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Weekly Fixed Income Commentary

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Inflation data boost Treasury yields further

U.S. Treasury yields rose sharply, led by short maturities. Headline inflation for January surprised to the upside, with the core measure substantially beating expectations and previous readings being revised upward.

HIGHLIGHTS

- **All major taxable sectors posted negative total returns: Treasuries, taxable munis, MBS, CMBS, ABS, preferreds, investment grade and high yield corporates, loans and emerging markets.**
- **Preferred securities, high yield, emerging markets and MBS underperformed similar-duration Treasuries most substantially.**
- **Municipal bond yields increased across the curve. New issue supply was low at $5.7B, with flows of $216M. This week's new issue supply should be $6.1B ($1.2B taxable).**

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CIO of Global Fixed Income

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Head of Municipals

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 relatively 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.

SENIOR LOAN RETURNS REMAIN POSITIVE FOR THE YEAR

U.S. Treasury yields rose again, led by 2- to 3-year maturities increasing 19 basis points (bps). Yields jumped after Thursday's surprisingly strong consumer price reading. Short rates increased the most, as investors quickly priced in an additional Fed rate hike in 2022. After the CPI release, market probabilities indicated about 6.5 rate hikes in 2022, which is reflected most directly in shorter maturities. An escalation of the Russia/Ukraine situation on Friday stoked the risk-off sentiment, pushing Treasury rates lower. The decline largely offset Thursday's rise for longer maturities, but only modestly diminished the increase in shorter maturities, which flattened the yield curve significantly.

Investment grade corporates weakened modestly, returning -0.39% and underperforming similar-duration Treasuries by -3 bps. The sector has struggled during this unusual risk-off environment that has been accompanied by rising Treasury yields. Only 11 issuers priced $12.4 billion in new deals, well below the expected $20-25 billion of issuance. Deals were approximately 3.6x oversubscribed, but average new issue concessions widened.

High yield corporates underperformed, falling -0.96% on a total return basis and lagging similar-duration Treasuries by -68 bps. The sector has been hurt by relentless selling pressure from ETFs as outflows continue to be driven by falling stock prices. Liquidity has become challenged, and the new issue market has paused. Lower quality continues to post higher returns, although spreads have shown some recent weakness. Loan total returns were down -0.10%, for the week, but remain positive year-to-date. The sector saw its third week with more than $2 billion in inflows in the last several weeks.

Emerging markets underperformed, trailing similar-duration Treasuries by -31 bps and falling -0.59% in total return. EM followed other risk sectors lower late in the week after the high U.S. inflation data and tensions escalated in Ukraine. The sector continues to see outflows primarily from external currency funds, which are being largely offset by strong inflows into local currency funds, which resulted in a small net outflow of -$45 million last week. It was a busy central bank week, with eight central bank decisions yielding no real surprises despite the global inflationary trend.

HIGH YIELD MUNICIPALS PROVE RESILIENT

Municipal bond yields increased across the curve last week, with the 1- and 30-year yields rising 17 bps and 19 bps, respectively. The market remains orderly, and municipal bond yields remain fairly valued versus Treasuries. This trend should continue, as municipal new issuance has been thin.

Investors fear the Fed is behind the curve in fighting inflation. The 10-year Treasury yield hit 2% last week before rallying to close at 1.93% on Friday on a flight-to-quality rally. Earlier last week, Federal Reserve Board member James Bullard said he supports raising short-term rates by a full percentage point by the beginning of July. He suggested the Fed should start by raising rates 50 bps in March because inflation is at its highest level in four decades.

The state of Washington issued $269 million general obligation bonds in a competitive bid process (rated Aaa/AA+). The deal included 5% coupon bonds due in 2043 issued at a yield of 1.96%. Those same bonds traded 5 bps cheaper at 2.01% later in the week, reflecting how yields in general continued to rise.

High yield municipal bonds generally are proving resilient amid the recent onslaught of volatility in risk asset markets. Credit spreads have tightened slightly overall, but much more so when removing high beta areas of the market. Demand for new issuance remains robust, despite outflows. Puerto Rico GO bonds have been some of the best performing bonds recently. Fund flows have been relatively stable, with just -$66 million in outflows last week. With this week's light new issue calendar, the market will likely focus almost entirely on secondary trade volume being fed by heavier tax loss swap activity.

Senior loans saw the third week with more than $2 billion in inflows in the last several weeks.

In focus

Senior loan demand remains robust

Amid heightened volatility in the U.S. Treasury and investment grade corporate credit markets, senior loans enjoyed strong inflows in January, following surging demand in 2021.

With their floating-rate coupons, loans appear poised to benefit from a more hawkish Federal Reserve. Indeed, markets now anticipate more than six Fed rate hikes in 2022. Meanwhile, loan issuer fundamentals continue to improve and could strengthen further even if U.S. growth begins to slow. Such a positive backdrop should help reduce credit (i.e., default) risk, a major consideration for loans.

Loans also combine near-zero interest rate risk and an attractive yield — a rare combination — making them a highly sought-after asset class for both institutional investors and their retail counterparts (through mutual funds and ETFs).

Investors may be best served by floating-rate loan funds that focus on bottom-up security selection and fundamental research. These characteristics appear especially important in today's environment, where spreads remain slightly wider than their historical averages and therefore may offer limited price appreciation.

And as increased demand drives richer valuations, active management may be increasingly important to help maximize total returns in the asset class.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	1.51	0.19	0.33	0.77
5-year	1.86	0.09	0.25	0.59
10-year	1.94	0.03	0.16	0.43
30-year	2.24	0.03	0.13	0.34

Source: Bloomberg L.P., 11 Feb 2022. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.05	0.17	0.15	0.81
5-year	1.34	0.18	0.12	0.75
10-year	1.61	0.17	0.06	0.58
30-year	2.03	0.19	0.08	0.54

Source: Bloomberg L.P., 11 Feb 2022. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	84
30-year AAA Municipal vs Treasury	91
High Yield Municipal vs High Yield Corporate	64

Source: Bloomberg L.P., Thompson Reuters, 11 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	Month-to-date	Year-to-date
Municipal	1.85	–	5.18	-0.90	-0.44	-3.16
High Yield Municipal	3.71	184[1]	7.17	-1.07	-0.37	-3.16
Short Duration High Yield Municipal[2]	3.34	186	3.76	-0.53	-0.28	-1.70
Taxable Municipal	2.85	79[3]	9.47	-0.21	-1.39	-3.88
U.S. Aggregate Bond	2.36	39[3]	6.65	-0.41	-1.32	-3.45
U.S. Treasury	1.83	–	7.01	-0.31	-1.21	-3.08
U.S. Government Related	2.29	48[3]	5.96	-0.48	-1.24	-3.20
U.S. Corporate Investment Grade	3.01	108[3]	8.32	-0.39	-1.56	-4.87
U.S. Mortgage-Backed Securities	2.52	26[3]	4.91	-0.56	-1.31	-2.77
U.S. Commercial Mortgage-Backed Securities	2.52	72[3]	5.01	-0.35	-1.15	-2.72
U.S. Asset-Backed Securities	1.82	34[3]	2.27	-0.35	-0.65	-1.21
Preferred Securities	4.46	220[3]	5.07	-1.85	-3.08	-5.46
High Yield 2% Issuer Capped	5.77	368[3]	4.11	-0.96	-1.33	-4.02
Senior Loans[4]	6.04	426	0.25	-0.10	-0.03	0.33
Global Emerging Markets	4.89	300[3]	6.87	-0.59	-1.04	-3.64
Global Aggregate (unhedged)	1.78	41[3]	7.38	-0.66	-1.00	-3.02

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, 11 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, 11 Feb 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 09 Feb 2022.

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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