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Weekly Fixed Income Commentary

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Promising economic data boost Treasury yields

U.S. Treasury yields rose last week on positive economic data. Longer duration investments lagged and spread sectors broadly outperformed Treasuries.

HIGHLIGHTS

- **Total returns were negative for Treasuries, agencies, taxable munis, investment grade corporates, MBS, CMBS, ABS, loans and emerging markets.**
- **High yield, preferreds and convertibles all had positive total returns.**
- **Municipal bond yields declined. New issue supply was light at $2.2B, with outflows of -$313M. This week's new issue supply is outsized at $14B ($2.8B taxable).**

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Watchlist

- *10-year Treasury yields rose. We expect them to remain volatile, but move modestly higher this year.*
- *Spread assets benefited from the improved growth outlook.*
- *Net-negative supply should provide some support to municipal bonds.*

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 remains 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 3.5%.

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

- Inflation fails to decline as expected, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- The Russia/Ukraine conflict continues to escalate.
- COVID-19 cases increase, or new variants emerge.

HIGH YIELD CORPORATES BENEFIT FROM INFLOWS

U.S. Treasury yields rose last week, with the 10-year yield ending 20 basis points (bps) higher. Economic data were positive, beginning with the ISM services survey on Wednesday, which beat expectations at 55.3 versus consensus forecasts for 54.0. On Friday, the June labor market report showed a net increase of 372,000 jobs for the month, with the unemployment rate staying steady at 3.6%. Wage growth expanded 0.3% month-over-month. That takes the 3-month annualized rate to 4.2%, a deceleration from the prior 12 months (5.6%). Finally, sentiment was further supported by news that China will boost infrastructure investment this year, which improved the global growth outlook and caused a rally in commodity prices.

The rise in yields dragged on investment grade corporates, with the asset class returning -0.49%. However, sentiment was well-supported and spreads broadly tightened, with the index ending -11 bps tighter at 147 bps, helping it outperform similar-duration Treasuries by 80 bps. Investment grade funds saw outflows of -$1.2 billion, the 19th consecutive weekly outflow, which is now the longest such streak on record. Under the surface, higher-quality names continue to outperform, with As tightening -2 bps more than BBBs.

High yield corporates outperformed, returning 1.32% on the week and beating similar-duration Treasuries by 222 bps. The asset class saw a similar dynamic as investment grade, with higher-rated bonds outperforming. BBs returned 1.74% for the week, while Bs and CCCs performed 1.08% and 0.31%, respectively. High yield benefited from a $889 million inflow, though loan funds saw an outflow of -$1.1 billion. That impacted loan performance, with the asset class returning -0.26%.

Emerging markets lagged slightly, returning -0.88% for the week, though they outperformed similar-duration Treasuries by 21 bps. Central banks in Hungary and Romania surprised by hiking rates by more than expected, which helped curves across the region to flatten. Turkey was downgraded from B+ to B by Fitch, with the currency weakening almost 3% and yields rising by around 15 bps. In the UK, Prime Minister Johnson resigned, and gilt yields rose 15 bps, in line with the moves in other core markets.

MUNIS BENEFIT FROM SUPPLY AND DEMAND IMBALANCE

Municipal bond yields rallied dramatically last week. Short maturities finished the week 14 bps lower, while the long end of the yield curve declined 10 bps. Conversely, the Treasury market sold off, with short yields ending the week 27 bps higher and the long end 13 bps higher.

Treasury rates rose in part due to strong employment data released last week. The numbers suggest continued strong demand for workers, meaning the Fed is likely to raise short-term rates another 75 bps in July as it continues to battle inflation.

Municipal yields ended lower last week, partially due to the supply and demand balance. An outsized amount or reinvestment money is returning to the municipal market while new issue supply has been muted. Tax-exempt munis are currently slightly rich to taxable Treasuries. Thus, we may see a slight sell off in the municipal market in the short term. However we would see any decline as a potential buying opportunity.

City of Denver, CO, issued $1.6 billion airport revenue bonds (rated Aa3/A+). Two series were issued: one contained bonds subject AMT and the other series was not subject to AMT.

High yield municipal yields decreased last week, but by less than investment grades, causing spreads to widen. High yield municipal credit spreads stand around 230 bps on average, 55 bps higher than the beginning of the year. Fund flows turned positive last week, and we expect this trend to continue building this week. Key leading indicators of liquidity-driven demand rallied significantly last week. New issuance should be very light this week, allowing the market to clear many existing deals. If not, demand will be forced to compete in the secondary market.

Investment grade corporate funds saw the 19th consecutive weekly outflow, the longest such streak on record.

In focus

Better times may beckon for bonds

In its 2022 midyear outlook, Nuveen's Global Investment Committee (GIC) analyzed current market conditions and identified opportunities across asset classes in the wake of a dismal first half. Below we highlight some of the GIC's key perspectives on fixed income.

In the GIC's view, markets are forecasting a slowdown or even a mild contraction in the U.S. economy. But unless economic and inflationary conditions worsen materially from here, bonds should find their footing. Fundamentals for debt issuers remain solid, and default rates aren't expected to rise significantly, even in a recession. For these reasons, the GIC prefers taking on credit risk over adding duration to portfolios.

As for specific fixed income categories, the GIC likes senior loans, whose nearly 10% yields are compelling and whose floating-rate coupons and low sensitivity to rising rates offer a measure of protection amid Fed tightening. High yield corporate bonds are also in favor, now yielding 8.5% with widening spreads that provide room for price appreciation.

The GIC's highest-conviction trade? Municipal bonds. Both investment grade and high yield munis fell unfair victim to broad macro issues (mainly rising rates) in the first half of 2022. Exposure to both duration and credit risk in the muni space should provide attractive yield and total return potential.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	3.11	0.27	0.15	2.38
5-year	3.13	0.25	0.09	1.86
10-year	3.08	0.20	0.07	1.57
30-year	3.25	0.14	0.06	1.35

Source: Bloomberg L.P., 08 Jul 2022. **Past performance does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.79	-0.14	-0.16	1.55
5-year	2.05	-0.13	-0.17	1.46
10-year	2.49	-0.17	-0.23	1.46
30-year	3.01	-0.10	-0.17	1.52

Source: Bloomberg L.P., 08 Jul 2022. **Past performance does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	81
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	61

Source: Bloomberg L.P., Thompson Reuters, 08 Jul 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 does not predict or guarantee future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.03	–	6.68	0.79	1.15	-7.93
High yield municipal	5.20	233[1]	10.27	0.99	1.56	-10.39
Short duration high yield municipal[2]	4.75	245	4.28	0.50	0.84	-4.82
Taxable municipal	4.41	117[3]	9.31	-1.73	-1.00	-14.83
U.S. aggregate bond	3.79	53[3]	6.45	-0.87	-0.27	-10.59
U.S. Treasury	3.20	–	6.40	-1.08	-0.55	-9.64
U.S. government related	3.77	59[3]	5.48	-0.83	-0.31	-9.46
U.S. corporate investment grade	4.71	147[3]	7.59	-0.49	0.06	-14.33
U.S. mortgage-backed securities	3.81	42[3]	5.90	-0.92	-0.15	-8.91
U.S. commercial mortgage-backed securities	4.17	101[3]	4.86	-0.98	-0.37	-8.62
U.S. asset-backed securities	3.92	76[3]	2.24	-0.57	-0.24	-4.00
Preferred securities	6.33	263[3]	4.90	0.54	0.97	-13.00
High yield 2% issuer capped	8.61	527[3]	4.21	1.32	1.51	-12.89
Senior loans[4]	9.94	667	0.25	-0.07	-0.18	-4.62
Global emerging markets	7.24	404[3]	6.30	-0.88	-0.30	-17.39
Global aggregate (unhedged)	2.91	55[3]	7.02	-1.12	-0.67	-14.49

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 Jul 2022. **Past performance does not predict or guarantee 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 Jul 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 06 Jul 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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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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