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Weekly Fixed Income Commentary

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A dovish Fed pressures Treasury yields lower

U.S. Treasury yields declined sharply and the yield curve steepened. Comments from U.S. Federal Reserve officials were more dovish than expected, and global growth and inflation data were mostly weaker. All of these factors contributed to the ongoing bond market rally.

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 dramatically. New issue supply was $8.8B and fund outflows were -$64M. This week's new issuance is estimated at $10.5B.**

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Watchlist

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

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.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

INVESTMENT GRADE CORPORATE ISSUANCE SETS SINGLE-DAY RECORD

U.S. Treasury yields rallied substantially last week, after more-dovish-than-expected comments from Federal Reserve officials. Governor Waller said rate cuts were possible next year even if growth does not deteriorate. This led markets to price in more Fed easing next year. The 10-year Treasury yield fell -27 basis points (bps), while the more policy-sensitive 2-year yield fell -41 bps. The move marked the third-biggest weekly 2-year yield rally since 2008, only exceeded by the Covid rally in March 2020 and the banking crisis in March 2023. Separately, global growth and inflation data were mostly weaker, putting further downward pressure on yields. The U.S. ISM manufacturing survey was also weaker than expected at 46.7, and the official China manufacturing PMI came in at 49.4. Euro area core CPI was much lower than expected, decelerating -0.6 percentage points in November to 3.6% year-over-year.

Investment grade corporates gained for the sixth straight week, returning 2.26% and outperforming similar-duration Treasuries by 37 bps. Trading volumes were historically elevated, with Thursday's $52 billion of transactions setting a single-day volume record. Spreads touched fresh year-to-date tights of 104 bps. Inflows continued, though decelerating somewhat, at $780 million. New issuance was healthy at almost $18 billion. November's new issuance totaled $108 billion, exceeding expectations. Those deals were well received, with tighter new issue concessions than the year-to-date average at 6.7 bps and average oversubscription rates of 3.9x.

High yield corporates also gained, returning 1.31% for the week and beating similar-duration Treasuries by 11 bps. Senior loans returned 0.20%. In both asset classes, CCC rated companies outperformed. Both markets had healthy inflows, at $296 million and $124 million for high yield bonds and senior loans, respectively.

Emerging markets also performed well, returning 1.47% for the week, but lagging similar-duration Treasuries by -21 bps. Hard currency sovereigns performed particularly well, with high yield names tightening -10 bps, versus -5 bps for investment grade. Local currency also performed well amid the rally in U.S. rates and the softer U.S. dollar, returning 0.52% for the week. New issuance was steady, with $3.3 billion coming to market and oversubscription rates averaging 3.3x.

MUNI BOND PERFORMANCE SETS RECORDS FOR NOVEMBER

Municipal bond yields rallied dramatically last week. Short-term yields ended the week down -26 bps, while long-term yields declined -23 bps. The new issue calendar was well received, and, if anything, investors complained about skimpy allotments. Mutual fund flows were negative, while muni exchange-traded fund flows were positive at $513 million, following positive flows of $812 million the week before. This week's new issue calendar should be well received.

The municipal bond market benefited from the Treasury bond rally. Munis saw a 6.35% return in November, the highest return for that month in 40 years. Slowing inflation served as a main driver, in addition to a robust $36 billion of reinvestment money on December 1. The new issue calendar should be strong for the next couple of weeks, then begin to slow as the holiday season approaches. A similarly large January 1 reinvestment is right around the corner.

The New York Transportation Development Corporation (JFK International Airport New Terminal One Project) issued $2 billion of special facilities revenue bonds (rated Baa3/NR and subject to AMT; some bonds were also AGMC insured). The deal was so successful that underwriters increased the size of the offering. Bonds traded in the secondary market 10 basis points richer from where they came in new issue.

The high yield municipal market returned over 7% return in November, led by high beta names such as Puerto Rico and tobacco bonds. We believe it will be difficult for these securities to maintain this pace, but we see excess return potential widely dispersed across other areas of the high yield muni market. We are tracking 13 deals this week totaling only $500 million. Market access and credit selection should drive performance after such a rapid technical rally.

Municipal bonds returned 6.35% in November, the highest return for that month in 40 years.

In focus

Making a case for preferreds

Rate volatility, economic uncertainty and questions about the direction of Fed monetary policy have made it challenging for investors to find value in bond markets. But in our view, preferred securities offer opportunities, making them a worthwhile component of a long-term, diversified portfolio.

Preferreds offer high levels of income (7.38% yield-to-worst as of 1 December according to the ICE BofA U.S. All Capital Securities Index), although most are rated investment grade. This income can serve as a buffer during periods of rising rates when bond prices fall. Also, payouts from preferreds are often taxed at lower, qualified dividend rates rather than ordinary income rates.

While we expect demand for preferreds to remain healthy thanks to their high-quality, tax-efficient income, supply could be limited. Banks — by far the largest issuer of preferreds — are already well capitalized, reducing their need to tap capital markets for additional funding. This favorable demand/supply dynamic should support valuations for the asset class.

Some investors may be concerned about preferreds' concentration in the financial sector, but we believe measures adopted by the FDIC and Fed to protect depositors and bolster bank liquidity following March's regional bank crisis could lead to tighter credit spreads over time. Additionally, we anticipate that banks — due to their financial strength — should experience extremely low default rates.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	November 2023	Year-to-date
2-year	4.54	-0.41	-0.41	0.11
5-year	4.13	-0.36	-0.59	0.12
10-year	4.20	-0.27	-0.61	0.32
30-year	4.39	-0.21	-0.60	0.42

Source: Bloomberg L.P., 01 Dec 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	November 2023	Year-to-date
2-year	2.83	-0.26	-0.83	0.23
5-year	2.57	-0.30	-0.92	0.05
10-year	2.61	-0.33	-0.98	-0.02
30-year	3.77	-0.23	-0.80	0.19

Source: Bloomberg L.P., 01 Dec 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	62
30-year AAA Municipal vs Treasury	86
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 01 Dec 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	November 2023	Year-to-date
Municipal	3.55	–	6.20	1.76	6.35	4.15
High yield municipal	5.78	234[1]	7.41	2.23	7.75	6.38
Short duration high yield municipal[2]	5.62	304	4.11	1.10	3.42	4.93
Taxable municipal	5.23	84[3]	7.99	2.27	4.95	4.89
U.S. aggregate bond	4.91	45[3]	6.26	2.04	4.53	2.51
U.S. Treasury	4.41	–	6.08	1.71	3.47	1.42
U.S. government related	4.92	47[3]	5.22	1.54	3.39	3.36
U.S. corporate investment grade	5.47	105[3]	6.98	2.26	5.98	4.91
U.S. mortgage-backed securities	5.10	52[3]	6.24	2.49	5.21	1.79
U.S. commercial mortgage-backed securities	5.70	133[3]	4.39	1.63	3.06	3.00
U.S. asset-backed securities	5.36	77[3]	2.68	0.99	1.71	3.97
Preferred securities	7.38	236[3]	4.81	2.03	6.37	6.46
High yield 2% issuer capped	8.35	374[3]	3.34	1.31	4.53	9.72
Senior loans[4]	9.73	560	0.25	0.20	1.19	11.29
Global emerging markets	7.54	312[3]	5.96	1.47	5.30	5.11
Global aggregate (unhedged)	3.85	46[3]	6.67	1.47	5.04	1.87

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, 01 Dec 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, 01 Dec 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 29 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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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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