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Weekly Fixed Income Commentary

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Treasury yields rise further on positive employment report

U.S. Treasury yields rose after positive economic data and another round of hawkish central bank meetings across developed markets. Spread assets were weaker after recent strong gains.

HIGHLIGHTS

- **Treasuries, taxable munis, MBS, CMBS, ABS, preferreds, investment grade and high yield corporates, and emerging markets all weakened in total return terms.**
- **High yield, ABS and emerging markets all outperformed in excess returns terms.**
- **Municipal bond yields declined. New issue supply was $10B, with flows of -$2.9B. This week's new issue supply is $5.7B.**

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Watchlist

- *10-year Treasury yields rose last week, and we anticipate increases in the quarters ahead.*
- *Spread assets were weaker after recent strong gains.*
- *Municipal bonds are moving closer to fair value.*

INVESTMENT VIEWS

Zero/negative global interest rate policy remains a key market support. While investors continue to focus on more hawkish Fed policy, overall rates are likely to remain low.

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

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 vaccine rollout, as well as new variants.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

SIZEABLE SENIOR LOAN INFLOWS CONTINUE

U.S. Treasury yields rose again, with the 10-year yield ending 14 basis points (bps) higher for the week. Most of the move was driven by higher real yields, which rose 19 bps, as inflation breakevens declined -5 bps. The January jobs report vastly exceeded expectations, showing a gain of 467,000 jobs in January, plus another 709,000 in net revisions to the prior two months. The labor force participation rate rose to 62.2% and average hourly earnings rose 5.7% year-over-year. Overall, the data suggested that the labor market is tighter than previously realized.

Investment grade corporates weakened again, returning -1.20% and underperforming similar-duration Treasuries by -16 bps. All-in yields reached a fresh 22-month high at 2.93%. Flows were light, with markets in Asia still mostly closed for the Lunar New Year holiday. New issue activity picked up, with 11 issuers bringing $20 billion of new supply. Overall, the primary calendar was 2.4x oversubscribed and came with concessions of around 2.5 bps, up from the year-to-date average of 2.2 bps.

High yield corporates outperformed. While still registering a negative total return of -0.30% for the week, the asset class outperformed similar-duration Treasuries by 22 bps. That came despite another sizeable outflow of -$4 billion, making the last four weeks the largest such stretch of outflows since August 2014. Loans gained 0.07%, with continued sizeable inflows of $1.3 billion. CLO warehouses remain active as well, further boosting demand. That said, there was emerging evidence of crossover accounts pivoting away from loans and into bonds, given the recent sharp underperformance by the latter.

Emerging markets also outperformed, beating similar-duration Treasuries by 48 bps, though the asset class posted a -0.47% total return for the week. Attention was dominated by hawkish policy meetings at the Bank of England (BoE) and European Central Bank (ECB). The BoE hiked rates 25 bps, and four of the nine committee members surprisingly voted for an even larger 50 bps hike. The UK sovereign curve bear flattened sharply, with 2-year yields up 29 bps and 10-year yields up 17 bps. In Europe, the ECB refrained from changing policy immediately, but signaled higher odds of rate hikes later this year. The market has now priced more than 50 bps of hikes this year. European curves also bear flattened, with 2- and 10-year bund yields up 36 and 25 bps, respectively.

LIGHT MUNICIPAL BOND NEW SUPPLY WILL NEED TO BE PRICED TO SELL

Municipal bond yields closed last week lower, although they sold off slightly on Friday due to the outsized jobs report. Municipal bond yields are relatively attractive versus taxable Treasury yields, so munis should remain well bid if Treasuries remain range bound. Municipal bond fund flows were negative for the third consecutive week. Light new issue supply this week will need to be priced to sell to pique investor interest.

The Fed will most likely begin to raise short-term rates beginning in March, after Friday's surprisingly strong jobs number. Many investors expect five rate hikes by year end. In terms of interest rates, the 10-year Treasury yield is the highest since December 2020. It is up to the Fed to show that inflation is under control. If so, rates should remain range bound.

Broward County, Florida, issued $199 million water and sewer utility revenue bonds (rated Aa1/AA). The deal was priced to sell, and some bonds broke to premiums from where they were issued. For example, the deal contained 4% coupon bonds due in 2047 issued at a yield of 2.26%. Those same bonds traded in the secondary market 5 basis points lower at 2.21%.

High yield municipal bond yields remain lower month-to-date on average, due to stronger demand after January's adjustments. Despite outflows, bonds are being firmly bid and tax loss swapping remains active. The new issue calendar remains light, with less than 10 high yield municipal deals expected this week. The market continues to focus on the execution of the Puerto Rico GO restructuring and bond exchange, which involves a massive cash injection into the market. Investors are watching how PROMESA and Puerto Rico will engage on PREPA's restructuring.

Municipal bond yields remain relatively attractive versus taxable Treasury yields.

In focus

The Fed preps for lift off

While the timing of U.S. monetary policy changes remains uncertain, the Fed has clearly laid out the anticipated sequence of events. Chair Powell discussed the intended path for policy adjustments at his last press conference, as the Fed "moves steadily away from highly accommodative policies."

The Fed will begin by finishing asset purchases, known as tapering. It will reduce assets purchases every month until it is only reinvesting maturing bonds to maintain the current balance sheet level. The taper is set to end in March.

Next comes the initial interest rate increase, referred to as lifting off. Although it is not a set policy rule, all rate hikes since 2000 have been 25 basis point (bps), which is the cadence we expect moving forward.

The third step would involve additional rate increases as appropriate. These hikes will come prior to beginning the fourth and final step. Beyond these hikes, adjustments will be ongoing, as the Fed views changing the target rate for fed funds as its primary means of adjusting monetary policy.

Finally, the Fed will allow the balance sheet to shrink, via run off, by no longer reinvesting portfolio payments. Based on Powell's comments last month, the process is likely to start no sooner than June. The Fed expects balance sheet reduction to "run in the background" until it achieves the desired size.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	January 2022	Year-to-date
2-year	1.31	0.15	0.45	0.58
5-year	1.77	0.16	0.35	0.51
10-year	1.91	0.14	0.27	0.40
30-year	2.21	0.14	0.21	0.31

Source: Bloomberg L.P., 04 Feb 2022. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	January 2022	Year-to-date
2-year	0.88	-0.01	-0.02	0.64
5-year	1.16	-0.05	-0.06	0.57
10-year	1.44	-0.11	-0.11	0.41
30-year	1.84	-0.11	-0.11	0.35

Source: Bloomberg L.P., 04 Feb 2022. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	75
30-year AAA Municipal vs Treasury	83
High Yield Municipal vs High Yield Corporate	65

Source: Bloomberg L.P., Thompson Reuters, 04 Feb 2022. 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	January 2022	Year-to-date
Municipal	1.66	–	5.10	0.43	-2.74	-2.28
High Yield Municipal	3.52	184[1]	6.88	0.56	-2.80	-2.11
Short Duration High Yield Municipal[2]	3.17	188	3.73	0.20	-1.42	-1.18
Taxable Municipal	2.81	80[3]	9.48	-1.31	-2.53	-3.68
U.S. Aggregate Bond	2.26	37[3]	6.66	-0.95	-2.15	-3.05
U.S. Treasury	1.74	–	7.03	-0.97	-1.89	-2.78
U.S. Government Related	2.17	47[3]	6.01	-0.80	-1.99	-2.73
U.S. Corporate Investment Grade	2.93	108[3]	8.36	-1.20	-3.37	-4.50
U.S. Mortgage-Backed Securities	2.40	22[3]	4.90	-0.72	-1.48	-2.23
U.S. Commercial Mortgage-Backed Securities	2.41	70[3]	5.02	-0.88	-1.59	-2.38
U.S. Asset-Backed Securities	1.61	30[3]	2.29	-0.29	-0.56	-0.86
Preferred Securities	4.14	200[3]	4.98	-0.90	-2.46	-3.69
High Yield 2% Issuer Capped	5.42	343[3]	4.09	-0.30	-2.73	-3.09
Senior Loans[4]	5.80	430	0.25	0.07	0.36	0.43
Global Emerging Markets	4.78	297[3]	6.93	-0.47	-2.63	-3.08
Global Aggregate (unhedged)	1.69	39[3]	7.43	-0.36	-2.05	-2.38

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, 04 Feb 2022. **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, 04 Feb 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 02 Feb 2022.

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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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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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