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Weekly Fixed Income Commentary

18 October 2021

Positive economic data leave Treasury yields mixed

U.S. Treasury yields were mixed last week, rallying overall amid sharp curve flattening. Economic data remain strong, and the market anticipates the removal of Federal Reserve policy accommodation.

HIGHLIGHTS

- **Treasuries, agencies, mortgage-backed securities, investment grade and high yield corporates, preferreds, convertibles, loans, and emerging markets all rallied.**
- **Asset-backed securities posted the weakest returns across fixed income markets.**
- **Municipal bond yields remained mostly unchanged. New issue supply was $7.8B, with flows of $461MM. This week's new issue supply is outsized at $12.8B ($3.9B taxable).**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *Treasury yields were mixed last week, and we continue to anticipate higher rates into year end.*
- *Spread sectors performed well.*
- *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, which we expect to happen later this year.

Unprecedented global fiscal stimulus should continue to boost consumption and growth into next year.

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

- Inflation rises in a disorderly way, negatively impacting asset values.
- Policymakers remove accommodation too rapidly, undermining the expansion.
- Further complications with the COVID-19 vaccine rollout and the Delta variant.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

EMERGING MARKETS GAIN, BUT STILL LAG

The Treasury curve flattened further last week, with 10-year yields falling -4 bps and 2-year yields rising 8 bps. Economic data were mostly positive, with retail sales beating expectations and continuing to run almost 14% above the pre-pandemic trend. Inflation data surprised to the upside again, with headline consumer prices rising 0.4% in September, taking the year-over-year rate back to 5.4%. Core prices rose more modestly, though inflation seems to be broadening to more categories. Finally, the minutes of the September FOMC meeting showed consensus building for an eight-month taper to be announced at next month's meeting.

Investment grade corporates outperformed, returning 0.71% and beating similar-duration Treasuries by 22 bps. Longer-duration bonds garnered more demand, with shorter-term areas seeing some selling. U.S. banks performed especially well after universally strong third quarter earnings reports, with spreads tightening slightly. Supply was on the lower end of expectations, with only six issuers bringing around $15 billion of new issuance in the holiday-shortened week.

High yield corporates also gained, returning 0.16% and outperforming similar-duration Treasuries by 20 bps. The asset class lagged high grade somewhat, as technicals were less supportive. Supply was on the high side at $10 billion, while outflows of $1.8 billion were the largest since mid-June. Loans also rallied, returning 0.05%, with the 12th consecutive weekly inflow. Focus was on the first loan issuance with SOFR-linked language, rather than LIBOR. There was some back-and-forth between the issuer and the buy side regarding the exact language, before settling on 10 bps, 15 bps and 25 bps above SOFR for 1-, 3-, and 6-month benchmarks, respectively. It remains to be seen what the new convention will be moving forward.

Emerging markets gained, but still lagged other fixed income markets, returning 0.21% and underperforming similar-duration Treasuries by -2 bps. The asset class saw the fourth consecutive week of outflows, at -$2.7 billion. That said, the market rallied at the end of the week. Rumors circulated regarding two China property companies, Kaisa and Shimao, with speculation that they may fail to make upcoming payments. Their bond fell by around 8 points. Both companies publicly refuted the rumors, and regulators loosened mortgage restrictions for the rest of the year.

STRONG DEMAND FOR MUNIS CONTINUES

The municipal bond market remained basically unchanged last week.

The fixed income market in general has a good tone. The Treasury market just finished its quarterly auctions, and all three auctions were well received at the recently adjusted (cheaper) levels. As we said last week, municipals have also sold off, and strong demand continues at these cheaper levels. We expect this pattern of equilibrium to continue through year end. New issue supply should remain outsized, but there is a significant amount of cash ready to be deployed on the longer end of the municipal yield curve.

Florida Turnpike Authority issued competitively priced $272 million revenue bonds (rated Aa2/AA). The deal was brought at a cheap level and most bonds were sold by the end of the week. For reference, the 10-year maturity came at a yield of 1.30% while the 10-year Treasury bond was trading at approximately 1.55%. This is 84% of the 10-year Treasury bond, which is attractive for a high grade tax-exempt bond.

High yield municipal outflows ended last week, as adjusted yield levels attracted investors and U.S. Treasury yield volatility stabilized. This week's new issue calendar is healthy again, with many new deals to choose from, which can help satisfy investors still managing significant cash balances. Despite unsurprising political theater, it appears the path has been cleared to restructuring Puerto Rico's GO obligations. A fully executed restructuring would become a major technical boost to the asset class.

High yield corporates lagged high grades, as technicals were less supportive.

In focus

Mixed returns on tap for 2021

A sharp rise in interest rates has weighed on fixed income market returns in 2021. With a total return of -1.72% so far this year, the Bloomberg U.S. Aggregate Bond Index is on pace for its fourth negative annual return since its inception in 1976. Its lowest annual return was -2.92% in 1994.

In contrast, several non-Treasury sectors have produced positive returns, supported by tightening spreads. Asset-backed securities and senior loan returns also benefited from their short duration profiles. High yield corporates and preferred securities have enjoyed solidly positive total returns, boosted by strong investor demand for yield.

Similarly, high yield municipal bonds have outperformed, with the Bloomberg Municipal High Yield Index returning 6.10% this year. While the broader municipal market has posted positive returns, higher quality credit has underperformed, with AAA-rated bonds posting negative returns. Furthermore, with the recent rise in interest rates, municipals posted negative returns across the curve in the trailing three months.

The recent pullback and upcoming year end presents an opportunity to consider potential for tax loss harvesting within portfolios.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.40	0.08	0.12	0.27
5-year	1.13	0.06	0.16	0.76
10-year	1.57	-0.04	0.08	0.66
30-year	2.04	-0.12	0.00	0.40

Source: Bloomberg L.P., 15 Oct 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	0.18	0.00	0.01	0.04
5-year	0.52	0.00	0.02	0.30
10-year	1.17	-0.01	0.03	0.46
30-year	1.68	-0.01	0.01	0.29

Source: Bloomberg L.P., 15 Oct 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	74
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	77

Source: Bloomberg L.P., Thompson Reuters, 15 Oct 2021. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg High Yield Municipal Index divided by the yield-to-worst for the Bloomberg 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	1.15	–	5.22	0.06	-0.10	0.69
High Yield Municipal	3.21	173[1]	6.73	-0.10	-0.40	6.10
Short Duration High Yield Municipal[2]	2.71	184	7.71	0.04	-0.09	4.95
Taxable Municipal	2.28	71[3]	9.74	0.65	0.02	0.52
U.S. Aggregate Bond	1.64	33[3]	6.77	0.33	-0.17	-1.72
U.S. Treasury	1.11	–	7.12	0.29	-0.22	-2.71
U.S. Government Related	1.49	41[3]	6.13	0.27	-0.19	-1.47
U.S. Corporate Investment Grade	2.20	85[3]	8.71	0.71	-0.06	-1.33
U.S. Mortgage-Backed Securities	1.88	25[3]	4.73	0.07	-0.18	-0.85
U.S. Commercial Mortgage-Backed Securities	1.68	59[3]	5.12	-0.02	-0.33	-0.85
U.S. Asset-Backed Securities	0.77	31[3]	2.36	-0.13	-0.21	0.02
Preferred Securities	2.88	157[3]	4.70	0.59	-0.05	3.39
High Yield 2% Issuer Capped	4.18	290[3]	3.98	0.15	-0.18	4.35
Senior Loans[4]	4.85	437	0.25	0.05	0.16	4.82
Global Emerging Markets	4.30	304[3]	6.98	0.21	-0.58	-1.71
Global Aggregate (unhedged)	1.23	33[3]	7.56	0.23	-0.13	-4.19

1 Yield difference between the Bloomberg 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, 15 Oct 2021. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg. 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, 15 Oct 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 13 Oct 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 Municipal Index; **high yield municipal:** Bloomberg High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index; **U.S. government related:** Bloomberg U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Global Aggregate Unhedged Index.

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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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