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Weekly Fixed Income Commentary

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A Fed pause boosts Treasury yields

U.S. Treasury yields rose after the U.S. Federal Reserve announced a "hawkish hold" at its June meeting. U.S. economic data remain mixed, with inflation reporting in line with expectations and jobless claims remaining elevated.

HIGHLIGHTS

- **Agencies, investment grade and high yield corporates, taxable municipals, MBS and emerging markets all gained.**
- **U.S. Treasuries experienced a modest selloff.**
- **Municipal bond yields declined slightly. New issue supply was $3.7B with outflows of -$257M. This week's new issuance should be $5.7B.**

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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.

INVESTMENT GRADE CORPORATES FIND SUPPORT FROM HEALTHY TECHNICALS

U.S. Treasury yields rose again last week, after the Fed delivered a hawkish hold at its policy meeting. Officials kept rates unchanged, as expected, but updated their economic projections to signal two more rate hikes this year, versus zero previously. They also increased their forecasts for real GDP growth and inflation this year. The prospect of further rate hikes sent the 2-year Treasury yield 12 basis points (bps) higher, while the 10-year rose a more modest 2 bps. Separately, the May CPI report came in mostly in line with expectations, showing a further modest deceleration in shelter prices. Jobless claims remained elevated for the second week in a row, potentially signaling some slowdown to come in the labor market.

Investment grade corporates gained, returning 0.52% for the week and outperforming similar-duration Treasuries by 54 bps. Spreads tightened -7 bps to reach a fresh three-month low of 131 bps for the index overall, though regional banks widened 5 to 10 bps. The investment grade market was supported by healthy technicals, with an inflow of $3.2 billion, the twelfth straight week. Issuance was lower than expected, at only $10.4 billion, as attention focused on the inflation data and Fed meeting.

High yield corporates continued their strong run, returning 0.44% for the week and outpacing similar-duration Treasuries by 58 bps. Lower-rated sectors continued to outperform, and inflows remained healthy at $615 million. Senior loans gained 0.55%, despite another outflow of -$87 million from the asset class. New issuance was also light, with only $2.8 billion of deals coming to market, and most of those were refinancings and extensions rather than new transactions.

Emerging markets outperformed, advancing 0.60% for the week and beating similar-duration Treasuries by 66 bps. Spreads tightened across sovereign and corporate spaces, and high yield names outperformed in both markets. Local currency markets also gained, returning 0.46%, amid the second consecutive weekly inflow of $57 million. Hard currency funds saw outflows continue, but at a reduced pace, with -$87 million leaving the asset class.

MUNICIPAL BONDS SHOULD REMAIN WELL BID THROUGH THE SUMMER

Municipal bond yields closed last week slightly lower, but with a strong tone. Fund flows were negative once again, but long-term flows were +$259 million while short-term flows were - $1.37 billion. This week's new issue supply is manageable, but underwriters should price deals to sell to keep inventory moving.

We expect munis to remain well bid for the near future for several reasons. We are only one month into the $100 billion of reinvestment money returning to the market through the summer. A supply overhang of $4 billion was created due to forced liquidation of bonds from banks that failed last spring. Roughly 58% of those bonds have been sold and the liquidation lists have been well absorbed. The Fed did not raise rates at the June meeting for the first time in 10 meetings. If inflation persists, the Fed will likely raise rates at subsequent meetings. Although some components of inflation continue to be sticky on the way down, inflation continues to abate.

The School District No. 2 of Richland Co., South Carolina, issued $158 million in general obligation bonds (rated Aa1/AA). Roughly half of the deal sold at original prices, then the underwriter raised prices as the fixed income market grew firmer throughout the week. The deal included 5% coupon bonds due in 2038 that were originally purchased at a 3.13% yield to a 2032 call.

High yield municipal fund flows were positive last week as the market firmed. Leading technical indicators from tobacco and Puerto Rico bonds were higher in price, suggesting strengthening demand. While total high yield muni supply is expected to be low this week at $400 million, the number of deals at 14 is relatively high and offers the opportunity for credit selection.

High yield corporate inflows remained healthy at $615 million last week.

In focus

The Fed delivers a hawkish hold

After raising interest rates 10 consecutive times, the U.S. Federal Reserve kept rates steady last week as expected, maintaining the target range for its policy rate at 5.00% to 5.25%. This pause permits the Fed to gauge the strength of the U.S. economy before making its next move.

However, the central bank's updated dot plot indicates that most policymakers project two additional quarter point (0.25%) increases this year. And in his post-meeting press conference, Chair Jerome Powell said that the Fed's July meeting will be "live," indicating that a rate hike is a strong possibility next month. This hawkish view stands in stark contrast to the Fed's stance in May, when it signaled an imminent end to its aggressive tightening cycle.

The Fed made few changes to its policy statement, which continued to signal that Powell and his colleagues will "closely monitor incoming information." Inflation data tops that list, especially underlying measures of core services prices excluding housing. Additionally, the statement specified that the Fed "is strongly committed to returning inflation to its 2% objective" — a theme Powell reinforced during his post-meeting press conference.

For the first time since March, the Fed issued updated economic projections, revising downward its expectations for unemployment, while revising upward its forecasts for 2023 GDP and, crucially, for inflation.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.72	0.12	0.31	0.29
5-year	3.99	0.07	0.23	-0.02
10-year	3.77	0.02	0.12	-0.11
30-year	3.85	-0.03	-0.01	-0.11

Source: Bloomberg L.P., 16 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	2.93	-0.02	-0.15	0.33
5-year	2.64	-0.02	-0.12	0.12
10-year	2.57	-0.02	-0.08	-0.06
30-year	3.50	0.00	-0.05	-0.08

Source: Bloomberg L.P., 16 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	68
30-year AAA Municipal vs Treasury	91
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 16 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	3.54	–	6.07	0.24	0.72	2.38
High yield municipal	5.76	248[1]	7.60	0.44	1.21	3.86
Short duration high yield municipal[2]	5.40	285	3.87	0.27	0.48	3.06
Taxable municipal	5.02	99[3]	8.20	0.20	-0.26	4.70
U.S. aggregate bond	4.73	51[3]	6.34	0.20	-0.24	2.22
U.S. Treasury	4.25	–	6.25	-0.02	-0.56	1.78
U.S. government related	4.81	52[3]	5.35	0.09	-0.31	2.45
U.S. corporate investment grade	5.46	131[3]	7.16	0.52	0.12	2.91
U.S. mortgage-backed securities	4.69	50[3]	6.10	0.29	-0.04	2.27
U.S. commercial mortgage-backed securities	5.55	133[3]	4.46	-0.09	-0.54	1.52
U.S. asset-backed securities	5.39	70[3]	2.80	0.01	-0.18	1.83
Preferred securities	7.40	260[3]	4.68	-0.40	0.39	2.25
High yield 2% issuer capped	8.56	403[3]	3.53	0.44	1.61	5.31
Senior loans[4]	10.29	596	0.25	0.55	1.49	5.55
Global emerging markets	7.45	328[3]	6.20	0.60	1.13	2.92
Global aggregate (unhedged)	3.79	49[3]	6.80	0.36	0.52	1.97

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, 16 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, 16 Jun 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 14 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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