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Weekly Fixed Income Commentary

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Treasury yields little changed as markets focus on U.S. economy

U.S. Treasury yields finished last week within 2 basis points of their opening levels. With little movement in U.S./China trade negotiations, the market turned to better-than-expected U.S. economic data. The market shows just a four percent chance of a Federal Reserve (Fed) rate hike later this month.

HIGHLIGHTS

- **Most non-Treasury sectors outpaced Treasuries, led by high yield and investment grade corporates.**
- **Municipal bond markets were quiet last week, as record fund flows continued.**
- **Emerging markets debt produced positive results for the seventh time in the past nine weeks.**

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TREASURY YIELDS REMAIN LITTLE CHANGED IN A QUIET WEEK

U.S. Treasury yields ended last week within 2 basis points (bps) of their opening levels.[1] Yields on 2- and 30-year maturities closed modestly lower, while intermediate-maturity yields were slightly higher.[1] There were no breakthroughs on the U.S./China trade negotiations front, and market attention was focused on U.S. economic data. Several economic releases on Wednesday reflected better-than-expected U.S. growth and prices. Stronger data resulted in the largest rate movement of the week for most Treasuries, with shorter maturities leading the move higher.[1] November ended with Treasury rates higher and the yield curve flatter.[1]

A modestly positive risk tone supported non-Treasury sector returns last week.[1] Most sectors outpaced Treasuries, led by high yield and investment grade corporates. The securitized sectors experienced the weakest returns. After recent outperformance, commercial mortgage-backed securities (CMBS) suffered the worst performance and was the only sector to post a negative weekly total return.[1] All sectors, except CMBS and asset-backed securities, outperformed similar-duration Treasuries last week, and only CMBS underperformed similar-duration Treasuries in November.[1] The higher-risk sectors added to positive yearly total returns in November.[1] Fixed income total returns have been strong in 2019, spanning between 4% to almost 17%.[1]

Market-based probabilities reflect a 4% chance that the Fed will raise rates at its December meeting, with no chance of a cut. However, through the end of 2020, market-based measures reflect a 66% probability of at least one rate cut.

The higher-risk sectors added to positive yearly total returns in November.

MUNICIPAL DEMAND BUILDS ON ITS ANNUAL RECORD

Municipal markets were quiet last week due to the Thanksgiving holiday, but maintained a constructive tone.[1] New issuance was a mere $1.3 billion, primarily composed of a few large short-maturity deals.[2] Fund flows continued their positive streak for the 47th consecutive week at $2.3 billion.[3] This week's new issue calendar is expected to increase to an impressive $18 billion.[2] It should be priced to sell and well received. Fund flows continue to build on their annual record, at $84.1 billion year to date.[3]

We continue to see opportunities across fixed income markets, including municipals. The U.S. economy continues to chug along and inflation is muted, and we believe rates will remain range bound in 2020. We're not expecting much in the way of near-term Fed action.

Although we expect outsized new issue supply for the next two weeks, the calendar should then be substantially finished for the year. In terms of demand, $35 billion of reinvestment money will be available for both December 1 and January 1.[4] Thus the outsized new issue supply should be well received. Institutional managers continue to look at the outsized calendar to purchase blocks of bonds to reach their mandated investment objectives.

The historically strong pace of high yield municipal fund flows continued last week.[3] We expect 27 high yield municipal deals to be issued this week.[2] However, 22 will come non-rated and cover various sectors. In addition, three large high-beta deals collectively offer close to $2 billion: McCormick Place IL Sales Tax, NJ Transportation Appropriation and Osceola County Parkway.[2] Two other small existing publicly rated charter schools should offer modest supply. We have just a few weeks left in the new issue calendar, and fund flows remain at historic levels. We expect deals to be routinely oversubscribed and market access to be highly valuable, meaning credit selection should continue to remain key.

HIGH YIELD CORPORATES GAIN AFTER TWO DOWN WEEKS

High yield corporate bonds rebounded to lead all non-municipal sectors, breaking a two-week losing streak.[1] Spreads narrowed by more than 20bps amid modestly increased risk appetites, a supportive equity market and range-bound Treasury yields.[1] Fund flows into the asset class were positive, led by ETFs.[3]

Investment grade corporates posted a gain for the third consecutive week and finished only slightly behind their high yield counterparts.[1] Credit spreads were marginally tighter (-3bps).[1] Cable satellite, health insurers and food and beverage were among the leading sectors. Year to date, investment grade credit has returned 14.17%, second only to preferred securities among all fixed income categories.[1]

Cable satellite, health insurers and food and beverage were among the leading investment grade corporate sectors.

Emerging markets (EM) debt produced positive results for the seventh time in the past nine weeks, exhibiting resilience amid continued U.S./China trade uncertainty.[1] Although the two sides aren't close to wrapping up a "phase one" trade agreement, EM debt has risen incrementally (+0.4%) since President Trump announced the deal on October 11.[1] Gains for the asset class remain in double digits (+11.42%) for the year through the end of November.[1]

In focus

Taxable outlook favors active, multisector strategies

Taxable fixed income markets are poised to finish 2019 with broadly positive returns, including double-digit gains for many asset classes. Where do we see opportunities and risks in 2020?

We expect the 10-year U.S. Treasury yield to remain relatively range-bound between 1.75% and 2% next year. This "lower for longer" rate environment leads us to be more comfortable taking on duration risk.

In credit markets, we prefer investment grade over high yield. We think U.S. consumers—stalwarts in sustaining economic growth—will remain resilient. This suggests opportunities in mortgage- and asset-backed securities and consumer-related corporate credit.

We are bullish on emerging markets (EM) debt, given the attractive risk-adjusted return potential, especially relative to certain lower-rated U.S. credit sectors. We particularly favor hard-currency denominated issues.

Risks to our outlook and preferences include stronger-than-expected economic growth, which would work against our longer-duration, higher-quality bias in the U.S. Worsening trade tensions and/or a stronger U.S. dollar would hinder EM debt.

Against this backdrop, we think investors will be best served by focusing on diversification to generate income via active, multisector strategies.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	November 2019	Year-to-date
2-year	1.61	-0.02	0.09	-0.88
5-year	1.63	0.00	0.11	-0.89
10-year	1.78	0.01	0.09	-0.91
30-year	2.21	-0.02	0.03	-0.81

Source: Bloomberg L.P. As of 29 Nov 2019. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	November 2019	Year-to-date
2-year	1.07	-0.02	-0.04	-0.71
5-year	1.15	-0.02	0.00	-0.79
10-year	1.47	-0.03	-0.02	-0.81
30-year	2.06	-0.03	0.00	-0.96

Source: Bloomberg L.P. As of 29 Nov 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	83
30-year AAA Municipal vs Treasury	93
High Yield Municipal vs High Yield Corporate	72

Source: Bloomberg L.P., Thompson Reuters. As of 29 Nov 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	November 2019	Year-to-date
Municipal	1.81	–	5.30	0.18	0.25	7.21
High Yield Municipal	4.03	215[5]	6.98	0.22	0.39	10.35
Short Duration High Yield Municipal[6]	3.34	208	3.47	0.14	0.32	6.97
Taxable Municipal	2.95	110[7]	9.36	0.14	-0.23	11.87
U.S. Aggregate Bond	2.30	44[7]	5.88	0.15	-0.05	8.79
U.S. Treasury	1.76	–	6.58	0.09	-0.30	7.46
U.S. Government Related	2.39	62[7]	5.86	0.12	-0.13	8.97
U.S. Corporate Investment Grade	2.87	105[7]	7.91	0.38	0.25	14.17
U.S. Mortgage-Backed Securities	2.53	45[7]	3.05	0.06	0.08	6.06
U.S. Commercial Mortgage-Backed Securities	2.40	70[7]	5.25	-0.13	-0.41	8.56
U.S. Asset-Backed Securities	2.03	38[7]	2.17	0.01	0.01	4.42
Preferred Securities	3.49	143[7]	4.51	0.02	0.00	16.94
High Yield 2% Issuer Capped	5.59	370[7]	3.10	0.42	0.33	12.08
Senior Loans[8]	6.55	498	0.25	0.19	0.55	6.46
Global Emerging Markets	5.05	327[7]	6.15	0.19	0.03	11.42
Global Aggregate (unhedged)	1.41	42[7]	7.15	0.02	-0.76	6.22

5 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **6** 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. **7** Option-adjusted spread to Treasuries. **8** 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 29 Nov 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, 29 Nov 2019. **3** Lipper Fund Flows. **4** Siebert Williams.

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 Taxable Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. **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%.

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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