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Weekly Fixed Income Commentary

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Treasury yields fall on a flight-to-quality rally

U.S. Treasury yields fell sharply after Silicon Valley Bank surprisingly failed on Friday. Investors flocked to safe-haven Treasuries at the expense of risk assets. The collapse appears to be an isolated issue and should not spark broader financial market contagion.

HIGHLIGHTS

- **Total returns were positive for Treasuries, investment grade corporates, taxable munis, MBS, ABS, senior loans and emerging markets.**
- **Preferreds, convertibles and high yield corporates all had negative total returns.**
- **Municipal bond yields declined. New issue supply was $10.9B with outflows of -$308M. This week's new issuance should be $6.8B.**

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Watchlist

- *U.S. Treasury yields decreased across the curve.*
- *Spread assets sold off in the wake of the Silicon Valley Bank failure.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

“Higher for longer” emerges as a theme, as the Fed battles to control inflation. Rates are likely to rise higher than either markets – or even the Fed itself – anticipated just a few months ago.

The underlying growth outlook remains healthy, thanks to strong consumer balance sheets and solid levels of businesses investment. This combination should keep corporate defaults low.

Treasury yields are likely to fall this year, and we expect the 10-year Treasury yield to end 2023 around 3.25%.

We favor selectively taking on risk in this environment of attractive prices and yields. Credit selection is key as we search for bonds with favorable income and characteristics.

KEY RISKS

- Inflation fails to moderate as expected, weighing on asset prices.
- Policymakers tighten too rapidly, undermining the global economic expansion.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

INVESTORS FLOCK TO SAFE-HAVEN TREASURIES

U.S. Treasury yields fell sharply last week, with 10-year yields down -25 basis points (bps) to 3.70%. The front-end rallied even more, with 2-year yields down -27 bps. Silicon Valley Bank’s failure sparked a strong bond market flight-to-quality rally on Friday. Our analysis suggests this is an isolated, one-off event based on the bank’s concentration in venture capital. We don’t expect broad contagion throughout the banking system. Before the bank failure news, U.S. Federal Reserve Chair Powell leaned hawkish in congressional testimony, opening the door more firmly to a 50 bps rate hike at the 22 March meeting. The latest jobs report showed continued labor market strength, albeit with a higher unemployment rate and decelerating wage gains.

Investment grade corporates gained last week amid the rally in Treasuries, returning 0.77%. However, the asset class lagged similar-duration Treasuries by -111 bps, as spreads widened and risk assets were broadly pressured after Silicon Valley Bank failed on Friday. The new issue market remained busy, with almost $40 billion of new deals pricing. Inflows remained positive as well, at $1.7 billion.

High yield corporates retreated, returning -0.89% for the week and lagging similar-duration Treasuries by -204 bps. Unlike investment grade, which is longer duration and was helped by the rally in rates, high yield as an asset class has a shorter duration profile and was therefore less supported by the fall in Treasury yields. Spreads widened 53 bps to 451, which is still close to the long-run historical average. The new issue market was quiet, and flows were close to flat. Senior loans also traded close to flat for the week, returning 0.02%.

Emerging markets gained, returning 0.47% for the week, though they also underperformed similar-duration Treasuries by -122 bps. Inflows accelerated, totaling $1.6 billion for the week. The new issue market picked up, with more than $6 billion of new issuance for the week. Spreads widened 18 bps, but yields only rose 8 bps, as the rally in Treasuries helped to support fixed income more broadly.

THE MUNICIPAL MARKET REMAINS WELL BID

Municipal bond yields ended lower last week, in tandem with Friday's rally following the collapse of Silicon Valley Bank. Outsized new issue supply was priced to sell and well received, while fund flows were negative. Most deals were several times oversubscribed, suggesting cash remains on the sidelines waiting to be invested. This demand should continue supporting the market.

The full consequences of the Silicon Valley Bank failure remain to be seen. We believe the banking system remains solid, so the Fed should resume its battle against inflation by raising short-term rates at the next meeting.

Pennsylvania Turnpike Commission issued $345 million turnpike revenue bonds (rated A3/A+). The deal included 5% bonds due in 2043 yielding 4.18%. Those bonds traded in the secondary market on Friday at a yield of 4.04%, reflecting the flight-to-quality rally on Friday following the Silicon Valley Bank news.

High yield municipal bond yields decreased by 14 bps on average last week, versus 12 bps for high grades. High yield muni fund outflows continued to decrease early in the week, due to the resurgence of rate volatility. However, by week's end that trend reversed with the massive rate rally on Friday. High yield new issuance should be unusually light this week at just $200 million. Trading in Brightline bonds surged last week, moving prices higher, in response to the introduction of 24 months of additional debt reserves. Month-over month ridership levels continue to grow strongly.

Muni bond deals were several times oversubscribed, suggesting cash remains on the sidelines to be reinvested.

In focus

Municipal issuance picks up with the seasons

As the calendar moves toward spring, municipal issuance is slated to increase. So far in 2023, issuance is 27% lower year-over-year. This lower issuance, combined with supportive fund flows, pushed municipals richer versus U.S. Treasuries until late February.

However, visible supply – the value of deals coming to market in the next 30 days – ended last week at $12.7 billion. This marks two consecutive weeks of posting forward supply of more than $12 billion, the highest level since September. This total falls well above the 2022 and 2023 averages of $9.8 billion and $7.0 billion, respectively.

Issuance traditionally picks up in the spring and early summer, before dropping off again until the fall. We typically see heightened selling in the spring to meet tax balances, but we expect lower selling pressure this year given the market's performance in 2022. This should mean less impact on performance, but heightened issuance should provide an attractive entry point for investors to capitalize on February's market repricing.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	4.59	-0.27	-0.23	0.16
5-year	3.97	-0.28	-0.22	-0.04
10-year	3.70	-0.25	-0.22	-0.18
30-year	3.71	-0.17	-0.21	-0.26

Source: Bloomberg L.P., 10 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	2.83	-0.16	-0.12	0.23
5-year	2.59	-0.09	-0.05	0.07
10-year	2.51	-0.12	-0.08	-0.12
30-year	3.48	-0.12	-0.08	-0.10

Source: Bloomberg L.P., 10 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	68
30-year AAA Municipal vs Treasury	94
High Yield Municipal vs High Yield Corporate	65

Source: Bloomberg L.P., Thompson Reuters, 10 Mar 2023. 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. **Performance data shown represents past performance and does not predict or guarantee future results.**

Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	3.51	–	6.12	0.94	0.76	1.31
High yield municipal	5.72	242[1]	7.69	1.60	1.13	2.30
Short duration high yield municipal[2]	5.35	285	4.10	0.57	0.43	1.69
Taxable municipal	4.86	93[3]	8.31	2.12	2.08	4.80
U.S. aggregate bond	4.67	55[3]	6.34	1.17	1.04	1.45
U.S. Treasury	4.16	–	6.31	1.63	1.46	1.57
U.S. government related	4.74	55[3]	5.38	1.18	1.06	1.59
U.S. corporate investment grade	5.41	136[3]	7.17	0.77	0.98	1.69
U.S. mortgage-backed securities	4.71	60[3]	5.99	0.85	0.47	1.04
U.S. commercial mortgage-backed securities	5.20	107[3]	4.54	1.20	0.92	1.65
U.S. asset-backed securities	5.06	52[3]	2.85	0.82	0.73	1.29
Preferred securities	7.43	264[3]	4.98	-3.17	-3.49	2.85
High yield 2% issuer capped	8.84	451[3]	3.75	-0.89	-0.59	1.88
Senior loans[4]	10.24	589	0.25	0.02	0.09	3.31
Global emerging markets	7.51	343[3]	6.15	0.47	0.18	1.08
Global aggregate (unhedged)	3.73	51[3]	6.80	1.31	1.11	0.96

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, 10 Mar 2023. **Performance data shown represents past performance and 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, 10 Mar 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 08 Mar 2023.

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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