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Weekly Fixed Income Commentary

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Economic data push Treasury yields higher

U.S. Treasury yields moved higher last week, as strong U.S. economic data and hawkish U.S. Federal Reserve rhetoric caused markets to push back expectations for rate cuts. The market is now pricing fewer than five rate cuts this year, down from more than six cuts earlier this year.

HIGHLIGHTS

- **Total returns were positive in high yield corporates and senior loans, and excess returns were positive in high yield corporates, emerging markets, preferreds and securitized sectors.**
- **Treasuries and investment grade corporates produced negative total returns.**
- **Municipal bond yields increased. New issue supply was $9.2B and fund outflows were -$121M. This week's new issuance is estimated to be undersized at $4B.**

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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.

HIGH YIELD CORPORATES SEE HEALTHY INFLOWS

U.S. Treasury yields rose last week, as U.S. economic data showed resilience and remarks from Fed Chair Powell continued to lean hawkish. The ISM services index rebounded to 53.4 for January, up 2.9 percentage points for its biggest gain in a year. Meanwhile, Powell continued to push back against market pricing for a possible rate cut at next month's Fed meeting. The market is now pricing fewer than five rate cuts this year, down from more than six cuts earlier this year. That movement pressured Treasury yields higher across the curve, with the 10-year yield rising 15 basis points (bps) for the week to 4.18%.

Investment grade corporates weakened, returning -0.95% for the week. The asset class performed in line with similar-duration Treasuries. The weakness came amid the increase in rates, despite a surge in inflows. More than $7 billion entered investment grade funds for the week, the largest weekly inflow since July 2021. At the same time, the new issue market remained heavy, with $45 billion pricing for the week, almost double the roughly $25 billion expected. Demand for the new issuance was robust, with average oversubscription rates of 3.9x, leading to average new issue concessions of around 3.5 bps, in line with levels that have prevailed this year.

High yield corporates outperformed, returning 0.13% for the week and outpacing similar-duration Treasuries by 49 bps. The asset class was boosted by a healthy inflow of $549 million. Separately, senior loans returned 0.22% for the week, despite outflows of -$273 million. Both asset classes continued to see continued heavy supply. Despite high overall yield levels relative to recent history, spread levels are very tight and companies are finding it attractive to refinance deals at tight levels. The high yield market saw $6.1 billion of issuance and loans saw $13.6 billion.

Emerging markets were mixed, returning -0.30% for the week but beating similar-duration Treasuries by 50 bps. Spreads compressed in both sovereign and corporate markets, with high yield names leading the way in both markets. Emerging markets funds saw their first inflows in two months, led by a $231 million inflow in local currency funds, which was partially offset by a -$150 million outflow from hard currency funds.

MUNICIPAL BOND YIELDS RISE WITH TREASURIES

Municipal bond yields ended last week higher. Short- and long-term yields rose 12 bps and 10 bps, respectively. The new issue calendar was well received, while fund outflows per Lipper returned at -$121 million (-$443 million for exchange-traded funds). However, ICI data shows municipal fund flows have netted a positive $4.3 billion so far in 2024. This week's new issue supply should be undersized and well received. In fact, the market would welcome a larger calendar.

The municipal market sold off in sympathy with Treasuries. Munis remain rich to taxable bonds, but municipal yields are their highest in a few years. So we expect munis to remain well bid. We would consider any selloffs as a potential buying opportunity. Demand is high, with too much cash chasing too few bonds.

The state of Wisconsin issued $248 million general obligation bonds (rated Aa1/AA+). Although the market continued to sell off during the week, some bonds from this deal traded later at the same yield as where they were issued. For example, 5% bonds due in 2034 came at a yield of 2.51% and traded in the secondary market at the original yield. This demonstrates the market's continued need for-tax exempt bonds.

The high yield municipal market inflows continued last week, as investors remained steadfast through the latest rebound in U.S. Treasury rates. New issue deals remain heavily oversubscribed. A Washington, D.C., charter school deal was 11x oversubscribed and bumped 15 bps tighter in final pricing. We are tracking 11 high yield muni deals coming this week across land-secured, student housing, multi-family housing, charter schools, senior living and industrial development sectors.

Municipal fund flows have netted a positive $4.3 billion so far in 2024.

In focus

Senior loans look to navigate uncertainty

Loans have started the year by posting a modest total return (+0.98%) and a healthy 9.33% yield — tops among major fixed income segments. A strategic allocation has benefited investors.

Much to the Fed's satisfaction, inflation continues to moderate, even as the central bank has yet to declare victory over rising prices. At its 31 January meeting, Chair Jerome Powell all but dashed hopes for a March rate cut. And with the economy showing further signs of strength, as evidenced by January's robust job creation, the Fed is in no rush to take its foot off the brakes. However, Powell has assured markets that easier policy is forthcoming this year. Loans have performed well during periods of rising and declining rates, reinforcing the case for a strategic allocation to the asset class.

Meanwhile, issuers of senior loans are being forced to endure steep borrowing costs, which have contributed to a pickup in default rates. An economic slowdown later in the year — a distinct possibility, in our view — would also pressure issuers, mainly those entering this period with weaker credit profiles.

Given these challenges, we believe investors looking to benefit from an allocation to loans are better served by active management. Pairing deep fundamental research with top-down views can help managers spot loans across the full spectrum of ratings whose fundamental risks have been mispriced by the market.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.48	0.12	0.27	0.23
5-year	4.14	0.16	0.30	0.29
10-year	4.18	0.15	0.26	0.3
30-year	4.37	0.15	0.21	0.34

Source: Bloomberg L.P., 09 Feb 2024. **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	2.73	0.12	0.09	0.21
5-year	2.41	0.10	0.05	0.13
10-year	2.43	0.10	0.05	0.15
30-year	3.57	0.10	0.05	0.15

Source: Bloomberg L.P., 09 Feb 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	58
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters, 09 Feb 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	Month-to-date	Year-to-date
Municipal	3.41	–	6.11	-0.45	-0.10	-0.61
High yield municipal	5.63	238[1]	7.13	-0.50	-0.02	-0.49
Short duration high yield municipal[2]	5.31	290	3.83	-0.13	-0.01	0.64
Taxable municipal	5.05	70[3]	7.96	-0.97	-1.11	-1.16
U.S. aggregate bond	4.81	40[3]	6.27	-0.82	-1.20	-1.47
U.S. Treasury	4.35	–	6.10	-0.81	-1.18	-1.46
U.S. government related	4.84	47[3]	5.27	-0.63	-0.96	-1.09
U.S. corporate investment grade	5.31	95[3]	6.98	-0.95	-1.29	-1.45
U.S. mortgage-backed securities	5.01	47[3]	6.24	-0.79	-1.23	-1.69
U.S. commercial mortgage-backed securities	5.36	107[3]	4.35	-0.40	-0.72	-0.01
U.S. asset-backed securities	5.09	59[3]	2.64	-0.19	-0.36	0.10
Preferred securities	6.66	175[3]	4.59	-0.16	-0.15	2.46
High yield 2% issuer capped	7.75	316[3]	3.20	0.13	0.17	0.17
Senior loans[4]	9.33	527	0.25	0.22	0.19	0.98
Global emerging markets	7.24	289[3]	6.05	-0.30	-0.38	-0.94
Global aggregate (unhedged)	3.76	42[3]	6.67	-0.81	-1.41	-2.77

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, 09 Feb 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, 09 Feb 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 07 Feb 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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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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