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Weekly Fixed Income Commentary

29 March 2021

Treasury yields fall on rising demand

Rates stabilized last week, with the 10-year U.S. Treasury yield down for the week for the first time since January. Positive economic news alleviated some of the rally late in the week and put upward pressure on the dollar. But yields across most fixed income market segments ended the week lower as buyers stepped and provided a positive technical dynamic.

HIGHLIGHTS

- **Corporate credit outperformed, including investment grade and high yield, as well as preferred securities. Loans traded flat, as lower rates offset better risk sentiment.**
- **Municipal bond yields declined. New issue supply was $10.6 billion, with flows of $592 million. This week's new issue supply is expected to be only $4.8 billion ($2.0 billion taxable).**
- **Emerging markets weakened amid dollar strength and volatility in Turkey.**

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Watchlist

- *Treasury yields declined as technicals turned more favorable after the recent selloff, though we still expect rates to be higher at year end.*
- *Risk assets performed well, with high yield spreads tightening and equities hitting fresh all-time highs.*
- *Municipal bonds are unlikely to remain so rich.*
- *The dollar strengthened, pressuring emerging markets, but should depreciate moving forward.*

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.

HIGH YIELD CORPORATES SEE SPREAD COMPRESSION

U.S. Treasury yields stabilized, with 10-year yields falling -5 basis points (bps) and the yield curve flattening, after seven consecutive weeks of bear steepening. There was some evidence that buyers stepped in to purchase U.S. bonds after significant underperformance versus equities ahead of quarter end. Economic data was mostly positive, with global flash PMIs for March outperforming and signaling the fastest pace of expansion since before the COVID-19 crisis, causing yields to bounce somewhat off their lows in the second half of the week.

Investment grade credit stabilized as well, though somewhat lagged the move in Treasuries, with spreads widening 3 bps. Total returns were still positive at 0.51%, the first weekly gain since the week of January 15. There were some signs of Asia-based buyers returning to the market, with reported flows of $2.2 billion from that investor base after sales of $4 billion in February. Supply was again strong, with $41.6 billion of new issuance priced across 41 tranches.

High yield credit also performed well, seeing 0.63% total returns and -12 bps spread compression. In contrast to recent dynamics, lower-rated paper underperformed, as there were signs of buyers stepping in to buy long-duration, higher-quality securities that have recently lagged. Leveraged loans weakened slightly amid the fall in rates, but still saw the 11th consecutive weekly inflow, with $784 million entering the asset class.

Emerging markets weakened, returning -0.14% as the decline in global yields did not offset the headwinds from continued dollar strength. The greenback gained 0.9% on the week, taking it to a four-month high. Turkish bonds were the most stressed, after President Erdogan fired the central bank governor last weekend, with hard currency bond spreads widening 150 bps and local yields rising 350 to 400 bps.

SECTOR AND CREDIT SELECTION WILL DRIVE HIGH YIELD MUNI PERFORMANCE

Municipal bond yields declined last week, along with U.S. Treasury bond yields.

Fixed income in general appears to be range bound for the foreseeable future. Fed Chairman Powell spoke publicly again last week, acknowledging that the prices of some goods are beginning to rise. However he also asserted that there is no inflation on the horizon. He further forecast that there will be no inflation pressures until most of the 10 million unemployed people return to work as the economy recovers. Investors were comforted by Powell's statement.

Remember that the 10-year Treasury yield is currently 1.67%, more than 100 basis points cheaper than the low of 0.52% reached in the summer of 2020. Investors are satisfied that this substantial increase sufficiently compensates for current inflation fears. The next test will be the level of inflation pressure once the U.S. economy nears full employment.

New York City Transitional Finance Authority (TFA) issued $1 billion in bonds (rated Aa1/AAA). The deal was priced to sell and was well received. For example, the 10-year bonds were priced at a 1.51% yield, which was close to the 10-year Treasury yield of 1.67%. This appears attractive for in-state residents seeking tax-exempt income.

High yield municipal bond yields also fell last week. Fund flows totaled $256 million, continuing the strong demand that is putting downward pressure on credit spreads. Holidays and spring break schedules will make this week relatively light in activity, outside of a handful of land-secured deals and Washington State Convention Center. The first quarter may be a strong indicator of performance drivers for the remainder of the year. We believe sector allocation and credit selection will be the differentiators for high yield municipal performance.

Emerging markets weakened, as the decline in global yields did not offset the headwinds from dollar strength.

In focus

States and locals get a stimulus boost

The $1.9 trillion American Rescue Plan Act will provide the first direct stimulus to state and local governments unrelated to pandemic response efforts. The expected aid is well above projected near-term budget gaps: $350 billion over two years.

The stimulus touches virtually every sector of the municipal market, covering initiatives such as enhanced unemployment benefits, direct stimulus payments to individuals and other measures that will indirectly support tax revenues. It mitigates pressure on state and local governments and will fuel tax revenue growth.

The aid is meaningful, especially with tax revenues holding up well over the last year. Though state revenues were projected to steeply decline in 2020, they were down only 2% from April through December versus the year before.

Most states rely heavily on income taxes, and the unemployment spike in early 2020 did not bode well for state revenues. But job losses have been concentrated in low wage sectors, mitigating the net impact on state revenues. Overall, tax-backed credits have held up well, benefiting from their broad flexibility to respond to revenue fluctuation.

Half of the funding will be available in the next few months, with the remainder distributed a year from now. Governments have until the end of 2024 to spend it, allowing for a strategic and staggered use of funds. If this stimulus proves effective, revenues could return to normal quickly.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.14	-0.01	0.01	0.02
5-year	0.87	-0.02	0.13	0.50
10-year	1.68	-0.04	0.27	0.76
30-year	2.38	-0.05	0.23	0.74

Source: Bloomberg L.P. As of 26 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	0.14	-0.07	-0.05	0.00
5-year	0.50	-0.07	-0.06	0.28
10-year	1.11	-0.05	-0.03	0.40
30-year	1.74	-0.05	-0.06	0.35

Source: Bloomberg L.P. As of 26 Mar 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	66
30-year AAA Municipal vs Treasury	73
High Yield Municipal vs High Yield Corporate	84

Source: Bloomberg L.P., Thompson Reuters. As of 26 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	1.17	–	5.26	0.41	0.61	-0.35
High Yield Municipal	3.65	211[1]	7.36	0.45	0.96	1.99
Short Duration High Yield Municipal[2]	3.04	228	3.70	0.21	0.46	1.81
Taxable Municipal	2.45	81[3]	9.78	0.83	-1.21	-3.15
U.S. Aggregate Bond	1.58	34[3]	6.40	0.35	-1.15	-3.28
U.S. Treasury	0.96	–	6.83	0.40	-1.24	-3.96
U.S. Government Related	1.42	45[3]	6.01	0.30	-0.64	-2.67
U.S. Corporate Investment Grade	2.28	96[3]	8.45	0.51	-1.88	-4.81
U.S. Mortgage-Backed Securities	1.81	17[3]	4.07	0.16	-0.47	-1.05
U.S. Commercial Mortgage-Backed Securities	1.64	70[3]	5.18	0.14	-0.77	-1.98
U.S. Asset-Backed Securities	0.53	34[3]	2.09	0.01	-0.10	-0.10
Preferred Securities	2.87	177[3]	4.75	0.57	1.13	-0.47
High Yield 2% Issuer Capped	4.36	326[3]	3.87	0.63	-0.11	0.59
Senior Loans[4]	4.87	452	0.25	0.02	0.04	1.98
Global Emerging Markets	3.96	279[3]	6.69	-0.14	-1.02	-3.26
Global Aggregate (unhedged)	1.13	34[3]	7.42	-0.07	-1.49	-4.04

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 26 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, 26 Mar 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 19 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.

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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 professional 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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