

11 September 2023

# Economic data drive Treasury yields higher

*U.S. Treasury yields rose once again, as U.S. economic growth remains strong. U.S. Federal Reserve officials indicated that monetary policy is sufficiently restrictive, while emphasizing the need to monitor incoming data.*

## HIGHLIGHTS

- **Treasuries, agencies, investment grade and high yield corporates, taxable munis, preferreds and emerging markets all had negative total returns.**
- **Municipal bond yields rose slightly on the long end. New issue supply was \$8.1B with outflows of -\$798M. This week's new issuance should be \$7.0B.**



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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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# Watchlist

- *10-year U.S. Treasury yields increased, but we anticipate modest declines over the rest of 2023.*
- *Spread assets, with the exception of investment grade corporates and preferreds, underperformed Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

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## INVESTMENT VIEWS

**“Higher for longer” rates remains 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 business investment. This combination should keep corporate defaults low.

**Treasury yields are likely to fall slightly this year**, and we expect the 10-year Treasury yield to end 2023 around 3.75%.

**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.

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## 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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## EMERGING MARKETS SHOW MIXED PERFORMANCE

**U.S. Treasury yields rose last week**, led by the short end of the curve. 2- to 5-year yields rose 11 basis points (bps) and the 10-year yield rose by 9 bps, while the 30-year yield rose only 4 bps. U.S. economic data were mostly stronger than expected. The ISM Services Index exceeded expectations at 54.5. Underlying data saw broad strength: prices paid, employment and new orders all rose month-over-month and remain in expansionary territory. A number of U.S. Federal Reserve officials spoke last week and indicated that monetary policy is sufficiently restrictive but emphasized the need to continue monitoring incoming data. The market is currently pricing in a 50% chance of another hike in 2023.

**Investment grade corporates declined by -0.25% for the week.** The asset class outperformed similar-duration Treasuries by 7 bps, as spreads were flat. The outperformance is notable considering the high level of issuance last week, totaling \$53 billion. On average, orderbooks were more than three times over-subscribed. Inflows totaled \$1.6 billion, driven by mutual funds.

**High yield corporates dropped** by -0.32% but underperformed similar-duration Treasuries by -11 bps. Senior loans returned 0.35%, making it the only asset class to post positive total returns for the week. The new issuance calendar was very quiet. Only \$800 million in high yield corporate new issues came to market, and no senior loan issues. High yield and senior loan inflows totaled \$252 million and \$97 million, respectively. Unlike the investment grade corporate market, flows were driven by exchange-traded funds.

**Emerging markets declined**, returning -0.34% for the week and underperforming similar-duration Treasuries by -3 bps. Performance was mixed, as sovereign spreads widened by 8 bps while corporates tightened by -6 bps. High yield EM strongly outperformed its investment grade counterparts within both sovereigns and corporates. Hard currency flows eased from the prior week to -\$484 million, but local currency outflows rose to -\$597 million. China continued to be in focus, as the market digests recent People’s Bank of China stimulative measures focused on propping up the beleaguered property sector.

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## MUNICIPAL TAXABLE-EQUIVALENT YIELDS GARNER INVESTORS' ATTENTION

**Municipal bond yields rose slightly on the long end** of the curve last week. New issuance was priced to sell, yet some deals saw balances remaining. Fund flows were negative yet again. This week's new issue calendar will need to be priced to sell to pique investor interest.

**The market is navigating opposing forces:** the U.S. economy remains strong and inflation is declining. The Fed maintains it will continue raising short-term rates to bring inflation under control for the long term. We remain constructive on fixed income given the Fed's vigilant resolve.

**The municipal market appears alive and well.** Trading is orderly and investors are seeing elevated tax-exempt yields as a buying opportunity. We see value in the both the short and long ends of the yield curve. Institutional investors are adjusting portfolios accordingly. Individual investors are active also, snapping up short-term bonds at 3%, intermediate bonds at 4% and long-term bonds at 5%. These yields are attractive on their own, and even more compelling on a taxable-equivalent basis.

**The state of California** issued \$2.6 billion general obligation bonds (rated Aa2/ AA-). Separate order periods were set up for individual investors and retail investors. The deal was well received and underwriters lowered yields across the curve upon final pricing.

**High yield municipal yields were materially less volatile than high grades in August**, increasing 20 bps versus 30 bps, respectively. Yields have contracted in September as investors appear to respond to average absolute yields near 6%, levels not seen since the end of the Great Financial Crisis. With supply constrained, the window of opportunity may close quickly if fund flows return to the market. Therefore, investors may underestimate the reinvestment risk if they wait to reallocate to current high yield muni valuations.

***Tuesday was the sixth busiest day ever and the single busiest since March 2020 for investment grade corporate issuance.***

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## *In focus*

# ***IG corporate issuance surges***

*After a particularly quiet August, the investment grade corporate new issue calendar picked up steam last week. Tuesday was the sixth busiest day on record and the single busiest since March 2020. Total issuance for the week exceeded \$50 billion.*

The investment grade corporate market is one of the few sectors that allows U.S. and international investors to add securities maturing in 20 to 30 years, which typically offer healthier yields than their shorter-dated counterparts. However, last week's market action was focused primarily on the shorter end of the yield curve. With 30-year Treasury yields at their highest level in more than a decade (4.34% as of 08 September), issuers were reluctant to lock in elevated funding costs. Instead, they opted for shorter-duration debt that they hope to refinance at lower rates in a few years.

This trend has been prevalent throughout 2023. Year-to-date issuance of 25-year and longer maturities has been 26% lower than the 5-year average, which excludes 2020 given the record issuance driven by Covid-related concerns. The lack of long-duration issuance has provided a strong technical backdrop for the longer-maturity segment of the investment grade corporate curve.

The high level of issuance was easily absorbed by investors, as investment grade spreads held steady at 120 basis points as of 08 September. Deals were oversubscribed with reasonable new issuance concessions.

## U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	Month-to-date	Year-to-date
2-year	4.99	0.11	0.13	0.56
5-year	4.40	0.11	0.15	0.40
10-year	4.27	0.09	0.16	0.39
30-year	4.34	0.04	0.13	0.37

Source: Bloomberg L.P., 08 Sep 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	3.13	0.00	-0.01	0.53
5-year	2.88	0.00	0.00	0.36
10-year	2.98	0.04	0.05	0.35
30-year	3.92	0.04	0.04	0.34

Source: Bloomberg L.P., 08 Sep 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	91
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 08 Sep 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, 08 Sep 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 06 Sep 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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## Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%)		
				Week	Month-to-date	Year-to-date
Municipal	3.84	–	6.22	-0.23	-0.25	1.34
High yield municipal	5.89	218 <sup>1</sup>	7.72	-0.17	-0.22	3.29
Short duration high yield municipal <sup>2</sup>	5.52	264	4.18	-0.08	-0.09	3.67
Taxable municipal	5.34	89 <sup>3</sup>	8.04	-0.25	-0.84	3.00
U.S. aggregate bond	5.11	49 <sup>3</sup>	6.26	-0.30	-0.77	0.59
U.S. Treasury	4.63	–	6.06	-0.30	-0.74	-0.04
U.S. government related	5.15	49 <sup>3</sup>	5.23	-0.38	-0.68	1.54
U.S. corporate investment grade	5.75	119 <sup>3</sup>	6.94	-0.25	-0.83	1.90
U.S. mortgage-backed securities	5.16	54 <sup>3</sup>	6.33	-0.33	-0.80	0.14
U.S. commercial mortgage-backed securities	5.93	132 <sup>3</sup>	4.39	-0.28	-0.52	0.84
U.S. asset-backed securities	5.61	64 <sup>3</sup>	2.63	-0.12	-0.22	2.21
Preferred securities	7.49	236 <sup>3</sup>	4.72	-0.16	-0.26	3.57
High yield 2% issuer capped	8.56	374 <sup>3</sup>	3.46	-0.32	-0.31	6.82
Senior loans <sup>4</sup>	9.93	548	0.25	0.35	0.40	9.39
Global emerging markets	7.72	314 <sup>3</sup>	6.06	-0.34	-0.52	2.73
Global aggregate (unhedged)	4.02	49 <sup>3</sup>	6.69	-0.84	-1.25	-0.52

**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, 08 Sep 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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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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