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Weekly Fixed Income Commentary

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Treasury yields mixed on strong economic data

Long-end U.S. Treasury yields moderated last week after sharp recent moves, while the front-end continued to move higher on positive economic data and expectations for rate hikes. Spread sectors have extended the recent trend of outperformance.

HIGHLIGHTS

- **Agencies, MBS, CMBS, investment grade and high yield corporates, preferreds, convertibles, loans, and emerging markets notched strong total returns and beat similar-duration Treasuries.**

- **Asset-backed securities had a slightly negative return, but still outperformed Treasuries.**

- **Municipal bond yields remained essentially unchanged. New issue supply was $10.6B, with outflows of -$2B. This week's new issue supply is $12B ($1.8B taxable).**

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CIO of Global Fixed Income

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Watchlist

- *10-year Treasury yields fell last week, but we continue to expect rates to rise further this year.*
- *Spread sectors have extended the recent trend of outperformance.*
- *Municipal bonds appear attractive vs. 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 2.5% – 2.75%.

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.

HEAVY INVESTMENT GRADE CORPORATE SUPPLY SHOULD MODERATE

Long-end Treasury yields fell for the first time since early March, with the 10-year yield dropping -9 bps to 2.38%. The front-end continued to rise, with 2-year yields up 19 bps to 2.46%. That flattened the 2y10y curve by 28 bps, the biggest weekly move since 2009. U.S. economic data continued to be strong, with the March jobs report showing a net gain of 431,000 new jobs plus 95,000 in upward revisions to the prior two months. That took the unemployment rate down to 3.6%, reinforcing expectations for the Federal Reserve to front-load rate hikes to combat high inflation.

Investment grade corporates gained, returning 1.37% for the week and outperforming similar-duration Treasuries by 53 bps. Technicals were a headwind, with another large outflow of -$1.4 billion concentrated in short-dated funds. Intermediate- and long-dated funds saw inflows. The primary market calendar remained busy, with 16 issuers bringing $32 billion of new supply. That took the March total to $226 billion, far outpacing consensus estimates for around $160 billion. The flood of supply is expected to moderate moving forward, with most desks calling for around $100 billion in April, which should provide a positive technical boost.

High yield corporates also gained, rallying 0.74% and outperforming similar-duration Treasuries by 66 bps. The asset class saw the first positive inflow in 11 weeks, at $1.2 billion, while supply remained light. The loan market gained 0.62%, and much of the market is now trading above pre-Russia/Ukraine invasion levels. Loan funds also saw an inflow of $1.2 billion, taking the fund total to more than $100 billion for the first time since 2018.

Emerging markets outperformed again, gaining 1.40% and beating similar-duration Treasuries by 90 bps. Within the asset class, high yield continued to compress versus investment grade, and inflows rebounded, with $1 billion entering hard currency funds. Optimism on negotiations between Russia and Ukraine helped bonds rally by around 8 pts and 5 pts in the two countries, respectively. That optimism, combined with softer oil prices and positive U.S. economic data, helped the broader market rally as well. On the policy front, several emerging markets central banks hiked rates, though they tended to surprise on the dovish side, with Chile and Colombia hiking by 50 bps less than consensus expectations. That steepened curves, with front-end yields down -40 to -100 bps and the long-end up 20 to 30 bps.

MUNICIPAL BONDS REMAIN WELL BID

Municipal bond yields remained essentially unchanged last week. Short-term yields did rise 5 bps, with Fed signaling many short-term interest rate increases this year to curtail inflation.

Wall Street's biggest banks are forecasting the Fed will raise rates by 50 bps at the May and June meetings, resulting in an inverted Treasury yield curve. Short-term rates are rising, while longer-term rates are lower. Some investors are betting that short-term rate increases will lower long-term yields. They are locking in yields now before long-term rates drop further.

Municipal yields did not react as dramatically to the Fed's tough talk. This is to be expected, as the municipal market is less efficient. However, municipals remain cheap on a relative and absolute basis versus Treasuries and should remain well bid. A 10-year high-grade muni bond yielding 1.04% on the first trading day of 2022 now yields 2.22%, 118 bps cheaper. This additional yield should attract investors.

Broward Co., Florida, issued $389 million convention center revenue bonds (rated Aa1/AAA). The deal traded at a substantial premium in the secondary market, reflecting the positive tone of fixed income. For example, 5% coupon bonds due in 2047 came at a yield of 3.32% and traded in the secondary market at 3.19%.

High yield municipal bond yields were generally higher last week, but skewed by the new Puerto Rico GO bonds added to the index at month end. As a sign of current demand, the largest high yield municipal deal of the year was as much as 10 times oversubscribed in certain maturities, and was easily absorbed with lower yields in the final pricing. This week's new issue calendar is light on "new" deals, but may pave the way for several deals hung up in day-to-day status due to rate sensitivities. If technicals can hold on, we think this week could prove to be an inflection point.

High yield corporates saw the first positive inflow in 11 weeks, at $1.2 billion.

In focus

Floating rate loans: a contrarian play?

Flows into floating rate funds tend to increase when interest rates are expected to rise. Such has been the case this year (and throughout 2021), with the Federal Reserve signaling a willingness to tighten aggressively to combat decades-high levels of inflation.

When demand for loans heats up, their prices are often pinned at par, offering little room for the debt to appreciate in value. But over the past few weeks, despite the Fed's rate liftoff in March and increasingly hawkish rhetoric, loans have been trading at a material discount to par – presenting investors with a compelling opportunity.

While loans have rallied off their mid-March lows, they've recouped only 56% of their losses, and as of 01 April are priced, on average, at 97.5% of par. In an asset class whose returns are driven largely by income, that discount enhances total return potential. The below-par dynamic stands in contrast to the optimism on display in equity markets, with the S&P 500 Index up nearly 8% since Russia invaded Ukraine on 24 February.

Loans aren't selling at "fire sale" prices, nor are there high levels of stress in the market. But loan risk premiums (the rate of return over and above the risk-free rate on assets such as U.S. government bonds) have widened. The key drivers of this trend: the war in Eastern Europe, rising commodity/input costs and the possibility that the Fed will tighten policy too quickly, sending the U.S. economy into recession.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week*	March 2022	Year-to-date
2-year	2.34	0.19	0.90	1.60
5-year	2.46	0.01	0.74	1.20
10-year	2.34	-0.09	0.51	0.83
30-year	2.45	-0.15	0.29	0.55

Source: Bloomberg L.P., 31 Mar 2022. *Weekly data as of 01 Apr 2022. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week*	March 2022	Year-to-date
2-year	1.77	0.05	0.70	1.52
5-year	1.98	0.02	0.70	1.38
10-year	2.18	0.00	0.65	1.15
30-year	2.53	-0.01	0.63	1.04

Source: Bloomberg L.P., 31 Mar 2022. *Weekly data as of 01 Apr 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	104
High Yield Municipal vs High Yield Corporate	72

Source: Bloomberg L.P., Thompson Reuters, 31 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week*	March 2022	Year-to-date
Municipal	2.60	–	5.55	-0.04	-3.24	-6.23
High yield municipal	4.30	190[1]	8.05	-0.10	-3.61	-6.53
Short duration high yield municipal[2]	4.02	198	3.77	0.06	-1.53	-3.24
Taxable municipal	3.48	99[3]	9.35	0.68	-5.03	-8.28
U.S. aggregate bond	2.92	41[3]	6.58	0.75	-2.78	-5.93
U.S. Treasury	2.42	–	6.78	0.55	-3.11	-5.58
U.S. government related	2.90	50[3]	5.87	0.47	-2.43	-5.40
U.S. corporate investment grade	3.60	116[3]	8.15	1.37	-2.52	-7.69
U.S. mortgage-backed securities	2.99	24[3]	5.18	0.59	-2.60	-4.97
U.S. commercial mortgage-backed securities	3.26	85[3]	4.94	0.23	-2.90	-5.59
U.S. asset-backed securities	2.84	57[3]	2.28	-0.09	-1.71	-2.88
Preferred securities	4.80	195[3]	4.91	1.31	-0.83	-6.33
High yield 2% issuer capped	6.02	326[3]	3.94	0.74	-1.14	-4.82
Senior loans[4]	7.09	449	0.25	0.62	0.04	-0.10
Global emerging markets	5.62	320[3]	6.84	1.40	-2.34	-9.23
Global aggregate (unhedged)	2.15	42[3]	7.28	0.39	-3.05	-6.16

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, 31 Mar 2022. *Weekly data as of 01 Apr 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, 01 Aor 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 30 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.

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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