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Weekly Fixed Income Commentary

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Treasury yields rise amid improved risk sentiment

U.S. Treasury yields rose last week as investors continued to digest the June Federal Reserve meeting. Economic data were generally in line with expectations and fiscal policymakers reached a deal on a U.S. infrastructure package, though the final agreement will take time and likely end up larger than this initial announcement.

HIGHLIGHTS

- **Longer-duration assets retreated, with investment grade corporates and emerging markets sovereigns generating negative returns, but outperforming similar-duration Treasuries.**
- **Shorter-duration assets outperformed, as mortgage-backed securities, high yield corporates and loans produced positive returns.**
- **Municipal bond yields rose slightly. New issue supply was $6.8 billion, with flows of $1.3 billion. This week's new issue supply is light again at $6.8 billion.**

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Watchlist

- *Treasury yields rose last week, and 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

- Policymakers become cautious and remove accommodation too early.
- 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.

RISK SENTIMENT BOOSTS HIGH YIELD CORPORATES

U.S. Treasury yields rose last week, as the market continued to digest the surprisingly hawkish June Fed meeting results. The yield curve steepened and rates rose, challenging returns for Treasuries and the broader fixed income market. Economic data generally came in line with expectations, with core PCE inflation (the Fed's official target) matching expectations at 3.4% year-over-year. Global PMIs accelerated in Europe and moderated in the U.S., though a robust economic expansion continues. On the policy front, the Biden administration reached a deal with a bipartisan group of senators for an initial infrastructure package totaling around $580 billion of new spending. But this is likely only the first step toward a much larger reconciliation package later this year. Rates did not move materially after the fiscal deal was announced.

Investment grade corporates weakened with the selloff in rates, returning -0.70% but generating 12 basis points (bps) of outperformance versus similar-duration Treasuries. Spreads were generally steady at their recent tight levels, though some areas of the reopening trade continue to perform well, with the gaming sector tightening -4 bps. As we approach the halfway point of the year, overall supply is running -32% below the blockbuster levels of 2020. However, there has been a large shift in composition, with financials (+13%) outpacing industrials (-14%).

High yield corporates continued to perform well, as the sector was helped by the risk-on sentiment and was less affected by the selloff in longer-duration bonds. High yield generated total returns of 0.37%, which equated to 55 bps of outperformance versus similar-duration Treasuries. That puts the asset class on track for its best month of relative performance since December. Meanwhile, loans also performed well, gaining 0.09% in total returns, as demand remains supported by both CLO buying and retail demand.

Emerging markets matched the moves in other credit markets, facing headwinds from rising rates but benefiting from risk sentiment. The asset class returned -0.24%, but outperformed similar-duration Treasuries by 28 bps. Several emerging markets countries started to tighten policy, partially in response to the hawkish shift from the Fed. Curves in those countries generally flattened and their currencies rallied.

HIGH YIELD MUNICIPAL CREDIT SPREADS EXPERIENCE DOWNWARD PRESSURE

Both municipal and Treasury yields rose slightly last week, but both markets had constructive tones. Some municipal deals struggled to get sold, and underwriters cheapened deals to clear the market. We expect this trend to continue this week.

The fixed income market remains range bound, with investors evenly divided. Many feel the economy will overheat as the Fed provides very low interest rates to help the economy recover, which could lead to higher interest rates. However, just as many believe that the current inflation signals are merely a blip, meaning rates would remain lower for longer. We probably won't get a true feel for what will happen until later this year. Thus, rates should remain range bound. Tax-exempt yields should also hold steady, as the municipal market has $180 billion of reinvestment money to deploy during the summer.

The Pennsylvania Turnpike Commission issued $388 million turnpike revenue bonds (rated A1/A+). Market acceptance for a turnpike bond was strong and the deal was completely sold. This deal demonstrates that the market believes the ill effects of the pandemic are over, expecting people to resume driving as much they did previously.

In the high yield municipal market, fundamental and technical trends are firmly in place. And the typical summer seasonal strength trend is providing an additional boost. Credit spreads continue to experience downward pressure and drive below +200 bps on average, but relative value dispersion still exists. Fund flows remain robust, and supply will likely contract ahead of the 4th of July holiday in the U.S.

High yield corporates are on track to post the best month of outperformance versus similar-duration Treasuries since December.

In focus

TIPS stabilize after Fed jolt

Treasury Inflation Protected Securities (TIPS) are among this year's top-performing fixed income sectors. Demand for TIPS has risen amid upside surprises in Consumer Price Index (CPI) data and higher breakevens (a market-based gauge of inflation expectations), which hit an eight-year peak in May.

At its June meeting, the Fed raised its inflation forecasts, with Chair Jerome Powell acknowledging "the possibility that inflation could turn out to be higher and more persistent than we anticipate."

Markets interpreted the tone of the meeting and its accelerated dot plot as evidence of a more hawkish Fed — less tolerant of inflation running too hot for too long, and one that was more willing to tighten monetary policy sooner rather than later.

Inflation breakevens fell and TIPS performance suffered in the immediate wake of the meeting, but have since stabilized. This suggests markets recognize they overreacted and generally remain aligned with the Fed's assessment that recent spikes in inflation are transitory, largely driven by the base effects of year-ago comparisons (which should fade) and supply chain bottlenecks (which should ease).

That said, both the markets and the Fed may be underestimating some medium-term inflation factors. These include an inevitable rise in wages in a post-pandemic "new world order" and higher fixed costs (real estate) for companies that require employees to return to the office.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.27	0.01	0.12	0.15
5-year	0.92	0.05	0.12	0.56
10-year	1.53	0.09	-0.07	0.61
30-year	2.15	0.14	-0.13	0.50

Source: Bloomberg L.P., 25 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	0.16	0.00	0.06	0.02
5-year	0.50	0.00	0.07	0.28
10-year	1.01	0.05	0.02	0.30
30-year	1.52	0.07	-0.07	0.13

Source: Bloomberg L.P., 25 Jun 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	66
30-year AAA Municipal vs Treasury	73
High Yield Municipal vs High Yield Corporate	82

Source: Bloomberg L.P., Thompson Reuters, 25 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	1.03	–	5.05	-0.17	0.14	0.93
High Yield Municipal	3.14	180[1]	5.92	0.04	0.99	5.83
Short Duration High Yield Municipal[2]	2.58	188	3.57	0.11	0.77	4.49
Taxable Municipal	2.25	73[3]	9.67	-0.92	0.82	-0.55
U.S. Aggregate Bond	1.54	32[3]	6.59	-0.41	0.30	-2.00
U.S. Treasury	0.99	–	6.98	-0.57	0.19	-3.02
U.S. Government Related	1.41	43[3]	6.11	-0.35	0.26	-1.53
U.S. Corporate Investment Grade	2.10	81[3]	8.67	-0.70	0.98	-1.90
U.S. Mortgage-Backed Securities	1.81	25[3]	4.31	0.07	-0.18	-0.91
U.S. Commercial Mortgage-Backed Securities	1.53	58[3]	5.18	-0.37	-0.04	-0.74
U.S. Asset-Backed Securities	0.49	23[3]	2.03	-0.03	-0.08	0.12
Preferred Securities	2.52	140[3]	4.55	0.08	1.00	2.46
High Yield 2% Issuer Capped	3.87	276[3]	3.85	0.37	1.07	3.34
Senior Loans[4]	4.81	443	0.25	0.09	0.35	3.42
Global Emerging Markets	3.81	264[3]	6.91	-0.24	0.60	-0.70
Global Aggregate (unhedged)	1.15	33[3]	7.49	-0.04	-0.67	-3.20

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, 25 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, 25 Jun 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 23 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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