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Weekly Fixed Income Commentary

20 March 2023

Banking uncertainty weighs heavily on bond markets

U.S. Treasury yields continued to fall steeply amid heightened economic and financial uncertainty. We expect the U.S. Federal Reserve to hike rates by 25 basis points this week, though the longer-term outlook is much less clear than it was just one week ago.

HIGHLIGHTS

- **Total returns were positive for Treasuries, investment grade corporates, taxable munis, MBS, ABS and emerging markets.**
- **In contrast, preferreds, convertibles, high yield corporates, and senior loans had negative total returns.**
- **Municipal bond yields declined. New issue supply was $6.8B with outflows of -$461M. This week's new issuance is undersized at $3.3B.**

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Watchlist

- *U.S. Treasury yields decreased across the curve.*
- *Spread assets sold off in the wake of banking sector uncertainty.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" emerges as a theme, as the Fed battles to control inflation. Higher interest rates are likely to cause additional volatility.

The underlying growth outlook remains healthy, thanks to strong consumer balance sheets and solid levels of businesses investment. This combination should keep corporate 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 selectively taking on risk in this environment of attractive prices and yields. Credit selection is key as we search for bonds with favorable income and characteristics.

KEY RISKS

- Inflation fails to moderate as expected, weighing on asset prices.
- Policymakers tighten too rapidly, undermining the global economic expansion.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

CORPORATE BOND MARKET SEES ZERO NEW ISSUANCE

U.S. Treasury yields fell sharply as uncertainty and risk aversion both accelerated last week. The 10-year Treasury yield fell -27 bps, while the 2-year yield fell -75 bps. That marked the biggest weekly front-end rally since 1987. In addition to the large directional moves, intraday volatility remains high. The 2-year yield has moved up or down by at least 20 bps in each of the last seven sessions, the longest streak on record going back to 1976. We continue to expect the Fed to hike rates by 25 bps at this week's policy meeting, though the longer-term outlook is much less clear than it was just one week ago.

Investment grade corporates gained last week, helped by the huge rally in Treasuries, returning 0.76%. Excess returns were negative, at -89 bps. Even relatively safe, highly rated corporates were shunned by investors, leading to spread widening. The asset class saw an outflow of -$3.8 billion, snapping a streak of 10 straight weekly inflows. At the same time, the new issue market completely dried up, with zero new deals coming to market. That was the first non-holiday week of zero issuance since February 2020, at the start of the Covid crisis.

High yield corporates weakened, returning -0.42% for the week. Similar to the prior week, the rally in rates helped total returns, but did not fully offset the impact of wider credit spreads. The asset class underperformed similar-duration Treasuries by -89 bps. High yield assets experienced a strong decompression trend. BB-rated corporates returned 0.18%, while CCCs fell -2.05%. As in investment grade, the new issue market was completely closed and fund flows were negative. Around -$1.4 billion left high yield corporate funds and -$1.6 billion exited loan funds. Senior loans returned -1.04% for the week, its biggest weekly selloff since September.

Emerging markets eked out a positive return of 0.12% for the week, though the asset class lagged similar-duration Treasuries by -156 bps. Most of the weakness was concentrated in lower-rated segments. Within sovereigns, investment grade spreads rose 7 bps, versus high yield's 78 bps widening. As in other markets, the new issue market was completely closed amid the volatility and outflows picked up, with -$1.3 billion leaving the asset class, the largest outflow of the year.

MUNICIPAL CREDIT REMAINS STRONG AMID BANKING TURMOIL

Municipal bond yields declined last week, following the Treasury curve flight-to-quality rally. Muni yields declined -30 basis points on the short end and only -6 basis points on the long end. Weekly new issue supply was well received, while fund flows were negative. This week's undersized new issue supply should be well received.

Markets in general remain volatile due to banking sector concerns. Some investors believe banks may be forced to sell municipal holdings and use the cash to shore up their balance sheets. At this time, we see no credit issues appearing in municipals as an asset class. Banks would be selling to raise liquidity to meet customers' withdrawal demands. With excess cash on the sidelines waiting to be invested, we would see any municipal sell off as a potential buying opportunity.

NYC Transitional Finance Authority (TFA) issued $950 million tax-secured bonds (rated Aa1/AAA). The deal included 4% coupon bonds due in 2051 yielding 4.45%. Those bonds traded in the secondary market at a yield of 4.40%.

Municipal bond yields were significantly less volatile than Treasury yields last week, and high yield municipal yields were even less volatile. As high yield muni inflows resume and market liquidity normalizes, the typical low correlation to rate volatility is also returning. High yield municipal yields decreased by just 2 bps last week on average, making their relative value more attractive compared to much larger decreases for high grade muni bonds and Treasuries. Some higher risk areas of the market like Puerto Rico and tobacco showed greater volatility, but rebounded by end of the week. Net inflows totaled $300 million. New issuance this week is very light, with less than six high yield municipal deals pricing.

The 2-year Treasury yield has moved up or down by at least 20 bps in each of the last seven sessions.

In focus

Banks enter the Fed's calculus

Until very recently, the Fed had set its sights on taming inflation. But suddenly the health of the banking system entered the equation, complicating matters for the central bank.

Following the shuttering of Silicon Valley Bank on 10 March and Signature Bank two days later, Chair Jerome Powell and his colleagues now must consider the potential economic fallout of bank sector turmoil. Investors "voted" by shunning risk assets in favor of safe-haven securities like U.S. Treasuries, despite the Fed's opening of a new lending facility to provide extra funding for banks to meet future deposit withdrawals.

These events make this week's Fed meeting the most up-in-the-air gathering in recent memory, with reasonable cases for an interest rate hike, a pause or even a cut. The market is pricing in around a 60% chance of a 25 bps hike and a 40% chance of a pause.

There's been no word from policymakers, as they're in the blackout period preceding every Fed gathering, prohibiting them from speaking publicly. In our view, the lack of additional bank runs, coupled with the muted reaction to the European Central Bank's 50 bps rate increase on 16 March, gives the Fed a window to tighten further, most likely by 25 bps.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	3.84	-0.75	-0.98	-0.59
5-year	3.50	-0.47	-0.68	-0.50
10-year	3.43	-0.27	-0.49	-0.45
30-year	3.63	-0.08	-0.29	-0.34

Source: Bloomberg L.P., 17 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.53	-0.30	-0.42	-0.07
5-year	2.35	-0.24	-0.29	-0.17
10-year	2.38	-0.13	-0.21	-0.25
30-year	3.42	-0.06	-0.14	-0.16

Source: Bloomberg L.P., 17 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	70
30-year AAA Municipal vs Treasury	95
High Yield Municipal vs High Yield Corporate	63

Source: Bloomberg L.P., Thompson Reuters, 17 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	Month-to-date	Year-to-date
Municipal	3.35	–	6.13	0.78	1.54	2.10
High yield municipal	5.69	245[1]	7.69	0.13	1.26	2.44
Short duration high yield municipal[2]	5.34	300	4.12	0.21	0.64	1.90
Taxable municipal	4.74	108[3]	8.29	0.46	2.55	5.27
U.S. aggregate bond	4.36	60[3]	6.36	1.43	2.48	2.90
U.S. Treasury	3.74	–	6.34	1.60	3.09	3.20
U.S. government related	4.36	60[3]	5.39	1.22	2.29	2.82
U.S. corporate investment grade	5.30	158[3]	7.23	0.76	1.75	2.46
U.S. mortgage-backed securities	4.41	56[3]	5.96	1.87	2.35	2.93
U.S. commercial mortgage-backed securities	5.01	133[3]	4.55	0.68	1.61	2.34
U.S. asset-backed securities	4.64	71[3]	2.87	0.96	1.70	2.26
Preferred securities	7.92	321[3]	4.75	-3.25	-6.62	-0.50
High yield 2% issuer capped	8.99	511[3]	3.76	-0.42	-1.01	1.45
Senior loans[4]	10.09	633	0.25	-1.04	-0.95	2.23
Global emerging markets	7.44	374[3]	6.15	0.12	0.30	1.20
Global aggregate (unhedged)	3.48	57[3]	6.86	1.65	2.77	2.62

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, 17 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, 17 Mar 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 15 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.

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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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