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Weekly Fixed Income Commentary

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# Treasury yields fall further on global growth concerns

*U.S. Treasury yields closed sharply lower again last week, led by long maturities. By mid-week, the 2-year/10-year Treasury yield relationship inverted for the first time since 2007 and the 30-year yield closed below 2% for the first time ever. Market expectations remain certain for a September Federal Reserve (Fed) rate cut, with a 2/3 probability it will be a 25 basis point cut and 1/3 it will be 50 bps.*

## HIGHLIGHTS

- **Emerging markets suffering the worst returns among bond markets, followed by senior loans and high yield corporates.**
- **The rising supply of high yield municipal bonds could cause spread tightening in that market.**
- **The global aggregate sector was the only sector to outperform similar-duration Treasuries.**

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## TREASURY YIELDS CONTINUE TO PLUMMET

**U.S. Treasury yields closed sharply lower again last week,** led by a precipitous drop in long maturities, as global growth concerns pushed rates down across the globe.[1] Despite a delay in new U.S. tariffs and stronger-than-expected inflation data, U.S. yields fell early in the week as economic data in Europe and China disappointed investors. By mid-week, the 2-year/10-year Treasury yield relationship inverted for the first time since 2007 and the 30-year yield closed below 2% for the first time ever.[1] Fears of a global economic slowdown flattened the yield curve, as long-term growth expectations fell and risk-off sentiment stoked demand for U.S. Treasuries. These trends reversed later in the week, offsetting a portion of the earlier moves. The 2- to 10-year Treasury spread actually closed steeper for the week.[1]

**The Treasury market led performance in a strong risk-off market last week.[1]** Sharply falling yields fueled positive total returns, with Treasuries returning 1.3%.[1] Investment grade corporates also delivered a total return above 1%, but underperformed similar-duration Treasuries, as did all U.S. sectors.[1] The highest-risk sectors underperformed again last week, with emerging markets suffering the worst returns followed by senior loans and high yield corporates.[1] The global aggregate sector posted a modest total return and was the only sector to outperform similar-duration Treasuries, supported by strong relative performance in the European region.[1]

**Surprisingly, given the turmoil, expectations for monetary policy shifted only modestly** during the volatile week, and reflect a 1/3 probability of a 50 basis point (bps) Fed rate cut in September and 2/3 chance of a 25 bps cut.

***The 30-year Treasury yield closed below 2% for the first time ever.***

## MUNICIPAL FUND FLOWS SET A RECORD

**The municipal bond market continued to rally last week,** with long maturity yields hitting all-time lows.[1] New issuance totaled $8.2 billion and was readily absorbed.[2] Municipal fund flows remained positive for the 32nd consecutive week at $1.6 billion.[3] Flows stand at a record $59.3 billion year to date.[3] This week's new issue supply is expected to be $6.3 billion and should be readily absorbed.[2]

**U.S. fixed income yields are at all-time lows.[1]** 10-year and longer municipal benchmarks are at all-time lows, as is the 30-year Treasury bond.[1] Yet these rates are high relative to the rest of the world: approximately $16 trillion of debt is trading globally at negative rates.[1] U.S. yields are positive because the U.S. economy remains the world's most resilient. We believe this trend is likely to continue, and we do not see U.S. rates going negative. However, we don't see a catalyst for interest rates going higher any time soon. Thus we think interest rates will generally remain low for an extended period of time.

**The state of Maryland** issued two general obligation deal (rated AAA/AAA).[4] Maryland is one of the richest trading names in the municipal market, and both deals offered very low yields. Underwriters appear comfortable owning bonds for inventory as the demand for tax-exempt bonds remains strong.

**High yield municipal credit spreads are the widest of the year** and 50 bps wider year over year, as high yield municipal bonds yields have fallen less than U.S. Treasury bonds and high grade municipals.[1] High yield municipal bond fund flows totaled $384 million last week, taking the year-to-date total to $12.7 billion.[3] This week's high yield municipal new supply is expected to be limited.[2] The Chicago Board of Education is expected to come to market in September, leading off a possible 2019 fall supply surge.[4] We think a supply increase could be a catalyst for tighter spreads in this technical environment.

## INVESTMENT GRADE CORPORATES MAINTAIN POSITIVE MOMENTUM

**Investment grade corporate bonds kept their winning streak alive** with the best one-week total return of 2019 so far.[1] The asset class has produced gains in 16 of the past 20 weeks, a span that includes all of the second quarter and half of the third.[1] The energy sector improved last week, as oil prices stabilized. Investment grade spreads widened only modestly overall, and no sectors recorded a negative return.[1]

**High yield corporates struggled again, as risk aversion remained the dominant market theme.[1]** During the third quarter, high yield bonds have posted a loss in five of seven weeks, including the last three.[1] Spread widening (+22 bps), poor equity market performance and sustained outflows took a toll on last week's performance. The brief inversion of the 2-year/10-year portion of the U.S. Treasury curve also weighed on sentiment, as history shows such inversions tend to be followed by spread widening over the following 12 months.[1]

***Investment grade corporates produced gains in 16 of the past 20 weeks.***

**Emerging markets (EM) debt suffered its worst week of the year.[1]** Heightened global growth concerns and primary election results in Argentina that were widely seen as market-unfriendly drove broadly negative EM returns. In the wake of the election outcome, the Argentine peso plunged in value, two ratings agencies downgraded the country's debt and the Treasury minister resigned.

*In focus*

# The positives to negative yields

*Negative-yielding debt continues to proliferate, now making up about 30% of the world's investment grade bond market.[5] While headlines have focused on the causes of this phenomenon, there's been far less emphasis on the recent performance of these bonds.*

Some, like German Treasuries (yielding -0.1% in January and -0.8% as of 15 August) have delivered attractive total returns (+7.2% in euro terms year to date through 15 August).[1] Heavy demand for Germany's debt—widely considered Europe's safest—has pushed prices up and yields down. Such performance highlights a key point: Despite negative yields, investors don't "lock in" losses unless they hold the bonds to maturity.

These securities may also offer diversification benefits, as they don't move in lockstep with other asset classes. Since 1 July, for example, Germany's DAX stock index has fallen 7.7%, while German Treasuries have gained 7.2%.[1]

Will U.S. rates join the "subzero club"? We don't think so. Yields in part reflect economic growth, and the U.S. economy has been outperforming the eurozone and Japan, where negative yields prevail. Moreover, the U.S. Treasury is issuing far more debt than those countries. To the extent negative yields result from demand exceeding supply, they're less likely to occur when supply is also on the rise.

The DAX is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | Month-to-date | Year-to-date |
| 2-year | 1.48 | -0.17 | -0.40 | -1.01 |
| 5-year | 1.42 | -0.16 | -0.41 | -1.09 |
| 10-year | 1.56 | -0.19 | -0.46 | -1.13 |
| 30-year | 2.04 | -0.22 | -0.49 | -0.98 |

Source: Bloomberg L.P. As of 16 Aug 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 | 0.94 | -0.01 | -0.13 | -0.84 |
| 5-year | 0.96 | -0.02 | -0.15 | -0.98 |
| 10-year | 1.22 | -0.11 | -0.30 | -1.06 |
| 30-year | 1.87 | -0.14 | -0.37 | -1.15 |

Source: Bloomberg L.P. As of 16 Aug 2019. **Past performance is no guarantee of future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 79 |
| 30-year AAA Municipal vs Treasury | 93 |
| High Yield Municipal vs High Yield Corporate | 65 |

Source: Bloomberg L.P., Thompson Reuters. As of 16 Aug 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 | 1.62 | – | 5.28 | 0.50 | 1.57 | 7.61 |
| High Yield Municipal | 4.00 | 232[6] | 7.08 | 0.85 | 2.13 | 9.62 |
| High Yield Municipal, ex Puerto Rico | 3.96 | 228[6] | 7.74 | 0.59 | 1.72 | 8.81 |
| Short Duration High Yield Municipal[7] | 3.44 | 240 | 3.53 | 0.45 | 1.02 | 6.03 |
| Short Duration High Yield Municipal, ex Puerto Rico[7] | 3.44 | 240 | 3.29 | 0.36 | 0.90 | 5.62 |
| U.S. Aggregate Bond | 2.16 | 50[8] | 5.80 | 0.95 | 2.29 | 8.78 |
| U.S. Treasury | 1.57 | – | 6.75 | 1.30 | 3.24 | 8.46 |
| U.S. Government Related | 2.24 | 65[8] | 5.80 | 0.93 | 2.43 | 9.00 |
| U.S. Corporate Investment Grade | 2.87 | 124[8] | 7.88 | 1.19 | 2.56 | 13.29 |
| U.S. Mortgage-Backed Securities | 2.36 | 51[8] | 2.55 | 0.27 | 0.66 | 5.28 |
| U.S. Commercial Mortgage-Backed Securities | 2.19 | 70[8] | 5.28 | 0.55 | 2.10 | 9.09 |
| U.S. Asset-Backed Securities | 1.89 | 36[8] | 2.16 | 0.28 | 1.02 | 4.21 |
| Preferred Securities | 3.25 | 131[8] | 4.32 | 0.34 | 0.23 | 14.19 |
| High Yield 2% Issuer Capped | 6.14 | 437[8] | 3.22 | -0.17 | -0.81 | 9.67 |
| Senior Loans[9] | 6.14 | 475 | 0.25 | -0.25 | -0.50 | 5.71 |
| Global Emerging Markets | 4.91 | 333[8] | 6.10 | -0.53 | 0.04 | 10.53 |
| Global Aggregate (unhedged) | 1.21 | 47[8] | 7.22 | 0.53 | 1.96 | 7.34 |

**6** Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **7** 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. **8** Option-adjusted spread to Treasuries. **9** 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 16 Aug 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, 16 Aug 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 14 Aug 2019. **5** Bloomberg Barclays Global Aggregate Index as of August 15.

**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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### A word on risk

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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