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Weekly Fixed Income Commentary

23 November 2020

# Accelerating coronavirus cases suppress Treasury yields

*U.S. Treasury yields closed lower last week, led by longer maturities. Despite positive news on possible vaccine progress, investors were focused on the potential near-term damage from surging virus cases across the globe. A public dispute between the U.S. Treasury and the Federal Reserve (Fed) about the Fed's lending facilities also undermined investor confidence.*

## HIGHLIGHTS

- **Credit sectors enjoyed strong performance, led by investment grade corporates.**
- **Municipal yields declined, and we expect the good tone to continue.**
- **The global aggregate index delivered a solidly positive total return in excess of U.S. markets.**


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## COVID-19 CASE SPIKE PULLS TREASURY YIELDS DOWN

**All U.S. Treasury yields closed lower last week, led by longer maturities.** Rates fell and the yield curve flattened, as accelerating coronavirus cases stoked concerns about potential lockdown measures. While additional positive vaccine news early in the week improved the longer-term economic outlook, investors were more focused on potential near-term damage from surging virus cases across the globe. Economic data showed continued strength in the housing market, but also a surprising drop in U.S. retail sales. Weakening U.S. growth and diminished hopes of additional fiscal stimulus have fueled speculation that the Fed may need to adjust its bond buying program at its December meeting to purchase more long-maturity issues. The week ended with a soft risk tone, as a public dispute between the Treasury and the Fed about the central bank's lending facilities undermined investor confidence.

**Non-Treasury sectors fared well last week,** despite a cautious risk tone, and all sectors posted positive total returns. The credit sectors enjoyed the strongest performance, led by investment grade corporates. Taxable municipals, preferred securities and high yield corporates followed suit with total returns surpassing Treasuries. Duration drove returns for the week, as the longest components of the aggregate index enjoyed returns above 2%, while the shortest assets were up less than 10 basis points (bps). The securitized sectors posted the lowest weekly returns, with asset-backed, mortgage-backed and commercial mortgage-backed securities all experiencing only modest positive total returns. The global aggregate index delivered a solidly positive total return ahead of U.S. markets, as Asian and European markets produced similarly strong returns.

***Duration drove taxable returns, as the longest components of the aggregate index enjoyed returns above 2%.***

## MUNICIPAL REINVESTMENT DEMAND REMAINS HEAVY

**Municipal yields declined last week.** The new issue calendar returned to outsized supply at $11.4 billion and was well received. Fund flows were positive at $1.3 billion. This week's new issue supply should be muted at $2.1 billion due to the Thanksgiving holiday.

**The municipal market has a very good tone, which we expect to continue.** The Fed has signaled that rates will stay lower for longer, at least until the U.S. recovers from the pandemic. Municipal new issue supply was muted just prior to the election, and this trend should occur again during Thanksgiving week. Reinvestment demand is heavy, with December and January  bringing outsized reinvestment coupons.

The **state of New Jersey** issued $3.7 billion general obligation coronavirus emergency bonds (rated A3/BBB+). The deal was heavily oversubscribed, with all maturities trading 20 bps richer in the secondary market. Yet the deal was priced to sell. For example, the 10-year bonds were issued at a yield of 2.08%, more than 100 bps of additional yield to the MMD tax-exempt AAA curve.

**High yield municipals are performing well in November.** Fund flows are dominantly positive, credit spreads are contracting at an accelerating rate and year-to-date performance is recovering. Supply should be minimal in a holiday-shortened week. Fund flows will likely continue to climb, setting up the market to perform when supply is better able to respond to demand. In Puerto Rico, the Oversight Board has given authority to resume mediation with general obligation creditors, and allowed filing a plan of adjustment should those negotiations fail.

### INVESTMENT GRADE CORPORATES OUTPERFORM ON ROBUST DEMAND FOR LONGER-DATED DEBT

**Investment grade corporate bonds were last week's top performer,** benefiting from their longer duration as rates fell and the Treasury curve flattened. The average investment grade yield closed the week at 1.85%, within a few basis points of its all-time low. Fund inflows totaled $4.6 billion, the most in four weeks. In the primary market, 32 issuers priced $38 billion in new supply. The tone soured late in the week after the U.S. Treasury Department unexpectedly asked the Fed to end its pandemic-related emergency lending programs.

**High yield corporates produced gains for the third week in a row.** Lower-quality credits and previously lagging sectors like transportation and energy led the way. Overall spreads tightened by 13 bps, and fund flows were modestly positive at $490 million. The average yield on high yield credit, which hit an all-time low of 4.57% two weeks ago on the heels of the Pfizer vaccine announcement, continued to hover in historically low territory.

***The average yield on high yield corporate credit continued to hover in historically low territory.***

**Emerging markets (EM) debt finished near the middle of the pack,** bolstered by positive news on the vaccine front but tempered by caution amid surging COVID-19 cases and related shutdowns. Strong new-issue supply met healthy demand, evident in another week of increased flows into EM funds. Local-currency debt bested U.S. dollar-denominated issues. The Turkish lira and Brazilian real have fared especially well against the dollar.

*In focus*

## *Treasury asks to end emergency lending facilities*

*Despite some alarm-inducing headlines surrounding a premature end to the Municipal Liquidity Facility (MLF), Secondary Market Corporate Credit Facility (SMCCF) and Term Asset-Backed Securities Loan Facility (TALF), we expect limited market impact. Overall liquidity remains strong, issuers have access to other funding sources and any possible interruptions in the program may turn out to be short-lived.*

Use of the MLF and TALF has been limited, as most issuers found it more economical to access funding from the traditional cash market and/or direct borrowing from banks. The end of the SMCCF program could be a modest negative for investment grade corporates since it removes a backstop against market instability. But the spread impact has been minimal.

Municipal fund flows are strong, issuance remains high and we see strong demand for new issues across the credit spectrum.

AAA and TALF-eligible ABS spreads have narrowed meaningfully since March and that segment is functioning well. Non-AAA, non-index-eligible ABS remain quite dislocated, and we view this market segment to be quite attractive relative to similarly rated corporate debt with significantly longer durations and tighter spreads.

Likewise, improving corporate fundamentals and strong technicals should support spread compression in investment grade corporates.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | Month-to-date | Year-to-date |
| 2-year | 0.16 | -0.02 | 0.00 | -1.41 |
| 5-year | 0.37 | -0.04 | -0.01 | -1.32 |
| 10-year | 0.83 | -0.07 | -0.05 | -1.09 |
| 30-year | 1.52 | -0.13 | -0.14 | -0.87 |

Source: Bloomberg L.P. As of 20 Nov 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 | 0.15 | -0.03 | -0.06 | -0.89 |
| 5-year | 0.22 | -0.04 | -0.08 | -0.87 |
| 10-year | 0.73 | -0.08 | -0.20 | -0.71 |
| 30-year | 1.42 | -0.13 | -0.29 | -0.67 |

Source: Bloomberg L.P. As of 20 Nov 2020. **Past performance is no guarantee of future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 88 |
| 30-year AAA Municipal vs Treasury | 93 |
| High Yield Municipal vs High Yield Corporate | 88 |

Source: Bloomberg L.P., Thompson Reuters. As of 20 Nov 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 | 1.19 | – | 5.26 | 0.64 | 1.36 | 4.42 |
| High Yield Municipal | 4.26 | 306[1] | 8.03 | 0.89 | 2.07 | 2.63 |
| Short Duration High Yield Municipal[2] | 3.97 | 355 | 3.87 | 0.52 | 1.17 | 1.97 |
| Taxable Municipal | 2.22 | 130[3] | 10.06 | 0.73 | 1.90 | 9.33 |
| U.S. Aggregate Bond | 1.16 | 49 | 6.23 | 0.59 | 0.94 | 7.32 |
| U.S. Treasury | 0.57 | – | 7.30 | 0.52 | 0.45 | 8.36 |
| U.S. Government Related | 1.11 | 58[3] | 6.02 | 0.32 | 0.98 | 5.53 |
| U.S. Corporate Investment Grade | 1.85 | 110[3] | 8.86 | 1.22 | 2.44 | 9.04 |
| U.S. Mortgage-Backed Securities | 1.27 | 50[3] | 2.18 | 0.14 | 0.13 | 3.71 |
| U.S. Commercial Mortgage-Backed Securities | 1.43 | 96[3] | 5.29 | 0.31 | 0.63 | 7.15 |
| U.S. Asset-Backed Securities | 0.52 | 36[3] | 2.12 | 0.09 | 0.10 | 4.26 |
| Preferred Securities | 2.64 | 189[3] | 4.23 | 0.65 | 2.60 | 5.61 |
| High Yield 2% Issuer Capped | 4.85 | 423[3] | 3.65 | 0.61 | 3.23 | 4.33 |
| Senior Loans[4] | 5.60 | 534 | 0.25 | 0.22 | 1.70 | 1.04 |
| Global Emerging Markets | 3.75 | 308[3] | 6.88 | 0.45 | 2.86 | 4.71 |
| Global Aggregate (unhedged) | 0.87 | 41[3] | 7.43 | 0.71 | 1.54 | 7.45 |

**1** Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **2** 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. **3** Option-adjusted spread to Treasuries. **4** 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 20 Nov 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.

## For more information, please visit nuveen.com.

**Performance:** Bloomberg, L.P. **Issuance:** The Bond Buyer, 20 Nov 2020. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 18 Nov 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.**

**Representative indexes: municipal:** Bloomberg Barclays Municipal Index; **high yield municipal:** Bloomberg Barclays High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Barclays Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg Barclays U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg Barclays U.S. Treasury Index; **U.S. government related:** Bloomberg Barclays U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg Barclays U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg Barclays U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg Barclays CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Barclays Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg Barclays High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Barclays Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Barclays Global Aggregate Unhedged Index.

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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 appropriateness 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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