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**CIO Weekly Commentary**
21 November 2022

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

# When will bonds act like bonds again?

## Bottom line up top:

**2022: A Bond Oddity.** Like many who left theaters after watching the groundbreaking 1968 sci-fi epic 2001: A Space Odyssey, investors looking back on this year's fixed income results may be scratching their heads, wondering what it was they just saw. While 2022 has been historically challenging for almost all asset classes, the unwavering hawkish monetary policy of central banks to crush inflation fueled an upward spiral in rates that was particularly jarring for bonds. While higher rates resulted in attractive yields across a number of sectors, it also fueled significant downturns across the broad taxable fixed income market and in areas like investment grade municipals where investors aren't accustomed to outsized negative returns. (Figure 1). As of 18 November, year-to-date losses for these bond categories in the U.S. were similar in magnitude to those of the S&P 500 Index. In fact, the year-to-date correlation between the Bloomberg U.S. Aggregate Bond Index and the S&P 500 Index at the end of October was 0.68 — not just unusual but among the highest levels observed in the past 30 years.

**2023: Here's hoping the sequel will be better than the original.** Over the past two weeks, favorable inflation data, indicating that wholesale and consumer prices may have peaked, has helped drive yields sharply lower, allowing some of the hardest-hit areas of the bond market to rally: For the two weeks ended 18 November, the Bloomberg U.S. Aggregate Bond Index is up +2.92%, the Bloomberg Municipal Index rose +3.30% and the Bloomberg U.S. Corporate Index gained +3.95%.

**Saira Malik, CFA**
*Chief Investment Officer*

*On behalf of Nuveen's Global Investment Committee*

As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

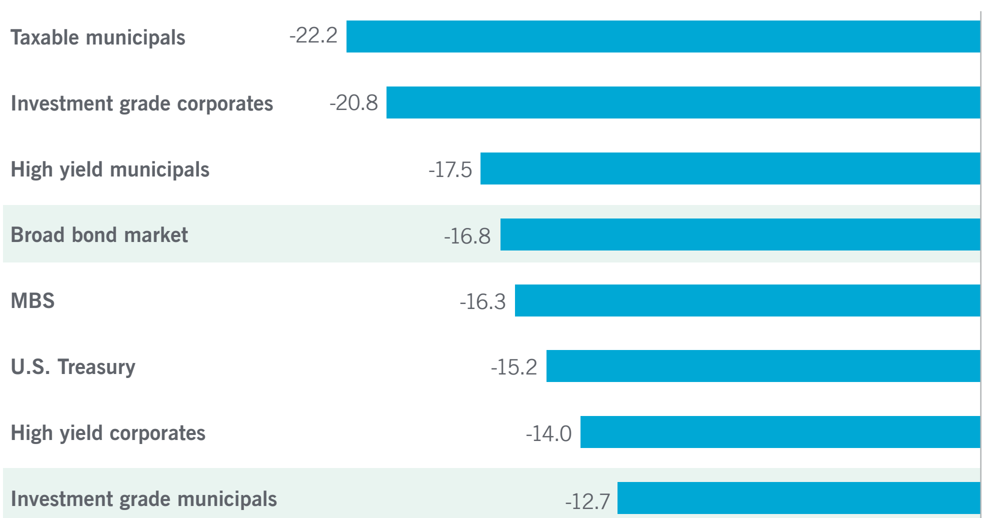
We anticipate a sustained moderation in inflation, which should provide the Fed with some breathing room. In our view, the majority of rate hikes is likely behind us. That said, we don't expect inflation to decelerate at a rapid pace from here, mainly because key components of services inflation, such as shelter/rent, continue to exhibit "sticky" prices.

**Bond Appétit.** Should a convincing pattern of slower inflation indeed materialize, we would likely see the Fed transition into the next phase of its inflation fight: "higher for longer" policy rates, but without additional large hikes like those implemented since May. This could pave the way for a mild and potentially short-lived recession in the U.S. — our base case scenario — and foster an environment in which bonds begin to act like bonds again. That means lower correlations versus equities and the ability to provide meaningful diversification benefits and ballast in investor portfolios. These will be sought-after qualities, as we expect equities and other risk assets to remain vulnerable to more downside risk given slowing economic activity and negative earnings revisions.

***We expect inflation to continue to moderate, which should allow bond markets to act more 'normally' in 2023.***

**FIGURE 1: NEARLY ALL AREAS OF THE BOND MARKET HAVE BEEN HARD HIT**

*YTD returns (%)*




Data source: Bloomberg, L.P., as of 31 Oct 2022. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: Broad bond market:** Bloomberg U.S. Aggregate Bond Index; **High yield corporates:** Bloomberg U.S. Corporate High Yield Index; **High yield municipals:** Bloomberg High Yield Municipal Bond Index; **Investment grade corporates:** Bloomberg U.S. Corporate Investment Grade Index; **Investment grade municipals:** Bloomberg Municipal Bond Index; **Mortgage-backed securities (MBS):** Bloomberg MBS (fixed rate) Index; **Taxable municipals:** Bloomberg Taxable Municipal Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index.

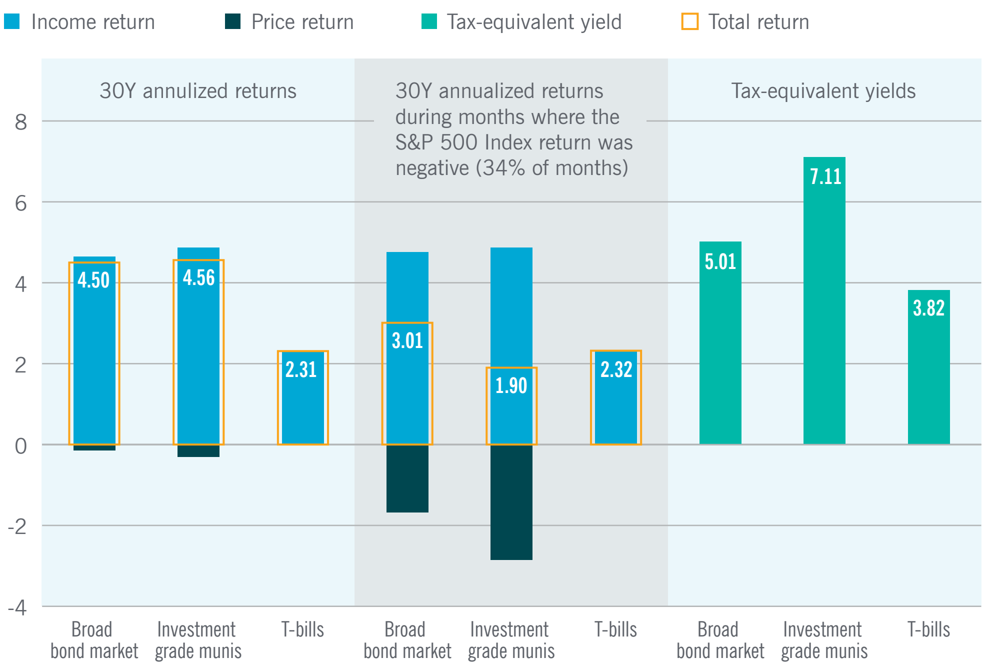
# Portfolio considerations:

Investment grade fixed income (both U.S. aggregate bonds and municipals) have historically shown they usually deliver positive total returns in periods of negative equity market returns. But this isn't carved in stone; rather, it has been based on bonds' ability to generate consistent income returns that might offset any negative price return ***most of the time*** (Figure 2).

2022 has not been a normal time. Still, today's yields are above historical norms, and signs of decelerating core inflation give us confidence that bonds might finally begin to "act like bonds" again in 2023. Investors rolling T-bills in their fixed income sleeves may be better served by putting cash to work in longer-duration strategies, as long-term yields tend to peak before the end of the Fed's hiking cycle.

***As markets normalize, investors may want to consider extending duration to closer to neutral.***

**FIGURE 2: BOND INCOME COMPOUNDS, EVEN WHEN STOCK RETURNS ARE NEGATIVE (%)**




Data source: Bloomberg, L.P., 1 Nov 1997 to 31 Oct 2022. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: Broad bond market:** Bloomberg U.S. Aggregate Bond Index; **Investment grade municipals:** Bloomberg Municipal Bond Index; **T-bills:** Bloomberg U.S. Treasury Bills 1-3 Months Index. The **taxable-equivalent yield** is based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income (the Net Investment Income Tax). Individual tax rates may vary.

## About Nuveen's Global Investment Committee

*Nuveen's Global Investment Committee (GIC) brings together the most senior investors from across our platform of core and specialist capabilities, including all public and private markets.*

*Regular meetings of the GIC lead to published outlooks that offer:*

- macro and asset class views that gain consensus among our investors
- insights from thematic "deep dive" discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

**For more information, please visit nuveen.com.**

**Endnotes**

**Sources**

All market and economic data from Bloomberg, FactSet and Morningstar.

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