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Weekly Fixed Income Commentary

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Risk-off sentiment pushes U.S. Treasury yields slightly lower

U.S. Treasury yields ended last week a few basis points lower across maturities. Investors were concerned with the slow rate of coronavirus vaccinations, as well as potentially delayed fiscal stimulus. The Federal Reserve (Fed) acknowledged that the pace of economic recovery has slowed, indicating that asset purchases and the policy rate will remain unchanged.

HIGHLIGHTS

- **Among the taxable sectors, commercial mortgage-backed securities, taxable municipals and emerging markets outperformed Treasuries.**
- **High grade and high yield municipal markets outperformed Treasuries.**
- **The global aggregate index experienced negative total returns, dragged down by European and Asian markets.**

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TREASURY YIELDS RETREAT SLIGHTLY

U.S. Treasury yields declined by 1 to 2 basis points (bps) last week across maturities. The week began with a soft risk tone, pushing rates down. Longer maturities led the way lower and the yield curve flattened. Investors were concerned with new variants of the coronavirus, slower-than-expected vaccination rates and the prospect of delayed and less fiscal stimulus. The market absorbed record Treasury issuance without incident and saw a record low 2-year auction yield. The Treasury announced its issuance expectations for 2021, totaling more than $770 billion in new cash being raised. The trend toward lower rates and a flatter yield curve reversed later in the week, as stronger-than-expected U.S. economic data helped drive rates higher. Long maturity yields rose 4 to 5 bps.

The Fed meeting went as expected, with no adjustments in monetary policy. The statement acknowledged that the pace of recovery had slowed, and Chair Jerome Powell reiterated that it was too soon to discuss reducing asset purchases or increasing the policy rate.

Non-Treasury sectors struggled under the weight of the negative risk tone. However, some sectors did outpace Treasuries, led by commercial mortgage-backed securities. Taxable municipals and emerging markets also delivered slightly higher total returns for the week. Sectors with higher correlations to the equity markets performed worst and experienced negative weekly returns. Preferred securities fell the most, followed by senior loans and high yield corporates. The global aggregate index also experienced weak performance and negative total returns, as both European and Asian markets posted negative total returns.

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MUNICIPAL FUND FLOWS REMAIN ROBUST

Municipal bond yields closed lower last week. New issue supply was $6 billion, with robust fund flows of $2.8 billion. New issuance is expected to be $8.5 billion this week, and should be well received.

The month of February brings both good news and bad news for the municipal market. Bad news: the municipal market often sells off in this second calendar month. New issue supply ramps up in earnest (the market has finally moved beyond the holiday season) and January 1 coupon money is already fully invested. Good news: Fed Chair Powell reiterated that the central bank will keep rates low and continue purchasing securities "until the recovery is complete." As we have been saying, rates will remain lower for longer, and we see any market dips as a potential buying opportunity.

Fairfax County, Virginia, issued $263 million general obligation bonds (rated Aaa/AAA). Bonds issued in 2033 with a 2% coupon yielding 1.23% traded later in the week in the secondary market at a yield of 1.15%. By comparison, the Treasury market was basically unchanged, showing the market's limitless need for tax-exempt income.

High yield municipal credit spreads continue to compress, driving further outperformance. High yield municipal bond yields decreased by 9 bps on average last week, 3 bps more than AAA-rated munis. Investors added $778 million in net flows, bringing the January total to $2.47 billion. The Chicago Board of Education deal was heavily oversubscribed last week, which led to reduced yields at final pricing. Not only is the City of Detroit coming to market with GO bonds, as it continues to battle the stigma of bankruptcy and treatment of bondholders, but it is also doing so with a taxable deal and labeling the deal as "social bonds."

EMERGING MARKETS DEBT SHOWS RESILIENCE IN A MOSTLY NEGATIVE WEEK FOR RISK ASSETS

Emerging markets (EM) debt posted a gain for the second consecutive week and 11 of the last 13. It was one of only two non-municipal sectors to outperform U.S. Treasuries last week. Strong fund flows (+$3.9 billion) and lighter issuance, particularly in the sovereign space, buoyed the asset class, though profit-taking limited spread tightening to 1 bps. EM currencies were generally weaker, led by the Mexican peso (-2.7%).

High yield corporate returns were negative for the first time in 13 weeks. Spreads widened by 14 bps, and the asset class suffered its largest outflows (-$1.3 billion) since early December. Last week marked the sixth outflow in the past seven weeks. A volatile U.S. equity market — roiled by the drama of loosely organized retail investors putting a squeeze on short sellers of a few small cap stocks — provided an unsettled backdrop for high yield. Meanwhile, continued heavy new issuance capped the busiest January on record, with roughly $55 billion coming to market last month.

A volatile U.S. equity market provided an unsettled backdrop for high yield.

Investment grade corporate bonds realized a small loss for the second week in a row and finished last among all fixed income categories for the month. Spreads were only marginally wider (+2 bps) on the week, however, and fund inflows remained robust at $5.3 billion. The primary market was relatively light, with 11 issuers pricing $25 billion in new deals. Overall, corporate earnings fundamentals sor far look promising for this reporting season.

In focus

A quiet start to 2021 for the Fed

After a string of dovish policy moves throughout the second half of 2020, the Fed opted to stand pat at its first meeting of 2021, held last Wednesday. No new policies were announced, and none are expected for a while as the Fed evaluates the path of COVID-19 and its ongoing effect on the economy.

In his post-meeting Q&A session, Chair Powell stressed that talk of tapering the Fed's pace of quantitative easing (QE) asset purchases was "premature" and that it would be "some time" before the economy could make substantial enough progress toward the Fed's employment and inflation goals to consider slowing down those purchases. Therefore, we expect QE to remain in effect at least through 2021.

Regarding the Fed's previous calls for additional fiscal stimulus, President Biden's proposed $1.9 trillion relief package would likely boost GDP growth in 2021 and 2022. A stronger economy could drive inflation higher through faster wage gains. Given the Fed's previously stated willingness to tolerate hotter inflation, the Fed would likely welcome more stimulus, especially with unemployment at 6.7% and more than 4 million workers having left the labor force in the past year.

Those signs of considerable slack in the labor market suggest the economy is at little risk of overheating any time soon. As long as those conditions remain, we doubt the Fed would even consider tightening policy.

U.S. Treasury market

Maturity	Yield	Change (%) Week	January 2021	Year-to-date
2-year	0.11	-0.01	-0.01	-0.01
5-year	0.42	-0.01	0.06	0.06
10-year	1.07	-0.02	0.15	0.15
30-year	1.83	-0.02	0.19	0.19

Source: Bloomberg L.P. As of 29 Jan 2021. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	January 2021	Year-to-date
2-year	0.11	-0.02	-0.03	-0.03
5-year	0.22	-0.03	0.00	0.00
10-year	0.72	-0.05	0.01	0.01
30-year	1.38	-0.06	-0.01	-0.01

Source: Bloomberg L.P. As of 29 Jan 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	65
30-year AAA Municipal vs Treasury	74
High Yield Municipal vs High Yield Corporate	82

Source: Bloomberg L.P., Thompson Reuters. As of 29 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	January 2021	Year-to-date
Municipal	0.95	–	5.11	0.39	0.64	0.64
High Yield Municipal	3.55	236[1]	6.77	0.55	2.08	2.08
Short Duration High Yield Municipal[2]	2.98	257	3.63	0.50	1.65	1.65
Taxable Municipal	2.11	97[3]	9.88	0.09	-0.03	-0.03
U.S. Aggregate Bond	1.17	36[3]	6.09	0.03	-0.72	-0.72
U.S. Treasury	0.65	–	7.10	0.07	-0.96	-0.96
U.S. Government Related	1.13	49[3]	6.10	0.04	-0.52	-0.52
U.S. Corporate Investment Grade	1.86	97[3]	8.70	-0.06	-1.28	-1.28
U.S. Mortgage-Backed Securities	1.20	18[3]	2.20	0.06	0.08	0.08
U.S. Commercial Mortgage-Backed Securities	1.28	72[3]	5.26	0.16	-0.03	-0.03
U.S. Asset-Backed Securities	0.39	26[3]	2.07	0.06	0.14	0.14
Preferred Securities	2.82	205[3]	4.49	-0.42	-0.75	-0.75
High Yield 2% Issuer Capped	4.33	363[3]	3.67	-0.15	0.33	0.33
Senior Loans[4]	4.84	461	0.25	-0.16	1.27	1.27
Global Emerging Markets	3.59	280[3]	6.86	0.09	-0.85	-0.85
Global Aggregate (unhedged)	0.88	35[3]	7.36	-0.17	-0.88	-0.88

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 29 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, 29 Jan 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 27 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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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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