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Weekly Fixed Income Commentary

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Strong U.S. jobs report boosts Treasury yields

U.S. Treasury yields ended the week modestly higher and risk assets rebounded last week, as volatility persisted. The increase in rates was bolstered by continued hawkish U.S. Federal Reserve rhetoric, cemented on Friday with stronger-than-expected non-farm payrolls.

HIGHLIGHTS

- **Rising rates dragged total returns into negative territory for Treasuries, agencies, MBS, taxable munis, preferreds, CMBS and ABS.**
- **Returns were positive for senior loans, as well as investment grade and high yield corporates.**
- **Municipal bond yields decreased slightly. New issue supply remained light at $4.1B, with outflows of -$2.1B. This week's new issue supply should be muted again at $2.5B.**

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Watchlist

- *10-year Treasury yields moved higher last week.*
- *Spread assets outperformed amid elevated volatility.*
- *Net-negative supply should provide some support to municipal bonds.*

INVESTMENT VIEWS

Accommodative 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 even after several rate hikes.

The underlying growth outlook remains healthy, as consumers have strong balance sheets, businesses are reinvesting and Covid recedes. This should keep defaults low.

Treasury yields are likely to rise this year, but the pace of long-term increases should remain relatively modest.

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 fails to moderate as expected, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- The Russia/Ukraine conflict continues to escalate.
- Covid-19 cases increase, or new variants emerge.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

RISK ASSETS RALLY BACK

U.S. Treasury yields rose modestly last week, with 10-year yields ending 5 basis points (bps) higher. Rates began the week with a precipitous drop on Monday led by the 5-year. However, yields marched steadily higher throughout the rest of the week to finish 3 to 5 bps higher in a relatively parallel increase across maturities. The increase in rates was bolstered by continued hawkish Fed rhetoric, which was cemented on Friday with non-farm payrolls coming in stronger than expected.

Investment grade corporates rebounded slightly last week, posting a positive total return of 0.15% and outpacing similar-duration Treasuries by 59 bps. Spreads recovered a portion of last week's widening, tightening -5 bps to end at 154 bps. Outflows continued, but slowed to- $2.3 billion for the week. Primary market activity picked up, with 10 issuers pricing $13.6 billion. The new issues were roughly 2.9x oversubscribed and priced with an average of 25 bps new issue concession.

High yield bounced back, returning 1.42% for the week and sharply outperforming similar-duration Treasuries by 163 bps. Risk assets rallied back as positive sentiment from equities and lower interest rates to start the week encouraged investors. Senior loans also produced positive total returns, delivering 0.74%. Higher-quality BB rated segments outperformed in both high yield and loans, as the decompression theme continued. The high yield market experienced investor inflows while the loan market endured outflows.

Emerging markets recovered, returning 0.33% and outperforming similar-duration Treasuries by 70 bps. Reversing last quarter's theme of decompression, high yield sovereign and corporate spreads rebounded versus their investment grade counterparts. In the sovereign space, high yield names tightened -43 bps versus investment grade at -14 bps. High yield corporates showed a similar pattern, with those spreads tightening more than investment grade credits. EM bond funds experienced additional large outflows totaling -$3.7 billion.

HOPEFUL SIGNS EMERGE FOR THE MUNICIPAL MARKET

Municipal yields ended the week slightly lower. New issue supply remained muted and fund flows were negative for the ninth consecutive week.

Fixed income in general sold off in response to Friday's strong jobs report, as the data reinforced the Fed's position that it must continue raising rates until inflation is under control.

Nevertheless, we see rays of hope for munis, including low new issue supply and strong two-sided activity between dealers and institutional managers who continue to rework portfolios. Demand from individual investors remains strong, as some tax-exempt bonds may be purchased at a 4% yield. Volatility should continue through the end of the year, but we believe the Fed will no longer need to raise rates beyond early 2023.

The City of New York issued $950 million general obligation bonds (rated AA2/AA). The deal was priced to sell, but bonds remain in the account. For example, a 5 .5% bond due in 2047 came at a yield of 4.39%. Those bonds traded Friday in the secondary market at 4.42 %. This demonstrates how the market cheapened as the week progressed.

High yield municipal yields are highly attractive, with the average yield-to-worst of the Barclays High Yield Municipal Bond Index now at 6%. The asset class saw inflows to exchange-traded funds, while mutual fund outflows continued. Valuations remained stable to slightly firmer. New issuance has been minimal, but secondary market trade flow is sizable.

The jobs report reinforced the Fed's position that it must continue raising rates until inflation is under control.

In focus

Market challenges persisted in 3Q

Fixed income performance continued to be driven by three main factors: central bank policy, volatility and inflation. Treasury yields rose sharply, buffeting all sectors. Where do we see opportunity going forward?

In the taxable fixed income arena, U.S. high yield bonds offer near double-digit yields. Default rates should remain below their long-term averages, and the financial health of high yield companies overall appears stronger than it did prior to the 2020 recession. A deep global slowdown would hurt the asset class, but we think it's well positioned to withstand the more modest contraction we anticipate.

Preferred securities also merit consideration. The financial sector (where they're heavily concentrated) is in good shape, with banks supported by ample liquidity and high capitalization levels.

Municipal market performance has improved, but uncertainty continues. Look for interest rate volatility to eventually subside, leaving attractive muni yields intact. Combined with solid fundamentals and healthy credit conditions, value created in the market should entice investors. We believe extending duration risk and increasing credit exposure can help generate additional income and boost total return. We see significant value in investment grade and high yield names. In a slowing economy, active management and in depth credit research remain critical.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.31	0.03	0.03	3.58
5-year	4.14	0.05	0.05	2.88
10-year	3.88	0.05	0.05	2.37
30-year	3.84	0.06	0.06	1.94

Source: Bloomberg L.P., 07 Oct 2022. **Past performance does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.97	-0.12	-0.12	2.73
5-year	3.02	-0.10	-0.10	2.43
10-year	3.18	-0.12	-0.12	2.15
30-year	3.76	-0.14	-0.14	2.27

Source: Bloomberg L.P., 07 Oct 2022. **Past performance does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	82
30-year AAA Municipal vs Treasury	97
High Yield Municipal vs High Yield Corporate	64

Source: Bloomberg L.P., Thompson Reuters, 07 Oct 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 does not predict or guarantee future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.94	–	7.08	0.83	0.83	-11.40
High yield municipal	5.93	234	10.58	1.01	1.01	-15.18
Short duration high yield municipal[2]	5.78	272	4.34	0.33	0.33	-7.30
Taxable municipal	5.27	122	9.07	-0.45	-0.45	-19.64
U.S. aggregate bond	4.82	62	6.24	-0.25	-0.25	-14.83
U.S. Treasury	4.22	–	6.11	-0.43	-0.43	-13.47
U.S. government related	4.83	61	5.20	-0.25	-0.25	-12.93
U.S. corporate investment grade	5.70	154	7.12	0.15	0.15	-18.59
U.S. mortgage-backed securities	4.89	71	6.02	-0.32	-0.32	-13.94
U.S. commercial mortgage-backed securities	5.31	112	4.67	-0.52	-0.52	-12.27
U.S. asset-backed securities	5.03	64	2.15	-0.26	-0.26	-5.30
Preferred securities	7.27	260	5.09	-0.22	-0.22	-15.06
High yield 2% issuer capped	9.30	499	4.08	1.42	1.42	-13.52
Senior loans[4]	10.83	644	0.25	0.74	0.74	-2.60
Global emerging markets	8.17	399	5.97	0.33	0.33	-20.24
Global aggregate (unhedged)	3.76	62	6.77	-0.39	-0.39	-20.21

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, 07 Oct 2022. **Past performance does not predict or guarantee 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, 07 Oct 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 05 Oct 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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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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