nuveen
A TIAA Company

Weekly Fixed Income Commentary

6 December 2021

Treasury yields mixed on concerns over COVID-19 and economic growth

The U.S. Treasury curve flattened sharply last week, as COVID-19 and economic growth concerns weighed on long-end yields and more hawkish Fed rhetoric supported front-end yields.

HIGHLIGHTS

- **Treasuries, agencies, investment grade and high yield corporates, taxable municipals, mortgage-backed securities, preferreds and emerging markets showed positive returns.**
- **Convertibles had negative total returns, while agencies, MBS, investment grade corporates and preferreds all underperformed similar-duration Treasuries.**
- **Municipal bond prices ended the week basically unchanged. New issue supply was $8.3B, with light flows of $36M. This week's new issue supply is substantial at $17.6B ($8.2B taxable).**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *10-year Treasury yields fell last week, but we anticipate higher rates over the medium term.*
- *Spread assets generally underperformed Treasuries, but we expect strong fundamentals to support credit market 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 affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- Further complications with the COVID-19 vaccine rollout, as well as multiple variants.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

INVESTMENT GRADE CORPORATE SPREADS REACH THEIR WIDEST LEVEL IN 2021

The U.S. Treasury curve flattened substantially last week, with 10-year yields falling -13 basis points (bps) on COVID-19 and growth concerns, while 2-year yields rose 9 bps on more hawkish Fed rhetoric. The resulting -22 bps move in the 2y/10y curve was the sharpest one-week flattening since June 2012. The uncertainty around the emerging COVID-19 Omicron variant weighed on sentiment. These fears were compounded on Friday by a weak headline jobs number, with the economy adding only 210,000 jobs in November versus expectations for 550,000. Separately, Fed Chair Powell indicated that “it is appropriate” to discuss accelerating the tapering of asset purchases to end “a few months sooner.” The implication that the Fed will also accelerate its rate hiking schedule led short-end yields to rise notably.

Investment grade corporates rallied, though spreads reached their widest level of the year at 101 bps. The asset class returned 0.86%, but underperformed similar-duration Treasuries by -10 bps. Amid the rally in long-end Treasuries, investment grade credit’s long duration turned into a tailwind. Technical factors were unfavorable, with $40 billion of new supply expected (though only $28 billion materialized), elevated dealer balance sheets, seasonally low liquidity and weak fund flows. The asset class saw an outflow of $2.7 billion, the largest since April 2020.

High yield corporates also rallied, gaining 0.63% and outperforming similar-duration Treasuries by 40 bps. Despite outperforming investment grade corporates, spreads remained relatively wide at 326 bps, up from the July low of 262 bps and the year-to-date average of 304 bps. Loan prices declined amid the weak risk sentiment and the drop in rates, returning -0.13%. Both asset classes saw notable outflows, at -$2.6 billion and -$495 million for high yield bonds and loans, respectively. However, all of the outflow in loans was driven by ETFs, with actively managed mutual funds seeing a small inflow of $31 million.

Emerging markets returned 0.70% and outperformed similar-duration Treasuries by 10 bps. There was notable decompression between higher- and lower-rated issuers, with spreads widening 9 bps in investment grade space and 21 bps in high yield. Despite the somewhat weak tone and a large outflow of -$1.5 billion, there was consistent demand from Asian life insurers for high grade securities, which ended up driving the decompression dynamic.

MUNICIPAL BOND MARKET SHOULD REMAIN WELL BID

Municipal bond prices remained essentially unchanged last week, but ended the week with a constructive tone.

U.S. Treasury bonds are very well bid, as Fed Chairman Powell has been renominated for another term. He indicated he believes it is time for the Fed to taper the easy money policies that have been in place since the pandemic began in March 2020. Also, investors believe the Fed will begin to raise short-term rates in the first half of 2022. Municipal bond prices have lagged, in part due to outsized new issue supply. However municipals should remain well bid, as there are billions of dollars left to reinvest from the December 1 coupon. The January 1 coupon – also in the billions – is only a few weeks away.

The state of Illinois issued $200 million general obligation bonds (rated Baa2/BBB). As part of the deal, 4% coupon bonds due in 2034 were issued at a yield of 1.85%. Those same bonds traded in the secondary market at the same yield of 1.85%, suggesting that the municipal market remains held in a trading range.

High yield municipal bond flows showed strong cross currents again last week, with significant outflows and inflows netting to $48 million. This week's new issue calendar is heavy again with a high number of deals, as well as a large total volume. Headlining the week's new issuance are refunding deals for Golden State Tobacco, City of Chicago and San Joaquin Toll Road. Due to lower rates and the upward pressure on spreads from heavier new issuance, high yield municipal credit spreads are the cheapest they have been since June, despite arguably stronger credit fundamentals across many sectors. We expect a strong end to the year due to meaningful uninvested demand, improving fundamentals and a lack of tax loss opportunities.

Despite outperforming investment grade corporates, high yield corporate spreads remain relatively wide at 326 bps.

In focus

Bond issuance surges in 2021

Both the corporate and municipal bond markets saw healthy levels of supply in 2021, meeting or exceeding 2020 record levels.

High yield corporate issuance has already exceeded the 2020 record, as issuers took advantage of low yields to refinance debt and fund mergers and acquisitions. Investment grade corporate gross issuance likely won't surpass the 2020 record, but it is on track to become the second highest. Both markets have absorbed the high level of issuance well, with spreads remaining range bound and below historical averages.

Looking ahead to 2022, we expect high yield gross issuance to decline around 10% to 20%, as refinance activity should slow down. Investment grade gross issuance should be flat to slightly lower, since the high level of cash on corporate balances sheet should limit financing needs. Flat to lower issuance should support valuations.

Municipal new issue supply is tracking 2020's record-setting pace, though the composition is different. Taxable and refunding deals remain significant components of new issue supply, but they are less dominant in 2021. At the same time, traditional new money tax-exempt bonds issued for new capital purposes are up year-over-year. As a result, the overall municipal bond market has grown to more than $4 trillion in total par value of bonds outstanding.

In 2022, we expect tax-exempt supply to be challenged by strong demand, seasonal swings, and sizeable taxable issuance.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	November 2021	Year-to-date
2-year	0.59	0.09	0.07	0.47
5-year	1.13	-0.03	-0.02	0.77
10-year	1.35	-0.13	-0.11	0.43
30-year	1.68	-0.15	-0.14	0.03

Source: Bloomberg L.P., 03 Dec 2021. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	November 2021	Year-to-date
2-year	0.24	0.00	0.00	0.10
5-year	0.60	0.00	0.01	0.38
10-year	1.03	-0.03	0.00	0.32
30-year	1.48	-0.03	0.00	0.09

Source: Bloomberg L.P., 03 Dec 2021. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	76
30-year AAA Municipal vs Treasury	88
High Yield Municipal vs High Yield Corporate	66

Source: Bloomberg L.P., Thompson Reuters, 03 Dec 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	November 2021	Year-to-date
Municipal	1.11	–	5.07	0.25	0.85	1.43
High Yield Municipal	3.08	179[1]	6.10	0.24	1.31	7.56
Short Duration High Yield Municipal[2]	2.67	180	3.62	0.14	0.81	5.81
Taxable Municipal	2.16	75[3]	9.56	0.76	0.95	2.41
U.S. Aggregate Bond	1.68	41[3]	6.84	0.52	0.30	-0.97
U.S. Treasury	1.12	–	7.29	0.62	0.77	-1.42
U.S. Government Related	1.55	47[3]	6.19	0.48	0.20	-0.84
U.S. Corporate Investment Grade	2.27	100[3]	8.82	0.86	0.06	-0.36
U.S. Mortgage-Backed Securities	1.94	38[3]	4.63	0.08	-0.09	-0.98
U.S. Commercial Mortgage-Backed Securities	1.79	70[3]	5.09	0.24	-0.09	-0.87
U.S. Asset-Backed Securities	1.01	39[3]	2.30	-0.06	-0.07	-0.23
Preferred Securities	3.50	203[3]	4.76	0.18	-1.38	2.11
High Yield 2% Issuer Capped	4.69	327[3]	3.98	0.63	-0.98	3.74
Senior Loans[4]	5.26	449	0.25	-0.13	-0.15	4.82
Global Emerging Markets	4.53	333[3]	7.12	0.70	-1.07	-1.91
Global Aggregate (unhedged)	1.24	39[3]	7.66	0.31	-0.29	-4.26

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, 03 Dec 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, 03 Dec 2021. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 01 Dec 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.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Past performance is no guarantee of future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

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.

Nuveen provides investment advisory solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.