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Weekly Fixed Income Commentary

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Treasury yields rise after a 2023 year-end rally

U.S. Treasury yields rose on generally strong U.S. economic data. Jobs showed a net gain in December, with the unemployment rate remaining flat. However, the declining quits rate signals softer conditions ahead.

HIGHLIGHTS

- **Total returns were broadly negative, including Treasuries, investment grade and high yield corporates, MBS, ABS, preferreds and emerging markets.**
- **Senior loans enjoyed a positive total return.**
- **Municipal bond yields remained unchanged. New issue supply was essentially zero and fund outflows were -$558M. This week's new issuance is estimated to be $8.9B.**

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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

Rates have probably peaked for this cycle, as attention pivots toward rate cuts in response to softer growth and easing inflation.

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.

Risk premiums may widen further, with entry points for taxable fixed income likely to become more attractive over the coming quarters. Credit selection is key as we search for bonds with favorable income and solid fundamentals.

KEY RISKS

- Inflation fails to continue moderating as expected, weighing on asset prices.
- Policymakers unsuccessfully juggle fighting inflation with supporting economies still struggling to gain traction.
- Geopolitical flare-ups intensify: Israel, China, Russia and Iran.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

2024 STARTS SLOWLY FOR TAXABLE FIXED INCOME AFTER A DECEMBER RALLY

U.S. Treasury yields rose after a strong rally at the end of 2023. 10-year yields rose 17 basis points (bps) to end the week above 4% for the first time since early December. The move came after a 7.0% rally for the Treasury market over November and December, the best two-month performance since 2008. Employment data were generally strong, as fresh U.S. data showed a net gain of 216,000 jobs in December and a flat unemployment rate at 3.7%. However, other data softened, with the private quits rate dropping to a new multi-year low, signaling softer labor market conditions ahead. The ISM services survey also weakened to 50.6, a level historically consistent with real GDP growth around 0.3%. This is notably lower than the recent pace of approximately 3% and the consensus for 2024 near 1%.

Investment grade corporates weakened to start the year, returning -1.54% and lagging similar-duration Treasuries by -26 bps. That move came after 2023's strong year-end rally, which saw the investment grade corporate asset class return 8.5% in the fourth quarter. That marked the third-best quarterly performance since 1985, outpaced only by the post-recession rallies in 2009 and 2020. Partially in response to the 2023 rally, new issuance picked up to start the year. The asset class saw $55 billion of new deals launched. Demand was somewhat more tepid than last year, with average oversubscription rates of 2.7x, versus the 2023 full-year average of 3.5x. Separately, inflows continued at $5.3 billion.

High yield corporates also retreated, returning -1.12% after a 7.16% gain in the fourth quarter. The asset class lagged similar-duration Treasuries by -66 bps for the week. Senior loans outperformed, returning 0.25%. High yield funds saw outflows totaling -$438 million, while loan funds had inflows of $64 million. New issuance picked up after the holiday lull, though not as much as the investment grade market. High yield saw two new deals totaling $750 million.

Emerging markets fell -1.45% last week, lagging similar-duration Treasuries by -38 bps, after a 8.1% rally in the fourth quarter. Local markets weakened -1.34%. Both asset classes were pressured by the stronger dollar, which rallied 1.1% for the week. Outflows also continued, with -$512 million exiting the asset class. New issuance also picked up, with $22 billion total pricing across both sovereign and corporate emerging markets.

MUNICIPAL BOND YIELDS SHOULD KEEP INVESTORS FOCUSED

Municipal bond yields remained unchanged last week. New issue supply was essentially zero and fund flows began the year with an outflow of -$558 million. Even exchange-traded fund flows were negative at -$203 million. However, tax-exempt money market fund flows were positive at $3.1 billion, suggesting that many investors still want to take advantage of elevated short-term rates. This week's new issue supply should be priced to sell and well received.

We see a few cross winds in the municipal market as the year begins. First the good news: $33 billion of 01 January money needs to be reinvested, which should stabilize the market. However, new issue supply has begun in earnest already this week. While municipal bond yields are rich to Treasuries, muni yields themselves are much cheaper than they were a couple of years ago. Munis will likely remain range bound, and current yields should keep investors focused on the asset class. However, we would see any declines as potential buying opportunities.

The high yield municipal market returned 9.21% in 2023, led by tobacco and Puerto Rico. The outperformance of these sectors is intuitive in hindsight, given their high beta nature, heavy issuance and availability (representing nearly 25% of the index) amid strong exchange-traded fund demand and a significant supply constraint for traditional project revenue bond issuance. We believe this performance trend is likely to reverse in 2024 for technical and fundamental reasons. High yield municipal credit spreads were remarkably unchanged in 2023, on average, ending the year at 244 bps.

Municipal bond yields are much cheaper than they were a couple of years ago.

In focus

IG Corporate net issuance for 2024: lighter and shorter

Investment grade corporate gross issuance ended 2023 about equal with 2022 at $1.2 trillion. The average maturity of new issuance dropped to a 6-year low of 9.1 years from 9.5 years.

Last year's issuance with maturities greater than 10 years made up a historically low percentage of total supply, given reluctance to issue longer-term debt at historically elevated coupons.

Gross issuance is expected to increase slightly in 2024, while net issuance will likely decline due to a higher level of Covid-related maturities.

Financial sector issuance should be higher year-over-year, owing to maturities, regional banks' funding needs to satisfy capital requirements, and ongoing bank balance sheet management activities.

We expect non-financial gross issuance to decline, although a recent increase in mergers and acquisitions announcements could result in upside to our estimates.

The 2024 new issue calendar started strong, with $55 billion issued during last week's holiday-shortened week. Following the recent trend, most of that supply offered maturities of 10 years or less, with 30-year issuance representing only 6%.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	December 2023	2023
2-year	4.38	0.13	-0.43	-0.18
5-year	4.01	0.16	-0.42	-0.16
10-year	4.05	0.17	-0.45	0.00
30-year	4.20	0.17	-0.47	0.06

Source: Bloomberg L.P., 05 Jan 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	December 2023	2023
2-year	2.47	-0.05	-0.32	-0.08
5-year	2.25	-0.03	-0.31	-0.24
10-year	2.28	0.00	-0.35	-0.35
30-year	3.43	0.01	-0.35	-0.16

Source: Bloomberg L.P., 05 Jan 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	56
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters, 05 Jan 2024. 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	December 2023	2023
Municipal	3.28	–	6.07	-0.29	2.32	6.40
High yield municipal	5.62	249[1]	7.11	-0.64	3.00	9.21
Short duration high yield municipal[2]	5.32	306	3.91	0.06	1.83	6.72
Taxable municipal	5.03	81[3]	8.01	-1.41	4.96	8.84
U.S. aggregate bond	4.72	43[3]	6.25	-1.20	3.83	5.53
U.S. Treasury	4.23	–	6.14	-1.02	3.37	4.05
U.S. government related	4.76	50[3]	5.33	-0.98	3.01	5.83
U.S. corporate investment grade	5.28	103[3]	7.01	-1.54	4.34	8.52
U.S. mortgage-backed securities	4.89	50[3]	6.07	-1.26	4.31	5.05
U.S. commercial mortgage-backed securities	5.44	126[3]	4.40	-0.71	3.03	5.42
U.S. asset-backed securities	5.07	65[3]	2.68	-0.29	1.91	5.54
Preferred securities	6.96	218[3]	4.77	-0.15	3.18	9.28
High yield 2% issuer capped	8.00	353[3]	3.26	-1.12	3.73	13.44
Senior loans[4]	9.08	525	0.25	0.25	1.61	13.04
Global emerging markets	7.26	302[3]	6.08	-1.45	4.20	9.09
Global aggregate (unhedged)	3.65	44[3]	6.71	-1.38	4.16	5.72

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, 05 Jan 2024. **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, 05 Jan 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 03 Jan 2024.

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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