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Weekly Fixed Income Commentary

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Democratic victories boost Treasury yields

U.S. Treasury yields closed higher last week, led by longer maturities. Democratic victories in both Georgia Senate races led investors to expect significantly more fiscal stimulus, which could further spark economic growth. The Federal Reserve (Fed) reaffirmed that asset purchases would continue until "substantial further progress" was made toward its goals.

HIGHLIGHTS

- **Most non-Treasury sectors enjoyed solid relative performance versus Treasuries, despite experiencing negative weekly returns.**
- **Municipal yields ended last week slightly higher.**
- **Emerging markets debt posted a negative return for the first time in 11 weeks.**

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DEMOCRATIC MAJORITY SENDS TREASURY YIELDS SHARPLY HIGHER

U.S. Treasury yields closed higher last week, with longer maturities jumping by more than 20 basis points (bps). Expectations for Democratic Senate victories in Georgia began to push rates higher on Tuesday and continued throughout the week. Investors expect that Democratic control of the Senate will likely result in more fiscal stimulus. Consequently, economic growth is more likely to increase, along with related inflation expectations and Treasury supply to fund the outlays. Inflation expectations rose sharply last week, and with implied inflation rates in 10-year TIPS rising by more than 10 bps by Thursday. This represented the majority of the increase in 10-year nominal Treasury rates, which were about 16 bps higher at that point.

The Fed reaffirmed that it would maintain its accommodative monetary policy for the foreseeable future. Notably, it clarified the comment that asset purchases would continue until "substantial further progress" was made toward its goals by stating that judgment would "be broad, qualitative, and not based on specific numerical criteria or thresholds."

Most non-Treasury sectors enjoyed solid relative performance, despite experiencing negative weekly returns. Only investment grade corporates underperformed the lagging Treasury market. Returns for the longer-duration sectors were dragged down, as longer-maturity yields experienced the most significant increases. This caused investment grade corporates and taxable municipals to post weekly total returns below -1%. However, the overall tone was constructive for risk assets, with both senior loans and high yield corporates delivering positive total returns. Senior loans led all sectors, bouncing back nicely from a relatively disappointing 2020.

Inflation expectations rose sharply last week.

MUNICIPAL YIELDS GET A BOOST FROM TREASURIES

Municipal yields ended last week slightly higher, boosted by rising Treasury yields. The new issue calendar was light at only $3.3 billion. Fund flows were positive at $1.8 billion. The new issue calendar picks up in earnest this week. Currently new issue supply is expected to be $7.6 billion ($3.6 billion taxable).

The high grade municipal market finished 2020 with a return of approximately 5.2%. This is quite a feat, as yields sold off over 200 bps after the coronavirus pandemic first hit in March. The federal government enabled municipal bond prices to recover with two-pronged attack. The Fed lowered short-term rates to nearly zero and the federal government provided trillions of stimulus dollars to aid the ailing economy.

Interest rates in general appear to have bottomed, and may rise slightly. The U.S. has begun vaccinating its citizens, which should help the U.S. economy to eventually recover. However, we believe this will be a long process and rates will remain lower for longer.

The New Jersey Economic Development Authority issued $350 million school facilities construction bond (rated Baa1/BBB). The maximum yield bonds were priced as 4% bonds in 2050 at a yield of 2.70%. This is approximately 130 bps cheaper than the AAA MMD yield of 1.41% for the same 2050 maturity.

High yield municipals are producing strong performance to start 2021, with credit spreads tightening even in the face of rising U.S. Treasury yields. Bonds like Buckeye Tobacco and Puerto Rico COFINA, are close to re-testing highs. Areas that lagged in 2020, including industrial development and dedicated tax bonds, are leading performance in 2021. Sales tax bonds for Chicago's Metropolitan Pier and Exposition, American Dream, Baltimore Convention, Wisconsin Convention, as well as property tax bonds for Carousel Mall Project in Syracuse, NY, have outperformed recently. Illinois state general obligation bonds have also rallied on better tax revenue performance and expectations for additional state aid.

INVESTMENT GRADE CORPORATES STUMBLE OUT OF THE GATE IN 2021

Investment grade corporate bonds started the new year with a loss (-1.52%) after gaining nearly 10% in 2020. The asset class entered January with a record-low average yield of 1.74%, which climbed to 1.88% last week as the Treasury curve steepened. Because of their long duration (8.73 years), investment grade corporates have been particularly vulnerable to the sharp increase in long-term Treasury rates. The overall trading tone, however, remained firm. In the primary market, 28 issuers priced $50 billion in new deals, easily beating street estimates.

High yield corporates extended their winning streak into 2021, delivering positive results for the 10th week in a row and 14 of the last 15. Spreads tightened by 12 bps, and the average yield hit an all-time low of 4.16% last Wednesday. Within high yield, lower-quality (CCC) credits outperformed their B and BB counterparts. Fund flows were mildly negative (-$196 million). New issuance, expected to rebound strongly after the holiday lull, was lighter than anticipated.

Within high yield, CCC credits outperformed their B and BB counterparts.

Emerging markets (EM) debt posted a negative return for the first time in 11 weeks. Robust demand for the asset class, evident in continued healthy inflows (+$2 billion), belied its less-than-stellar performance. On the supply side, new issuance roared back from the year-end doldrums. More than $22 billion in EM sovereign and corporate deals came to market and were well-absorbed — a major improvement compared to the $7 billion issued in the first week of 2020.

In focus

Munis show resilience in 2020

The municipal bond market ended the tumultuous 2020 on a high note, returning 5.21% for the year. U.S. Treasury yields have been more sensitive to shifting economic sentiment, causing municipal-to-Treasury yield ratios to bounce around throughout the year. The 10- and 30-year ratios ended the year at 76% and 84%, respectively, after each exceeded 200% earlier during 2020.

Municipal outflows totaled -$43 billion in March, the worst month on record, before turning positive in May. Supply grew to meet the accelerated demand, primarily with a taxable municipal increase of 129% through November.

Municipal payment defaults totaled only $1.9 billion through November, a very small percentage of the overall market. Defaults were largely concentrated in the nursing homes and industrial development revenue sectors. State and local government revenues fared better than initially feared at the onset of the coronavirus pandemic. 2021 should be a transition year, with a long but ultimately successful path to normalization.

Despite the Democratic takeover of the Senate, we are unlikely to see massive policy shifts, as most legislation requires 60 votes to pass in the Senate. For individuals, municipal tax exemption remains hugely valuable in the event of future tax increases.

U.S. Treasury market

Maturity	Yield	Change (%) Week ending 8 Jan 2021	December 2020	2020
2-year	0.12	0.01	-0.03	-1.45
5-year	0.36	0.12	0.00	-1.33
10-year	0.92	0.20	0.08	-1.00
30-year	1.65	0.23	0.08	-0.74

Source: Bloomberg L.P. As of 31 Dec 2020. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week ending 8 Jan 2021	December 2020	2020
2-year	0.14	0.01	-0.01	-0.90
5-year	0.22	0.04	-0.01	-0.87
10-year	0.71	0.07	-0.01	-0.73
30-year	1.39	0.07	-0.02	-0.70

Source: Bloomberg L.P. As of 31 Dec 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	76
30-year AAA Municipal vs Treasury	84
High Yield Municipal vs High Yield Corporate	91

Source: Bloomberg L.P., Thompson Reuters. As of 31 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 ending 8 Jan 2021	December 2020	2020
Municipal	1.07	–	5.18	-0.09	0.61	5.21
High Yield Municipal	3.82	265[1]	7.25	0.72	1.88	4.89
Short Duration High Yield Municipal[2]	3.51	311	3.69	0.64	1.70	4.08
Taxable Municipal	2.10	111[3]	9.99	-1.06	1.08	10.52
U.S. Aggregate Bond	1.12	42[3]	6.22	-0.94	0.14	7.51
U.S. Treasury	0.57	–	7.21	-1.18	-0.23	8.00
U.S. Government Related	1.06	52[3]	6.03	-0.75	0.46	5.94
U.S. Corporate Investment Grade	1.74	96[3]	8.84	-1.52	0.44	9.89
U.S. Mortgage-Backed Securities	1.25	39[3]	2.34	-0.11	0.22	3.87
U.S. Commercial Mortgage-Backed Securities	1.28	81[3]	5.31	-0.66	0.73	8.10
U.S. Asset-Backed Securities	0.45	33[3]	2.10	-0.06	0.20	4.52
Preferred Securities	2.35	160[3]	4.19	-0.73	1.55	7.63
High Yield 2% Issuer Capped	4.20	361[3]	3.56	0.24	1.88	7.05
Senior Loans[4]	5.10	486	0.25	0.85	1.30	2.78
Global Emerging Markets	3.50	281[3]	6.89	-0.81	1.52	6.52
Global Aggregate (unhedged)	0.83	37[3]	7.43	-0.46	1.34	9.20

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 31 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, 08 Jan 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 06 Jan 2021.

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.

A word on risk