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Weekly Fixed Income Commentary

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Moderating economic data push Treasury yields slightly lower

U.S. Treasury yields fell slightly, while spreads on corporates and structured products widened. Retail sales fell in July and the Federal Reserve took another step toward tapering asset purchases.

HIGHLIGHTS

- **Treasuries saw positive total returns, as did investment grade corporates, emerging markets and taxable municipals.**
- **High yield corporates, preferred securities and convertibles all registered negative total returns.**
- **Municipal bond yields remained unchanged. New issue supply was $9.3B, with flows of $1.8B. This week's new issue supply should be $7.9B.**

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Watchlist

- *Treasury yields fell last week, but we continue to anticipate increases in the months ahead*
- *Spread assets widened somewhat as economic growth slowed and expectations picked up for the withdrawal of monetary policy accommodation*
- *Municipal bonds are unlikely to remain so rich*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. Investors continue to focus 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, with second quarter GDP growth approaching 10%.

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 also 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.

INVESTMENT GRADE CORPORATES GAIN

U.S. Treasury yields fell slightly last week, with the 10-year yield ending -2 basis points (bps) lower at 1.26%. The yield curve flattened, with some measures reaching their narrowest levels since last August. The 30-year yield fell -6 bps for the week, while 2-year yields rose 2 bps. July retail sales fell -1.1%, indicating a weaker pace of consumer spending than expected. Additionally, the minutes of the July Fed meeting suggested a growing preference to announce tapering at the November meeting. The former dynamic drove 10-year inflation breakevens down -12 bps, their sharpest weekly drop since April 2020. At the same time, the latter dynamic around Fed tapering pushed 10-year real yields 10 bps higher. This combination of slower growth and reduced monetary accommodation could be a headwind for risk assets, though the net effect so far has been modestly lower rates, which has cushioned the impact on fixed income markets.

Investment grade corporates gained, returning 0.19%, though they underperformed similar-duration Treasuries by -22 bps. Supply and trading activity was muted, with only around $4 billion of new issuance, less than the $10 to $15 billion expected. This week, only another $5 billion is expected. Inflows were strong, with another $4.3 billion entering the asset class, building on the prior week's strong inflow.

High yield corporates weakened again, returning -0.06% and underperforming similar-duration Treasuries by -13 bps. Similar to the dynamics in high grade markets, activity was slow, with only $5 billion of new issuance. The market saw a small inflow of $4 million, while loan funds had stronger inflows of $352 million. The loan market returned 0.06% on the week.

Emerging markets gained 0.15% on the week, though they underperformed similar-duration Treasuries by -5 bps. Hard currency sovereign yields fell -2 bps, matching the move in Treasuries, but local currency debt yields rose 2 bps. Local currency debt was pressured somewhat by the stronger dollar, which rallied 1.1% on the week after the Fed's hawkish signal on tapering. The strong dollar weighed on commodity prices, with oil, copper, and iron prices down -9.0%, -5.6% and -5.7%, respectively, for the week, which negatively impacted commodity-reliant emerging markets.

MUNICIPAL YIELDS EXPECTED TO DRIFT CHEAPER

Municipal yields remained unchanged last week, while Treasury yields were steady on the short end and moved moderately lower on the longer end.

The Fed indicated last week it may begin to taper its accommodative monetary policy by year end. This suggests interest rates would gradually rise as the economy continues to normalize to prepandemic levels. However, with more signs that the Delta variant may hamper reopening, interest rates remained unchanged. We expect this stalemate to continue until the ongoing pandemic eases. Municipal yields will probably drift cheaper, as yields remain rich to Treasuries and the fall new issue calendar promises to be robust. But a lot of cash remains on the sidelines waiting to be invested at cheaper levels.

Miami-Dade County issued $701 million seaport revenue bonds (both AMT and non-AMT, rated A3/AA), with some backed by an insurance policy from AGMC. Insured 3% coupon bonds due in 2050 were issued at a yield of 2.39%. Those bonds traded in the secondary market at a yield of 2.35%. Institutional investors continue to have strong demand for large blocks of tax-exempt bonds.

The high yield municipal market remains well bid as fundamentals continue to improve. Fund flows continue at record pace, and even the robust number of new deals coming to market is not enough to satisfy demand. The growing progress of the Puerto Rico bond restructurings is a major force contributing to market demand.

High yield corporates saw a small inflow, while loan funds had stronger inflows.

In focus

Convertibles take center stage

Convertible bonds – hybrid securities with both equity and debt characteristics - have reached an inflection point and may be set to enter a new growth phase. Following exceptional returns of more than 40% in 2020, expectations remain high in 2021, driven primarily by strong underlying equity returns and supplemented with tightening credit spreads and attractive income.

Following a year ravaged by the COVID-19 crisis, the standout returns of convertible bonds since the market's bottom were accompanied by record new issuance, the largest organic growth in decades, a breakout from the prior peak in market size (set in 2008), a significantly broadening issuer base and substantially better liquidity (trading volumes and turnover). This momentum has carried over into 2021, aided by positive fund flows and an expanding investor base.

In today's environment, we find the risk/reward tradeoff of converts attractive, and their low duration characteristics particularly appealing. Convert market technicals have strengthened, aggregate valuations are fair, credit spreads offer relative value and default risk exposure is minimal. The asset class could also benefit from significant innovation taking place in its top three represented industries: technology, health care and consumer discretionary.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.23	0.02	0.04	0.10
5-year	0.78	0.01	0.09	0.42
10-year	1.26	-0.02	0.03	0.34
30-year	1.87	-0.06	-0.02	0.23

Source: Bloomberg L.P., 20 Aug 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	0.08	0.00	0.02	-0.06
5-year	0.38	0.00	0.02	0.16
10-year	0.88	0.00	0.06	0.17
30-year	1.50	0.00	0.11	0.11

Source: Bloomberg L.P., 20 Aug 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	70
30-year AAA Municipal vs Treasury	80
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters, 20 Aug 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	0.94	–	5.11	0.02	-0.29	1.60
High Yield Municipal	2.95	164[1]	5.83	0.06	-0.09	7.30
Short Duration High Yield Municipal[2]	2.44	182	3.41	0.05	0.16	2.12
Taxable Municipal	2.05	74[3]	9.75	0.41	0.16	2.12
U.S. Aggregate Bond	1.43	38[3]	6.67	0.16	-0.15	-0.65
U.S. Treasury	0.86	–	7.22	0.30	0.00	-1.25
U.S. Government Related	1.25	41[3]	6.13	0.19	0.07	-0.29
U.S. Corporate Investment Grade	2.00	91[3]	8.81	0.19	-0.31	-0.23
U.S. Mortgage-Backed Securities	1.71	38[3]	4.11	-0.05	-0.25	-0.40
U.S. Commercial Mortgage-Backed Securities	1.41	62[3]	5.16	0.07	-0.18	0.25
U.S. Asset-Backed Securities	0.53	27[3]	2.23	0.01	-0.04	0.34
Preferred Securities	2.73	164[3]	4.71	-0.04	0.06	3.32
High Yield 2% Issuer Capped	4.17	313[3]	3.93	-0.06	-0.41	3.58
Senior Loans[4]	4.87	453	0.25	0.06	0.21	3.69
Global Emerging Markets	3.90	290[3]	7.01	0.15	0.42	-0.01
Global Aggregate (unhedged)	1.00	35[3]	7.60	-0.32	-0.63	-2.53

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, 20 Aug 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, 20 Aug 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 18 Aug 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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