nuveen
A TIAA Company

Weekly Fixed Income Commentary

06 March 2023

Inflation surprises push Treasury yields higher

U.S. Treasury yields rose further, after yet another round of unfavorable inflation data. The ISM survey showed a rebound in prices, which will support U.S. inflation and likely spur the U.S. Federal Reserve to continue raising rates several more times this year.

HIGHLIGHTS

- **Total returns were positive for agencies, investment grade and high yield corporates, convertibles and senior loans.**
- **Preferreds, MBS, CMBS and emerging markets had slightly negative returns.**
- **Municipal bond yields rose once again. New issue supply was $4.8B with outflows of -$905M. This week's new issuance should be outsized at $10.8B ($4.9B taxable).**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *U.S. Treasury yields rose across the curve.*
- *Spread assets gained after retreating in February.*
- *Net-negative supply should provide some support to municipal bonds.*

INVESTMENT VIEWS

The end to U.S. central bank tightening appears near, as we expect Fed rate hikes to cease early this year. The overall level of rates is likely to remain relatively low by historical standards.

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 fall this year, and we expect the 10-year Treasury yield to end 2023 around 3.25%.

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.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.
- Covid cases increase, or new variants emerge.

HIGH YIELD CORPORATES CONTINUE TO OUTPERFORM

U.S. Treasury yields rose again last week, with the 10-year yield increasing 1 basis point (bps) to 3.96%. Buyers stepped in as yields touched 4% mid-week, but other core government bond markets have continued to sell off, with 10-year German bund yields rising 18 bps to reach new multi-year highs. The main catalyst was another upside surprise to inflation, this time in Europe, where core prices rose 5.6% and are likely to move higher again next month before peaking. In the U.S., the ISM survey showed a rebound in prices as well, which will support U.S. inflation in the near-term and likely spur the Fed to continue raising rates several more times this year.

Investment grade corporates gained last week, returning 0.42% and beating similar-duration Treasuries by 24 bps. That leaves the asset class up 0.91% for the year, as the strong rally from January mostly retraced in February. Inflows continued to be healthy, at $5 billion last week. That enabled the market to digest an elevated week of supply, as 38 issuers brought almost $46 billion of new issuance, comfortably above expectations of around $35 billion. Those deals were generally well subscribed, though the issuance from industrial company Stanley Black and Decker met soft demand and ended up pricing 10 bps wide from initial discussions. That is rare in the investment grade market, and signals that investors are becoming more selective in the current environment.

High yield corporates outperformed again, returning 0.78% for the week and outperforming similar-duration Treasuries by 80 bps. Loans also gained, returning 0.18%. In both markets, CCCs outperformed, with investors comfortable adding credit risk exposure despite macro volatility. Both high yield and senior loan funds saw outflows last week, totaling -$2.3 billion and -$616 million, respectively.

Emerging markets lagged, returning -0.13% for the week and underperforming similar-duration Treasuries by -23 bps. Most of the weakness was concentrated in the hard currency, sub-investment grade sovereign sector, where spreads widened 11 bps overall. Spreads tightened in investment grade sovereigns and across the corporate space. Hard currency funds saw another week of outflows totaling -$739 million, while local currency funds had the largest weekly outflows since November at -$835 million. Nevertheless, local markets returned 0.43%, as commodity prices rose and the dollar weakened.

HIGH YIELD MUNICIPAL BOND ISSUANCE SHOULD BE LIGHTER THIS WEEK

Municipal bond yields ended last week higher. Dealers struggled to sell new deals and fund flows were negative. This week's new issue supply should be outsized and will need to be priced to sell to pique investor interest.

"Higher for longer" remains the theme in the fixed income market. The 10-year Treasury yield hit 4% last week for the first time in quite a while. The market believes the Fed must continue working to control inflation, and Fed officials reiterated their commitment to this objective last week. But inflation persists, so we expect the Fed to continue raising rates. The average fixed income investor could see this as an opportunity to enjoy higher bond yields.

The Chicago Board of Education accessed the municipal debt markets with two deals worth more than $1 billion last week. One deal contained $529 million dedicated capital improvement tax bonds (rated NR/NR/A/BBB+). Its largest maturity was reportedly 9 times oversubscribed and bonds traded more than 20 bps tighter in the secondary market.

High yield municipal market outflows slowed last week, and the new issue calendar expected this week is only $300 million. February took its toll on the highest beta bonds. For example, Golden State Tobacco bonds were down as much as 25%. Average high yield muni bond yields are nearly as high, but not quite where they were at the start of the year.

Investment grade corporate inflows continued to be healthy, enabling the market to digest elevated supply.

In focus

Preferreds in a portfolio?

With the economy heating up, additional Fed rate hikes looming and Treasury yields rising, investors may hesitate to allocate capital to preferred securities, given their reputation as highly sensitive to interest rates. But we think now may be a good time to consider including preferreds in a well-diversified fixed income portfolio.

Attractive, potentially tax-exempt income: As of 3 March, the asset class yielded a healthy 6.9%, according to the ICE BofA U.S. All Capital Securities Index. Moreover, most dividends are treated as qualified dividends, meaning they are taxed as capital gains rather than ordinary income.

Strong fundamentals: Banks — which make up the largest percentage of the preferred universe — remain well capitalized. And forecasted defaults for banks and insurance companies are low compared to the broad credit market, thanks to their financial strength.

Favorable supply/demand landscape: In the near-to-medium-term, we expect net new supply will be flat, thanks to banks' and insurance companies' high capital levels and stable credit ratings. Meanwhile, investor demand should remain strong for high quality, tax-efficient income.

Still-attractive valuations: Although spreads have tightened in 2023, they remain close to levels from one year ago.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	February 2023	Year-to-date
2-year	4.86	0.04	0.62	0.43
5-year	4.25	0.03	0.57	0.24
10-year	3.96	0.01	0.41	0.08
30-year	3.88	-0.06	0.28	-0.09

Source: Bloomberg L.P., 03 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	February 2023	Year-to-date
2-year	2.99	0.04	0.78	0.39
5-year	2.68	0.07	0.59	0.16
10-year	2.63	0.04	0.40	0.00
30-year	3.60	0.04	0.36	0.02

Source: Bloomberg L.P., 03 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	66
30-year AAA Municipal vs Treasury	92
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters, 03 Mar 2023. 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. **Performance data shown represents past performance and does not predict or guarantee future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	February 2023	Year-to-date
Municipal	3.65	–	6.19	-0.15	-2.26	0.36
High yield municipal	5.84	242[1]	7.87	-0.37	-3.14	0.70
Short duration high yield municipal[2]	5.49	290	4.14	-0.16	-1.17	1.12
Taxable municipal	5.10	92[3]	8.28	0.33	-2.27	2.62
U.S. aggregate bond	4.85	47[3]	6.31	0.12	-2.59	0.28
U.S. Treasury	4.42	–	6.19	0.12	-2.34	-0.06
U.S. government related	4.97	52[3]	5.36	0.08	-1.79	0.40
U.S. corporate investment grade	5.51	120[3]	7.14	0.42	-3.18	0.91
U.S. mortgage-backed securities	4.83	47[3]	6.10	-0.13	-2.64	0.19
U.S. commercial mortgage-backed securities	5.43	102[3]	4.52	-0.08	-1.87	0.44
U.S. asset-backed securities	5.34	54[3]	2.83	0.01	-0.85	0.47
Preferred securities	6.92	200[3]	4.92	-0.02	-1.91	6.22
High yield 2% issuer capped	8.57	398[3]	3.76	0.78	-1.27	2.80
Senior loans[4]	10.57	585	0.25	0.18	0.63	3.28
Global emerging markets	7.59	325[3]	6.13	-0.13	-2.23	0.61
Global aggregate (unhedged)	3.89	47[3]	6.76	0.02	-3.32	-0.35

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, 03 Mar 2023. **Performance data shown represents past performance and 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, 03 Mar 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 01 Mar 2023.

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. **Performance data shown represents past performance and 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.