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Weekly Fixed Income Commentary

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Treasury yields rise, markets watch the Fed

U.S. Treasury yields rose despite softer economic data ahead of this week's U.S. Federal Reserve meeting. We expect officials to keep rates unchanged but to take a hawkish tone.

HIGHLIGHTS

- **Treasuries, agencies, investment grade corporates, taxable munis and preferreds had negative total returns.**
- **High yield corporates, senior loans, MBS and emerging markets had positive returns.**
- **Municipal bond yields remained unchanged. New issue supply was $9.8B with inflows of $460M. This week's new issuance is expected to be only $3.7B.**

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Watchlist

- *U.S. Treasury yields rose, but 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.

SENIOR LOANS SEE THEIR BEST PERFORMANCE SINCE MARCH

U.S. Treasury yields rose last week and the curve flattened further. 10-year Treasury yields rose 5 basis points (bps) to 3.74%, touching their highest levels in three months. 2-year yields moved more, up 10 bps to 4.60%, also to their recent highs. The moves came despite relatively soft economic data, with the ISM services survey dropping to 50.3, barely in expansionary territory (above 50). Initial jobless claims also rose to a new high of 261,000, now above the peaks of 2018-19 and approaching concerning levels. This week attention will focus on the May CPI report on Tuesday and the U.S. Federal Reserve meeting on Wednesday, where we expect no change to interest rates but a signal that another hike is possible or even likely later this summer.

Investment grade corporates sold off slightly, returning -0.31% for the week and lagging similar-duration Treasuries by -14 bps. The asset class was pressured by a large bout of new issuance of $50 billion for the week, the fourth-heaviest week of the year. Those deals were 2.9x oversubscribed on average, resulting in healthy new issue concessions of around 7 bps. Investment grade funds had inflows of $2.6 billion, which helped to somewhat alleviate the technical pressure.

High yield corporates gained again, returning 0.31% for the week and beating similar-duration Treasuries by 47 bps. The rally sent high yield spreads down to 418 bps, their tightest levels since early March. Loans returned 0.71%, their best week since March, and were helped by the first inflows in 19 weeks at $320 million. High yield funds had inflows of $2.5 billion. Meanwhile, the loan and high yield markets saw $2.0 and $4.3 billion of new issuance, respectively.

Emerging markets also rallied last week, returning 0.36% and outpacing similar-duration Treasuries by 54 bps. Within the sovereign space, high yield names continued to tighten against investment grade, as several low-rated countries rallied strongly, including Egypt (5 points), El Salvador (4 pts), and Argentina (2.5 pts). While local currency funds had healthy inflows of $107 million, hard currency funds had their seventeenth weekly outflow with -$445 million leaving the asset class.

MUNICIPAL MARKET SUPPORTED BY SUMMER REINVESTMENT MONEY

Municipal bond yields remained essentially unchanged last week and the market closed with a constructive tone. Dealers struggled to sell deals, and some balances remained by week's end. Fund flows were positive after 16 consecutive weeks of outflows. This week's new issue supply will need to be priced to sell to pique investor interest.

All eyes will be on the Fed this week. While no hike is expected, many believe this is only a "skip" and the Fed will raise rates in July. Either way, the Fed must continue to show its commitment to fighting inflation. The May CPI report will be released this week as well, so Fed members can assess how well they think they have done to curtail inflation. Fixed income in general should remain range bound. In fact, municipal bonds may be better bid than fixed income in general due to tax-exempt summer reinvestment money totaling more than $100 billion.

Indiana Finance Authority for Indiana University Health issued $693 million bonds (rated AA2/AA). The deal included 5% bonds due in 2053 that came at a yield of 4.25%. At Friday's close, the underwriter quoted a bid of 4.25%, the same price at which the bonds were issued.

High yield municipal performance in June has been driven by technical strength. High yield muni yields have decreased by 6 bps on average this month, roughly in line with high grade munis and significantly outperforming U.S. Treasuries. Yield ratios have compressed and credit spreads continue to contract. Supply is running well below average, roughly 25% less than 2022 levels, and we expect that trend to continue.

Municipal bond fund flows were positive at $460 million after 16 consecutive weeks of outflows.

In focus

Financials are back in focus

Investment grade corporate U.S. bank issuance has been muted since the collapse of Silicon Valley Bank in early March. While some U.S. bank issuers came to market after the March banking crisis, issuance has been dominated by the largest issuers in the space.

However, Truist, Capital One, PNC, U.S. Bancorp and Ally issued senior debt last week, coinciding with a broader strengthening in tone around U.S. banks, particularly regional banks.

Regional banks have retraced most of the spread widening experienced in early May, following the failure of First Republic Bank. Last week's deals were well over-subscribed, featured reasonable concessions and performed well. This robust demand can be interpreted as a show of confidence for the strength of the sector.

While issuance has picked up, gross supply for U.S. banks remains well below 2022 levels and net supply was negative year-to-date through May, as maturities have outpaced supply so far this year. The negative net supply dynamic has supported spreads in the banking sector.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.60	0.10	0.19	0.17
5-year	3.91	0.07	0.16	-0.09
10-year	3.74	0.05	0.10	-0.13
30-year	3.88	-0.01	0.02	-0.08

Source: Bloomberg L.P., 09 Jun 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.95	-0.04	-0.13	0.35
5-year	2.66	0.00	-0.10	0.14
10-year	2.59	0.00	-0.06	-0.04
30-year	3.50	0.00	-0.05	-0.08

Source: Bloomberg L.P., 09 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	69
30-year AAA Municipal vs Treasury	90
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 09 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.57	–	6.09	0.10	0.47	2.13
High yield municipal	5.78	250[1]	7.64	0.21	0.77	3.40
Short duration high yield municipal[2]	5.45	288	3.90	0.03	0.21	2.79
Taxable municipal	5.02	102[3]	8.19	-0.09	-0.45	4.49
U.S. aggregate bond	4.71	54[3]	6.36	-0.15	-0.44	2.01
U.S. Treasury	4.20	–	6.24	-0.19	-0.54	1.80
U.S. government related	4.77	54[3]	5.35	-0.19	-0.41	2.35
U.S. corporate investment grade	5.49	138[3]	7.14	-0.31	-0.40	2.38
U.S. mortgage-backed securities	4.69	54[3]	6.20	0.04	-0.32	1.97
U.S. commercial mortgage-backed securities	5.49	134[3]	4.48	-0.13	-0.45	1.60
U.S. asset-backed securities	5.32	74[3]	2.80	-0.02	-0.19	1.82
Preferred securities	7.36	257[3]	4.64	-0.25	0.79	2.66
High yield 2% issuer capped	8.59	418[3]	3.56	0.31	1.17	4.86
Senior loans[4]	10.29	610	0.25	0.71	0.93	4.97
Global emerging markets	7.51	338[3]	6.20	0.36	0.52	2.31
Global aggregate (unhedged)	3.74	52[3]	6.81	-0.02	0.16	1.61

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, 09 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, 09 Jun 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 07 Jun 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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