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Weekly Fixed Income Commentary

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Treasury yields rise, awaiting Fed action

U.S. Treasury yields rose slightly, retracing some of the recent rally, ahead of this week's U.S. Federal Reserve meeting. Markets are pricing in almost 100% odds of a rate hike in the continued effort to control U.S. inflation.

HIGHLIGHTS

- **Investment grade and high yield corporates, taxable municipals, preferreds, senior loans and emerging markets all had positive total returns.**
- **Treasuries, agencies and MBS all posted negative returns amid the rise in rates.**
- **Municipal bond yields declined. New issue supply was $9.1B with strong inflows of $1.04B. This week's new issuance should be $6.1B.**

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Watchlist

- *10-year U.S. Treasury yields were flat; we anticipate modest declines over the course of 2023.*
- *Spread assets outperformed 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.

INFLOWS RETURN TO EMERGING MARKETS

U.S. Treasury yields retraced some of their recent rallies. 10-year yields ended the week flat, but 2-year yields rose 6 basis points (bps). Economic data were mostly stronger, with jobless claims falling to a two-month low after briefly spiking in June. Housing market data were softer, with new starts, building permits and existing home sales declining. Finally, retail sales were mixed. The headline number disappointed, but the "control group" (which strips out volatile elements) actually rose at a healthy rate of 0.6% month-over-month. Markets continue to price in almost 100% odds of a Fed rate hike at this week's policy meeting, followed by a roughly one-in-three chance of an additional hike later this year.

Investment grade corporates rallied again, returning 0.20% for the week and beating similar-duration Treasuries by 20 bps. Yield levels were flat for the week, though spreads tightened -2 bps. Inflows continued at $302 million, though they decelerated to the slowest pace since March. Attention was focused on the new issue calendar at $29 billion, with around two-thirds of that amount concentrated from three major bank issuers: JPMorgan, Wells Fargo and Morgan Stanley. Wells Fargo also brought a preferred deal to market, which was only the fourth U.S. preferred issuance of the year. The preferred market performed well, rallying 0.41% last week and beating similar-duration Treasuries by 45 bps.

High yield corporates rallied, returning 0.11% and outperforming similar-duration Treasuries by 20 bps. Senior loans advanced, returning 0.08%. Lower-quality names outperformed in both markets, led by CCC rated corporates. Both markets saw continued inflows of $2.2 billion and $237 million, respectively. Meanwhile, new issuance picked up as well, with $2.8 billion of new supply in the high yield market and $9.1 billion in loans.

Emerging markets gained, returning 0.12% and beating similar-duration Treasuries by 16 bps. Spreads were generally tighter across both investment grade and high yield names. After three weeks of outflows, inflows returned to the asset class, with hard currency and local funds seeing inflows of $107 million and $128 million, respectively. In contrast to U.S. corporates, issuance was on the lighter side, with only $4.5 billion coming to market for the week.

MUNICIPAL BOND INVESTORS IMPLEMENT A BARBELL APPROACH

Municipal bond yields declined last week. The new issue market was priced to sell and well received. Fund flows were finally strongly positive. This week's new issue supply should be limited, as most issuers are awaiting Wednesday's Fed meeting.

Investors are showing strong interest in two portions of the muni yield curve. Longer-dated bonds look attractive, as investors are locking in long-term rates before the expected decline in 2024. However, a tremendous amount of money is also invested in the short end of the curve. Both the municipal bond and Treasury yield curves are inverted, meaning short-term paper is available at higher yields than intermediate bonds. This barbell approach to investing has become very popular, and we expect the short and long parts of the barbell to be actively traded through the end of the year.

New York City Transitional Finance Authority issued $950 million future tax-secured subordinated bonds (rated Aa1/AAA). The deal was well received, and bonds were selling at a premium in the secondary market for virtually all maturities.

The high yield municipal market saw another week of inflows. Multiple deals were massively oversubscribed, with the largest deal allowing important security features to be erased. Meanwhile, a large dispersion remains in the secondary trading of more dated high yield paper, especially among higher beta names. For example, the yield-to-worst of Buckeye Tobacco 5s was as high as 5.68%, dipped below 5.30% and closed the week at 5.38%.

After three weeks of outflows, inflows returned to emerging markets debt.

In focus

More to senior loans than their 2023 rally

We believe a blend of distinguishing features makes senior loans a valuable addition to a long-term, diversified portfolio. Their solid performance in 2023 year-to-date enhances our view.

Also called leveraged loans or floating-rate loans, senior loans don't pay a fixed interest rate. Instead, their coupon payments adjust at regular intervals to reflect changes in short-term rates. This characteristic has helped them during the Fed's current hiking cycle, while many fixed income asset classes have struggled. Also, due to their ultra-low duration, loans are less sensitive to rising rates than many of their bond counterparts.

Since loans are considered high yield debt, they generally provide payouts well above those of investment grade bonds. For example, the Credit Suisse Leveraged Loan Index currently yields 10%, versus 4.8% for the Bloomberg U.S. Aggregate Bond Index. At the same time, loans sit atop the corporate capital structure, as they're typically secured by the issuer's assets such as inventory or receivables. In the event of bankruptcy, loan holders are paid off before other creditors, preferred stockholders and common stockholders.

Not only have loans returned 7.5% year to date, but they're attractively valued, as the Credit Suisse Index is priced at 94.2. With the right credit underwriting, allocating to loans trading at a discount may offer capital appreciation potential, further enhancing total return opportunities.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.84	0.07	-0.06	0.42
5-year	4.09	0.05	-0.06	0.09
10-year	3.84	0.00	0.00	-0.04
30-year	3.90	-0.03	0.04	-0.07

Source: Bloomberg L.P., 21 Jul 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	2.87	-0.03	-0.06	0.27
5-year	2.52	-0.06	-0.10	0.00
10-year	2.50	-0.09	-0.06	-0.13
30-year	3.46	-0.05	-0.03	-0.12

Source: Bloomberg L.P., 21 Jul 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	65
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters, 21 Jul 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	3.43	–	6.04	0.52	0.68	3.37
High yield municipal	5.65	245[1]	7.48	0.70	1.01	5.49
Short duration high yield municipal[2]	5.30	284	3.84	0.26	0.47	4.10
Taxable municipal	5.05	95[3]	8.17	0.12	0.24	5.01
U.S. aggregate bond	4.79	50[3]	6.30	0.01	0.21	2.30
U.S. Treasury	4.34	–	6.18	-0.02	0.12	1.70
U.S. government related	4.89	50[3]	5.32	-0.05	0.30	2.70
U.S. corporate investment grade	5.45	122[3]	7.12	0.20	0.35	3.57
U.S. mortgage-backed securities	4.80	53[3]	6.10	-0.10	0.17	2.04
U.S. commercial mortgage-backed securities	5.65	133[3]	4.43	-0.06	0.45	1.66
U.S. asset-backed securities	5.43	65[3]	2.75	0.01	0.41	2.15
Preferred securities	7.36	247[3]	4.64	0.41	0.56	3.43
High yield 2% issuer capped	8.35	378[3]	3.44	0.11	1.10	6.54
Senior loans[4]	10.00	571	0.25	0.08	1.07	7.46
Global emerging markets	7.44	318[3]	6.22	0.12	0.77	4.10
Global aggregate (unhedged)	3.81	48[3]	6.76	-0.53	1.06	2.51

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, 21 Jul 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, 21 Jul 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 19 Jul 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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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.

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