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Weekly Fixed Income Commentary

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# Treasury yields rise on hopes for a vaccine

*U.S. Treasury yields rose last week, as investors expressed optimism regarding developing a COVID-19 vaccine.[1] The first 20-year Treasury issue in decades was auctioned on Wednesday, with the issue's yield ending the week slightly lower. The Federal Reserve (Fed) reiterated its stance that its toolbox will not include negative interest rate policy.*

## HIGHLIGHTS

- **High yield corporates, emerging markets, preferred securities, investment grade corporates and senior loans all enjoyed returns above 1%.**
- **High grade municipal bond prices have improved for the last 16 trading days**
- **The global aggregate index outperformed U.S. markets, buoyed by strong returns in Europe.**


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## INVESTOR OPTIMISM LIFTS TREASURY YIELDS

**The week began on a positive note, with all U.S. Treasury yields moving higher** on optimism over a possible COVID-19 vaccine.[1] The increase turned out to be the largest movement and constituted the net change for the week.[1] Treasury market optimism waned throughout the week, as tensions between the U.S. and China heated up over political developments in Hong Kong. The first 20-year Treasury issue in decades was auctioned on Wednesday, with the yield closing almost 6 basis points (bps) lower on the week.[1]

**Non-Treasury sectors performed well last week.[1]** High yield corporates, emerging markets debt, preferred securities, investment grade corporates and senior loans all enjoyed weekly returns above 1%.[1] The highest risk sectors performed best, led by high yield corporates, as spreads marched tighter steadily through the week.[1] Within high yield, the transportation and energy sectors outperformed based on an expected boost in economic activity.[1] Non-U.S. markets followed suit, with emerging markets posting the second-best fixed income returns. The global aggregate index also outperformed U.S. markets, buoyed by strong returns in Europe.[1]

**The Fed offered few surprises** in either its April meeting minutes or Chair Powell's congressional testimony. Both reiterated the Fed's unwavering commitment to use its full range of tools to support the economy. However, the Fed continues to reinforce that the list of available tools will not include negative interest rate policy.

*A strong catalyst for municipal market recovery is outsized reinvestment money coming in June and July.*

## MUNICIPAL MARKET CONTINUES TO RECOVER

**Municipal bond prices increased every day last week** and the market ended with a good tone.[1] New issue supply was just $5.6 billion.[2] Fund flows turned positive, at $1.8 billion.[3] This week's new issue calendar is expected to be only $3.3 billion ($749 million taxable) due to the Memorial Day holiday.[2] It should be well received.

**The municipal market continues to improve.** A strong catalyst for recovery is outsized reinvestment money: $32 billion pending on June 1 and $37 billion on July 1.[4] With new issue supply expected to remain muted, demand for tax-exempt bonds is turning robust.

**High grade municipal bonds have moved richer for the last 16 trading days,** and high yield also continues to improve.[1] Two high yield deals thought to be shut out of the market illustrate how much the high yield market has moved. The New York Metropolitan Transportation Authority (MTA) has seen a 90% decline in ridership, and many thought MTA would be charged 6% to access the tax-exempt market. The deal came at 5.08 % (rated A2/A-) and is now trading at 4.15%.[5] The state of Illinois issued bonds (rated Baa3/BBB-) at a yield of 5.85%. Bonds are now trading up to 5.27%.[5] These credits have challenges, but the market has determined both are essential services and worthy to access the credit markets.

**The state of Connecticut** issued $850 million special tax obligation bonds (rated A).[5] The 4% bonds due in 2036 issued at 2.81%, and a block size traded in the secondary at 2.54%.

**High yield municipal market inflows of $773 million last week** showed increased investor confidence.[3] This shift has been driven by historic relative values, growing optimism for economic recovery and broader understanding of security features designed to bridge revenue disruptions for bond issuers. However, the high yield municipal market has lagged the larger recovery in high grades, as the municipal-to-Treasury yield ratio continues to readjust.

## HIGH YIELD CORPORATES LEAD FOR THE WEEK, EM DEBT FOR THE MONTH

**High yield corporates outperformed all other fixed income categories** last week, rebounding emphatically from the prior week's losses.[1] Encouraging headlines about a potential COVID-19 vaccine, together with a 13% rise in oil prices and the initial easing of economic lockdowns in the U.S., helped high yield spreads tighten by 77 bps.[1] All 50 states have now taken steps to reopen their economies, albeit to varying degrees. Continued demand for high yield bonds was evidenced by an eighth consecutive week of fund inflows.[3]

**Emerging markets (EM) debt was the week's second-best performer,** aided by 37 bps of spread tightening.[1] Both hard- and local-currency markets benefited as global risk sentiment improved. After four straight weeks of positive performance, EM debt now leads all fixed income asset classes so far in May, with returns topping 4%.[1]

***Investment grade corporates have returned an impressive 13.6% since bottoming in late March.***

**Investment grade corporate bonds extended their recent winning ways** amid declining yields (-20 bps) and narrowing spreads (-22 bps).[1] All sectors produced gains for the week, led by energy. REITs and utilities were among the relative laggards. Since bottoming in late March, investment grade corporates have returned an impressive 13.6%, delivering favorable results in seven of the past nine weeks.[1]

***In focus***

# *Robust demand for new 20-year Treasury bond*

*Demand overwhelmed supply in last week's auction of the U.S. Treasury's new 20-year bond, the first such offering since 1986. Public bids for the security exceeded $50 billion, against $20 billion of issuance.[1]*

The decision to relaunch 20-year Treasuries after a 34-year hiatus was announced in January, driven by the need for more long-term financing of ongoing government deficits. Those deficits have ballooned further in the wake of massive fiscal stimulus programs to combat the economic impact of the coronavirus pandemic.

Reflecting the appetite for the new issue, its yield declined from an initial level of 1.22% last Wednesday to 1.12% at Friday's close.[1] Yields on the 7-, 10- and 30-year maturities also fell on the last two days of the week, but not by as much.[1] Despite these moves, we believe the yield curve could steepen, with the longer end drifting modestly higher as increased supply meets decreasing Fed purchases. Shorter maturities will likely remain anchored at zero for some time, given the Fed's commitment to hold the overnight target rate there for as long as it deems necessary.

A rise in longer rates could be mitigated if the Fed boosts or focuses its bond buying on longer maturities, but that's unlikely while yields are historically low and liquidity is adequate. If liquidity deteriorates or financial conditions tighten, the Fed could shift its purchase operations to offset any steepening.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | Month-to-date | Year-to-date |
| 2-year | 0.17 | 0.02 | -0.03 | -1.40 |
| 5-year | 0.34 | 0.03 | -0.03 | -1.36 |
| 10-year | 0.66 | 0.02 | 0.02 | -1.26 |
| 30-year | 1.37 | 0.04 | 0.09 | -1.02 |

Source: Bloomberg L.P. As of 22 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 | 0.18 | -0.31 | -0.73 | -0.86 |
| 5-year | 0.41 | -0.31 | -0.68 | -0.68 |
| 10-year | 0.84 | -0.17 | -0.62 | -0.60 |
| 30-year | 1.65 | -0.17 | -0.63 | -0.44 |

Source: Bloomberg L.P. As of 22 May 2020. **Past performance is no guarantee of future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 127 |
| 30-year AAA Municipal vs Treasury | 120 |
| High Yield Municipal vs High Yield Corporate | 72 |

Source: Bloomberg L.P., Thompson Reuters. As of 22 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 | 1.65 | – | 5.69 | 1.04 | 2.96 | 1.03 |
| High Yield Municipal | 5.40 | 396[6] | 10.71 | 1.41 | 3.18 | -7.17 |
| Short Duration High Yield Municipal[7] | 4.74 | 410 | 4.26 | 0.54 | 1.08 | -3.85 |
| Taxable Municipal | 2.80 | 200[8] | 9.93 | 0.30 | 0.33 | 3.15 |
| U.S. Aggregate Bond | 1.38 | 79[8] | 6.01 | 0.35 | 0.24 | 5.23 |
| U.S. Treasury | 0.51 | – | 7.18 | -0.22 | -0.18 | 8.69 |
| U.S. Government Related | 1.39 | 92[8] | 5.88 | 0.75 | 1.14 | 2.55 |
| U.S. Corporate Investment Grade | 2.51 | 186[8] | 8.42 | 1.52 | 0.83 | 2.26 |
| U.S. Mortgage-Backed Securities | 1.41 | 73[8] | 2.15 | -0.03 | 0.01 | 3.48 |
| U.S. Commercial Mortgage-Backed Securities | 2.04 | 161[8] | 5.33 | 0.09 | 0.73 | 3.17 |
| U.S. Asset-Backed Securities | 1.44 | 124[8] | 2.14 | 0.20 | 0.79 | 1.92 |
| Preferred Securities | 4.28 | 313[8] | 4.58 | 1.53 | 0.73 | -3.93 |
| High Yield 2% Issuer Capped | 7.48 | 680[8] | 3.82 | 2.57 | 2.54 | -6.41 |
| Senior Loans[9] | 8.21 | 790 | 0.25 | 1.21 | 2.05 | -7.61 |
| Global Emerging Markets | 5.16 | 457[8] | 6.41 | 2.31 | 4.01 | -3.40 |
| Global Aggregate (unhedged) | 1.03 | 69[8] | 7.28 | 0.54 | -0.35 | 1.27 |

**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 22 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, 22 May 2020. **3** Lipper Fund Flows. **4** JP Morgan. **5** Market Insight, MMA Research, 20 May 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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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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