

14 March 2022

Treasury yields rise amid continued uncertainty

U.S. Treasury yields rose last week and fixed income returns were broadly negative amid continued geopolitical, economic and policy uncertainty. Spread assets remained weaker.

HIGHLIGHTS

- **Total and excess returns were negative across Treasuries, investment grade and high yield corporates, MBS, CMBS, ABS, preferreds, convertibles, loans and emerging markets.**
- **Commercial mortgage-backed securities eked out a positive excess return.**
- **Municipal bond yields rose across the curve. New issue supply was outsized at \$12.3B, with outflows of -\$662M. This week's new issue supply is light at \$6.4B.**



Anders Persson
CIO of Global Fixed Income



John Miller
Head of Municipals

Watchlist

- 10-year Treasury yields rose last week, and we continue to expect rates to rise this year.
- Spread assets were weaker amid elevated uncertainty.
- Municipal bonds are attractive versus Treasuries.

INVESTMENT VIEWS

Accommodative 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 even after several rate hikes.

The underlying growth outlook is healthy, as consumers have strong balance sheets, businesses are reinvesting and Covid recedes. This should keep defaults low.

Treasury yields are likely to rise this year, but we don't expect the 10-year Treasury yield to rise much above 2.25%.

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

- The Russia/Ukraine conflict continues to escalate.
- Inflation rises in a disorderly way, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- COVID-19 cases increase, including any new variants.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

02 | Weekly Fixed Income Commentary 14 March 2022

EMERGING MARKETS OUTPERFORMED OTHER SPREAD SECTORS

U.S. Treasury yields continued to see heightened volatility, with 10-year yields ending the week 26 basis points (bps) higher. All of the moves were due to higher inflation breakevens, even as the February CPI report came in line with expectations and oil prices fell -5.5%. The European Central Bank delivered a more-hawkish-than-expected policy meeting, announcing a faster-than-expected taper of its asset purchase program, though it continued to signal patience on the rate hiking front. This week, the U.S. Federal Reserve will hold its policy meeting, and is expected to hike rates by 25 bps.

Investment grade corporates weakened, returning -2.69% for the week and underperforming similar-duration Treasuries by -83 bps. The asset class was pressured by headwinds: a) the selloff in Treasuries pushing rates higher, b) a large outflow of -\$4.7 billion, the largest since mid-January, and c) heavy primary issuance of \$70 billion. That total included fourth-largest deal of all time, from AT&T subsidiary Magallanes, and resulted in the full-week total notching the 8th-highest total of all time. Concessions moved higher again, averaging 14.5 bps, illustrating the relatively tepid demand for the deluge of new issuance.

High yield corporates also sold off, returning -1.53% and underperforming similar-duration Treasuries by -49 bps. Liquidity was relatively thin and activity slowed. Some analysts have begun to lower their full-year issuance forecasts by as much as \$100 billion to a new total of around \$225 billion. The asset class also saw an outflow of -\$1.6 billion, though loan funds saw a very modest inflow of \$15 million. With elevated uncertainty and high volatility, CLO activity has slowed as well. Given the fact that CLOs account for around two-thirds of the loan market investor base, loan prices drifted lower as well, with the asset class returning -0.98% for the week.

Emerging markets sold off but outperformed other spread sectors, returning -1.90% and underperforming similar-duration Treasuries by -29 bps. Russia/Ukraine developments continued to dominate attention. Negotiations between the two sides, held in Turkey, did not yield concrete progress, though Russian President Putin did acknowledge a "positive shift in talks" on Friday. Central banks in Poland and Hungary hiked rates, albeit by less than expected, which nevertheless helped their currencies rally 2.3% and 1.3%, respectively, as local yields rose.

MUNICIPAL BONDS ARE ATTRACTIVE RELATIVE TO TREASURIES

Municipal bond yields rose across the curve last week, tracking the Treasury selloff. Short muni yields were 21 bps higher by week's end, while 30-year yields rose 23 bps.

Yields rose as the market focused on inflation, which is running at the highest rate in 40 years. The 10-year Treasury now yields 2%, higher than before the pandemic when the U.S. economy was very strong. The Fed is all but certain to raise short-term rates 25 bps this week to begin cooling the economy and thus cooling inflation. However, many investors worry the Fed is behind the curve in its battle to control inflation.

Municipal credit remains fundamentally sound. Municipalities were primary beneficiaries of the \$5 trillion of relief funds that Congress injected into the U.S. economy during the pandemic. Also, tax-exempt bonds are cheap relative to Treasuries. The 10-year muni bond is yielding an attractive 92% of the 10-year Treasury bond. The municipal market is experiencing muted new issue supply, so municipal bonds should remain well bid as long as Treasury bonds remain range bound.

The state of California issued \$2.2 billion general obligation bonds (rated Aa2/AA-). The deal was priced to sell and was well received. This deal illustrates how inexpensive tax-exempt bonds are relative to Treasuries. The 10-year bond was priced with a 5% coupon and 2.05% yield. This represents 1.025% of the 10-year Treasury bond yielding 2%.

The high yield municipal market moved in step with the general level of rate increases last week, based on market average statistics. Larger, higher beta issuances are selling off, while more idiosyncratic issuers are proving far less sensitive. Net outflows have declined and cash is abundant. Puerto Rico remains on track to exit bankruptcy on March 15.

Investment grade corporates were pressured by the Treasury selloff, large outflows and heavy new issuance.

In focus

Inflation is a key headwind

Headline prices rose 7.9% year-over-year though February (core rose 6.4%), the highest rate since 1982. We expect inflation to decelerate but remain above-target over the medium term, ending 2022 near 4% and supporting modest further increases in yields.

Most of the increase was due to energy (+3.5% month-over-month) and shelter (+0.5%). Energy included a 6.6% increase in gasoline prices and 7.7% increase in fuel oil prices. Given the moves in global commodity markets over the last few weeks, both are almost certain to see substantial further upside in the near term. Shelter is also running higher, while used car prices have fallen and are likely to turn into a drag on inflation moving forward.

Higher inflation translates directly into higher yields, pressuring fixed income returns. However, front-end yields already include a relatively high degree of inflation expectations, with two- and five-year breakevens implying average CPI inflation of 4.7% and 3.6%, respectively. That is close to our forecasts, so we see relatively less potential for front-end yields to be further pressured, barring a further shock.

In the longer-term, five year-five year breakevens imply an inflation rate of 2.5%, close to the Fed's implied target. PCE, its official target, typically runs around 30 bps lower than the CPI, against which breakevens are indexed. We see modest potential for long-end yields to rise further from here, supporting our forecast for 10-year yields to rise to around 2.25% by the end of the year.

U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	Month-to-Date	Year-to-date
2-year	1.75	0.27	0.32	1.02
5-year	1.95	0.31	0.23	0.68
10-year	2.00	0.26	0.17	0.48
30-year	2.36	0.20	0.19	0.45

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

Municipal market

Maturity	Yield to Worst	Change (%)		
		Week	Month-to-Date	Year-to-date
2-year	1.29	0.21	0.23	1.05
5-year	1.56	0.22	0.23	0.97
10-year	1.84	0.23	0.20	0.81
30-year	2.26	0.23	0.22	0.77

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

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	92
30-year AAA Municipal vs Treasury	96
High Yield Municipal vs High Yield Corporate	64

Source: Bloomberg L.P., Thompson Reuters, 11 Mar 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%)		
				Week	Month-to-Date	Year-to-date
Municipal	2.15	–	5.39	-1.13	-1.35	-4.39
High yield municipal	3.97	185 ¹	7.67	-1.31	-1.59	-4.57
Short duration high yield municipal ²	3.66	196	3.78	-0.61	-0.73	-2.45
Taxable municipal	3.11	94 ³	9.34	-2.71	-2.63	-5.96
U.S. aggregate bond	2.60	49 ³	6.61	-1.76	-1.60	-4.79
U.S. Treasury	1.99	–	6.95	-1.61	-1.27	-3.78
U.S. government related	2.52	56 ³	5.89	-1.41	-1.32	-4.32
U.S. corporate investment grade	3.50	143 ³	8.11	-2.69	-2.83	-7.98
U.S. mortgage-backed securities	2.69	30 ³	5.09	-1.23	-1.04	-3.45
U.S. commercial mortgage-backed securities	2.82	89 ³	4.98	-1.34	-1.10	-3.84
U.S. asset-backed securities	2.25	54 ³	2.27	-0.64	-0.69	-1.87
Preferred securities	4.83	241 ³	5.06	-1.35	-1.57	-7.03
High yield 2% issuer capped	6.20	395 ³	4.15	-1.53	-1.88	-5.54
Senior loans ⁴	6.87	484	0.25	-0.98	-1.09	-1.22
Global emerging markets	5.66	363 ³	6.82	-1.90	-3.39	-10.21
Global aggregate (unhedged)	1.93	48 ³	7.36	-1.88	-2.11	-5.25

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

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.