nuveen
A TIAA Company

Weekly Fixed Income Commentary

05 June 2023

Treasury yields decline on healthy economic data

U.S. Treasury yields fell last week, supported by strong economic data, the resolution of the U.S. debt ceiling standoff, and comments from U.S. Federal Reserve officials that aligned with expectations.

HIGHLIGHTS

- **All major fixed income sectors had positive total and excess returns, including agencies, MBS, CMBS, ABS, investment grade and high yield corporates, preferreds and emerging markets.**
- **Municipal bond yields declined. New issue supply was $6.6B with outflows of -$1.3B. This week's new issuance is expected to be $9.8B.**

Anders Persson
CIO of Global Fixed Income

Daniel Close
Head of Municipals

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

Watchlist

- *U.S. Treasury yields fell, and we anticipate further declines over the course of 2023.*
- *Spread assets gained relative to Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" remains 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 slightly 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.

HIGH YIELD CORPORATES ENJOY SUBSTANTIAL GAINS

U.S. Treasury yields fell last week, with the 10-year yield down -11 basis points (bps) to 3.70%. 2-year yields declined more modestly at -6 bps. The last set of public communications from U.S. Federal Reserve officials before the June 14 meeting generally aligned with expectations for a "hawkish hold." The U.S. debt ceiling was resolved before the x-date, allowing the Treasury to avoid a technical default, which led to a relief rally. Economic data were healthy, with inflation moderating in Europe and the U.S. labor market showing continued impressive performance.

Investment grade corporates rallied, returning 1.06% for the week and beating similar-duration Treasuries by 26 bps. Spreads tightened -3 bps and have retraced almost all their widening after First Republic Bank failed earlier this year. Preferreds also gained, returning 1.71% for the week, outperforming similar-duration Treasuries by an impressive 117 bps. Investment grade funds saw their tenth consecutive week of inflows, with $499 million entering the asset class, while new issuance was somewhat muted given the U.S. holiday-shortened week. Eight issuers brought $15.4 billion of new supply, which was more than 4x oversubscribed, leading to concessions of only around 5 bps.

High yield corporates gained substantially, returning 1.14% for the week and outperforming similar-duration Treasuries by 72 bps. Loans also gained, returning 0.32%. Both asset classes were helped by the resolution of the debt limit as well as healthy economic data. High yield funds had outflows of -$2.2 billion, while loan funds experienced outflows of -$926 million. On the other hand, new supply was soft, with only $1.4 billion coming to market.

Emerging markets debt also rallied last week, though the asset class lagged U.S. fixed income. Emerging markets returned 0.92% for the week, roughly in line with similar-duration Treasuries. Outflows were the largest in seven weeks, with -$706 million leaving hard currency funds and -$235 million exiting local currency funds. New issue supply was healthier than other markets, with $9.5 billion split across sovereigns and corporates, though it was entirely investment grade. That, plus some positive developments in Turkey, Nigeria and Colombia, led high yield to outperform investment grade across the asset class.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

MUNICIPAL BOND REINVESTMENT MONEY IS BEING PUT TO WORK

The municipal market had a strong week last week, with short-term yields declining -16 bps and long-term yields falling -12 bps. Weekly new issuance was well received, and fund flows were negative for the sixteenth consecutive week. This week's new issue supply should be priced to sell and well received.

We recently outlined the bad news/good news for fixed income markets. First let's review the status of the trouble spots. Lawmakers agreed to raise the U.S. debt ceiling and the market reacted positively. Second, a Fed rate increase of 25 bps in June is now more possible due to last Friday's robust employment data. The Fed may raise rates again to head off any resulting inflation. Lastly, the FDIC continues to liquidate billions of dollars of bonds from the regional banks that failed over the last several months. Overall, the market has absorbed the bonds at constructive levels. Finally, municipal new issuance remains outsized. Dealers are pricing new issuance to sell, and the cheap deals are being well received.

As for the good news? Total tax-exempt reinvestment money is anticipated to be more than $100 billion during the summer months. $36 billion became available on 01 June and is being put to work.

The state of Connecticut issued $366 million general obligation bonds (rated Aa3/AA-). The deal included 5% coupon bonds due in 2033 that came at a yield of 3.00%. Those bonds traded in the secondary market at 2.84%, reflecting the strengthening of the fixed income market as the week progressed.

The high yield municipal market enjoyed a stronger week, bolstered by June 1 cash flows and light supply. High yield municipal credit spreads ended the week tighter and trading volume picked up. We expect a strong technical backdrop this summer, supported by a robust beginning in June.

$36 billion of muni reinvestment money became available on 01 June and is already being put to work.

In focus

What's ahead for the Fed?

After its May meeting, the Federal Reserve signaled an imminent end to its aggressive tightening cycle, which began in March 2022. The central bank stated that additional firming "may be appropriate," and that it would "closely monitor incoming information."

That incoming information included May's stronger-than-expected job report released last Friday (+339,000 payrolls, plus significant upward revisions to March and April). But despite the labor market's staying power, the odds were still a healthy 70% shortly after the report that the Fed will stand pat at its 14 June meeting, as we expect. Such a strategy would give Chair Jerome Powell and his colleagues more time to study the economic effects of this cycle's rate hikes, in addition to any fallout due to the recent regional bank failures.

We think the Fed's July meeting will be "live," meaning a hike is possible based on June's employment numbers and additional inflation data. Although we expect U.S. core inflation to moderate to around 4% by December — which is still well above the Fed's 2% target — we're not anticipating any rate cuts in 2023. Traders are far more dovish, however, having priced in 30 bps of easing sometime later this year.

In terms of Treasury yields, softer inflation should help the bellwether 10-year note finish 2023 at around 3.25%, which would be down from approximately 3.70% as of Friday. Historically, the long end of the curve has tended to outperform after the Fed ends rate hiking cycles.

U.S. Treasury market

Maturity	Yield	Change (%) Week	May 2023	Year-to-date
2-year	4.50	-0.06	0.40	0.07
5-year	3.85	-0.08	0.27	-0.16
10-year	3.70	-0.11	0.22	-0.18
30-year	3.89	-0.07	0.19	-0.08

Source: Bloomberg L.P., 02 Jun 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	May 2023	Year-to-date
2-year	2.99	-0.16	-0.09	0.39
5-year	2.66	-0.17	-0.10	0.14
10-year	2.59	-0.13	-0.06	-0.04
30-year	3.50	-0.12	-0.05	-0.08

Source: Bloomberg L.P., 02 Jun 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	70
30-year AAA Municipal vs Treasury	90
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 02 Jun 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	May 2023	Year-to-date
Municipal	3.58	–	6.10	0.90	-0.87	2.03
High yield municipal	5.77	249[1]	7.62	1.40	-0.69	3.18
Short duration high yield municipal[2]	5.43	286	3.90	0.55	-0.08	2.75
Taxable municipal	4.98	102[3]	8.20	1.23	-1.44	4.59
U.S. aggregate bond	4.65	54[3]	6.40	0.96	-1.09	2.17
U.S. Treasury	4.13	–	6.28	0.73	-1.16	1.99
U.S. government related	4.70	53[3]	5.37	0.67	-0.90	2.55
U.S. corporate investment grade	5.40	134[3]	7.17	1.06	-1.45	2.69
U.S. mortgage-backed securities	4.68	57[3]	6.24	1.29	-0.73	1.93
U.S. commercial mortgage-backed securities	5.44	135[3]	4.49	0.65	-0.61	1.74
U.S. asset-backed securities	5.29	78[3]	2.80	0.37	-0.34	1.84
Preferred securities	7.32	251[3]	4.58	1.71	-1.15	2.91
High yield 2% issuer capped	8.56	426[3]	3.56	1.14	-0.92	4.53
Senior loans[4]	10.36	630	0.25	0.32	-0.09	4.23
Global emerging markets	7.51	344[3]	6.21	0.92	-0.75	1.95
Global aggregate (unhedged)	3.69	52[3]	6.84	1.15	-1.95	1.63

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, 02 Jun 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, 02 Jun 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 31 May 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.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Performance data shown represents past performance and does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

Important information 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.

Nuveen provides investment advisory solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

GWP-2936005PG-W0623P