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Weekly Fixed Income Commentary

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Banking concerns overshadow another Fed rate hike

U.S. Treasury yields fell further, despite a rate hike from the U.S. Federal Reserve, as concerns over the banking system continued. U.S. investors viewed Treasury Secretary Yellen's comments regarding deposit insurance as a negative surprise.

HIGHLIGHTS

- **Total returns were positive for Treasuries, investment grade and high yield corporates, taxable munis, MBS, ABS and emerging markets.**
- **Preferred securities and senior loans both had negative total returns.**
- **Municipal bond yields rallied. New issue supply was $3.3B with outflows of -$427M. This week's new issuance remains low at $5.4B.**

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Watchlist

- *U.S. Treasury yields declined further.*
- *Spread assets were mixed as banking sector uncertainty continued.*
- *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.

INVESTMENT GRADE CORPORATES CONTINUE TO RALLY

U.S. Treasury yields ended last week lower, with the 10-year yield down -5 basis points (bps) after a volatile week. Yields rose in the first half of the week, as risk sentiment improved after the announcement of the UBS takeover of Credit Suisse. However, that trend reversed on Wednesday when the Fed hiked rates by 25 bps and Treasury Secretary Yellen stated that officials are not considering broad deposit insurance for the U.S. banking system. The comments were viewed as a negative surprise, even though that position aligns with current law that allows regulators to insure deposits above the $250,000 limit only if there is high systemic risk.

Investment grade corporates gained last week, returning 0.86% for their fourth consecutive weekly rally. The asset class beat similar-duration Treasuries by 48 bps. Spreads widened late in the week after the Fed rate hike and the general risk-off sentiment following Secretary Yellen's comments, yet they ultimately tightened by -9 bps. Bank debt, especially Additional Tier 1 (AT1) securities, was in focus after a large writedown to the value of Credit Suisse's AT1s in their takeover by UBS. European bank AT1 prices fell -5 points on average. The investment grade market saw continued outflows, with -$500 million exiting the asset class for the week. The new issue market was steady at $21 billion, with deals oversubscribed by a healthy 6x on average.

High yield corporates also gained, returning 0.35% for the week, though they lagged similar-duration Treasuries by -6 bps. Yields fell -5 bps, but spreads rose 7 bps to reach their widest levels in five months. Outflows continued, with -$902 million leaving high yield funds and $1.7 billion leaving loan funds. The loan asset class had a small negative return of -0.02%.

Emerging markets rallied, returning 0.46% for the week and beating similar-duration Treasuries by 6 bps. The asset class was helped by the decline in interest rates, though a few idiosyncratic dynamics also helped. Bonds from high yield issuers Angola, Pakistan and Morocco rallied on country-specific news, helping the below-investment grade segment to outperform. Outflows continued, with another -$1.4 billion leaving the asset class.

MUNICIPAL BONDS AVOID BANKING INDUSTRY WOES

Municipal bond yields rallied last week, outperforming Treasuries. Short-term muni yields ended the week -13 bps lower and long-term yields declined -7 bps. Weekly new issue supply was light last week, and fund flows were negative. This week's new issue calendar remains low.

The Fed raised rates an additional 25 bps last week in its continued effort to combat inflation. With the fed funds rate now at 5%, borrowing may not be profitable, which should cool the economy. Banks are also more reluctant to lend money in general, as they want to maintain their capital in ultra-high quality, ultra-low duration investments. Municipal bonds do not appear to be affected by the banking industry woes. The market remains well bid, and we expect this trend to continue for the foreseeable future.

The city of Birmingham, Michigan, issued $129 million GO school bonds (rated AA+). The deal was well received and repriced to lower yields upon final pricing.

High yield municipal bond yields declined 17 bps on average month-to-date, demonstrating continued resiliency and firmer demand. Outflows totaled -$185 million last week, after $305 million of positive flows the week before. However, most of last week's outflows were concentrated in short-duration high yield and related to asset rotation. This week's new issuance is expected to be very light, with only four relatively small deals scheduled. Municipal bond investors viewed last week's court ruling in the ongoing Puerto Rico Electric Power Authority (PREPA) bankruptcy to be a net positive affirmation of bondholder recourse in system-wide revenues, with the proceedings now moving into the debate about the nature of those revenues.

Investment grade corporate new issuance was steady, with deals oversubscribed by a healthy 6x on average.

In focus

The Fed raises rates, keeps its eye on the banks

With inflation still running hot, the Fed hiked interest rates by 25 bps, taking the fed funds target range to 4.75% - 5.00%. But after the failure of several banks, the Fed remains mindful of potential threats to the financial sector.

In its policy statement, the Fed noted that the U.S. banking system is "sound and resilient." Nonetheless, it believes that recent developments will likely make it more challenging for households and businesses to borrow.

In his post-meeting press conference, Fed Chair Jerome Powell explained that he expects additional tightening will be warranted, although it's unclear if that will come from higher policy rates or slower bank lending. Either way, the Fed remains committed to lowering inflation.

Separately, there were no major changes to the Fed's macroeconomic projections, its first since last December. The median forecast is for slightly higher inflation and lower growth, while the terminal interest rate — the peak rate during this cycle — remained unchanged at 5.1%.

In this uncertain economic and policy-rate environment, and with inflation running well above the Fed's 2% target, we expect one more rate hike later this year. Crucially, contagion risks in the banking sector look low for now, thanks to the quick and forceful reaction from policymakers, including the opening of a credit facility designed to ensure that banks can meet deposit withdrawals.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	3.77	-0.07	-1.05	-0.66
5-year	3.41	-0.09	-0.78	-0.60
10-year	3.38	-0.05	-0.55	-0.50
30-year	3.65	0.02	-0.27	-0.32

Source: Bloomberg L.P., 24 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	2.40	-0.13	-0.55	-0.20
5-year	2.24	-0.11	-0.40	-0.28
10-year	2.29	-0.09	-0.30	-0.34
30-year	3.35	-0.07	-0.21	-0.23

Source: Bloomberg L.P., 24 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	68
30-year AAA Municipal vs Treasury	92
High Yield Municipal vs High Yield Corporate	64

Source: Bloomberg L.P., Thompson Reuters, 24 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	3.28	–	6.10	0.41	1.96	2.52
High yield municipal	5.68	253[1]	7.66	0.29	1.55	2.73
Short duration high yield municipal[2]	5.34	309	4.08	0.10	0.74	2.00
Taxable municipal	4.73	112[3]	8.27	0.12	2.67	5.40
U.S. aggregate bond	4.26	57[3]	6.33	0.52	3.01	3.44
U.S. Treasury	3.66	–	6.31	0.36	3.46	3.57
U.S. government related	4.28	60[3]	5.38	0.39	2.69	3.23
U.S. corporate investment grade	5.14	149[3]	7.24	0.86	2.63	3.35
U.S. mortgage-backed securities	4.34	54[3]	5.87	0.49	2.85	3.44
U.S. commercial mortgage-backed securities	5.00	141[3]	4.54	0.19	1.81	2.54
U.S. asset-backed securities	4.69	86[3]	2.86	0.01	1.71	2.27
Preferred securities	7.83	325[3]	4.70	-0.10	-6.71	-0.59
High yield 2% issuer capped	8.95	518[3]	3.74	0.35	-0.66	1.80
Senior loans[4]	10.01	638	0.25	-0.02	-0.97	2.21
Global emerging markets	7.38	375[3]	6.17	0.46	0.76	1.66
Global aggregate (unhedged)	3.42	56[3]	6.84	0.75	3.55	3.39

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, 24 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, 24 Mar 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 22 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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