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Weekly Fixed Income Commentary

1 June 2021

Treasury yields decline in a positive week for fixed income

U.S. Treasury yields fell slightly and the broad fixed income market performed well last week. The economic calendar was light, with core PCE price inflation slightly beating expectations at 3.1% year-over-year. But the market mostly overlooked this data and inflation breakevens ended the week flat.

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HIGHLIGHTS

- **All major fixed income segments rallied, led by investment grade corporates, taxable munis, and convertibles. High yield corporates, preferreds and structured assets posted positive returns.**
- **Municipal bond prices finished higher. New issue supply was $7.2 billion, with robust flows of $1.5 billion. This week's new issue supply is expected to be only $4.8 billion.**
- **Emerging markets outperformed, helped by the slightly weakening dollar.**

Watchlist

- *Treasury yields fell last week, but we continue to anticipate further increases throughout 2021*
- *Spread assets were well-supported versus Treasuries, and strong growth should continue to support fundamentals moving forward*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

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

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

Record supply of investment grade corporates has been followed by high levels of 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.

MAJOR FIXED INCOME SEGMENTS RALLY

U.S. Treasury yields declined modestly last week. The Treasury auctioned 2-, 5- and 7-year notes, which were met with strong demand. Investors were focused on the large increase in use of the Federal Reserve's reverse repo facility, which saw a record $495.3 billion uptake. As asset purchases continue, and the Treasury also runs down its cash balance, the level of reserves in the system has risen. This has pushed short-end interest rates lower and ultimately incentivizes banks to use the Fed's zero-yielding facility rather than lend out their funds at negative rates. This dynamic does not have implications for fixed income beyond the shortest-yielding instruments.

Investment grade corporates rose last week, returning 0.55%, with spreads narrowing to their lowest levels since 2007. The asset class outperformed similar-duration Treasuries by 23 basis points (bps). After posting the worst quarterly performance since 1980 in the first quarter, investment grade corporates have rallied for two consecutive months. Fund flows totaled $911 million, continuing a multi-month streak of positive demand, but that was the smallest weekly inflow of the year.

High yield corporates performed well, returning 0.35% after lagging earlier in the month. The asset class saw similar excess returns as the high grade market, posting 22 bps of outperformance versus similar-duration Treasuries. May saw total issuance of around $47 billion, the busiest May ever, with energy providing around half of that total. Senior loans saw continued strong performance as well, posting 0.17% total returns.

Emerging markets gained, returning 0.44% and outperforming similar-duration Treasuries by 9 bps. Yields fell across the board, following the move in Treasuries, and spreads generally narrowed. The asset class also received a boost from currency dynamics. Even though the headline dollar index traded flat for the week, an index of emerging markets currencies gained 0.6%, with the Brazilian real (2.7%), South African rand (1.4%) and Colombian peso (1.1%) leading gains. The Chinese yuan broke through the closely-watched 6.40 per dollar level, taking it to its strongest level since 2018, possibly clearing the way for further EM currency appreciation in the months to come.

HIGH YIELD MUNICIPALS SEE ACCELERATED INFLOWS

Municipal bond prices finished higher, while U.S. Treasury bonds remained range bound.

Technical factors dominate the news in the municipal bond market. Supply is expected to be limited over the summer, with 30-day new issue supply at only $6.7 billion. Yet demand should remain robust, as reinvestment money totals $122 billion from June 1 to August 1. Municipals should remain well bid through the summer as long as Treasuries remain range bound.

Washington Metropolitan Area Transit Authority issued $788 million revenue green bonds (rated Aa/AA) Bonds traded at a premium in the secondary market. For example, 5% coupons issued at a yield of 1.27% traded in the secondary market at 1.25%. Note that green bonds are certified to be friendly to the environment. This designation on municipal bond issues is becoming increasingly more popular as investors want to invest in a socially responsible way.

High yield municipal bond yields decreased by 9 bps las week on average, 3 bps more than AAA yields. Inflows continued to accelerate at $814 million. This marked the fourth highest weekly flow of 2021, but in any other year it would have easily set a record. As a result, more than 20 high yield municipal new deals were heavily oversubscribed. We expect much lighter new issuance this week, which puts even greater focus on secondary market supply and should keep downward pressure on credit spreads. Credit spreads are now at +200 bps. With the current momentum, the market appears poised to usher in a sub-200 bps credit spread environment.

High yield corporates saw their busiest month of May ever, with total issuance of around $47 billion.

In focus

Summer appears strong for munis

The municipal market heads into the summer on strong fundamental and technical footing. We believe this combination of factors should support performance over the next few months.

On the fundamental side, revenues have fared better than originally projected at the onset of the pandemic, and they continue to improve as stimulus dollars sent to state and local governments work their way through the system. Reopenings will likely provide an additional boost to municipal credits. Traffic is building on toll roads, hospitals are operating at normal capacity, hotel occupancy is improving, TSA passenger check-ins are increasing and capacity at tourist destinations is expanding.

From the technical side, the summer typically sees lighter new issuance, and we expect this year to be no different. At the same time, demand remains robust. Maturities and coupons are especially heavy in July and August, and investors are considering the probability of higher future tax rates. We expect this outsized demand to continue outpacing the light summer supply, ultimately supporting tax-exempt municipal market performance.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.14	-0.01	-0.02	0.02
5-year	0.80	-0.02	-0.05	0.44
10-year	1.60	-0.03	-0.03	0.68
30-year	2.28	-0.04	-0.02	0.64

Source: Bloomberg L.P., 28 May 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	0.10	-0.04	0.00	-0.04
5-year	0.48	-0.02	0.05	0.26
10-year	0.99	-0.02	0.00	0.28
30-year	1.51	-0.06	-0.08	0.12

Source: Bloomberg L.P., 28 May 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	63
30-year AAA Municipal vs Treasury	67
High Yield Municipal vs High Yield Corporate	81

Source: Bloomberg L.P., Thompson Reuters, 28 May 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	1.02	–	5.06	0.20	0.30	0.78
High Yield Municipal	3.28	196[1]	6.24	0.39	1.15	4.79
Short Duration High Yield Municipal[2]	2.72	199	3.72	0.29	0.69	3.67
Taxable Municipal	2.31	73[3]	9.72	0.56	0.67	-1.35
U.S. Aggregate Bond	1.50	30[3]	6.49	0.35	0.33	-2.29
U.S. Treasury	0.91	–	6.92	0.36	0.34	-3.20
U.S. Government Related	1.35	42[3]	6.02	0.34	0.41	-1.78
U.S. Corporate Investment Grade	2.11	84[3]	8.59	0.55	0.77	-2.85
U.S. Mortgage-Backed Securities	1.75	16[3]	4.15	0.14	-0.18	-0.73
U.S. Commercial Mortgage-Backed Securities	1.48	58[3]	5.21	0.28	0.71	-0.70
U.S. Asset-Backed Securities	0.41	25[3]	1.99	0.07	0.22	0.20
Preferred Securities	2.79	161[3]	4.64	0.37	0.57	1.44
High Yield 2% Issuer Capped	4.04	297[3]	3.88	0.35	0.30	2.25
Senior Loans[4]	4.72	443	0.25	0.17	0.52	3.06
Global Emerging Markets	3.81	267[3]	6.85	0.44	0.92	-1.30
Global Aggregate (unhedged)	1.12	32[3]	7.44	0.26	0.74	-2.54

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, 28 May 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, 28 May 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 26 May 2021. **Municipal reinvestment:** JPMorgan.

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

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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