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Weekly Fixed Income Commentary

30 January 2023

Mixed economic data boost Treasury yields

U.S. Treasury yields rose as economic data mostly beat expectations. The data are consistent with steady economic expansion, but also point to heightened risks over the medium term. Markets also anticipate indications that rate tightening should soon end at this week's U.S. Federal Reserve meeting.

HIGHLIGHTS

- **Total returns were positive for investment grade and high yield corporates, MBS, taxable munis, preferreds, senior loans and emerging markets.**
- **U.S. Treasuries, CMBS and ABS all produced negative total returns.**
- **Municipal bond yields remained essentially unchanged. New issue supply was $5.5B with inflows of $1.3B. This week's new issuance should be $1.6B.**

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Watchlist

- *U.S. Treasury yields rose across most of the curve.*
- *Spread assets appreciated.*
- *Net-negative supply should provide some support to municipal bonds.*

INVESTMENT VIEWS

The end to U.S. central bank tightening appears near, as we expect Fed rate hikes to cease early this year. The overall level of rates is likely to remain historically low.

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 fall this year, and we expect the 10-year Treasury yield to end the year around 3.25%.

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.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.
- Covid cases increase, or new variants emerge.

HIGH YIELD CORPORATE ISSUANCE PICKS UP

U.S. Treasury yields rose last week, with the 10-year yield ending 2 basis points (bps) higher, as U.S. economic data were mixed. The latest reading of the Conference Board's Leading Economic Indicator, a popular gauge of future economic activity, weakened further and signals high odds of recession in the next year. However, purchasing managers' indexes for January across developed markets beat expectations, suggesting reduced risk of near-term economic weakness. Additionally, inflation data came in line with expectations. Altogether, the data are consistent with steady economic expansion but heightened risks over the medium term.

Investment grade corporates rallied, returning 0.24% for the week and beating similar-duration Treasuries by 27 bps. The asset class experienced its fourth straight weekly inflow at $3.8 billion. Despite heavy supply, with 15 issuers bringing $28 billion in new issuance, deals were heavily oversubscribed at 4.1x on average. That led to very narrow new issue concessions of 1.2 bps on average, as the asset class remains very supported technically.

High yield corporates rebounded, returning 0.38% and outperforming similar-duration Treasuries by 51 bps. The asset class saw the new issue market continue to pick up, with $3.8 billion of new deals pricing. The loan market is seeing more activity, with around $3 billion of new supply for the week, though most of the attention is dominated by amend-and-extend transactions amid the transition from LIBOR to SOFR. Senior loans returned 0.44% for the week, marking a seventh straight weekly rally, matching the longest streak since 2021.

Emerging markets gained again, returning 0.29% for the week and beating similar-duration Treasuries by 37 bps. The asset class remains supported by robust inflows, which totaled $3.1 billion into hard currency funds for the week, the most in almost two years. Local currency funds also saw steady inflows of $813 million. The weaker dollar, which has depreciated in each of the last three weeks, has also helped.

THE MUNICIPAL MARKET SHOULD REMAIN WELL BID

The municipal market was listless last week, ending the week essentially unchanged with a slightly bearish tone. Fund flows remained positive, and this week's new issue supply is expected to be very thin.

All eyes are on the Fed meeting on Wednesday. The Fed's comments will be important, no matter the size of the rate increase. Many investors believe inflation is abating, but appreciate the Fed erring on the side of caution by continuing to raise rates and promising to keep rates high until inflation is overpowered for this cycle. We expect a 25 bps rate increase with the Fed saying more increases will come if necessary. This edict should be welcomed by investors.

The tax-exempt market pause last week is normal for February. The outsized January 1 coupon is substantially reinvested, and February 1 generally has a historically low coupon to reinvest. However, with new issue supply remaining muted, munis should remain well bid.

Weld Co. School District No. Re-4, Colorado, issued $271 million general obligation bonds (rated Aa2/AA). The deal included 5.25% coupon bonds due in 2047 that came at a yield of 3.53%. At week's end, those bonds traded at roughly the same price.

High yield municipal fund inflows saw another strong week at $652 million, while new issuance remains unusually light, even for this time of year. The secondary market must play a larger role in servicing demand, which is increasing the downward pressure on credit spreads. SIFMA (short-term money market rate) decreased further. Leveraged strategies benefited, with nearly 400 bps difference between the average high yield muni index yield and 7-day borrowing rates. We have observed some exchange-traded fund outflows, proving that some of the ETF inflows from 2022 are returning to mutual funds in 2023.

Senior loans saw the seventh straight weekly rally, matching the longest streak since 2021.

In focus

IG corporate issuance should remain robust

Investment grade corporate gross issuance ended 2022 at $1.2 trillion, modestly higher than forecast. Financial issuance accounted for 51% of total supply, the highest percentage in 15 years.

We expect gross issuance to be similar in 2023, with net issuance increasing by 5% to 10%. The gross issuance level should be comparable to the average over the last five years, excluding the supply surge in 2020. We expect the proportion of issuance from the financial sector to decline modestly from the heightened level in 2022. Conversely, supply related to mergers and acquisitions is expected to increase in 2023 after a light year in 2022.

Following a quiet month in December, we saw strong issuance in the first two weeks of January as yields declined from 2022 highs. Activity has since quieted again in the second half of the month. Despite the higher level of issuance year-to-date, strong demand has allowed the asset class to post a positive total return and outperform similar-duration Treasuries.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.20	0.03	-0.23	-0.23
5-year	3.61	0.05	-0.39	-0.39
10-year	3.51	0.02	-0.37	-0.37
30-year	3.62	-0.03	-0.34	-0.34

Source: Bloomberg L.P., 27 Jan 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.17	0.00	-0.43	-0.43
5-year	2.05	-0.02	-0.47	-0.47
10-year	2.19	-0.02	-0.44	-0.44
30-year	3.20	0.02	-0.38	-0.38

Source: Bloomberg L.P., 27 Jan 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	62
30-year AAA Municipal vs Treasury	88
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 27 Jan 2023. 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. **Performance data shown represents past performance and does not predict or guarantee future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.10	–	6.08	0.00	2.83	2.83
High yield municipal	5.44	245[1]	7.64	-0.17	4.41	4.41
Short duration high yield municipal[2]	5.13	304	4.05	0.00	2.39	2.39
Taxable municipal	4.75	104[3]	8.37	0.36	4.86	4.86
U.S. aggregate bond	4.31	44[3]	6.32	0.09	2.99	2.99
U.S. Treasury	3.88	–	6.25	-0.04	2.33	2.33
U.S. government related	4.46	55[3]	5.39	0.07	2.33	2.33
U.S. corporate investment grade	5.00	119[3]	7.29	0.24	3.78	3.78
U.S. mortgage-backed securities	4.25	36[3]	5.91	0.17	3.45	3.45
U.S. commercial mortgage-backed securities	4.86	107[3]	4.60	-0.10	2.53	2.53
U.S. asset-backed securities	4.82	64[3]	2.88	-0.01	1.33	1.33
Preferred securities	6.47	206[3]	4.86	0.98	7.99	7.99
High yield 2% issuer capped	8.13	414[3]	3.76	0.38	3.91	3.91
Senior loans[4]	9.79	581	0.25	0.44	2.47	2.47
Global emerging markets	7.01	320[3]	6.27	0.29	3.34	3.34
Global aggregate (unhedged)	3.47	47[3]	6.80	-0.03	3.30	3.30

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, 27 Jan 2023. **Performance data shown represents past performance and 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, 27 Jan 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 25 Jan 2023.

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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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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