nuveen
A TIAA Company

Weekly Fixed Income Commentary

12 July 2021

Treasury yields decline over economic data and COVID-19 concerns

U.S. Treasury yields fell last week and fixed income markets broadly rallied amid weaker-than-expected economic data and lingering concerns over COVID-19. These moves were exacerbated by technical factors.

HIGHLIGHTS

- **Most major fixed income market segments rallied, led by taxable municipals, investment grade corporates, high yield corporates and preferred securities.**
- **Convertibles notably lagged, with negative total returns; emerging markets generated positive total returns but offered the weakest relative performance.**
- **The municipal bond market rallied. New issue supply was muted at $4 billion, with robust flows of $2.2 billion. This week's new issue supply should be outsized at $9.1 billion.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields declined last week, but we continue to anticipate increases in the months ahead*
- *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, with second quarter GDP growth likely around a 10% pace.

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 also 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 appear particularly attractive. Essential service municipal credits also look compelling.

KEY RISKS

- Policymakers become cautious and remove accommodation too early.
- 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.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

INVESTMENT GRADE CORPORATE SPREADS WIDEN

U.S. Treasury yields declined notably last week, but ended well above the lows. The 10-year yield ended down -6 basis points (bps), including an 11 bps increase in the second half of the week. The moves were partially driven by weaker-than-expected economic data, with the ISM services survey surprisingly falling -3.9 points. The spread of the delta variant of COVID-19 also remains a risk. The moves were likely exacerbated by capitulation of short positions in the long end, which had been a popular trade lately.

Investment grade corporates rallied, generating total returns of 0.29%. They somewhat underperformed similar-duration Treasuries (by 27 bps) as spreads widened 3 bps, a small move that was nevertheless the largest weekly widening since early March. The modest uptick in volatility caused some issuers to postpone planned deals, leaving overall supply modest with only eight issuers pricing around $13.5 billion.

High yield corporates also appreciated, returning 0.20% for the week but underperforming similar-duration Treasuries by 3 bps. Mirroring the move in higher-rated segments, spreads widened slightly (2 bps) but yields fell in tandem with the move in Treasuries. The yield-to-worst on the high yield index touched a fresh all-time low of 3.53% before paring that rally to end the week yielding 3.66%. Despite the low level of yields, money flowed into the asset class for the third straight week, with $728 million allocated to high yield funds. Loans also saw robust demand, with the 26th straight retail inflow, and CLOs continue to ramp up. One bank estimated that there were 48 new CLO warehouses opened in June, a monthly record. That dynamic helped loans to rally 0.05% for the week.

Emerging markets slightly lagged the rallies in other markets, generating 0.12% in total returns and underperforming similar-duration Treasuries by 36 bps. Supply has been heavy over the last two weeks, with high yield names in both the sovereign and corporate spaces seizing the opportunity of the recent rally to issue paper. There was some attention on China's decision to cut reserve requirements, which sparked a 9 bps rally in local 10-year government yields. Meanwhile, the European Central Bank announced a symmetrical 2% inflation target with room to overshoot, but there was minimal market impact since the shift was well-signaled in advance. Rates in developed markets mirrored the moves in Treasuries, with 10-year yields falling across regions.

MUNICIPAL BOND DEMAND OVERSHADOWS SUPPLY

Municipal bonds rallied last week, with tax-exempt supply continuing to lag demand.

Tension continues between the two prevailing market views. One camp believes low interest rates will produce inflation (and higher interest rates). The other camp believes rates will remain lower for longer, with the recovery taking much longer than expected. The lower-for-longer camp won last week. Economic recovery is slowing in China, one of the world's largest markets. Many fear the delta variant of COVID-19 may further slow China's progress, which would hurt the global recovery. This fear caused the 10-year Treasury yield to decline to 1.25 % last week, the lowest since February 2021 as the recovery was emerging. We believe fixed income in general should remain well bid until there is more evidence that global economies are recovering.

Collier County Water-Sewer District, Florida, issued $129 million water and sewer revenue bonds (rated Aaa). Bonds with a 4% coupon due in 2037 were issued with a yield of 1.26% and traded in the secondary market at 1.22%, reflecting the strong market.

High yield municipal bond yields have decreased by 17 basis points on average over the last two weeks. A typical summer wave of technical strength is in full flow, aided by a rally in U.S. Treasury yields that is generally dragging down fixed income yields. Fund flows totaled $683 million last week. More than a dozen high yield municipal deals are coming to market this week, and we expect they will again be heavily oversubscribed. In a positive result of the pandemic, Moody's upgraded the state of Illinois for the first time in 20 years.

A typical summer wave of technical strength is in full flow for high yield municipal bonds.

In focus

Fed likely begins tapering this fall

As economic growth improves and labor markets heal, investors are asking about withdrawal of Federal Reserve monetary policy accommodation: Why and when will it start, and what form will it take?

First, the why. The Fed said it will begin removing accommodation once "substantial further progress" is made on its dual mandate of stable prices and maximum employment. Fed meeting minutes stated that "activity and employment had strengthened," but noted that data provided "a less clear signal about the underlying economic momentum" and it would await more "information in coming months to make a better assessment."

As for the when, it will likely take several more months of positive data before the Fed reacts. That likely implies that September is the first meeting where policy could change. The minutes also referenced a desire to "provide notice well in advance of an announcement," indicating that the November and December meetings are where we could see a policy change.

Finally, the what. The Fed signaled that it will begin by tapering asset purchases, currently running at $120 billion per month. Purchases will likely decline by around $10 billion per month, split 2:1 between Treasuries and mortgage-backed securities, taking the overall level of purchases to zero by the end of 2022. Rate hikes will likely begin sometime after that. This outlook supports our expectations for the curve to steepen, yields to rise and spread assets to trade flat-to-modestly wider from here.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.22	-0.02	-0.04	0.09
5-year	0.79	-0.07	-0.11	0.42
10-year	1.36	-0.06	-0.11	0.45
30-year	1.99	-0.05	-0.10	0.34

Source: Bloomberg L.P., 09 Jul 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	0.12	-0.05	0.02	-0.02
5-year	0.41	-0.09	-0.02	0.19
10-year	0.84	-0.12	-0.15	0.13
30-year	1.33	-0.14	-0.26	-0.06

Source: Bloomberg L.P., 09 Jul 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	61
30-year AAA Municipal vs Treasury	67
High Yield Municipal vs High Yield Corporate	81

Source: Bloomberg L.P., Thompson Reuters, 09 Jul 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	0.90	–	5.02	0.58	0.66	1.73
High Yield Municipal	2.97	182[1]	5.59	0.66	0.79	6.96
Short Duration High Yield Municipal[2]	2.43	182	3.37	0.37	0.46	5.13
Taxable Municipal	2.12	73[3]	9.65	0.57	0.69	0.99
U.S. Aggregate Bond	1.45	35[3]	6.60	0.31	0.44	-1.18
U.S. Treasury	0.89	–	7.09	0.44	0.61	-1.99
U.S. Government Related	1.26	39[3]	6.10	0.34	0.41	-0.78
U.S. Corporate Investment Grade	2.01	85[3]	8.77	0.29	0.45	-0.82
U.S. Mortgage-Backed Securities	1.73	32[3]	4.09	0.12	0.19	-0.58
U.S. Commercial Mortgage-Backed Securities	1.44	60[3]	5.18	0.30	0.42	-0.09
U.S. Asset-Backed Securities	0.46	24[3]	2.03	0.05	0.07	0.25
Preferred Securities	2.50	148[3]	4.63	0.17	0.22	3.05
High Yield 2% Issuer Capped	3.67	270[3]	3.80	0.20	0.40	4.03
Senior Loans[4]	4.74	441	0.25	0.05	0.09	3.57
Global Emerging Markets	3.83	278[3]	7.01	0.12	0.14	-0.46
Global Aggregate (unhedged)	1.07	34[3]	7.55	0.45	0.47	-2.75

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, 09 Jul 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, 09 Jul 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 07 Jul 2021.

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.

Nuveen provides investment advisory solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.

GCM-1716736PG-W0721P