nuveen
A TIAA Company

Weekly Fixed Income Commentary

12 March 2018

Treasury yields vary over global trade concerns and strong employment data

U.S. Treasury yields fluctuated late last week as investors focused on new trade tariffs and a stronger-than-expected employment report. The announcement of new steel and aluminum tariffs caused a risk-off sentiment, pushing yields lower. Meanwhile, a strong jobs report drove rates higher, led by 10-year maturities.

HIGHLIGHTS

- **Risk-friendly market sentiment benefited preferreds and high yield corporates, but not investment grade corporates.**
- **Demand for municipal bonds remains tepid. This situation could persist for the next few weeks.**
- **Emerging market debt eked out gains, despite some challenges.**

A STRONG EMPLOYMENT REPORT LIFTS YIELDS MODESTLY HIGHER

Yields were little changed early last week, ahead of President Trump's tariff announcement on Thursday and Friday's payroll report.[1] The announcement pushed Treasury yields lower, as the specter of a trade war weighed on markets.[1] Friday's strong labor market data propelled rates higher, led by the 10-year maturity range.[1] February's employment report showed 100,000 more jobs than expected were added, but wage inflation was muted. The market saw no reason to alter expectations for Federal Reserve (Fed) policy and shorter maturity rates were little changed.[1]

Domestic non-Treasury total returns fell further into negative territory for the year for all sectors except high yield corporates and preferred securities.[1] The risk-friendly market sentiment benefited preferred and high yield, but investment grade corporates did not enjoy the same support.[1] Within the investment grade corporate universe, the longer duration utility sector suffered the most as longer maturity yields led the weekly increase.[1] Investment grade corporate spreads widened steadily throughout February, a trend that has carried into March.[1] The Global Aggregate Index produced the lowest total return across sectors last week, as the Asian Pacific region posted weak returns.[1]

Ongoing strength in the U.S. labor markets should keep the Fed on pace for three rate increases in 2018. If inflationary data does not show a significant increase, there would be little reason to accelerate normalization of interest rate policy. Tuesday's CPI report could provide useful insight as to the Fed's progress toward its inflation target. We are focusing on earning income using bottom-up selection opportunities within the credit-related sectors to drive returns.

Recent softness in the municipal market can be explained by the timeless equation of supply and demand.

HIGH YIELD MUNICIPAL FUND FLOWS TURN POSITIVE

Municipal bond prices were steady last week, until Friday's selloff in reaction to positive employment data.[1] New issue supply ticked up to $8.6 billion and was well received.[2] Weekly fund flows were $407 million.[3] This week's new issue supply calendar is expected to be $6.3 billion and should be readily absorbed.[2]

Recent softness in the municipal market can be explained by the timeless equation of supply and demand. While new issue supply has been low in 2018, several institutions are filling this void by selling large lists of bonds into the secondary market.[2] Demand is muted, as high grade municipals remain expensive compared to Treasuries.[1] Tepid demand may continue over the next few weeks as we enter the part of the year when investors focus on paying taxes rather than investing in tax-exempt bonds.

The state of California issued $2.2 billion of general obligation bonds (rated Aa3/AA-).[4] The deal was priced to sell and oversubscribed. The bonds held their value after Friday's employment data that softened demand for fixed income in general.

The employment report was good for risk assets. Credit spreads continue to contract in the face of upward pressure on yields, just as they have tended to do historically.[1] High yield municipal bond fund flows turned positive at $128 million,[3] while new issue supply remained very light.[2] We would like to see another week or two of positive flows before believing that the trend will continue.

Dealer selling activity appears to be subsiding.[2] Dealers are actively buying bonds again, highlighting the attractiveness of the long municipal-to-Treasury ratio. The current level of 97% may allow for outperformance if the historical supply shock affects relative valuations. Over time, we expect this ratio to decline. We consider near-term pressures like outflows and dealer selling activity to be transitory.

HIGH YIELD CORPORATE AND EMERGING MARKET BONDS OVERCOME HEADWINDS

High yield corporate bonds proved resilient in the face of rising Treasury yields, a sharp increase in new supply and continued outflows.[1] Sector returns were mostly positive, led by broadcasters, telecom and aerospace.[1] From a quality perspective, lower-rated issues (CCC) were the best performers, followed by Bs and BBs.[1]

High yield corporates saw the busiest week of the year in terms of new issuance, with 14 deals totaling $9.1 billion coming to market.[2] Meanwhile, the asset class marked its eighth consecutive week of outflows, albeit at a slightly slower pace.[3]

Investment grade credit continued to underperform amid further spread widening and volatile trading conditions.[1] New issuance was heavy, with investors clearly focused on major bond deals to fund merger and acquisition activity in the health care sector.[2] In the secondary market, trading flows were robust across all sectors.

High yield corporates saw the busiest week of the year for new issuance.

Emerging market debt eked out a gain, despite some challenges.[1] Although the midweek resignation of trade-friendly White House economic adviser Gary Cohn weighed on markets, emerging markets enjoyed a small relief rally heading into the weekend.[1] Support came from Friday's strong U.S. payrolls data, unexpected optimism about tensions between the U.S. and North Korea and some calming of recent tariff worries.

In focus

Fixed income may help manage volatility

As the U.S. transitions to less central bank accommodation, fixed income markets will likely experience increased volatility. Several investment strategies may help reduce the effects of price fluctuations.

Broadly flexible mutual fund mandates and separately managed accounts have characteristics that may make them attractive to investors in uncertain times.

A fund that invests in multiple sectors may have a distinct advantage if market dynamics shift rapidly, with changes predominately affecting a single sector.

As changing prices drive investor flows in or out of a particular sector, a broader fund can shift its allocation to capitalize on changes in relative valuations. The fund avoids being forced to sell into weakness or buy into strength.

Investing in a separately managed account gives the investor more control over buying and selling. For example, even if the account invests in a single sector that is suffering price declines and outflows, the investor does not have to sell.

Despite potential price declines, the investor may hold these bonds until maturity, mitigating the effect of the interim price fluctuation.

U.S. Treasury market

		% Change		
Maturity	Yield	Week	Month-to-Date	Year-to-Date
2-year	2.26	0.02	0.01	0.38
5-year	2.65	0.02	0.01	0.44
10-year	2.90	0.03	0.03	0.49
30-year	3.16	0.02	0.03	0.42

Source: Bloomberg L.P. As of 9 Mar 2018. **Past performance is no guarantee of future results.**

Municipal market

		% Change		
Maturity	Yield to Worst	Week	Month-to-Date	Year-to-Date
2-year	1.56	0.05	0.04	0.00
5-year	1.98	0.02	0.01	0.30
10-year	2.49	0.04	0.02	0.51
30-year	3.07	0.04	0.01	0.53

Source: Bloomberg L.P. As of 9 Mar 2018. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	86
30-year AAA Municipal vs Treasury	97
High Yield Municipal vs High Yield Corporate	87

Source: Bloomberg L.P., Thompson Reuters. As of 9 Mar 2018. 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	2.68	–	6.22	-0.05	0.01	-1.46
High Yield Municipal	5.37	243[5]	8.74	-0.06	0.14	-0.73
High Yield Municipal, ex Puerto Rico	5.26	232[5]	7.32	-0.06	0.14	-0.77
Short Duration High Yield Municipal[6]	4.78	259	3.75	0.02	0.13	0.71
Short Duration High Yield Municipal, ex Puerto Rico[6]	4.50	231	3.66	0.00	0.12	0.33
U.S. Aggregate Bond	3.18	38[7]	6.13	-0.12	-0.13	-2.22
U.S. Treasury	2.63	–	6.09	-0.12	-0.04	-2.15
U.S. Government Related	3.15	54[7]	5.41	-0.06	-0.04	-1.63
U.S. Corporate Investment Grade	3.78	101[7]	7.45	-0.15	-0.41	-2.96
U.S. Mortgage-Backed Securities	3.38	26[7]	5.30	-0.08	-0.02	-1.84
U.S. Commercial Mortgage-Backed Securities	3.35	63[7]	5.38	-0.34	-0.19	-1.88
U.S. Asset-Backed Securities	2.78	48[7]	2.10	-0.11	0.00	-0.56
Preferred Securities	3.38	62[7]	4.74	0.24	0.17	-0.89
High Yield 2% Issuer Capped	6.14	336[7]	4.07	0.35	-0.15	-0.40
Global Emerging Markets	4.95	225[7]	5.81	0.07	-0.11	-1.64
Global Aggregate (unhedged)	1.89	36[7]	7.11	-0.19	0.25	0.55

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.

Source: Morningstar Direct, Bloomberg L.P. As of 9 Mar 2018. **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, 9 Mar 2018. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 7 Mar 2018.

Any reference to municipal 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. **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. **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%.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy or sell securities, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her advisors.

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. Institutional and retail managed accounts and mutual funds have differences, including the impact of fees, which may affect performance when evaluating investment products.

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.

This information represents the opinion of Nuveen, LLC and its affiliates and is not intended to be a forecast of future events and or guarantee of any future result. Information was obtained from third party sources which we believe to be reliable but are not guaranteed as to their accuracy or completeness. There is no assurance that an investment will provide positive performance over any period of time.

The investment advisory services, strategies and expertise of TIAA Investments, a division of Nuveen, are provided by Teachers Advisors, LLC and TIAA-CREF Investment Management, LLC. Nuveen Asset Management, LLC is a registered investment adviser and affiliate of Nuveen, LLC.