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Weekly Fixed Income Commentary

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Treasury yields fall with inflation data steady

U.S. Treasury yields fell across the curve as inflation data met expectations. This week, the European Central Bank is scheduled to meet and Fed Chair Powell will testify to Congress. On Friday, the February jobs report is expected to show a hiring slowdown.

HIGHLIGHTS

- **Total returns were positive across the board, including Treasuries, investment grade and high yield corporates, MBS, preferreds, senior loans and emerging markets.**
- **Municipal bond yields remained essentially unchanged. New issue supply was $7.6B and fund inflows were $72M. This week's new issuance is expected to be $6.8B.**

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Watchlist

- *The 10-year U.S. Treasury yield declined last week, and we expect yields to moderate over the course of the year.*
- *Spread assets generally gained, but lagged the rally in 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.

EMERGING MARKETS CONTINUE TO OUTPERFORM

U.S. Treasury yields fell last week, with the 10-year yield down -7 basis points (bps) and the 2-year yield down -16 bps. The Personal Consumption Expenditures price index, the Fed's preferred inflation gauge, showed core prices rising 0.4% month-over-month and 2.8% year-over-year. There had been some fear of another upside surprise, after CPI inflation was hotter than expected earlier in the month, but this did not occur. Fixed income markets rallied in response. This week, the European Central Bank is scheduled to meet, where no change in policy is expected, and Fed Chair Powell will testify to Congress. On Friday, we expect the February jobs report to show a slowdown from January's blistering pace of 353,000 jobs created.

Investment grade corporates gained, returning 0.22% for the week, though the asset class lagged similar-duration Treasuries by -40 bps. Investment grade funds experienced their 18th straight week of inflows, with $6.5 billion entering the asset class. New issuance remained heavy, with $53 billion for the week, taking February's total to an all-time record of $197.4 billion. That was around 35% more than expected entering the month, taking this year's overall supply run rate to 26.5% more than the equivalent period last year.

High yield corporates also rallied, returning 0.20% for the week but underperforming similar-duration Treasuries by -22 bps. Senior loans gained 0.23%. High yield funds had outflows of -$449 million, while loan funds had inflows of $408 million. Both asset classes continued to see healthy new issuance, which was well-digested by the market, with $3.4 billion pricing in high yield and $5.1 billion in loans.

Emerging markets continued to outperform, returning 0.45% for the week. They lagged similar-duration Treasuries by -12 bps, which was still better than other risk asset classes. In hard currency sovereigns, high yield names outperformed again, with spreads compressing by -21 bps, while investment grade sovereigns widened 1 bps. Outflows continued, though the pace decelerated, with -$245 million exiting hard currency funds and -$258 million leaving local currency funds.

MUNI BOND NEW ISSUANCE CALENDAR SHOULD BUILD

Municipal bond yields were basically unchanged last week. New issuance was well received inflows returned, including exchange-traded fund inflows of $350 million. This week's new issue calendar should be priced to sell and well received.

Tax-exempt bonds continue to trade rich to their taxable counterparts, but they remain well bid. There is just not enough supply to meet demand. The new issue calendar is building, but March represents the fourth consecutive month with outside reinvestment money to be put to work. The calendar should build, but outsized cash will remain. We may see some weakness come tax time, but soon after that thoughts should turn to the outsized reinvestment income for June and July. We expect Treasuries and muni bonds to remain well bid. We would look at any potential sell off as a buying opportunity.

New York City, New York, issued $1.5 billion general obligation bonds (rated Aa2/AA). The deal was well received, and underwriters were able to lower yields on all but the short end of the curve. For example, 5% coupon bonds due in 2031 came at a yield of 2.69% and traded in the secondary market at 2.68%.

High yield municipal yields continue to decrease on average, resulting in inflows of $400 million last week. Demand is spreading to traditional areas of the high yield muni market in both primary and secondary markets.

Investment grade corporate new issuance remained heavy, taking February's total to an all-time record.

In focus

Investors prefer preferreds

While fixed income has generally struggled year-to-date, preferred securities are off to a solid start. Their 3.40% total return tops the bond market leaderboard, followed by senior loans (+1.73%) and high yield corporates (+0.47%).

This outperformance has been driven by spread compression, especially in the $25 par preferred sector, due to favorable technical factors. In particular, the segment's net supply has been negative, and issuers have stepped up call activity. Preferreds have also benefited from strong fundamentals. Banks, which make up the largest percentage of the asset class by issuer, sport healthy underlying credit metrics, as reflected in solid quarterly earnings and encouraging results from the Fed's 2023 stress tests.

Short-term results aside, we believe preferreds can play a key role in diversified portfolios, as they have demonstrated low correlation to stocks and traditional fixed income sectors while delivering attractive, tax-efficient payouts. And thanks to their fixed-to-floating-rate coupon structures, preferreds typically offer a measure of protection against interest rate volatility.

Because preferreds are a highly inefficient asset class, we believe active management is essential. We suggest strategies that invest across the full credit quality spectrum in both $25 par retail and $1,000 par institutional, in addition to contingent capital (CoCo) securities.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	February 2024	Year-to-date
2-year	4.53	-0.16	0.41	0.28
5-year	4.16	-0.12	0.41	0.31
10-year	4.18	-0.07	0.34	0.30
30-year	4.33	-0.04	0.21	0.30

Source: Bloomberg L.P., 01 Mar 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	February 2024	Year-to-date
2-year	2.73	-0.01	-0.10	0.21
5-year	2.44	0.00	-0.08	0.16
10-year	2.46	0.00	-0.08	0.18
30-year	3.59	0.00	-0.07	0.17

Source: Bloomberg L.P., 01 Mar 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	83
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters, 01 Mar 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	February 2024	Year-to-date
Municipal	3.41	–	6.11	0.19	0.13	-0.37
High yield municipal	5.57	230[1]	7.07	0.54	0.79	0.38
Short duration high yield municipal[2]	5.19	275	3.70	0.24	0.61	1.32
Taxable municipal	5.03	67[3]	7.95	0.85	-1.12	-0.61
U.S. aggregate bond	4.84	42[3]	6.29	0.47	-1.41	-1.30
U.S. Treasury	4.38	–	6.12	0.55	-1.31	-1.22
U.S. government related	4.87	46[3]	5.29	0.48	-0.98	-0.81
U.S. corporate investment grade	5.34	97[3]	7.02	0.22	-1.50	-1.28
U.S. mortgage-backed securities	5.06	51[3]	6.22	0.59	-1.63	-1.67
U.S. commercial mortgage-backed securities	5.36	103[3]	4.35	0.59	-0.77	0.31
U.S. asset-backed securities	5.13	56[3]	2.63	0.38	-0.28	0.38
Preferred securities	6.67	169[3]	4.64	0.23	0.86	3.40
High yield 2% issuer capped	7.82	316[3]	3.20	0.20	0.29	0.47
Senior loans[4]	9.29	515	0.25	0.23	0.89	1.73
Global emerging markets	7.20	283[3]	6.05	0.45	0.38	0.08
Global aggregate (unhedged)	3.77	41[3]	6.72	0.26	-1.26	-2.43

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 Mar 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, 01 Mar 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 28 Feb 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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