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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Municipal bonds: Time to test the waters again

Bottom line up top:

Municipal markets appear to be turning a corner. May marked the first positive monthly return (+1.1%) for the Bloomberg Municipal Bond Index since November 2021, and only the third over the past year. Of course, one month of performance doesn't make a trend, and munis are still down sharply (-9.0%) year to date. But we think the worst of the damage wrought by soaring yields and Fed policy uncertainty may be behind us.

The fundamental things apply. The 2022 selloff has been driven by technical and macro factors, not asset-class specifics. Muni credit fundamentals have remained quite healthy even as valuations have fallen. Consider:

- State and local tax revenues collections increased 15% in 2021 — the highest in 30 years — and collections in 2022 are on track to be even stronger.
- State reserves/fund balances are currently at 23% of expenditures, on average, the best since 1979.
- State pension funded ratios are topping 80% for the first time since 2008.
- Most muni sectors have a stable or positive ratings outlook. Last year, Moody's issued 817 upgrades and only 307 downgrades.

When will investors return? Despite sound fundamentals and improved performance, investors have been pulling money out of muni funds in historically large amounts — roughly $63 billion year to

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On behalf of Nuveen's Global Investment Committee

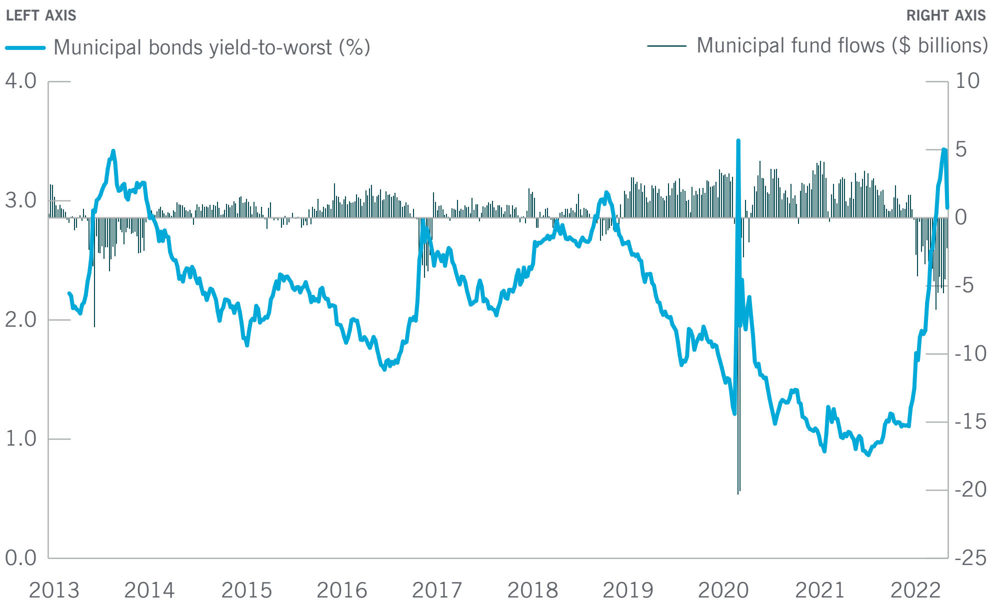
As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

date through May. This reflexive response is in keeping with a familiar pattern that almost seems like muscle memory: heavy muni fund outflows whenever yields start to rise (Figure 1). Negative flows have been the primary driver of today's cheaper municipal bond valuations, which could represent an attractive entry point for those willing to dip their toe back into the muni waters. In the discussion that follows, we take a closer look at these opportunities and where they may fit in diversified portfolios.

While municipal bond prices and valuations have fallen, fundamentals still look sound. That's a positive signal.

FIGURE 1: MUNICIPAL OUTFLOWS COULD SIGNAL AN ATTRACTIVE ENTRY POINT

Municipal bond fund flows and yields



Data source: Bloomberg, L.P., 2 Jan 2013 to 27 May 2022. Weekly data readings of the Bloomberg Municipal Index. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer actually defaulting. **Past performance does not predict or guarantee future results.**

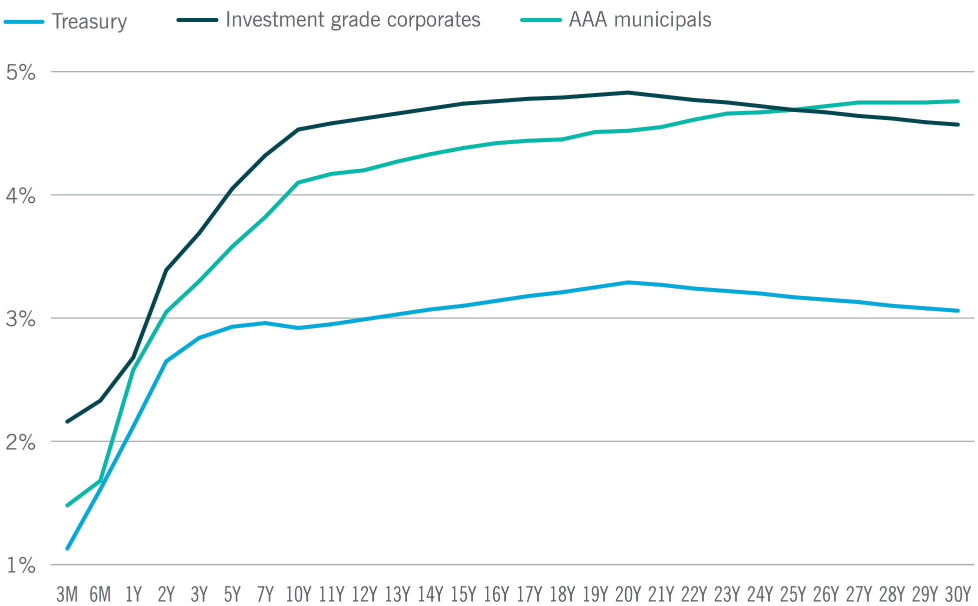
Portfolio considerations

In an uncertain macroeconomic environment, **diversification and thoughtful risk allocation take on heightened importance**. In addition to our bias toward higher quality (including higher-quality high yield), municipal bonds can be a very useful tool within fixed income allocations.

Adjusted for taxes, AAA munis currently offer greater income than Treasuries and are competitive with investment grade corporates (Figure 2). Given that corporates are much lower quality (A/BBB), we believe **municipal bonds offer more efficient yield per unit of credit risk.**

FIGURE 2: MUNICIPALS OFFER COMPETITIVE AFTER-TAX INCOME

Tax-equivalent yields (%)



Data source: Bloomberg, L.P., as of 3 Jun 2022. **Yield descriptions: Treasury:** Bloomberg U.S. Treasury Active Curve Index; **Municipal bonds:** Bloomberg AAA National Municipal Yield Curve Index; **investment grade corporates:** Bloomberg U.S. Investment Grade Corporate Yield Curve Index. The **taxable-equivalent yield** is based on the highest individual marginal federal tax rate of 37.0%, plus the 3.8% Medicare tax on investment income (the Net Investment Income Tax). Individual tax rates may vary. **Past performance does not predict or guarantee future results.**

Additionally, current yields indicate a favorable entry point for munis on the front end of the yield curve. This provides a potential yield advantage without the need to increase interest rate sensitivity. The ratio of the same muni and corporate yields from Figure 2 is 1.2 standard deviations in favor of municipals at one year of maturity. At three years, the ratio is 0.8 standard deviations favorable. Importantly, we compare municipals with corporate bonds rather than Treasuries since munis and corporates are the two most salient options for the purposes of stepping out of cash and generating incremental income.

Comparisons to Treasury and corporate yields suggest we could be seeing an attractive entry point for municipal bonds.

About Nuveen's Global Investment Committee

Nuveen's Global Investment Committee (GIC) brings together the most senior investors from across our platform of core and specialist capabilities, including all public and private markets.

Regular meetings of the GIC lead to published outlooks that offer:

- macro and asset class views that gain consensus among our investors
- insights from thematic "deep dive" discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

For more information, please visit nuveen.com.

Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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Important information on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. 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. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes. Investments will be subject to risks generally associated with the ownership of real estate-related assets and foreign investing, including changes in economic conditions, currency values, environmental risks, the cost of and ability to obtain insurance, and risks related to leasing of properties. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria exclude securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don't use these criteria. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not appropriate for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy.

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