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Weekly Fixed Income Commentary

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Treasury yields rise again on stronger inflation data

U.S. Treasury yields rose again after U.S. consumer price inflation surprised marginally to the upside. The European Central Bank (ECB) delivered a dovish hike last week, and all eyes are on the U.S. Federal Reserve this week.

HIGHLIGHTS

- **Treasuries, investment grade corporates, taxable munis, MBS and emerging markets had negative total returns.**
- **Preferreds, high yield corporates and senior loans advanced last week.**
- **Municipal bond yields rose slightly. New issue supply was $8.1B with outflows of -$117M. This week's new issuance is less than $5.0B.**

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Watchlist

- *10-year U.S. Treasury yields increased slightly, but we anticipate modest declines over the rest of 2023.*
- *Spread assets outperformed Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" rates remains as a theme, as central banks battle 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 3.75%.

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.

CORPORATE BOND MARKETS SEE HEAVY ISSUANCE AND INFLOWS

U.S. Treasury yields rose again last week after consumer price inflation surprised marginally to the upside. Core inflation came in at 0.3% month-over-month, slightly hotter than expected, with a sizable rebound in core services inflation excluding shelter, which rose at the fastest rate in almost a year. Separately, retail sales and industrial production both matched expectations, showing steady growth. The European Central Bank (ECB) delivered a dovish hike, raising policy rates by 25 basis points (bps), but suggesting it may be done with its hiking cycle, pending incoming inflation data.

Investment grade corporates weakened, returning -0.35% for the week but beating similar-duration Treasuries by 8 bps. New supply was heavy, with around $34 billion of new deals compared to expectations for closer to $25 billion. Overall, the new issuance was 4.3x oversubscribed and came with tight pricing, averaging only 3 bps of concessions. The supply was offset by strong inflows, with $2 billion entering the market last week. Inflows total $157 billion year-to-date, or around 4.5% of asset class AUM.

High yield corporates outperformed, returning 0.19% for the week and outpacing similar-duration Treasuries by 30 bps. Senior loans returned 0.50%. As with investment grade, the new issuance market was busy, with over $9.5 billion of new deals coming in both the high yield bond and senior loan markets. Inflows were strong as well, with $81 million entering high yield funds and $343 million going into loan funds.

Emerging markets sold off, returning -0.17% for the week but outperforming similar-duration Treasuries by 18 bps. Hard currency sovereign spreads tightened -7 bps, with most of the gains driven by high yield names including Ghana (3 pts), El Salvador (2 pts) and Egypt (2 pts). Unlike other major asset classes, emerging markets funds saw another week of outflows, with $467 million exiting hard currency funds and $529 million leaving local currency funds.

HIGH YIELD MUNIS EXPERIENCING A SUPPLY CONSTRAINT

The municipal bond market was range bound last week, with yields ending slightly higher. New issuance was priced to sell and fund flows were negative yet again. This week's light new issuance should be priced to sell and well received.

Investor confidence has been boosted by outsized yields not seen for more than a decade. At it's meeting this week, the Fed must renew its unequivocal commitment to fighting inflation, raising rates to whatever yields necessary. Should the Fed fail to do this, the market will have to reassess what constitutes fair value.

The municipal market remains orderly. Institutions continue to rearrange portfolios and retail buyers are active. New issue supply is priced to sell and should continue through year end. We are constructive on fixed income in general and tax-exempt bonds specifically.

Dormitory State of New York (DSNY) issued $889 million state personal income tax revenue bonds (rated Aa1/AA+). Some bonds traded at a slight premium after the deal was free to trade. For example, 5% coupon bonds due in 2031 came at a yield of 3.30% and traded at a 1 bps premium in the secondary market. This premium is seen as a win for the market, as New York is expected to be a prolific issuer through year end. Demand remains strong, given the premiums in the secondary market.

The high yield municipal market remains unusually quiet. Despite index average yields hovering at 6%, fund flows remain flat to slightly negative. We believe a significant supply constraint is going unappreciated. The intricacies of bond structures are creating a wide dispersion of relative value in this market.

We believe a significant high yield muni supply constraint is going unappreciated.

In focus

The ECB grits its teeth and raises interest rates

In a closely watched decision, the European Central Bank (ECB) hiked rates to an all-time peak, as it felt the need to enhance its battle against rising consumer prices.

The ECB's policy statement noted that inflation had cooled but "is still expected to remain too high for too long." Headline eurozone inflation registered 5.3% year-over-year in August, unchanged versus July but half of last October's 10.6% reading. Core inflation, which strips out food and energy prices, was unchanged at 5.3% in August, as distortions interrupted the downward inflation trajectory. With both readings staying well above the ECB's 2% target, the central bank lifted its key deposit rate by 25 bps, to 4%. Looking ahead, the ECB expects average inflation of 5.6% in 2023, 3.2% in 2024 — upward revisions reflecting higher energy costs — and 2.1% in 2025.

However, the central bank significantly lowered its economic growth projections. It now anticipates eurozone GDP to expand by 0.7% in 2023, 1.0% in 2024 and 1.5% in 2025, as the higher cost of capital dents domestic demand and international trade slows. The ECB also hinted that its key policy rates have peaked. The policy statement noted that "interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target." In the wake of the ECB's meeting, the euro fell to a three-month low versus the U.S. dollar.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	5.04	0.04	0.17	0.61
5-year	4.47	0.06	0.21	0.46
10-year	4.33	0.07	0.23	0.46
30-year	4.42	0.08	0.21	0.45

Source: Bloomberg L.P., 15 Sep 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	3.13	0.00	-0.01	0.53
5-year	2.93	0.05	0.05	0.41
10-year	3.00	0.02	0.07	0.37
30-year	3.94	0.02	0.06	0.36

Source: Bloomberg L.P., 15 Sep 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	69
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 15 Sep 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	3.88	–	6.24	-0.10	-0.36	1.23
High yield municipal	5.90	217[1]	7.74	0.01	-0.22	3.29
Short duration high yield municipal[2]	5.61	268	4.17	0.00	-0.09	3.67
Taxable municipal	5.39	91[3]	8.01	-0.42	-1.25	2.57
U.S. aggregate bond	5.17	49[3]	6.25	-0.33	-1.09	0.26
U.S. Treasury	4.69	–	6.03	-0.35	-1.09	-0.39
U.S. government related	5.20	48[3]	5.19	-0.26	-0.94	1.28
U.S. corporate investment grade	5.82	118[3]	6.91	-0.35	-1.18	1.55
U.S. mortgage-backed securities	5.23	55[3]	6.33	-0.30	-1.10	-0.15
U.S. commercial mortgage-backed securities	5.97	130[3]	4.39	-0.12	-0.64	0.72
U.S. asset-backed securities	5.66	65[3]	2.67	-0.06	-0.27	2.16
Preferred securities	7.42	231[3]	4.72	0.25	-0.01	3.83
High yield 2% issuer capped	8.55	376[3]	3.48	0.19	-0.11	7.03
Senior loans[4]	9.90	536	0.25	0.50	0.90	9.94
Global emerging markets	7.77	312[3]	6.03	-0.17	-0.68	2.56
Global aggregate (unhedged)	4.07	48[3]	6.66	-0.28	-1.53	-0.80

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, 15 Sep 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, 15 Sep 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 13 Sep 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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