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Weekly Fixed Income Commentary

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Treasury yields rise as inflation data surprises

U.S. Treasury yields rose sharply last week after inflation data showed a sharper uptick in prices than expected. The moves partially reversed later in the week, but ultimately almost all areas of the global bond market ended the week with negative returns.

HIGHLIGHTS

- **Investment grade credit, emerging markets, and CMBS all posted negative total returns, but outperformed similar-duration Treasuries. MBS, preferreds and high yield credit returns were negative, but underperformed versus Treasuries.**
- **Municipal bond yield rose moderately. New issue supply was $6.7 billion, with flows of $750 million. This week's new issue supply is outsized at $9.3 billion ($1.7 billion taxable).**
- **Senior loans were a notable bright spot, posting positive total returns despite volatility in other asset classes.**

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Watchlist

- *Treasury yields rose last week, and we continue to anticipate further increases throughout 2021*
- *Spread assets were well-supported versus Treasuries, and strong growth should continue to support fundamentals moving forward*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. Attention remains on the eventual tapering of purchases, but we do not expect that to happen any time soon.

Unprecedented global fiscal stimulus should boost consumption and growth this year. First quarter GDP rose at a robust pace of 6.4%.

Record supply of investment grade corporates has been followed by high levels of 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.

TAXABLE SEGMENTS SEE MAINLY NEGATIVE RETURNS

U.S. Treasury yields rose last week, after April's consumer price inflation data showed a surprisingly large uptick in prices. The headline index rose 0.8% for the month, taking the year-over-year rate to 4.2%. That is the highest level of inflation since 2008. Core prices, which strip out volatile food and energy components, were up even more, 3.0% year-over-year, for the fastest increase since 1996. However, most of the upturn can be explained by a combination of a) temporary factors due to the post-COVID reopening, and b) base effects from comparing to last spring's depressed levels. 10-year Treasury yields initially rose as much as 11 basis points (bps) for the week before paring the increase later in the week to end only 5 bps higher.

Investment grade credit weakened in tandem with the move in Treasuries, posting negative returns of -0.47%. However, spreads were actually -1 bp tighter for the week, and the asset class outperformed similar-duration Treasuries by 5 bps. After the inflation data-driven weakness, buyers stepped in, especially from outside the U.S., resulting in positive total returns on Thursday and Friday.

High yield credit also sold off, with total returns of -0.26%. Unlike high grade credit, high yield underperformed by -12 bps versus similar-duration Treasuries, as buyers were less willing to step in and support the lower-quality market segment. Loans were better supported, as they benefit from higher rates. Price levels were basically flat for the week despite the volatility in other asset classes, and inflows continued to be positive at $761 million. Loans ultimately returned 0.12% for the week, the only major taxable market segment with positive returns.

Emerging markets followed the move in Treasuries, with yields rising by around 4 bps in both sovereign and corporate markets. Similar to the dynamics seen in U.S. investment grade, Asian investors stepped in to buy higher-rated emerging market debt later in the week after the inflation-driven selloff. Spreads ultimately ended around 2 bps tighter, but total returns were -0.20%.

HIGH YIELD MUNICIPALS REMAIN RESILIENT

Municipal bond yields rose moderately this last week, along with Treasuries. Some new issue deals were difficult to sell, so underwriters raised yields where necessary to clear the market. This week's new issuance should also be priced to clear the market.

The economy is heating up in some areas, suggesting interest rates should rise. But employment is not rebounding as quickly as hoped. As a result, the fixed income market remains range bound. We expect the market will continue to trade sideways until we have better insight on the strength of the economy. Tax-exempt bond prices should remain well bid, as outsized reinvestment of $122 billion should return in June, July and August.

Fairfax County, Virginia, issued $216 million sewer revenue bonds (rated Aaa/AAA). Some bonds traded at a premium in the secondary market. The 15-year bond with a 5% coupon issued at a yield of 1.36% traded in the secondary at 1.30%. This shows the continued demand for tax-exempt bonds with large block sizes.

High yield municipal performance continues to be resilient. In the face of last week's increasing yields for U.S. Treasuries and AAA-rated municipal bonds, high yield municipal bond yields decreased. Demand remains robust, as fund inflows re-accelerated to $487 million last week. New issuance remains below average, but with consistent deals from the land secured, charter schools, health care and industrial development sectors. This week will also see a large Guam issuance for Business Privilege Tax bonds. Puerto Rico's restructuring process is progressing for general obligation, clawback and PREPA bonds, making more investors focused on highway bonds and their possible successful restructuring as HTA bonds continue trading at large discounts.

Senior loans were the only major taxable market segment with positive returns.

In focus

Convertibles offer two sides

Convertible securities originated more than a century ago, when railroad companies in the then-emerging U.S. economy needed to raise capital. The convertible market has since evolved into a dynamic global arena where the structure of mixing debt and equity provides compelling opportunities.

Convertibles allow investors to participate in potential equity price appreciation with limited downside risk, provided by the debt feature.

Two main determinants of a convertible security's performance are parity and conversion premium. Parity is the value of a convertible security if it were converted into stock. The conversion premium is the price an investor must pay above parity to own the convertible.

Additionally, the investment value is independent of the price of the underlying stock, and provides a theoretical floor below which the bond should not trade, given an unchanged interest rate environment. As the underlying equity increases, the parity of the bond also increases, though if the underlying equity declines, the convertible price is supported by the investment value.

We believe convertibles can potentially improve risk/return characteristics for investors, and can be considered part of a broad asset allocation strategy. What's more, since convertibles are not perfectly correlated with either stocks or bonds, their addition to a portfolio may help damp overall volatility.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	0.00	-0.01	0.03
5-year	0.81	0.04	-0.03	0.45
10-year	1.63	0.05	0.00	0.71
30-year	2.34	0.06	0.04	0.70

Source: Bloomberg L.P., 14 May 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	0.14	0.03	0.04	0.00
5-year	0.50	0.05	0.07	0.28
10-year	1.02	0.05	0.03	0.31
30-year	1.60	0.05	0.01	0.21

Source: Bloomberg L.P., 14 May 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	63
30-year AAA Municipal vs Treasury	68
High Yield Municipal vs High Yield Corporate	82

Source: Bloomberg L.P., Thompson Reuters, 14 May 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	1.06	–	5.12	-0.17	0.02	0.51
High Yield Municipal	3.36	195[1]	6.49	0.17	0.54	4.16
Short Duration High Yield Municipal[2]	2.79	205	3.63	0.09	0.27	3.23
Taxable Municipal	2.37	76[3]	9.74	-0.43	-0.06	-2.06
U.S. Aggregate Bond	1.54	31[3]	6.50	-0.37	-0.09	-2.70
U.S. Treasury	0.96	–	6.96	-0.40	-0.10	-3.63
U.S. Government Related	1.39	43[3]	6.05	-0.25	0.07	-2.11
U.S. Corporate Investment Grade	2.17	86[3]	8.57	-0.47	0.04	-3.55
U.S. Mortgage-Backed Securities	1.76	13[3]	4.10	-0.29	-0.29	-0.84
U.S. Commercial Mortgage-Backed Securities	1.53	62[3]	5.21	-0.13	0.33	-1.07
U.S. Asset-Backed Securities	0.47	29[3]	2.03	-0.02	0.10	0.08
Preferred Securities	3.00	175[3]	4.78	-0.51	-0.16	0.71
High Yield 2% Issuer Capped	4.13	304[3]	3.88	-0.26	0.03	1.98
Senior Loans[4]	4.82	450	0.25	0.12	0.18	2.71
Global Emerging Markets	3.87	270[3]	6.86	-0.20	0.37	-1.84
Global Aggregate (unhedged)	1.16	32[3]	7.44	-0.46	0.17	-3.09

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, 14 May 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, 14 May 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 12 May 2021. **Municipal reinvestment:** JPMorgan.

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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