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Weekly Fixed Income Commentary

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Coronavirus concerns drive investors to Treasuries

Longer-term U.S. Treasury yields ended the week modestly lower, while shorter maturities closed unchanged or slightly higher.[1] *Markets continued to focus on coronavirus concerns, with fears that the dramatic rise in U.S. cases may be slowing economic activity. However, the cautious Treasury market sentiment was not consistent across all sectors, as risk assets fared well.*

HIGHLIGHTS

- **Taxable municipals and the investment grade corporates posted higher returns than Treasuries.**
- **Municipal bond prices rose, with heavy demand continuing.**
- **The global aggregate sector outperformed U.S. markets, as both the Europe and Asia produced solid returns.**

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CORONAVIRUS CONCERNS DRIVE LONG TREASURY YIELDS LOWER

Longer-maturity U.S. Treasury yields closed lower last week, while 2- to 5-year maturity yields were unchanged to slightly higher.[1] U.S. COVID-19 cases reached a daily record mid-week, driving investors to seek the safety of Treasury securities.[1] Investors are concerned that the rise in cases may be slowing economic activity. However, cautious Treasury market sentiment was not pervasive, as risk assets fared well and the U.S. dollar declined.[1] Investor worries largely resulted in falling long maturity rates since short maturities have little room to decline as they are already close to zero. The U.S. Treasury auctioned 3-, 10- and 30-year maturities totaling $94 billion, all of which were met with strong investor demand.[1]

Non-Treasury sectors enjoyed strong returns and solid relative performance last week.[1] Taxable municipals and investment grade corporate bonds were the only U.S. sectors to post higher weekly total returns than Treasuries, boosted by their relatively longer durations.[1] However, all non-government-related U.S. sectors outpaced similar-duration Treasuries.[1] Preferred securities and commercial mortgage-backed securities delivered the best duration-adjusted performance versus Treasuries.[1] July has been a strong month for credit-related sectors, with preferred securities, investment grade and high yield corporates producing total returns above 1%.[1] Emerging markets struggled last week, underperforming similar-duration Treasuries while still producing a positive total return.[1] The global aggregate sector outperformed U.S. markets, as both Europe and Asia produced solid returns.[1]

DEMAND CONTINUES FOR MUNICIPAL BONDS

Municipal bond prices rose last week, boosted by the rally in U.S. Treasuries.[1] New issuance was a robust $10.6 billion.[2] Fund flows were higher for the eighth consecutive week at $1 billion.[3] This week's new issue supply should approach $13.1 billion ($3.5 billion taxable).[2]

High grade municipals have shown a positive return this year, but have underperformed the strong rally in Treasuries and corporate bonds.[1] Federal Reserve intervention has supported all three asset classes by keeping interest rates low and actively buying government and corporate bonds, and municipals to a lesser extent. We expect municipal bond prices to be well bid through the summer. High grade municipals remain the cheapest fixed income asset class on a relative basis, and heavy demand continues.

Tulane University sold $189 million revenue bonds (rated A2/A).[4] By week's end, the 30-year bond with a 4% coupon traded in block size at 2.33% compared to an original yield of 2.44%. The market is betting that U.S. higher education institutions will successfully open in the fall.

High yield municipal bonds posted the second highest return for the month of May and the highest return for the month of June in more than 25 years.[1] The asset class has seen a net positive total return for July through September in 20 out of the last 25 years.[1] July 2020 is off to a good start, with positive returns across high yield municipal sectors. High yield municipal credit spreads remain elevated despite the recent strong performance.[1] New issuance remains subdued, which will continue to support the market bid for available secondary supply.[2]

High grade municipals remain the cheapest fixed income asset class.

U.S. CORPORATE CREDIT GAINS IN A SLOW SUMMER WEEK

Investment grade corporate bonds recorded the highest weekly return among non-municipal fixed income sectors.[1] It was a quiet week marked by lighter daily trading activity in the post-Fourth of July environment. Demand was healthy, with more than $7 billion flowing into investment grade funds, suggesting that the hunt for yield remains strong.[3] In the primary market, 17 issuers brought nearly $18 billion in new deals to market, beating street estimates.[2]

High yield corporates posted positive results last week, but lagged their investment grade counterparts.[1] Within high yield, higher quality (BB) bonds outperformed B and CCC rated credits.[1] Overall spreads were unchanged for the week, staying just below 600 bps.[1] Secondary trading volumes were below average every day, reflecting both less volatility and the onset of summer. Inflows exceeding $2 billion recouped some of the prior week's $5.6 billion in outflows.[3]

Within high yield, higher quality bonds outperformed B and CCC rated credits.

Emerging markets (EM) debt extended its winning streak to 11 weeks.[1] Returns were slight, however, as the recent surge in U.S. COVID-19 cases has called into question the speed and sustainability of the economic recovery. Among EM segments, corporates edged sovereign issues, while local-currency markets outperformed as the U.S. dollar weakened. At nearly $1.4 billion, flows into EM bond funds largely reversed the previous week's outflows.[3]

In focus

High yield sees inflows while loans see outflows

Senior loans and high yield corporate bonds have many similarities. They offer comparable yields and return potential at today's levels, with their main risk being corporate credit risk. In fact, many companies issue both types of bonds.

With limited duration, both asset classes tend to correlate positively with equities, negatively with traditional fixed income and very strongly with one another. It could be argued that loans and corporate high yield represent a single universe.

Investors, however, often view these asset classes differently, as demonstrated by recent differences in demand. Since the week ending 25 March, high yield funds have seen a staggering $50 billion in inflows, with assets in dedicated high yield funds standing at a six-year high.[5] Conversely, loans have seen -$22.3 billion in steady outflows this year.[5] Following 85 weeks in which loans saw just 5 weekly inflows, assets in loan mutual funds and ETFs stand at just $85 billion vs. $154 billion in October 2018.[5]

Why the difference in demand? Investors tend to look purely at rates when it comes to floating-rate funds. However, despite lower rates, loans may still complement high yield corporates in a diversified portfolio.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.16	0.00	0.01	-1.42
5-year	0.31	0.01	0.02	-1.39
10-year	0.65	-0.02	-0.01	-1.27
30-year	1.34	-0.09	-0.07	-1.05

Source: Bloomberg L.P. As of 10 Jul 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	0.24	-0.03	-0.03	-0.80
5-year	0.38	-0.03	-0.03	-0.71
10-year	0.81	-0.09	-0.09	-0.63
30-year	1.53	-0.10	-0.10	-0.56

Source: Bloomberg L.P. As of 10 Jul 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	125
30-year AAA Municipal vs Treasury	115
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters. As of 10 Jul 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	1.43	–	5.32	0.50	0.50	2.58
High Yield Municipal	4.78	345[6]	9.21	0.84	0.84	-1.82
Short Duration High Yield Municipal[7]	4.30	370	4.05	0.22	0.22	-1.05
Taxable Municipal	2.33	155[8]	10.05	0.82	0.83	8.02
U.S. Aggregate Bond	1.19	64[8]	6.09	0.42	0.54	6.71
U.S. Treasury	0.49	–	7.28	0.44	0.33	9.08
U.S. Government Related	1.23	78[8]	6.03	0.29	0.38	4.25
U.S. Corporate Investment Grade	2.06	143[8]	8.68	0.74	1.32	6.41
U.S. Mortgage-Backed Securities	1.24	63[8]	1.89	0.09	0.09	3.59
U.S. Commercial Mortgage-Backed Securities	1.65	126[8]	5.34	0.41	0.40	5.61
U.S. Asset-Backed Securities	0.82	66[8]	2.10	0.08	0.08	3.40
Preferred Securities	3.86	279[8]	4.43	0.43	1.02	-1.66
High Yield 2% Issuer Capped	6.59	598[8]	3.80	0.34	1.07	-2.80
Senior Loans[9]	6.89	666	0.25	0.35	0.57	-4.22
Global Emerging Markets	4.56	400[8]	6.59	0.26	0.78	0.35
Global Aggregate (unhedged)	0.92	56[8]	7.36	0.74	0.84	3.85

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 10 Jul 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, 10 Jul 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 8 Jul 2020. **5** Morningstar.

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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