nuveen
A TIAA Company

Weekly Fixed Income Commentary

11 December 2023

Treasury yields rise, awaiting inflation data and the Fed

U.S. Treasury yields rose after the prior week's rally, amid strong labor market data. This week we expect another modest rise in core U.S. inflation and no change to U.S. Federal Reserve policy.

HIGHLIGHTS

- **Total returns were positive across the board, including Treasuries, investment grade and high yield corporates, MBS, ABS, preferreds, senior loans and emerging markets.**
- **Municipal bond yields declined. New issue supply was $10.5B and fund outflows were -$144M. This week's new issuance is estimated at only $5B.**

Anders Persson
CIO of Global Fixed Income

Daniel Close
Head of Municipals

Watchlist

- *The 10-year U.S. Treasury yield rose last week, but we anticipate declines in overall rates in the months ahead.*
- *Spread assets broadly outperformed 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 AND LOANS SEE HEALTHY INFLOWS

U.S. Treasury yields rose after the prior week's strong rally, with 10-year yields ending 3 basis points (bps) higher at 4.23%. 2-year yields, which had fallen more substantially in November, retraced by a larger margin, ending 18 bps higher at 4.72%. U.S. economic data was mostly strong, with the November jobs report showing a healthy gain of 199,000 net new jobs and a decline in the unemployment rate back to 3.7%. At the same time, the number of job openings decreased further. That suggests that wage inflation pressures are down from recent peaks of 5% to 6%, while still pointing to above-target nominal wage growth of around 4.0% to 4.5% year-over-year in 2024. This week the focus will be on the November CPI report on Tuesday and the Fed meeting on Wednesday. We expect another modest rise in core U.S. inflation and no change to Fed policy.

Investment grade corporates staged a small rally, returning 0.25% for the week and beating similar-duration Treasuries by 3 bps. Inflows rebounded strongly at $3.3 billion. The new issue market was also active, with 20 companies bringing $22.9 billion of new supply. That was slightly more than expected, but the market digested it well, with deals 3.3x oversubscribed on average and new-issue concessions averaging 5.7 bps, near the year-to-date average. Overall, supply is up 1.2% year-over-year, in line with expectations from the start of the year.

High yield corporates also advanced, returning 0.37% and outperforming similar-duration Treasuries by a substantial 55 bps. Senior loans returned 0.34%. The two asset classes are up 10.1% and 11.7% this year, respectively. Both asset classes also had healthy inflows of $2.1 billion into high yield and $82 million into loans. As in investment grade, the new issue market was active, with $6.8 billion and $13.3 billion pricing in bonds and loans, respectively.

Emerging markets also performed well, returning 0.73% for the week and outpacing similar-duration Treasuries by 62 bps. Spreads tightened across the board, led by high yield hard currency sovereigns, which tightened -15 bps. The strong rally came despite a renewal of outflows, with -$601 million exiting hard currency funds and -$233 million leaving local funds. Emerging markets were somewhat supported by a complete lack of new issuance, with no new deals brought for the week, in contrast to the active calendar in other fixed income markets.

THE MUNICIPAL MARKET BENEFITS FROM STRONG REINVESTMENT MONEY

Municipal bond yields diverged somewhat from Treasuries last week. The short end of the muni curve ended 11 bps lower, while long-term yields declined 6 bps. Municipal bond new issue supply was well received, while flows for mutual fund and exchange-traded funds were negative. This week's new issuance is expected to be light, as issuers remain on the sidelines awaiting results of the Fed meeting.

The municipal bond market continues to have a very good tone. $36 billion of 01 December reinvestment money is currently being put to work, and 01 January will present a similarly large reinvestment. New issue should remain subdued for the next several weeks. We expect the good tone for munis to remain until new issue supply picks up around the end of January.

American Municipal Power, Inc., OH issued $360 million energy revenue bonds (rated A1/A). The deal was well received, and bonds traded later in the secondary market at a premium. For example, 5% coupons maturing in 2038 were issued at a yield of 3.59% and traded later in the week at 3.45%.

High yield municipal bonds continued their rally last week, led by the tobacco sector. High yield muni yields decreased by 5 bps on average, compared to 10 to 11 bps for AAA-rated munis. As a result, high yield muni credit spreads widened further, now standing at 240 bps. The new issue calendar should be heavy this week, in what is likely the last surge of deals for the year. We are tracking 12 deals totaling over $1.1 billion. High yield municipals showed fund outflows last week of -$49 million and inflows of $42 million in exchange-traded funds, similar to seven of the last eight weeks.

Emerging markets spreads tightened across the board, led by high yield hard currency sovereigns.

In focus

Cautious optimism in bond markets

Nuveen's Global Investment Committee (GIC) highlighted some of our best fixed income ideas in our 2024 outlook.

After a bruising 2022 and challenging 2023, fixed income markets offer opportunities heading into the new year. In the GIC's view, inflation and central bank tightening have peaked for this cycle, potentially removing two major headwinds for bond investors. Moreover, while the GIC doesn't expect rate cuts until mid-2024 at the earliest, yields should still decline modestly next year, boosting bond prices. Against that backdrop, the GIC's favored asset classes include:

Securitized credit, as non-agency mortgage-backed securities are attractively valued, with little prepayment risk as rates are unlikely to decline rapidly.

Higher-quality (BB rated) senior loans are fundamentally sound and, thanks to their floating-rate coupons, could outperform in a higher-for-longer rate environment.

High yield municipal bonds, which sport favorable valuations and provide healthy yields.

Although money markets and Treasuries offer competitive payouts, the GIC thinks sitting in cash may result in missed opportunities. Instead, investors may be better served by dollar-cost-averaging back into their strategic allocations. Using a flexible, diversified multi-sector approach with a view toward modestly extending duration and focusing on higher-quality credit may prove effective in this regard.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.72	0.18	0.04	0.29
5-year	4.24	0.12	-0.03	0.24
10-year	4.23	0.03	-0.10	0.35
30-year	4.31	-0.08	-0.19	0.34

Source: Bloomberg L.P., 08 Dec 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	2.72	-0.11	-0.12	0.12
5-year	2.47	-0.10	-0.12	-0.05
10-year	2.50	-0.11	-0.13	-0.13
30-year	3.71	-0.06	-0.06	0.13

Source: Bloomberg L.P., 08 Dec 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	59
30-year AAA Municipal vs Treasury	86
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 08 Dec 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	3.46	–	6.16	0.56	0.72	4.73
High yield municipal	5.74	240[1]	7.34	0.59	0.93	7.01
Short duration high yield municipal[2]	5.54	307	4.06	0.43	0.56	5.38
Taxable municipal	5.23	84[3]	8.02	0.39	1.54	5.29
U.S. aggregate bond	4.95	45[3]	6.24	0.15	1.01	2.66
U.S. Treasury	4.47	–	6.08	0.11	0.86	1.53
U.S. government related	4.97	46[3]	5.23	0.14	0.74	3.51
U.S. corporate investment grade	5.51	105[3]	6.99	0.25	1.12	5.17
U.S. mortgage-backed securities	5.10	52[3]	6.17	0.14	1.22	1.93
U.S. commercial mortgage-backed securities	5.77	132[3]	4.38	-0.11	0.56	2.89
U.S. asset-backed securities	5.44	73[3]	2.69	0.00	0.39	3.97
Preferred securities	7.37	235[3]	4.84	0.11	0.62	6.57
High yield 2% issuer capped	8.29	360[3]	3.33	0.37	0.69	10.13
Senior loans[4]	9.70	553	0.25	0.34	0.37	11.67
Global emerging markets	7.47	300[3]	5.99	0.73	1.14	5.88
Global aggregate (unhedged)	3.84	45[3]	6.68	0.28	0.65	2.16

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 Dec 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, 08 Dec 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 06 Dec 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.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein 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.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

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.

Nuveen, LLC provides investment solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.