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Weekly Fixed Income Commentary

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Treasury yields rise on global health optimism

U.S. Treasury yields rose last week, led by 5-year maturities. Investors were optimistic over Chinese efforts to contain the coronavirus, along with stronger-than-expected U.S. economic data, pushing yields higher and prices down. Market expectations for Federal Reserve (Fed) rate cuts in 2020 fluctuated during the week, ending at approximately 1.5 cuts through the remainder of the year.

HIGHLIGHTS

- **Preferred securities led taxable performance, closely followed by high yield corporates.**
- **Municipal bond prices were mixed, lagging U.S. Treasuries.**
- **Emerging markets debt extended its winning streak to nine weeks.**

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TREASURY YIELDS BOUNCE HIGHER

Positive investor sentiment propelled U.S. Treasury yields higher last week, led by 5-year maturities.[1] Optimism about Chinese efforts to contain the coronavirus was reinforced with stronger-than-expected U.S. economic data. By midweek, yields on all Treasury maturities had risen 12 to 15 basis points (bps).[1] However, momentum waned later in the week, despite a solid January employment report and positive trade developments. Treasury yields dropped 4 to 6 bps on Friday, when the Fed pointed to the coronavirus as presenting a new risk to global growth.[1]

The first week of February was strong for non-Treasury sectors.[1] Rising yields dragged down total returns, but several sectors produced positive weekly returns.[1] Preferred securities led the way, closely followed by high yield corporates. Both sectors handily outperformed Treasuries.[1] Emerging markets, mortgage-backed securities and investment grade corporates joined preferred and high yield with positive weekly returns. Commercial mortgage-backed securities (CMBS) was the only domestic credit sector to underperform Treasuries, but even CMBS outpaced similar-duration Treasuries.[1] The global aggregate sector also outperformed similar-duration Treasuries, although its total return was significantly lower due to negative returns in both Europe and Asia.[1]

Expectations for Fed rate cuts changed considerably throughout the week. Market-based probabilities started out reflecting 2 rate cuts in 2020. By midweek, expectations priced in approximately 1.25 cuts. As optimism tempered, expectations rose to 1.5 2020 cuts to end the week.

Municipal fund flows stand at $111 billion since the inflows began 57 weeks ago.

POSITIVE FLOWS CONTINUE FOR MUNICIPAL BONDS

Municipal bond yields followed U.S. Treasury yields higher early in the week, but closed out with a strong tone.[1] The new issue calendar totaled $9.3 billion and was well received.[2] Weekly fund flows were positive for the 57th consecutive week at $1.6 billion.[3] New issue supply is expected to be $9.9 billion this week ($2 billion taxable) and should be well received.[2] Fund flows stand at $111 billion since the inflows began 57 weeks ago.[3]

Bond markets suggest the coronavirus will likely represent a drag on the global economy. China has implemented important measures to combat the virus — including quarantining millions of citizens in their homes, which is dampening consumer purchasing habits. Investors are locking in bond yields now, fearing prolonged effects of the virus may cause a global recession that leads to even lower bond yields. In our view, demand for municipals should remain high.

Dormitory Authority of the State of New York (DASNY) issued $356 million health care bonds backed by the Montefiore Obligated Group (rated Baa3/BBB).[4] The bonds were expensive for the rating, but demand for tax-exempt bonds continues, especially in high-tax states like New York. The bonds traded substantially higher in the secondary market as the week closed.

High yield municipal bond fund flows accelerated to the year's highest weekly total, at $711 million last week.[3] Credit spreads contracted further.[1] New issuance is expected to be rather sparse this week, with only 11 high yield municipal deals pricing with an average size of $22 million.[2] We believe this will create a strong secondary market that should support larger, more liquid secondary offerings. The PROMESA Oversight Board announced an agreement for a global settlement with holders of $8 billion Puerto Rico GO bonds that would apply to $35 billion of total liabilities.[2]

HIGH YIELD CORPORATES RALLY AS RISK RECLAIMS THE SPOTLIGHT

High yield corporate bonds rebounded following two weeks of losses.[1] Spreads tightened by 36 bps, erasing the prior week's widening.[1] The asset class benefited from a global bounce in risk assets amid optimism about containing the coronavirus. Other positive drivers included Chinese monetary stimulus and anticipated fiscal support, along with strong U.S. economic data and solid corporate earnings reports. With risk back in favor, lower-quality (CCC) bonds finished ahead of their higher-rated (B and BB) counterparts after two weeks of underperformance.[1]

Investment grade corporates retraced the previous week's modest spread widening and recorded a positive total return for the fourth week in a row.[1] Demand for U.S. credit remained healthy, with $6.7 billion in inflows for the week — the largest on record in the past five years.[3] New issuance of $19.3 billion was at the higher end of market expectations and skewed heavily to financials.[2]

With risk back in favor, lower-quality (CCC) bonds finished ahead of their higher-rated (B and BB) counterparts.

Emerging markets (EM) debt extended its winning streak to nine weeks, supported by the risk-on environment.[1] The bid for both sovereign and corporate debt rotated back to the high yield sector after the previous week's strong preference for investment grade issues. Overall, EM spreads narrowed by 10 bps.[1] The asset class experienced its first weekly outflow (-$32 million) of 2020, dominated by local-currency funds.[3]

In focus

The yield curve inverted... again

In late January 2020, the U.S. Treasury yield curve inverted when the yield on the 3-month Treasury bill exceeded the 10-year Treasury bond. As a general rule of thumb, the yield curve has typically inverted about one to two years prior to the onset of a recession.

In April 2019, the 3-month Treasury yield rose above the 10-year Treasury yield for the first time since 2006. By mid-October, that inversion had reversed on economic optimism and rate cuts from the Fed. However, the curve has flattened once again on concerns about the economic impact of the coronavirus, and the curve briefly returned to inversion at the end of January.

What does this mean for markets? History suggests that a recession could occur this year, but we aren't quite ready to turn out the lights on the expansion. While a flat yield curve typically is not a sign of a robust economic outlook, long-term U.S. rates may remain low for other reasons. Importantly, the shape of the yield curve isn't the only relevant economic indicator for predicting recessions, and other signs suggest this economic expansion should continue.

Although a recession does not appear imminent, the advanced economic and credit cycles warrant a more cautious approach for taxable fixed income investors. Late-cycle, defensive positioning with an emphasis on diversification remains prudent.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	1.40	0.09	0.09	-0.17
5-year	1.41	0.09	0.09	-0.29
10-year	1.58	0.08	0.08	-0.34
30-year	2.05	0.05	0.05	-0.34

Source: Bloomberg L.P. As of 07 Feb 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	0.87	0.04	0.04	-0.17
5-year	0.88	0.04	0.04	-0.21
10-year	1.18	0.03	0.03	-0.26
30-year	1.83	0.03	0.03	-0.26

Source: Bloomberg L.P. As of 07 Feb 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	74
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters. As of 07 Feb 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	1.51	–	5.18	-0.11	-0.11	1.69
High Yield Municipal	3.62	198[5]	6.16	0.03	0.03	2.49
Short Duration High Yield Municipal[6]	2.86	189	3.48	0.11	0.11	1.64
Taxable Municipal	2.69	104[7]	9.60	-0.28	-0.28	3.90
U.S. Aggregate Bond	2.05	40[7]	5.90	-0.07	-0.07	1.86
U.S. Treasury	1.56	–	6.77	-0.28	-0.28	2.16
U.S. Government Related	2.18	61[7]	6.03	-0.17	-0.17	1.97
U.S. Corporate Investment Grade	2.59	96[7]	8.10	0.10	0.10	2.45
U.S. Mortgage-Backed Securities	2.25	41[7]	2.64	0.13	0.13	0.83
U.S. Commercial Mortgage-Backed Securities	2.14	66[7]	5.29	-0.29	-0.29	2.19
U.S. Asset-Backed Securities	1.72	29[7]	2.14	-0.09	-0.09	0.91
Preferred Securities	2.52	78[7]	4.66	0.65	0.65	1.87
High Yield 2% Issuer Capped	5.27	354[7]	3.03	0.62	0.62	0.65
Senior Loans[8]	5.94	454	0.25	-0.06	-0.06	0.47
Global Emerging Markets	4.69	310[7]	6.32	0.27	0.27	1.81
Global Aggregate (unhedged)	1.28	38[7]	7.21	-0.70	-0.70	0.57

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 07 Feb 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, 07 Feb 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 05 Feb 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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