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Weekly Fixed Income Commentary

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Rising inflation data boost Treasury yields

U.S. Treasury yields rose last week after another high U.S. inflation print and a surprisingly weak 30-year Treasury auction. Spread assets felt the pressure, but we expect strong fundamentals to support credit market returns moving forward.

HIGHLIGHTS

- **Most fixed income market segments weakened, including mortgage-backed securities, investment grade and high yield corporates, preferreds, convertibles and emerging markets.**
- **Loans had positive total returns, while high yield corporates and emerging markets both outperformed versus similar-duration Treasuries despite their negative total returns.**
- **Municipal bond prices ended the week unchanged. New issue supply was $10.3B, with strong flows of $1.9B. This week's new issue supply is $11.4B.**

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Watchlist

- *Treasury yields rose last week, and we continue to anticipate higher rates into year-end.*
- *Spread assets were pressured by higher rates, but we expect strong fundamentals to support returns moving forward*
- *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 tapering and an eventual increase in interest rates.

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 bonds also look compelling.

KEY RISKS

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

HIGH YIELD CORPORATES GET BOOST FROM THEIR LOWER DURATION

U.S. Treasury yields rose across the curve last week, with both 2- and 10-year yields ending 11 basis points (bps) higher. Most of the increase happened on Wednesday, due to high inflation data and a weak 30-year auction. Headline consumer prices rose 0.9% month-over-month, taking the year-over-year rate to 6.2%, the fastest rate since 1990. The monthly data partially reflected familiar factors that are unlikely to be sustained into next year, such as rising gas and auto prices. However, the inflationary pressures appear to be broadening, with no categories showing offsetting price declines as they typically do. Given the higher inflation numbers and pressure on long-end Treasuries, the 30-year auction met with very weak demand.

Investment grade corporates weakened, as the selloff in Treasuries pressured returns, returning -0.99% last week and underperforming similar-duration Treasuries by -15 bps. Spreads ended the week 1 bp wider at 88 bps, in line with the average level this year, though 9 bps wider than the tightest levels reached in June. The technical backdrop was favorable, though not enough to offset the pressure from rates, as the asset class saw inflows of $1.8 billion and new supply of $22 billion.

High yield corporates performed relatively better, helped by their lower duration, returning -0.25% but outperforming similar-duration Treasuries by 26 bps. New issuance was high at $15 billion, though inflows totaled $2.6 billion. Since April, three of the four largest weekly inflows have been in the last four weeks. Loans performed well, returning 0.17%, as their floating-rate attribute makes higher rates a tailwind. Loans also saw strong inflows at $970 million. In both markets, lower-rated segments outperformed, with CCC bonds returning 0.59% and CCC loans up 0.61%.

Emerging markets also outperformed compared to Treasuries by 41 bps, though total returns were negative at -0.32%. Similar to the dynamic in U.S. high yield, the asset class saw strong retail inflows of $1 billion into hard currency funds. Attention was focused on the China property sector, with another major selloff at the start of the week. The weakness fed into investment grade-rated names for the first time, with many high-rated bonds weakening -15 to -20 points in price. However, conditions stabilized later in the week after reports circulated that the government will alter policies to support the sector, plus monthly mortgage origination numbers beat expectations.

HIGH YIELD MUNI DEMAND RECOVERS

Municipal bond prices rallied early last week, then sold off due to disappointing inflation data, ending the week basically unchanged.

Consumer Price Index (CPI) data showed inflation trending at a 30-year high. While Treasuries sold off considerably on the news, municipal yields wavered but ultimately finished relatively unchanged for the week. One reason for this stability is the strong demand for tax-exempt income. CPI is only a snapshot, and we believe the Fed has time to control inflation first by tapering purchases, then raising short-term interest rates. The onus is on the Fed to show that it intends to aggressively fight inflationary pressures. Otherwise, we could see more upward pressure on interest rates in both Treasuries and municipal bonds.

The District of Columbia issued $657 million general obligation bonds (rated Aaa/AA). The deal was priced to sell, but some bonds traded at a slight concession in the secondary market. For example, 5% coupon bonds due in 20 years came at a yield of 1.47%. Those bonds traded at a yield of 1.49% (or 2 basis points cheaper) in the secondary, as dealers wanted to keep moving inventory.

High yield municipal fund flows came roaring back last week at $1.22 billion. Yields have declined on average for three consecutive weeks, likely boosting investors' confidence. Puerto Rico's GO restructuring appears on track, and would ultimately return nearly $7 billion to current bondholders. The infrastructure bill does not include macro-level municipal bond features, but it could materially benefit certain muni-centric sectors and specific issuers in the utility and transportation sectors. This week's high yield new issue calendar remains robust. Last week, most deals were heavily oversubscribed. But several problematic deals remain unable to clear the market, demonstrating the market's continued vigilance.

The Fed must show it intends to fight inflationary pressures. Otherwise, we could see more upward pressure on rates in both Treasuries and munis.

In focus

Infrastructure passes, finally

President Biden is expected to sign the $1.2 trillion bipartisan Infrastructure Investment and Jobs Act (IIJA) bill into law today.

While pared down from the original $2 trillion, this bill represents the largest federal infrastructure investment in more than a decade, with $550 billion in new spending. Major provisions include:

>$178 billion for power & water systems

>$158 billion for transit (rail, public transit, airports, ports, safety)

>$110 billion for roads, bridges and major infrastructure projects

>$65 billion for broadband infrastructure

>$37 billion for other projects, including environmental remediation, electric vehicle plug-in infrastructures, electric bus/transit and reconnection communities

Tax increases are not required, with funding largely coming from diverted and unspent money from other programs.

Uncertainty remains regarding how the funds will be disbursed. Projects could be funded through existing formula-based programs, or through new grant programs. Regardless, it will require federal, state and local coordination.

Next on the Congressional agenda is the $1.9 trillion Build Back Better bill, which includes many of the social spending provisions stripped from the IIJA. Possible tax increases are under debate, though nothing is concrete. Also pending is the final decision on the debt ceiling.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.51	0.11	0.02	0.39
5-year	1.22	0.17	0.04	0.86
10-year	1.56	0.11	0.01	0.65
30-year	1.93	0.05	0.00	0.29

Source: Bloomberg L.P., 12 Nov 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	0.24	0.00	-0.01	0.10
5-year	0.61	-0.02	-0.03	0.39
10-year	1.08	-0.05	-0.13	0.37
30-year	1.53	-0.05	-0.16	0.14

Source: Bloomberg L.P., 12 Nov 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	68
30-year AAA Municipal vs Treasury	79
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters, 12 Nov 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	1.13	–	5.09	0.15	0.62	1.12
High Yield Municipal	3.09	176[1]	6.12	0.31	1.03	7.18
Short Duration High Yield Municipal[2]	2.64	173	3.63	0.24	0.54	5.49
Taxable Municipal	2.29	72[3]	9.62	-0.84	0.01	0.90
U.S. Aggregate Bond	1.71	34[3]	6.81	-0.75	-0.11	-1.69
U.S. Treasury	1.19	–	7.20	-0.71	-0.05	-2.61
U.S. Government Related	1.57	42[3]	6.15	-0.61	-0.07	-1.43
U.S. Corporate Investment Grade	2.26	88[3]	8.72	-0.99	-0.10	-1.12
U.S. Mortgage-Backed Securities	1.95	27[3]	4.76	-0.61	-0.21	-1.07
U.S. Commercial Mortgage-Backed Securities	1.81	64[3]	5.09	-0.80	-0.32	-1.23
U.S. Asset-Backed Securities	0.95	38[3]	2.30	-0.34	-0.14	-0.25
Preferred Securities	3.17	171[3]	4.77	-0.69	-0.30	3.03
High Yield 2% Issuer Capped	4.24	286[3]	3.96	-0.25	0.35	4.72
Senior Loans[4]	5.02	433	0.25	0.17	0.22	5.13
Global Emerging Markets	4.34	303[3]	7.09	-0.32	-0.01	-1.56
Global Aggregate (unhedged)	1.27	35[3]	7.60	-0.82	-0.13	-4.42

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, 12 Nov 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, 12 Nov 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 10 Nov 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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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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