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Weekly Fixed Income Commentary

22 June 2020

Treasury yields end virtually unchanged despite an active week

U.S. Treasury yields ended the week only slightly lower, masking the week's volatility.[1] Rates rose early in the week, led by longer maturities, when the Federal Reserve (Fed) announced it would begin purchasing individual corporate bonds. Growing investor concerns later in the week about a second COVID-19 outbreak erased earlier yield increases.

HIGHLIGHTS

- **Investment grade corporates enjoyed the highest return, on the heels of the Fed announcement.**
- **The municipal market was range bound last week, but ended with a constructive tone.**
- **The global aggregate index was slightly negative, dragged down by European bonds.**

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TREASURY RATES DIVERGE FROM RISK ASSETS

The modest change in Treasury yields last week masked intra-week volatility.[1] The week began on a positive note, with the Fed announcing purchases of individual corporate bonds in the secondary market. Rates drifted higher in response, led by longer maturities as risk assets rallied.[1] Growing concerns later in the week regarding a second COVID-19 outbreak damped market sentiment, pushing rates lower and erasing earlier increases.[1] The 30-year bond yield had risen more than 8 basis points (bps) to start the week before retracing the entire move to finish nearly unchanged.[1] The subsequent drop in rates more than offset earlier increases for all other maturities, led by the 10- to 20-year range.[1]

Risk assets diverged from the Treasury market and rallied throughout the week.[1] While investor worries caused Treasury rates to decline after peaking early in the week, non-Treasury sector spreads continued to tighten. All U.S. sectors produced positive total returns, except mortgage-backed securities, which suffered a negative return and underperformed similar-duration Treasuries.[1]

The investment grade corporate bond sector enjoyed the best performance on the heels of the Fed announcement.[1] The higher-risk sectors followed suit, and high yield corporates, preferred securities and emerging markets debt all delivered strong returns.[1] With the recent recovery, high yield corporates, senior loans and preferred securities all have double-digit returns for the second quarter. The global aggregate index endured a slightly negative weekly total return, as rising rates in the European region dragged on performance.[1]

High yield corporates, senior loans and preferred securities all have double-digit returns for the second quarter.

HIGH GRADE MUNICIPALS RECOVER FROM SELLOFF

The municipal market was range bound last week, but ended with a constructive tone.[1] New issue supply was $8.6 billion and was well received.[2] Fund flows were positive for the fifth consecutive week at $ 1.7 billion.[3] This week's new issue calendar will be lower at $8 billion ($2 billion taxable).[2]

The high grade municipal market has recovered from the selloff caused by the coronavirus pandemic. New issuance is robust and well received and the secondary market is actively traded. With the current supply/demand imbalance of net $52 billion of funds available to invest in the municipal market, this should bode well for trading over the next few months.[4]

High yield municipals continue to trail high grade bonds, but spreads are narrowing. Yields in general are very low, forcing investors to add risk to increase yield. Also, several federal programs are supporting municipal entities, including subsidies to municipalities directly affected by the pandemic and the Fed lending money directly to municipal borrowers through its Municipal Facility Liquidity Facility (MLF). We expect high yield spreads to continue compressing through the summer.

New York Urban Development Corporation issued $1.2 billion Personal Income Tax (PIT) revenue bonds (rated Aa1).[5] The deal was oversubscribed and underwriters lowered yields in some maturities before final pricing. In secondary trading, the 5s of 2042 traded in block size at 1.93% compared to an original yield of 2.00%.

The high yield municipal market saw positive fund flows for the fifth consecutive week.[3] Combined with heavy seasonal reinvestment cash flows, the market is saturated with strong demand. As a result, credit spreads continued to contract.[1] This seasonal strength is well entrenched, and we believe it should bode well for the market over the next few months.

CORPORATE CREDIT SECTORS GET A LIFT FROM THE FED

Investment grade corporate bonds extended their winning streak to six weeks, producing their highest weekly return since before Memorial Day.[1] Last week's performance was boosted by news that the Fed will begin implementing purchases of individual corporate bonds, as stipulated in its March quantitative easing announcement. Sector results were positive across the board, led by energy refiners. Overall, investment grade spreads narrowed by 13 basis points (bps) during the week, to 146 bps — below their 20-year average of 158 bps.[1]

High yield corporates rebounded from the prior week's drubbing, when they finished at the bottom of the fixed income pack.[1] A 9% jump in oil prices, combined with the Fed's bond-buying announcement (which includes fallen angels), created a favorable backdrop. The bulk of last week's gain came on Tuesday, as high yield performed in sync with rising U.S. equities and energy stocks in particular.[1] Spreads tightened by 31 bps during the week, and fund flows into the asset class exceeded $1 billion for the seventh week in a row.[1,3]

Investment grade corporate spreads narrowed by 13 basis points to 146, below their 20-year average of 158.

Emerging markets (EM) debt rallied after the previous week's nearly flat return.[1] The asset class has now delivered gains for eight consecutive weeks and 11 of the last 13, demonstrating resilience following steep declines in mid-March.[1] Last week's strong showing was led by sovereign debt, followed by corporates. EM local-currency markets declined, hampered in part by a stronger U.S. dollar.

In focus

The Fed keeps its promise

Last week the Fed announced it will begin buying individual investment-grade corporate bonds, fulfilling a pledge it made on 23 March at the height of market panic over the coronavirus pandemic. Adding high quality corporate debt to the Fed's quantitative easing (QE) toolbox is an unprecedented step.

Until now, the Fed has made a relatively modest investment ($7 billion) in exchange-traded funds (ETFs). The mere expectation that the Fed would purchase individual securities, however, has been enough to fuel a rally in credit markets, drive new bond issuance and lower corporate borrowing costs. Those costs should stay low with the Fed prepared to buy up to $750 billion of ETFs and individual bonds combined.

The Fed's portfolio of individual holdings will be based on a broad, diversified market index of U.S. corporate debt. Securities must be rated investment grade, but there is an exception for "fallen angels" — bonds downgraded to below-investment grade after 22 March (the day before the Fed unveiled its foray into corporate debt). All bonds must mature in five years or less.

This five-year time frame signals the Fed's awareness that easy monetary policy will be needed over a prolonged period. It's possible the Fed will still hold some of this debt on its balance sheet in 2025, long after (we hope) it has begun to raise interest rates amid an improving economy.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.19	-0.01	0.03	-1.38
5-year	0.33	0.00	0.02	-1.37
10-year	0.70	-0.01	0.04	-1.22
30-year	1.46	0.00	0.05	-0.93

Source: Bloomberg L.P. As of 19 Jun 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.27	0.03	0.11	-0.77
5-year	0.41	0.03	0.03	-0.68
10-year	0.88	0.03	0.04	-0.56
30-year	1.63	0.02	-0.02	-0.46

Source: Bloomberg L.P. As of 19 Jun 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	126
30-year AAA Municipal vs Treasury	111
High Yield Municipal vs High Yield Corporate	77

Source: Bloomberg L.P., Thompson Reuters. As of 19 Jun 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	Month-to-date	Year-to-date
Municipal	1.54	–	5.46	0.06	0.63	1.88
High Yield Municipal	4.94	351[6]	9.68	0.23	3.44	-3.13
Short Duration High Yield Municipal[7]	4.35	369	4.11	0.19	1.94	-1.57
Taxable Municipal	2.50	166[8]	10.03	0.67	1.98	6.10
U.S. Aggregate Bond	1.30	68[8]	6.09	0.20	0.43	5.92
U.S. Treasury	0.54	–	7.14	-0.04	-0.28	8.31
U.S. Government Related	1.31	80[8]	5.99	0.29	0.49	3.49
U.S. Corporate Investment Grade	2.16	146[8]	8.55	0.95	1.92	4.98
U.S. Mortgage-Backed Securities	1.46	75[8]	2.22	-0.25	-0.17	3.42
U.S. Commercial Mortgage-Backed Securities	1.78	134[8]	5.32	0.33	1.23	4.78
U.S. Asset-Backed Securities	0.90	70[8]	2.13	0.15	0.91	3.16
Preferred Securities	3.99	284[8]	4.49	0.73	0.84	-2.01
High Yield 2% Issuer Capped	6.45	580[8]	3.79	0.85	2.52	-2.34
Senior Loans[9]	6.85	657	0.25	0.28	2.41	-3.75
Global Emerging Markets	4.66	404[8]	6.53	0.75	2.42	-0.50
Global Aggregate (unhedged)	0.98	58[8]	7.34	-0.03	0.72	2.81

6 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **7** 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. **8** Option-adjusted spread to Treasuries. **9** 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 19 Jun 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, 19 Jun 2020. **3** Lipper Fund Flows. **4** Citigroup. **5** Market Insight, MMA Research, 17 Jun 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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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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