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# Treasury yields drift higher despite soft consumer data

*U.S. Treasury yields ended last week higher, led by longer maturities. Yields declined early in the week, due to dovish Fed comments and weaker than expected consumer price data. However, Thursday's soft 30-year Treasury auction reversed the momentum and yields began to climb, more than offsetting declines.*

## HIGHLIGHTS

- **High yield corporates posted the best weekly return among U.S. non-municipal sectors, followed by senior loans and preferreds.**
- **Municipal yields continued to grind lower last week, with high grade municipal-to-Treasury yields looking unusually rich.**
- **The global aggregate index delivered a solidly positive total return, as both the European and Asian markets outperformed U.S. markets.**



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## TREASURY YIELDS DRIFT HIGHER

**U.S. Treasury yields finished higher last week**, led by the 10-year maturity range. Interest rates declined to begin the week, with longer maturities falling the most. Strong 3- and 10-year auctions helped drive rates down, supported by dovish Fed comments and weaker-than-expected consumer price data. The 2-year Treasury yield touched a record low yield in overnight trading on Wednesday night. However, a soft 30-year Treasury auction on Thursday reversed the momentum and yields began to climb. The largest rate movements occurred later in the week, as long Treasury yields led the move higher and more than offset earlier declines. The 30-year Treasury yield closed the week above 2% for the first time since February 2020, and the 10-year yield also saw the highest level since before the pandemic.

**Most taxable sectors posted positive total returns** and outperformed the lagging Treasury market. Across U.S. sectors, high yield corporates once again outperformed and posted the highest weekly return among non-municipal sectors. Senior loans and preferreds also enjoyed positive returns and strong performance. Only mortgage-backed securities underperformed Treasuries, due to elevated prepayment speeds. All sectors have outperformed similar-duration Treasuries so far this year. The global aggregate index delivered a solidly positive total return last week, as both the European and Asian markets outperformed U.S. markets.

*The 30-year Treasury yield closed the week above 2% for the first time since February 2020.*

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## MUNICIPAL BONDS SHOULD MAINTAIN THEIR VALUE

**Municipal yields continued to grind lower last week.** New issue supply of \$7.2 billion was readily absorbed. Fund flows continued to be solid at \$2.6 billion. This week's new issue supply is expected to total \$5.2 billion.

**High grade municipal bonds appear rich versus Treasuries.** A typical 10-year high grade tax-exempt bond yields 0.69% versus 1.2% for the 10-year Treasury. That makes a yield ratio of 58%, compared to the long-term average in the mid-80% range. However, investors are comfortable with these rich ratios in the current environment. The Fed has in essence bailed out U.S. municipalities, pledging them \$350 billion. Also, taxes may eventually rise under the Biden administration, making tax-exempt municipal bonds even more attractive. Finally, there just aren't enough tax-exempt bonds to meet demand, as they are being replaced by taxable bonds that refund tax-exempt debt. We believe municipal bonds should maintain their value as long as current conditions prevail.

**New York City Industrial Development Agency** issued \$507 million refunding bonds for the New York Mets (Queens Baseball Stadium Project, rated Baa2/BBB-). The deal was very well received, with \$8 billion in orders. Investors are banking on the idea that the U.S. will one day be back to attending baseball games in person.

**High yield municipal bond yields and credit spreads continue to tighten**, with yields decreasing 11 basis points (bps) last week, 7 bps more than AAA-rated municipals. High yield inflows continued, with investors adding another \$832 million last week. Some of the best performing bonds in February have more economically sensitive credits like student housing, convention centers and sales tax bonds. In addition, both sales tax and property tax bonds for American Dream have rallied meaningfully in the last two weeks.

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## MORE THAN HALF OF HIGH YIELD CORPORATES NOW YIELD LESS THAN 4%

**High yield corporate bonds continued their winning ways.** The asset class has recorded gains in 14 of 15 weeks since early November. Last week's performance was similar across all quality tiers, and overall spreads tightened by 10 basis points (bps). The extended rally has driven the average yield on high yield corporates steadily downward, to a record-low close of 3.96% at midweek. Corporate earnings and new issuance were in focus, with nearly \$15 billion in deals coming to market, in line with January's torrid pace. Fund flows (-\$228 million), however, reversed the previous week's positive momentum.

**Investment grade corporates posted a negative result** for the fourth consecutive week and five of the last six. Total returns were hindered by rising long-term U.S. Treasury yields. Among sectors, energy outperformed, benefiting from a 5% jump in oil prices. Secondary trading volumes were light, and inflows (+\$2.7 billion) slowed from the prior week's four-month high. The primary market was quieter, with \$11.8 billion in new debt.

### *The average yield on high yield corporates hit a record-low close of 3.96% at midweek.*

**Emerging markets (EM) debt realized a small loss** after rising for three weeks in a row. Appetite for EM risk remained intact, with EM bond funds attracting \$3 billion of inflows. New supply failed to keep up with demand, especially in emerging Asia, where a lack of new sovereign issuance amid early Lunar New Year celebrations kept many investors sidelined.

## *In focus*

# *Surge in muni bond demand overwhelms supply*

*Investors continue to pour money into the municipal bond market, as the usual January effect has extended into February.*

The asset class has seen inflows in 38 of the past 39 weeks, for a year-to-date total of \$24 billion overall, \$4.5 billion in high yield municipals.

While investor appetite grows, the amount of municipal debt outstanding has been effectively flat for the past 10 years, and a decreasing portion is tax-exempt. Taxable new issuance totaled just 7% of the market in 2015, exploding to 31% in 2020. We expect taxable issuance to total around 35% for 2021.

Why the increase in taxable issuance? The Tax Cuts and Jobs Act eliminated advance refunding of tax-exempt bonds by issuing new tax-exempt bonds. As a result, issuers adopted programs selling taxable bonds to advance refund existing bonds. As long as advanced refunding deals continue to offer present value savings, issuers will continue issuing in the taxable market.

In this environment, access to new issue deals, as well as in-depth credit research, becomes critically important.

Going forward, we expect investors to be increasingly focused on the potential for rising tax rates, which should continue to boost demand for municipal bonds.

## U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	Month-to-date	Year-to-date
2-year	0.11	0.01	0.00	-0.01
5-year	0.49	0.03	0.07	0.13
10-year	1.21	0.05	0.14	0.30
30-year	2.01	0.04	0.18	0.37

Source: Bloomberg L.P. As of 12 Feb 2021. **Past performance is no guarantee of future results.**

## Municipal market

Maturity	Change (%)			
	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.08	-0.02	-0.03	-0.06
5-year	0.20	-0.03	-0.02	-0.02
10-year	0.69	-0.04	-0.03	-0.02
30-year	1.34	-0.04	-0.04	-0.05

Source: Bloomberg L.P. As of 12 Feb 2021. **Past performance is no guarantee of future results.**

## Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	58
30-year AAA Municipal vs Treasury	67
High Yield Municipal vs High Yield Corporate	86

Source: Bloomberg L.P., Thompson Reuters. As of 12 Feb 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	Month-to-date	Year-to-date
Municipal	0.90	-	5.08	0.28	0.37	1.01
High Yield Municipal	3.41	226 <sup>1</sup>	6.45	0.52	0.68	2.78
Short Duration High Yield Municipal <sup>2</sup>	2.87	249	3.61	0.37	0.57	2.24
Taxable Municipal	2.15	90 <sup>3</sup>	9.82	0.02	-0.49	-0.52
U.S. Aggregate Bond	1.24	34 <sup>3</sup>	6.18	-0.13	-0.52	-1.23
U.S. Treasury	0.72	-	7.13	-0.15	-0.78	-1.73
U.S. Government Related	1.18	47 <sup>3</sup>	6.15	0.02	-0.28	-0.79
U.S. Corporate Investment Grade	1.90	92 <sup>3</sup>	8.66	-0.09	-0.57	-1.84
U.S. Mortgage-Backed Securities	1.32	17 <sup>3</sup>	2.56	-0.17	-0.18	-0.10
U.S. Commercial Mortgage-Backed Securities	1.35	73 <sup>3</sup>	5.25	-0.04	-0.41	-0.44
U.S. Asset-Backed Securities	0.41	28 <sup>3</sup>	2.07	0.00	-0.05	0.09
Preferred Securities	3.00	209 <sup>3</sup>	4.72	0.04	0.39	-0.36
High Yield 2% Issuer Capped	3.98	324 <sup>3</sup>	3.66	0.30	1.00	1.33
Senior Loans <sup>4</sup>	4.73	448	0.25	0.20	0.44	1.71
Global Emerging Markets	3.55	267 <sup>3</sup>	6.89	-0.07	0.24	-0.61
Global Aggregate (unhedged)	0.93	33 <sup>3</sup>	7.38	0.29	-0.45	-1.32

<sup>1</sup> Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. <sup>2</sup> 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. <sup>3</sup> Option-adjusted spread to Treasuries. <sup>4</sup> 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 12 Feb 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, 12 Feb 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 10 Feb 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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