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Weekly Fixed Income Commentary

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Treasury yields decline on Fed news and solid payroll data

U.S. Treasury yields fell across the curve last week. The Federal Reserve announced a taper to its asset purchases, as expected. Economic data showed positive momentum, with October employment beating expectations. These data supported fixed income returns.

HIGHLIGHTS

- **All major fixed income market segments rallied, including Treasuries, agencies, mortgage-backed securities, investment grade and high yield corporates, preferreds, loans, convertibles and emerging markets.**
- **Most spread sectors outperformed similar-duration Treasuries, though emerging markets, preferreds, and mortgage-backed securities underperformed.**
- **The municipal market rallied. New issue supply was $6.7B, with flows of $603MM. This week's new issue supply is outsized at $10.3B.**

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Watchlist

- *Treasury yields fell last week, though we continue to anticipate higher rates into year-end.*
- *Spread assets performed well and fundamentals remain strong.*
- *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 tapering and an eventual increase in interest rates.

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

- Inflation rises in a disorderly way, negatively impacting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- Further complications with the COVID-19 vaccine rollout and Delta or future variants.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

HIGH YIELD CORPORATES ERASE SMALL OCTOBER SELLOFF

U.S. Treasury yields fell across the curve last week, with 10-year yields ending -10 basis points (bps) lower. Economic data were positive, with the October payrolls report showing a gain of 531,000 new jobs for the month, plus another 235,000 in net revisions, easily beating consensus forecasts for 450,000. The participation rate remained somewhat low, at 61.6%, resulting in another -0.2 percentage point fall in unemployment to 4.6%. Separately, the Fed announced a taper of its asset purchases, as expected.

Investment grade corporates gained strongly for the second straight week, returning 0.89% and outperforming similar-duration Treasuries by 16 bps. With stronger economic data and lack of surprises from the Federal Reserve, risk sentiment was well supported. Dealers reported low inventories by the end of the week amid the buying, while the primary market remained very strong. Across 18 issuers pricing $21.35 billion of new supply, oversubscription rates were at 2.55x and new issue concessions were only 1.3 bps. Another $20 to $25 billion is expected this week, though Thursday is a U.S. bond market holiday for Veterans Day.

High yield corporates joined the rally, returning 0.61% and outperforming similar-duration Treasuries by 22 bps. The performance in the first week of November already erased the small selloff from October. As with investment grades, the primary market saw robust demand, with $7.5 billion of new issuance. Retail flows turned negative at -$1.3 billion after two strong weeks of inflows. In contrast, the loan market continued to see steady retail demand, with inflows of $600 million. The loan asset class returned 0.08%.

Emerging markets gained, returning 0.32%, but continued to lag other asset classes, underperforming similar-duration Treasuries by -43 bps. Trading volumes were muted and supply was limited, though there was a healthy inflow of $950 million. Spreads nevertheless widened and high yield underperformed investment grade within the asset class. Central banks in Poland and the Czech Republic hiked rates by more than expected, causing some curve flattening in those markets. Developed market central banks, in contrast, leaned dovish, as the Bank of England surprisingly declined to hike rates and the Reserve Bank of Australia ended its yield curve control policy but pushed back on rate hike expectations. Short-term rates in the UK and Australia fell -20 bps to -30 bps.

HIGH YIELD MUNICIPAL CREDIT SPREADS WIDEN

The municipal market rallied last week, primarily on the long end of the yield curve.

The Fed spoke last week, indicating it would soon begin to taper the easy monetary policies implemented in March 2020. Investors liked what they heard, because they believe the Fed is staying ahead of the fight against inflation. Investors believe rates will possibly trend lower as a result, so they want to lock in higher yields now. The municipal bond rally was somewhat muted vs U.S. Treasuries due to the continued outsized municipal new issue calendar. However, we are seeing strong demand for all deals being priced.

The state of Washington issued $133 million general obligation bonds (rated Aaa/AA+). The 10-year bonds with a 5% coupon came at a yield of 1.25%. Those same bonds traded in the secondary market 8 bps richer at 1.17%. This deal illustrates the municipal market's rally last week.

High yield municipal bond credit spreads widened overall last week, although short-duration spreads tightened. Cross currents continue in high yield municipal fund flows, with highly concentrated outflows. We expect another week of robust issuance. We believe credit selection, as was the case in the first half of 2021, should be key to finding excess returns for the remainder of the year.

Amid stronger economic data and lack of surprises from the Federal Reserve, risk sentiment was well supported.

In focus

It's officially time to taper

As anticipated, the Federal Reserve announced last week that it will begin tapering its $120 billion/month quantitative easing (QE) asset purchases by $15 billion/month, starting in November and lasting until the process ends in mid-2022.

The current round of QE, launched to add liquidity to markets at the outset of the COVID-19 pandemic in March 2020, was kept intact to ensure financial conditions remained accommodative to foster a strong economic rebound. Having met that objective, the Fed now believes the risks of continuing to add large amounts of liquidity to the system roughly offset any further benefits.

Inflation was also in focus last week. The Fed still regards the current period of higher prices as transitory, largely the result of supply and demand imbalances related to COVID-induced lockdowns and the economy's subsequent reopening. In his press conference, Chair Powell noted that the Fed's tools "cannot ease supply constraints," but expressed optimism that those constraints would abate on their own.

As for raising rates, the Fed's policy statement emphasized that its tapering decision "does not imply any direct signal regarding our interest rate policy." The U.S. Treasury yield curve steepened after the statement's release, suggesting investors have become less concerned the Fed will err by tightening too quickly, even as they continue to bet on rate hikes beginning in 2022. We believe the Fed will remain more patient than the market anticipates.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.40	-0.10	-0.10	0.28
5-year	1.06	-0.13	-0.13	0.70
10-year	1.45	-0.10	-0.10	0.54
30-year	1.89	-0.05	-0.05	0.24

Source: Bloomberg L.P., 05 Nov 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	0.24	-0.01	-0.01	0.10
5-year	0.63	-0.01	-0.01	0.41
10-year	1.13	-0.08	-0.08	0.42
30-year	1.58	-0.11	-0.11	0.19

Source: Bloomberg L.P., 05 Nov 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	78
30-year AAA Municipal vs Treasury	85
High Yield Municipal vs High Yield Corporate	78

Source: Bloomberg L.P., Thompson Reuters, 05 Nov 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	1.15	–	5.12	0.47	0.47	0.97
High Yield Municipal	3.13	175[1]	6.25	0.72	0.72	6.86
Short Duration High Yield Municipal[2]	2.70	178	3.69	0.30	0.30	5.24
Taxable Municipal	2.18	72[3]	9.63	0.86	0.86	1.76
U.S. Aggregate Bond	1.58	34[3]	6.79	0.64	0.64	-0.95
U.S. Treasury	1.06	–	7.24	0.67	0.67	-1.91
U.S. Government Related	1.45	42[3]	6.18	0.55	0.55	-0.82
U.S. Corporate Investment Grade	2.13	86[3]	8.81	0.89	0.89	-0.14
U.S. Mortgage-Backed Securities	1.81	26[3]	4.52	0.40	0.40	-0.47
U.S. Commercial Mortgage-Backed Securities	1.64	62[3]	5.11	0.48	0.48	-0.44
U.S. Asset-Backed Securities	0.80	35[3]	2.31	0.20	0.20	0.09
Preferred Securities	2.82	158[3]	4.66	0.39	0.39	3.74
High Yield 2% Issuer Capped	4.06	285[3]	3.91	0.61	0.61	4.99
Senior Loans[4]	5.03	440	0.25	0.08	0.08	4.98
Global Emerging Markets	4.29	311[3]	7.12	0.32	0.32	-1.24
Global Aggregate (unhedged)	1.19	34[3]	7.62	0.70	0.70	-3.63

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, 05 Nov 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, 05 Nov 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 03 Nov 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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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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