nuveen
A TIAA Company

Weekly Fixed Income Commentary

02 May 2022

Treasury yields rise, awaiting another Fed rate hike

U.S. Treasury yields rose again, but the moves were relatively mild compared to recent dynamics. First quarter U.S. GDP growth surprised to the downside, but the details behind the headlines were strong.

HIGHLIGHTS

- **Total returns were negative for Treasuries, agencies, investment grade and high yield corporates, preferreds, convertibles, loans and emerging markets.**

- **MBS and ABS had positive total returns.**

- **Municipal bond yields rose slightly. New issue supply was outsized at $13.5B, with outflows of -$2.8B. This week's new issue supply is light at $5.1B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

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%.

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.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

SENIOR LOANS SEE INFLOWS

Treasury yields rose for the fourth consecutive week, but the moves continue to decelerate. The 10-year yield was up 4 basis points (bps), while the 2-year yield rose 5 bps. First quarter GDP growth surprised to the downside, contracting -1.4%, but the details were strong. Personal consumption grew 2.7%, while fixed investment grew 7.3%. The drag came from net exports, inventories and government. The best measure of demand, final sales to private domestic purchasers, expanded 3.7%. It has lower variance than headline GDP and better represents underlying growth.

Investment grade corporates weakened again, returning -0.40% for the week and underperforming similar-duration Treasuries by -21 bps. The technical backdrop continues to be a headwind, with outflows of -$2.9 billion, excluding short-term funds. Supply moderated somewhat, with seven new deals totaling $8.6 billion, but demand remains tepid. Those issues were 2.6x oversubscribed on average, and came with concessions of 10.3 bps to existing bonds, a still-elevated level. Flows are expected to be somewhat muted this week, with much of Asia celebrating the Golden Week holiday.

High yield corporates lagged, returning -0.92% and underperforming similar-duration Treasuries by -91 bps. The asset class saw modest outflows of -$118 million. Though the rate increase continued to be a headwind, the selloff was not primarily driven by duration. CCCs, which tend to have shorter duration, returned -1.44% for the week, while longer BBs returned -0.83%. Only two deals priced, still more than the recent average, though both met with weak demand. Senior loans saw inflows of $667 million, but still returned -0.32%.

Emerging markets sold off as well, returning -0.87% and underperforming similar-duration Treasuries by -88 bps. The asset class had a large outflow of $3 billion, split evenly between local and hard currency funds. In general, high yield names underperformed across Latin America, Africa and the Gulf, consistent with the broader risk aversion across fixed income markets. Two major idiosyncratic nations traded well: first, officials in China pledged more policy support for infrastructure and technology, helping property and technology companies to rally; second, Russia reportedly made payments on two dollar bonds before the end of the grace period, which would have triggered default, helping bonds to rally 10 to 15 points.

WE SEE A LIGHT FOR MUNI BONDS

Municipal bond yields rose slightly last week, while Treasury yields ended slightly lower.

All eyes are on the Fed this week. The central bank is expected to raise short-term rates 50 bps and it will no longer purchase government securities in the secondary market, moving into quantitative tightening mode.

The small increase in municipal yields was due primarily to outsized new issuance and mutual fund redemptions. However, there may be a light at the end of the tunnel, for a few reasons: Fixed income yields in general may have crested, new issuance of tax-exempt bonds may be lower for the foreseeable future, muni redemptions may be lighter now that the U.S. tax deadline has passed, and outsized coupon reinvestment of $38 billion came due on May 1.

Tax-exempt municipal yields are approaching 3% in the intermediate range, which is drawing interest on an absolute basis. And intermediate municipal yields are roughly 100% of Treasuries, which is extremely attractive on a relative basis.

Hampton Roads Transportation Accountability Commission, VA, issued $408 million revenue bonds (rated Aa2/AA). The deal was well received, and some bonds traded at a premium in the secondary market. For example, a 30-year bond with a 4% coupon came at a yield of 4.08%. Those bonds later traded at a yield of 4.04%.

High yield municipal trade volume is high. Credit spreads remain unchanged. This market is uncharacteristically tied to rates, and credit spreads would normally contract in this environment. All eyes remain on fund flows, which remain strong and shouldn't cause further dislocations. The market is holding the line, not allowing credit spreads to widen, waiting for an inflection point.

Intermediate municipal yields are roughly 100% of Treasuries, which is extremely attractive on a relative basis.

In focus

Markets anticipate more Fed rate hikes

The Fed just began raising rates, but fixed income markets are already expecting additional hikes.

At the March meeting, Fed projections showed the policy rate at 1.9% by the end of 2022, then increasing to 2.8% by 2023 before falling to 2.4% after 2024. At that time, market rates largely reflected these levels.

Market-based probabilities have risen sharply since then, embedded in the yields of short-term market instruments. Most models reflect 50 bps hikes at each of the next three meetings, with a policy rate of about 2.7% in December 2022.

Indications of Fed hikes can often be confusing because it is implied that each increase is 25 bps. This has been the case for policy rate changes recently, but is not mandated. In fact, we expect (and markets reflect) that the policy rate will increase by 50 bps this week.

Looking ahead, inflation data will be critical in determining the actual path of monetary policy. We are closely watching wage growth, inflation expectations and actual realized inflation. All three metrics are running too hot right now, and further upside surprises would prompt a more aggressive pace of Fed hikes. We expect these factors to moderate over the coming quarters, however.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	April 2022	Year-to-date
2-year	2.72	0.05	0.38	1.98
5-year	2.96	0.02	0.50	1.69
10-year	2.94	0.03	0.60	1.43
30-year	3.00	0.05	0.55	1.10

Source: Bloomberg L.P., 29 Apr 2022. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	April 2022	Year-to-date
2-year	2.22	0.00	0.46	1.98
5-year	2.45	0.04	0.50	1.86
10-year	2.72	0.04	0.46	1.69
30-year	3.05	0.02	0.48	1.56

Source: Bloomberg L.P., 29 Apr 2022. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	94
30-year AAA Municipal vs Treasury	103
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters, 29 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	April 2022	Year-to-date
Municipal	3.18	–	6.08	-0.25	-2.77	-8.82
High yield municipal	4.87	195[1]	9.20	-0.43	-3.55	-9.85
Short duration high yield municipal[2]	4.58	201	4.42	-0.15	-1.74	-4.93
Taxable municipal	4.10	108[3]	9.21	-0.16	-5.35	-13.19
U.S. aggregate bond	3.48	49[3]	6.48	-0.02	-3.79	-9.50
U.S. Treasury	2.88	–	6.48	-0.03	-3.10	-8.50
U.S. government related	3.42	54[3]	5.58	-0.18	-3.30	-8.52
U.S. corporate investment grade	4.31	135[3]	7.70	-0.40	-5.47	-12.73
U.S. mortgage-backed securities	3.59	40[3]	5.72	0.40	-3.51	-8.31
U.S. commercial mortgage-backed securities	3.78	87[3]	4.88	-0.13	-2.31	-7.77
U.S. asset-backed securities	3.40	69[3]	2.28	0.03	-0.76	-3.62
Preferred securities	5.49	235[3]	5.11	-0.85	-4.29	-10.35
High yield 2% issuer capped	6.99	379[3]	4.15	-0.92	-3.55	-8.20
Senior loans[4]	7.66	458	0.25	-0.32	0.17	0.07
Global emerging markets	6.30	338[3]	6.54	-0.87	-4.33	-13.15
Global aggregate (unhedged)	2.57	48[3]	7.13	-0.97	-5.48	-11.30

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, 29 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, 29 Apr 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 27 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.

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.

GWP-2172388PG-W0522P