

17 April 2023

# Treasury yields rise, boosted by stronger economic data

*U.S. Treasury yields rose and spread sectors gained on positive economic data. Signals from U.S. Federal Reserve officials pointed to greater odds of another rate hike in May. The market now prices in an 82% chance of such an increase.*

## HIGHLIGHTS

- **Treasuries, agencies, investment grade corporates, MBS, CMBS, taxable munis and ABS all had negative total returns.**
- **In contrast, preferreds, high yield corporates, senior loans and emerging markets all had positive total returns.**
- **Municipal bond yields remained essentially unchanged. New issue supply was \$5.9B with outflows of -\$256M. This week's new issuance is expected to be outsized at \$11.2B.**



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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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# Watchlist

- U.S. Treasury yields moved higher.
- Spread assets gained with strong economic data.
- 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 solid fundamentals.

## 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.

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## INVESTMENT GRADE CORPORATE SPREADS TIGHTEN, BOOSTING EXCESS RETURNS

**U.S. Treasury yields rose last week**, with the 10-year yield ending 12 basis points (bps) higher at 3.52%. Yields briefly moved lower on Wednesday after the March CPI report showed a deceleration in U.S. inflation. But they ultimately bounced back for the week as other economic data were strong and signals from Fed officials pointed to greater odds of another rate hike in May. Headline inflation fell to 5.0% year-over-year, but the decline was mostly due to energy prices. Core inflation accelerated to 5.6% as expected. Meanwhile, retail sales were stronger than anticipated, industrial production expanded and consumer sentiment improved. The minutes of the March FOMC meeting, plus public speeches from officials including Governor Waller, signaled comfort with further tightening, and the market now prices around an 82% chance of another rate hike next month.

**Investment grade corporates weakened**, returning -0.33% for the week, but outperforming similar-duration Treasuries by 43 bps. Overall returns were pressured by the renewed uptick in rates, but spreads broadly tightened, helping excess returns. The technical backdrop was supportive, with another healthy inflow of \$1.7 billion for the week, while the new issue market was open but quiet at \$11 billion. Despite news that First Republic Bank is suspending the dividend on their preferred bonds, preferred securities performed well, returning 0.87% and besting similar-duration Treasuries by 186 bps.

**High yield corporates outperformed**, returning 0.76% and outperforming similar-duration Treasuries by 107 bps. The asset class enjoyed inflows of \$235 million, while loan funds saw another outflow of -\$461 million. The senior loan asset class still returned 0.35%, supported by both the move higher in rates and reports that several CLOs are preparing to issue in the near term. The new issue market was also quiet, with around \$4 billion pricing in the high yield bond market and around \$2 billion in the loan space.

**Emerging markets also gained**, with a total return of 0.15%. The asset class outperformed similar-duration Treasuries by 78 bps. Most of the positive price action was in investment grade sovereigns, where spreads tightened -9 bps, while movement in high yield was close to flat overall. The asset class had outflows of -\$742 million from hard currency funds and -\$294 million from local funds, but local markets still gained 1.04% for the week.

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## MUNICIPAL BOND SUPPLY REMAINS RELATIVELY MUTED

**Municipal bond yields remained basically unchanged last week.** The new issue calendar was priced to sell, and most deals were well received, although some balances remained. Weekly fund flows remained negative. This week's new issue supply looks to be outsized, but it is expected to include large deals from the state of Illinois, Southeast Energy and New Jersey Schools.

**Fixed income in general has a positive tone,** which should continue as long as the Fed talks tough on inflation. Inflation levels have not yet reached the Fed's 2% target, but the data are declining. With the Fed expected to hike rates another 25 bps at the May meeting, munis should trade slightly better than the range-bound Treasury market. New issue muni supply remains relatively muted amid strong demand for tax-exempt income. We expect this trend to continue.

**The state of Louisiana** issued \$238 million general obligation bonds (rated Aa2/AA-). Balances remain, and some bonds have traded at a discount to where they were issued. For example, 5% coupons bonds due in 2039 came at a yield of 2.88%. These bonds traded out of the original deal at 2.91%. This deal illustrates how dealers prefer to keep inventory moving.

**Confidence in high yield municipal bond liquidity continues to improve** as general interest rates affirm a stable trading range. Key liquidity indicators such as tobacco and Puerto Rico firmed last week, especially in the latter half as fund flows turned positive for the week. New issuance continues to be limited, and we expect strong reinvestment cash flows during the summer months. High yield municipal bond credit spreads remain elevated after lagging the recent rate stabilization. This trend is most pronounced in the inversion of the high yield muni bond credit spread curve.

*With the Fed expected to hike rates again, munis should trade slightly better than the range-bound Treasury market.*

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## In focus

# Senior loans look to maintain momentum

*After outperforming most major fixed income asset classes by double digits in 2022, senior loans are poised to deliver a well-received encore this year.*

Last month, financial markets battled familiar foes, including interest rate hikes intended to quell still-hot inflation, as well as an unexpected one: the perceived instability of the U.S. and European banking sectors following the collapse of two U.S. regional banks and UBS's plan to purchase Credit Suisse. Senior loans tumbled during the height of the banking turmoil from 9 March to 20 March, with Morningstar's LSTA U.S. Leveraged Loan Index falling 1.50% during that stretch. For March as a whole, however, loans demonstrated resilience, losing just 0.03%.

Looking ahead, we believe loans have the potential for solid results in 2023. Higher-quality issues offer yields in the 7% to 8% range. Although we expect default rates to rise, they should remain contained as credit fundamentals for the asset class overall are good. And over the past few years, many issuers have taken advantage of low rates to extend their maturity wall — the period in which existing debt arrangements come due or approach maturity.

Active management is essential as we anticipate pockets of credit deterioration and single-name volatility to persist — and possibly elevate — heading into a more challenging macroeconomic backdrop, as higher funding costs weigh on issuers' operating margins to varying degrees.

## U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	Month-to-date	Year-to-date
2-year	4.10	0.12	0.08	-0.33
5-year	3.61	0.11	0.03	-0.40
10-year	3.52	0.12	0.05	-0.36
30-year	3.74	0.12	0.09	-0.23

Source: Bloomberg L.P., 14 Apr 2023. Performance data shown represents past performance and does not predict or guarantee future results.

## Municipal market

Maturity	Yield to Worst	Change (%)		
		Week	Month-to-date	Year-to-date
2-year	2.23	-0.05	-0.15	-0.37
5-year	2.08	-0.02	-0.14	-0.44
10-year	2.10	0.00	-0.17	-0.53
30-year	3.18	0.00	-0.12	-0.40

Source: Bloomberg L.P., 14 Apr 2023. Performance data shown represents past performance and does not predict or guarantee future results.

## Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	60
30-year AAA Municipal vs Treasury	85
High Yield Municipal vs High Yield Corporate	66

Source: Bloomberg L.P., Thompson Reuters, 14 Apr 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.

## For more information, please visit nuveen.com.

**Performance:** Bloomberg, L.P. **Issuance:** The Bond Buyer, 14 Apr 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 12 Apr 2023.

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**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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## Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%)		
				Week	Month-to-date	Year-to-date
Municipal <sup>5</sup>	3.09	–	6.05	0.11	1.03	3.83
High yield municipal	5.57	261 <sup>1</sup>	7.59	-0.16	1.44	4.22
Short duration high yield municipal <sup>2</sup>	5.19	317	3.92	-0.01	0.73	2.96
Taxable municipal	4.79	106 <sup>3</sup>	8.28	-0.66	0.11	5.32
U.S. aggregate bond	4.41	56 <sup>3</sup>	6.37	-0.48	0.01	2.97
U.S. Treasury	3.85	–	6.31	-0.64	-0.09	2.92
U.S. government related	4.44	57 <sup>3</sup>	5.40	-0.34	0.17	3.05
U.S. corporate investment grade	5.15	134 <sup>3</sup>	7.25	-0.33	0.12	3.63
U.S. mortgage-backed securities	4.53	65 <sup>3</sup>	6.02	-0.42	0.00	2.53
U.S. commercial mortgage-backed securities	5.21	141 <sup>3</sup>	4.50	-0.32	0.21	2.03
U.S. asset-backed securities	4.98	85 <sup>3</sup>	2.80	-0.19	0.06	1.92
Preferred securities	7.21	265 <sup>3</sup>	4.61	0.87	1.28	2.80
High yield 2% issuer capped	8.42	441 <sup>3</sup>	3.65	0.76	0.85	4.45
Senior loans <sup>4</sup>	9.83	596	0.25	0.35	0.69	3.83
Global emerging markets	7.25	345 <sup>3</sup>	6.26	0.15	0.42	2.58
Global aggregate (unhedged)	3.58	53 <sup>3</sup>	6.83	-0.47	0.22	3.23

**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, 14 Apr 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.

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.

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### 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.

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