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Weekly Fixed Income Commentary

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Treasury yields decline as risk assets perform well

U.S. Treasury yields declined again last week, as technical dynamics and non-U.S. demand outweighed better economic data and rising inflation. 10-year Treasury yields fell -8 basis points, helping all major fixed income market segments to rally.

HIGHLIGHTS

- **Corporate credit saw positive total returns, boosted by lower rates, even as spreads traded flat. Preferreds and CMBS outperformed.**
- **Municipal bond yields decreased. New issue supply was $8.1 billion ($3.1 taxable), with flows of $2.2 billion. This week's new issue supply ticks up at $10.8 billion ($2.3 taxable).**
- **Emerging markets outperformed, helped by lower U.S. rates, higher commodity prices and a weaker dollar.**

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CIO of Global Fixed Income

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Watchlist

- *Treasury yields fell, and all major fixed income market segments rallied*
- *Risk assets continued to perform well, boosted by the fall in rates and improving technical dynamics*
- *We still expect yields to rise over the medium term as the growth and inflation outlook improves from here*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Unprecedented global fiscal stimulus will boost consumption and growth this year, with retail sales already rising at their fastest-ever pace.

Zero/negative global interest rate policy remains a key market support, but investors are beginning to focus on the eventual normalization of policy.

Record supply of investment grade corporates has been followed by issuance from high yield, middle market loans and the broadly syndicated loan market. Taxable municipal supply continues to grow.

We favor a risk-on stance, focused on credits with durable free cash flow and solid balance sheets across a wide range of sectors. Mid-quality rating segments remain particularly attractive. Essential service municipal credits also look compelling.

KEY RISKS

- Inflation rising in a disorderly way, forcing premature policy tightening.
- Further complications with the COVID-19 vaccine rollout.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.
- Policymakers become cautious or run out of stimulus capacity.

EMERGING MARKETS LEAD THE WAY

U.S. Treasury yields fell last week, despite strong economic data, with the 10-year yield declining -8 basis points (bps). Concerns about the Johnson and Johnson vaccine safety surfaced early in the week, but sentiment ultimately improved following strong inflation, retail sales and industrial survey data. Nevertheless, a combination of robust Treasury auction demand, short-covering and increased foreign demand for U.S. fixed income ultimately drove yields lower.

Investment grade spreads were range-bound, though the asset class benefited from the fall in Treasury yields to generate +0.39% total returns. Several of the large money center banks came to market with large deals, namely Goldman Sachs, JPMorgan, and Bank of America, with deals of $6, $13, and $15 billion, respectively. The last two were the largest-ever bank transactions, and helped total weekly supply of $44.8 billion to vastly eclipse expectations of around $20 to $25 billion.

High yield corporates also generated positive returns of +0.20%. High yield slightly lagged the investment grade market given the lower duration profile of high yield markets. Still, the asset class generated 3 bps of excess returns over similar-duration Treasuries. The technical backdrop was not a major factor, as both supply and demand moderated somewhat from recent levels. Senior loans saw robust inflows of $1.08 billion, along with high supply volumes totaling $30 billion of gross issuance and $20 billion net. Returns were somewhat challenged by the fall in yields, but the asset class still returned 0.04% for the week.

Emerging markets debt strongly outperformed, generating total returns of 0.70% and 33 bps of excess returns over similar-duration Treasuries. Lower-rated sovereigns did especially well, boosted by the rally in the U.S. A few idiosyncratic stories also drove price action. Russia and Ukraine sovereigns weakened 2 bps – 5 bps early in the week amid escalating tensions, but ultimately rallied back after U.S. sanctions were milder than feared. Huarong, a large Chinese, government-controlled asset manager, generated volatility amid fears of a potential downgrade, but also ultimately rallied after its management said it would make scheduled upcoming payments normally.

DEMAND FOR MUNICIPAL BONDS CONTINUES

The municipal market rallied strongly last week, and continued to grow richer versus U.S. Treasury bonds for several reasons. Tax-exempt supply has been muted in the face of strong and growing demand. And an outsized coupon reinvestment period begins in only six weeks on June 1. Also, taxes are very likely headed higher in the U.S. in the coming months. Finally, the massive amount of federal stimulus going to municipalities has eased the fear of municipal defaults for the foreseeable future and improved overall municipal credit quality. We expect the asset class to remain solid for the foreseeable future.

San Diego Co. Water Authority issued $272 million water revenue bonds (rated Aa2/AAA). The deal was well received, and the bonds traded at a premium in the secondary market. For example, 4% bonds due in 2035 came at a yield of 1.33%and were trading at a yield of 1.16% by the end of the week. Fixed income in general was trading higher, and outsized demand continues for tax-exempt bonds.

High yield municipal inflows totaled $1.32 billion last week, more than any week during the recovery in 2020, signaling a further strengthening in demand for municipal credit risk and persistent expectations for downward pressure on credit spreads. Strong recent retail sales results should bode well for sales tax securitization and credit fundamentals. We are tracking at least seven high yield municipal deals coming this week, and a limited offering for a sizable PRASA refunding is coming soon. PRASA is a unique Puerto Rico credit because it has avoided bankruptcy and remained independently solvent.

Senior loans saw robust inflows, along with high supply volumes.

In focus

YoY comparison drives headline inflation higher

Consumer price inflation rose higher than expected in March, with the headline year-on-year pace rising to 2.6%, the highest since 2018. This partially reflects strong base effects, as the one-year comparison is now calculated against last spring's lockdown-driven drop in prices.

This dynamic will become more pronounced over the next two months, driving headline inflation even higher. At the same time, some supply bottlenecks are forming as economic normalization accelerates, exacerbating near-term price pressures.

As a result, we expect inflation to continue rising over the next few months. However, over the next few years, we anticipate prices will revert to around 2% increases per year. The secular headwinds that have kept a lid on prices over the last quarter century remain: unfavorable demographics and aging populations, slower productivity growth, globalization and an excess global supply of savings.

We are comfortable with our forecast for higher long-end yields over the next few quarters. Measures of long-term inflation expectations still have room to move higher. At the same time, the Federal Reserve is unlikely to respond to temporarily higher inflation with higher interest rates, leaving the front-end of the yield curve anchored. This combination bodes well for shorter-duration and riskier assets like high yield credit, as well as floating-rate assets like leveraged loans.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.16	0.01	0.00	0.04
5-year	0.83	-0.03	-0.11	0.47
10-year	1.58	-0.08	-0.16	0.67
30-year	2.27	-0.06	-0.15	0.62

Source: Bloomberg L.P., 16 Apr 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	0.07	-0.06	-0.07	-0.07
5-year	0.36	-0.11	-0.15	0.14
10-year	0.93	-0.10	-0.19	0.22
30-year	1.55	-0.09	-0.20	0.16

Source: Bloomberg L.P., 16 Apr 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	69
High Yield Municipal vs High Yield Corporate	85

Source: Bloomberg L.P., Thompson Reuters, 16 Apr 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	1.02	–	5.12	0.46	0.93	0.58
High Yield Municipal	3.40	204[1]	6.67	0.54	1.47	3.61
Short Duration High Yield Municipal[2]	2.87	225	3.86	0.36	0.71	2.04
Taxable Municipal	2.35	76[3]	9.78	0.69	1.59	-1.94
U.S. Aggregate Bond	1.51	30[3]	6.40	0.35	0.84	-2.56
U.S. Treasury	0.95	–	6.93	0.37	0.82	-3.47
U.S. Government Related	1.38	42[3]	6.08	0.41	0.86	-2.02
U.S. Corporate Investment Grade	2.18	89[3]	8.57	0.39	1.17	-3.54
U.S. Mortgage-Backed Securities	1.67	8[3]	3.78	0.25	0.55	-0.56
U.S. Commercial Mortgage-Backed Securities	1.57	65[3]	5.22	0.44	0.97	-1.38
U.S. Asset-Backed Securities	0.51	32[3]	2.06	0.07	0.12	-0.03
Preferred Securities	2.55	144[3]	4.69	0.42	1.24	0.83
High Yield 2% Issuer Capped	4.01	293[3]	3.82	0.20	0.90	1.77
Senior Loans[4]	4.81	446[3]	0.25	0.04	0.41	2.43
Global Emerging Markets	3.91	276[3]	6.85	0.70	1.34	-2.19
Global Aggregate (unhedged)	1.11	32[3]	7.44	0.58	1.27	-3.25

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, 16 Apr 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, 16 Apr 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 14 Apr 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 professional 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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