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Weekly Fixed Income Commentary

26 June 2023

Treasury yields are mixed on varied economic data

The U.S. Treasury curve flattened amid hawkish central bank rhetoric and mixed economic data. U.S. jobless claims have increased materially in recent weeks, while the housing market showed unexpected strength.

HIGHLIGHTS

- **Treasuries, investment grade corporates, MBS, senior loans and emerging markets all had positive total returns.**
- **High yield corporates and preferred securities had negative total returns.**
- **Municipal bond yields declined slightly. New issue supply was $5.7B with inflows of $672M. This week's new issuance should be $10.6B.**

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Watchlist

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

INVESTMENT VIEWS

"Higher for longer" rates 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 CORPORATE SPREADS TOUCH 2022 LEVELS

U.S. Treasury yields were mixed last week, with the 10-year yield falling -3 basis points (bps) and the 2-year yield rising 3 bps. Another very hot CPI report in the UK prompted the Bank of England to hike rates by a surprising 50 bps at its policy meeting. Flash PMIs for June in Europe and the U.S. were generally soft. Initial jobless claims remained near recent highs, which remain historically low but have increased materially in recent weeks. The U.S. housing market showed unexpected strength, with housing starts rebounding 22% month-over-month after rates-driven weakness in recent months. Finally, Fed Chair Powell struck a hawkish tone in his congressional testimony, consistent with the prior week's FOMC meeting.

Investment grade corporates rose again, returning 0.14% for the week, though the asset class lagged similar-duration Treasuries by -10 bps. Spread levels touched their end-2022 levels at 130 bps, though they widened slightly on Friday to end the week at 132 bps. Investment grade funds saw their 13th consecutive weekly inflow at $3.9 billion. The new issue market was somewhat subdued amid the U.S. holiday-shortened week, with only eight issuers bringing less than $14 billion of new supply.

High yield corporates softened after three weeks of strong gains. The asset class returned -0.76% and underperformed similar-duration Treasuries by -84 bps. Senior loans gained 0.17%. Unlike the investment grade market, leveraged finance markets saw robust new issuance, with $5.2 billion and $4.6 billion coming to market in the high yield and senior loan markets, respectively. Encouragingly, several of those were new money deals, including one LBO.

Emerging markets gained again, returning 0.29% for the week and beating similar-duration Treasuries by 10 bps. Local markets retreated -0.06%, though they experienced their third consecutive weekly inflow with $296 million entering the market. Hard currency funds saw outflows of -$167 million. As in U.S. leveraged finance, emerging markets saw a healthy amount of issuance, with six deals totaling $3.4 billion coming to market.

MUNICIPAL BOND MARKET CONTINUES TO STRENGTHEN

Municipal yields were slightly lower for the second consecutive week. Weekly new issue supply was priced to sell and well received, and fund flows turned positive again. This week's new issue supply is outsized and should be well received.

The municipal market continues to strengthen, driven by several factors. We are entering the second month of the $100 billion summer reinvestment money, with July 1 expected to provide $40 billion. Roughly 77% of the $6.9 billion tax-exempt bonds forced to liquidate from spring bank failures has been sold. The Fed decided to keep rates steady at the June meeting, but its continued commitment to controlling inflation is benefiting fixed income markets. We expect this positive tone to continue for the foreseeable future.

The Pennsylvania State University issued $205 million revenue bonds (rated Aa1/AA). The deal included 5% coupon bonds due in 2038 priced at 3.24%.

High yield municipal inflows were strong last week. The market firmed in response, shaping up June's performance as we approach quarter end. This week showcases at least 10 high yield municipal bond deals, but many should have little volume. The market appears to be firming into a stronger rally, with July 1st cash flows around the corner and fund flows turning firmly positive.

The muni market benefits from $40 billion in reinvestment money in July.

In focus

Midyear 2023 outlook: Testing the waters

In our 2023 midyear outlook, Nuveen's Global Investment Committee (GIC) provides our view of the fixed income market and best investment ideas.

Many market participants are holding high levels of cash and cash equivalents, preferring to simply earn what looks like a decent yield in today's higher interest rate environment rather than invest in bonds.

However, the GIC believes that fixed income's risk/reward tradeoff seems attractive, as the Fed's aggressive tightening appears to be over. Rate volatility may remain high in 2023, especially on the front end of the curve, but the 10-year Treasury yield should trade between 3.25% to 3.75% in the second half of the year. And although recession odds have increased, the GIC doesn't anticipate an especially long or deep contraction. Weakness across taxable and municipal markets ahead of a recession could offer enticing entry points if spreads widen.

Within taxable fixed income, since rates have likely peaked for this cycle, it may be prudent to reduce short-duration positions and move closer to neutral, as well as focus on higher-quality segments of individual asset classes.

Municipal bond fundamentals remain sound, with state/local governments flush with cash. Credit quality looks healthy, and valuations are still reasonable. The GIC sees compelling opportunities in high yield and longer-dated (15 year+) munis.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.74	0.03	0.34	0.32
5-year	3.99	0.01	0.24	-0.01
10-year	3.74	-0.03	0.09	-0.14
30-year	3.81	-0.04	-0.05	-0.15

Source: Bloomberg L.P., 23 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	2.91	-0.02	-0.17	0.31
5-year	2.60	-0.04	-0.16	0.08
10-year	2.53	-0.04	-0.12	-0.10
30-year	3.46	-0.04	-0.09	-0.12

Source: Bloomberg L.P., 23 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	63

Source: Bloomberg L.P., Thompson Reuters, 23 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	3.50	–	6.04	0.30	1.02	2.69
High yield municipal	5.71	247[1]	7.53	0.49	1.71	4.37
Short duration high yield municipal[2]	5.45	294	3.90	-0.64	-0.23	2.42
Taxable municipal	4.99	99[3]	8.19	0.37	0.11	5.09
U.S. aggregate bond	4.72	52[3]	6.33	0.14	-0.10	2.36
U.S. Treasury	4.25	–	6.23	0.18	-0.38	1.97
U.S. government related	4.81	52[3]	5.34	0.22	-0.10	2.67
U.S. corporate investment grade	5.46	132[3]	7.15	0.14	0.26	3.05
U.S. mortgage-backed securities	4.69	52[3]	6.09	0.06	0.02	2.33
U.S. commercial mortgage-backed securities	5.54	132[3]	4.45	0.20	-0.33	1.72
U.S. asset-backed securities	5.39	70[3]	2.78	0.08	-0.10	1.92
Preferred securities	7.47	266[3]	4.65	-0.23	0.16	2.02
High yield 2% issuer capped	9.05	428[3]	3.54	-0.76	0.84	4.51
Senior loans[4]	10.29	596	0.25	0.17	1.66	5.73
Global emerging markets	7.47	331[3]	6.21	0.29	1.42	3.22
Global aggregate (unhedged)	3.79	50[3]	6.79	-0.26	0.27	1.71

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, 23 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, 23 Jun 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 21 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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