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Weekly Fixed Income Commentary

25 January 2021

Treasury yields remain stable in a quiet week

U.S. Treasury yields were little changed last week, as the Federal Reserve (Fed) was in a pre-meeting communications blackout period and there were few notable economic releases. No significant policy changes are expected at this week's Fed meeting, but asset purchases are expected to continue for some time.

HIGHLIGHTS

- **Taxable municipals, emerging markets and preferred securities led performance.**
- **The municipal market experienced another positive yet slow week.**
- **The global aggregate index posted a positive total return boosted by the European region.**

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TREASURY YIELDS HOLD STEADY IN A QUIET WEEK

U.S. Treasury yields were little changed, with all maturities closing within 2 basis points (bps) of where they began the week. The Fed was in its pre-meeting communications blackout period with few notable economic releases. The 20-year Treasury auction received tepid demand from investors, despite its unchanged size at $24 billion and recent strong auctions for both 10- and 30-year bonds. The $15 billion 10-year TIPS auction saw more robust interest. Investor demand has pushed TIPS break-even spreads and implied inflation rates to multi-year highs for most maturities. Currently, the TIPS curve reflects expected inflation rates above 2% for all maturities from 1 to 30 years.

We don't expect significant policy changes from this week's Fed meeting. The Fed will likely continue growing its balance sheet through asset purchases of at least $80 billion per month for some time. The markets will have to absorb $211 billion in Treasury auctions for maturities of 2-, 5- and 7-year bonds.

Non-Treasury sectors experienced mixed results last week. Ongoing virus concerns and potential opposition to fiscal stimulus proposals caused a cautious tone toward the end of the week. Most sectors enjoyed positive total returns above Treasuries, led by taxable municipals, emerging markets and preferred securities. Investment grade corporates were dragged down by wider spreads and their longer duration, which resulted in a negative total return for the week and the worst performance across all sectors. Likewise, the mortgage-backed securities sector endured a slightly negative total return for the week. The global aggregate index posted a positive total return boosted by higher returns in the European region.

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TAILWINDS BLOW FOR THE MUNICIPAL MARKET

The municipal market had another positive but slow week. The new issue calendar of $6.5 billion was well received. Fund flows were positive at $2.4 billion. This week's new issue supply is only $7.7 billion.

The municipal market continues to experience a good tailwind for several reasons: January 1 coupon money continues to be reinvested, new issue supply remains muted with a dwindling supply of tax-exempt municipals, the Fed promises to remain accommodative and fiscal policies suggest municipalities will receive aid for budget shortfalls.

The Port Authority of New York and New Jersey issued $1.1 billion revenue bonds (rated Aa3/A+). The deal included non-AMT, AMT and taxable bonds. The underwriting was priced to sell, yet it was so well received that underwriters lowered the yield upon final pricing and increased the size of the offering. Still, the 10-year bond came at a yield of 1.07%, nearly equivalent to the 10-year Treasury yield at 1.08%. These entities depend on revenues from facilities affected by the pandemic. But investors looked past these hurdles in favor of the tax-exempt income for these two high-tax states.

High yield municipal yields decreased by -6 bps on average last week, compared to -3 bps for AAA-rated municipals. Inflows continued at $528 million. New issuance this week will be led by a $560 million Chicago Public Schools new money and refunding deal, while the Board of Education and the Chicago Teacher's Union remain in a standoff over re-opening classrooms. The land-secured sector continues to provide a steady stream of new deals, enjoying strong demand for new homes. Nearly all land-secured deals come without public ratings and require independent research.

EM DEBT GOES FROM WORST TO FIRST ON RISING SENTIMENT AND ROBUST FUND FLOWS

Emerging markets (EM) debt was last week's top performer among non-municipal fixed income sectors, after finishing at the bottom of the pack the week before. Sentiment was buoyed by stability in U.S. rates and Treasury Secretary Janet Yellen's support for expansive fiscal stimulus. The primary market was busy, with roughly $13 billion in new sovereign issuance. On the demand side, EM funds enjoyed their strongest week of inflows (+$4.5 billion) since February 2019.

High yield corporates extended their streak of gains to 12 weeks, and 16 of the last 17. The energy sector was an outlier, recording a loss amid the announcement of regulations affecting oil and gas leases. Outside of energy, the compression trade remained intact, with lower-quality (CCC rated) credits continuing to outperform. New supply was heavy (+$12 billion), but most of this was refinancing activity and well-absorbed by the market. Fund flows (-$905 million) were negative for the fifth time in the past six weeks.

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Investment grade corporate bonds posted a slightly negative return, continuing the see-saw between weekly gains and losses that has characterized their 2021 performance. Fund flows were healthy (+$8.3 billion), while new issuance fell a bit short of expectations at $23 billion. About two-thirds of that amount represented deals from three large U.S. banks whose earnings blackout periods ended last week.

In focus

Still in favor: senior loans seeing the love

Individual investors have historically had a love-hate relationship with floating rate corporate loans (also known as senior loans). These somewhat extreme shifts tend to be driven by one thing: interest rates.

When retail investors perceive that interest rate risk is growing, they have flooded into the market, and vice versa. The last two years have been a prime example: Between October 2018 and December 2020, investors pulled $86 billion from loan funds, as short- and long-term rates recalibrated lower.

Recently, however, that trend has begun to reverse rather abruptly. With the yield curve at its steepest since 2017 amid upward pressure on the long end, individuals have returned to the loan market in a big way. Open-end vehicles have seen inflows in six of the last seven weeks, culminating in last week's $1.4 billion inflow (the largest since December 2016). ETFs are on an 11-week inflow streak.

Strong demand and limited net new supply have put upward pressure on prices. While investors are never unhappy about higher NAVs, this could create an environment where loan spreads begin to come under pressure. Despite that risk, we believe the overall case for loans in an asset allocation framework remains strong.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.12	-0.01	0.00	0.00
5-year	0.43	-0.02	0.07	0.07
10-year	1.09	0.00	0.17	0.17
30-year	1.85	0.01	0.20	0.20

Source: Bloomberg L.P. As of 22 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	0.13	-0.02	-0.01	-0.01
5-year	0.25	-0.02	0.03	0.03
10-year	0.77	-0.02	0.06	0.06
30-year	1.44	-0.03	0.05	0.05

Source: Bloomberg L.P. As of 22 Jan 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	70
30-year AAA Municipal vs Treasury	78
High Yield Municipal vs High Yield Corporate	88

Source: Bloomberg L.P., Thompson Reuters. As of 22 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	1.03	–	5.16	0.23	0.25	0.25
High Yield Municipal	3.64	239[1]	6.99	0.41	1.53	1.53
Short Duration High Yield Municipal[2]	3.08	262	3.66	0.27	1.14	1.14
Taxable Municipal	2.11	100[3]	9.90	0.35	-0.12	-0.12
U.S. Aggregate Bond	1.18	36[3]	6.08	0.01	-0.75	-0.75
U.S. Treasury	0.65	–	7.11	0.06	-1.02	-1.02
U.S. Government Related	1.14	49[3]	6.11	0.14	-0.56	-0.56
U.S. Corporate Investment Grade	1.86	95[3]	8.73	-0.08	-1.22	-1.22
U.S. Mortgage-Backed Securities	1.22	21[3]	2.08	-0.01	0.01	0.01
U.S. Commercial Mortgage-Backed Securities	1.31	74[3]	5.26	0.15	-0.19	-0.19
U.S. Asset-Backed Securities	0.41	28[3]	2.08	0.07	0.09	0.09
Preferred Securities	2.65	182[3]	4.46	0.24	-0.33	-0.33
High Yield 2% Issuer Capped	4.16	349[3]	3.63	0.12	0.48	0.48
Senior Loans[4]	4.76	451	0.25	0.15	1.43	1.43
Global Emerging Markets	3.61	281[3]	6.85	0.25	-0.94	-0.94
Global Aggregate (unhedged)	0.88	35[3]	7.37	0.11	-0.71	-0.71

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 22 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, 22 Jan 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 20 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

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.