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Weekly Fixed Income Commentary

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# A dovish Fed pushes Treasury yields lower

*U.S. Treasury yields fell across the curve as U.S. economic data softened and U.S. Federal Reserve communications leaned dovish. Chair Powell said he wants to see "just a bit more evidence" that inflation is heading lower before cutting rates.*

## HIGHLIGHTS

- **Total returns were positive across the board, including Treasuries, investment grade and high yield corporates, MBS, preferreds, senior loans and emerging markets.**
- **Municipal bond yields also declined. New issue supply was $6.8B and fund inflows were $869M. This week's new issuance is expected to spike to $9.9B.**

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# *Watchlist*

- *The 10-year U.S. Treasury yield declined last week, and we expect yields to moderate over the course of the year.*
- *Spread assets generally gained and outpaced the rally in Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

## INVESTMENT VIEWS

**Rates have probably peaked for this cycle,** as attention pivots toward rate cuts in response to softer growth and easing inflation.

**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.

**Risk premiums may widen further,** with entry points for taxable fixed income likely to become more attractive over the coming quarters. Credit selection is key as we search for bonds with favorable income and solid fundamentals.

## KEY RISKS

- Inflation fails to continue moderating as expected, weighing on asset prices.
- Policymakers unsuccessfully juggle fighting inflation with supporting economies still struggling to gain traction.
- Geopolitical flare-ups intensify: Israel, China, Russia and Iran.

## INVESTMENT GRADE CORPORATE ISSUANCE REMAINS STRONG

**U.S. Treasury yields fell again last week,** with the 10-year yield down -11 basis points (bps) to 4.08%. The 2-year yield declined by a smaller magnitude, rallying -6 bps to 4.48%. The decline was driven by softer economic data and dovish comments from Fed Chair Powell. The ISM services survey showed slowing expansion and a worrying drop in the employment subcomponent. The official February jobs report also showed further softening. The headline job creation number beat expectations at 275,000, but that strength was offset by -167,000 in downward revisions to the prior two months. The unemployment rate rose to 3.9%, a new cycle high, while average hourly earnings growth slowed to 0.1% month-over-month, the slowest pace in two years.

**Investment grade corporates rallied,** returning 0.87% for the week and outpacing similar-duration Treasuries by 18 bps. Overall, the investment grade market saw $51.2 billion of new issuance, the third straight week where volumes outpaced expectations. Those deals were met with healthy demand and oversubscribed by an average of 4.9x. Overall, year-to-date supply is running 34% higher than the same period in 2023. Inflows have been strong, with $9.5 billion entering the asset class this week for the 19th straight week of inflows.

**High yield corporates gained,** returning 0.55% and beating similar-duration Treasuries by 19 bps. Senior loans returned 0.32% for the week. CLO issuance has picked up, boosting demand for loans trading at a discount and leading to outperformance for the lower-rated market segments. Inflows have provided another tailwind, with $347 million entering high yield funds and $497 million flowing into loan funds for the week. That helped address robust new issuance, with $7.6 billion pricing in high yield and $4.6 billion in loans.

**Emerging markets advanced,** returning 0.70% and outperforming similar-duration Treasuries by 9 bps. That was a deceleration after a few weeks of strong outperformance, as technicals turned less favorable. Hard currency funds had outflows of -$732 million, while local currency funds had outflows of -$679 million. Issuance picked up at $16.8 billion, almost all of it investment grade. The dollar weakened -1.1% for the week in response to the weaker data and more dovish Fed communications, which provided a tailwind to emerging markets. We expect this dynamic to continue as U.S. rates move lower.

## THE MUNICIPAL BOND MARKET WELCOMES A SPIKE IN ISSUANCE

**Municipal bond yields ended last week lower** in a quiet week. Both the short and long ends of the muni curve declined 2 bps. New issue supply was well received, and positive fund flows included exchange-traded fund inflows of $118 million. Investors are looking forward to this week's outsized supply so they can put cash on the sidelines back to work.

**The muni market story continues:** Tax-exempt munis are very rich compared to their taxable government counterparts, but outsized muni bond reinvestment demand continues to chase undersized new issue supply. That dynamic should change this week as the market welcomes a spike in new issuance.

**The New York City Municipal Water Finance Authority** issued $1.3 billion revenue bonds (rated Aa1/AA+). The deal was well received, and many maturities broke to a premium once the deal was free to trade. For example, 5% coupon bonds due in 2034 came at a yield of 2.63% and traded in the secondary market at 2.54%.

**High yield municipal credit spreads continued to contract last week** as fund flows are building back. The average yield of the high yield muni index decreased by -8 bps on average, compared to just -2 bps for high grade munis. Net fund inflows totaled $400 million last week, bringing the year-to-date high yield muni total to $3.95 billion, representing more than half of overall muni fund flows in 2024. This week's new issue calendar is expected to be exceptionally light. Only six deals are pricing, all from the land-secured sector. The cash component of the Energy Harbor transaction has settled and Vistra is planning to pay a monthly dividend on the new Vistra Vision equity.

***Inflows have provided another tailwind for high yield corporate bonds, helping to address robust new issuance.***

***In focus***

# *The ECB gets ready to ease*

*As expected, the European Central Bank (ECB) left interest rates on hold last week, maintaining its benchmark deposit rate at an all-time high of 4%. However, it signaled openness to cutting rates later this year, which we believe will take place in June.*

In her post-meeting press conference, ECB President Christine Lagarde stated that, "We are making good progress towards our inflation target and we are more confident as a result. But we are not sufficiently confident. We will know a little more in April, but we will know a lot more in June."

Recent data underscores this progress. Last month, the annual rate of headline inflation in the eurozone edged closer to the central bank's 2% target by slowing to 2.6%, while core inflation, which strips out food and energy prices, dipped to 3.1%. However, the ECB now expects core inflation to decline to 2% in the medium term, signaling confidence in further disinflation.

The ECB is not the only major central bank preaching patience. Last week, Fed Chair Jerome Powell noted that the Fed won't begin cutting rates "until it has gained greater confidence that inflation is moving is moving sustainably toward its 2% goal."

We also believe eurozone inflation will fall, particularly if energy prices stay low. And we're looking for  the ECB to begin cutting rates (by 25 bps) in June, with another 100 bps of easing by year-end, all while remaining data dependent.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | Month-to-date | Year-to-date |
| 2-year | 4.48 | -0.06 | -0.14 | 0.23 |
| 5-year | 4.05 | -0.11 | -0.20 | 0.20 |
| 10-year | 4.08 | -0.11 | -0.18 | 0.20 |
| 30-year | 4.25 | -0.07 | -0.13 | 0.23 |

Source: Bloomberg L.P., 08 Mar 2024. **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 | 2.71 | -0.02 | -0.03 | 0.19 |
| 5-year | 2.40 | -0.04 | -0.04 | 0.12 |
| 10-year | 2.40 | -0.06 | -0.06 | 0.12 |
| 30-year | 3.57 | -0.02 | -0.02 | 0.15 |

Source: Bloomberg L.P., 08 Mar 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 59 |
| 30-year AAA Municipal vs Treasury | 84 |
| High Yield Municipal vs High Yield Corporate | 71 |

Source: Bloomberg L.P., Thompson Reuters, 08 Mar 2024. 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 | 3.35 | – | 6.09 | 0.40 | 0.41 | 0.03 |
| High yield municipal | 5.49 | 224[1] | 6.96 | 0.81 | 0.88 | 1.20 |
| Short duration high yield municipal[2] | 5.12 | 274 | 3.64 | 0.41 | 0.46 | 1.73 |
| Taxable municipal | 4.93 | 66[3] | 7.97 | 0.94 | 1.52 | 0.33 |
| U.S. aggregate bond | 4.73 | 39[3] | 6.27 | 0.81 | 1.21 | -0.50 |
| U.S. Treasury | 4.29 | – | 6.13 | 0.63 | 1.01 | -0.60 |
| U.S. government related | 4.80 | 47[3] | 5.31 | 0.56 | 0.87 | -0.26 |
| U.S. corporate investment grade | 5.23 | 95[3] | 7.05 | 0.87 | 1.27 | -0.42 |
| U.S. mortgage-backed securities | 4.91 | 44[3] | 6.10 | 1.12 | 1.55 | -0.57 |
| U.S. commercial mortgage-backed securities | 5.26 | 101[3] | 4.34 | 0.59 | 0.96 | 0.90 |
| U.S. asset-backed securities | 5.07 | 55[3] | 2.63 | 0.28 | 0.48 | 0.67 |
| Preferred securities | 6.57 | 164[3] | 4.55 | 0.60 | 0.50 | 4.02 |
| High yield 2% issuer capped | 7.72 | 314[3] | 3.15 | 0.55 | 0.73 | 1.02 |
| Senior loans[4] | 9.12 | 508 | 0.25 | 0.32 | 0.37 | 2.05 |
| Global emerging markets | 7.12 | 283[3] | 6.08 | 0.70 | 0.96 | 0.77 |
| Global aggregate (unhedged) | 3.67 | 39[3] | 6.73 | 1.36 | 1.56 | -1.10 |

**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, 08 Mar 2024. **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, 08 Mar 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 06 Mar 2024.

**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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