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Weekly Fixed Income Commentary

22 January 2024

Strong economic data boost U.S. Treasury yields

U.S. Treasury yields rose on healthy U.S. economic data and hawkish central bank commentary. Nevertheless, spread sectors generally outperformed Treasuries. The market-implied odds of a rate cut by March fell from 83% to 49%.

HIGHLIGHTS

- **Total returns were negative across most major asset classes, including Treasuries, investment grade and high yield corporates, preferreds and emerging markets. Each of those asset classes outperformed Treasuries.**

- **Municipal bond yields increased. New issue supply was \$6.3B and fund inflows were \$898M. This week's new issuance is estimated to be \$8.3B.**

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Watchlist

- *The 10-year U.S. Treasury yield rose last week, but we anticipate 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

Rates have probably peaked for this cycle, as attention pivots toward rate cuts in response to softer growth and easing inflation.

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.

Risk premiums may widen further, with entry points for taxable fixed income likely to become more attractive over the coming quarters. Credit selection is key as we search for bonds with favorable income and solid fundamentals.

KEY RISKS

- Inflation fails to continue moderating as expected, weighing on asset prices.
- Policymakers unsuccessfully juggle fighting inflation with supporting economies still struggling to gain traction.
- Geopolitical flare-ups intensify: Israel, China, Russia and Iran.

INVESTMENT GRADE CORPORATES SEE HEAVY ISSUANCE IN JANUARY

U.S. Treasury yields rose last week, with the 10-year yield ending 18 basis points (bps) higher and the 2-year yield up 24 bps. The moves responded to strong U.S. economic data and hawkish central bank commentary. On the data front, retail sales beat expectations for December, with the core measure expanding 0.8% for the month and 5.6% year-over-year, the fastest pace in almost a year. Meanwhile, U.S. Federal Reserve Governor Waller said rate cuts are likely this year, "as long as inflation doesn't rebound." Waller is considered a useful gauge of the committee's thinking and supports "methodically and carefully" lowering rates this year. The market-implied odds of a cut by March fell from 83% to 49%, and the total cuts priced for this year fell from 6.7 to 5.4.

Investment grade corporates weakened, returning -1.00% for the week. Nevertheless, spreads tightened further, to 95 bps for the index, leading the investment grade asset class to outperform similar-duration Treasuries by 18 bps. Heavy new issuance of more than $47 billion met strong demand, with oversubscription rates of 4x on average. That resulted in very low new issue concessions of only 0.9 bps. New issuance has totaled around $145 billion so far this month – only $5 to $10 billion away from the pre-January estimates for full-month supply – with eight trading days remaining.

High yield corporates also sold off, returning -0.52% for the week. The asset class outperformed similar-duration Treasuries by 5 bps. High yield corporates were helped by their relatively shorter duration versus investment grade. This dynamic also supported senior loans, returning 0.14% for the week. High yield saw a healthy inflow of $1 billion, while loan funds experienced outflows of -$3 million. Both markets saw relatively active new issuance, with $5.5 billion pricing in high yield and $23.9 billion in loans.

Emerging markets retreated -0.77% for the week but outpaced similar-duration Treasuries by 26 bps. Spreads tightened across the hard currency sovereign space, with both investment grade and high yield names compressing. Outflows nevertheless continued, with -$351 million leaving hard currency funds and -$210 million exiting local currency funds. Local currency markets returned -1.69% for the week. Unlike the U.S. corporate markets, the new issue market was relatively quiet in emerging markets. Only $10 billion priced for the week, the smallest weekly total of the year so far.

THE MUNICIPAL BOND MARKET SEES IMPRESSIVE INFLOWS

Municipal yields sold off last week across the curve. Short-term yields ended 11 bps cheaper, while long-term yields ended 14 bps cheaper. The new issue calendar was priced to sell and well received. Fund inflows were the highest in 25 weeks, including exchange-traded fund inflows of $189 million. This week's new issue calendar should be priced to sell, as dealers want to keep inventory moving.

Muni bond yields are rich compared to Treasuries, so it makes sense that the tax-exempt space followed the Treasury sell off. Tax-exempt investors need more yield compensation versus rising government yields. However, much of the $37 billion of 01 January reinvestment money has yet to be invested. This should provide stability in the municipal market. New issue supply is building, but still manageable. We believe Treasuries in general should remain range bound, with munis following this pattern.

The North Carolina Turnpike Authority issued $340 million revenue bonds (rated AA by S&P, as the deal was AGMC insured). It was priced to sell, but interest was tepid. In fact, some bonds traded in the secondary market at the same price as they were issued. For example, the 5% coupon bond due in 2058 came at a 4.23% yield and traded in block size at the same yield.

High yield municipal bond yields increased 13 bps on average last week. Mutual fund inflows saw another strong week, and exchange-traded fund outflows slowed. New issue deals were well subscribed. The tobacco sector performed worst, led by Buckeye 5% coupon bonds with yields increasing 30 bps and producing a one-week total return of -4%. This week's new issue calendar is expected to be very light, and demand in the secondary market should strengthen as a result to the extent fund flows remain on a positive trend.

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In focus

Securitized sectors looking sunny in 2024

The securitized sectors offer substantial value compared to similarly rated taxable fixed income sectors and are supported by strong fundamentals.

Mortgage-backed: Mortgage market fundamentals remain strong despite declines in home sales and high interest rates. Low home supply benefits the sector, but rising mortgage rates have cooled issuance. Non-agency MBS is particularly appealing given its high yields and supportive macroeconomic conditions. Agency MBS may be favorable for high-grade portfolios due to attractive valuations. We are selectively adding agencies to extend portfolio duration heading into the predicted Fed rate cuts this year.

Commercial mortgage-backed: While CMBS struggled in 2023, the current outlook is slightly more positive based on a soft landing and potential rate cuts in 2024. We are selectively adding high quality office exposure in tier one cities while looking to add credit risk in lower-rated defensive sectors like industrial and self-storage.

Asset-backed: Consumer and commercial credit performance have shown signs of stabilization, but risks remain where asset valuations have come under pressure. Because the fourth quarter rally generally tightened the sector, we expect ABS market sentiment to be driven by inflation, economic growth and the outlook for Fed rate policy.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.39	0.24	0.14	0.14
5-year	4.05	0.22	0.20	0.20
10-year	4.12	0.18	0.24	0.24
30-year	4.33	0.15	0.30	0.30

Source: Bloomberg L.P., 19 Jan 2024. **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	2.73	0.11	0.21	0.21
5-year	2.45	0.20	0.17	0.17
10-year	2.46	0.18	0.18	0.18
30-year	3.59	0.14	0.17	0.17

Source: Bloomberg L.P., 19 Jan 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	59
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters, 19 Jan 2024. 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	3.45	–	6.10	-0.77	-1.01	-1.01
High yield municipal	5.75	248[1]	7.27	-1.40	-1.76	-1.76
Short duration high yield municipal[2]	5.45	301	3.94	-0.40	-0.13	-0.13
Taxable municipal	5.08	78[3]	7.95	-1.16	-1.80	-1.80
U.S. aggregate bond	4.75	40[3]	6.25	-1.10	-1.39	-1.39
U.S. Treasury	4.28	–	6.05	-1.04	-1.39	-1.39
U.S. government related	4.78	47[3]	5.27	-0.85	-1.08	-1.08
U.S. corporate investment grade	5.26	95[3]	6.99	-1.00	-1.29	-1.29
U.S. mortgage-backed securities	4.95	47[3]	6.23	-1.37	-1.61	-1.61
U.S. commercial mortgage-backed securities	5.41	119[3]	4.38	-0.68	-0.45	-0.45
U.S. asset-backed securities	5.05	63[3]	2.66	-0.38	-0.10	-0.10
Preferred securities	6.86	202[3]	4.73	-0.05	1.01	1.01
High yield 2% issuer capped	7.89	338[3]	3.23	-0.52	-0.68	-0.68
Senior loans[4]	9.21	526	0.25	0.14	0.58	0.58
Global emerging markets	7.28	299[3]	6.04	-0.77	-1.45	-1.45
Global aggregate (unhedged)	3.72	42[3]	6.66	-1.42	-2.42	-2.42

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, 19 Jan 2024. **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, 19 Jan 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 17 Jan 2024.

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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