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Weekly Fixed Income Commentary

1 November 2021

Treasury yield curve flattens, awaiting the Fed

Long-dated U.S. Treasury yields fell last week, while short-end rates moved higher ahead of the Federal Reserve's policy meeting this week. The Fed is expected to announce a timeline to begin tapering its asset purchases.

HIGHLIGHTS

- **All major market segments rallied, especially taxable munis, investment grade and high yield corporates, Treasuries, agencies and mortgage-backed securities.**
- **Most spread sectors lagged the Treasury rally, with the sole notable exception of investment grade corporates.**
- **Long municipal bond yields declined. New issue supply was just $7.8B, with flows of $397MM. This week's new issue supply is light at $6.7B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields fell last week, though we continue to anticipate higher rates into year-end.*
- *Spread assets lagged the move in rates, but still performed well.*
- *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 global economic expansion.
- Further complications with the COVID-19 vaccine rollout and Delta or future variants.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

TECHNICALS TURNING SUPPORTIVE FOR INVESTMENT GRADE CORPORATES

The Treasury curve flattened further last week, with the 10-year yield falling -8 basis points (bps) and the 30-year yield down -14 bps. Front-end yields rose 4 bps. Economic data was mostly positive, with durable and capital goods orders beating expectations for September and the University of Michigan consumer sentiment survey rising from the preliminary reading. Third quarter GDP disappointed somewhat at 2.0%, however, down from 6.7% in the second quarter. A slowdown was expected, and we expect growth to rebound again in the fourth quarter.

Investment grade corporates exhibited strength, rallying 0.80%, though only outperforming similar-duration Treasuries by 1 bps. Trading flows were around 10% lighter than usual, with attention focused on rate volatility. The primary market saw robust demand, with order books oversubscribed 2.75x on average, resulting in a small average concession of half a basis point. October saw around $108 billion of new issuance, slightly more than the $100 billion expected. Moving forward, the technical backdrop should turn more supportive, with the next four weeks set to include the largest surge of cash returns of the year, including around $24 billion scheduled to be returned via maturities, coupons and tenders this week.

High yield corporates lagged the rally in higher-rated markets, returning 0.08% for the week and underperforming similar-duration Treasuries by -14 bps. Coupon payments outweighed a slight drop in prices. Loans saw similar dynamics though they continued to grind better, returning 0.02%. Under the surface, BB-rated securities outperformed lower-rated segments of the bond market, but underperformed in loans. Retail inflows were strong, at $1.2 billion and $700 million in bonds and loans, respectively.

Emerging markets gained, returning 0.37% last week, though they underperformed similar-duration Treasuries by -8 bps. Overall, high-rated sovereigns lagged the rally in Treasuries by 2 to 3 bps on average. Technicals turned supportive, with only around $3 billion of new issuance pricing last week. Inflows returned after a month of steady outflows, led by a $1.3 billion flow into hard currency funds. Brazil remained a notable laggard for the second week in a row, with spreads widening 20 to 25 bps for both the sovereign and quasi-sovereign names like Petrobras, as concerns persist about the financing of planned social spending increases.

MUNICIPAL YIELDS SHOULD REMAIN RANGE BOUND

Long municipal yields ended the week slightly lower, although less than long Treasuries. Both markets had good tones. The 30-year U.S. Treasury bond yield fell -14 bps last week, suggesting that investors are not currently fearing inflation. Rather, they are looking to lock in current interest rates, as they believe rates will move lower going forward.

Municipal yields will have a hard time moving substantially lower through the end of the year, as new issue supply will likely remain outsized. We expect both municipal and Treasury rates to remain range bond in the near term. Beginning in January, we should have a better idea of whether the economy has fully recovered from the pandemic.

Miami-Dade County Health Facilities Authority issued $162 million revenue bonds for Children's Hospital Project (rated A). The deal was priced to sell and well received. The deal included 30-year bonds with a 4% coupon priced at a yield of 2.56%. Those same bonds traded at 2.39% in the secondary market, demonstrating the continued demand for high yield tax-exempt bonds.

High yield and AAA-rated municipal bond yields decreased evenly by 4 bps on average last week. Cross currents in high yield municipal fund flows were evenly balanced, with net flows of $3 million. High yield municipal new issuance remains active, with at least 30 deals this coming week. The Puerto Rico Fiscal Oversight Board announced it accepted recently passed legislation clearing the way to finish restructuring roughly $17 billion of debt. An old and once-popular Puerto Rico credit – Auxilio Mutuo Hospital – returns to the market this week, a sign that market access is returning to Puerto Rico credits that were blocked due to its bankruptcy proceedings.

The 10-year muni bond yield benchmark has risen to 1.24%, a high for 2021.

In focus

Non-fixed rate preferreds may boost income

Preferred securities come with different coupon structures that active managers can use to help adjust a portfolio for changing rate environments. Non-fixed rate preferred securities look particularly attractive in today's environment.

Many preferreds are fixed-to-floating rate issues that start with a fixed coupon for a defined period, and then reset, with the initial change occurring on the first call date.

Another structure is fixed-to-fixed, in which the initial fixed rate resets to a different fixed rate. When the coupon shifts from the initial fixed rate to the new rate, that second one is based on a current market rate plus a margin. This limits duration. The reset market-based coupon should roughly equal the coupon of a newly issued security priced at 100. So the duration of the preferred security would approximate the duration of a bond with a maturity date matching the reset date.

In a rising interest rate environment, non-fixed preferreds offer an advantage over fixed-rate issues, whose coupons never reset. As rates rise, the duration of those fixed coupon securities extends, as they're less likely to be called. In contrast, non-fixed coupon issues reprice toward 100 when the coupon resets.

As interest rates may continue to drift higher, the interest rate risk protection they offer could become important.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	October 2021	Year-to-date
2-year	0.50	0.04	0.22	0.38
5-year	1.19	-0.01	0.22	0.82
10-year	1.56	-0.08	0.07	0.64
30-year	1.93	-0.14	-0.11	0.29

Source: Bloomberg L.P., 29 Oct 2021. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	October 2021	Year-to-date
2-year	0.25	0.04	0.08	0.11
5-year	0.64	0.04	0.14	0.42
10-year	1.21	-0.03	0.07	0.50
30-year	1.69	-0.04	0.02	0.30

Source: Bloomberg L.P., 29 Oct 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	78
30-year AAA Municipal vs Treasury	88
High Yield Municipal vs High Yield Corporate	76

Source: Bloomberg L.P., Thompson Reuters, 29 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	October 2021	Year-to-date
Municipal	1.21	–	5.19	0.10	-0.29	0.50
High Yield Municipal	3.21	172[1]	6.62	0.27	-0.41	6.09
Short Duration High Yield Municipal[2]	2.75	181	3.68	0.07	-0.15	4.93
Taxable Municipal	2.27	72[3]	9.70	0.91	0.39	0.89
U.S. Aggregate Bond	1.66	33[3]	6.74	0.52	-0.03	-1.58
U.S. Treasury	1.14	–	7.09	0.53	-0.07	-2.56
U.S. Government Related	1.53	42[3]	6.15	0.39	-0.07	-1.36
U.S. Corporate Investment Grade	2.22	87[3]	8.71	0.80	0.25	-1.02
U.S. Mortgage-Backed Securities	1.89	24[3]	4.63	0.28	-0.19	-0.86
U.S. Commercial Mortgage-Backed Securities	1.73	60[3]	5.11	0.30	-0.39	-0.92
U.S. Asset-Backed Securities	0.87	36[3]	2.31	0.02	-0.35	-0.11
Preferred Securities	2.85	152[3]	4.61	0.10	-0.10	3.34
High Yield 2% Issuer Capped	4.24	288[3]	3.98	0.08	-0.18	4.35
Senior Loans[4]	5.03	440	0.25	0.02	0.24	4.90
Global Emerging Markets	4.30	304[3]	7.02	0.37	-0.42	-1.55
Global Aggregate (unhedged)	1.29	34[3]	7.54	0.02	-0.24	-4.29

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, 29 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, 29 Oct 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 27 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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