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Weekly Fixed Income Commentary

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Treasury yields decline as markets assess policial discord

U.S. Treasury yields fell slightly last week, led by 2-year maturities. Political concerns weighed on market sentiment, and escalating U.S./China trade tensions and weakening consumer confidence data added to investor concerns. Market-based expectations declined for a Federal Reserve (Fed) rate cut in October.

HIGHLIGHTS

- **Investment grade corporates delivered the highest non-Treasury return, followed by commercial mortgage-backed and preferred securities.**
- **High yield municipal bond yields decreased last week, but less than for high grades.**
- **The global aggregate sector underperformed U.S. markets, as both the European and Asian regions posted negative total returns.**

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POLITICAL TURMOIL PUSHES U.S. TREASURY YIELDS LOWER

U.S. Treasury yields fell slightly last week as markets assessed the impact of additional political turmoil.[1] A modestly risk-adverse sentiment helped stoke demand for U.S. Treasuries early in the week, and rates fell quickly. Political discord fueled volatility, and Treasury rates rebounded to unchanged levels mid-week, only to fall throughout the remainder of the week.[1] Escalating U.S. trade tensions with China and weakening consumer confidence data added to investor concerns and helped support the move lower in interest rates. By the end of the week, all Treasury yields were several basis points lower, led by the 2-year maturity range.[1]

All non-Treasury sectors underperformed U.S. Treasuries, as political concerns weighed on market sentiment.[1] Only asset-backed securities marginally outperformed similar-duration Treasuries.[1] Falling yields generally supported positive total returns, with investment grade corporates delivering the highest non-Treasury return, followed by commercial mortgage-backed and preferred securities.[1] However, the worst performing sectors suffered negative total returns. High yield corporates posted the lowest return, joined by emerging markets and senior loans.[1] The global aggregate sector underperformed U.S. markets, as both the European and Asian regions posted negative total returns.[1]

Market-based expectations for a Fed rate cut at the October meeting declined to about 43% from 53%. However, the probability of a cut at the December meeting only declined slightly, falling to 73% from 76%.

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MUNICIPALS FACE MORE NEW SUPPLY THAN PROJECTED DEMAND

Municipal and U.S. Treasury bond prices closed last week slightly higher.[1] The new issue calendar was $8.3 billion, which was priced to sell and well received.[2] Fund flows continued to be positive for the 38th consecutive week at $1.64 billion.[3] The new issue calendar is expected to be priced to sell and should be well received. Fund flows now total $68.4 billion year to date, the largest the industry has ever experienced.[3]

Fixed income in general remains fundamentally sound, as we don't see signs of inflation. Fixed income has sold off recently from all time low yields, as some investors chose to take profits. The municipal market is solid, but continues to face more new issue supply than projected demand (through bond calls.) We believe this supply and demand imbalance will continue through year end, so municipals should continue to trade somewhat cheaply. However, we expect rates will be lower for longer, and we would see any weakness as a buying opportunity.

The New Jersey Transportation Trust Fund Authority issued $1 billion of bonds (rated Baa1/BBB+).[4] The deal was well received, and underwriters raised the amount of issuance from the originally planned $800 million and lowered some yields upon final pricing. The New Jersey deal epitomizes what the municipal market wants: cheap, lower rated bonds that institutional managers can buy in size.

High yield municipal bond yields decreased last week, but less than for high grades, resulting in higher average credit spreads.[1] Spreads remain attractive and well above historical tights at +220 basis points (bps), on average.[1] Strong high yield municipal fund flows returned last week, keeping the strength of demand intact.[3] New issuance remains high in terms of the number of deals, but constrained in volume.[2] Puerto Rico's Oversight Board formally proposed a plan of adjustment for Commonwealth and other claims, including pensioners. With wide ranging and conflicting recoveries, the plan will highly likely spark litigation among creditors.

RISK-OFF TONE FAVORS INVESTMENT GRADE OVER HIGH YIELD CORPORATES

High yield corporate bonds struggled in last week's risk-off environment.[1] The asset class posted a loss for the first time in six weeks, as equity volatility fed through to other risk assets.[1] High yield spreads widened by 18 bps, and trading volumes were light.[1] Fund flows were modestly negative.[3] In keeping with recent trends, higher quality credits (BB and B) fared better than their lower rated counterparts.[1]

Investment grade corporates stayed positive for the second week in a row, extending their rebound from sharp mid-month losses.[1] Trading was choppy, in part reflecting the week's political headlines, but overall spreads were just 1 bps wider.[1] New supply was well below market expectations while demand was healthy, evidenced by $1+ billion of net flows into investment grade funds.[2,3] On a sector basis, technology, media and telecom performed best, while Yankee banks and energy lagged the most.[1]

Flows into emerging markets bonds exceeded $1 billion.

Emerging markets (EM) debt finished in the red for only the fourth time in the past 13 weeks, with the launch of the Trump impeachment inquiry adding more uncertainty to the U.S./China trade saga.[1] EM sovereign spreads widened by 14 bps, led by weakness in sub-Saharan Africa, the Middle East and Latin America.[1] Flows into EM bond funds exceeded $1 billion, with the lion's share going to hard-currency strategies.[3]

In focus

Red flags in the corporate credit market?

Lately we are often asked, "Are you seeing red flags in the credit market?" While certain data points might imply that the credit market is getting overheated, we believe overall fundamentals are fairly balanced in this late cycle environment.

Within the high yield market, new volumes of lower rated debt, such as CCC, have consistently declined in recent years. The number of so-called PIK toggle bonds, an aggressive structure found on high yield bonds, have ticked up recently, but levels remain well below historical norms.

The senior loan market is seeing fewer second-lien loans come to market. And dividend deals, where debt is issued to pay a dividend to equity holders, are down as well. Leveraged buyout debt also remains low, another good thing for investors.

However, while difficult to quantity, credit agreements are clearly getting more aggressive in certain new transactions, reminding us that investors will reach for yield late in the cycle. As a result, while we don't necessarily see many glaring red flags, credit selection is becoming more critical in today's market. It pays to know what you own.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	1.63	-0.05	0.13	-0.86
5-year	1.56	-0.04	0.18	-0.95
10-year	1.68	-0.04	0.19	-1.00
30-year	2.13	-0.03	0.17	-0.89

Source: Bloomberg L.P. As of 27 Sep 2019. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.22	-0.03	0.21	-0.56
5-year	1.23	-0.05	0.20	-0.71
10-year	1.42	-0.05	0.20	-0.86
30-year	2.01	-0.06	0.17	-1.01

Source: Bloomberg L.P. As of 27 Sep 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	84
30-year AAA Municipal vs Treasury	94
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters. As of 27 Sep 2019. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	1.86	–	5.20	0.28	-0.82	6.73
High Yield Municipal	4.06	223[5]	6.72	0.32	-0.24	9.65
Short Duration High Yield Municipal[6]	3.51	224	3.40	0.11	-0.07	6.18
U.S. Aggregate Bond	2.27	47[7]	5.79	0.37	-0.58	8.47
U.S. Treasury	1.72	–	6.60	0.54	-0.87	7.69
U.S. Government Related	2.36	63[7]	5.78	0.25	-0.65	8.73
U.S. Corporate Investment Grade	2.92	115[7]	7.83	0.45	-0.70	13.14
U.S. Mortgage-Backed Securities	2.48	48[7]	2.78	0.09	-0.01	5.51
U.S. Commercial Mortgage-Backed Securities	2.32	69[7]	5.26	0.35	-0.69	8.63
U.S. Asset-Backed Securities	2.04	36[7]	2.22	0.19	-0.16	4.11
Preferred Securities	3.08	110[7]	4.30	0.34	0.66	15.78
High Yield 2% Issuer Capped	5.68	377[7]	3.08	-0.32	0.37	11.42
Senior Loans[8]	6.31	478	0.25	-0.06	0.38	6.35
Global Emerging Markets	4.96	324[7]	6.16	-0.12	0.04	10.79
Global Aggregate (unhedged)	1.30	44[7]	7.20	0.10	-0.91	6.43

5 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **6** 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. **7** Option-adjusted spread to Treasuries. **8** 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. As of 27 Sep 2019. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. 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. All indices are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 27 Sep 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 25 Sep 2019.

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.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

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A word on risk

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 advisor regarding the suitability 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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