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Weekly Fixed Income Commentary

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Rising inflation concerns drag on returns

U.S. Treasury yields rose last week and the yield curve steepened, as the U.S. Federal Reserve (Fed) kept policy unchanged. The moves were driven by higher inflation expectations, as the Fed doubled down on its commitment to let the economy run hot, which benefited credit sectors.

HIGHLIGHTS

- **Corporate credit provided positive excess returns over similar-duration Treasuries, though only high yield and leveraged loans saw outright positive total returns.**
- **Municipal bonds sold off slightly. New issue supply was only $5.4 billion, with flows of $1.6 billion. This week's new issue supply ticks up to $10.4 billion ($2 billion taxable).**
- **Emerging markets spreads tightened, but total returns were negative amid the global rise in yields.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields rose and the yield curve steepened, in line with our medium-term expectations for a higher and steeper yield curve*
- *Spread sectors outperformed across market segments, led by the lower-quality areas*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. Attention remains on the eventual tapering of purchases, but we do not expect that to happen any time soon.

Unprecedented global fiscal stimulus will boost consumption and growth this year. First quarter GDP rose at a very robust pace of +6.4%.

Record supply of investment grade corporates has been followed by issuance from high yield, middle market loans and the broadly syndicated loan market. 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 particularly attractive. Essential service municipal credits also look compelling.

KEY RISKS

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

HIGH YIELD CORPORATE AND SENIOR LOANS OUTPERFORM

U.S. Treasury yields rose and the curve steepened last week as the Fed kept policy unchanged. 10-year yields rose 7 basis points (bps), with the moves entirely driven by higher inflation expectations. Real yields were flat. Chair Powell signaled that monetary policy will remain accommodative and asset purchases will continue over the near-term, as expected, while also slightly upgrading the economic outlook. This combination should lead to higher long-end interest rates, but is also positive for risk assets.

Investment grade spreads returned to their tightest levels in several years, down -2 bps to 88 bps for the index overall. Yields rose in tandem with the broader moves in rates, so IG markets ultimately returned -0.29%, which was nevertheless 11 bps better than similar-duration Treasuries. Technical dynamics were supportive, with strong inflows and relatively light new issue volumes of $14 billion, taking the April total to $98 billion. The pace of issuance should accelerate from here, with most dealers forecasting around $135 billion to $150 billion of supply in May.

High yield and leveraged loans outperformed, benefiting from their shorter-duration and floating-rate nature, respectively. In both markets, CCCs led performance, returning 0.57% and 0.45% in bond and loan markets, respectively. Issuance volumes remained healthy, taking April and year-to-date totals to relatively high levels. Inflows were relatively modest, making the strong compression in spreads (-7 bps for high yield overall) even more impressive.

Emerging markets debt spreads narrowed by 2 bps, with both investment grade and high yield market segments tightening. Some of the recent laggard sovereigns outperformed (Turkey spreads narrowed 10-15 bps after selling off 35-40 bps the previous week). Local markets lagged slightly, with yields rising 6 bps. The asset class saw strong inflows of $600 million, with almost all of the flows going into hard currency funds.

MUNICIPALS MOVE CLOSER TO FAIR VALUE

Municipal bonds sold off slightly last week, while Treasury bonds remained range bound, meaning municipals actually underperformed Treasury bonds. Both markets ended the week with constructive tones.

The municipal selloff was not a surprise, as munis have been trending to very rich levels vs. taxable Treasury bonds. The selloff brought them closer to fair value.

New Jersey Transportation Trust Fund Authority issued $304 million transportation system bonds (forward delivery, rated Baa1/BBB). The bonds were priced to sell and the deal was well received. For example, 4% bonds of 2038 issued at a 2.74%yield later traded in the secondary market at 2.62%. New Jersey has high state taxes, and federal taxes are likely to rise in the near future. It is not surprising that in-state investors have a strong interest in tax-exempt New Jersey bonds.

High yield municipals continued with record inflows last week, as investors added another $630 million. High yield municipal bond yields were resilient in the face of yield increases for both U.S. Treasuries and AAA-rated municipal bonds. Tobacco bonds, particularly Buckeye Tobacco 5% coupon bonds, are cheaper by roughly 40 bps in reaction to efforts to ban menthol-flavored cigarettes. The land-secured and charter schools sectors continue to offer consistent new issue supply, driven by population growth and residential development in key states.

CCCs led performance for the high yield corporate and senior loan asset classes.

In focus

No Fed moves despite the economic boom

Evidence continues to mount that a combination of vaccinations and stimulus is generating some of the strongest economic growth data in decades. Even so, last week's Fed meeting demonstrated a firm commitment to easy monetary policy until unemployment falls further and inflation heats up.

In its policy statement, the Fed reiterated its long-standing pledge to maintain the target federal funds rate at 0%-0.25% because "the ongoing public health crisis continues to weigh on the economy, and risks to the economic outlook remain." At the same time, the statement acknowledged that "indicators of economic activity and employment have strengthened" — a nod to March's robust jobs report and retail sales figures.

In his post-meeting press conference, Chair Jerome Powell emphasized that the Fed would not reduce its monthly asset purchases until "substantial further progress" has been made toward achieving the Fed's dual mandate of full employment and 2% inflation. He added that those two objectives were unlikely to be reached any time soon.

During the previous recovery cycle, the Fed started to remove accommodative policy as the economy slowly improved and forecasts signaled higher inflation just ahead. This time, the Fed is adamant that it will not tighten based on outlooks, but on actual data.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	April 2021	Year-to-date
2-year	0.16	0.00	0.00	0.04
5-year	0.85	0.03	-0.09	0.49
10-year	1.63	0.07	-0.11	0.71
30-year	2.30	0.06	-0.11	0.65

Source: Bloomberg L.P., 30 Apr 2021. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	April 2021	Year-to-date
2-year	0.10	0.03	-0.04	-0.04
5-year	0.43	0.07	-0.08	0.21
10-year	0.99	0.06	-0.13	0.28
30-year	1.59	0.04	-0.16	0.20

Source: Bloomberg L.P., 30 Apr 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	60
30-year AAA Municipal vs Treasury	69
High Yield Municipal vs High Yield Corporate	86

Source: Bloomberg L.P., Thompson Reuters, 30 Apr 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	April 2021	Year-to-date
Municipal	1.04	–	5.12	-0.16	0.84	0.48
High Yield Municipal	3.44	204[1]	6.74	-0.09	1.46	3.60
Short Duration High Yield Municipal[2]	2.83	214	3.61	0.15	0.93	2.90
Taxable Municipal	2.36	76[3]	9.76	-0.35	1.52	-2.01
U.S. Aggregate Bond	1.51	29[3]	6.39	-0.18	0.79	-2.61
U.S. Treasury	0.95	–	6.86	-0.24	0.75	-3.53
U.S. Government Related	1.40	44[3]	6.03	-0.13	0.70	-2.18
U.S. Corporate Investment Grade	2.18	88[3]	8.54	-0.29	1.11	-3.59
U.S. Mortgage-Backed Securities	1.68	7[3]	3.90	0.00	0.55	-0.55
U.S. Commercial Mortgage-Backed Securities	1.58	65[3]	5.21	-0.16	0.94	-1.40
U.S. Asset-Backed Securities	0.50	31[3]	2.05	-0.02	0.14	-0.02
Preferred Securities	2.74	157[3]	4.79	-0.13	1.29	0.87
High Yield 2% Issuer Capped	4.00	292[3]	3.84	0.21	1.08	1.95
Senior Loans[4]	4.84	449	0.25	0.09	0.51	2.53
Global Emerging Markets	3.89	273[3]	6.82	-0.13	1.33	-2.20
Global Aggregate (unhedged)	1.13	32[3]	7.40	-0.36	1.26	-3.25

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, 30 Apr 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, 30 Apr 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 28 Apr 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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