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Weekly Fixed Income Commentary

13 September 2021

Treasury yields rise, with heavy new supply across markets

U.S. Treasury yields rose slightly last week, despite strong auction demand, as market action was dominated by a robust new issuance calendar across asset classes.

HIGHLIGHTS

- **Investment grade corporates, mortgage-backed securities, high yield corporates, loans and emerging markets all generated positive returns.**
- **U.S. Treasuries sold off slightly, along with preferreds, convertibles, commercial mortgage-backed securities and taxable municipals.**
- **Municipal bond yields were range bound. New issue supply was $5.2B, with flows of $1.0B. This week's new issue supply should be $11.2B ($2.4B taxable).**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

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 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 and the Delta variant.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

HEAVY NEW ISSUANCE DOMINATES TAXABLE MARKETS

U.S. Treasury yields rose slightly last week, with the 10-year yield up 2 basis points (bps) to 1.34%. The selloff retraced somewhat after Thursday's very strong auction of 30-year bonds, which saw primary dealers take only 13.1% of the issuance, the lowest in at least 12 years. Low dealer take indicates strong investor demand for the new securities. Separately, the European Central Bank announced that it will reduce the pace of asset purchases moving forward. This was expected, but still pushed 10-year German bund yields up 3 bps, now 17 bps over the last three weeks, which helped drag Treasury yields higher for the week.

The investment grade corporate market was also dominated by heavy issuance, with 47 issuers issuing $72.8 billion of new supply last week. That was significantly above expectations, though the market digested the deluge well. The asset class has seen robust inflows over the prior few weeks, presenting a positive technical backdrop despite the heavy calendar. This week, cash positions are set to remain strong, with $32.8 billion due to be returned to investors via maturities and coupon payments, the largest week of returned cash flows of the year. Overall, investment grade corporate spreads tightened 1 bp and generated 0.11% total returns, outperforming similar-duration Treasuries by 13 bps.

High yield corporates also rallied, generating 0.11% of total returns and outperforming similar-duration Treasuries. Attention was focused on the primary market calendar, with $5.75 billion pricing. The market digested the new supply well, with cash positions healthy after several weeks of strong inflows. Last week saw another inflow of $710 million into high yield corporate credit, with loans seeing $718 million. The loan market saw even more issuance, with around 30 deals launched totaling $25 billion. Performance was strong, with total returns for loans of 0.18%.

Emerging markets lagged U.S. credit somewhat, generating total returns of 0.05% and outperforming similar-duration Treasuries. The asset class saw 15 deals totaling $12 billion, mostly in the corporate space. The new issuance did not spark spread widening, with the market easily handling the new supply. A few idiosyncratic stories drove price action, including protests in Brazil, and headlines suggesting that China property firm Evergrande may suspend some payments before other reports suggested the company is being allowed to reset terms of the loans.

MUNICIPAL MARKET REMAINS RANGE BOUND

Municipals and Treasuries were range bound last week, but both markets ended the week with constructive tones.

U.S. Treasury bonds will likely remain range bound for the foreseeable future. With the Delta variant dragging on the U.S. and the global economic recoveries, there doesn't appear to be upward pressure on interest rates.

We believe municipals may sell off as we head into year end. This week's new issue calendar is outsized, and there is a good chance that this outsized supply will continue. Also, tax-exempt rates are not compelling at their current yields. Deals may have to be cheapened to pique investor interest. However, we would view any potential short-term increase in tax-exempt rates as a buying opportunity. A large amount of cash and ultra-short tax-exempt bonds continue to wait to be reinvested at cheaper yields.

The state of Minnesota competitively issued four tranches of general obligation bonds (rated AAA). Balances existed after sale time, and some bonds traded at a slight concession to where the deals were purchased. Dealers don't want to own a lot of bonds going into a week with outsized new issue supply.

High yield municipal spreads widened last week, despite 15 deals coming to market. Investors welcomed soft pocket, despite a historic amount of cash on the sidelines. This week we expect a number of high yield municipal deals, where credit selection will be key to finding attractive opportunities.

This week's municipal new issue calendar is outsized, and there is a good chance that this outsized supply will continue.

In focus

Sustainable bonds soar in popularity

Global issuance of sustainable debt – including green bonds, social bonds and sustainability bonds – is on pace to reach $850 billion this year, according to Moody's. Through the first half of 2021, issuance has almost doubled year-over-year, and will soon pass the $500 billion issued during 2020.

The accelerating push toward climate-based goals, innovation in renewable technology and the rise of ESG investing have driven sustainable bonds to likely account for 8% to 10% of total bond issuance in 2021, as governments and corporations increasingly explore ways to finance impactful environmental and societal outcomes.

As investors grow more interested in understanding where and how their capital is being directed, data transparency and standardization of reporting practices will be hot-button topics. Our engagement efforts have focused on impact reporting frameworks and pushing issuers and underwriters toward best practices for transparency, relevance and accountability.

As the market expands and evolves with increasing sector diversification and issuer types, evidence is growing that investors may not have to sacrifice financial performance to achieve sustainable outcomes – dispelling a common myth.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.21	0.01	0.00	0.09
5-year	0.82	0.03	0.04	0.46
10-year	1.34	0.02	0.03	0.43
30-year	1.94	-0.01	0.00	0.29

Source: Bloomberg L.P., 10 Sep 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	0.11	0.00	0.00	-0.03
5-year	0.41	0.00	0.01	0.19
10-year	0.94	0.01	0.02	0.23
30-year	1.53	0.01	0.01	0.14

Source: Bloomberg L.P., 10 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	79
High Yield Municipal vs High Yield Corporate	78

Source: Bloomberg L.P., Thompson Reuters, 10 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	Month-to-date	Year-to-date
Municipal	0.97	–	5.13	0.00	-0.04	1.49
High Yield Municipal	2.96	162[1]	6.04	-0.01	0.00	7.23
Short Duration High Yield Municipal[2]	2.54	188	3.50	0.00	-0.07	5.55
Taxable Municipal	2.10	74[3]	9.75	0.00	-0.07	1.69
U.S. Aggregate Bond	1.44	35[3]	6.71	0.02	-0.05	-0.74
U.S. Treasury	0.89	–	7.22	-0.02	-0.13	-1.55
U.S. Government Related	1.27	40[3]	6.17	-0.02	-0.08	-0.35
U.S. Corporate Investment Grade	2.01	86[3]	8.82	0.11	0.02	-0.20
U.S. Mortgage-Backed Securities	1.71	32[3]	4.25	0.01	0.02	-0.30
U.S. Commercial Mortgage-Backed Securities	1.45	62[3]	5.15	-0.07	-0.13	0.11
U.S. Asset-Backed Securities	0.54	28[3]	2.21	-0.03	-0.03	0.35
Preferred Securities	2.62	153[3]	4.71	-0.01	0.32	3.79
High Yield 2% Issuer Capped	3.80	280[3]	3.85	0.11	0.30	4.86
Senior Loans[4]	4.78	444	0.25	0.18	0.28	4.27
Global Emerging Markets	3.85	281[3]	7.03	0.05	0.03	0.57
Global Aggregate (unhedged)	1.06	34[3]	7.61	-0.22	0.03	-2.30

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, 10 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, 10 Sep 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 08 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.

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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