nuveen
A TIAA Company

Weekly Fixed Income Commentary

01 August 2022

# Treasury yields fall as markets await a Fed pause

*U.S. Treasury yields fell again last week and spread sectors outperformed. After the U.S. Federal Reserve hiked interest rates by 75 basis points as expected, the market began to more firmly price in an eventual end of the rate hiking cycle.*

## HIGHLIGHTS

- **Total returns were positive across fixed income markets, including Treasuries, agencies, taxable munis, investment grade corporates, preferreds, high yield corporates, MBS, CMBS, ABS, loans, and emerging markets.**
- **Municipal bond yields declined. New issue supply was $2.5B, with inflows of $236M. This week's new issue supply should be light at $4.1B.**


**Anders Persson**
*CIO of Global Fixed Income*



**John Miller**
*Head of Municipals*

# *Watchlist*

- *10-year Treasury yields declined. We expect them to remain volatile, but move modestly higher this year.*
- *Spread assets benefited from the improved economic 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 3.00%.

**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

- Inflation fails to moderate 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.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.



## HIGH YIELD CORPORATES RALLY AGAIN

**U.S. Treasuries rallied again,** with the 10-year yield falling another -10 basis points (bps) for the week to end at 2.65%, now -85 bps from the intraday peak close to 3.50% reached in mid-June. Two-year yields also rallied, trading -9 bps to 2.88%, leaving the 2/10 yield curve inverted. After the Fed hiked interest rates by 75 bps as expected, the market began to more firmly price in the end of the rate hiking cycle. Futures prices now imply the Fed will pause its hiking cycle by December. This dovish shift in pricing sparked the rally across the Treasury curve, as the terminal policy rate is now expected to be around 3.30% instead of 4.05%.

**Investment grade corporates rallied again,** returning 0.50% for the week, though they marginally underperformed similar-duration Treasuries, by -1 bps. The asset class snapped a streak of 18 consecutive weekly outflows, with a positive inflow of $1.5 billion for the week, which contributed to the buying pressure. The primary market continued its recent trend, with another $17.6 billion pricing for the week. The July total now stands at $83.6 billion, more than the approximately $65 billion expected. Concessions remain wide at around 11 bps, and BBBs continue to underperform versus As at the margin.

**High yield corporates capped off a strong July with another weekly rally,** returning 1.53% for the week and outperforming similar-duration Treasuries by 85 bps. July's total return ended at 5.90%, the strongest monthly performance since 2009. As in investment grade markets, the asset class was boosted by a large inflow of $4.8 billion, the largest since June 2020. Loan funds saw another outflow of -$833 million, for the seventh consecutive week, but still returned 0.19%.

**Emerging markets outperformed,** gaining 1.88% and beating similar-duration Treasuries by 139 bps. Similar to recent weeks of poor performance, liquidity was thin, causing some sharp moves as dealers bid aggressively into a market with few sellers. High yield outperformed sharply, especially corporates where liquidity was exceptionally poor, with high yield corporate spreads tightening -23 bps for the week. In Europe, inflation surprised to the upside again, at 8.9% year-over-year, but yields nevertheless rallied sharply. Ten-year German bund yields fell -21 bps amid the global rates rally.

## FAVORABLE TECHNICALS CONTINUE TO SUPPORT MUNICIPAL BONDS

**Both municipal bond and Treasury yields rallied substantially last week,** and both markets closed Friday with strong tones.

**Fixed income markets were encouraged** by the news that the Fed raised rates another 75 bps. Investors were even happier when many Fed officials declared they are “strongly committed to returning inflation to its 2% objective.” Although investors enjoyed hearing the Fed members’ tough rhetoric, many believe inflation has crested and the U.S. may be headed for a recession. This gave more ammunition for rates to decline further. The 10-year U.S. Treasury bond dropped to 2.65% from a high of 3.47% in mid-June. The inverted curve suggests that long-term rates should decline even further. Municipal bonds continue to be well bid. This trend should continue, as supply is light and reinvestment of outsized bond call money continues.

**The city of Belton, Texas,** issued $166 million unlimited tax school building general obligation bonds (rated AA-). The deal included 5% bonds due in 2032 priced at a yield of 2.43%.

**High yield municipal fund flows are building,** demand is strengthening and market performance is improving. Fund flows totaled $569 million last week. Tobacco and Puerto Rico, leading indicators of market technicals, are rallying. We are tracking at least 20 new issue deals for this coming week. However, five of the largest deals remain in day-to-day status from prior weeks. Some deals may clear, but some credits may be too weak to solicit sufficient demand.

***High yield corporates were boosted by a large inflow of $4.8 billion, the largest since June 2020.***

*In focus*

# The Fed’s “Summer of ‘75” continues

*June’s decades-high Consumer Price Index (CPI) reading compelled the Federal Reserve to maintain its brisk pace of policy tightening.*

Last week, as expected, the Fed raised its target fed funds rate by 75 bps for the second consecutive meeting, to 2.25% to 2.50%. This action brings the policy rate close to the Fed’s estimate of neutral, the level at which interest rates neither stimulate nor restrain the economy. Markets had briefly priced in a 100 bps jump after the June CPI release, but the Fed hadn’t endorsed such an outsized move, nor had economic data strengthened enough to warrant it.

At his post-meeting press conference, Fed Chair Jerome Powell was vague about the Fed’s tightening plans when it next gathers on September 21. He and his colleagues will examine incoming data, which will include two monthly employment reports and several inflation readings. But rather than provide specific forward guidance, Powell stated that any decisions will be made on a “meeting by meeting” basis. Powell’s decision to avoid any predictions was driven by the Fed’s assurances that a 50 bps hike was in store for June, which fell by the wayside as inflation continued to spike, leading to a 75 bps increase instead.

Rates are nearly certain to move significantly higher before year-end, although the pace of hiking should slow. Markets are pricing 100 bps of increases in total over the last three meetings of 2022.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | July 2022 | Year-to-date |
| 2-year | 2.89 | -0.09 | -0.07 | 2.15 |
| 5-year | 2.68 | -0.17 | -0.36 | 1.41 |
| 10-year | 2.65 | -0.10 | -0.37 | 1.14 |
| 30-year | 3.01 | 0.04 | -0.17 | 1.11 |

Source: Bloomberg L.P., 29 Jul 2022. **Past performance does not predict or guarantee future results.**

## Municipal market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield to Worst | Week | July 2022 | Year-to-date |
| 2-year | 1.60 | -0.10 | -0.35 | 1.36 |
| 5-year | 1.80 | -0.14 | -0.42 | 1.21 |
| 10-year | 2.21 | -0.18 | -0.51 | 1.18 |
| 30-year | 2.89 | -0.10 | -0.29 | 1.40 |

Source: Bloomberg L.P., 29 Jul 2022. **Past performance does not predict or guarantee future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 83 |
| 30-year AAA Municipal vs Treasury | 96 |
| High Yield Municipal vs High Yield Corporate | 65 |

Source: Bloomberg L.P., Thompson Reuters, 29 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 | July 2022 | Year-to-date |
| Municipal | 2.79 | – | 6.58 | 0.92 | 2.64 | -6.58 |
| High yield municipal | 5.02 | 227[1] | 10.14 | 1.37 | 3.73 | -8.48 |
| Short duration high yield municipal[2] | 4.49 | 246 | 4.11 | 0.80 | 2.21 | -3.52 |
| Taxable municipal | 4.11 | 123[3] | 9.36 | 0.49 | 1.92 | -12.31 |
| U.S. aggregate bond | 3.42 | 49[3] | 6.40 | 0.64 | 2.44 | -8.16 |
| U.S. Treasury | 2.89 | – | 6.49 | 0.29 | 1.59 | -7.69 |
| U.S. government related | 3.48 | 63[3] | 5.54 | 0.59 | 1.66 | -7.67 |
| U.S. corporate investment grade | 4.33 | 144[3] | 7.70 | 0.50 | 3.24 | -11.61 |
| U.S. mortgage-backed securities | 3.35 | 27[3] | 5.48 | 1.29 | 3.22 | -5.85 |
| U.S. commercial mortgage-backed securities | 3.82 | 106[3] | 4.88 | 0.54 | 1.83 | -6.61 |
| U.S. asset-backed securities | 3.71 | 82[3] | 2.21 | 0.21 | 0.48 | -3.30 |
| Preferred securities | 5.69 | 226[3] | 4.71 | 1.60 | 5.23 | -9.34 |
| High yield 2% issuer capped | 7.74 | 471[3] | 4.02 | 1.53 | 5.90 | -9.12 |
| Senior loans[4] | 8.93 | 602 | 0.25 | 0.19 | 1.87 | -2.66 |
| Global emerging markets | 6.90 | 405[3] | 6.43 | 1.88 | 2.11 | -15.39 |
| Global aggregate (unhedged) | 2.60 | 54[3] | 7.06 | 1.15 | 2.13 | -12.08 |

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

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 does not predict or guarantee 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.**

### Important information 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-2323536PG-W0722P