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Weekly Fixed Income Commentary

22 April 2019

Treasury yields remain steady in a quiet week

U.S. Treasury yields fell slightly during in a holiday-shortened week. The biggest movement came on Tuesday, with a just over 3 basis points (bps) increase in the 10-year maturity, after stronger-than-expected data from China. The Federal Reserve (Fed) is still not committed to a specific path for interest rates, and the market is not expecting a hike in 2019.

HIGHLIGHTS

- **Preferred securities enjoyed the strongest returns, closely followed by senior loans.**
- **Municipal bonds traded sideways, but closed with a strong tone.**
- **Investment grade corporate bonds fared slightly better than their high yield counterparts.**

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TREASURY RATES FALL SLIGHTLY IN A SHORT, QUIET WEEK

U.S. Treasury rates were little changed last week, with yields on all maturities falling slightly.[1] The most noteworthy development was a batch of stronger-than-expected economic data out of China prior to Wednesday's session. However, even the much-watched Chinese data had little impact on U.S. Treasuries. The largest movement occurred when rates rose just over 3 basis points (bps) on Tuesday, led by the 10-year maturity.[1] All maturities finished within 2 bps of where they began the holiday-shortened week, with the 30-year moving the most.[1]

All taxable sectors showed modestly positive total returns, except mortgage-backed securities and global aggregate.[1] Preferred securities enjoyed the strongest returns, closely followed by senior loans.[1] Not all risk sectors performed well, as high yield corporates underperformed similar-duration Treasuries and posted a lower total return.[1] In non-U.S. markets, the prior week's performance reversed and emerging markets outperformed developed regions.[1] Negative returns in both Europe and Asia dragged down the global aggregate sector performance, and it suffered the lowest return across all fixed income.[1]

A Fed official commented that an additional rate increase was still possible this year. While there is no consensus about hiking rates, it does indicate that the Fed is not committed to a specific path of interest rate policy. Market-based measures are less balanced and currently reflect a 45% chance of a rate cut in 2019 with a 0% probability of a hike.

Unbalanced supply and demand tips the scale in favor of municipal bond performance.

MUNICIPAL MARKET SUPPLY AND DEMAND IMBALANCE CONTINUES

Municipal bonds traded sideways during the holiday-shortened week, but closed with a strong tone.[1] New issue supply was just under $3 billion due to the holiday, and was readily absorbed.[2] Weekly fund flows were positive for the 15th consecutive week at $421 million.[3] This week's new issue supply is expected to be only $5.3 billion and should be readily absorbed.[2]

The supply and demand equation continues to be the story in the municipal bond market. First quarter new issue supply was only $75 billion.[2] Net supply was essentially zero, however, considering that approximately an equal amount of bonds matured or were called in the same time period.[4] Yet the demand for tax-exempt income continues: First quarter fund flows were the strongest since 2009, collecting $27.9 billion.[3] Unbalanced supply and demand tips the scale in favor of municipal bond performance. And the Fed continues to appear comfortable about the level of interest rates. We expect the trend to continue to favor tax-exempt bonds for the foreseeable future.

Cleveland Clinic Heath System Obligated Group issued $500 million of hospital revenue bonds (rated Aa2/AA).[5] Cleveland Clinic is a world-renowned hospital group, and the deal was well received. Bonds were trading in the secondary market at a premium to where the deal sold in the primary market.

High yield municipal fund flows continued last week at a strong $350 million, bringing the year-to-date total to nearly $6 billion.[3] The supply constraint continues, and the holiday muted supply even further. In this environment, a $612 million non-rated deal for Hunt Refining, a deal that required substantial independent credit research, was more than 10 times oversubscribed.[4]

MODEST SPREAD WIDENING TEMPERS HIGH YIELD GAINS

The strong rally in high yield corporates slowed last week.[1] Spreads widened for the first time in five weeks, and the asset class eked out a positive return after gaining more than 1% in the first half of April and north of 7% in the first quarter.[1] High yield has delivered positive results for six weeks in a row and in 14 of the past 16.[1]

Dealer inventories have shrunk, amid strong demand for high yield, exacerbating spread tightening. Last week's modest widening may be a sign of fatigue, in line with our view that the degree of recent spread compression is not sustainable. Historically, late spring and early summer are seasonally volatile for high yield, even in otherwise bullish years.

Investment grade corporate bonds fared slightly better than their high yield counterparts.[1] Spreads were flat and total returns were in the middle of the pack among taxable fixed income sectors.[1] Demand for BBB rated corporate credit (the lowest tier of investment grade quality) has surged, evidenced by sharply narrower spreads between BBB and BB securities (the top rating for high yield bonds).

High yield delivered positive results for six weeks in a row and 14 of the past 16.

U.S. dollar-denominated emerging markets (EM) debt outperformed both high yield and investment grade U.S. credit.[1] Local currency EM returns lagged as the U.S. dollar strengthened.

In focus

Leverage differs among high yield issuers

Concerns over high yield market weakness seemed to be abating during the first quarter, as credit spreads tightened and performance rebounded. But the growing gap in debt ratios highlights the importance of security selection as the economic cycle continues to age.

Leverage levels for non-financial high yield issuers are generally flat-to-down since peaking in early 2016. However, by breaking the market down by credit rating, we see a growing disparity.

Higher quality issuers appear to be improving their balance sheets and, we believe, better positioning themselves for slower growth in the future.

Among lower-quality issuers (B and CCC), overall leverage has remained steady since early 2016. However, the bottom quartile of most indebted companies are nearly 40% more highly leveraged than they were in 2016.[6] At the same time, the least-levered companies in this group reduced net debt ratios by nearly the same amount over that period.

In a market where debt levels are rising among the most highly leveraged companies, we believe fundamental security selection becomes more important to achieving investment goals.

Leverage is defined as net debt to EBITDA (earnings before interest, tax, depreciation and amortization).

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	2.38	-0.01	0.12	-0.11
5-year	2.37	-0.01	0.14	-0.14
10-year	2.56	0.00	0.16	-0.12
30-year	2.96	-0.02	0.15	-0.05

Source: Bloomberg L.P. As of 18 Apr 2019. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.56	0.01	0.07	-0.22
5-year	1.67	0.00	0.10	-0.27
10-year	1.95	0.02	0.09	-0.33
30-year	2.70	0.02	0.10	-0.32

Source: Bloomberg L.P. As of 18 Apr 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	76
30-year AAA Municipal vs Treasury	91
High Yield Municipal vs High Yield Corporate	77

Source: Bloomberg L.P., Thompson Reuters. As of 18 Apr 2019. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	2.39	–	5.85	0.02	-0.19	2.70
High Yield Municipal	4.75	223[7]	8.82	0.04	-0.20	3.62
High Yield Municipal, ex Puerto Rico	4.62	210[7]	7.74	0.04	-0.01	3.38
Short Duration High Yield Municipal[8]	3.76	202	3.80	0.08	0.10	2.72
Short Duration High Yield Municipal, ex Puerto Rico[8]	3.68	194	3.68	0.07	0.09	2.51
U.S. Aggregate Bond	3.03	43[9]	5.93	0.06	-0.35	2.58
U.S. Treasury	2.49	–	6.19	0.09	-0.68	1.42
U.S. Government Related	3.09	60[9]	5.47	0.11	-0.32	2.79
U.S. Corporate Investment Grade	3.66	110[9]	7.41	0.10	0.09	5.24
U.S. Mortgage-Backed Securities	3.21	39[9]	4.44	-0.03	-0.30	1.86
U.S. Commercial Mortgage-Backed Securities	3.10	65[9]	5.25	0.11	-0.31	2.91
U.S. Asset-Backed Securities	2.78	38[9]	2.21	0.07	-0.03	1.45
Preferred Securities	4.05	136[9]	4.63	0.26	1.05	9.46
High Yield 2% Issuer Capped	6.17	354[9]	3.40	0.03	1.10	8.44
Senior Loans[10]	6.77	435	0.25	0.22	1.21	5.03
Global Emerging Markets	5.34	283[9]	5.85	0.16	0.14	5.58
Global Aggregate (unhedged)	1.85	46[9]	7.06	-0.17	-0.49	1.70

7 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **8** 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. **9** Option-adjusted spread to Treasuries. **10** 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. As of 18 Apr 2019. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. 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. All indices are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 18 Apr 2019. **3** Lipper Fund Flows. **4** *Long-term Bond Sales,* Bond Buyer; Loop Capital,14 Jan 2019. **5** Market Insight, MMA Research, 17 Apr 2019 **6** *U.S. HY: Leverage Metrics Across Sectors, Tiers,* CreditSights, 4 Apr 2019.

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.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

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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 advisor regarding the suitability 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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