nuveen
A TIAA Company

Weekly Fixed Income Commentary

26 April 2021

Treasury yields decline as investors fret over rising tax rates

U.S. Treasury yields declined last week and risk assets weakened slightly. Despite positive economic data, investor sentiment took a hit as attention centered on reports that the Biden administration is preparing a proposal to raise capital gains tax rates. The Federal Reserve (Fed) will be in focus this week, though no major policy changes are expected.

HIGHLIGHTS

- **Corporate credit saw positive returns, although both investment grade and high yield segments underperformed similar-duration Treasuries.**
- **Municipal bond yields were range bound. New issue supply was $10.8 billion, with flows of $1.9 billion. This week's new issue supply is only $5.4 billion ($800 million taxable).**
- **Emerging markets gained, helped by lower rates and the weaker dollar.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields fell, and all major fixed income market segments rallied*
- *Credit spreads widened slightly, as attention focused on the risk of higher capital gains tax rates*
- *We still expect yields to rise over the medium term as the growth and inflation outlook improves*
- *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.

INVESTMENT GRADE CORPORATE SPREADS WIDEN SLIGHTLY

U.S. Treasury yields fell again last week, with the 10-year yield ending -2 basis points (bps) lower and the curve marginally flattening. The sharpest price action came on Thursday, when risk assets weakened and rates fell sharply, after media outlets reported that Biden administration is preparing a proposal to raise the top federal capital gains tax rate to as high as 43.4% for individuals with over $1 million of income. The data calendar was light, though flash global PMIs for April beat expectations, signaling a continued acceleration in economic activity.

Investment grade corporate total returns remain positive at 0.23% amid the further decline in rates, though spreads widened slightly. Secondary markets saw relatively muted volumes, with most of the action in financials names after recent issuance. Bank debt tightened 5 - 10 bps. Broader technicals were supportive, with a robust $3.6 billion inflow combined with a relatively light supply calendar.

High yield corporates weakened slightly, returning -0.03%, as the tailwind from lower rates did not fully offset headwinds from broader risk sentiment and technical pressure from outflows. $1.3 billion left the asset class last week. Loans performed better, trading close to flat (0.01% total return) despite above-average primary activity, with 15 new deals totaling $11 billion. Inflows totaled $1.1 billion for the week, and there were signs of CLO buying picking up again.

Emerging markets saw positive returns. The asset class returned 0.11%, though trading was relatively muted. There were small positive inflows of $159 and $300 million into hard currency and local bond funds, respectively. Ukraine notably outperformed, tightening around 25 bps, after Russia pulled back troops from the border. In Europe, German bund yields rose for the fourth consecutive week, helping the dollar to weaken -0.76% versus other developed currencies amid narrower rate differentials.

HIGH YIELD MUNICIPAL DEMAND REMAINS STRONG

Both municipal bonds and Treasuries were range bound last week, but ended with constructive tones. This may be a pattern for municipals in the next few weeks, as nothing on the horizon suggests outsized inflation, which would cause bond prices to decline. In fact, when the Fed meets this week, policymakers will very likely say that inflation is not a concern to the U.S. economy. That should be further impetus for fixed income in general to stay the course. Tailwinds for municipals should persist, as we are coming up on outsized coupon reinvestments for June 1 and July 1.

The state of California issued $1 billion general obligation bonds (rated Aa2/AA). The bonds were well received and traded at a premium in the secondary market. For example, a 20-year maturity bond came with a 5% coupon at a yield of 1.71%, then traded in the secondary market at 1.65%.

High yield municipal bond yields tightened slightly last week. Demand for both new issue and secondary market high yield municipals remains firm, bolstered by existing cash balances. Fund inflows totaled $642 million last week, bringing this year's total to $8.31 billion. Demand for residential real estate is strong, with new home sales up 20.8% in March. This bodes well for recently issued or new issue land-secured deals, a sector that has provided steady supply. Based on comments from Puerto Rico's most recent Federal Oversight Management Board meeting, PREPA bonds could likely be restructured, and an exit from bankruptcy looks possible for fourth quarter 2021 or first quarter 2022. The existing restructuring support agreement is highly favored to serve as the framework for PREPA's path forward.

Demand for real estate bodes well for recently issued land-secured deals.

In focus

Demand continues for senior loans with floating-rate coupons

Senior loan funds that invest in higher yielding, floating-rate corporate loans saw inflows of more than $1 billion again last week, marking 15 consecutive weeks of positive demand.

Senior loan inflows total $17.4 billion for the year, a nearly 25% increase in assets under management since January. In fact, several funds in the category have seen assets more than double since the end of 2020 as the result of inflows.

Historically, senior loan inflows have been closely linked to periods of rising rates, when investors typically see relative weakness within their fixed income portfolio allocations.

Longer-dated Treasury yields have steadily fallen throughout April, but this hasn't impacted demand for senior loans. Inflows have totaled $1 billion or more every week during April, seeming to reflect investors' concerns about a longer-term trend of rising interest rates.

The amount of new capital coming into the senior loan market this year represents just 20% of the $86 billion that exited the asset class between December 2018 and December 2020. We expect demand will continue, providing support for the loans market going forward.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.16	0.00	0.00	0.04
5-year	0.82	-0.02	-0.12	0.46
10-year	1.56	-0.02	-0.18	0.64
30-year	2.24	-0.03	-0.18	0.59

Source: Bloomberg L.P., 23 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	0.00	-0.07	-0.07
5-year	0.36	0.00	-0.15	0.14
10-year	0.93	0.00	-0.19	0.22
30-year	1.55	0.00	-0.20	0.16

Source: Bloomberg L.P., 23 Apr 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	59
30-year AAA Municipal vs Treasury	69
High Yield Municipal vs High Yield Corporate	84

Source: Bloomberg L.P., Thompson Reuters, 23 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	1.01	–	5.11	0.06	1.00	0.64
High Yield Municipal	3.39	203[1]	6.63	0.09	1.55	3.69
Short Duration High Yield Municipal[2]	2.85	223	3.62	0.12	0.80	2.74
Taxable Municipal	2.32	78[3]	9.76	0.29	1.88	-1.66
U.S. Aggregate Bond	1.50	31[3]	6.42	0.13	0.97	-2.43
U.S. Treasury	0.93	–	6.91	0.17	0.99	-3.30
U.S. Government Related	1.38	45[3]	6.05	-0.03	0.82	-2.06
U.S. Corporate Investment Grade	2.16	90[3]	8.58	0.23	1.40	-3.31
U.S. Mortgage-Backed Securities	1.67	10[3]	3.88	0.00	0.55	-0.56
U.S. Commercial Mortgage-Backed Securities	1.55	65[3]	5.21	0.14	1.11	-1.24
U.S. Asset-Backed Securities	0.50	31[3]	2.05	0.03	0.16	0.00
Preferred Securities	2.52	140[3]	4.67	0.17	1.42	1.00
High Yield 2% Issuer Capped	4.05	299[3]	3.83	-0.03	0.87	1.74
Senior Loans[4]	4.84	449	0.25	0.01	0.42	2.43
Global Emerging Markets	3.88	275[3]	6.84	0.11	1.46	-2.07
Global Aggregate (unhedged)	1.10	32[3]	7.44	0.35	1.63	-2.91

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, 23 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, 23 Apr 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 21 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.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Past performance is no guarantee of future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an 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 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.

Nuveen provides investment advisory solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.