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Weekly Fixed Income Commentary

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Jobs report disappoints, Treasury yields decline

U.S. Treasury yields fell after the May jobs report fell short of high expectations. The Federal Reserve surprisingly announced that it will begin winding down holdings of corporate credit, but weak economic data ultimately reinforced expectations that policy will remain accommodative for longer.

HIGHLIGHTS

- **Fixed income markets gained broadly, helped by the move in Treasuries. Preferreds, high yield corporates and emerging markets led gains, outperforming similar-duration Treasuries.**
- **Municipal bond prices rallied. New issue supply was $5.5 billion, with flows of $999 million. This week's new issue supply is expected to be outsized at $12.7 billion ($3.5 billion taxable).**
- **Investment grade corporates and mortgage-backed securities lagged comparable Treasuries, but posted positive total returns.**

Anders Persson
CIO of Global Fixed Income

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Watchlist

- *Treasury yields fell last week, but we continue to anticipate further increases in the months ahead*
- *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. Investors remain focused 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 6.4% pace.

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 appear 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.

FIXED INCOME MARKETS ENJOY A BOOST

U.S. Treasury yields fell last week, with all of the declines coming on Friday after another disappointing jobs report. The U.S. economy added 559,000 jobs in May, less than the 675,000 expected. Average hourly earnings rose +0.5% month-over-month, faster than expected. The 10-year yield ultimately ended -5 basis points (bps) lower, with both inflation breakevens and real rates declining, and the curve flattening somewhat.

Investment grade corporates benefited from the move in Treasuries, returning 0.23%. Attention focused on the surprise announcement from the Fed that it will begin winding down its $4.9 billion of cash bonds and $8.6 billion of ETF holdings. It will start selling ETFs as soon as this week, with the cash bond portion of the liquidation to start later this summer. The move marks another concrete step toward removing monetary accommodation, though the policy change is unlikely to impact spreads. Overall, the liquidation will equal approximately 0.14% of secondary trading volumes between now and year-end. Investor confidence that the Fed now has the ability to intervene directly in credit markets in a future crisis is more important, and that has not changed.

High yield corporates rallied as well, gaining 0.28% for the week, with lower-quality segments outperforming. CCC-rated bonds gained 0.46%, even though valuations are relatively full after the recent multi-month rally. Supply was on the lower end of expectations at $6.5 billion, but $10 billion per week is expected for the remainder of June. Similar dynamics emerged in the loan market, with a robust appetite for risk. We saw some selling of lower-yielding names which already trade at par, and some buying of still-discounted names.

Global yields followed the dynamics in Treasuries, with emerging markets gaining 0.19%. Even though the dollar index edged 0.1% higher, emerging markets currencies still gained around 0.51%. The asset class was helped by a renewed rally in commodities, with WTI oil prices gaining 5.0% to touch a fresh two-year high. There was some enthusiasm from issuers to get deals done before the summer doldrums, but emerging markets saw inflows of $1.5 billion, which helped technicals remain supportive. In developed markets, yields mirrored the Treasury market, with 10-year German bund yields down -3 bps.

DEMAND FOR MUNICIPALS SHOULD REMAIN HIGH

The municipal bond market rallied last week, and ended Friday with a constructive tone.

Bond markets rallied on the news of Friday's disappointing monthly employment number. Since the economic recovery is showing signs of stalling, inflation concerns appear off the table. And the Fed has been adamant that rates will remain low until the U.S. economy is well on its way to full employment. We think demand for fixed income in general and municipals in particular will remain high over the summer. From June through August, $180 billion of coupon and principal reinvestment money will be available. It is projected that $30 billion of investor demand will enter the system through mutual funds.

The Metropolitan Washington Airports Authority issued $897 million airport revenue bonds, subject to the alternative minimum tax (rated Aa3/A+). The deal was well received, and bonds traded at a premium in the secondary market. For example, a 30 year bond with a 4% coupon issued at a yield of 2.03% traded in the secondary market at 1.99%. In March 2020, it was difficult to get a bid on an airport bond. This sector is now trading near pre-pandemic levels.

High yield municipal bonds remain in high demand. Yields tightened again last week as fund flows remained very robust at $340 million, albeit slower then recent breakneck paces. New issue deals were routinely extremely oversubscribed, as demand is being bolstered by June reinvestment cash flows. While some deals were as much as 30x oversubscribed, investors demonstrated vigilance as a few highly speculative project revenue deals were unable to clear the market.

From June through August, $180 billion of municipal coupon and principal reinvestment money will be available.

In focus

Jobs report supports risk-on

The May jobs report was weaker than expected, at 100,000 fewer jobs created than anticipated. The unemployment rate fell slightly to 5.8%, partially due to a modest yet surprising fall in the labor force participation rate to 61.6%. The labor market remains far weaker than in early 2020, and the pace of improvement has disappointed.

Average hourly earnings increased 0.5% month-over-month, taking the two-month annualized rate to a very strong 7.4%. This suggests robust demand for labor, but workers are likely deterred by generous unemployment benefits, lack of childcare options and lingering COVID-19 concerns.

The combination of disappointing job growth but accelerating wage pressures could present a dilemma for the Fed, as it seeks to support employment growth but maintain stable prices. Ultimately, the Fed places a greater weight on minimizing employment shortfalls. "Substantial further progress" in employment has been interpreted as around 1 million jobs per month, far below the recent trend.

Looking ahead, watch the employment-to-prime-age-population ratio, which controls for changes in the participation rate and demographics. It increased to 70.4% from 70.2% for the month, but far short of the pre-covid level of 74.2%. At the latest 3-month pace of job growth, it would take 15 months to close the gap; at the 6-month pace, it would take 23 months. Until this dynamic changes, the Fed is likely to remain accommodative, supporting our preference for risk-on positioning.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	0.01	0.01	0.03
5-year	0.78	-0.02	-0.02	0.42
10-year	1.56	-0.04	-0.04	0.64
30-year	2.23	-0.05	-0.05	0.59

Source: Bloomberg L.P., 04 Jun 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	0.10	0.00	0.00	-0.04
5-year	0.44	-0.04	0.01	0.22
10-year	0.96	-0.03	-0.03	0.25
30-year	1.48	-0.03	-0.11	0.09

Source: Bloomberg L.P., 04 Jun 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	62
30-year AAA Municipal vs Treasury	66
High Yield Municipal vs High Yield Corporate	58

Source: Bloomberg L.P., Thompson Reuters, 04 Jun 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	1.00	–	5.06	0.21	0.21	0.99
High Yield Municipal	3.23	194[1]	6.09	0.40	0.40	5.21
Short Duration High Yield Municipal[2]	2.70	201	3.61	0.13	0.13	3.81
Taxable Municipal	2.28	76[3]	9.73	0.31	0.31	-1.05
U.S. Aggregate Bond	1.50	32[3]	6.55	0.12	0.12	-2.17
U.S. Treasury	0.92	–	6.98	0.13	0.13	-3.07
U.S. Government Related	1.36	43[3]	6.09	0.16	0.16	-1.63
U.S. Corporate Investment Grade	2.11	85[3]	8.65	0.23	0.23	-2.63
U.S. Mortgage-Backed Securities	1.74	19[3]	4.21	0.01	0.01	-0.72
U.S. Commercial Mortgage-Backed Securities	1.46	59[3]	5.21	0.13	0.13	-0.57
U.S. Asset-Backed Securities	0.41	25[3]	1.99	0.01	0.01	0.21
Preferred Securities	2.67	158[3]	4.69	0.41	0.41	1.86
High Yield 2% Issuer Capped	4.03	298[3]	3.89	0.28	0.28	2.53
Senior Loans[4]	4.73	445	0.25	0.07	0.07	3.13
Global Emerging Markets	3.81	269[3]	6.90	0.19	0.19	-1.12
Global Aggregate (unhedged)	1.12	33[3]	7.50	0.07	0.07	-2.48

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, 04 Jun 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, 04 Jun 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 02 Jun 2021. **Municipal reinvestment:** Bank of America.

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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