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Weekly Fixed Income Commentary

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Treasury yields hold steady as news is quiet

U.S. Treasury yields ended nearly flat last week and spread sectors broadly outperformed amid minimal economic news or fundamental changes. The minutes from the April Federal Reserve meeting sharpened concerns around the eventual tapering of asset purchases, but any policy change remains several months away.

HIGHLIGHTS

- **Investment grade corporates, structured investments and emerging markets generated positive returns and outperformed similar-duration Treasuries.**
- **The municipal bond market remained range bound. New issue supply was $9.4 billion, with flows of $725 million. This week's new issue supply is expected to be $7.0 billion.**
- **High yield corporates lagged amid heavy outflows from the asset class, but it remains the best-performing sector so far this year.**

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Watchlist

- *Treasury yields were flat last week, but we continue to anticipate further increases throughout 2021*
- *Spread assets were well-supported versus Treasuries, and strong growth should continue to support fundamentals moving forward*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. Investors remain focused on the eventual tapering of purchases, but we do not expect that to happen any time soon.

Unprecedented global fiscal stimulus should boost consumption and growth this year. First quarter GDP rose at a robust pace of 6.4%.

Record supply of investment grade corporates has been followed by high levels of issuance from high yield, middle market loans and the broadly syndicated loan market. Taxable municipal supply continues to grow.

We favor a risk-on stance, focused on credits with durable free cash flow and solid balance sheets across a wide range of sectors. Mid-quality rating segments remain particularly attractive. Essential service municipal credits also look compelling.

KEY RISKS

- Inflation rising in a disorderly way, forcing premature policy tightening.
- Further complications with the COVID-19 vaccine rollout.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.
- Policymakers become cautious or run out of stimulus capacity.

INVESTMENT GRADE SPREADS REMAIN STABLE

U.S. Treasury yields traded close to flat last week, with the long-end rallying 1-2 basis points (bps) and the front-end and middle rising close to 1 bp. 10-year yields rose as much as 6 basis points by mid-week, seeing their highest levels after the release of the minutes from the April Fed meeting. The minutes showed that several officials suggested it may soon be time to start considering when to end asset purchases. In a now-familiar dynamic, however, buyers stepped in at the wider levels to push yields back down, leaving them roughly unchanged for the week.

Investment grade corporates advanced last week, with total returns of 0.18% and outperformance versus similar-duration Treasuries of 4 bps. Headline spreads have been remarkably stable lately, with the high-grade index trading in a very narrow 3 bps range over the last four weeks. The market has absorbed incoming supply nicely, with $32.2 billion coming last week and deals oversubscribed by 3.2x, on average. The index was further boosted by news from AT&T, which is the most indebted non-financial company and the third biggest constituent in the investment grade index. The company announced plans to spin off WarnerMedia assets, which will result in faster-than-expected deleveraging, causing spreads to tighten 15-20 bps.

High yield corporates lagged last week, with total returns of -0.09% and underperformance versus similar-duration Treasuries of -11 bps. Active funds saw sharp outflows, with -$2.8 billion leaving for the week. This was partially offset by a $1.1 billion inflow in ETFs, and the selling pressure was well-absorbed by existing cash balances and refinancing activity. Loans continued to perform well, with prices up and total returns at 0.16%. Retail funds saw inflows of $685 million, and CLOs increased activity in the primary market. In both bond and loan markets, lower quality outperformed versus higher quality, and supply picked up.

Emerging markets were steady, generating positive total returns for the week amid fairly muted action in primary issuance, secondary trading and flows. As in U.S. corporates, lower quality generally outperformed, but the action was driven mainly by idiosyncratic stories. For example, Colombia and El Salvador sovereigns sold off after respective headwinds from a ratings downgrade and new barriers to an IMF financing deal.

MUNICIPAL MARKET REMAINS IN A NARROW TRADING RANGE

The municipal market remained range bound last week, along with Treasuries. Both markets closed the week with constructive tones.

Investors have been troubled for a while now about the Fed's perceived lack of concern about inflation. However, the Fed's April meeting minutes showed that officials are indeed monitoring inflation pressures. The Fed will begin to taper purchases of government securities if it deems that inflation is becoming a problem. This news barely moved the market. However, the municipal market is now in a sound trading range, which we expect to continue. The Fed has said it will remain accommodative to support the economic recovery until signs of inflation begin. We expect the municipal market to remain well bid for the foreseeable future, due to $122 billion of reinvestment money returning to the market from June through August.

The state of Connecticut sold $691 million general obligation bonds (rated Aa3/A+). The deal was well received and underwriters were able to lower yields between 1 to 5 basis points.

High yield municipal market performance continues to be strong, as high yields outpace investment grade municipals and high-quality taxable fixed income. High yield municipal fund flows remain strong. Investor confidence is building and spreads continue to narrow. This week we expect an unusually large senior living facility deal. The sector has been the driver of monetary defaults over the last 18 months. Security selection and credit research within the sector has been key.

Investment grade corporates have been absorbing supply nicely.

In focus

Non-fixed preferreds for rising rates

As rates continue to drift higher, non-fixed-rate preferred securities may benefit income investors seeking to mitigate interest rate risk.

Non-fixed preferred securities are broadly defined as those with changing dividend/coupon rates. Most start with a fixed coupon for a defined period, with the initial reset typically coinciding with the first call date.

One non-fixed structure is fixed-to-fixed, in which the initial fixed rate resets to another fixed rate. The reset coupon rate is based on a market rate plus a margin.

Resetting to a current market-based coupon limits duration. The reset market-based coupon should roughly equal the coupon of a newly issued security priced at 100. That means the duration would approximate the duration of a bond with a maturity date matching the reset date.

In a rising interest rate environment, non-fixed preferreds offer a potential advantage over fixed-rate issues that never reset. As rates rise, the duration of fixed-coupon securities extends because they're less likely to be called. In contrast, non-fixed coupon issues reprice towards 100 when the coupon resets.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	0.01	-0.01	0.03
5-year	0.82	0.01	-0.03	0.46
10-year	1.62	-0.01	-0.01	0.71
30-year	2.32	-0.02	0.02	0.67

Source: Bloomberg L.P., 21 May 2021. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.14	0.00	0.04	0.00
5-year	0.50	0.00	0.07	0.28
10-year	1.01	-0.01	0.02	0.30
30-year	1.57	-0.03	-0.02	0.18

Source: Bloomberg L.P., 21 May 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	62
30-year AAA Municipal vs Treasury	67
High Yield Municipal vs High Yield Corporate	80

Source: Bloomberg L.P., Thompson Reuters, 21 May 2021. 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	1.05	–	5.10	0.08	0.10	0.59
High Yield Municipal	3.35	197[1]	6.39	0.22	0.76	4.39
Short Duration High Yield Municipal[2]	2.80	206	3.49	0.13	0.45	3.43
Taxable Municipal	2.35	75[3]	9.72	0.16	0.10	-1.90
U.S. Aggregate Bond	1.53	31[3]	6.48	0.07	-0.02	-2.63
U.S. Treasury	0.95	–	6.91	0.08	-0.02	-3.55
U.S. Government Related	1.39	44[3]	6.02	0.00	0.07	-2.11
U.S. Corporate Investment Grade	2.16	86[3]	8.58	0.18	0.22	-3.38
U.S. Mortgage-Backed Securities	1.77	15[3]	4.11	-0.03	-0.32	-0.87
U.S. Commercial Mortgage-Backed Securities	1.52	60[3]	5.21	0.09	0.43	-0.98
U.S. Asset-Backed Securities	0.44	27[3]	2.00	0.05	0.14	0.13
Preferred Securities	2.86	165[3]	4.70	0.36	0.20	1.07
High Yield 2% Issuer Capped	4.19	308[3]	3.90	-0.09	-0.06	1.89
Senior Loans[4]	4.77	446	0.25	0.16	0.35	2.88
Global Emerging Markets	3.86	270[3]	6.84	0.11	0.48	-1.74
Global Aggregate (unhedged)	1.15	33[3]	7.43	0.30	0.47	-2.80

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, 21 May 2021. **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.

For more information, please visit nuveen.com.

Performance: Bloomberg, L.P. **Issuance:** The Bond Buyer, 21 May 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 19 May 2021. **Municipal reinvestment:** JPMorgan.

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.

Representative indexes: municipal: Bloomberg Barclays Municipal Index; **high yield municipal:** Bloomberg Barclays High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Barclays Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg Barclays U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg Barclays U.S. Treasury Index; **U.S. government related:** Bloomberg Barclays U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg Barclays U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg Barclays U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg Barclays CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Barclays Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg Barclays High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Barclays Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Barclays Global Aggregate Unhedged Index.

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 professional 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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