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Weekly Fixed Income Commentary

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Strong employment data boost Treasury yields

U.S. Treasury yields continued increasing and the yield curve steepened after the stronger-than-expected U.S. jobs report on Friday. While expectations for an eventual decline in rates remain, we may see elevated rates for longer.

HIGHLIGHTS

- **Total returns were once again broadly negative across fixed income sectors, but most pronounced among longer-duration and higher-yielding asset classes.**

- **Preferreds, emerging markets and taxable municipals experienced the steepest negative returns.**

- **Municipal bond yields increased once again. New issue supply was priced to sell with outflows of -$1.2B. This week's new issuance is estimated at $4.8B.**

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CIO of Global Fixed Income

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Watchlist

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

INVESTMENT VIEWS

"Higher for longer" rates remains as a theme, as central banks battle 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.

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 and Israel.

INVESTMENT GRADE CORPORATE YIELDS REACH 2023 HIGHS

U.S. Treasury yields moved sharply higher last week. The 10-year yield rose 23 basis points (bps) to a year-to-date high of 4.80%. The selloff began early in the week, as fears of a U.S. government shutdown abated and most economic readings outperformed market expectations. Conditions intensified on Friday, with nonfarm payrolls for September sharply exceeding consensus estimates. The 30-year yield also surged, reaching an intra-year high and briefly touching 5.00% before settling at 4.97%. Odds edged higher for one more U.S. Federal Reserve rate hike before year-end. The 2-year yield increased by 4 bps to 5.08%. The curve continued to steepen as markets repriced for a higher-for-longer environment. The difference between 2- and 10-year yields ended the week at -29 bps.

Investment grade corporates came under pressure, returning -1.44% for the week and lagging similar-duration Treasuries by -16 bps. Overall index yields edged 15 bps higher to 6.18%, a level not seen since last year. As investors broadly shunned risk assets, spreads inched 4 bps wider to 125 bps. Rate volatility impacted new issues: 10 issuers priced $8.9 billion in supply, falling short of the estimated $15-20 billion supply forecast. High quality issuance remained a theme, as did maturities inside 10 years. New issuance is expected to stay light and perhaps move even quieter if rate volatility persists.

High yield corporates weakened, returning -1.21% for the week and underperforming similar-duration Treasuries by -84 bps. Senior loans also posted negative results of -0.23%. Higher quality issues outperformed as volatility increased amid broader macro uncertainty. High yield bond spreads widened 35 bps, driven largely by the significant move in rates. High yield and loan funds saw outflows of -$2.6 billion and -$942 million, respectively.

Emerging markets sold off, returning -1.66% for the week and lagging similar-duration Treasuries by -62 bps. Within sovereigns, spreads widened modestly for investment grade names (3 bps) but significantly for high yield (30 bps). Outflows increased sharply, with -$1.9 billion exiting the hard currency asset class. The move in rates and market volatility resulted in subdued new issuance at only $2 billion.

THE MUNICIPAL BOND YIELD CURVE REPRESENTS VALUE

Municipal bond yields rose again last week. The new issue calendar was priced to sell and well received. Some deals were pulled due to weak market conditions. Weekly fund flows were negative, and this week's new issue calendar is muted. Deals will likely need to be priced at distressed levels to clear the market.

We are bullish on the municipal bond market and expect fixed income investments in general will look attractive by mid-2024. Tax-exempt muni yields are at or near 10-year highs. We believe investors should remain allocated to muni bonds and consider implementing tax-loss swaps, as we see opportunities to increase tax-exempt income in portfolios. Also, similar to Treasuries, the entire muni bond yield curve represents value.

We expect muni market volatility to continue through the end of the year due to heavier supply. Also, dealers are reluctant to support the muni market with strong bidding in the secondary market. We would see any selloffs as a buying opportunity.

San Diego International Airport issued $1 billion airport revenue bonds (rated A1/NR). The bonds were subject to the alternative minimum tax (AMT). The deal was priced to sell and well received.

We believe investors should remain allocated to muni bonds and consider implementing tax-loss swaps.

In focus

4Q 2023 outlook: laying out the fixed income landscape

In our 2023 fourth quarter outlook, Nuveen's Global Investment Committee (GIC) highlighted some of our best investment ideas.

The GIC believes the high current yields — which correspond to low prices — available on many asset classes make an attractive investment backdrop. And although some central banks will continue to raise rates, we think the Fed is near the end of its tightening cycle. That should help stabilize the market in what has been another challenging year for fixed income. With an eye toward modestly extending duration and favoring higher-quality credits, the GIC sees income generation potential in:

Senior loans, which offer attractive spread levels compared to other credit sectors, along with a compelling yield (10.4%).

High yield corporates, particularly the BB area of the market.

Select emerging markets debt, with a focus on countries whose central banks are further along in the fight against inflation and are therefore more likely to begin lowering rates.

Municipal bonds. According to the GIC, fundamentals and market technicals are solid, and municipals' longer-duration profile should provide a tailwind if rates have peaked. Compelling opportunities exist in both high yield credits and bonds with maturities exceeding 15 years, both of which appear undervalued.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	5.08	0.04	0.04	0.65
5-year	4.76	0.15	0.15	0.75
10-year	4.80	0.23	0.23	0.93
30-year	4.97	0.27	0.27	1.00

Source: Bloomberg L.P., 06 Oct 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	3.70	0.04	0.04	1.10
5-year	3.49	0.08	0.08	0.97
10-year	3.56	0.11	0.11	0.93
30-year	4.45	0.11	0.11	0.87

Source: Bloomberg L.P., 06 Oct 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	75
30-year AAA Municipal vs Treasury	90
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 06 Oct 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	4.43	–	6.41	-0.64	-0.64	-2.01
High yield municipal	6.36	210[1]	7.91	-1.03	-1.03	-1.03
Short duration high yield municipal[2]	6.08	257	4.41	-0.51	-0.51	1.74
Taxable municipal	5.77	85[3]	7.82	-1.64	-1.64	-0.77
U.S. aggregate bond	5.54	53	6.13	-1.17	-1.17	-2.36
U.S. Treasury	4.97	–	5.80	-1.04	-1.04	-2.55
U.S. government related	5.48	48[3]	5.07	-0.90	-0.90	-0.55
U.S. corporate investment grade	6.23	125[3]	6.69	-1.44	-1.44	-1.42
U.S. mortgage-backed securities	5.76	65[3]	6.51	-1.22	-1.22	-3.46
U.S. commercial mortgage-backed securities	6.29	135[3]	4.36	-0.74	-0.74	-0.58
U.S. asset-backed securities	5.81	68[3]	2.62	-0.17	-0.17	1.81
Preferred securities	8.16	271[3]	4.98	-2.60	-2.60	-0.01
High yield 2% issuer capped	9.22	424[3]	3.56	-1.21	-1.21	4.59
Senior loans[4]	10.36	566	0.25	-0.23	-0.23	9.66
Global emerging markets	8.29	331[3]	5.80	-1.66	-1.66	-0.77
Global aggregate (unhedged)	4.31	52[3]	6.55	-1.03	-1.03	-3.21

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, 06 Oct 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, 06 Oct 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 04 Oct 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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