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Weekly Fixed Income Commentary

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Another Fed hike boosts Treasury yields

U.S. Treasury yields rose again after central banks tightened policy, and economic data surprised to the upside. The U.S. Federal Reserve and European Central Bank raised rates as expected. Meanwhile, the Bank of Japan expanded the band around its target rate for the 10-year Japanese government bond.

HIGHLIGHTS

- **Longer-duration sectors like Treasuries, MBS, taxable munis and investment grade corporates had negative returns.**
- **In contrast, high yield corporates, preferreds, senior loans and emerging markets had positive returns.**
- **Municipal bond yields rose slightly. New issue supply was $6.1B with inflows of $552M. This week's new issuance should be $11.9B.**

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Watchlist

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

HIGH YIELD CORPORATE SPREADS HIT A ONE-YEAR LOW

U.S. Treasury yields rose again, with 10-year yields ending 11 basis points (bps) higher at 3.95%. Strong economic data drove the upward moves, after the second quarter U.S. GDP report showed a healthy 2.4% annualized rate of expansion. Jobless claims declined and consumer sentiment continued to improve. Central banks broadly tightened policy further, with the U.S. Federal Reserve and European Central Bank raising rates 25 bps as expected. Meanwhile, the Bank of Japan expanded the band around its target rate for the 10-year Japanese government bond yield by 50 bps, to a ceiling of 1.00%. Front-end yields were closer to unchanged, with 2-year Treasuries ending 3 bps higher at 4.88%.

Investment grade corporates weakened alongside the move higher in rates, returning -0.23% for the week. However, spreads continued to tighten, and the asset class outperformed similar-duration Treasuries by 47 bps. That rally took spreads on the index to 115 bps, matching a 15-month low. Inflows also picked up, at $2.9 billion. New supply was relatively muted, with eight issuers bringing only $14.7 billion of new deals.

High yield corporates gained, returning 0.08% for the week and outperforming similar-duration Treasuries by 32 bps. Spreads on the high yield bond index reached 374 bps, a one-year low. Senior loans also advanced, returning 0.17%. Despite the rallies, both asset classes saw outflows of -$376 million and -$58 million in bonds and loans, respectively. Unlike investment grade, the new issue market was relatively active, with $2.6 billion pricing in high yield and $11.5 billion in loans, both accelerating from the prior week.

Emerging markets led gains, returning 0.19% and beating similar-duration Treasuries by 79 bps. Within sovereigns, high yield outperformed, with spreads tightening -23 bps versus a move of -11 bps in investment grade. The new issue market was quiet, with only two new deals, while inflows continued for the second consecutive week. $647 million entered hard currency funds, which was partially offset by a -$313 million outflow from local currency funds.

THE MUNI MARKET EXPECTS MORE REINVESTMENT MONEY IN AUGUST

Municipal bond yields ended last week slightly higher. The new issue market was undersized, yet some deals struggled to sell. Fund flows were positive for the second week in a row. This week's new issue calendar will need to be priced to sell to pique investor interest.

Fixed income in general sold off slightly with the Fed rate hike last week, but markets were pleased with the central bank's continued resolve to fight inflation. We expect attractive municipal market performance going forward. August 1 will see another $46 billion of reinvestment money coming back into the market. Munis are currently rich relative to Treasuries, but demand for tax-exempt income remains strong.

The State of Washington sold $376 million motor vehicle general obligation bonds (rated Aaa/AA+). The deal included 5% coupon bonds due in 2033 that came at a yield of 2.63%. Those bonds traded at 2.65% in the secondary market. This shows how dealers are eager to keep inventory moving.

The high yield municipal market showed resiliency last week, despite the short-term surge in U.S. Treasury volatility. The average high yield muni yield increased 2 bps, while the 10-year Treasury yield increased by 11 bps and long-term AAA muni yields increased by 5-14 bps. High yield muni inflows totaled $223 million. This week's new issuance calendar contains a handful of deals totaling just more than $300 million, but the quality of deals appears exceptionally weak.

The investment grade corporate bond rally dropped spreads to a 15-month low.

In focus

The Fed hikes, leaves markets guessing

As expected, the Fed increased the target range for its policy rate to a 22-year high of 5.25% - 5.50%. Additionally, the central bank reinforced its resolve to lower inflation to its long-term 2% target without tipping its hand about upcoming moves.

In his press conference, Chair Jerome Powell emphasized that the Fed remained concerned about "elevated" inflation, although the headline Consumer Price Index reading has fallen for the 12th straight month in June, to 3%, its lowest level since early 2021. He noted that while signs of easing prices were "welcomed," it was "only one report, one month's data."

As far as economic growth, the Fed's policy statement described the recent trend as "moderate" rather than "modest," a minuscule but material upgrade regarding the economy's health. As if on cue, one day after the Fed meeting, the government announced that the U.S. economy had topped forecasts by expanding 2.4% in the second quarter. Consumer spending cooled but remained healthy, and business investment surged.

Powell sidestepped questions about the Fed's next move. He declined to explicitly signal another hike at the September meeting. But with the economy seemingly on sound footing, he explained that "stronger growth could lead, over time, to higher inflation and that would require an appropriate response for monetary policy." According to June's dot plot, one more 25 basis point hike is likely in play for 2023.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.88	0.03	-0.02	0.45
5-year	4.18	0.08	0.02	0.17
10-year	3.95	0.11	0.11	0.08
30-year	4.01	0.11	0.15	0.04

Source: Bloomberg L.P., 28 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	3.00	0.13	0.07	0.40
5-year	2.66	0.14	0.04	0.14
10-year	2.57	0.07	0.01	-0.06
30-year	3.51	0.05	0.02	-0.07

Source: Bloomberg L.P., 28 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	87
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters, 28 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	3.49	–	5.97	-0.27	0.41	3.09
High yield municipal	5.70	240[1]	7.46	-0.39	0.61	5.07
Short duration high yield municipal[2]	5.34	281	3.85	-0.16	0.32	3.93
Taxable municipal	5.14	94[3]	8.08	-0.76	-0.52	4.21
U.S. aggregate bond	4.87	47[3]	6.22	-0.40	-0.20	1.89
U.S. Treasury	4.44	–	6.05	-0.59	-0.47	1.11
U.S. government related	4.97	49[3]	5.23	-0.33	-0.03	2.37
U.S. corporate investment grade	5.49	115[3]	7.03	-0.23	0.11	3.33
U.S. mortgage-backed securities	4.85	48[3]	6.09	-0.29	-0.12	1.74
U.S. commercial mortgage-backed securities	5.73	133[3]	4.37	-0.31	0.14	1.34
U.S. asset-backed securities	5.48	60[3]	2.68	-0.04	0.36	2.11
Preferred securities	7.31	235[3]	4.66	0.54	1.10	3.99
High yield 2% issuer capped	8.40	374[3]	3.42	0.08	1.18	6.62
Senior loans[4]	10.07	572	0.25	0.17	1.24	7.64
Global emerging markets	7.44	311[3]	6.12	0.19	0.97	4.30
Global aggregate (unhedged)	3.84	47[3]	6.67	-0.28	0.78	2.22

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, 28 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, 28 Jul 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 26 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.

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.

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