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Weekly Fixed Income Commentary

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Treasury yields decline on dismal consumer data

Treasury yields fell last week, led by longer maturities.[1] Markets focused on a record monthly decline in core consumer goods, despite better-than-expected sentiment and manufacturing data. Market-based expectations reflect negative interest rates by late 2020, but the Federal Reserve (Fed) has given reassurances to the contrary.

HIGHLIGHTS

- **Non-Treasury sectors struggled, with investment grade corporates being the only U.S. sector to outperform Treasuries.**
- **The municipal market rallied, and high yield municipal prices continue to improve.**
- **The global aggregate index underperformed the U.S., hurt by negative returns in Asia and Europe.**

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CAUTIOUS TONE PULLS TREASURY RATES LOWER

U.S. Treasury yields closed lower last week, led by longer maturities.[1] Rates fell despite heavy Treasury issuance and better-than-expected economic data later in the week. Treasury issuance was absorbed efficiently and yields declined slightly by Wednesday.[1] Rates fell as markets focused on the worst monthly decline in core consumer goods on record, dating back to February 1957. Market worries were reinforced when Fed Chair Powell noted that, "the coronavirus crisis raises longer-term concerns." However, the week ended on a positive note, with yields increasing slightly as the markets looked past the largest decline in retail sales since 1992 to better-than-expected sentiment and manufacturing reports.[1]

Non-Treasury sectors struggled last week, with investment grade corporates being the only U.S. sector to outperform Treasuries.[1] The sector's longer duration helped as longer maturity yields declined, supporting returns.[1] Senior loans also delivered a positive total return, only modestly trailing Treasuries.[1] Preferred securities and high yield corporates suffered the worst weekly returns.[1] Non-U.S. markets were mixed, as emerging markets enjoyed the best returns of the week, out-distancing both investment grade corporates and Treasuries.[1] But the global aggregate index underperformed, hurt by negative total returns in Asia and Europe.[1]

Market-based expectations continue to reflect negative interest rates by late 2020, but Fed Chair Powell and several Fed representatives reinforced that the Fed did not intend to move the fed funds target rate below zero.

MUNICIPAL MARKET CONTINUES TO RALLY

The municipal market rallied last week, finishing with a solid tone.[1] New issue supply totaled $9.5 billion and was well received.[2] Fund flows were positive at $582 million.[3] This week's new issue supply is expected to be $7.7 billion ($1.6 billion taxable).[2]

High grade municipal bond yields have declined for 11 consecutive trading sessions.[1] High yield bond performance also appears to be improving, thanks to several factors. Fed Chairman Powell reiterated that rates will remain low as long as it takes for the U.S. economy to recover. The Municipal Liquidity Facility will lend money to municipalities that have difficulty borrowing money. And the House approved the Heroes Act, a fourth massive spending package that in part will aid municipalities. Finally, $40 billion of municipal proceeds will come available for reinvestment as of June 1.[4]

The state of Illinois issued $800 million general obligation bonds (rated Baa3/ BBB-).[4] The deal was so well received that underwriters lowered yields by as much as 15 basis points (bps) and upsized the deal by $50 million upon final pricing. The deal traded 40 bps richer in the secondary market. It was questionable whether Illinois could access debt markets on their own, but the state benefited immensely by the efforts mentioned above to boost the municipal market.

High yield municipal bond yields declined last week, but high grade declined more.[1] As a result, high yield municipal credit spreads increased by another 10 bps on average. SIFMA (short-term debt) continues to grind tighter.

High grade muni bond yields have moved lower for 11 consecutive trading sessions.

EM DEBT: STILL CHIPPING AWAY AT EARLIER LOSSES

Emerging markets (EM) debt extended its winning streak to three weeks, and is now the top-performing non-municipal fixed income category for May.[1] Among hard-currency EM issues, sovereigns outperformed corporates last week.[1] On a regional basis, Europe, the Middle East and Africa (EMEA) posted the largest gains, while Latin America lagged and Asia finished in the middle of the pack.[1] Local-market bond funds suffered outflows amid further U.S. dollar strengthening versus EM currencies.

Investment grade corporate bonds rebounded after two weeks of negative returns.[1] Sector results were mixed, with energy outperforming as oil prices continued to recover, while utilities struggled after being a reliable defensive trade for most of 2020.[1] Although the Fed began its investment grade bond purchases last week, initial buying was reportedly minimal, making the program's impact more psychological than economic – for now. Fund flows were positive at $5 billion, indicating steady demand.[3] New issuance of nearly $57 billion, while substantial, was lighter than in recent weeks.[2]

The energy sector outperformed as oil prices continued to recover, while utilities struggled.

High yield corporates failed to sustain their two-week rally. The market traded lower as the week progressed, with fears around COVID-19 and the release of more abysmal U.S. economic data setting the tone. Spreads widened by 32 bps overall.[1] Despite the unsettled backdrop, $4.5 billion flowed into high yield funds last week.[3]

In focus

Investors focus on quality in the loan market

Investors putting money to work during the most recent market recovery have been somewhat discerning, preferring higher quality assets across various asset classes. The corporate loan and high yield markets are no exception.

The rally in senior loans that began March 23 vastly favored better quality loans and businesses that were less impacted by the lock-down of the global economy. However, that trend has recently reversed in the corporate loan market, as higher quality assets have declined at the same time higher risk, lower dollar-priced assets have rallied. While the price of BB loans has gradually fallen nearly 2% on average in recent weeks, single-B rated loans (i.e. lower quality) have rallied roughly 4%.[5]

These two-sided markets appear healthy, and we believe they represent an opportunity for active managers to add value. Potential catalysts (positive and negative) remain high following a large bounce in risk assets.

Default activity in both loans and high yield continues to accelerate, yet has been so far isolated to lower quality balance sheets and troubled businesses. Earnings, downgrades and economic data also represent potential drivers of volatility.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	-0.01	-0.05	-1.42
5-year	0.31	-0.03	-0.05	-1.38
10-year	0.64	-0.04	0.00	-1.28
30-year	1.33	-0.06	0.04	-1.06

Source: Bloomberg L.P. As of 15 May 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	0.49	-0.14	-0.42	-0.55
5-year	0.72	-0.15	-0.37	-0.37
10-year	1.01	-0.15	-0.45	-0.43
30-year	1.82	-0.15	-0.46	-0.27

Source: Bloomberg L.P. As of 15 May 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	158
30-year AAA Municipal vs Treasury	138
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters. As of 15 May 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	1.87	–	5.78	0.78	1.90	-0.01
High Yield Municipal	5.53	392[6]	10.74	0.65	1.74	-8.46
Short Duration High Yield Municipal[7]	4.87	404	4.28	0.29	0.53	-4.36
Taxable Municipal	2.81	172[8]	9.87	0.64	0.02	2.84
U.S. Aggregate Bond	1.41	84[8]	5.98	0.33	-0.11	4.86
U.S. Treasury	0.50	–	7.26	0.41	0.04	8.93
U.S. Government Related	1.43	99[8]	5.82	0.18	0.38	1.79
U.S. Corporate Investment Grade	2.71	208[8]	8.31	0.69	-0.68	0.72
U.S. Mortgage-Backed Securities	1.34	70[8]	2.07	-0.07	0.05	3.52
U.S. Commercial Mortgage-Backed Securities	2.05	164[8]	5.34	0.14	0.64	3.07
U.S. Asset-Backed Securities	1.51	132[8]	2.14	0.18	0.59	1.72
Preferred Securities	4.67	340[8]	4.75	-0.94	-0.79	-5.38
High Yield 2% Issuer Capped	8.18	757[8]	3.94	-0.68	-0.04	-8.76
Senior Loans[9]	8.60	831	0.25	0.27	0.82	-8.72
Global Emerging Markets	5.49	494[8]	6.30	0.71	1.66	-5.59
Global Aggregate (unhedged)	1.07	74[8]	7.26	-0.05	-0.89	0.73

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 15 May 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 indexes are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 15 May 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 13 May 2020. **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 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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