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Weekly Fixed Income Commentary

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Treasury yields rise as inflation appears mixed

10-year U.S. Treasury yields rose again following mixed U.S. inflation data. July's consumer price inflation came in close to expectations, while producer prices rose more than expected. We still believe the U.S. Federal Reserve may raise interest rates once more, particularly if the labor market remains strong.

HIGHLIGHTS

- **High yield corporates and senior loans delivered positive returns.**
- **Agencies, investment grade corporates, ABS, preferreds and emerging markets had negative total returns but positive excess returns.**
- **Municipal bond yields declined across the curve. New issue supply was $6.6B with inflows of $278M. This week's new issuance should be $6.2B.**

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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 business 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 3.35%.

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 ISSUANCE IS ACTIVE

U.S. Treasury yields increased last week, with the 10-year yield rising 12 bps to 4.16%. The entire curve shifted higher, with 2-year yields up 13 bps. July's consumer price inflation came in close to expectations, while producer prices rose more than expected. The releases point to an increase in PCE inflation (the Fed's preferred measure) of around 0.3% for last month.

Investment grade corporates weakened, returning -0.67% for the week, though the asset class outpaced similar-duration Treasuries by 1 bps. The new issue market was relatively active, at nearly $38 billion. That pace is expected to slow this week, with only around $20 billion of new supply anticipated. Meanwhile, the investment grade market saw a modest but healthy inflow of $217 million.

High yield corporates performed well, returning 0.33% for the week and outperforming similar-duration Treasuries by 72 bps. Senior loans gained 0.29%. Both asset classes had outflows, with -$559 million leaving high yield funds and -$182 million exiting loan funds. However, the high yield market had around $5 billion of new supply. Similar to the investment grade market, that pace is expected to slow this week.

Emerging markets were mixed, returning -0.03% for the week but beating similar-duration Treasuries by 60 bps. Economic data in China was very weak. Total social financing, a measure of credit growth, slowed to 8.9% year-over-year, as loan creation dropped sharply. New loans totaled CNY 346 billion in July, the lowest monthly print since 2009. Announced fiscal easing also disappointed versus expectations, presenting downside risks to Chinese growth this year. Outflows from emerging markets funds exceeded the movements in U.S. markets, with around -$1.6 billion combined leaving hard- and local-currency funds.

THE MUNICIPAL MARKET SHOULD REMAIN RANGE BOUND

The municipal bond yield curve ended the week slightly lower and remains range bound. The new issue calendar was priced to sell, and most deals were well received. Weekly fund flows were positive and this week's new issue supply should be well received.

We expect the muni market to remain range bound in August. Trading is light, as usual during the summer doldrums. The Fed does not have a scheduled meeting this month, and economic data become more plentiful in September. Also, we will return to a full bench of market participants after Labor Day. Finally, we expect munis to remain well bid, as outsized reinvestment money still needs to be deployed.

Washington Metropolitan Area Transit Authority issued $798 million dedicated revenue bonds (rated NR/AA). The deal was priced to sell and was well received. Bonds sold at a premium in the secondary market. For example, 5.25% coupon bonds due in 2053 came at a yield of 4.14%. Those bonds traded in the secondary market at 4.06%.

The high yield municipal market is enjoying late summer stability, despite ongoing rate volatility. Inflows remain positive and deals are well subscribed, especially at higher yields. Last week, an attractive charter school deal, for an already existing school with good demand, priced at 7% yields. This week we see only four high yield municipal deals on the calendar. Summer technicals should remain supportive for several more weeks, but we expect even the typical fall seasonal weakness to be more muted this year. SIFMA (a measure of short-term yield and tax-exempt borrowing rates) settled back to the year-to-date average, resetting at 3.00%, making leverage on new bonds at current market yields quite attractive. Tender-option bond turnover and resetting leverage remains an important focus for portfolio construction.

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In focus

The Fed bides its time on inflation

July's headline Consumer Price Index (CPI) inflation readings were in line with forecasts, as the year-over-year figure edged up 3.2% (compared to 3% in June), snapping a streak of 12 straight declines.

For the month, prices increased 0.2%, the same as they did in June. Core inflation, which strips out food and energy costs, also rose 0.2% last month. The annual core figure (+ 4.7%) slowed from June's 4.8% pace but stayed well above the Federal Reserve's 2% target.

Looking under the CPI hood, airline fares fell 8.1% in July, matching their largest monthly drop since last summer. Prices for medical services (-0.4%) and used car/trucks (-1.3%) slipped as well. However, pre-owned vehicles cost a bit more (+0.2%), while shopping for items such as meat, poultry, fish and eggs set shoppers back +0.5%. The closely watched shelter index (+0.4%), which makes up 42% of the broad CPI basket, contributed over 90% to July's overall increase.

Although inflation broadly continues to ease, we still believe the Fed may raise interest rates once more — most likely in November — particularly if the labor market remains strong. Markets are more dovish, with fed fund futures signaling just a 28% chance of a hike this year. For its part, the Fed will continue to weigh incoming data, particularly August's CPI data report, set for release one week before its September meeting.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.90	0.13	0.02	0.47
5-year	4.30	0.17	0.13	0.30
10-year	4.16	0.12	0.19	0.28
30-year	4.26	0.06	0.25	0.30

Source: Bloomberg L.P., 11 Aug 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	3.10	-0.07	0.10	0.50
5-year	2.77	-0.07	0.11	0.25
10-year	2.70	-0.07	0.13	0.07
30-year	3.69	-0.04	0.18	0.11

Source: Bloomberg L.P., 11 Aug 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	86
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters, 11 Aug 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	3.66	–	6.13	0.42	-0.83	2.22
High yield municipal	5.79	233[1]	7.59	0.81	-0.97	4.10
Short duration high yield municipal[2]	5.42	276	4.02	0.38	-0.17	3.78
Taxable municipal	5.30	93[3]	8.06	-0.70	-1.48	2.74
U.S. aggregate bond	5.03	50[3]	6.29	-0.64	-1.35	0.64
U.S. Treasury	4.55	–	6.09	-0.58	-1.09	0.12
U.S. government related	5.07	48[3]	5.23	-0.37	-0.80	1.67
U.S. corporate investment grade	5.68	119[3]	6.95	-0.67	-1.68	1.82
U.S. mortgage-backed securities	5.11	57[3]	6.35	-0.78	-1.63	0.13
U.S. commercial mortgage-backed securities	5.81	129[3]	4.40	-0.59	-0.44	0.97
U.S. asset-backed securities	5.48	59[3]	2.68	-0.16	-0.07	2.10
Preferred securities	7.39	231[3]	4.71	-0.04	-0.65	3.83
High yield 2% issuer capped	8.50	375[3]	3.47	0.33	-0.24	6.58
Senior loans[4]	10.07	572	0.25	0.29	0.29	8.03
Global emerging markets	7.53	303[3]	6.14	-0.03	-0.97	3.50
Global aggregate (unhedged)	3.96	48[3]	6.69	-0.76	-1.50	0.60

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, 11 Aug 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, 11 Aug 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 09 Aug 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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