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Weekly Fixed Income Commentary

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Treasury yields march generally higher

10-year U.S. Treasury yields rose again, though shorter yields declined. U.S. core PCE inflation came in close to expectations, but still showed an impressive deceleration. Markets continue to price in a more benign near-term U.S. Federal Reserve outlook.

HIGHLIGHTS

- **Total returns were broadly negative last week, including Treasuries, investment grade and high yield corporates, taxable munis, MBS, preferreds, senior loans and emerging markets.**

- **Municipal bond yields increased substantially. New issue supply was $8.3B with outflows of -$1.2B. This week's new issuance is $8.0B.**

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Watchlist

- *10-year U.S. Treasury yields increased, but we anticipate modest declines over the rest of 2023.*
- *Spread assets underperformed Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" rates remains as a theme, as central banks battle 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 business investment. This combination should keep corporate defaults low.

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.

INVESTMENT GRADE CORPORATE YIELDS TOP 6% WITH MUTED SPREADS

U.S. Treasury yields continued to rise last week, with the 10-year yield ending 14 basis points (bps) higher at 4.57%. The selloff was even steeper in the first part of the week, before relatively supportive inflation data on Friday helped the 10-year yield fall -11 bps from the intra-week highs. Core PCE inflation on Friday came in at 3.9% year-over-year, close to expectations but still an impressive deceleration from the recent pace. That was the first sub-4% print in more than two years. As a result, markets continue to price in a more benign near-term Fed outlook, including only 40% odds of another rate hike. That dynamic helped the more policy-sensitive 2-year Treasury yield rally -7 bps for the week.

Investment grade corporates sold off, returning -1.18% for the week and lagging similar-duration Treasuries by -28 bps. Overall yield levels for the investment grade index moved above 6% for the first time in almost a year. However, spread levels remain much more muted than a year ago, around 120 bps versus 160 bps last fall. Despite the selloff, the new issue market remained healthy, with 11 issuers bringing almost $20 billion of new supply for the week. For September, new issuance totaled $120 billion, though that pace is expected to slow to around $80 billion in October.

High yield corporates weakened, returning -0.43% for the week and underperforming similar-duration Treasuries by -31 bps. Senior loans returned -0.11%, the asset class's first weekly selloff after 17 straight weeks of gains. Over that streak of gains, the loan asset class returned 5.9%. Loans also reverted to outflows for the first time in five weeks, with -$356 million exiting the asset class. High yield funds saw bigger outflows of -$2.4 billion. Meanwhile, the new issue market remained active, with $4 and $10 billion pricing in high yield and loans, respectively.

Emerging markets sold off as well, returning -0.99% for the week and lagging similar-duration Treasuries by -30 bps. Within sovereigns, spreads widened materially, 11 bps for investment grade names and 32 bps for high yield. Outflows also picked up, with -$1.4 billion exiting the hard currency asset class.

MUNI MARKET CHOPPINESS EXPECTED TO CONTINUE

Municipal bond yields rose substantially across the curve last week. Most new issue deals were well received, and fund flows were negative yet again. This week's new issue calendar should be priced at levels that will clear the market.

We expect choppiness in the municipal bond market through the end of the year. Munis were expensive versus taxable bonds at the beginning of the year, but that richness is receding mainly due to plentiful new issue supply and muted demand.

Municipal bond investors may consider executing tax swaps to increase income from current holdings. Also, muni yields are generally cheap. Risk averse investors may remain short and earn a 4% tax-exempt yield. The flat yield curve provides the same 4% yield through the midpoint. Long-term investors may purchase 30-year bonds at 5%. We believe these yields will look attractive some time in 2024.

Texas Water Development Board issued $1 billion state water revenue bonds (rated NR/AAA). The deal was well-received and some bonds traded at a premium from where they were issued. For example, 5% coupon bonds due in 2035 came at a yield of 3.79% and traded in the secondary market at 3.77%.

The Bloomberg High Yield Municipal Bond Index average yield stands at 6.25%, an increase of 44 bps year-to-date. Outflows totaled -$365 million last week, taking year-to-date flows into negative territory at -$240 million. The Brightline commuter rail deal last week was modestly oversubscribed. We are tracking only 4 new deals for this week, and we expect investors to be focused on yield opportunities in the secondary market. For example, Buckeye Tobacco 5% coupon bonds briefly traded at 6.00% last week before tightening back to 5.94% on Friday.

Within emerging markets sovereigns, spreads widened materially last week.

In focus

Senior loans don't dread the Fed

Although many bond asset classes have struggled in 2023 due to the Fed's hawkish, inflation-fighting resolve, senior loans have been star performers.

Unlike most fixed income securities, senior loans don't pay a fixed interest rate. Instead, their coupon payments adjust at regular intervals to reflect changes in short-term rates. This has boosted returns during the Fed's hiking cycle and could continue to do so, given the central bank's intention to keep interest rates elevated as long as inflation remains above its 2% target.

Loans have advanced 9.9% year-to-date versus -1.2% for the broad investment grade Bloomberg U.S. Aggregate Bond Index, which has struggled amid rising interest rates. And since year-end 2021, loans have gained about 9.3% compared to -14% for the Bloomberg index. Aiding this outperformance has been loans' near-zero duration, making them less sensitive to rising rates than their fixed income counterparts. Retail investors have taken notice. Amid selloffs in the Treasury and equity markets, loan funds have seen inflows in five of the last seven weeks.

We believe active management is crucial in today's volatile environment, considering our expectation for rising default rates as the economy slows. We favor higher quality loans (issuers rated B+ and above), which offer healthy yields (about 9%) with less default risk than lower-rated issuers.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	September 2023	Year-to-date
2-year	5.05	-0.07	0.18	0.62
5-year	4.61	0.05	0.36	0.61
10-year	4.57	0.14	0.46	0.70
30-year	4.70	0.18	0.49	0.73

Source: Bloomberg L.P., 29 Sep 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	September 2023	Year-to-date
2-year	3.66	0.29	0.52	1.06
5-year	3.41	0.29	0.53	0.89
10-year	3.45	0.29	0.52	0.82
30-year	4.34	0.27	0.46	0.76

Source: Bloomberg L.P., 29 Sep 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	75
30-year AAA Municipal vs Treasury	92
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters, 29 Sep 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	September 2023	Year-to-date
Municipal	4.32	–	6.37	-1.53	-2.93	-1.38
High yield municipal	6.25	210[1]	7.93	-1.90	-3.40	0.00
Short duration high yield municipal[2]	5.96	256	4.32	-0.85	-1.44	2.27
Taxable municipal	5.59	84[3]	7.90	-1.01	-2.88	0.88
U.S. aggregate bond	5.39	52[3]	6.15	-0.96	-2.54	-1.21
U.S. Treasury	4.85	–	5.86	-0.64	-2.21	-1.52
U.S. government related	5.36	47[3]	5.07	-0.50	-1.85	0.35
U.S. corporate investment grade	6.04	121[3]	6.76	-1.18	-2.67	0.02
U.S. mortgage-backed securities	5.57	66[3]	6.42	-1.42	-3.19	-2.26
U.S. commercial mortgage-backed securities	6.12	130[3]	4.38	-0.22	-1.19	0.16
U.S. asset-backed securities	5.75	67[3]	2.65	-0.06	-0.43	1.99
Preferred securities	7.62	239[3]	4.73	-0.75	-1.14	2.65
High yield 2% issuer capped	8.90	396[3]	3.52	-0.43	-1.20	5.87
Senior loans[4]	10.11	551	0.25	-0.11	0.88	9.91
Global emerging markets	8.00	316[3]	5.89	-0.99	-2.28	0.91
Global aggregate (unhedged)	4.22	50[3]	6.56	-0.93	-2.92	-2.21

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 Sep 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, 29 Sep 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 27 Sep 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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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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