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Weekly Fixed Income Commentary

20 November 2023

Treasury yields fall on softer U.S. inflation data

U.S. Treasury yields fell across the curve after softer-than-expected inflation data. Core prices rose at their slowest rate in more than two years. A meeting between President Biden and President Xi, along with the U.S. Congress averting a government shutdown, were positive developments.

HIGHLIGHTS

- **Total returns were positive across the board, including for Treasuries, investment grade and high yield corporates, MBS, ABS, preferreds, senior loans and emerging markets.**

- **Municipal bond yields declined. New issue supply was $9 billion and fund flows were essentially neutral. This week's new issuance is estimated at only $1.5B.**

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Watchlist

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

INVESTMENT GRADE CORPORATE SPREADS TIGHTEN TO NEAR THEIR 2022 LOW

U.S. Treasury yields rallied substantially last week, with the 10-year yield dropping -22 basis points (bps) and the 2-year yield down -18 bps. The moves were primarily driven by softer-than-expected inflation data. Core prices rose 4.0% year-over-year, the slowest rate in more than two years. The details were also supportive, with shelter and other core services cooling after recent strength. Separately, President Biden and China's President Xi announced progress on several bilateral policy issues. The U.S. Congress also acted to avert a federal government shutdown. The resolution of these events without any negative surprises was a clear positive development.

Investment grade corporates gained again, returning 1.75% for the week and 4.27% month-to-date. The asset class outpaced similar-duration Treasuries by 57 bps, taking November outperformance to 121 bps. Investment grade corporate spreads have tightened -16 bps this month to 114 bps, now just 5 bps away from the lowest level since early 2022. Inflows continued at $519 million last week, though they eased from the strong pace earlier in the month. New issuance was healthy, with 24 companies bringing $31.3 billion last week. That pace should slow this week given the Thanksgiving holiday in the U.S.

High yield corporates rallied, retuning 0.88% for the week and outperforming similar-duration Treasuries by 12 bps. Senior loans returned 0.28%. Both asset classes saw inflows, with $4.5 billion entering high yield funds and $299 million flowing into loan funds. New issuance remained healthy in both markets, with $4.3 billion coming to market in the high yield corporate space and $6.5 billion in loans.

Emerging markets joined the rally, returning 1.29% for the week and outperforming similar-duration Treasuries by 24 bps. EM has lagged other fixed income market segments this year. But November has been strong, up 3.21% for the month. The rally came despite another week of outflows from hard currency funds, with -$1.3 billion exiting the asset class, while local funds also reverted to outflows at -$113 million. New issuance was somewhat lighter than in other asset classes, with only $3.6 billion in the primary market across sovereign and corporate issuers.

THE MUNICIPAL MARKET RALLY CONTINUES

The municipal bond yield curve rallied substantially last week, marking three consecutive weeks. Short- and long-term yields declined 15 bps. New issue supply was well received and fund flows were essentially unchanged. This week's new issue is light due to the Thanksgiving holiday.

The 30-year AAA municipal yield has dropped -50 bps from 4.57% on 01 November to 4.07% at the end of last week. The muni market outlook continues to improve. Heavy supply should continue through the end of the year, and bond dealers are reluctant to hold oversized positions of municipal bonds. That being said, we expect increased demand with the outsized reinvestment money coming on 01 December and 01 January.

The District of Columbia issued $622 million income tax secured revenue bonds (rated Aa1/AAA). The deal was well received and bonds traded at a premium in the secondary market. For example, 5% coupon bonds due in 2033 came at a yield of 3.29%. Those bonds traded in the secondary market at 3.14%, reflecting the market rally as the week progressed.

High yield municipal market performance has turned, driven mainly by rates as credit spreads have yet to contract. Fund flows are becoming less negative as tax loss redemptions are decreasing and gross inflows are building. A backdrop of lower supply remains. The net issue calendar for this coming week should be minimal.

Investment grade corporate inflows continued, though they eased from the strong pace earlier in the month.

In focus

Inflation is down — so are Treasury yields

Last Tuesday, investors anxiously awaited October's Consumer Price Index (CPI) report for further evidence that inflation had continued to cool. They weren't disappointed.

After registering 3.7% in August and September, year-over-year headline CPI fell to a lower-than-expected 3.2%. Core inflation, which excludes food and energy costs, slipped from 4.1% in September to 4.0%, also below forecasts. Both, however, remain above the Fed's 2% target. For October, headline CPI was unchanged, while core inflation increased 0.2%.

Underlying inflation data were encouraging as well. Shelter costs, which make up about 40% of core CPI, rose 0.3% in October, half of September's gain. Meanwhile, prices declined for new (-0.1%) and used vehicles (-0.8%), as well as for airfares (-0.9%), another closely watched CPI metric.

Although the Fed has yet to declare victory in its long-running battle with inflation, markets now believe that a December rate hike is all but off the table and expect the Fed to begin cutting rates in May. We're not that dovish. In our view, the Fed is done hiking rates, but will wait for further evidence of moderating inflation or softening growth before it starts lowering them, more likely in the second half of 2024.

Treasuries rallied in the wake of the CPI data. The 10-year U.S. Treasury yield fell 19 bps on Tuesday, to 4.45%, while the policy sensitive 2-year Treasury yield finished at 4.84%, down 20 bps.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.89	-0.18	-0.20	0.46
5-year	4.44	-0.24	-0.41	0.44
10-year	4.44	-0.22	-0.50	0.56
30-year	4.59	-0.17	-0.51	0.62

Source: Bloomberg L.P., 17 Nov 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	3.14	-0.15	-0.53	0.54
5-year	2.92	-0.20	-0.59	0.40
10-year	3.01	-0.19	-0.60	0.38
30-year	4.07	-0.15	-0.50	0.49

Source: Bloomberg L.P.,17 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	68
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 17 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	Month-to-date	Year-to-date
Municipal	3.92	–	6.31	1.33	4.03	1.71
High yield municipal	6.02	224[1]	7.60	1.45	5.12	3.44
Short duration high yield municipal[2]	5.87	291	4.27	0.66	1.99	3.35
Taxable municipal	5.48	86[3]	7.91	1.48	3.85	2.61
U.S. aggregate bond	5.21	49[3]	6.20	1.37	3.40	0.54
U.S. Treasury	4.69	–	5.99	1.04	2.62	-0.16
U.S. government related	5.20	49[3]	5.15	1.04	2.33	1.69
U.S. corporate investment grade	5.83	114[3]	6.84	1.75	4.27	2.33
U.S. mortgage-backed securities	5.38	58[3]	6.29	1.64	4.17	-0.30
U.S. commercial mortgage-backed securities	6.02	138[3]	4.33	0.96	2.12	1.38
U.S. asset-backed securities	5.72	83[3]	2.66	0.51	1.02	2.86
Preferred securities	7.61	241[3]	4.89	1.59	4.88	4.42
High yield 2% issuer capped	8.73	389[3]	3.42	0.88	3.05	7.81
Senior loans[4]	9.97	558	0.25	0.28	0.91	10.94
Global emerging markets	7.89	321[3]	5.86	1.29	3.21	2.61
Global aggregate (unhedged)	4.04	48[3]	6.61	1.93	3.73	0.23

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, 17 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, 17 Nov 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 15 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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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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