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Weekly Fixed Income Commentary

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Treasury yields rise on disappointing jobs data and delayed debt ceiling

U.S. Treasury yields rose again last week, with 10-year yields up to their highest levels in more than four months. Despite a disappointing jobs report, the Federal Reserve (Fed) is expected to announce the beginning of tapering in November. And Congress appears to have resolved the debt ceiling impasse for now, pushing rates higher.

HIGHLIGHTS

- **In line with Treasury weakness, investment grade and high yield corporates, mortgage-backed securities, preferred securities, convertibles and emerging markets weakened.**
- **Loans were the sole major bright spot, boosted by their floating rate nature.**
- **Municipal bond yields rose. New issue supply was $10B, with tepid flows of $37MM. This week's new issue supply should be manageable at $7.8B.**

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Watchlist

- *Treasury yields rose last week, and we continue to anticipate higher rates into year end.*
- *Spread assets were mixed, given the rise in rates.*
- *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 continue to boost consumption and growth into next year.

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.

DEMAND SUPPORTS SENIOR LOANS

U.S. Treasuries continued to sell off last week, with 10-year yields ending 15 bps higher at 1.61%, their highest levels since early June. Though the headline number of the September jobs report disappointed at 194,000, an additional 169,000 jobs were added to prior months' prints, and the unemployment rate fell to 4.8%. Wage growth remains strong at 4.6% year-over-year. Overall, the Federal Reserve will likely announce the beginning of tapering next month, as expected. Separately, Congress appears to have resolved the debt ceiling impasse, removing the risk of a technical default until December, which further pushed rates higher.

Investment grade corporates weakened alongside Treasuries, returning -1.16% and underperforming similar-duration Treasuries by -16 bps. The index's spread widened 1 bp, while yields rose 10 bps. The asset class saw its first outflows since June, at -$300 million. The primary market also surprised to the upside, with $27 billion of new issuance versus $15-20 billion expected. Those deals were still 2.4 times oversubscribed on average, but came with an average concession of 2.1 bps, slightly wider than recent levels.

High yield corporates also weakened, returning -0.33%, but outperformed similar-duration Treasuries by 8 bps. Higher rates weighed on the market, though better risk sentiment and stronger equities insulated high yield from the selloff somewhat. B-rated credit outperformed, weakening only -0.12%. Loans performed well, gaining 0.11%, as demand continued and higher rates boost their appeal. Investor demand supported the loan asset class, with an inflow of $561 million, while high yield bonds saw a similar outflow to investment grade at -$294 million.

Emerging markets also weakened, returning -0.83% on the week, underperforming similar-duration Treasuries by -3 bps. Supply was healthy, hitting $600 billion for the year, already eclipsing the previous annual record. The asset class also saw another outflow, with the majority ($1.4 billion) coming from hard currency funds. Emerging markets were pressured by continued concerns regarding China's property sector. Several lower-rated names weakened by 15-20 points in price, while investment grade names sold off by around 5-10 points. There were also signs of contagion to other sectors in IG Asia markets, as some funds are reportedly becoming forced sellers to raise liquidity. So far, the pressures have not spread further, but we continue to monitor the situation.

MUNICIPAL YIELDS ARE CONSIDERED ATTRACTIVE

Both U.S. Treasury and tax-exempt municipal yields rose last week. The 10-year U.S. Treasury yield is currently being contained by a new and important technical threshold of 1.60%. If the 1.60% resistance level holds, volatility may decline, especially with further resolution of political risks.

While Friday's employment data were disappointing, investors believed the results were sufficient for the Fed to begin tapering its easy monetary policy later this year. We expect Treasury rates to continue moving slightly cheaper as investors adjust their interest rate predictions to factor in higher inflation. On the tax-exempt side, municipal rates have sold off over the last few weeks, and tax-exempt yields are now considered attractive. Thus, equilibrium between buyers and issuers should be constructive through the end of this year.

Volatility in the U.S. Treasury market continues to pull on municipal bond valuations, despite very little municipal trading volume. Even with cross currents emerging, creating net outflows this week, mutual funds continue to buy to invest their large cash balances. New issuance remains well received, and large oversubscriptions are common. Investors concerned with reinvestment risk are enjoying adjusted levels in high yield municipals. The average high yield municipal yield has risen 35 bps since July 31, the peak of summer strength.

Metropolitan government of Nashville and Davidson County issued $377 million water revenue bonds (rated Aa2/AA). The bonds were priced to sell and the deal was well received. Bonds were bid at a premium to where the deal came in the secondary market.

Loans performed well, as demand continues and higher rates boost their appeal.

In focus

Muni issuance remains robust

Municipal new issue supply set a record at approximately $485 billion in 2020. The pace has been virtually identical throughout the first three quarters of 2021, while the composition and timing were different. Taxable municipals accounted for a record 30% of 2020 supply. Refunding volume was an impressive $150 billion, as many taxable deals were used for refunding tax-exempt bonds.

Taxable municipals have accounted for 25% of issuance so far in 2021, which equates to more than $80 billion in par value. This remains a historically high figure, but down 38% from last year's pace. Similarly, refunding volumes remain very strong at $111 billion year-to-date, but this is 26% lower than last year. While issuance has outpaced last year, third quarter issuance was 16% lower year-over-year as many municipalities have capitalized on lower interest rates.

In sum, taxable deals and refunding deals remain very significant components of new issue supply, but they are less dominant than in 2020. At the same time, traditional tax-exempt bonds issued for new capital purposes are up 19% year-over-year through the end of September. As a result of slightly less refunding volume amid robust new issuance, the municipal bond market has recently grown to more than $4 trillion in total par value of bonds outstanding.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.32	0.06	0.04	0.20
5-year	1.06	0.13	0.10	0.70
10-year	1.61	0.15	0.13	0.70
30-year	2.17	0.14	0.12	0.52

Source: Bloomberg L.P., 08 Oct 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	0.18	0.01	0.01	0.04
5-year	0.52	0.01	0.02	0.30
10-year	1.18	0.04	0.04	0.47
30-year	1.69	0.02	0.02	0.30

Source: Bloomberg L.P., 08 Oct 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	73
30-year AAA Municipal vs Treasury	78
High Yield Municipal vs High Yield Corporate	77

Source: Bloomberg L.P., Thompson Reuters, 08 Oct 2021. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg High Yield Municipal Index divided by the yield-to-worst for the Bloomberg 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	1.16	–	5.22	-0.15	-0.16	0.63
High Yield Municipal	3.18	169[1]	6.56	-0.26	-0.30	6.21
Short Duration High Yield Municipal[2]	2.71	184	3.71	-0.14	-0.13	4.95
Taxable Municipal	2.31	72[3]	9.72	-0.97	-0.63	-0.13
U.S. Aggregate Bond	1.63	33[3]	6.75	-0.77	-0.50	-2.05
U.S. Treasury	1.07	–	7.03	-0.80	-0.51	-3.00
U.S. Government Related	1.47	41[3]	6.09	-0.64	-0.45	-1.74
U.S. Corporate Investment Grade	2.22	86[3]	8.66	-1.16	-0.77	-2.03
U.S. Mortgage-Backed Securities	1.89	25[3]	4.86	-0.43	-0.25	-0.92
U.S. Commercial Mortgage-Backed Securities	1.64	60[3]	5.11	-0.53	-0.31	-0.84
U.S. Asset-Backed Securities	0.66	28[3]	2.31	-0.13	-0.08	0.15
Preferred Securities	3.10	176[3]	4.89	-0.62	-0.64	2.78
High Yield 2% Issuer Capped	4.18	296[3]	4.01	-0.33	-0.33	4.20
Senior Loans[4]	4.81	437	0.25	0.11	0.12	4.77
Global Emerging Markets	4.28	303[3]	6.94	-0.83	-0.79	-1.92
Global Aggregate (unhedged)	1.22	33[3]	7.55	-0.66	-0.36	-4.41

1 Yield difference between the Bloomberg 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, 08 Oct 2021. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg. 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, 08 Oct 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 06 Oct 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 Municipal Index; **high yield municipal:** Bloomberg High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index; **U.S. government related:** Bloomberg U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg 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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