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Weekly Fixed Income Commentary

14 December 2020

Risk-off sentiment drives Treasury yields lower

U.S. Treasury yields declined last week, led by longer maturities. Risk sentiment deteriorated, with investors concerned about a potential no-deal Brexit, rising coronavirus cases and waning prospects for additional U.S. fiscal stimulus. This week's Federal Reserve (Fed) meeting is not expected to result in any policy shifts, but the Fed could extend the maturity of its Treasury purchases.

HIGHLIGHTS

- **Only taxable municipals and commercial mortgage-backed securities outperformed Treasuries.**
- **Municipal bond prices closed stronger, and high yield municipals are showing signs of strength.**
- **Emerging markets debt posted gains for the sixth week in a row.**

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BREXIT CONCERNS DRIVE U.S. TREASURY YIELDS LOWER

Risk sentiment deteriorated last week and Treasury yields declined, led by longer maturities. Concerns rose that the United Kingdom would leave the European Union without first securing a trade deal. And the market tone was further eroded by rising coronavirus cases and waning optimism over additional U.S. fiscal stimulus. As a result, yields on all Treasury maturities closed the week lower. Long maturities fell the most, but the 2-year Treasury yield approached its all-time low on Friday after experiencing its largest single day move in more than a month. There was $118 billion in Treasury coupon supply made available in three auctions. The auction results largely supported a flattening yield curve, with a soft 3-year auction and a well-supported 30-year auction.

The risk-averse market sentiment weighed on non-Treasury sectors. Only taxable municipals and commercial mortgage-backed securities outperformed Treasuries. However, falling yields supported positive total returns for all sectors. Mortgage-backed securities suffered the lowest weekly return, but investment grade corporates endured the worst performance versus similar-duration Treasuries. Investment grade corporate spreads widened, offsetting a significant portion of the positive returns produced by the sector's longer duration.

We don't expect this week's Fed meeting to include any material policy shift announcements. However, there is speculation that the Fed could extend the maturity of its Treasury purchases to support the markets through near-term economic risks posed by rising virus cases.

We will soon enter one of the strongest periods of technical strength for munis in any calendar year.

HIGH YIELD MUNICIPALS SHOW SIGNS OF STRENGTH

Municipal bond prices closed stronger last week. New issue supply of $8.6 billion was well received. Fund flows were positive at $992 million. This week's new issue supply is expected to be $7.7 billion ($2.3 billion taxable).

High grade municipal prices have been grinding richer since the summer, spurred by government policies. The Fed lowered short-term rates to zero and the federal government injected trillions of dollars into the U.S. economy in response to the coronavirus crisis. Congress is now considering another stimulus package.

We continue to believe that interest rates should remain lower for longer as the economy recovers from the pandemic. However, we see some headwinds for high grade municipals in 2021. Specifically, new issue supply could reach an all-time high of $500 billion as America begins rebuilding aging infrastructure. However, we do not believe outsized supply would overwhelm the market, as municipals investors will view this as a buying opportunity.

New York Transportation Development Corporation issued $628 million bonds for a terminal project at JFK Airport (rated Baa1/NR). The deal was well received. The 20-year bond with a 4% coupon was issued originally at a 2.06% yield, but traded in the secondary market at 1.98%. This once again shows the market's continued optimism that people will someday travel by plane again in earnest.

The high yield municipal market is showing several signs of strength. Flows accelerated to $365 million last week. PRASA successfully refunded its 2008 debt with a limited public offering. Brightline FL successfully placed $950 million of completion bonds for phase two. We will soon enter one of the strongest periods of technical strength in any calendar year, giving the market a strong tailwind. After lagging for several months behind other risk assets, we expect high yield municipals to continue outperforming, although careful credit selection remains critically important.

EMERGING MARKETS DEBT AND U.S. INVESTMENT GRADE CREDIT FINISH AHEAD OF HIGH YIELD

Emerging markets (EM) debt posted gains for the sixth week in a row. Despite continued fund inflows (+$2.9 billion), the bid for EM risk slowed as investors searched for a catalyst to justify further spread tightening. Uncertainty about a near-term U.S. fiscal relief package and the increased chance of a no-deal Brexit also crimped enthusiasm last week, and there were pockets of profit taking in higher-quality, lower-spread names. Within EM, corporate credit outperformed sovereign bonds.

Investment grade corporate bonds returned to positive territory last week following the prior week's moderate loss. The overall tone was muted, with 5 basis points (bps) of spread widening and middle-of-the-pack returns. In the primary market, 14 issuers priced more than $20 billion in new investment grade supply. This week will likely be the last opportunity for any new issuance in 2020, given the likely expected slowdown in activity ahead of the holidays.

Within emerging markets, corporate credit outperformed sovereign bonds.

High yield corporates delivered a positive return and maintained their lead over other fixed income categories for the fourth quarter — a period in which the asset class has experienced only one negative week. Last week's gain, however, was the smallest for high yield since late October. Spreads widened by 7 bps, and fund flows were essentially flat. Lower-quality (CCC rated) issues continued to outperform their B and BB counterparts even in the face of tempered investor demand for risk.

In focus

Muni market is well-positioned for 2021

The municipal market is entering 2021 on a strong note. High grade valuations have returned to pre-pandemic levels, and high yield is trending in a favorable direction. We believe this leaves room for spreads to contract in the first half of next year.

Fundamental strength will depend on how long the economy takes to recover from the pandemic. The next few months will be challenging, but we expect more normalcy by the second half of the year. Defaults may show a small uptick, but not a huge shift in the overall security of the asset class. We believe performance will be based on credit and technicals, with a bit of politics, rather than purely interest rates.

Technicals appear solid going into the first quarter. Gross supply should continue at or near record levels, most of it taxable. The net supply is likely to be relatively modest, as tax-exempt bonds are called away and replaced with taxables. Meanwhile, we expect strong demand to continue.

Next year, we anticipate rising interest rates, but spreads could be narrowing, which could benefit total returns. Interest rates could rise if that happens, but municipals have shown they can perform well in such an environment.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	0.12	-0.03	-0.03	-1.45
5-year	0.37	-0.05	0.00	-1.33
10-year	0.90	-0.07	0.06	-1.02
30-year	1.63	-0.11	0.06	-0.76

Source: Bloomberg L.P. As of 11 Dec 2020. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	0.14	-0.01	-0.01	-0.90
5-year	0.22	-0.02	-0.01	-0.87
10-year	0.70	-0.02	-0.02	-0.74
30-year	1.38	-0.04	-0.03	-0.71

Source: Bloomberg L.P. As of 11 Dec 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	78
30-year AAA Municipal vs Treasury	85
High Yield Municipal vs High Yield Corporate	89

Source: Bloomberg L.P., Thompson Reuters. As of 11 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	Month-to-date	Year-to-date
Municipal	1.11	–	5.21	0.31	0.37	4.96
High Yield Municipal	3.96	280[1]	7.30	0.61	1.25	4.24
Short Duration High Yield Municipal[2]	3.61	321	3.75	0.46	1.10	3.47
Taxable Municipal	2.14	116[3]	10.02	1.21	0.73	10.13
U.S. Aggregate Bond	1.17	47[3]	6.27	0.35	-0.14	7.21
U.S. Treasury	0.57	–	7.30	0.61	-0.20	8.04
U.S. Government Related	1.09	55[3]	6.03	0.38	0.13	5.60
U.S. Corporate Investment Grade	1.83	105[3]	8.84	0.26	-0.26	9.13
U.S. Mortgage-Backed Securities	1.32	49[3]	2.40	0.04	-0.06	3.58
U.S. Commercial Mortgage-Backed Securities	1.33	85[3]	5.31	0.67	0.45	7.80
U.S. Asset-Backed Securities	0.46	33[3]	2.11	0.16	0.14	4.46
Preferred Securities	2.54	179[3]	4.31	0.15	0.76	6.78
High Yield 2% Issuer Capped	4.46	385[3]	3.63	0.18	0.97	6.08
Senior Loans[4]	5.20	497	0.25	0.32	0.80	2.27
Global Emerging Markets	3.60	291[3]	6.89	0.29	0.65	5.61
Global Aggregate (unhedged)	0.84	40[3]	7.49	0.35	0.65	8.45

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 11 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, 11 Dec 2020. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 09 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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