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Weekly Fixed Income Commentary

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Treasury yields snap long selloff streak

Long U.S. Treasury yields fell for the first time in months, and fixed income assets rallied broadly as a result. The U.S. Federal Reserve is expected to hike rates another 75 basis points on Wednesday.

HIGHLIGHTS

- **Treasuries, agencies, CMBS, ABS, MBS, investment grade and high yield corporates, convertibles, taxable munis, loans and emerging markets all had positive total returns.**
- **Only CMBS and ABS underperformed similar-duration Treasuries.**
- **Municipal bond yields increased. New issue supply was $10.5B, with outflows of -$1.8B. This week's new issuance is only $2.8B.**

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Watchlist

- *10-year Treasury yields declined last week.*
- *Spread assets gained amid the rates rally.*
- *Net-negative supply should provide some support to municipal bonds.*

INVESTMENT VIEWS

Accommodative interest rate policy remains a key market support. While investors continue to focus on more hawkish Fed policy, overall rates are likely to remain relatively low even after several rate hikes.

The underlying growth outlook remains healthy, as consumers have strong balance sheets, businesses are reinvesting and Covid recedes. This should keep defaults low.

Treasury yields are likely to rise this year, but the pace of long-term increases should remain relatively modest.

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 bonds also look compelling.

KEY RISKS

- Inflation fails to moderate as expected, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- The Russia/Ukraine conflict continues to escalate.
- Covid-19 cases increase, or new variants emerge.

HIGH YIELD CORPORATES SEE THEIR STRONGEST RALLY SINCE JULY

Long U.S. Treasury yields declined last week, snapping a streak of 12 straight weekly selloffs. The 10-year yield fell -20 basis points (bps) to end the week at 4.02%. U.S. economic data disappointed, with flash PMIs for October dropping to around 47 for the U.S., UK and euro area. A reading below 50 indicates economic contraction. The latest monthly data on U.S. home prices also moderated. A gauge of prices across 20 major cities declined -1.3% month-over-month, the sharpest drop since 2009. Separately, central banks in Canada and the euro area both delivered dovish rate hikes. The Bank of Canada hiked by 50 bps, when a 75 bps hike was expected, and the European Central Bank signaled it may decelerate the pace of hikes sooner than previously expected.

Investment grade corporates gained, returning 1.97% for the week and outperforming similar-duration Treasuries by 58 bps. Spread levels were -6 bps tighter and yields fell -23 bps to 5.87%, the first weekly yield decline since early August. The asset class snapped a streak of eight weekly outflows, with $1.6 billion entering the asset class. At the same time, issuance picked up, with almost $35 billion of new supply pricing during the week, more than expected. Estimates for November supply hover around $75 billion.

High yield corporates outperformed, gaining 2.43% for the week and the strongest rally since July. The asset class beat similar-duration Treasuries by 168 bps. Leveraged loans lagged, returning only 0.10% for the week. The dovish tilt from central banks and associated decline in rates helped bonds more than floating-rate loans. Investor flows mirror that dynamic, with high yield funds seeing a $2.8 billion inflow, while loan funds saw a -$847 million outflow.

Emerging markets gained as well. The asset class returned 1.99% for the week, outperforming versus similar-duration Treasuries by 84 bps. Most of the rally was in the sovereign space, where high yield names tightened substantially versus investment grade (-32 bps tighter spreads in HY versus 1 bps wider spreads in IG). Corporates weakened overall, with fresh declines for China technology and property names after the Party Congress confirmed President Xi's position as leader.

INVESTORS ARE LOOKING TO LOCK IN MUNI BOND YIELDS

Municipal bond yields sold off last week, amid high volatility. Short-term yields increased 5 basis points and long-term rates rose 15 basis points. Fund flows were negative for the twelfth consecutive week. This week's new issue calendar is expected to be muted due to the Fed meeting on Wednesday.

We expect the Fed to raise rates an additional 75 bps this week. Conventional wisdom is that rates will increase to 5% to be sure inflation is under control. Ironically, the 10-year Treasury is currently yielding 4%, which is lower than short-term rates. Many investors want to lock in current rates, as the bond market could rally once the Fed is done hiking.

Tax-exempt municipals are volatile, in part due to the billions dollars of tax swaps taking place. However, investors can buy tax-exempt 10-year bonds at a 4% yield and long-term bonds at 5%. We expect continued volatility in munis through the end of the year, but we believe 2023 looks to be promising for investors.

New York City Transitional Finance Authority (TFA) issued $950 million future tax-secured bonds (rated Aa1/AAA). The deal was priced to sell and was well received. For example, 5% coupon bonds due in 2046 came at a yield of 4.82% and traded in the secondary market at 4.77%.

The high yield municipal market ended last week with a firmer tone, as yields gained more attention and fund outflows showed signs of slowing. Tobacco and Puerto Rico bonds both began to rally toward the end of the week, which we see as an early signal of strengthening liquidity and optimism in technical factors. The average yield-to-worst for the Bloomberg High Yield Municipal Index is 6.26%, which supports a very attractive taxable-equivalent yield compared to taxable high yield corporate bond yields.

We expect continued volatility in munis through the end of the year, but 2023 looks to be promising for investors.

In focus

Why are TIPS' prices down when inflation is up?

In 2022, inflation has heated up and stayed hot. Yet Treasury Inflation Protected Securities (TIPS), which are designed to provide a measure of protection against higher costs, have posted negative returns. This trend has confounded many investors.

Last month, the Personal Consumption Expenditure Price Index rose 0.3% and 6.2% year-over-year, well above the Fed's 2% target. Stripping out food and energy costs, the core PCE index— the Fed's preferred inflation gauge — jumped 0.5% in September and 5.1% over the past 12 months. This is the highest rate of increase since March. The usual culprits continued to drive up inflation, including still-snarled supply chains and heightened demand, particularly for services.

Seeking shelter from sticker shock, investors have long turned to TIPS, whose principal is adjusted semiannually according to changes in the Consumer Price Index. But their prices have fallen this year, even as they've been relative outperformers compared to nearly all traditional fixed income segments.

What's behind this drop? TIPS are U.S. Treasuries, so their prices decline as yields rise — and yields have surged across the Treasury curve this year. This demonstrates a key element of TIPS: While they may help protect investors against inflation over the long term, they aren't necessarily a hedge against inflation in the short run.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	4.42	-0.06	0.14	3.69
5-year	4.19	-0.16	0.09	2.92
10-year	4.02	-0.20	0.18	2.50
30-year	4.15	-0.19	0.37	2.24

Source: Bloomberg L.P., 28 Oct 2022. **Past performance does not predict or guarantee future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	3.18	0.05	0.09	2.94
5-year	3.24	0.05	0.12	2.65
10-year	3.41	0.07	0.11	2.38
30-year	4.14	0.15	0.24	2.65

Source: Bloomberg L.P., 28 Oct 2022. **Past performance does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	85
30-year AAA Municipal vs Treasury	100
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters, 28 Oct 2022. 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 does not predict or guarantee future results.**

Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	4.22	–	7.36	-0.58	-0.93	-12.95
High yield municipal	6.26	234[1]	10.70	-0.43	-2.06	-17.76
Short duration high yield municipal[2]	6.15	285	4.42	-0.13	-0.81	-8.36
Taxable municipal	5.46	126[3]	8.95	1.37	-1.94	-20.85
U.S. aggregate bond	4.94	62[3]	6.13	1.65	-0.88	-15.36
U.S. Treasury	4.32	–	5.96	1.20	-1.08	-14.03
U.S. government related	4.94	62[3]	5.09	1.20	-0.66	-13.29
U.S. corporate investment grade	5.87	158[3]	6.98	1.97	-0.75	-19.33
U.S. mortgage-backed securities	4.99	65[3]	6.00	2.23	-0.72	-14.28
U.S. commercial mortgage-backed securities	5.57	130[3]	4.63	0.59	-1.27	-12.94
U.S. asset-backed securities	5.40	94[3]	2.75	0.01	-0.70	-5.73
Preferred securities	7.69	283[3]	5.09	1.16	-2.34	-16.87
High yield 2% issuer capped	9.01	457[3]	3.97	2.43	3.03	-12.15
Senior loans[4]	11.06	658	0.25	0.10	0.73	-2.60
Global emerging markets	8.45	415[3]	5.90	1.99	-0.61	-20.99
Global aggregate (unhedged)	3.76	60[3]	6.73	2.50	-0.05	-19.93

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, 28 Oct 2022. **Past performance does not predict or guarantee 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, 28 Oct 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 26 Oct 2022.

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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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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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