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Weekly Fixed Income Commentary

29 January 2024

Treasury yields mixed on strong economic data

U.S. Treasury yields were mixed last week and spread sectors outperformed as fourth quarter U.S. GDP exceeded expectations. The market continues to price in a 50% chance of a U.S. Federal Reserve rate cut by March, and around five total cuts for this year.

HIGHLIGHTS

- **Total returns were positive across most major asset classes, including Treasuries, investment grade and high yield corporates, preferreds, senior loans and emerging markets.**

- **Municipal bond yields were mixed. New issue supply was $8.3B and fund inflows were $211M. This week's new issuance is estimated to be a light $4.5B.**

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Watchlist

- *The 10-year U.S. Treasury yield fell slightly last week, and 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.

PREFERRED SECURITIES SHOW STRONG PERFORMANCE

U.S. Treasury yields were relatively flat last week, with the 10-year yield rising 1 basis point (bps) and the 2-year yield falling -4 bps. U.S. economic data were strong, with fourth quarter GDP beating expectations at 3.3% quarter-over-quarter annualized, versus near 2% consensus. Consumption slowed modestly but continued to expand at a healthy rate of 2.8%. Both residential and nonresidential fixed investment also grew. Core PCE inflation moderated to 2.9% year-over-year in December, its slowest pace since early 2021, and lower than the Fed's most recent forecasts. The market continues to price in a 50% chance of a rate cut by March, and around 5.4 total cuts for this year.

Investment grade corporates rallied, returning 0.22% for the week and beating similar-duration Treasuries by 21 bps. Spreads on the index tightened further, compressing -2 bps for the week to reach a new two-year low of 92 bps. Preferreds had a strong week, rallying 1.39%, boosted by the robust demand for the first U.S. bank new issuance since September. The preferred asset class has now returned 2.4% for the year, the best-performing major fixed income asset class. Separately, investment grade funds had their thirteenth consecutive week of inflows, with $5.4 billion entering the asset class. Supply was healthy at $20 billion.

High yield corporates also gained, returning 0.61% for the week and outpacing similar-duration Treasuries by 51 bps. Senior loans returned 0.14%. Both asset classes had healthy inflows, with $752 million into high yield and $213 million into loans. New issuance remained strong, with $6.8 billion in high yield and $35.3 billion in loans. So far this year, the two asset classes have seen around $20 billion and $110 billion of new issuance, respectively, though the vast majority (80% in high yield and 96% in loans) has been refinancing rather than new paper.

Emerging markets lagged, returning 0.13% for the week and beating similar-duration Treasuries by 9 bps. Outflows continued to be a headwind, with -$454 million leaving hard currency funds and -$274 million exiting local currency funds. New issuance picked up, with $21 billion pricing for the week.

MUNICIPAL BONDS REMAIN RANGE BOUND

Municipal bond yields remained range bound last week. Short-term yields ended down -2 bps while long-term rates rose 2 bps. New issue supply was well received. Fund flows were positive for the second week in a row, while exchange-traded fund flows were negative at -$323 million. This week's new issue supply should be light as the Fed holds its January meeting.

Muni bonds are range bound along with Treasuries, and this trend should persist. However, tax-exempt bonds are rich compared to their taxable counterparts, and this dynamic will also likely remain for a while. New issuance has begun in earnest, but demand remains robust. The $32 billion reinvestment money for 01 January is still being incorporated. And coupon reinvestment for February is expected to be outsized at $32 billion. This is truly an outlier, as February is normally one of the lowest reinvestment months of the year.

The state of Washington issued $334 million general obligation bonds (rated Aaa/AA+). The deal was well received, and some bonds traded at a premium in the secondary market. For example, 5% coupon bonds due in 2048 came at a yield of 3.89% and traded in the secondary market at 3.83%.

The high yield municipal market inched out a positive total return last week, despite a lot of noise. Most important, fund flows were net positive, while exchange-traded funds saw consistent and sizable outflows. Surprisingly, the market was challenged with an active manager looking to sell larger positions in tobacco and territory paper, among others. The market remains firmly bid with attractive absolute yields.

Investment grade corporate funds had their thirteenth consecutive week of inflows, and issuance remained strong.

In focus

Muni taxable-equivalent income appeal

Municipal bond yields offer an attractive income opportunity for investors. A 20-year AAA muni bond offers a 5.26% taxable-equivalent yield (TEY), equal to an affordable muni-to-Treasury yield ratio of 1.17x.

Municipal investors can combine federal, state and local income tax rates to calculate overall TEY. For example, New York City investors are subject to a maximum marginal tax rate of 55.5%. At this rate, investors would receive a TEY of 7.39% on a New York 20-year AAA muni bond.

Tax burdens were higher from 2020 to 2022 than in any other year since 1978. High-income, high-tax states saw collections soar due to a stock market boom, a boost in spending from federal aid, and a hot housing market translating into higher property tax assessments.

The conclusion of the Fed hiking cycle likely means the end for these compelling yields. And Congress is deliberating a range of tax issues related to the expiration of the Tax Cuts and Jobs Act at the end of 2025. Removing the cap on the state and local tax deduction would increase the top 1 percent earners' after-tax incomes by about 2.7%. Additionally, the lower marginal rates for most individual tax brackets could return to their previously higher levels.

Data source: Bloomberg, L.P., 26 Jan 2024. **Performance data shown represents past performance and does not predict or guarantee future results.** Yields are yield to worst. Taxable-equivalent yield is the yield a taxable investment needs to possess (before taxes) for its yield to be equal to that of a tax-free municipal investment. The yields shown are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary. They do not take into account the effects of the federal alternative minimum tax (AMT) or capital gains taxes.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	4.35	-0.04	0.10	0.10
5-year	4.04	-0.01	0.19	0.19
10-year	4.14	0.01	0.26	0.26
30-year	4.37	0.04	0.34	0.34

Source: Bloomberg L.P., 26 Jan 2024. **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	2.71	-0.02	0.19	0.19
5-year	2.43	-0.02	0.15	0.15
10-year	2.46	0.00	0.18	0.18
30-year	3.61	0.02	0.19	0.19

Source: Bloomberg L.P., 26 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	59
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	74

Source: Bloomberg L.P., Thompson Reuters, 26 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	3.47	–	6.11	-0.09	-1.10	-1.10
High yield municipal	5.72	243[1]	7.25	0.23	-1.53	-1.53
Short duration high yield municipal[2]	5.44	300	3.89	0.11	-0.02	-0.02
Taxable municipal	5.05	75[3]	7.94	0.29	-1.51	-1.51
U.S. aggregate bond	4.74	39[3]	6.24	0.10	-1.30	-1.30
U.S. Treasury	4.28	–	6.03	0.02	-1.37	-1.37
U.S. government related	4.78	47[3]	5.23	0.04	-1.05	-1.05
U.S. corporate investment grade	5.23	92[3]	6.98	0.22	-1.08	-1.08
U.S. mortgage-backed securities	4.95	46[3]	6.23	0.09	-1.52	-1.52
U.S. commercial mortgage-backed securities	5.35	114[3]	4.37	0.31	-0.14	-0.14
U.S. asset-backed securities	5.02	61[3]	2.65	0.18	0.07	0.07
Preferred securities	6.60	176[3]	4.64	1.39	2.40	2.40
High yield 2% issuer capped	7.75	325[3]	3.19	0.61	-0.07	-0.07
Senior loans[4]	9.19	527	0.25	0.14	0.72	0.72
Global emerging markets	7.26	298[3]	6.02	0.13	-1.33	-1.33
Global aggregate (unhedged)	3.70	41[3]	6.64	0.08	-2.33	-2.33

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, 26 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, 26 Jan 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 24 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.

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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