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Weekly Fixed Income Commentary

19 January 2021

Treasury yields decline after a long climb

U.S. Treasury yields closed lower last week, led by longer maturities. Continued recent yield increases prompted strong investor demand, augmented by disappointing economic data, which shifted market momentum and pushed rates modestly lower.

HIGHLIGHTS

- **Taxable municipals led performance, followed by senior loans and investment grade corporates.**
- **High grade municipal bond yields rose slightly last week, and high yield continues to perform.**
- **Emerging markets endured the lowest returns, followed closely by the global aggregate sector.**

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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
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TREASURY YIELDS RETREAT FROM RECENT HIGHS

U.S. Treasury yields finished last week lower, led by longer maturities. However, the week began with rates continuing their recent climb, and the 10-year Treasury yield reached its highest level since March. Longer maturity rates have been rising as investors anticipate the effects of additional fiscal stimulus. Economic growth and inflation are expected to increase, boosting yields in response. Likewise, higher supply of Treasury securities is almost a foregone conclusion, as the spending must be funded. Both of these influences have pushed longer maturity Treasury yields up.

Higher Treasury yields helped spur interest in last week's 10- and 30-year auctions, which offered the highest yield levels going into an auction since February. This strong investor demand, augmented by disappointing economic data, shifted market momentum and pushed rates modestly lower the rest of the week. Rising long-term Treasury rates over the last months has significantly steepened the yield curve, as short maturity rates have remained anchored by Fed policy. The gap between the 10- and 2-year Treasury yields has jumped to the largest differential since mid-2017.

All U.S. sectors delivered positive total returns, and most outpaced Treasuries. Taxable municipals, aided by their long duration, posted the highest weekly return. Senior loans had another strong week with the second-best return, followed by investment grade corporates and commercial mortgage-backed securities. The non-U.S. markets struggled with negative returns and weak performance. Emerging markets debt endured the lowest return for the week across all sectors. The global aggregate sector was close behind, as soft returns in Europe dragged down the entire sector.

The supply of traditional tax-exempt municipal bonds is declining, with demand growing as a result.

HIGH YIELD MUNICIPALS CONTINUE TO PERFORM

Municipal yields rose slightly last week. New issue supply totaled $4.6 billion and was well received. Fund flows were positive at $2.6 billion. This week's new issue supply is expected to be $9.9 billion ($4.5 billion taxable).

High grade municipals are considered historically rich. However, such richness may represent a secular change. Tax-exempt supply is dwindling, as many issuers are accessing markets through the taxable municipal market. This has caused the supply of traditional tax-exempt bonds to dwindle, with demand growing as a result. Also, with the new Biden administration means taxes will likely rise, which will further increase demand. With interest rates lower for longer, coupled with strong demand for tax-exempt bonds, we see bright prospects for the tax-exempt market.

Cook County Illinois issued $325 million general obligation bonds (rated A2/A+). The deal was priced to sell. The 10-year bond came at 1.29%, which is substantially cheaper than the 10-year Treasury bond that was trading at 1.08% at the time. The Biden administration's proposed fiscal stimulus package should help entities like Cook County that were negatively impacted by the coronavirus.

High yield municipals continued the positive performance trend that began in early November. Fund flows hit a record $1.07 billion last week. Credit spreads have contracted by 34 basis points (bps) on average so far this year. Positive technical and fundamental trends have boosted the market. Supply is highly constrained while demand is historically strong. Defaults appear contained and investors' outlook for 2021 is increasingly optimistic.

EMERGING MARKETS DEBT CONTINUES ITS SLOW START

Emerging markets (EM) debt recorded a loss for the second week in a row after nine weeks of positive results. EM trading has been volatile to start 2021, hampered by January's rise in U.S. Treasury yields and broader questions about the COVID-19 vaccine rollout and the Biden administration's stimulus plans. Spreads widened by 6 bps last week as flows of nearly $700 million into hard-currency EM funds weren't enough to absorb last week's new-issue supply.

Investment grade corporate bonds rebounded from the prior week's loss, but remained near the bottom of the pack for the month and year to date. Investment grade corporate yields and spreads proved resilient during the week, despite a more fragile U.S. macro backdrop, that included a miss on retail sales, weaker labor market data and worrisome COVID-19 case counts. The primary market was quieter than the week before, though generally in line with expectations, as 18 issuers priced $21.4 billion in new deals.

Emerging markets spreads widened, as demand could not keep up with supply.

High yield corporates posted a modest gain, marking 11 consecutive weeks of positive returns. The market saw fairly steady price action while absorbing significant new issuance. Within high yield, the compression trade remained strong, with spreads on lower-rated (CCC) credits tightening more than their higher-quality (B and BB) counterparts. The energy sector remained a source of outperformance, rising more than 1% amid recent Saudi production cuts. Fund flows were negative (-$1.26 billion) for the fourth time in the last five weeks.

In focus

A turbulent year for IG corporates

Investment grade corporates delivered a positive total return of 9.89% for 2020, with spreads finishing a mere 3 basis points (bps) wider at +96. But strong annual data masks the extreme volatility that occurred during the year.

During the height of the coronavirus-induced market selloff in March, spreads reached +373, which was 280 bps wider for the year. At that point, the sector was down more than -10.5% year to date.

Unprecedented fiscal and monetary stimulus boosted the credit markets, causing Treasury yields to plummet. The investment grade corporate index closed the year at an all-time low yield of 1.74%. In similar record-setting fashion, corporations capitalized on the low cost of funds by issuing $1.8 trillion in bonds, easily surpassing the previous high set in 2017.

We are looking forward to more stability in 2021, with modest spread tightening to be driven by a rebound in economic growth, lower primary issuance and improving credit fundamentals. We anticipate recovering global growth will support a rebound in corporate earnings that will result in better leverage metrics. Additionally, we believe reduced debt costs can generate cash flow that could be used to pay down debt.

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U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.14	0.00	0.01	0.01
5-year	0.45	-0.03	0.09	0.09
10-year	1.08	-0.03	0.17	0.17
30-year	1.83	-0.04	0.19	0.19

Source: Bloomberg L.P. As of 15 Jan 2021. **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	0.00	0.01	0.01
5-year	0.27	0.01	0.05	0.05
10-year	0.79	0.01	0.08	0.08
30-year	1.47	0.01	0.08	0.08

Source: Bloomberg L.P. As of 15 Jan 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	71
30-year AAA Municipal vs Treasury	79
High Yield Municipal vs High Yield Corporate	89

Source: Bloomberg L.P., Thompson Reuters. As of 15 Jan 2021. 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	1.07	–	5.21	0.10	0.02	0.02
High Yield Municipal	3.71	243[1]	7.18	0.39	1.11	1.11
Short Duration High Yield Municipal[2]	3.14	266	3.69	0.23	0.87	0.87
Taxable Municipal	2.15	100[3]	9.93	0.60	-0.47	-0.47
U.S. Aggregate Bond	1.18	36[3]	6.09	0.19	-0.76	-0.76
U.S. Treasury	0.67	–	7.16	0.10	-1.08	-1.08
U.S. Government Related	1.15	50[3]	6.08	0.06	-0.69	-0.69
U.S. Corporate Investment Grade	1.85	94[3]	8.75	0.38	-1.14	-1.14
U.S. Mortgage-Backed Securities	1.21	19[3]	2.08	0.13	0.02	0.02
U.S. Commercial Mortgage-Backed Securities	1.33	75[3]	5.27	0.32	-0.34	-0.34
U.S. Asset-Backed Securities	0.44	30[3]	2.11	0.08	0.02	0.02
Preferred Securities	2.77	191[3]	4.53	0.16	-0.57	-0.57
High Yield 2% Issuer Capped	4.19	351[3]	3.63	0.12	0.36	0.36
Senior Loans[4]	4.78	453	0.25	0.43	1.28	1.28
Global Emerging Markets	3.63	282[3]	6.83	-0.39	-1.19	-1.19
Global Aggregate (unhedged)	0.87	34[3]	7.39	-0.35	-0.82	-0.82

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 15 Jan 2021. **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, 15 Jan 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 13 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.

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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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