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Weekly Fixed Income Commentary

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# Treasury yields decline as central banks hold steady

*The 10-year U.S. Treasury yield declined substantially last week after major central banks – including the U.S. Federal Reserve, European Central Bank and Bank of England – kept interest rates steady and economic data disappointed versus expectations.*

## HIGHLIGHTS

- **Total returns were positive across the board, including Treasuries, taxable munis, MBS, investment grade and high yield corporates, preferreds, emerging markets and senior loans.**
- **Municipal bond yields declined. New issue supply was only $3.4 billion and outflows totaled -$1.5B. This week's new issuance is estimated at $9B.**

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# *Watchlist*

- *The 10-year U.S. Treasury yield declined sharply, and we anticipate further declines in overall rates in the months ahead.*
- *Spread assets outperformed strongly versus 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.

**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 intensify: China, Russia, Turkey, Iran and Israel.





## CORPORATE BONDS RALLY STRONGLY

**U.S. Treasury yields rallied substantially last week,** with the 10-year yield falling -26 basis points (bps) to end at 4.57%. That was the biggest weekly rally since March. 2-year yields dropped -16 bps. The Federal Reserve, European Central Bank and Bank of England kept rates steady at their policy meetings. Separately, economic data was weaker than expected. The ISM manufacturing index fell to 46.7, indicating contraction and approaching cyclical lows. Nonfarm payrolls were softer-than-expected, with 150,000 new jobs in October but -101,000 in downward revisions to the prior two months. The unemployment rate also ticked higher again to 3.9%.

**Investment grade corporates rallied strongly,** returning 2.08% for the week and beating similar-duration Treasuries by 29 bps. This weekly performance was the best in a year and the second-best post-Covid. Inflows returned, with $1.7 billion entering the asset class, partially reversing the sizeable outflow from the prior week. Yields fell back to 6% overall, down -28 bps for the week. With that rally in rates, issuers returned to the market more substantially. Eighteen issuers brought $29 billion of total new supply, nearly half from the financial sector. With rates remaining accommodative, supply is expected to be healthy again this week, with estimates at around $40 billion.

**High yield corporates also gained strongly,** returning 2.75% and outpacing similar-duration Treasuries by 179 bps. Senior loans joined the rally, gaining 0.30%. The rally was initially led by higher-quality names, but the fall in rates ultimately drove a rally across the spectrum, with CCC corporates returning 1.62% for the week. Outflows returned, with -$953 million leaving high yield funds. Loan funds saw inflows of $126 million. New issuance was muted, with $1 billion pricing in high yield and $1.3 billion in loans.

**Emerging markets rallied as well,** returning 2.12% for the week and beating similar-duration Treasuries by 56 bps. The fall in core government rates and lack of hawkish commentary from the Fed sparked a 1.44% depreciation in the dollar, which helped the emerging markets asset class. High yield sovereigns had outsized gains, with spreads tightening -44 bps versus a move of -4 bps for investment grade sovereigns. As in U.S. high yield corporates, the strong performance came despite continued outflows, with -$831 million exiting hard currency funds and -$630 million leaving local funds.

## MUNI BOND CHOPPINESS SHOULD CONTINUE THROUGH YEAR END

**Municipal bond yields declined strongly last week.** Weekly new issue supply was well received and fund flows were negative once again. However, municipal bond exchange-traded funds saw one-day positive flows of $474 million. This week's new issue supply will still need to be priced to sell to clear the market.

**The 10-year muni AAA MMD rate curve ended last week -27 bps lower to 3.32%.** We are constructive on municipal yields to be lower by mid-2024. We expect choppiness to continue through the end of this year due to continued heavy new issuance and outsized tax swaps.

**Chicago Midway Airport** issued $ 513 million revenue bonds, both AMT and non-AMT (rated A/A). The deal was priced to sell and well received. For example, underwriters lowered the yield 7 bps on the 5 1/2s due in 2053 AMT bonds. They were underwritten at a 5.48% yield.

**High yield municipal fund outflows slowed last week.** The Bloomberg High Yield Municipal Bond Index returned 2.62%, with the average yield decreasing -23 bps. Higher beta names like Buckeye Tobacco traded 40 bps tighter in yield as the market bid available bonds higher in anticipation of a market turn. High yield muni new issuance still offers highly attractive absolute yields. We are tracking heavy new issuance for this week that still offers attractive yields. New issuance appears more attractive than the secondary market, which was gobbled up last week with the change in market sentiment.

***Investment grade corporates rallied, with the best weekly performance in a year and the second-best post-Covid.***

*In focus*

# *The Fed pauses but leaves the door open*

*Last week, as expected, the Federal Reserve held interest rates at 5.25%-5.50% for the second straight meeting but left open the possibility of a December rate hike.*

In its policy statement, the Fed continued to characterize inflation as "elevated," even as its preferred inflation barometer, the core Personal Consumption Expenditures (PCE) Price Index, fell to 3.7% year-over-year in September. Although this marked the PCE's lowest level since May 2021, it stayed well above the Fed's 2% target. Regarding the U.S. economy, the Fed's assessment improved incrementally, from "solid" in September to "strong."

During his post-meeting Q&A, Chair Jerome Powell explained that the Fed can afford to "proceed carefully" in its inflation battle. He explained that, "one of the reasons we have slowed the process down was to give monetary policy time to get into the economy." But Powell's guidance that the Fed will take upcoming decisions on a meeting-by-meeting basis leads us to believe that a 25 bps rate hike next month remains possible. In the meantime, financial conditions have tightened, driving up borrowing costs for both individuals and businesses.

U.S. Treasuries rallied in the wake of the Fed meeting, as investors dialed down their rate expectations over the next several quarters. The yield on the policy-sensitive 2-year note fell 7 bps, to a two-month low of 4.94%, while that of the bellwether 10-year security declined 4 bps, to 4.76%.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | October 2023 | Year-to-date |
| 2-year | 4.84 | -0.16 | 0.04 | 0.41 |
| 5-year | 4.50 | -0.26 | 0.24 | 0.50 |
| 10-year | 4.57 | -0.26 | 0.36 | 0.70 |
| 30-year | 4.77 | -0.25 | 0.39 | 0.80 |

Source: Bloomberg L.P., 03 Nov 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

## Municipal market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield to Worst | Week | October 2023 | Year-to-date |
| 2-year | 3.41 | -0.24 | -0.26 | 0.81 |
| 5-year | 3.25 | -0.24 | -0.26 | 0.73 |
| 10-year | 3.32 | -0.27 | -0.29 | 0.69 |
| 30-year | 4.33 | -0.24 | -0.24 | 0.75 |

Source: Bloomberg L.P., 03 Nov 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 73 |
| 30-year AAA Municipal vs Treasury | 91 |
| High Yield Municipal vs High Yield Corporate | 71 |

Source: Bloomberg L.P., Thompson Reuters, 03 Nov 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 | October 2023 | Year-to-date |
| Municipal | 4.23 | – | 6.42 | 1.88 | -0.85 | -0.42 |
| High yield municipal | 6.22 | 215[1] | 7.81 | 2.62 | -1.60 | 0.96 |
| Short duration high yield municipal[2] | 6.05 | 277 | 4.39 | 1.01 | -0.91 | 2.33 |
| Taxable municipal | 5.59 | 89[3] | 7.87 | 2.08 | -2.05 | 1.18 |
| U.S. aggregate bond | 5.30 | 52[3] | 6.19 | 1.99 | -1.58 | -0.53 |
| U.S. Treasury | 4.73 | – | 5.94 | 1.52 | -1.21 | -0.90 |
| U.S. government related | 5.24 | 49[3] | 5.13 | 1.39 | -0.97 | 1.00 |
| U.S. corporate investment grade | 6.00 | 125[3] | 6.76 | 2.08 | -1.87 | 0.56 |
| U.S. mortgage-backed securities | 5.49 | 60[3] | 6.44 | 2.85 | -2.07 | -1.36 |
| U.S. commercial mortgage-backed securities | 6.09 | 140[3] | 4.34 | 1.28 | -0.89 | 0.75 |
| U.S. asset-backed securities | 5.71 | 81[3] | 2.57 | 0.56 | -0.16 | 2.50 |
| Preferred securities | 7.84 | 252[3] | 4.93 | 3.81 | -3.01 | 3.00 |
| High yield 2% issuer capped | 8.83 | 395[3] | 3.44 | 2.75 | -1.17 | 7.20 |
| Senior loans[4] | 10.10 | 568 | 0.25 | 0.30 | 0.03 | 10.27 |
| Global emerging markets | 8.03 | 329[3] | 5.84 | 2.12 | -1.48 | 1.50 |
| Global aggregate (unhedged) | 4.14 | 50[3] | 6.58 | 1.93 | -1.20 | -1.24 |

**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, 03 Nov 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, 03 Nov 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 01 Nov 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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