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Weekly Fixed Income Commentary

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More taper talk boosts Treasury yields

U.S. Treasury yields rose last week and the yield curve flattened amid positive economic data and further signals from Federal Reserve Chair Jerome Powell of a taper announcement at the November meeting. The market now prices two full rate hikes next year and another three in 2023.

HIGHLIGHTS

- **Treasuries, agencies, mortgage-backed securities, investment grade and high yield corporates, preferreds and emerging markets weakened.**
- **Senior loans and convertible securities rallied.**
- **Municipal bond yields rose across the curve. New issue supply was $7.8B, with flows of $177MM. This week's new issue supply is outsized at $8.9B ($2.2B taxable).**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields rose last week and we continue to anticipate higher rates into year-end.*
- *Lower-rated assets generally outperformed.*
- *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 this quarter.

Unprecedented global fiscal stimulus should continue to boost consumption and growth into next year.

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

- Inflation rises in a disorderly way, negatively impacting asset values.
- Policymakers remove accommodation too rapidly, undermining the expansion.
- Further complications with the COVID-19 vaccine rollout and the Delta variant.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

INVESTMENT GRADE CORPORATE SUPPLY GROWS TO DOUBLE EXPECTATIONS

Treasury yields moved higher last week, with the 10-year yield hitting 1.70% before retracing somewhat to end at 1.63%, up 6 basis points (bps) for the week. Flash October PMIs on Friday were the only major economic data release. The PMIs showed accelerating growth in the U.S., UK and Australia, and a slight deceleration in the euro area after strong recent performance over the last several months. In a speech, Fed Chair Powell strongly signaled that a taper announcement is likely at the November 3 policy meeting. The yield curve flattened somewhat after those remarks, and ultimately ended the week unchanged. The market now prices two full rate hikes next year and another three in 2023.

Investment grade corporates underperformed, with total returns of -0.48%, lagging similar-duration Treasuries by -7 bps. Spreads closed close to flat, but the rise in rates plus a surprising uptick in supply became modest headwinds. Overall supply was over double expectations at $44 billion. The low BBB issuance saw strong demand, at 3.5x oversubscribed. It traded well in the secondary market, with spreads tightening 4 to 18 bps by the end of the week.

High yield corporates outperformed similar-duration Treasuries by 17 bps, though total returns were slightly negative at -0.08%. The loan market also performed relatively well, with total returns of 0.05%. Individual investor demand ticked up in both asset classes, with high yield seeing an inflow of $2.3 billion to erase the prior week's large outflow, while loans had an inflow of $927 million, the most since last April.

Emerging markets were mixed. Mirroring the dynamics in investment grade credit, the asset class posted negative total returns (-0.21%) amid the move higher in rates, though spreads tightened and the asset class outperformed similar-duration Treasuries by 19 bps. Focus was centered on a few idiosyncratic dynamics, namely in Brazil and Turkey. Brazilian assets weakened sharply on Friday after Economic Minister Guedes backed President Bolsonaro's plan to breach the spending cap with new social programs. Guedes was the last prominent voice in favor of fiscal discipline, so his pivot was interpreted by investors as a catalyst to sell. Local rates rose by 150 bps and long-end dollar bond spreads widened by around 30 bps. In Turkey, the central bank surprisingly cut interest rates -200 bps to 16%, causing the currency to weaken almost -4% and long-end yields to rise 40 to 50 bps.

HIGH YIELD MUNI FLOWS SEE CROSS CURRENTS

Both U.S. Treasury yields and municipal bond yields rose across the curve last week. The 10-year municipal bond yield benchmark (the MMD curve) has risen to 1.24%, a high for 2021. Many would say it reflects the normalization of interest rates as the U.S. continues to recover from the economy being virtually shut down in March 2020 due to the pandemic. At that time, the Fed implemented an extremely easy monetary policy to keep the economy afloat. Fed officials now acknowledge the economy has healed enough for it to begin tapering these policies.

We expect Treasury and municipal bond yields to remain range bound through the end of 2021. Next year we will have a better idea how far the economy has recovered from the pandemic. If the recovery is full, the Fed will likely need to tighten monetary policy to avert inflation.

Hudson Yards Infrastructure Corporation, NY (a Manhattan-based development project) issued $454 million revenue Bonds (rated Aa2/AA-). The bonds were priced to sell, with the 10-year bonds priced at a yield of 1.69%. The deal was met with decent demand.

High yield municipal fund flows continue to see cross currents, responding to adjusted rates, ratios and spreads. However, the low correlation of high yield municipal bonds is being again demonstrated in this recent rate move.

The high yield municipal new issue calendar is robust this week with at least 25 deals pricing. The high number of deals means the market has limited interest in weak deals or those hampered by debt. Puerto Rico's legislature once again failed to deliver the legislation they agreed to pass to support a GO restructuring deal. The deal now faces real chances of risk, and Puerto Rico can no longer say it can't afford to pay their debt in full as their cash coffers are quite full.

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In focus

Loans lead the pack

The Treasury market has shown increased volatility in the month following the Fed's September announcement that it would begin tapering its asset purchases. Markets are concerned that rising rates may be to come. Not surprisingly, nearly all fixed income sectors have seen prices fall over that period. But senior loans, in contrast, have held up well.

With their floating rate coupon structure, loans have often outperformed other areas of the fixed income market during periods of rising rates.

While the coupon structure of loans certainly explains the recent and historical resilience of the asset class, demand has also helped stabilize the price of loans amid the recent volatility. Both individual and institutional investors have been consistent buyers of loans in recent weeks and months.

Mutual funds and exchange-traded funds have recorded $38 billion of inflows in 2021, according to Morningstar, reversing nearly half of the $86 billion of outflows in the prior two years. And loan demand from institutions accessing the market via collateralized loan obligations (CLOs) is the highest ever recorded.

Should Treasuries remain volatile, loan demand could continue as investors look to lower their interest rate risk. This trend may help further contribute to the outperformance of the asset class.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.46	0.06	0.18	0.33
5-year	1.20	0.07	0.23	0.83
10-year	1.63	0.06	0.15	0.72
30-year	2.07	0.03	0.02	0.42

Source: Bloomberg L.P., 22 Oct 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	0.21	0.03	0.04	0.07
5-year	0.60	0.08	0.10	0.38
10-year	1.24	0.07	0.10	0.53
30-year	1.73	0.05	0.06	0.34

Source: Bloomberg L.P., 22 Oct 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	75
30-year AAA Municipal vs Treasury	83
High Yield Municipal vs High Yield Corporate	77

Source: Bloomberg L.P., Thompson Reuters, 22 Oct 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	Month-to-date	Year-to-date
Municipal	1.22	–	5.24	-0.29	-0.39	0.40
High Yield Municipal	3.25	172[1]	6.79	-0.28	-0.68	5.81
Short Duration High Yield Municipal[2]	2.76	182	3.71	-0.14	-0.22	4.85
Taxable Municipal	2.34	71[3]	9.71	-0.53	-0.51	-0.01
U.S. Aggregate Bond	1.70	33[3]	6.76	-0.37	-0.54	-2.09
U.S. Treasury	1.18	–	7.05	-0.37	-0.60	-3.08
U.S. Government Related	1.55	40[3]	6.11	-0.27	-0.46	-1.74
U.S. Corporate Investment Grade	2.27	86[3]	8.66	-0.48	-0.54	-1.81
U.S. Mortgage-Backed Securities	1.95	24[3]	4.85	-0.29	-0.47	-1.14
U.S. Commercial Mortgage-Backed Securities	1.76	59[3]	5.10	-0.37	-0.69	-1.22
U.S. Asset-Backed Securities	0.85	33[3]	2.33	-0.15	-0.36	-0.13
Preferred Securities	2.91	154[3]	4.69	-0.15	-0.20	3.23
High Yield 2% Issuer Capped	4.24	286[3]	3.99	-0.08	-0.26	4.27
Senior Loans[4]	4.98	438	0.25	0.05	0.21	4.87
Global Emerging Markets	4.32	300[3]	6.98	-0.21	-0.79	-1.92
Global Aggregate (unhedged)	1.29	33[3]	7.54	-0.13	-0.26	-4.31

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, 22 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, 22 Oct 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 20 Oct 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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