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Weekly Fixed Income Commentary

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Treasury yields rise on hawkish Fed rhetoric

Long-end U.S. Treasury yields rose again amid hawkish comments from Federal Reserve (Fed) officials signaling balance sheet runoff to start next month. Spread sectors were weaker amid elevated uncertainty.

HIGHLIGHTS

- **Treasuries, investment grade and high yield corporates, MBS and preferreds weakened.**
- **Agencies, CMBS and emerging markets outperformed.**
- **Municipal bond yields rose dramatically. New issue supply was $12B, with outflows of -$3.2B. This week's new issue supply is $5.1B ($1.9B taxable).**

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Watchlist

- *Treasury yields rose again, and we continue to expect rates to rise further this year.*
- *Spread sectors were weaker amid elevated uncertainty.*
- *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 2.75%.

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, or new variants emerge.

HIGH YIELD CORPORATE NEW ISSUE MARKET REOPENS

Long-end U.S. Treasury yields rose sharply again, with 10-year yields up 32 basis points (bps) to 2.70%. For context, 10-year yields declined to 0.50% in mid-2020 and are now within 55 bps of their highest level of the last decade (3.24%) reached in late 2018. Hawkish comments from usually dovish Fed officials including Governor Brainard sparked the selloff early in the week, which was then ratified by hawkish commentary in the published minutes of the last FOMC meeting. Brainard referenced a "rapid pace" of balance sheet runoff, and the minutes subsequently confirmed that officials plan to start the runoff process in May.

Investment grade corporates weakened alongside the selloff in Treasuries, returning -2.36% and underperforming by -13 bps. The asset class continued to face unfavorable technical dynamics, with an outflow of -$3.7 billion and another surprisingly heavy primary issuance calendar. Sixteen issuers brought new deals totaling $23.5 billion, more than the $15-20 billion expected. Concessions remain very wide at more than 10 bps, as the market struggles to digest the deluge of issuance amid higher rates.

High yield corporates fell -1.34% and underperformed similar-duration Treasuries by -58 bps. The new issue market reopened somewhat, with almost $5 billion pricing after the slowest first quarter since 2016, with just $43 billion pricing. High yield also benefited from a second consecutive retail inflow of $296 million, while loan funds saw inflows of $2 billion. At the same time, CLO issuance picked up again, with four new structures pricing for a total of $1.6 billion, providing a further tailwind. The loan market returned 0.35% on the week.

Emerging markets outperformed amid the selloff, weakening -1.19% but outperforming similar-duration Treasuries by 57 bps. Several central banks hiked rates, including those in Romania, Serbia and Poland. Their rhetoric leaned hawkish, helping their long-end bonds outperform somewhat. The U.S. Treasury department blocked Russia's dollar payments on their maturing bond, sending their international bonds down -10 to -15 points in price, to trade in the 20s. Credit default swaps now imply almost certain default in the near term.

THE MUNICIPAL BOND MARKET REMAINS ORDERLY, DESPITE SELLING OFF

The municipal market sold off dramatically across the curve last week, following the large selloff in the Treasury market. Short-term muni bond yields ended 14 bps higher and the 30-year bond ended up 16 bps.

The Fed ratcheted up concerns about inflation, as well as its intention to continue with quantitative tightening in an effort to curb it. Plans appear to include several 50 bps increases in short-term rates over the next several months. Treasury yields rose accordingly after the announcement. Municipal bond yields substantially track government rates, and rose in tandem. However, the municipal market continues to trade in an orderly fashion. Although muni yields are generally rising, investors are continuing to buy bonds when yields move cheaper. This makes sense, as municipals are relatively cheap to Treasuries and on an absolute basis versus levels at the beginning of the year.

New York Power Authority issued $609 million green transmission project revenue bonds (rated A2/NR, with some insured by AGMC). The bonds traded cheaper in the secondary market. For example, 4% bonds due in 25 years came at a yield of 3.38% and traded in the secondary market at 3.52%.

The high yield municipal market is experiencing a strong period of two-way secondary trade flows, despite accelerating retail outflows. Spreads for high beta names like tobacco and Illinois widened again, although they are stronger fundamentally. Both credits offer a stark example of what is happening to the asset class. High beta spreads are widening, while idiosyncratic risk is held in. Investors can buy credits that are technically cheaper and fundamentally stronger. Institutional demand is coming in while retail demand is lagging. Liquidity is providing a premium once again.

Munis are cheap relative to Treasuries and on an absolute basis versus levels at the beginning of the year.

In focus

Rising rates aren't always bad for muni investors

The Fed recently began hiking rates, and inflation and geopolitical events are concerning investors. Municipal yields have risen more than 120 bps year to date, with the Bloomberg Municipal Bond Index down -6.89%.

Municipal underperformance is being driven by curve positioning, with longer-dated bonds underperforming. Meanwhile, credit fundamentals are strong. State revenue collections, reserves and pension-funded ratios are the highest in decades.

While yields have increased, municipal-to-Treasury yield ratios are the highest since October 2020. The 10-year ratio ended the quarter at 94% (67% historical average) and 30-year ratio moved to 104% (vs. 93%). Muni funds experienced net outflows, but ETFs see inflows as institutional investors find relative value at the higher ratios. New issuance has been slightly lighter.

Rising rates do not necessarily correlate to losses in bond portfolios, and attempting to time markets can negatively impact performance. Historically, remaining invested has benefited investors over longer periods. In five periods where municipal yields increased by at least 100 bps in less than one year, the principle value of a hypothetical portfolio based on Bloomberg Municipal Bond Index returns was higher 12 months after the rise in rates.

For more details, see Municipal market: How rates rise matters on nuveen.com.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	2.52	0.06	0.18	1.78
5-year	2.76	0.20	0.29	1.49
10-year	2.71	0.32	0.36	1.19
30-year	2.72	0.29	0.27	0.82

Source: Bloomberg L.P., 08 Apr 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	1.91	0.14	0.15	1.67
5-year	2.12	0.14	0.15	1.53
10-year	2.34	0.16	0.15	1.31
30-year	2.69	0.16	0.15	1.20

Source: Bloomberg L.P., 08 Apr 2022. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	86
30-year AAA Municipal vs Treasury	98
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters, 08 Apr 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	2.78	–	5.69	-0.83	-0.83	-7.01
High yield municipal	4.47	191[1]	8.33	-1.08	-1.06	-7.52
Short duration high yield municipal[2]	4.02	181	4.06	-0.56	-0.57	-3.79
Taxable municipal	3.83	101[3]	9.31	-2.77	-3.21	-11.23
U.S. aggregate bond	3.22	42[3]	6.59	-1.82	-2.08	-7.89
U.S. Treasury	2.70	–	6.64	-1.65	-1.93	-7.39
U.S. government related	3.18	49[3]	5.79	-1.40	-1.73	-7.03
U.S. corporate investment grade	3.91	116[3]	7.98	-2.36	-2.47	-9.96
U.S. mortgage-backed securities	3.33	31[3]	5.59	-1.72	-2.08	-6.95
U.S. commercial mortgage-backed securities	3.54	82[3]	4.91	-0.99	-1.42	-6.93
U.S. asset-backed securities	3.11	60[3]	2.30	-0.24	-0.48	-3.35
Preferred securities	5.09	200[3]	5.06	-1.34	-1.41	-7.65
High yield 2% issuer capped	6.42	339[3]	4.07	-1.34	-1.48	-6.23
Senior loans[4]	7.26	437	0.25	0.35	0.48	0.38
Global emerging markets	5.81	309[3]	6.78	-1.19	-1.36	-10.46
Global aggregate (unhedged)	2.35	44[3]	7.27	-1.77	-2.33	-8.35

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, 08 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, 08 Apr 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 06 Apr 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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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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