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Weekly Fixed Income Commentary

19 October 2020

# Treasury yields fall due to rising coronavirus cases and stalled stimulus

*U.S. Treasury yields declined across the yield curve last week, led by longer maturities. Markets are concerned about rising COVID-19 case counts in the U.S. and Europe, stalemated U.S. fiscal stimulus negotiations and the pausing of several coronavirus drug and vaccine trials. Yields rose later in the week, however, on positive earnings and stronger-than-expected retail sales.*

## HIGHLIGHTS

- **Investment grade corporates performed best, followed by taxable municipals.**
- **Municipal bond prices remained essentially unchanged.**
- **The global aggregate and emerging markets sectors posted positive total returns, but underperformed similar-duration Treasuries.**

**Anders Persson**
*CIO of Global Fixed Income*

**John Miller**
*Head of Municipals*

## TREASURY RATES MOVE LOWER AS CORONAVIRUS CASES RISE AND STIMULUS STALLS

**U.S. Treasury yields declined across the curve last week,** led by longer maturities, with most of the decline occurring on Tuesday. Markets are concerned about rising COVID-19 case counts in the U.S. and Europe, stalemated U.S. fiscal stimulus negotiations and the pausing of various drug and vaccine trials. Treasury yields reversed slightly later in the week, responding to positive corporate earnings releases and stronger-than-expected September retail sales.

**All U.S. taxable sectors posted positive returns last week.** Investment grade corporates performed best, followed by taxable municipals. These sectors benefited from their longer relative durations, since longer Treasury yields declined the most last week. The relative return story was mixed, as only agencies, investment grade corporates and asset-backed securities outperformed similar-duration Treasuries. The investment grade corporate sector benefited from strong investor inflows from both the U.S. and Asia. The global aggregate and emerging markets sectors posted positive total returns, but underperformed similar-duration Treasuries. Emerging markets posted the weakest relative return, with both the sovereign and corporate sectors underperforming.

*The investment grade corporate sector benefited from strong investor inflows from both the U.S. and Asia.*

## MUNICIPAL NEW ISSUANCE CONTINUES TO BE OUTSIZED

**Municipal bond prices remained essentially unchanged last week.** Outsized new issue supply of $10.8 billion was priced to sell and well received. Fund flows remained positive for the second consecutive week at $614 million. This week's new issue supply should be extremely large at $20.6 billion ($10.1 taxable.)

**The municipal market continues to be range bound.** If Congress does not agree on another stimulus package, the market will likely remain within its current price band at least until after the presidential election. The new issue municipal market continues at a torrid pace, yet demand remains strong for both taxable and tax-exempt bonds. With tax-exempt bonds cheaper than their taxable U.S. Treasury counterparts, demand for municipals should remain strong.

**The Louisiana Public Facilities Authority** issued $385 million revenue bonds for the Ochsner Clinic (rated A3/A). There were 4% bonds in 2049 issued at a yield of 2.92%. Those same bonds traded in the secondary market at 2.84%, showing the continued need for higher yielding tax-exempt bonds.

**High yield municipal bond yields continue to tighten.** Despite mega deals like Brightline West, which was postponed for structural improvements, high yield new issuance is light compared to the massive amount of high grade issuance being rushed to market prior to the election. High yield fund flows were negative again last week at -$89 million after a positive $350 million the week before. Investors remain uncertain about the current economic and political environment. For longer-term, fundamentally driven investors, we believe current high yield municipal valuations represent potential opportunities. But credit selection remains key.

## INVESTMENT GRADE CORPORATES OUTPERFORM AS TECHNICALS REMAIN SUPPORTIVE

**Investment grade corporate bonds posted their highest weekly return since late July.** The asset class was supported by continued strong technicals, as fund flows ($6.4 billion) were positive for the 27th consecutive week and supply was muted, with only 10 issuers bringing a total of $14.9 billion in new deals to market. Average trading volumes were light and overall spreads essentially unchanged. The average investment grade yield closed the week below 2% for the first time in a month.

**High yield corporates, the prior week's top performer, finished near the bottom of the pack.** Coupon income was enough to overcome slightly negative price action, resulting in a modestly positive return for the week. The investment backdrop for high yield credit was mixed: equity markets were more volatile, but flows into high yield bond funds ($2.2 billion) remained favorable. Volatility in the sector could increase amid uncertainty about the U.S. election, fiscal stimulus, corporate earnings and economic data.

***Volatility in the high yield corporate sector could increase amid uncertainty.***

**Emerging markets (EM) debt recorded the week's smallest gain.** Fund flows (nearly $2 billion) were healthy, however, continuing a pickup that began early in the month. These flows have favored safer, more liquid, investment grade EM credits. The U.S. dollar strengthened against EM currencies last week, weighing on local-currency markets.

*In focus*

# *U.S. recovery: from a V to a lightning bolt?*

*We expect annualized third quarter GDP growth to come in at around 30% or possibly higher, bolstered by housing, consumer spending on goods and other segments of the U.S. economy that have fared well despite the ongoing pandemic. But with entire industries like travel and leisure still closed or operating well below capacity, such a heady pace of growth is unlikely to continue in the fourth quarter.*

In fact, it's possible GDP expansion could flatten out to about 0% at the end of the year, reflecting the likely failure of negotiators in Washington to deliver fiscal relief for businesses, states and individuals until after the November 3 election, and perhaps not until next year.

If it turns out a V-shaped recovery in the U.S. is no longer in progress, perhaps we should expect more of a lightning bolt shape, with high-growth periods in the third quarter of 2020 and the second quarter of 2021 bookending two low-growth quarters in between.

In such an environment, we would expect interest rates and inflation to remain subdued in the near term, with investors still challenged in their search for income. Potential solutions may include select opportunities within emerging markets debt, high grade and high yield municipal bonds, and investments emphasizing environmental, social and governance (ESG) factors.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | Month-to-date | Year-to-date |
| 2-year | 0.14 | -0.01 | 0.02 | -1.43 |
| 5-year | 0.32 | -0.02 | 0.04 | -1.37 |
| 10-year | 0.75 | -0.03 | 0.06 | -1.17 |
| 30-year | 1.53 | -0.04 | 0.07 | -0.86 |

Source: Bloomberg L.P. As of 16 Oct 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 | 0.16 | 0.01 | -0.03 | -0.88 |
| 5-year | 0.28 | -0.01 | -0.02 | -0.81 |
| 10-year | 0.94 | -0.01 | -0.07 | -0.50 |
| 30-year | 1.72 | -0.01 | -0.10 | -0.37 |

Source: Bloomberg L.P. As of 16 Oct 2020. **Past performance is no guarantee of future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 124 |
| 30-year AAA Municipal vs Treasury | 113 |
| High Yield Municipal vs High Yield Corporate | 86 |

Source: Bloomberg L.P., Thompson Reuters. As of 16 Oct 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 | 1.39 | – | 5.60 | 0.11 | -0.31 | 3.01 |
| High Yield Municipal | 4.56 | 306[1] | 9.15 | 0.41 | 0.12 | 0.49 |
| Short Duration High Yield Municipal[2] | 4.23 | 366 | 4.17 | 0.09 | 0.06 | 0.65 |
| Taxable Municipal | 2.27 | 141[3] | 10.09 | 0.31 | -0.52 | 8.40 |
| U.S. Aggregate Bond | 1.18 | 57[3] | 6.15 | 0.24 | 0.01 | 6.81 |
| U.S. Treasury | 0.53 | – | 7.27 | 0.25 | -0.40 | 8.47 |
| U.S. Government Related | 1.12 | 63[3] | 5.99 | 0.28 | 0.21 | 5.17 |
| U.S. Corporate Investment Grade | 1.96 | 125[3] | 8.74 | 0.46 | 0.59 | 7.27 |
| U.S. Mortgage-Backed Securities | 1.29 | 58[3] | 2.14 | 0.00 | -0.04 | 3.58 |
| U.S. Commercial Mortgage-Backed Securities | 1.47 | 105[3] | 5.28 | 0.11 | -0.11 | 6.86 |
| U.S. Asset-Backed Securities | 0.55 | 41[3] | 2.14 | 0.06 | 0.02 | 4.17 |
| Preferred Securities | 3.03 | 218[3] | 4.21 | 0.10 | 1.12 | 3.43 |
| High Yield 2% Issuer Capped | 5.34 | 472[3] | 3.66 | 0.05 | 1.41 | 1.98 |
| Senior Loans[4] | 5.89 | 565 | 0.25 | 0.06 | 0.51 | -0.32 |
| Global Emerging Markets | 3.95 | 332[3] | 6.81 | 0.02 | 1.00 | 2.96 |
| Global Aggregate (unhedged) | 0.88 | 47[3] | 7.41 | 0.10 | 0.46 | 6.21 |

**1** Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **2** 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. **3** Option-adjusted spread to Treasuries. **4** 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 16 Oct 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.

**Performance:** Bloomberg, L.P. **Issuance:** The Bond Buyer, 16 Oct 2020. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 14 Oct 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 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%.



### 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 appropriateness 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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