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Weekly Fixed Income Commentary

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Treasury yields rise on Fed rhetoric

U.S. Treasury yields rose last week, as investors focused on central bank statements suggesting the Fed could start winding down asset purchases later this year. Spread assets outperformed, with healthy global growth supporting fundamentals.

HIGHLIGHTS

- **Treasuries and taxable municipals saw negative total returns.**
- **Investment grade and high yield corporates, mortgage-backed securities, preferreds, senior loans and emerging markets rallied and outperformed similar-duration Treasuries.**
- **Municipal bond yields rose slightly. New issue supply was $8.0B, with flows of $1.8B. This week's new issue supply should be $5.8B.**

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Watchlist

- *Treasury yields rose last week, as Fed tapering expectations continue to be priced in*
- *Spread assets outperformed, with healthy global growth supporting fundamentals*
- *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, which could start to happen later this year.

Unprecedented global fiscal stimulus should boost consumption and growth this year, with second quarter GDP growth approaching 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.

TAXABLE BONDS OUTPERFORM SIMILAR-DURATION TREASURIES

U.S. Treasury yields rose last week, with 10-year yields ending 5 basis points (bps) higher. The biggest event of the week was Federal Reserve Chair Powell's speech at Jackson Hole, which further supported the Fed's signaling for a taper announcement this year. Before that, economic data was mixed, with global flash PMIs for August coming in slightly lower. The U.S. composite reading fell to 55.4, while the euro area remained strong at 59.5. Perhaps encouraged by those resilient numbers, several European Central Bank officials hinted in public remarks that the central bank's macro forecast could be revised higher at its September policy meeting, and even opened the door to reducing the pace of asset purchases. Those comments drove the initial rise in rates on Wednesday and Thursday, with 10-year Treasuries rising 12 bps for the week, before the moves moderated somewhat on Friday after Chair Powell's remarks.

Investment grade corporates traded flat, amid low supply and thin trading volumes. However, that was still enough to generate 28 bps of outperformance versus similar-duration Treasuries. High grade structured assets also performed well, with mortgage-backed securities returning 0.08% and outperforming similar-duration Treasuries by 17 bps. Conditions are expected to be similarly muted this week, with around $0 to $5 billion of new issuance expected before activity picks up after Labor Day.

High yield corporates rallied, generating 0.70% of total return and 75 bps of outperformance versus similar-duration Treasuries. Lower-rated credits outperformed, with CCCs returning 0.82% for the week, their best week since February after seven straight weekly declines. Inflows were healthy, with $532 million entering the asset class. Loans saw an inflow of $621 million, the most since early July, and returned 0.19%. As in the high grade market, high yield issuance is expected to be very low this week before picking up after Labor Day.

Emerging markets joined the rally, returning 0.34% and outperforming similar-duration Treasuries by 55 bps. The asset class saw $172 million inflows into hard currency funds, and a small outflow of $9 million from local currency funds. Both market segments rallied, though local debt outperformed, gaining 0.88%, helped by the dollar's -0.9% depreciation.

MUNICIPAL BOND YIELDS RISE MODESTLY

Municipal bond yields rose slightly last week, closing firmer on Friday.

Investors and the markets were happy with Fed Chair Powell's comments about tapering, as it showed that the Fed remains vigilant on keeping inflation in check.

The Treasury bond market rallied on this news, and municipal yields also rallied slightly. Municipal yields are low on an absolute level, so it would be hard for prices to rally dramatically. However, demand remains strong for tax-exempt bonds. We expect municipal rates to remain range bound, and we would see any potential sell off as a buying opportunity.

The state of North Carolina issued $215 million revenue bonds (rated A2/AA). The deal was well received. 5% coupon bonds with a 10-year maturity were issued at a yield of 1.10%. Those bonds traded in the secondary market at a yield of 1.08%. This deal shows the continued demand for blocks of quality tax-exempt bonds.

High yield municipal yields were also up modestly last week. Fund flows re-accelerated as we approach the Labor Day weekend in the U.S. Despite the pending holiday, we are tracking at least 11 new high yield municipal deals across eight sectors from nine dealers.

CCCs returned 0.82% for the week, their best week since February after seven straight monthly declines.

In focus

Powell talks tapering

At the Fed's annual Jackson Hole retreat, Chair Powell gave a highly anticipated speech on the U.S. economy, with new signals on the timeline and outlook for tapering asset purchases.

Powell modestly upgraded his description of the economy, citing the strong July jobs number. He confirmed that he expects further improvement, and that it could be appropriate to reduce the pace of asset purchases this year. Powell emphasized that the criteria for raising interest rates remains separate from tapering, and the former will not mechanically follow the latter.

Markets have already internalized this guidance for the timing of tapering and rate hikes, with real yields rising over the last four weeks and interest rate futures fully pricing a rate hike for the fourth quarter of 2022. In the immediate aftermath of Powell's speech, these figures moved partially, reflecting the lower probability of a September taper announcement. A statement in November or December is more likely, and would be in line with our forecasts.

Moving forward, we expect real yields to rise further as tapering gets underway, boosting nominal 10-year Treasury yields into year-end. We are positive toward corporates, emerging markets and other spread assets, even though they underperformed in the last tapering episode in 2013. This time, the change in policy is well signaled and will coincide with still above-trend growth and improving fundamentals.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.22	-0.01	0.03	0.10
5-year	0.80	0.02	0.11	0.44
10-year	1.31	0.05	0.09	0.39
30-year	1.92	0.05	0.02	0.27

Source: Bloomberg L.P., 27 Aug 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	0.10	0.02	0.04	-0.04
5-year	0.40	0.02	0.04	0.18
10-year	0.91	0.03	0.09	0.20
30-year	1.52	0.02	0.13	0.13

Source: Bloomberg L.P., 27 Aug 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	72
30-year AAA Municipal vs Treasury	81
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters, 27 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	0.96	–	5.11	-0.11	-0.40	1.49
High Yield Municipal	2.96	162[1]	5.95	-0.12	-0.21	7.17
Short Duration High Yield Municipal[2]	2.46	182	3.41	0.00	-0.19	2.12
Taxable Municipal	2.08	75[3]	9.73	-0.35	-0.19	1.76
U.S. Aggregate Bond	1.43	36[3]	6.66	-0.05	-0.20	-0.70
U.S. Treasury	0.87	–	7.17	-0.18	-0.17	-1.43
U.S. Government Related	1.24	39[3]	6.11	-0.02	0.05	-0.31
U.S. Corporate Investment Grade	2.00	88[3]	8.79	0.00	-0.32	-0.23
U.S. Mortgage-Backed Securities	1.70	34[3]	4.15	0.08	-0.17	-0.32
U.S. Commercial Mortgage-Backed Securities	1.43	62[3]	5.16	-0.11	-0.29	0.14
U.S. Asset-Backed Securities	0.52	28[3]	2.22	0.01	-0.04	0.35
Preferred Securities	2.69	161[3]	4.68	0.10	0.16	3.42
High Yield 2% Issuer Capped	3.96	295[3]	3.87	0.70	0.29	4.31
Senior Loans[4]	4.83	449	0.25	0.19	0.40	3.89
Global Emerging Markets	3.85	283[3]	6.99	0.34	0.77	0.33
Global Aggregate (unhedged)	1.03	34[3]	7.57	0.17	-0.46	-2.37

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, 27 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, 27 Aug 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 25 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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