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Weekly Fixed Income Commentary

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Risk-off tone leaves Treasury yields mixed

U.S. Treasury yields finished last week mixed, with longer maturities higher and shorter issues falling a similar magnitude. Global macro weakness has put downward pressure on risk assets and upward pressure on yields the last few weeks. Most credit sectors struggled with negative absolute returns and weak relative performance.

HIGHLIGHTS

- **Senior loans produced the highest returns, while high yield corporates endured a week of negative returns and underperformance to Treasuries.**
- **Emerging markets continued to struggle amid cautious risk sentiment.**
- **Municipal bonds sold off. New issue supply was outsized at $11.2B, with flows of $408MM. This week's new issue supply should be large at $10B.**

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Watchlist

- *Treasury yields finished mixed last week, and we continue to anticipate higher rates into year end*
- *Most credit sectors posted negative returns and underperformed duration-matched Treasuries.*
- *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.

SENIOR LOANS CONTINUE TO SHOW POSITIVE PERFORMANCE

U.S. Treasury yields finished mixed last week, with longer maturities higher by 1 to 4 basis points (bps) and shorter issues falling similarly. Yields rose sharply to reach highs on Tuesday before retreating the remainder of the week. The 5-year yield closed Tuesday at its post-pandemic high before finishing the week down 2 bps. Yields ended September higher for all maturities, with the increase more than offsetting declines in July and August for maturities out to 10 years. However, maturities longer than 10 years finished the quarter modestly lower. Treasuries suffered a negative total return for September, but managed a slightly positive return for the third quarter.

Investment grade corporates ended September slightly weaker, with global macro weakness putting downward pressure on risk assets the last few weeks. The sector posted a -1.05% return for the month, although spreads tightened and it outpaced similar-duration Treasuries by 26 bps. The market continues to enjoy solid technical support. New deals in September were 2.9 times oversubscribed and new issue concessions were just 0.8 bps. Investor inflows averaged $4 billion. The sector finished the quarter with a flat total return and lagged similar-duration Treasuries by -15 bps.

High yield corporates endured a week of negative returns and relative underperformance, closing the week down -0.31%, and finishing September flat. However, tighter spreads helped the sector outperform similar-duration Treasuries for the month and the quarter by 53 bps and 87 bps, respectively. Last week's inflow was the fifth week with positive flows in the last six, and the $1.9 billion inflow over the third quarter was the first positive quarter of 2021. The senior loan market was once again one of the few sectors to produce a positive weekly total return and the only fixed income sector to deliver a positive return in September. Steady performance in loans has produced some of the highest returns in fixed income for the month, quarter and year.

A cautious risk sentiment weighed on emerging markets again last week. The risk-off tone spurred market volatility and propelled $2.1 billion in investor outflows. The sector fell -0.59% last week and lagged similar-duration Treasuries by -50 bps. Despite the softer tone, emerging markets held up reasonably well and digested increased primary market issuance, which is expected to pick up over the next two weeks.

MUNICIPAL BOND NEW ISSUANCE CONTINUES TO BE OUTSIZED

The municipal market sold off last week, with the 10-year MMD benchmark increasing 14 bps.

The Treasury market remains volatile as Congress examines two massive spending bills: the $1.2 trillion infrastructure bill and the $3.5 billion Build Back Better Act. Most investors thought inflation pressures were transitory. But as prices continue to rise, many now believe inflation will be a bigger problem than previously thought.

Tax-exempt municipal bonds are selling off, but this is not unexpected since yields have been low compared to taxable bonds. Also, new issuance continues to be outsized through the end of the year and is expected to be priced at whatever it takes to clear the market.

Maryland Department of Transportation (DOT) competitively issued $295 million bonds (rated Aa1/AAA). The deal included 3% bonds due in 2031 priced at a yield of 1.40%. The same day, the 10-year Treasury bond was trading at a yield of approximately 1.50%. The Maryland DOT bonds yielded 93% of the taxable 10-year bond. This ratio has cheapened over the last few weeks.

High yield municipal yields increased by 10 bps last week, while AAA-rated yields increased by 14 bps. High yield municipal investors who are still managing elevated cash balances are enjoying a retracement in yields despite improving credit fundamentals. High yield municipal fund flows were negative last week for only the second time this year at -$103 million. According to the U.S. Census Bureau, state and local tax revenues have recovered sharply for the period ending 30 Jun 2021. We are tracking at least 19 high yield municipal deals expected to price in the primary market this week.

Municipal bond yields have been low compared to taxable bonds.

In focus

Treasury yields under pressure

U.S. Treasury rates have been under pressure since the Federal Reserve (Fed) meeting in September, especially in the mid- to long-end of the curve. The 10-year Treasury yield closed higher than 1.5% for the first time since June, but remains below the highs experienced in March. However, the 5-year yield has reached its highest level since February 2020.

The increase was largely driven by the Fed hinting that it will likely announce the beginning of the taper process at the November meeting, and that tapering should be finished by mid-2022. The Fed also increased its outlook for growth, inflation and policy rates for 2022.

The market appears to be pricing in a lessening impact of the Delta variant, which is positive for growth, coupled with continued upward pressure on inflation related to supply chain disruptions. As we look to the end of the year, inflation appears to be the key data point driving changes in interest rates.

We anticipate that the 10-year Treasury yield could continue drifting higher, potentially reaching 1.8% by year end. It may rise further in 2022, perhaps as high as 2% by midyear. Given our inflation outlook, this would still represent negative real interest rates for bonds beyond 10 years and mean that financial conditions would still be considered loose.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week*	September 2021	Year-to-date
2-year	0.28	-0.01	0.07	0.16
5-year	0.97	-0.02	0.19	0.60
10-year	1.49	0.01	0.18	0.57
30-year	2.05	0.04	0.11	0.40

Source: Bloomberg L.P., 30 Sep 2021. *Weekly data as 01 Oct 2021. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week*	September 2021	Year-to-date
2-year	0.17	0.03	0.06	0.03
5-year	0.50	0.06	0.10	0.28
10-year	1.14	0.14	0.22	0.43
30-year	1.67	0.08	0.15	0.28

Source: Bloomberg L.P., 30 Sep 2021. *Weekly data as 01 Oct 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	77
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	77

Source: Bloomberg L.P., Thompson Reuters, 30 Sep 2021. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg High Yield Municipal Index divided by the yield-to-worst for the Bloomberg 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*	September 2021	Year-to-date
Municipal	1.12	–	5.19	-0.51	-0.72	0.79
High Yield Municipal	3.11	164[1]	6.38	-0.46	-0.65	6.53
Short Duration High Yield Municipal[2]	2.70	187	3.62	-0.18	-1.24	5.09
Taxable Municipal	2.24	73[3]	9.71	-0.18	-1.24	0.50
U.S. Aggregate Bond	1.56	33[3]	6.71	-0.12	-0.87	-1.55
U.S. Treasury	1.01	–	7.06	-0.11	-1.08	-2.50
U.S. Government Related	1.39	40[3]	6.06	-0.18	-1.02	-1.29
U.S. Corporate Investment Grade	2.13	84[3]	8.71	-0.41	-1.05	-1.27
U.S. Mortgage-Backed Securities	1.83	27[3]	4.62	0.15	-0.36	-0.67
U.S. Commercial Mortgage-Backed Securities	1.58	61[3]	5.11	0.09	-0.77	-0.53
U.S. Asset-Backed Securities	0.62	29[3]	2.26	0.07	-0.15	0.23
Preferred Securities	2.80	159[3]	4.72	-0.30	-0.02	3.44
High Yield 2% Issuer Capped	4.05	290[3]	3.96	-0.31	0.00	4.54
Senior Loans[4]	4.79	438	0.25	0.13	0.65	4.65
Global Emerging Markets	4.20	302[3]	6.93	-0.59	-1.66	-1.14
Global Aggregate (unhedged)	1.17	33[3]	7.53	-0.50	-1.78	-4.06

1 Yield difference between the Bloomberg 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 Sep 2021. *Weekly data as 01 Oct 2021. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg. 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, 01 Oct 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 29 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 Municipal Index; **high yield municipal:** Bloomberg High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index; **U.S. government related:** Bloomberg U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg 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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