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Weekly Fixed Income Commentary

7 September 2021

Despite soft labor data, Treasury yields rise

Jobs numbers were somewhat weaker than expected, but U.S. Treasury yields rose and the yield curve steepened. The economic expansion continues and the Federal Reserve remains on track to begin tapering later this year.

HIGHLIGHTS

- **High yield corporates, mortgage-backed securities, convertibles, preferred securities, senior loans and emerging markets rallied.**
- **Treasuries, investment grade corporates and taxable municipals weakened amid the rise in yields.**
- **Municipal bond yields remained unchanged. New issue supply was $5.2B, with flows of $1.0B. This week's new issue supply should be $5.2B ($1B taxable).**

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Watchlist

- *Treasury yields rose last week, and we continue to anticipate higher rates into year end*
- *Spread assets performed well, as economic growth continued*
- *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 we expect to happen 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 and the Delta variant.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

HIGH YIELD CORPORATES SHOW ROBUST PERFORMANCE

U.S. Treasury yields rose again last week, despite somewhat softer labor market data. 10-year Treasury yields rose 2 basis points (bps) and the yield curve steepened. The August labor report showed a gain of only 235,000 jobs, much weaker than the 733,000 expected. That said, the unemployment rate fell -0.2 percentage points to a new post-COVID low of 5.2%. Wage growth was also surprisingly strong, at 0.6% month-over-month. Separately, the ISM manufacturing survey for August surprisingly rose 0.4 percentage points (pt)to 59.9, compared to expectations for a -1.0 pt drop. Taken together, economic activity seemingly continued to expand in August, though supply constraints in the labor market continue to bite. We will be much more focused on the September and October jobs reports, which will reflect hiring after most schools reopen and expanded unemployment benefits expire across the U.S.

Investment grade corporates weakened slightly last week, returning -0.08%, but outperforming similar-duration Treasuries by 8 bps. Primary market activity was slow, with only $3.75 billion of new issuance pricing. Issuance should heat up, with $40 to $45 billion expected this week and $130 to $140 billion expected for September. Investment grade corporate spreads have widened 8 bps from their lows at the end of June, but remain historically low, leading corporates to seize the opportunity to issue new securities and refinance existing liabilities.

High yield corporates showed strong gains, generating 0.41% of total returns for the week, with all of that gain (41 bps) representing outperformance versus similar-duration Treasuries. Senior loans also rallied, gaining 0.19% for the week. As in the high grade market, both the high yield and leveraged loan markets are set to see robust issuance in September. Expectations are around $40 to $50 billion of new issuance this month for both asset classes.

Emerging markets notched another gain last week, returning 0.20% for their fifth consecutive weekly gain. That represented 27 bps of outperformance versus similar-duration Treasuries. The asset class has been supported by the weaker dollar, which depreciated another -0.7% last week to touch its weakest level in a month, and by the rally in commodity prices. Front-month WTI oil prices gained another 0.8%, after rallying over 10% the prior week.

MUNICIPAL YIELDS REMAIN LOW ON AN ABSOLUTE BASIS

Municipal bond prices were unchanged in a quiet week due to the Labor Day holiday in the U.S.

The disappointing employment report pushed talk of Federal Reserve (Fed) tapering of easy monetary policy further into the future. The Fed will require solid evidence that the economy is in full recovery from COVID-19 before it begins tapering. Thus, as we have been saying for quite some time, we expect interest rates to remain lower for longer.

Tax-exempt municipal interest rates may see slight upward pressure. The new issue calendar often builds toward the end of the year and deals may need to be cheapened. Also, municipal yields remain low on an absolute basis. However, a tremendous amount of cash remains on the sidelines. We continue to view any potential short-term increase in tax-exempt rates would as a buying opportunity.

The New York City Transitional Finance Authority (TFA) issued $950 million revenue bonds (rated Aa1/AAA). The deal was well received and underwriters were able to increase price on some maturities. The underwriter was quoting a bid of 2 bps richer on most maturities from where the deal came.

The high yield municipal market is snapping back to attention after the holiday. We are tracking at least 15 deals this week, including a gargantuan $500 million senior living project deal. Since mid-July, yields for both high yield municipals and U.S. Treasuries have remained range bound, while AAA-rated municipal yields have risen 20 bps. The softness in high grade munis has given investors opportunities to invest cash that has accumulated through the summer. This trend has not diminished high yield inflows, which continued at $396 million last week.

The municipal new issue calendar often builds near the end of the year and deals may need to be cheapened.

In focus

Municipal credit proves resilient

State and local tax governments proved to be surprisingly resilient during the pandemic. This was quite unexpected last spring when most governments projected steep revenue losses and crafted budgets in an environment of significant uncertainty.

Substantial federal monetary and fiscal support helped stabilize the fiscal health of state and local governments. For the first quarter of 2021, total state and local tax revenues were up 10.4%, compared to the first quarter of 2020. Sales tax collections have steadily improved over the past three quarters after modest declines in early 2020.

Property taxes, which account for about half of local government revenues, have remained remarkably stable. States did not see the huge losses in income taxes that many expected, as most jobs lost were concentrated in lower-wage sectors. The U.S. labor market lost 22.4 million jobs due to COVID-19, and most projections do not expect total employment to recover to pre-pandemic levels until sometime next year.

Moody's revised its outlook for local governments to stable from negative and upgraded Illinois from Baa3 to Baa2. New York, New Jersey and Louisiana have garnered positive outlooks. S&P maintains negative outlooks on only 6% of rated credits, down from 8% a year ago.

While overall credit conditions have improved, the specifics are more nuanced for credits with structurally imbalanced budgets. Monitoring how stimulus funding is deployed will ensure that spending doesn't create future budgetary cliffs.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	August 2021	Year-to-date
2-year	0.21	-0.01	0.02	0.09
5-year	0.78	-0.02	0.09	0.42
10-year	1.32	0.02	0.09	0.41
30-year	1.94	0.02	0.04	0.30

Source: Bloomberg L.P., 03 Sep 2021. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	August 2021	Year-to-date
2-year	0.11	0.01	0.05	-0.03
5-year	0.41	0.01	0.05	0.19
10-year	0.93	0.02	0.11	0.22
30-year	1.52	0.00	0.13	0.13

Source: Bloomberg L.P., 03 Sep 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	78
High Yield Municipal vs High Yield Corporate	78

Source: Bloomberg L.P., Thompson Reuters, 03 Sep 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	August 2021	Year-to-date
Municipal	0.98	–	5.13	0.00	-0.37	1.49
High Yield Municipal	2.95	162[1]	5.99	0.07	-0.16	7.25
Short Duration High Yield Municipal[2]	2.53	187	3.50	-0.01	-0.19	1.69
Taxable Municipal	2.09	75[3]	9.75	-0.07	-0.19	1.69
U.S. Aggregate Bond	1.43	36[3]	6.70	-0.06	-0.19	-0.76
U.S. Treasury	0.88	–	7.19	-0.11	-0.18	-1.53
U.S. Government Related	1.26	40[3]	6.17	-0.02	0.08	-0.33
U.S. Corporate Investment Grade	2.01	88[3]	8.81	-0.08	-0.30	-0.31
U.S. Mortgage-Backed Securities	1.71	33[3]	4.26	0.02	-0.16	-0.31
U.S. Commercial Mortgage-Backed Securities	1.43	62[3]	5.16	0.04	-0.18	0.18
U.S. Asset-Backed Securities	0.51	27[3]	2.21	0.03	-0.01	0.38
Preferred Securities	2.57	151[3]	4.71	0.37	0.19	3.80
High Yield 2% Issuer Capped	3.78	280[3]	3.87	0.41	0.52	4.74
Senior Loans[4]	4.79	448	0.25	0.19	0.49	4.09
Global Emerging Markets	3.85	281[3]	7.05	0.20	0.97	0.52
Global Aggregate (unhedged)	1.04	34[3]	7.62	0.29	-0.42	-2.09

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, 03 Sep 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, 03 Sep 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 01 Sep 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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