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Weekly Fixed Income Commentary

24 April 2023

Treasury yields continue their climb higher

U.S. Treasury yields rose again on stronger economic data in the U.S. In addition, inflation in the UK also surprised substantially to the upside, pushing global developed market bond yields higher.

HIGHLIGHTS

- **Treasuries, agencies, investment grade and high yield corporates, MBS, taxable munis and emerging markets all had negative total returns.**
- **In contrast, preferreds and senior loans enjoyed positive total returns.**
- **Municipal bond yields rose dramatically across the curve. New issue supply was outsized at $11.2B with substantial outflows of -$2.9B. This week's new issuance remains robust at $8.5B.**

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Watchlist

- *U.S. Treasury yields moved higher.*
- *Spread assets widened after recent gains.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" emerges as a theme, as the Fed battles to control inflation. Higher interest rates are likely to cause additional volatility.

The underlying growth outlook remains healthy, thanks to strong consumer balance sheets and solid levels of businesses investment. This combination should keep corporate defaults low.

Treasury yields are likely to fall this year, and we expect the 10-year Treasury yield to end 2023 around 3.25%.

We favor selectively taking on risk in this environment of attractive prices and yields. Credit selection is key as we search for bonds with favorable income and solid fundamentals.

KEY RISKS

- Inflation fails to moderate as expected, weighing on asset prices.
- Policymakers tighten too rapidly, undermining the global economic expansion.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

PREFERREDS GET A BOOST FROM POSITIVE TONE AROUND BANKS

U.S. Treasury yields rose again last week, with the 10-year yield ending 6 basis points (bps) higher at 3.57%. Front-end yields also rose, with 2-year Treasury yields up 8 bps. Stronger economic data in the U.S., highlighted by a positive print from the New York Fed's manufacturing survey and robust flash PMIs, put upward pressure on yields. Inflation in the UK also surprised substantially to the upside, at 10.1% year-over-year, which pushed global developed market bond yields higher. However, other U.S. economic data were weak, including building permits, home sales, and jobless claims.

Investment grade corporates weakened slightly, returning -0.22% for the week, but the asset class outperformed similar-duration Treasuries by 7 bps. Overall, spreads tightened -1 bps, though financials led gains and tightened -6 bps. Large, national bank earnings were generally strong, and there have been no negative surprises from regional banks. The positive tone around banks also helped preferreds, which returned 0.46% for the week and beat similar-duration Treasuries by 66 bps. The new issuance market was active at around $26 billion, the vast majority from major banks.

High yield corporates lagged after recent outperformance, returning -0.33% and underperforming similar-duration Treasuries by -16 bps. BB rated corporates have been a popular overweight recently, and spreads on that market segment compressed to only 108 bps over BBBs, which prompted some investors to take profits. Senior loans returned 0.19% for the week, despite another outflow of -$461 million. High yield funds had a large outflow of -$3.1 billion.

Emerging markets underperformed, returning -0.75% and lagging similar-duration Treasuries by -49 bps. Sovereigns weakened across the board, though high yield underperformed. The weakness was led by a few idiosyncratic countries, such as Egypt and Argentina, which weakened -3 to -4 points. In the face of underperformance, the EM asset class broke a streak of nine consecutive weekly outflows, highlighted by a $576 million inflow into local currency bond funds.

MUNICIPAL BOND SUPPLY SURGE SENDS YIELDS HIGHER

Municipal bond yields rose dramatically across the curve last week. The 2-year tax-exempt yield ended the week 33 basis points higher, while the 30-year yield rose 22 bps. The new issue municipal calendar (taxable and tax-exempt) was outsized, and underwriters had to price deals cheaply to pique investor interest. Weekly fund flows were substantially negative. This week's new issue calendar remains robust and will again need to be priced cheaply.

It was no surprise that municipal bonds sold off last week. They had been trading rich to taxable bonds for several weeks, a trend that changed due to an increase in supply. Also, spring is typically a slow time of year for bond reinvestment, when many investors are redeeming holdings to pay taxes. However, demand strengthened at the cheaper levels. We expect Treasury yields to remain range bound for the foreseeable future. This means municipal bonds may present a potential buying opportunity when yields rise.

The state of Illinois issued $2.3 billion general obligation bonds (rated A3/A-). The deal was priced to sell and very well received, later breaking to a premium in the secondary market. For example, 5.50% coupon bonds due in 2047 came at a yield of 4.50%. Those bonds traded in the secondary market at 4.32%.

High yield municipal bond yields changed on par with high grades on average last week, increasing by 17 bps. The short-duration area, where the credit spread curve remains inverted, is attractive on both a relative and absolute yield level. Investors are again faced with low supply to reinvest upcoming summer cash flows.

Municipal new issue supply is down 29% year-over-year, marking its slowest start since 2018.

In focus

Munis see unusually high new issuance

The municipal bond market underperformed to start last week, as significant new issuance and news of the sale of Silicon Valley Bank's balance sheet spurred investors to reposition portfolios to prepare for liquidity.

Municipal new issue supply is down 29% year-over-year, marking its slowest start since 2018. However, issuance swelled to $12 billion last week, which projects to an annual figure of approximately $600 billion. This level is nearly double the current pace of $304 billion. Issuance was coupled with news that the FDIC is facilitating the sale of Silicon Valley Bank's municipal balance sheet, estimated to be worth $6.5 billion.

This market liquidity came despite municipals trading richer versus Treasuries. Given this confluence, municipals sold off drastically to start last week, moving closer to historic averages relative to Treasuries. Monday's decline was the largest since October. However, municipals strengthened toward the end of the week with back to back positive days.

We anticipate pockets of issuance to periodically offer attractive investment opportunities. But we believe issuance will remain relatively constrained, and this does not change our outlook for municipals moving forward. With the U.S. Federal Reserve nearing a pause in rate hikes and the economy showing signs of softening, we continue to see short-term mispricing as a potential buying opportunity.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.18	0.08	0.16	-0.25
5-year	3.67	0.06	0.09	-0.34
10-year	3.57	0.06	0.10	-0.30
30-year	3.78	0.04	0.13	-0.19

Source: Bloomberg L.P., 21 Apr 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	2.56	0.33	0.18	-0.04
5-year	2.36	0.28	0.14	-0.16
10-year	2.36	0.26	0.09	-0.27
30-year	3.40	0.22	0.10	-0.18

Source: Bloomberg L.P., 21 Apr 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	66
30-year AAA Municipal vs Treasury	90
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 21 Apr 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[5]	3.37	–	6.10	-1.36	-0.34	2.43
High yield municipal	5.73	255[1]	7.68	-1.51	-0.09	2.64
Short duration high yield municipal[2]	5.37	309	3.94	-0.60	0.13	2.35
Taxable municipal	4.84	105[3]	8.25	-0.20	-0.10	5.11
U.S. aggregate bond	4.47	55[3]	6.32	-0.23	-0.22	2.73
U.S. Treasury	3.92	–	6.25	-0.25	-0.34	2.66
U.S. government related	4.51	56[3]	5.35	-0.26	-0.09	2.79
U.S. corporate investment grade	5.20	133[3]	7.20	-0.22	-0.10	3.40
U.S. mortgage-backed securities	4.58	63[3]	5.99	-0.21	-0.21	2.31
U.S. commercial mortgage-backed securities	5.25	139[3]	4.52	-0.14	0.07	1.88
U.S. asset-backed securities	5.03	82[3]	2.80	0.01	0.07	1.93
Preferred securities	7.17	255[3]	4.54	0.46	1.75	3.28
High yield 2% issuer capped	8.57	449[3]	3.64	-0.33	0.52	4.10
Senior loans[4]	9.88	595	0.25	0.19	0.89	4.03
Global emerging markets	7.40	353[3]	6.21	-0.75	-0.33	1.82
Global aggregate (unhedged)	3.62	52[3]	6.79	-0.51	-0.30	2.70

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, 21 Apr 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, 21 Apr 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 19 Apr 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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