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Weekly Fixed Income Commentary

20 September 2021

Treasury yields rise slightly as economic data strengthen

U.S. Treasury yields rose slightly last week on strong economic data, even as inflation moderated more than expected. Most credit sectors of the market performed well, and we expect credit investments to remain attractive.

HIGHLIGHTS

- **Investment grade corporates, high yield corporates, loans, convertibles and preferred securities rallied.**
- **Treasuries sold off slightly, along with emerging markets, mortgage-backed securities and commercial mortgage-backed securities.**
- **Municipal bond yields continue to be range bound. New issue supply was outsized at $11.2B, with flows of $1.2B. This week's new issue supply should be outsized again at $10.8B.**

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Watchlist

- *Treasury yields rose last week, and we continue to anticipate higher rates into year end*
- *Spread assets performed well, as economic growth continued*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. Investors continue to focus on the eventual tapering of purchases, which we expect to happen later this year.

Unprecedented global fiscal stimulus should continue to boost growth moving forward, as consumers have accumulated more than $2 trillion of savings from prior support.

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 also 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 appear particularly attractive. Essential service municipal credits also look compelling.

KEY RISKS

- Policymakers become cautious and remove accommodation too early.
- Inflation rising in a disorderly way, forcing premature policy tightening.
- Further complications with the COVID-19 vaccine rollout and the Delta variant.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

HIGH YIELD CORPORATE SUPPLY IS LOWER THAN EXPECTED

U.S. Treasury yields ended last week around two basis points (bps) higher, as economic data pointed to faster growth over the last several weeks. Yields started the week trading lower, as consumer price data showed moderating inflation in August. As the week progressed, yields rose as the first September industrial surveys beat expectations and improved from last month. Retail sales for August also surprised to the upside, rising 0.7% month-over-month versus expectations for a decline.

The investment grade corporate market traded close to flat last week, with spreads and yields unchanged. The asset class returned 0.08%, outperforming similar-duration Treasuries by 9 bps. The asset class saw the sixth straight week of inflows, with $2.6 billion entering the market, and supply remained robust. Thirty-one issuers brought $38 billion of new supply, which was well-received by the market. It was oversubscribed by 2.8x on average and prices compressed -24 bps from initial guidance.

High yield corporates rallied, with total returns of 0.14%, outperforming similar-duration Treasuries by 23 bps. Lower-quality segments outperformed, with CCCs returning 0.34%. Supply has generally been lower than expected so far in September, with less than $10 billion of new issuance last week after around $5 billion the prior week. Investors had generally built up cash balances ahead of Labor Day in anticipation of elevated primary market activity, which is now chasing opportunities to be deployed. Loans also performed well, returning 0.17% on the week, with prices reaching their highest level since October 2018.

Emerging markets lagged U.S. credit again, with supply and a few idiosyncratic stories dominating attention. Corporate issuers brought around $25 billion of new issuance to market. It generally performed well in the secondary market, though the asset class returned -0.19% for the week. Two dynamics in China weighed on the market. First, headlines continued to weigh on Chinese property company Evergrande. Reports suggest that the company may not make interest payments on loans due this week. Other property sector issuers sold off between -3 and -10 percentage points. Separately, Macau gaming companies faced heightened regulatory risks amid a new law and regulatory process ahead of license renewals scheduled for next June. Exposed issuers saw bond prices fall around -5 points in response.

MUNICIPAL BOND DEMAND SHOULD CONTINUE

Both municipal bond and Treasury yields were range bound last week. Both markets ended the week with constructive tones.

The municipal market remains alive and well, with this week marking the 28th consecutive week of positive fund flows into the asset class. We expect demand to persist, as investors seek income in an environment where interest rates in general will probably remain lower for longer. Investors are also looking for tax-exempt income. However, we may see a selloff in tax-exempt yields as we approach year end, as the new issue calendar will likely continue to be outsized. Deals will likely be priced to clear the market. However, flows continue into the asset class, and a tremendous amount of short-duration bonds are looking to be redeployed at higher yields further out on the yield curve.

The state of California issued $2.1 billion tax-exempt general obligation bonds (rated AA2/AA-). The deal was priced to sell and well received. Underwriters were able to lower yields slightly upon final pricing. Bonds then traded at a slight premium in the secondary market.

High yield municipal bond yields have barely changed month-to-date, increasing just 2 bps on average. Fund flows were stronger at $338 million last week. We are tracking a potentially large wave of issuance this week, with at least 23 new deals being reviewed. Puerto Rico bondholders continue to observe signs that restructuring deals may be nearing execution.

Lower-quality segments outperformed in the high yield corporate sector, with CCCs returning 0.34%.

In focus

LIBOR's last hurrah

The London Interbank Offered Rate (LIBOR) is one of the world's most widely used interest rate benchmarks. The transition away from LIBOR is a dynamic process that requires careful planning, resources and focus.

LIBOR represents the cost of short-term, unsecured, wholesale borrowing by large banks. It is widely used as a reference point to set interest rates across residential mortgages, corporate bonds, derivatives and elsewhere, underpinning trillions of dollars of financial contracts.

However, its credibility has declined over time. It has behaved in unpredictable and volatile ways, and a manipulation scandal raised further questions about its reliability.

As a result, the regulator of LIBOR called for the development of alternative risk-free benchmark rates supported by liquid and observable markets. The Secured Overnight Financing Rate (SOFR) is the industry's preferred alternative to U.S. dollar LIBOR.

Various asset classes use floating-rate instruments whose benchmark rates have been tied to LIBOR, including derivatives, business loans, consumer loans, floating-rate bonds and securitization securities.

It is difficult to predict the full impact of the transition, but Nuveen believes the risks associated with our LIBOR exposure are manageable at this time. Our flexible transition strategy continues to adapt to this significant industry event. We are monitoring industry developments and our positions on behalf of our clients' investment objectives.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.22	0.01	0.01	0.10
5-year	0.86	0.05	0.08	0.50
10-year	1.36	0.02	0.05	0.45
30-year	1.90	-0.03	-0.03	0.26

Source: Bloomberg L.P., 17 Sep 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	0.11	0.00	0.00	-0.03
5-year	0.41	0.00	0.01	0.19
10-year	0.94	0.00	0.02	0.23
30-year	1.54	0.01	0.02	0.15

Source: Bloomberg L.P., 17 Sep 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	69
30-year AAA Municipal vs Treasury	81
High Yield Municipal vs High Yield Corporate	79

Source: Bloomberg L.P., Thompson Reuters, 17 Sep 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	0.98	–	5.14	0.01	-0.02	1.50
High Yield Municipal	2.99	165[1]	6.08	-0.06	-0.05	7.17
Short Duration High Yield Municipal[2]	2.57	190	3.60	0.00	-0.08	5.52
Taxable Municipal	2.11	73[3]	9.74	0.00	-0.08	1.69
U.S. Aggregate Bond	1.47	35[3]	6.73	-0.03	-0.07	-0.77
U.S. Treasury	0.92	–	7.21	-0.04	-0.17	-1.59
U.S. Government Related	1.30	40[3]	6.16	-0.10	-0.18	-0.46
U.S. Corporate Investment Grade	2.02	85[3]	8.82	0.08	0.10	-0.12
U.S. Mortgage-Backed Securities	1.74	32[3]	4.32	-0.09	-0.07	-0.38
U.S. Commercial Mortgage-Backed Securities	1.50	63[3]	5.13	-0.23	-0.37	-0.12
U.S. Asset-Backed Securities	0.58	30[3]	2.27	-0.04	-0.07	0.31
Preferred Securities	2.57	151[3]	4.66	0.20	0.52	4.00
High Yield 2% Issuer Capped	3.78	275[3]	3.86	0.14	0.44	5.01
Senior Loans[4]	4.77	440	0.25	0.17	0.46	4.45
Global Emerging Markets	3.94	287[3]	7.05	-0.19	-0.15	0.38
Global Aggregate (unhedged)	1.09	33[3]	7.60	-0.52	-0.49	-2.81

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, 17 Sep 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, 17 Sep 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 15 Sep 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

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.

Nuveen provides investment advisory solutions through its investment specialists.

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