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Weekly Fixed Income Commentary

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Treasury yields rise, awaiting another Fed rate hike

U.S. Treasury yields rose as the market continues to front-load U.S. Federal Reserve rate hike expectations, pressuring fixed income returns. The underlying U.S. economic growth outlook remains healthy.

HIGHLIGHTS

- **Total and excess returns were negative across the board. Treasuries, agencies, MBS, CMBS, investment grade and high yield corporates, preferreds, convertibles and emerging markets all saw downturns.**

- **Senior loans were the sole bright spot, with a slightly positive return.**

- **Municipal bond yields rose once again. New issue supply was light at $5B, with outflows of -$5.5B. This week's new issue supply builds at $13.5B ($3B taxable).**

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Watchlist

- *10-year Treasury yields rose again, and we expect modest further increases 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 3.00%.

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 fails to decline as expected, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- COVID-19 cases increase, or new variants emerge.

TREASURY YIELDS APPROACHING MULTIYEAR HIGHS

U.S. Treasury yields rose again, led by the front-end, as the market continues to front-load Fed rate hike expectations. The two-year yield rose 21 bps, while the 10-year yield was up 7 bps. Both are around 30 bps away from their multiyear highs achieved in 2018. Fed Chair Powell specifically mentioned 50 bps rate hikes were "on the table," while other Fed officials mentioned a "couple" such moves and even suggested 75 bps hikes were possible. The market is fully pricing in 50 bps hikes at each of the next four meetings.

Investment grade corporates continued to weaken, returning -1.43% and underperforming similar-duration Treasuries by -78 bps. Yields overall are at 4.25%, the highest since the Covid selloff in March 2020. Spreads widened, but remain relatively contained at 132 bps; they touched 373 bps in March 2020. The market continues to digest elevated supply, with another $51.6 billion priced last week. The deals came at around 10 to 15 bps concessions versus existing bonds, while non-financial concessions were around 5 bps.

High yield corporates outperformed versus investment grade, but still weakened -0.88% for the week. As in higher-rated segments, rates and duration remain the biggest driver of the selloff, while credit concerns remain relatively benign. BBs returned -0.42% for the week, while Bs and CCCs returned -0.20% and -0.27%, respectively. Overall, the high yield market underperformed similar-duration Treasuries by -34 bps. Loans outperformed again, returning 0.02%, as investors continue to flock to the floating-rate asset class amid the selloff in Treasuries. While high yield funds experienced outflows of -$886 million, loan funds had inflows of $826 million. CLO creation also continues at a healthy pace, totaling $8.7 billion so far in April after $11.7 billion in March, providing further support to the asset class.

Emerging markets also fell, returning -1.21% and underperforming similar-duration Treasuries by -57 bps. Chinese corporates were weaker, as attention focuses on ongoing Covid lockdowns, with gaming and property names down around 0.5 to 2pts and 2 to 5pts, respectively. In non-U.S. developed markets, yields rose alongside the move in Treasuries, with 10-year German bund yields up 13 bps. Officials from the European Central Bank hinted that July will be a "live" meeting, and markets now price in around 40% odds of a 10 bps hike, with 84 bps of hikes priced by year-end.

TAX-EXEMPT MUNICIPAL CREDIT REMAINS STRONG

Municipal bond yields rose once again across the curve last week, up 19 bps on the short end and 22 bps on the long end.

The Fed is expected to raise short-term rates by 50 bps at the May meeting to continue battling inflation. Many investors believe this is not aggressive enough, thus Treasury rates sold off substantially in the short end of the curve to yields not seen in four years.

The municipal market selloff is essentially due to rising rates, as tax-exempt credit remains strong. Institutional managers continue to used the selloff to retool portfolios. Munis remain well bid as they are approximately 90% of the 10-year Treasury. Muni yields are much cheaper than at the beginning of this year. On January 4, the 10-year AAA MMD curve yielded 1.04%, versus 2.66% today.

Hamblen Co., TN, issued $94 million general obligation bonds (rated Aa3/AA-). The deal included 5% bonds due in 2030 that came at a yield of 2.78%. Those bonds traded later in the week 10 bps cheaper at a yield of 2.88%. This reflects how interest rates in general moved higher throughout the week.

High yield municipal bond yields rose 22 bps on average last week. We're tracking at least 18 new deals of interest for this week. Several deals from last week needed to be cheapened, along with improved security for investors, to clear the market. Investors currently have purchasing power, with outflows totaling -$697 million last week. Interestingly, since the new Puerto Rico GO bonds reentered high yield muni indexes in April, the yield for the Bloomberg Barclays High Yield Municipal Index is 13 bps lower when including Puerto Rico bonds.

The market is fully pricing in 50 bps Fed rate hikes at each of the next four meetings.

In focus

Consider non-fixed-rate preferreds when rates rise

In a rising rate environment, fixed-to-variable rate preferred securities typically experience less duration extension than fixed-rate structures. This makes their prices less sensitive to interest rate changes, and they typically experience better relative performance.

Fixed-to-variable structures come in two types: fixed-to-floating and fixed-to-fixed. Both pay a fixed coupon/dividend rate for a preset number of years (commonly five or ten) before resetting to a market-based rate. The reset date typically coincides with the first call date. The new rate is based on a benchmark plus a spread. They differ in how often the rate resets as well as the benchmark used.

Fixed-to-floating rate securities convert to a floating rate on the first reset date. The floating rate is based on a short benchmark that typically corresponds to the reset frequency, commonly every three months.

Fixed-to-fixed securities reset their rates at regular longer intervals – typically five years. The new rate is based on a longer benchmark, such as the 5-year Treasury.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	2.67	0.21	0.33	1.94
5-year	2.93	0.15	0.47	1.67
10-year	2.90	0.07	0.56	1.39
30-year	2.95	0.03	0.50	1.04

Source: Bloomberg L.P., 22 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	2.22	0.19	0.46	1.98
5-year	2.41	0.19	0.46	1.82
10-year	2.68	0.22	0.42	1.65
30-year	3.03	0.22	0.44	1.54

Source: Bloomberg L.P., 22 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	103
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters, 22 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	3.13	–	5.98	-1.17	-2.52	-8.59
High yield municipal	4.80	190[1]	9.01	-1.58	-3.13	-9.46
Short duration high yield municipal[2]	4.54	201	4.20	-0.65	-1.60	-4.79
Taxable municipal	4.07	107[3]	9.21	-0.95	-5.19	-13.05
U.S. aggregate bond	3.48	51[3]	6.52	-1.04	-3.78	-9.49
U.S. Treasury	2.88	–	6.51	-0.60	-3.07	-8.47
U.S. government related	3.39	53[3]	5.62	-0.94	-3.12	-8.35
U.S. corporate investment grade	4.25	132[3]	7.75	-1.43	-5.08	-12.38
U.S. mortgage-backed securities	3.65	48[3]	5.78	-1.37	-3.89	-8.67
U.S. commercial mortgage-backed securities	3.73	84[3]	4.87	-0.75	-2.18	-7.65
U.S. asset-backed securities	3.38	70[3]	2.29	-0.41	-0.80	-3.65
Preferred securities	5.42	222[3]	5.14	-1.37	-3.47	-9.58
High yield 2% issuer capped	6.75	356[3]	4.12	-0.88	-2.66	-7.35
Senior loans[4]	7.52	443	0.25	0.02	0.49	0.39
Global emerging markets	6.15	325[3]	6.61	-1.21	-3.49	-12.40
Global aggregate (unhedged)	2.55	47[3]	7.17	-1.36	-4.56	-10.44

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, 22 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, 22 Apr 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 20 Apr 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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