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Weekly Fixed Income Commentary

1 June 2020

Treasury yields mixed despite social turmoil

Long U.S. Treasury yields ended last week slightly higher, while shorter-maturity yields finished lower. Longer maturities responded mainly to risk-friendly developments over the Memorial Day weekend. The Federal Reserve (Fed) is not expected to change rates at its June 10 meeting.

HIGHLIGHTS

- **High yield corporates led total returns, closely followed by senior loans.**
- **The municipal market continued to rally.**
- **The global aggregate index outpaced U.S. markets, again boosted by strong returns in Europe.**

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TREASURY YIELDS ARE MIXED IN A HOLIDAY WEEK

The U.S. Treasury market was relatively quiet last week, despite widespread social turmoil. Only the 30- and 20-year Treasuries experienced a daily change of more than 4 basis points (bps).[1] Their largest move occurred on Monday, as rates rose in response to risk-friendly developments over the long weekend. These yields closed the week slightly higher, while shorter maturities finished lower.[1] Treasury markets struggled to digest the ever-increasing supply, as auctions for 5- and 7-year notes, and several T-bills, showed weak investor demand.[1]

Non-Treasury sectors continued their strong Fed-supported recovery last week and throughout May.[1] High yield corporates led the way, closely followed by senior loans.[1] The highest-risk sectors have rebounded significantly since bottoming in late March.[1] For April and May combined, preferred securities and high yield corporates have returned more than 9%, senior loans have a total return above 8% and emerging markets have delivered in excess of 7%.[1] However, devastating performance in March has kept total returns negative for the year for all four sectors.[1] All sectors still trail similar-duration Treasuries in 2020, although second quarter-to-date performance has recovered approximately half of the underperformance.[1] The global aggregate sector outpaced U.S. markets, as European debt outperformed again.

The Fed is entering its communications blackout period ahead of the June 10 meeting. Market-based probabilities reflect no change in interest rate policy, but continue to expect a move into negative rates in September. We think this is extremely unlikely.

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HIGH GRADE MUNICIPAL MARKET FULLY RECOVERS

The municipal market continued to rally last week.[1] New issue supply of $4.1 billion was well received.[2] Fund flows were positive once again at $1.1 billion.[3] This week's new issue supply is expected to be $7.6 billion ($3 billion taxable).[2]

High grade municipal bond prices have now recovered completely from the selloff caused by the coronavirus pandemic. In fact, the municipal yield curve from 1 to 5 years sits at an all-time low and the 10-year bond yield remains only 6 bps above its all-time low.[1] The Fed has been instrumental this recovery effort. Chairman Powell lowered short-term rates to zero and pledged they will stay there until the markets – including municipals – recover. With short-term rates at zero, investors are forced to take risk by either investing further out on the yield curve or adding credit risk. We expect the municipal market to continue with a good tone. The upcoming June and July supply/demand dynamics bode well for stable bond prices.

The territory of Guam issued $134 million water and wastewater system revenue bonds (rated Baa2/A-).[4] In the secondary market, the 30-year maturity, which came as 5% coupons at a 4%yield, traded up 26 bps to 3.74%.

High yield still lags high grade, but high yield continues to grind richer. Consider State of Illinois bonds. As recently as a month ago, many thought it would require a 6% yield for the state to access the debt markets. It actually issued 5.75% bonds at a 5.85 % yield a few weeks ago. That same term was being bid at 5% for a 5 million bond block as of Friday's close.[1] Thus high yield State of Illinois bonds are nearly 100 bps richer than where it was thought they would be to clear the market only three weeks ago.

High yield municipal bond fund flows remained positive last week as the early signs of a recovery rally become more entrenched.[3] Yields decreased on average.[1] Investors continue to build a consensus that credit spreads are too wide, and projections of heavy reinvestment flows in June and July are encouraging demand.

EM DEBT CAPS A WINNING MONTH WITH ANOTHER WEEK OF GAINS

Emerging markets (EM) debt extended its winning streak to five weeks, bringing its total return for May to 4.6%.[1] Corporates and high yield sovereigns led last week's gains.[1] A pickup in headline risk around U.S./China relations slightly tempered EM fund flows, but President Trump's Friday afternoon press conference regarding Hong Kong and the World Health Organization turned out to be a non-event, as no concrete measures were announced.

High yield corporate bonds led all fixed income categories for the second consecutive week.[1] The asset class was supported by a strong risk-on market tone, continued spread tightening (-42 bps) and robust inflows (+$6.3 billion), Fed purchases of corporate bond ETFs and broader participation in the high yield rally by sectors that lagged during the downturn—transportation, energy, autos, leisure/lodging and gaming.[1] Within high yield, lower-rated (CCC) credits outperformed higher-quality (B and BB) securities last week.[1]

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Investment grade corporates trailed their high yield counterparts, but nonetheless generated solid results for the week.[1] Favorable sentiment was fueled by the gradual reopening of economies, continued positive fund flows, moderating supply growth after months of record-setting new issuance, the Fed's buying of credit ETFs and ongoing Asian demand for U.S. credit. Additionally, ratings downgrades for investment grade bonds slowed from $260 billion in March to slightly more than $100 billion in both April and May.[1]

In focus

Fed intervention buoys high quality sectors

Since the equity market low on 23 March, Fed intervention has helped stabilize fixed income markets, allowing many sectors to rebound substantially. The Fed's initiatives give the central bank the ability to purchase unlimited Treasuries, agency mortgage-backed securities (MBS) and select other assets. Other broader market support programs, such as buying corporates and funding securitized asset purchases, have only just begun.

The magnitude of the Fed's buying is astounding. It began purchasing $75 billion Treasuries each day in the first week of the program. It has since tapered to $5 billion per day, but since 11 March it holds more than $1.5 trillion additional Treasuries. Agency MBS purchases total more than $650 billion.

As a result, the highest quality fixed income sectors – such as U.S. Treasuries, U.S. agencies and agency MBS – have appreciated the most year to date, benefiting from both the direct purchase programs and rate cuts. This leaves little yield to generate future returns.

With yields so low, any upward rate pressure could result in price declines. While high quality sectors can provide relative portfolio stability, investors looking for income or total return may want to consider sectors outside of Treasuries and agency MBS.

Data source: Federal Reserve Bank of St. Louis.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	May 2020	Year-to-date
2-year	0.16	-0.01	-0.03	-1.41
5-year	0.30	-0.03	-0.06	-1.39
10-year	0.65	-0.01	0.01	-1.27
30-year	1.41	0.04	0.12	-0.98

Source: Bloomberg L.P. As of 29 May 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	May 2020	Year-to-date
2-year	0.16	-0.02	-0.75	-0.88
5-year	0.38	-0.03	-0.71	-0.71
10-year	0.84	0.00	-0.62	-0.60
30-year	1.65	0.00	-0.63	-0.44

Source: Bloomberg L.P. As of 29 May 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	129
30-year AAA Municipal vs Treasury	117
High Yield Municipal vs High Yield Corporate	76

Source: Bloomberg L.P., Thompson Reuters. As of 29 May 2020. 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	May 2020	Year-to-date
Municipal	1.61	–	5.67	0.22	3.18	1.24
High Yield Municipal	5.33	389[5]	10.81	0.88	4.08	-6.35
Short Duration High Yield Municipal[6]	4.65	404	4.22	0.42	1.50	-3.44
Taxable Municipal	2.72	191[7]	9.99	0.87	1.20	4.04
U.S. Aggregate Bond	1.34	76[7]	6.01	0.23	0.47	5.47
U.S. Treasury	0.51	–	7.15	-0.07	-0.25	8.61
U.S. Government Related	1.33	87[7]	5.92	0.42	1.56	2.98
U.S. Corporate Investment Grade	2.40	174[7]	8.43	0.73	1.56	3.00
U.S. Mortgage-Backed Securities	1.40	73[7]	2.15	0.11	0.12	3.60
U.S. Commercial Mortgage-Backed Securities	1.99	158[7]	5.33	0.33	1.06	3.51
U.S. Asset-Backed Securities	1.31	111[7]	2.12	0.30	1.09	2.23
Preferred Securities	3.80	275[7]	4.40	1.16	1.90	-2.82
High Yield 2% Issuer Capped	7.03	638[7]	3.75	1.79	4.37	-4.74
Senior Loans[8]	7.63	734	0.25	1.72	3.80	-6.02
Global Emerging Markets	5.06	448[7]	6.44	0.58	4.61	-2.85
Global Aggregate (unhedged)	1.01	65[7]	7.27	0.80	0.44	2.08

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 29 May 2020. **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 indexes are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 29 May 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 27 May 2020.

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 Taxable Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. **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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