-0.63	-1.59	-3.52
U.S. Aggregate Bond	1.57	33[3]	6.34	-0.43	-1.22	-3.35
U.S. Treasury	0.97	–	6.88	-0.51	-1.34	-4.06
U.S. Government Related	1.44	46[3]	6.03	-0.19	-0.85	-2.88
U.S. Corporate Investment Grade	2.29	98[3]	8.43	-0.64	-2.18	-5.10
U.S. Mortgage-Backed Securities	1.73	11[3]	3.80	-0.19	-0.27	-0.86
U.S. Commercial Mortgage-Backed Securities	1.60	67[3]	5.21	-0.11	-0.59	-1.81
U.S. Asset-Backed Securities	0.50	30[3]	2.06	-0.05	-0.11	-0.10
Preferred Securities	3.09	182[3]	4.85	0.29	0.64	-0.95
High Yield 2% Issuer Capped	4.40	327[3]	3.86	-0.06	-0.21	0.49
Senior Loans[4]	4.78	445	0.25	0.09	0.08	2.03
Global Emerging Markets	3.94	276[3]	6.70	-0.24	-1.16	-3.39
Global Aggregate (unhedged)	1.14	33[3]	7.40	-0.19	-1.20	-3.76

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 12 Mar 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, 12 Mar 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 10 Mar 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.

A word on risk