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Weekly Fixed Income Commentary

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Treasury yields fall, awaiting a last Fed hike

U.S. Treasury yields fell amid mixed U.S. economic data ahead of this week's U.S. Federal Reserve meeting. We expect the Fed to raise interest rates by 25 basis points, in likely its final move of this tightening cycle.

HIGHLIGHTS

- **Treasuries, agencies, investment grade and high yield corporates, MBS, taxable munis, emerging markets and senior loans all enjoyed positive total returns.**

- **Preferred securities was the only major asset class with negative returns, though it still ended April with the best performance.**

- **Municipal bond yields remained essentially unchanged. New issue supply was $8.5B with outflows of -$92M. This week's new issuance is expected to be $6.5B.**

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Watchlist

- *U.S. Treasury yields fell sharply.*
- *Spread assets gained, but generally lagged Treasuries.*
- *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. Higher interest rates are likely to cause additional volatility.

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 solid fundamentals.

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.

INVESTMENT GRADE INFLOWS CONTINUE

U.S. Treasury yields fell sharply last week, with 10-year yields down -15 basis points (bps) to 3.43%. 2-year yields fell even more, dropping -18 bps. The moves came amid soft industrial survey data pointing to weaker U.S. economic growth ahead. However, the housing market appears to be rebounding, with home prices rising by the most in nine months and new home sales increasing the most in seven months. First quarter GDP data surprised to the downside, mainly due to a drawdown in inventories; actual underlying spending increased. Additionally, inflation data came in slightly hotter than expected. Overall, the U.S. economic outlook looks better than feared, but still highly uncertain. We expect the Fed to raise rates by 25 bps this week, in likely its final move of the tightening cycle. However, rates could move further if inflation and labor market data continue to surprise to the upside. Next week, we also get the April jobs report on Friday.

Investment grade corporates rebounded, returning 0.87% for the week, though they lagged similar-duration Treasuries by -15 bps. The market experienced its fifth straight weekly inflow, with $2 billion entering the asset class, while supply was in line with expectations at around $17 billion. For April overall, supply was -22% lower than expected, at $62.2 billion. In May, that is expected to change, with most banks penciling in around $135 billion of supply for the month. Preferred returns were poor after a recent strong run, returning -0.24% for the week but still 1.51% in April, the best major fixed income asset class.

High yield corporates rallied, returning 0.49% for the week, though they also underperformed similar-duration Treasuries by -15 bps. Senior loans eked out a gain of 0.06%, despite the fall in rates and another outflow of -$717 million. High yield funds had inflows of $594 million. In both markets, earnings dominated attention and drove idiosyncratic price action. Overall, first quarter results have been better than expected.

Emerging markets returned 0.72% and lagged similar-duration Treasuries by -18 bps. In both corporate and sovereign markets, investment grade names outperformed high yield. Colombia was a notable laggard, with spreads widening 35 bps after President Petro shook up his cabinet and appointed a new finance minister. Across the EM asset class, outflows returned, with -$539 million exiting hard currency funds and -$94 million leaving local currency funds.

MUNICIPAL BONDS SHOULD REMAIN WELL BID

Municipal bond yields remained essentially unchanged last week. New issuance was generally well received, but some balances remained. Fund flows were negative yet again. This week's new issue supply will need to be priced to sell to clear the market.

All eyes will be on the Fed this week, as it is expected to raise rates an additional 25 bps to the 5.00% – 5.25% range. The Fed maintains that hikes will continue until U.S. inflation declines to 2%. Most investors are pleased with the Fed's progress and commitment. Thus, long-term rates are lower than the fed funds rate. We see a potential opportunity to lock in rates longer out on the curve, as these rates will not likely be this cheap by year's end.

Municipal bonds should remain well bid. We are approaching historically large reinvestment months in May, June and July, with muted new issue supply.

The state of Wisconsin issued $495 million general obligation refunding bonds (rated Aa1/AA+). The deal included 5% coupon bonds due in 2033 that came at a yield of 2.57%. This yield is roughly 73% of the 10-year U.S. Treasury bond, rich by historical standards.

High yield municipal bond yields declined slightly last week, ending April only modestly higher compared to larger increases in high grade yields. High yield muni credit spreads tightened slightly on average, and even more so for short-duration high yield, suggesting the credit spread curve inversion is beginning to normalize. High yield municipal spreads ended the month at 256 bps for 20-year bonds versus 304 bps for 7-year bonds. The pace of outflows tapered by month-end. New issuance should be light this week, but soon the market will be fed with large reinvestment cash flows in June, July and August. May 1 cash flows will likely also have a positive impact on demand.

Earnings dominated attention and drove idiosyncratic price action in both the high yield corporate and senior loan markets.

In focus

Banks report encouraging earnings

Most banks have released first quarter earnings, which were of particular interest to credit markets in the wake of the March banking crisis. Overall, the results have been encouraging.

While deposits are lower across both the global systemically important banks (GSIBs) and regional banks, the decline was generally modest for most institutions, and banks remain well capitalized. First Republic Bank was an outlier, and was placed into FDIC receivership early Monday morning. JP Morgan has acquired the bank's deposits, loans and securities, but will not assume the debt and preferred securities.

Bank earnings and profitability metrics were generally better than expected. However, net interest margins will likely be under pressure, particularly among regional banks that may have to pay up to retain and/or attract deposits.

Commercial real estate (CRE) exposure continues to be an area of focus, but we believe that stress within this space is more likely to be an earnings event. We don't expect it to materially impact capital levels.

With the bank earnings season mostly in the rearview mirror, GSIBs have recently issued senior debt after a long, quiet period during the March banking crisis. New issuance has been well received with limited concessions.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	April 2023	Year-to-date
2-year	4.01	-0.18	-0.02	-0.42
5-year	3.49	-0.18	-0.09	-0.52
10-year	3.43	-0.15	-0.05	-0.45
30-year	3.68	-0.10	0.03	-0.29

Source: Bloomberg L.P., 28 Apr 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	April 2023	Year-to-date
2-year	2.69	0.13	0.31	0.09
5-year	2.38	0.02	0.16	-0.14
10-year	2.35	-0.01	0.08	-0.28
30-year	3.39	-0.01	0.09	-0.19

Source: Bloomberg L.P., 28 Apr 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	92
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 28 Apr 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	April 2023	Year-to-date
Municipal	3.39	–	6.07	0.11	-0.23	2.54
High yield municipal	5.69	252[1]	7.62	0.67	0.58	3.33
Short duration high yield municipal[2]	5.34	304	3.90	0.30	0.42	2.65
Taxable municipal	4.70	103[3]	8.29	1.32	1.23	6.50
U.S. aggregate bond	4.35	57[3]	6.33	0.83	0.61	3.59
U.S. Treasury	3.79	–	6.28	0.88	0.54	3.56
U.S. government related	4.37	56[3]	5.39	0.89	0.80	3.70
U.S. corporate investment grade	5.10	136[3]	7.23	0.87	0.77	4.29
U.S. mortgage-backed securities	4.48	66[3]	5.93	0.73	0.52	3.06
U.S. commercial mortgage-backed securities	5.11	140[3]	4.53	0.79	0.86	2.69
U.S. asset-backed securities	4.92	83[3]	2.87	0.43	0.50	2.37
Preferred securities	7.24	268[3]	4.49	-0.24	1.51	3.04
High yield 2% issuer capped	8.50	454[3]	3.60	0.49	1.01	4.61
Senior loans[4]	9.78	599	0.25	0.06	0.95	4.09
Global emerging markets	7.32	359[3]	6.24	0.72	0.39	2.55
Global aggregate (unhedged)	3.52	54[3]	6.80	0.74	0.44	3.46

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, 28 Apr 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, 28 Apr 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 26 Apr 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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