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Weekly Fixed Income Commentary

9 August 2021

Treasury yields rise on strong employment data

U.S. Treasury yields rose and the curve steepened as a result of strong economic data. The July jobs report beat expectations and showed robust improvement in the labor market, supporting the outlook for continued economic growth and gradual withdrawal of monetary policy accommodation.

HIGHLIGHTS

- **Negative total returns for Treasuries weighed on investment grade corporates, taxable munis, mortgage-backed securities and high yield corporates.**
- **Emerging markets, senior loans, preferreds and convertibles registered positive total returns.**
- **Municipal bond yields ended the week higher. New issue supply was $8.2B, with flows of $1.2B. This week's new issue supply should be $8.0B ($1.2B taxable).**

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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
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Watchlist

- *Treasury yields increased last week, and 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 continue to focus 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 reaching close to 10%.

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.

EMERGING MARKETS OUTPERFORM

Treasury yields rose last week amid strong economic data, with the 10-year yield rising 7 basis points (bps) to 1.30%. The July jobs report showed the overall economy added 943,000 jobs last month, plus another 119,000 in upward revisions to prior months. That took the unemployment rate to a fresh post-COVID-19 low of 5.4%. A broader measure of the labor market, the employment-to-working-age-population ratio, rose by +0.6pp to 71.6%. While still below the pre-covid level of 74.2%, the current ratio implies a deficit of 'only' 5.4 million jobs, down from a peak deficit of 23.4 million jobs last April. If the recent pace of jobs growth from the past three months were to continue for the next six months, the labor market would completely return to pre-COVID-19 levels.

Investment grade markets weakened, with yields rising 8 bps and spreads widening 2 bps. That led to total returns of -0.68%, snapping a five-week run of weekly gains and -22 bps of underperformance versus similar-duration Treasuries. Supply was larger than forecasted, with $37 billion of new issuance pricing. That, combined with a modest outflow of -$364 million, provided a modest technical headwind.

High yield corporates also sold off, with yields rising 14 bps and spreads widening 7 bps. That resulted in total returns of -0.19% for the week, though the asset class outperformed similar-duration Treasuries by 3 bps. Much of this relative strength was due to the asset class's relatively lower duration. High yield saw outflows of -$1.2 billion, the third outflow in the last four weeks. The loan market saw inflows of $130 million, below the year-to-date average of around $700 million per week, but still the 28th inflow over the last 29 weeks. Senior loans generated total returns of 0.03% on the week.

Emerging markets outperformed notably, with total returns of 0.08% and outperformance versus similar duration Treasuries of 48 bps. The asset class had lagged over recent weeks, amid concerns over both high inflation and a slowdown in macro growth in some regions. In developed markets, European bonds outperformed versus Treasuries, with 10-year yields in Germany and Italy trading flat and down -5 bps, respectively. The moves took the entire German yield curve out to 30-years into negative territory. The divergence in yields helped the dollar to rally 1.0% against both developed and emerging market currencies.

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HIGH YIELD MUNICIPAL INFLOWS CONTINUE

Municipal yields ended higher last week, primarily on the long end of the yield curve.

The economy continues to improve. The July jobs report showed an increase of almost 1 million jobs, the largest increase in a year, and the unemployment rate declined to 5.4%. Interest rates sold off slightly in response to this good news, but fixed income markets generally remain range bound. The Fed does not fear the current inflation signs, believing the situation to be transitory. When there are stronger signs of inflation, the Fed has vowed to tighten interest rates. It appears the market will need more signs of persistent inflation for interest rates to go higher.

The New York City Transitional Finance Authority issued $930 million tax-secured bonds (rated Aa1/AAA). The deal was priced to sell. For example, the 10-year bond was priced at a yield of 1.04%, versus the 10-year Treasury bond yield at 1.22%. However, by week's end some bonds were trading cheaper than where they came, reflecting a selloff in interest rates.

High yield municipal fund flows continued at $492 million, even though U.S. Treasury yields increased 9 bps while high yield municipal yields only increased 4 bps. The number of new deals remains healthy compared to the investment dollar amount. This week's new issue calendar should give us an example of how the market handles the valuation of weakening sales tax revenues versus demand of credit risk.

High yield corporates outperformed similar-duration Treasuries, mainly due to their relatively lower duration.

In focus

The case for senior loans remains strong

Senior loans, with their floating-rate coupons, have historically seen demand from individual investors when rising rates negatively impact traditional fixed income allocations. That has certainly been the case this year, as floating rate mutual funds and ETFs have seen inflows of roughly $30 billion.

Although demand has slightly moderated recently, positive flows have continued since April, even as the 10-year U.S. Treasury yield has declined.

This positive demand is well supported by fundamentals. In fact, the argument is not necessarily all about rates. Other factors can be bigger drivers of performance, including credit fundamentals, earnings and economic data. These inputs are continuing to move generally in the right direction for loans, and should keep credit losses and defaults rates contained for the foreseeable future.

However, risk premiums have widened marginally recently in response to the COVID-19 Delta variant. In our view, this trend represents a rational repricing of risk and leaves the risk/return opportunity in loans attractive despite increased market uncertainty.

Data source: Morningstar.

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U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	0.21	0.02	0.02	0.09
5-year	0.77	0.08	0.08	0.41
10-year	1.30	0.08	0.08	0.38
30-year	1.95	0.05	0.05	0.30

Source: Bloomberg L.P., 06 Aug 2021. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	0.08	0.02	-0.08	-0.06
5-year	0.37	0.01	-0.12	0.15
10-year	0.87	0.05	-0.12	0.16
30-year	1.43	0.04	-0.07	0.04

Source: Bloomberg L.P., 06 Aug 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	70
30-year AAA Municipal vs Treasury	76
High Yield Municipal vs High Yield Corporate	75

Source: Bloomberg L.P., Thompson Reuters, 06 Aug 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	0.90	–	5.07	-0.13	-0.13	1.77
High Yield Municipal	2.94	170[1]	5.66	-0.06	-0.06	7.34
Short Duration High Yield Municipal[2]	2.42	181	3.44	0.04	-0.40	1.54
Taxable Municipal	2.08	74[3]	9.71	-0.40	-0.40	1.54
U.S. Aggregate Bond	1.43	36[3]	6.66	-0.42	-0.42	-0.92
U.S. Treasury	0.88	–	7.20	-0.40	-0.40	-1.65
U.S. Government Related	1.26	40[3]	6.14	-0.20	-0.20	-0.55
U.S. Corporate Investment Grade	2.01	88[3]	8.77	-0.68	-0.68	-0.60
U.S. Mortgage-Backed Securities	1.70	32[3]	4.14	-0.26	-0.26	-0.40
U.S. Commercial Mortgage-Backed Securities	1.42	62[3]	5.17	-0.34	-0.34	0.08
U.S. Asset-Backed Securities	0.51	27[3]	2.21	-0.08	-0.08	0.30
Preferred Securities	2.50	148[3]	4.71	0.29	0.29	3.55
High Yield 2% Issuer Capped	4.03	302[3]	3.91	-0.19	-0.19	3.81
Senior Loans[4]	4.87	454	0.25	0.03	0.03	3.51
Global Emerging Markets	3.93	290[3]	7.02	0.08	0.08	-0.36
Global Aggregate (unhedged)	1.02	34[3]	7.61	-0.47	-0.47	-2.38

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, 06 Aug 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, 06 Aug 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 04 Aug 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.

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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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