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Weekly Fixed Income Commentary

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Treasury yields decline amid risk-on sentiment

U.S. Treasury yields closed slightly lower last week, with less volatile intra-week shifts. Longer maturities led the decline, and the yield curve flattened further. Markets showed strong consensus that the Federal Reserve (Fed) will likely cut rates by 25 basis points at the September meeting.

HIGHLIGHTS

- **High yield corporates led all taxable fixed income categories for the second week in a row.**
- **The municipal market was quiet, but ended with a constructive tone.**
- **Emerging markets debt performance was mixed, amid U.S. dollar strengthening, trade uncertainty and pessimism regarding global growth.**

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TREASURY YIELDS FALL MODESTLY DURING A QUIET WEEK

Treasury rates closed modestly lower last week, led by longer maturities.[1] In contrast to recent volatile weeks, most of the weekly change occurred on one day, with yields little changed the other four days. Yields fell sharply on Tuesday when the 30-year yield declined more than 8 basis points (bps).[1] There was no clear cause for the move that day, or throughout the week. The 2-year Treasury was the most stable, with daily changes of 2 bps or less every day.[1] The result was a flatter yield curve. The yield inversion between the 3-month T-bill and the 10-year Treasury reached the deepest level of the cycle, with the short maturity yield exceeding the longer maturity by the highest level since early 2007.[1] The market absorbed more than $130 billion in Treasury issuance throughout the week.

All total returns were slightly positive, as yields declined and most sectors outperformed similar-duration Treasuries.[1] A lack of negative developments helped stoke risk-on market sentiment. High yield posted the best total return again last week on broad based outperformance, but the strong recent performance of the non-Treasury sectors could not overcome the soft returns early in the month. For August, every sector posted lower total returns than the soaring Treasury market, and only asset-backed securities outperformed similar-duration Treasuries.[1] The month was particularly painful for senior loans, the only sector to suffer a negative total return.[1]

Market-based expectations reflect a 93% chance that the Fed will cut the policy rate 25 bps at its September meeting.

The strong Treasury market means we view any sell offs in the municipal market as a buying opportunity.

MUNICIPAL BOND TECHNICALS SHIFT

The municipal market was quiet last week, but ended with a constructive tone.[1] New issue supply was high for a pre-holiday week at $6.3 billion and was well received.[2] Fund flows continued their record pace (now in the 34th week) at $1.5 billion.[3] This week's new issue calendar of longer-term debt is estimated at $6.6 billion and should be well received.[2]

The municipal bond market is reversing the supply and demand dynamic in place all year. Supply is expected to increase, with issuers seeking historically low borrowing rates. Demand should be tempered, as monthly bond calls will be less than the record call pace seen in each month of 2019. We expect this trend to continue. However, the strong Treasury market means we would view any municipal market sell offs as a potential buying opportunity.

The city of Atlanta, Georgia, issued $686 million airport revenue bonds, AMT and non-AMT (general revenue bonds rated Aa3/AA-).[4] This deal represents what institutional investors are seeking: a globally known issuer (Hartsfield-Jackson Atlanta International Airport is one of the world's largest) issuing bonds to finance "bricks and mortar" entities where debt is repaid by revenues from that entity.

High yield municipal bond fund flows accelerated to $479 million last week, $13.8 billion year to date.[3] Credit spreads grind tighter as high yield municipal yields have failed to keep pace with the rally in U.S. Treasuries and high grade municipals.[1] High yield corporate spreads have contracted materially year to date, whereas high yield municipal spreads have widened. This environment makes high yield municipal bonds a more compelling relative value story in this new rate environment.

The 7th Circuit Illinois Court ruled against an attempt to invalidate specific issuances of Illinois general obligation (GO) bonds. The market responded by trading IL GO bonds 30 bps tighter to levels prior to the petition being filed.[4] Petitioners pledge to appeal, so the case may hang over the market for some time.

HIGH YIELD CORPORATE BONDS END AUGUST ON A STRONG NOTE

High yield corporates led all taxable fixed income categories for the second week in a row.[1] Supported by a rebounding equity market and a nearly 2% rise in oil prices, the asset class ended the month in modestly positive territory.[1] Among last week's top-performing high yield sectors were retail REITs, chemicals, construction machinery and independent energy.[1] Spreads narrowed by 14 bps overall.[1]

Investment grade corporate bonds produced a small gain, extending their weekly winning streak to seven.[1] Only U.S. Treasuries posted a higher total return for August.[1] Both Treasuries and U.S. corporate credit have benefited from strong non-U.S. demand, as global yields continue to fall. Year to date, investment grade corporates have delivered the second-highest total return (+11%) in taxable fixed income markets.[1]

Both Treasuries and U.S. corporate credit have benefited from strong foreign demand, as global yields continue to fall.

Emerging markets (EM) debt performance was mixed amid U.S. dollar strengthening, continued trade uncertainty and pessimism regarding global growth.[1] Country-specific risk, notably in Argentina—where currency controls were imposed over the weekend to prevent capital flight—has also weighed on broader sentiment. Last week's declining EM currencies included the Russian ruble, Chinese yuan and Mexican peso. Against that backdrop, dollar-denominated EM bonds realized gains, while their local-currency counterparts remained in the red.

In focus

Credit selection is growing more important for corporate debt

Late cycle dynamics are beginning to play out for investors in high yield corporate bonds and senior loans. The amount of bonds and loans trading below 70% of par (typically defined as distressed issuers) has risen dramatically in the last year.

Roughly 5% of the high yield market now trades below 70% of par, versus 1.5% as recently as September 2018.[5] Similarly, 2% of the loan market trades below 70% of par, up from 0.5%.[5] More bonds and loans trading below 70% has historically been a leading indicator of higher defaults.

However, signs of distressed pricing are concentrated in the weaker sectors of both markets. Within high yield, energy, retail and health care are the primary drivers. For example, approximately 20% of high yield issuers in the energy space now trade below 70% of par, versus 5% at this time last year.[5] For senior loans, the energy, retail and consumer sectors have been largely responsible for the shift.

Given the potential slowdown in U.S. economic growth, we believe active management may become critical to proactively reducing risk within weaker sectors and issuers as the cycle progresses.

U.S. Treasury market

Maturity	Yield	Change (%) Week	August 2019	Year-to-date
2-year	1.51	-0.03	-0.37	-0.98
5-year	1.39	-0.03	-0.44	-1.13
10-year	1.50	-0.04	-0.52	-1.19
30-year	1.96	-0.06	-0.56	-1.05

Source: Bloomberg L.P. As of 30 Aug 2019. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	August 2019	Year-to-date
2-year	1.01	0.03	-0.06	-0.77
5-year	1.03	0.02	-0.08	-0.91
10-year	1.22	-0.02	-0.30	-1.06
30-year	1.84	-0.05	-0.40	-1.18

Source: Bloomberg L.P. As of 30 Aug 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	81
30-year AAA Municipal vs Treasury	94
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters. As of 30 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	August 2019	Year-to-date
Municipal	1.65	–	5.20	0.13	1.58	7.61
High Yield Municipal	3.96	231[6]	6.80	0.25	2.41	9.91
Short Duration High Yield Municipal[7]	3.44	238	3.46	0.21	1.23	6.26
U.S. Aggregate Bond	2.13	48[8]	5.75	0.21	2.59	9.10
U.S. Treasury	1.58	–	6.69	0.21	3.40	8.63
U.S. Government Related	2.21	62[8]	5.76	0.46	2.85	9.44
U.S. Corporate Investment Grade	2.81	120[8]	7.89	0.14	3.14	13.94
U.S. Mortgage-Backed Securities	2.28	47[7]	2.40	0.23	0.89	5.53
U.S. Commercial Mortgage-Backed Securities	2.17	70[8]	5.31	0.22	2.38	9.38
U.S. Asset-Backed Securities	1.90	34[8]	2.14	0.05	1.09	4.28
Preferred Securities	3.25	132[8]	4.28	0.34	0.96	15.02
High Yield 2% Issuer Capped	5.72	393[8]	3.07	0.49	0.40	11.00
Senior Loans[9]	6.11	473	0.25	0.11	-0.28	5.94
Global Emerging Markets	4.92	335[8]	6.12	0.12	0.25	10.75
Global Aggregate (unhedged)	1.18	45[8]	7.19	0.06	2.03	7.42

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 30 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, 30 Aug 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 28 Aug 2019. **5** Credit Suisse.

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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