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Weekly Fixed Income Commentary

22 February 2022

Treasury yields fall amid geopolitical uncertainty

U.S. Treasury yields fell last week on heightened Russia/Ukraine tensions and Federal Reserve meeting minutes that were less hawkish than expected. In contrast, spread assets generally weakened.

HIGHLIGHTS

- **U.S. Treasuries and asset-backed securities posted positive total returns.**
- **MBS, investment grade and high yield corporates, preferreds, convertibles, high yield bonds, senior loans and emerging markets all had negative total returns.**
- **Municipal bond yields ended the week lower. New issue supply was light again at $5.7B, with flows of -$1.3B. This week's new issue supply should be $5.6B ($1.9B taxable).**

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Watchlist

- *10-year Treasury yields were nearly flat last week, and we anticipate increases this year.*
- *Spread assets were weaker amid elevated uncertainty.*
- *Municipal bonds are moving closer to fair value.*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. While investors continue to focus on more hawkish Fed policy, overall rates are likely to remain relatively low.

Unprecedented global fiscal stimulus should continue to boost consumption and growth.

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 bonds also look compelling.

KEY RISKS

- Inflation rises in a disorderly way, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- Further complications with the Covid vaccine rollout, as well as new variants.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

GEOPOLITICAL TENSIONS WEIGH ON RISK ASSETS

U.S. Treasury yields fell slightly last week, with most of the declines coming after the minutes of the January FOMC meeting were less hawkish than feared. The minutes made no reference to a 50 basis point (bps) hike at the March policy meeting and signaled that Fed officials are comfortable with tighter financial conditions to start the year. The market has returned to pricing around a 25% chance of a 50 bps hike, down from near-100% at the end of the prior week. At the same time, uncertainty over Russia/Ukraine tensions continued, putting further downward pressure on yields on perceived safe-haven demand.

Investment grade corporates weakened, returning -0.88% on the week. Roughly all of that weakness was underperformance versus similar-duration Treasuries, with spreads widening 9 bps to 115 bps, but yields rising only 1 bp to 3.11%. The market was pressured by a pickup in supply, with $31 billion in primary issuance for the week. Overall, concessions widened to around 10 bps, indicating deals coming in at higher spreads than benchmark outstanding debt. Another $25 billion is expected this week.

High yield corporates also sold off, returning -0.25% for the week and lagging similar-duration Treasuries by -30 bps. That marked the fifth consecutive weekly selloff, and outflows continued at a high rate, with $3.6 billion exiting the asset class for the week. Geopolitical tensions and uncertainty over interest rates combine to weigh on risk assets, with high yield bonds suffering as a result. Loan prices were also slightly weaker, as crossover investors continue to sell loans to raise liquidity after recent outperformance. The loan asset class had another large inflow of $1.8 billion, the sixth consecutive week with more than $1 billion of inflows.

Emerging markets performed similarly to U.S. credit, returning -0.43% and underperforming similar-duration Treasuries by -49 bps. Uncertainty remains elevated around the Russia/Ukraine tensions, and sovereign debt in both countries weakened notably. Russian bonds were down around -3 points, while Ukraine's were down -4 points. Away from that, the Chinese property sector remains in focus, with bonds from Shimao, Sunac and Agile group declining by -2 to -10 points.

MUNICIPAL BONDS SHOULD REMAIN RELATIVELY WELL BID

Municipal bond yields rose at the beginning of last week, then declined Thursday and Friday due to a flight-to-quality in Treasury bonds. Both the AAA-rated municipal yield curve and the municipal-to-Treasury ratio curve flattened, with 10-year ratios (85%) becoming cheap relative to 30-year ratios (90%).

The fixed income market reflects the precarious position the world finds itself in right now. The Fed is preparing to begin raising rates to curtail inflation, yet tensions in Ukraine may pause those plans. Fixed income yields pushed higher at the beginning of last week, reflecting inflationary fears, then escalating tensions in Ukraine caused a flight to quality rally in high grade bonds. Treasury bonds were more volatile last week than they have been in two years. We expect fixed income in general to remain volatile for the next few weeks. Municipal bonds should remain relatively well bid due to low new issue supply.

Wake County, North Carolina, issued $206 million general obligation bonds (rated AAA/AAA). The deal included 10-year bonds with a 5% coupon issued at a yield of 1.73%. There were balances in the account at the end of the first day of purchase.

High yield municipal credit spreads stand at 190 bps on average. High beta bellwether names like Golden State Tobacco and Puerto Rico COFINA had begun to tighten on improved buying activity by the end of last week. High yield municipal bonds saw more outflows at -$776 million, but outflows have not produced widespread selling pressure. This week's new issue calendar is minimal, and the market is expected to focus on trading the secondary market. Large swaths of the high yield muni market offer yields not observed in quite some time. The Puerto Rico GO exchange will serve as a major liquidity injection that will likely boost market demand materially.

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In focus

Treasury yield increases should slow

10-year Treasury yields are 42 basis points higher to start the year, and measures of bond market volatility recently touched their highest levels since early 2020.

This rise in yields has dominated markets, and we anticipate further increases during 2022. However, those future moves should be more modest and well contained.

The first and most mechanical factor driving rates higher is the Federal Reserve. We anticipate six rate hikes this year, in 25 bps increments, starting in March. This has already put upward pressure on front-end yields, and we think this dynamic should play out further over the course of this year.

Our forecasts imply only another 30 bps rise in yields this year, less than has already occurred in the last six weeks.

We think the move upward will decelerate for several reasons. Secular headwinds associated with aging populations and lower productivity growth remain. Excess global savings mean a persistent demand for low-risk, liquid assets. The terminal fed funds rate is likely to be lower than in prior cycles. Inflation should remain somewhat high in the near-term, but ultimately moderate back toward trend. Inflation breakevens already price in a 2.45% rate of inflation over the next 10 years, leaving minimal room for further increases. Taking these factors together, we expect the 10-year Treasury yield to end the year around 2.25%.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	1.47	-0.04	0.29	0.74
5-year	1.82	-0.04	0.21	0.56
10-year	1.93	-0.01	0.15	0.42
30-year	2.24	0.00	0.14	0.34

Source: Bloomberg L.P., 18 Feb 2022. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.11	0.06	0.21	0.87
5-year	1.41	0.07	0.19	0.82
10-year	1.65	0.04	0.10	0.62
30-year	2.02	-0.01	0.07	0.53

Source: Bloomberg L.P., 18 Feb 2022. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	86
30-year AAA Municipal vs Treasury	90
High Yield Municipal vs High Yield Corporate	66

Source: Bloomberg L.P., Thompson Reuters, 18 Feb 2022. 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	1.91	–	5.17	-0.18	-0.61	-3.33
High Yield Municipal	3.72	186[1]	7.09	-0.04	-0.41	-3.20
Short Duration High Yield Municipal[2]	3.40	185	3.76	-0.16	-0.45	-1.86
Taxable Municipal	2.85	78[3]	9.42	-0.03	-1.41	-3.91
U.S. Aggregate Bond	2.38	42[3]	6.62	-0.24	-1.56	-3.68
U.S. Treasury	1.82	–	6.97	0.05	-1.15	-3.03
U.S. Government Related	2.28	49[3]	5.93	-0.03	-1.26	-3.22
U.S. Corporate Investment Grade	3.11	118[3]	8.24	-0.88	-2.42	-5.71
U.S. Mortgage-Backed Securities	2.55	28[3]	4.95	-0.12	-1.42	-2.89
U.S. Commercial Mortgage-Backed Securities	2.55	76[3]	4.99	-0.16	-1.31	-2.87
U.S. Asset-Backed Securities	1.84	37[3]	2.28	0.02	-0.63	-1.19
Preferred Securities	4.48	225[3]	5.01	-0.08	-3.16	-5.54
High Yield 2% Issuer Capped	5.74	365[3]	4.12	-0.25	-1.58	-4.26
Senior Loans[4]	6.13	442	0.25	-0.32	-0.35	0.01
Global Emerging Markets	4.99	311[3]	6.83	-0.43	-1.47	-4.06
Global Aggregate (unhedged)	1.77	42[3]	7.37	0.00	-1.00	-3.03

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, 18 Feb 2022. **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, 18 Feb 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 16 Feb 2022.

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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