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Weekly Fixed Income Commentary

16 October 2023

Treasury yields decline on Middle East conflict

U.S. Treasury yields declined and the yield curve flattened. Rate volatility persisted due to escalating tensions in the Middle East and higher-than-expected inflation data. Fixed income gains were most pronounced among rate sensitive, longer-duration assets.

HIGHLIGHTS

- **Investment grade corporates, municipals, Treasuries and emerging markets debt experienced the strongest returns.**
- **Municipal bond yields declined. New issue supply was $4.8 billion and outflows totaled -$781M. This week's new issuance is estimated to spike at $12.3B.**

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Watchlist

- *10-year U.S. Treasury yields declined, and 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 intensify: China, Russia, Turkey, Iran and Israel.

HIGH YIELD CORPORATES SHOW BROAD-BASED STRENGTH

U.S. Treasury yields moved lower last week. The 10-year yield declined 19 basis points (bps) to 4.61%. Yields moved sharply lower early in the week as escalating tensions in the Middle East fueled demand for safe haven assets. Dovish comments from U.S. Federal Reserve officials also caused rates to rally. However, a hotter-than-expected September CPI print led to a selloff in Treasuries. CPI rose 0.4% for the month (higher than the 0.3% consensus expectation) and annual CPI held steady at 3.7%. Short-term yields ended the week 3 bps lower. The yield curve inverted further, with the difference between 2- and 10-year yields ending the week at -41 bps.

Investment grade corporates posted positive excess returns, returning 1.25% for the week and outperforming similar-duration Treasuries by 7 bps. Spreads inched tighter to 123 bps and the financial sector outperformed after several weeks of relative weakness. Five issuers priced $13.25 billion in supply, in line with the estimated $10 to 15 billion supply forecast. Healthy inflows of $2.6 billion represented an increase of $2.3 billion week-over-week. New issuance should remain steady this week.

High yield corporates performed well, returning 0.53% for the week and outperforming similar-duration Treasuries by 5 bps. Senior loans returned 0.36% but underperformed high yield for the first time in several weeks. High yield strength was broad based, while lower-quality loans underperformed their higher-quality counterparts. High yield bond spreads firmed, driven largely by rate declines. Outflows in high yield and senior loan funds totaled -$2.5 billion and -$100 million, respectively. New issue activity remained quiet, with high yield bonds and loans pricing new issues of $2.2 billion and $1.9 billion, respectively. The primary calendar should remain light.

Emerging markets were positive, returning 0.89% for the week and modestly lagging similar-duration Treasuries by -7 bps. Within sovereigns, spreads tightened modestly for investment grade names (8 bps) and high yield (13 bps). Hard currency outflows persisted at -$1.2 billion. Geopolitical events and rate volatility led to subdued issuance. New issuance totals $296.8 billion year-to-date, split between corporates ($183.6 billion) and sovereigns ($113.6 billion).

MUNICIPAL BOND SUPPLY SHOULD REMAIN OUTSIZED

Municipal bond yields rallied last week. Weekly new issue supply was priced to sell and well received. Fund flows remained negative, and this week's new issue supply will need to be priced to sell. With cash on the sidelines, deals should be placed if priced cheaply enough.

Fixed income in general rallied last week, due in part to a flight-to-quality rally caused by the conflict in Israel. However, inflation is still a concern. We believe short-term rates (currently near 6%) will cool the economy and reduce inflation over the long term.

We expect tax-exempt supply to remain outsized for the remainder of 2023. Market turnover should be heavy as money managers recalibrate bond portfolios to mandated durations. We still believe tax-exempt bonds will look attractive by mid-2024.

The New York Triborough Bridge and Tunnel Authority issued $1.1 billion senior lien bonds (rated NR/AA+). The deal was priced to sell and well received. The long bonds were repriced 12 bps lower upon final pricing.

High yield municipal bond yields lagged the dramatic declines in AAA rated muni yields last week. High yield muni yields decreased by 14 bps on average, while credit spreads widened by 8 bps. Outflows slowed to -$134 million. This week we are tracking nine high yield muni deals totaling just $190 million. We are seeing net inflows into exchange-traded funds, meaning perhaps some of the open-end fund outflows may represent tax-loss selling.

Higher municipal bond yields offer a compelling opportunity for tax-exempt income.

In focus

Municipal yields present an attractive opportunity

Municipal bond yields have cheapened relative to U.S. Treasuries over the past few weeks. Levels are approaching the cheapest of the year, signaling a possible investment opportunity.

The 10-year municipal-to-Treasury yield ratio is 73%, and the 30-year ratio is 89%. These levels are meaningfully cheaper compared to April ratios of 58% and 85%, respectively.

Municipal bonds also offer attractive absolute yields. Since April, yields have increased between 130 and 108 bps across the curve. Current yields mark the highest levels since the early 2000s, outside of a short spike following the Global Financial Crisis. Even if the Fed holds rates steady for an extended period, clipping coupons at these attractive rates should benefit investors.

Additionally, these higher yields offer a compelling opportunity for tax-exempt income. For investors in the 22% and 24% federal tax brackets, taxable-equivalent yields on AAA municipal bonds are in line with Treasuries for short- to intermediate-term maturities and greater than Treasuries for long-term maturities. For investors in higher tax brackets, taxable-equivalent yields exceed Treasuries across the curve.

Taxable equivalent yield represents the yield that must be earned on a fully taxable investment to equal the yield on a municipal investment on an after-tax basis.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	5.06	-0.03	0.01	0.63
5-year	4.64	-0.12	0.03	0.64
10-year	4.61	-0.19	0.04	0.74
30-year	4.75	-0.22	0.05	0.79

Source: Bloomberg L.P., 13 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	3.53	-0.17	-0.13	0.93
5-year	3.29	-0.20	-0.12	0.77
10-year	3.36	-0.20	-0.09	0.73
30-year	4.24	-0.21	-0.10	0.66

Source: Bloomberg L.P., 13 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	73
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters, 13 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	4.26	–	6.34	1.22	0.58	-0.82
High yield municipal	6.21	216[1]	7.78	1.78	0.73	0.73
Short duration high yield municipal[2]	5.98	267	4.36	0.59	0.08	2.35
Taxable municipal	5.63	85[3]	7.86	1.45	-0.21	0.67
U.S. aggregate bond	5.44	54[3]	6.16	0.95	-0.23	-1.43
U.S. Treasury	4.86	–	5.88	0.96	-0.09	-1.61
U.S. government related	5.37	48[3]	5.10	0.82	-0.09	0.26
U.S. corporate investment grade	6.10	124[3]	6.75	1.25	-0.21	-0.19
U.S. mortgage-backed securities	5.67	71[3]	6.45	0.74	-0.49	-2.75
U.S. commercial mortgage-backed securities	6.20	137[3]	4.35	0.57	-0.17	-0.01
U.S. asset-backed securities	5.79	71[3]	2.61	0.26	0.08	2.08
Preferred securities	8.14	278[3]	4.94	0.21	-2.39	0.20
High yield 2% issuer capped	9.13	414[3]	3.53	0.53	-0.69	5.14
Senior loans[4]	10.20	558	0.25	0.36	0.13	10.05
Global emerging markets	8.25	296[3]	5.76	0.89	-0.79	0.11
Global aggregate (unhedged)	4.23	52[3]	6.58	0.69	-0.34	-2.54

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, 13 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, 13 Oct 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research,10 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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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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