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Weekly Fixed Income Commentary

15 June 2020

Declining risk sentiment drags Treasury yields lower

U.S. Treasury yields ended lower last week, led by longer maturities.[1] Risk-off sentiment returned over fears of a second wave of the coronavirus and a cloudy U.S. economic forecast from the Federal Reserve (Fed). At its June meeting, the Fed kept asset purchases unchanged and offered a relatively downbeat assessment about the future of economic growth.

HIGHLIGHTS

- **Higher-risk sectors struggled, as high yield corporates and preferred securities performed the worst and suffered negative weekly total returns.**
- **The municipal market was basically unchanged, with longer maturities rallying slightly.**
- **Emerging markets debt eked out a positive return to stretch its winning streak to seven weeks.**

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RECOVERY IN RISK ASSETS GETS DERAILED

A sharp decline in risk sentiment dragged Treasury rates lower last week, led by longer maturities.[1] Soft investor demand for 10- and 30-year Treasury auctions, along with optimistic economic data, did not alter the path of falling interest rates. Even the Fed meeting did not lift yields, despite disappointing investors who hoped the Fed would announce a program of long-maturity Treasury purchases, referred to as yield curve control. The Fed did specify that the current level of Treasury and agency mortgage-backed security (MBS) purchases would remain unchanged, at $80 billion Treasuries and $40 billion MBS per month. Further, the National Bureau of Economic Research announced the longest expansion in U.S. history officially ended in February 2020.

Falling yields supported positive total returns for higher quality sectors last week, although only commercial mortgage-backed and asset-backed securities outperformed similar-duration Treasuries.[1] The higher-risk sectors struggled, as high yield corporates and preferred securities performed the worst and suffered negative weekly total returns.[1] Higher-risk sector performance remains negative for the year. Senior loans are down the most, followed by high yield corporates, preferred securities and emerging markets.[1]

The Fed meeting held few surprises as its asset purchases remained unchanged. This element of monetary policy was widely considered the most likely to be altered. However, it did specify that the purchases would continue "at least at the current pace to sustain smooth market functioning," which gives it the flexibility to buy more if necessary.

MUNICIPAL MARKET SEES NEAR RECORD INFLOWS

The municipal market was essentially unchanged last week, with longer maturities rallying slightly.[1] New issue supply of $12.3 billion was well received.[2] Fund flows were positive for a fifth consecutive week at $2.8 billion, the second largest week of inflows on record.[3] New issue supply is expected to be $11.9 billion this week ($2.5 billion taxable).[2]

The high grade municipal market is taking a pause, with yields near historic lows, while the high yield market continues to recover.[1] Supply and demand dynamics bode well for municipals in general. Net reinvestment for the summer remains expected to be $52 billion, and Fed Chairman Powell stated this week that he did not see the Fed raising rates until sometime in 2022.[4]

Prince George's County, Maryland, issued $380 million general obligation bonds (rated Aaa/AAA).[5] Once the deal was free to trade, all maturities traded at least 5 basis points richer from where the deal came, a direct result of the strong U.S. Treasury market rally.

The high yield municipal market saw heavy positive flows of $500 million, marking five consecutive weeks of positive flows.[3] We expect the market should ride a strong technical wave through the summer weeks, as we anticipate strong seasonal reinvestment flows. As a result, high yield municipal credit spreads are tightening at an accelerating pace.[1] Credit spreads for short duration high yield municipal bonds have been wider, as they have been more heavily relied upon for liquidity purposes.[1]

Municipal bond fund flows were $2.8 billion, the second largest week of inflows on record.

HIGH YIELD CORPORATES GO FROM FIRST TO WORST AS VIRUS FEARS RETURN

High yield corporate bonds finished at the bottom of the pack, ending their three-week run as the top-performing fixed income category.[1] Volatility was concentrated in sectors that were initially among the hardest hit by the pandemic but had recently rebounded, such as air travel, restaurants and autos. Major drivers of high yield's performance last week were fears of a second wave of the virus, along with the Fed's Wednesday meeting, which included a cloudy U.S. economic forecast. Demand for the asset class remained strong, with inflows of more than $5 billion.[3]

Investment grade corporates produced positive results for the fifth week in a row.[1] Weekly gains have continued to move progressively lower, however.[1] Among sectors, financials, led by REITs, beat industrials.[1] Energy was the week's biggest laggard, against a backdrop of falling oil prices and increased profit-taking after nearly 400 bps of investment grade spread tightening from their widest levels in March. Fund inflows were robust, approaching $10 billion, and the Fed added another $1.2 billion to its ETF holdings.[3]

Financials, led by REITs, beat industrials. Energy was the week's biggest laggard.

Emerging markets (EM) debt eked out a positive return to stretch its winning streak to seven weeks.[1] After starting last Monday with a healthy gain, EM began to lose steam and saw its rally come to a complete halt on Thursday as coronavirus fears resurfaced and profit-taking kicked in. Investors shed liquid sovereign debt first, allowing EM corporates to outperform.

In focus

Fed continues to multi-task

Last week's Federal Reserve meeting capped an historic three-month stretch that began with March's trio of emergency meetings to bolster the U.S. economy against the coronavirus pandemic. This time, there were no "shock and awe" policy announcements.

The Fed kept its fed funds target rate at zero (0.00%-0.25%) while also offering dovish, albeit unconventional, forward guidance. At his post-meeting press conference, Chair Jerome Powell stated that "We're not even thinking about thinking about raising rates." Indeed, members of the Fed's board of governors expect rates to remain at zero through 2022.

While rates won't be going up, Fed bond-buying might be. Last week Powell and his colleagues pledged to maintain "at least" their current pace of quantitative easing (QE) asset purchases – about $80 billion/month of U.S. Treasuries and $40 billion/month of agency mortgage-backed securities. The Fed believes further monetary stimulus is necessary given its cloudy economic forecast: a 6.5% drop in GDP this year, an improving but still elevated unemployment rate (6.5%) at the end of 2021 and inflation remaining below 2% through 2022.

With interest-rate policy on hold and QE set to continue, the Fed will focus on getting people back to work. The Fed recently expanded its Main Street Lending Program so more small and medium-sized businesses – essential components of the economy – are eligible for financial aid.

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U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.19	-0.02	0.03	-1.38
5-year	0.33	-0.14	0.03	-1.36
10-year	0.71	-0.19	0.05	-1.21
30-year	1.46	-0.21	0.05	-0.93

Source: Bloomberg L.P. As of 12 Jun 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	0.24	0.05	0.08	-0.80
5-year	0.38	0.00	0.00	-0.71
10-year	0.85	-0.04	0.01	-0.59
30-year	1.61	-0.09	-0.04	-0.48

Source: Bloomberg L.P. As of 12 Jun 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	120
30-year AAA Municipal vs Treasury	111
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters. As of 12 Jun 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	1.54	–	5.49	0.56	0.57	1.82
High Yield Municipal	4.95	354[6]	9.89	1.07	3.21	-3.35
Short Duration High Yield Municipal[7]	4.37	374	4.15	0.54	1.75	-1.76
Taxable Municipal	2.59	174[8]	10.04	2.59	1.30	5.39
U.S. Aggregate Bond	1.30	68[8]	6.03	0.72	0.23	5.71
U.S. Treasury	0.54	–	7.19	1.30	-0.24	8.35
U.S. Government Related	1.34	83[8]	5.99	0.66	0.20	3.19
U.S. Corporate Investment Grade	2.28	159[8]	8.51	0.45	0.96	3.99
U.S. Mortgage-Backed Securities	1.31	61[8]	2.05	0.16	0.08	3.68
U.S. Commercial Mortgage-Backed Securities	1.83	139[8]	5.32	1.42	0.90	4.44
U.S. Asset-Backed Securities	0.95	74[8]	2.13	0.56	0.76	3.01
Preferred Securities	4.32	311[8]	4.67	-1.08	0.11	-2.71
High Yield 2% Issuer Capped	6.78	611[8]	3.83	-1.38	1.66	-3.16
Senior Loans[9]	6.90	662	0.25	0.15	2.12	-4.03
Global Emerging Markets	4.77	415[8]	6.51	0.07	1.65	-1.25
Global Aggregate (unhedged)	0.99	60[8]	7.33	0.73	0.75	2.84

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 12 Jun 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, 12 Jun 2020. **3** Lipper Fund Flows. **4** Citigroup. **5** Market Insight, MMA Research, 10 Jun 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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