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Weekly Fixed Income Commentary

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Treasury yields end nearly unchanged on a cautious tone

Short-maturity U.S. Treasury yields fell slightly last week, while longer maturities were unchanged. Rates rose early in the week before inflation data and negative trade news shifted momentum. A more cautious risk tone caused the yield curve to steepen. Markets focused on stronger-than-expected data releases, reducing expectations for a Federal Reserve (Fed) rate cut in 2020.

HIGHLIGHTS

- **Emerging markets delivered the best returns, followed by high yield and senior loans.**
- **Municipal bond prices ended last week higher and outperformed U.S. Treasuries.**
- **The global aggregate sector suffered a negative total return, dragged down by the Asia-Pacific region.**

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U.S. TREASURY YIELDS REMAIN NEARLY UNCHANGED

Short maturity U.S. Treasury yields fell slightly last week, while longer Treasuries finished nearly unchanged.[1] Rates rose slightly at the beginning of the week, before weak inflation data and negative news regarding U.S. tariffs on China shifted momentum. Tuesday and Wednesday saw the largest declines, fueled by the deteriorating market sentiment.[1] The more cautious risk tone also caused the yield curve to flatten, as long maturity yields fell further than short maturities.[1] However, stronger-than-expected U.S. economic data and a surprise Treasury announcement reversed rates once again. The U.S. Treasury announced it would soon issue a 20-year bond, causing Treasury yields near this maturity range to rise and the yield curve to steepen. For 10- to 30-year Treasuries, this increase offset all earlier declines and most of the drop for shorter maturities.

All domestic non-Treasury sectors posted positive total returns and outperformed similar-duration Treasuries last week.[1] Emerging markets delivered the best returns, followed by high yield and senior loans.[1] Other credit-related sectors – investment grade corporates and preferred securities – also experienced solid returns and good relative performance.[1] Only the global aggregate sector suffered a negative total return, with performance dragged down by the Asia-Pacific region.[1]

U.S. economic data was mixed overall, but the markets focused on the stronger-than-expected releases. The optimistic outlook helped reduce the market-based probability of a Fed rate cut in 2020. However, the market is still pricing in one rate cut this year.

The more cautious risk tone caused the Treasury yield curve to flatten, as long maturity yields fell further than short maturities.

MUNICIPAL BONDS LOOK EXPENSIVE COMPARED TO U.S. TREASURIES

Municipal bond prices ended last week higher and outperformed U.S. Treasury bonds.[1] New issue supply totaled $7 billion and was readily absorbed.[2] Fund flows of $2.5 billion marked the 54th consecutive positive week.[3] This week's new issue municipal supply is expected to be $8.5 billion, evenly divided between tax-exempt and taxable issues.[2]

Municipal bonds currently look expensive compared to taxable Treasury bonds, as relative yields have reached their highest levels since the 1990s.[1] This may represent a secular change for municipals, as there are simply not enough tax-exempt bonds available to meet demand. Taxable bond deals are refinancing previous tax-exempt issues, as rates have declined over the last few years. Issuers can still save money by issuing lower-yielding taxable bonds to refinance the previous (higher-coupon) tax-exempt deals. We expect this richness to continue as long as the supply/demand imbalance remains.

The City of Chicago issued $466 million general obligation bonds (rated NR/BBB+).[4] The deal was priced cheaply and so well received that the issuer upsized the deal by $100 million and lowered yields by 15 to 20 basis points. Bonds traded at a premium in the secondary market to where they were originally issued. The city benefited from the market's insatiable demand for higher-yielding debt.

High yield municipal bond new issuance begins to build this week, with 15 new deals (10 without public ratings) expected to produce $463 million in par value.[2] Fund flows totaled $686 million last week.[3] Demand for yield is strong, as Chicago's sales tax deal was 25x oversubscribed and yields were lowered 35 basis points (bps) in final pricing.

Credit spreads continued to tighten, and steady Treasury yields appear to provide a path for this trend to continue.[1] We expect spreads to continue to tighten as demand builds on top of an already historic pace, combined with little fundamental stress.

EMERGING MARKETS DEBT OUTPERFORMS AS DEMAND FOR RISK EXTENDS RALLY

Emerging markets (EM) debt posted gains for the sixth consecutive week and for 14 of the past 16.[1] The asset class has returned more than 3% since the beginning of the fourth quarter of 2019.[1] Last week, the continued bid for risk assets overwhelmed dealer inventories, as investors awaited new sovereign debt supply. About $30 billion in primary corporate issuance came to market, with each deal oversubscribed and trading higher upon reoffer.[2] Flows into EM debt funds were north of $2.5 billion.[3]

High yield corporate bonds continued their uninterrupted weekly run of positive returns dating back to Thanksgiving.[1] The market's relentless hunt for yield has caused spreads to compress by 50 bps over that period, to 320 bps.[1] Favorable supply and demand technicals have remained the primary driver of high yield performance. Last week's fund flows (+$1.73 billion) exceeded $1 billion for a second consecutive week.[2] In keeping with the risk-on market tone, lower-rated (CCC) credits outperformed higher-quality (BB and B) issues.[1]

Emerging markets have returned more than 3% since the beginning of the fourth quarter of 2019.

Investment grade corporates bounced back from the previous week's slight decline.[1] Among sectors, banks and autos outperformed, while energy and industrials lagged.[1] Overall, spreads tightened modestly.[1] New investment grade corporate supply topped $31 billion from 20 issuers.[2] Inflows totaled $6.6 billion.[3]

In focus

Senior loan funds and ETFs see rare inflows

Senior loan open-end funds experienced outflows in 58 of 59 weeks coming into January 2020.[3] However, that trend has shifted to inflows for the last two consecutive weeks, with loan ETFs in particular seeing a surge.[3] The actual dollar amount isn't overwhelming, but the shift in sentiment is notable.

Over the last year, investors pulled nearly $58 billion from senior loan funds, while adding to high yield funds.[3] We question that strategy, however. In our opinion, loans and high yield corporate bonds have historically offered similar yields, yet loans have a lower risk profile.[1]

As a result of strong demand from institutions, and more recently retail investors, we expect spreads on loans will likely decline due to repricing or refinancing activity.

Despite this, we believe loans may offer an attractive investment opportunity for investors seeking attractive current income and lower volatility. This is particularly the case for high yield investors looking to lower the duration and risk profile of their investments while maintaining income.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	1.56	-0.01	-0.01	-0.01
5-year	1.62	-0.01	-0.07	-0.07
10-year	1.82	0.00	-0.10	-0.10
30-year	2.28	0.00	-0.11	-0.11

Source: Bloomberg L.P. As of 17 Jan 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.90	-0.04	-0.14	-0.14
5-year	0.91	-0.10	-0.18	-0.18
10-year	1.29	-0.06	-0.15	-0.15
30-year	1.94	-0.04	-0.15	-0.15

Source: Bloomberg L.P. As of 17 Jan 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	70
30-year AAA Municipal vs Treasury	85
High Yield Municipal vs High Yield Corporate	74

Source: Bloomberg L.P., Thompson Reuters. As of 17 Jan 2020. 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	1.60	–	5.27	0.32	1.04	1.04
High Yield Municipal	3.77	202[5]	6.58	0.47	1.56	1.56
Short Duration High Yield Municipal[6]	3.05	200	3.55	0.19	0.81	0.81
Taxable Municipal	2.95	107[7]	9.51	0.10	1.12	1.12
U.S. Aggregate Bond	2.25	39[7]	5.88	0.06	0.51	0.51
U.S. Treasury	1.76	–	6.57	-0.03	0.47	0.47
U.S. Government Related	2.35	58[7]	5.89	0.10	0.54	0.54
U.S. Corporate Investment Grade	2.78	93[7]	7.97	0.19	0.74	0.74
U.S. Mortgage-Backed Securities	2.45	38[7]	3.04	0.06	0.32	0.32
U.S. Commercial Mortgage-Backed Securities	2.39	68[7]	5.28	0.02	0.70	0.70
U.S. Asset-Backed Securities	1.94	34[7]	2.12	0.10	0.35	0.35
Preferred Securities	2.68	76[7]	4.45	0.13	0.94	0.94
High Yield 2% Issuer Capped	5.12	320[7]	2.99	0.27	0.71	0.71
Senior Loans[8]	6.04	442	0.25	0.23	0.75	0.75
Global Emerging Markets	4.73	293[7]	6.22	0.37	0.90	0.90
Global Aggregate (unhedged)	1.42	38[7]	7.15	-0.01	-0.15	-0.15

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 17 Jan 2020. **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, 17 Jan 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 15 Jan 2020.

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%.

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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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