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Treasury yields rise on prospects for stimulus

Long U.S. Treasury yields increased sharply last week, while shorter-maturity yields were little changed. Prospects for additional U.S. fiscal stimulus, boosted by weaker-than-expected employment data, provided investors with hope that a new federal aid package would lift future growth. Concerns remain over short-term virus-related challenges, however.

HIGHLIGHTS

- **High yield corporates led all sectors, followed by senior loans and preferred securities.**
- **The municipal market was quiet but firm, closing on Friday with a constructive tone.**
- **Both the global aggregate index and emerging markets posted positive total returns.**



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HOPE OF U.S. FISCAL STIMULUS LIFT TREASURY RATES

Longer-maturity U.S. Treasury yields increased sharply last week, while short maturities were little changed. Hopes of additional fiscal stimulus fueled the move higher, bolstered by weaker-than-expected jobs data. Weaker economic data would usually push Treasury rates lower, as investors look for safer investment options. In this case, in contrast, investors viewed the disappointing employment report as potentially compelling Congress to pass another fiscal aid package. As a result, longer-maturity Treasury yields rose significantly. Shorter Treasury yields were little changed, however. Investors are anticipating that a fiscal aid package would lift future growth, but near-term virus-related challenges will likely cause short-term economic weakness.

Investor optimism supported all non-Treasury sectors. Every sector outpaced struggling Treasuries, although several experienced negative weekly total returns due to rising yields. High yield corporates once again led all sectors, followed by senior loans and preferred securities. Asset-backed securities (ABS) joined those sectors as the only U.S. sectors with positive weekly total returns. Taxable municipals and investment grade corporates suffered the lowest non-Treasury returns, as their long durations dragged down performance. Relative performance against Treasuries continues to recover for all sectors. And with last week's performance, investment grade corporates joined high yield and ABS in outperforming similar-duration Treasuries so far this year. Non-U.S. markets enjoyed strong performance, and both the global aggregate index and emerging markets posted positive total returns last week.

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HIGH GRADE MUNICIPAL YIELDS REMAIN STEADY

The municipal market was quiet but firm last week, closing on Friday with a constructive tone. New issue supply of \$9.8 billion was priced to sell and well received. Fund flows were positive \$201 million. This week's new issue supply is expected to be \$8.6 billion.

High grade municipal bonds are trading rich vs. their taxable Treasury counterparts. Treasury yields continue to trend to higher, while high grade municipal yields remain relatively unchanged. We expect this trend to continue, due to outsized municipal reinvestment coupons on December 1 and January 1. The current new issue supply cannot meet the high grade demand. It is no coincidence that *high yield* municipal bonds continue to grind richer. Tax-exempt investors are being forced to take additional risk to gain yield compared to high grade municipals.

The New Jersey Transportation Trust Fund Authority issued \$1.5 billion transportation program bonds (rated Baa1/BBB). The deal was so well received in the initial pricing that underwriters lowered yields as much as 20 basis points in some areas. For example, the 30-year bond came with a 5% coupon yielding 2.84%. This maturity traded in the secondary yielding 2.75%. This shows once again the market's desire for yield.

High yield municipal performance and credit spread contraction continued to accelerate, especially for short duration bonds. Fund flows totaled \$57 million overall last week, but some select complexes continued to exhibit large outflows. A strong rally in bonds for Brightline led performance last week, along with many airline, hospital, sales tax and industrial development bonds. Brightline rallied on news of an agreement for the Disney station location, clearing the way for the issuance of the completion bonds for phase two of the project. Aside from the new Brightline deal, new issue supply should be limited this week.

HIGH YIELD CORPORATE BONDS CAP A WINNING NOVEMBER

High yield corporates repeated as the top-performing fixed income asset class last week. High yield has now posted gains for five weeks in a row and nine of the last 10. Aggressive yield shopping drove spreads 34 basis points (bps) tighter, to their narrowest level since February, while the average yield fell to a new record-low of 4.40%. Outperformance was led by lower-quality (CCC rated) credits and some of the most virus-vulnerable sectors, including department stores, oil field services, recreation and travel. Fund flows (-\$1.39 billion) were the only downbeat note.

Investment grade corporate bonds realized a loss for the fourth time in seven weeks. Moderate spread tightening and robust fund flows (+\$3.5 billion) weren't enough to overcome the negative impact of the category's long duration, as the 10-year U.S. Treasury yield spiked 13 bps. Energy and its subsectors fared well amid a 2% bump in oil prices, despite news that OPEC and Russia would increase output slightly. In the primary market, 27 issuers priced nearly \$22 billion in new deals.

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Emerging markets (EM) debt extended its November winning streak into the first few days of December, as spreads narrowed by 14 bps and inflows totaled \$2.7 billion. Within EM, the reach for yield continued to drive high yield outperformance across sectors. Local markets were buoyed by further weakening of the U.S. dollar versus EM currencies, notably the Colombian peso, Brazilian real and Chilean peso.

In focus

Taxable outlook: modest risk overweight, focus on credit

We expect modest, if uneven, improvement in economic growth, low interest rates and ongoing monetary and fiscal policy support in 2021. The U.S. Federal Reserve and other global central banks have indicated that interest rates will remain extremely low for the foreseeable future, making finding income more difficult.

As we head into next year, our portfolio positioning includes a modest risk overweight with a focus on credit sectors. We think it makes sense to underweight Treasuries and other government bond sectors, as they appear relatively expensive. Instead, we prefer to focus on credit sectors.

We are looking for credits with durable free cash flow and solid balance sheets across a variety of markets, including investment grade credit, non-agency mortgage-backed securities, preferred securities and select high yield and emerging markets bonds. In particular, we are focused on the mid-quality rating segments, which we think offer the best relative value.

Environmental, social and corporate governance (ESG) factors remain important as we assess individual credits. We have long incorporated these factors into our investment selection process, and we believe investments that score highly on our internal ratings scale should be relatively advantaged.

U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	November 2020	Year-to-date
2-year	0.15	0.00	-0.01	-1.42
5-year	0.42	0.05	-0.02	-1.27
10-year	0.97	0.13	-0.03	-0.95
30-year	1.74	0.16	-0.09	-0.66

Source: Bloomberg L.P. As of 04 Dec 2020. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%)		
		Week	November 2020	Year-to-date
2-year	0.15	0.00	-0.06	-0.89
5-year	0.24	0.01	-0.07	-0.85
10-year	0.72	-0.01	-0.21	-0.72
30-year	1.42	0.00	-0.30	-0.67

Source: Bloomberg L.P. As of 04 Dec 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	82
High Yield Municipal vs High Yield Corporate	94

Source: Bloomberg L.P., Thompson Reuters. As of 04 Dec 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%)		
				Week	November 2020	Year-to-date
Municipal	1.17	–	5.26	0.13	1.51	4.64
High Yield Municipal	4.11	291 ¹	7.69	0.72	2.40	3.61
Short Duration High Yield Municipal ²	3.71	329	3.78	0.77	1.54	2.99
Taxable Municipal	2.26	120 ³	10.04	-0.45	1.91	8.81
U.S. Aggregate Bond	1.21	45 ³	6.27	-0.42	0.98	6.84
U.S. Treasury	0.63	–	7.20	-0.77	0.35	7.38
U.S. Government Related	1.14	54 ³	6.05	-0.23	0.91	5.20
U.S. Corporate Investment Grade	1.85	100 ³	8.84	-0.31	2.79	8.84
U.S. Mortgage-Backed Securities	1.36	45 ³	2.52	-0.11	0.07	3.54
U.S. Commercial Mortgage-Backed Securities	1.44	90 ³	5.29	-0.14	0.78	7.08
U.S. Asset-Backed Securities	0.51	35 ³	2.11	0.02	0.15	4.29
Preferred Securities	2.46	169 ³	4.35	0.52	2.96	6.62
High Yield 2% Issuer Capped	4.40	378 ³	3.62	0.86	3.96	5.89
Senior Loans ⁴	5.31	505	0.25	0.53	2.13	1.94
Global Emerging Markets	3.64	288 ³	6.89	0.35	3.07	5.31
Global Aggregate (unhedged)	0.89	39 ³	7.46	0.31	1.82	8.08

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 04 Dec 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, 04 Dec 2020. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 02 Dec 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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