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Weekly Fixed Income Commentary

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Hotter inflation data boost Treasury yields

U.S. Treasury yields rose last week on higher-than-expected U.S. inflation data. This trend suggests that inflation remains higher than the U.S. Federal Reserve's target of 2%, decreasing hopes for rate cuts in the near term.

HIGHLIGHTS

- **Total returns were negative across the board, led by Treasuries, taxable munis and MBS**
- **Most spread sectors outperformed Treasuries, including investment grade and high yield corporates, preferred securities and emerging markets.**
- **Municipal bond yields rose slightly. New issue supply was $11.3B and fund inflows were $295M. This week's new issuance is expected to be $6.0B.**

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 expect yields to moderate over the course of the year.*
- *Spread assets generally gained and outpaced the rally in 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 AND SENIOR LOANS OFFER ACTIVE NEW ISSUANCE

U.S. Treasury yields rose last week, retracing the steady declines of the last three weeks. 10-year yields ended 23 basis points (bps) higher at 4.31%, while 2-year yields rose 25 bps to 4.73%. The increase was driven by hotter-than-expected U.S. CPI and PPI data, causing markets to reduce the odds of near-term Fed rate cuts. The fed funds rate is now expected to end the year above 4.50%, the highest level priced in over four months. The move higher in yields was also supported by high wage inflation in Japan, where investors now expect an end to negative interest rate policy, and possibly a change to the yield curve control framework that has suppressed long-end Japanese bond yields.

Investment grade corporates retreated alongside the move higher in rates, returning -1.00% for the week. However, risk sentiment remained well supported and the asset class outpaced similar-duration Treasuries by 42 bps. Inflows continued, though they decelerated, with $4.8 billion entering the asset class. The primary market continued to run hot as well, with $37.1 billion of new deals for the week, taking year-to-date volumes to 34% more than 2023 levels. Those deals saw average oversubscription rates of 3.5x and only 2.9 bps of concession, which was around 1 bp below the year-to-date average and around 3 bps below the 2023 average.

High yield corporates performed similarly, returning -0.24% for the week but outperforming similar-duration Treasuries by 48 bps. Senior loans, which benefit from higher interest rates due to their floating-rate nature, returned 0.28%. Both markets experienced inflows, with $289 million into high yield and $458 million into loans. The new issue market also remained active, with $4.2 billion and $15.3 billion in high yield and loans, respectively. A significant portion of the new issuance this year has been refinancing, as corporates take advantage of tight spread levels. For instance, in the loan space, more than 80% of new issuance this year has been refinancing, with just 8% for M&A activity.

Emerging markets returned -0.54% for the week but outperformed similar-duration Treasuries by 71 bps. Spreads broadly tightened across sovereigns and corporates. Outflows continued, driven by a large exodus from local currency funds of -$843 million. The local currency asset class returned -0.33% for the week, as higher rates and a stronger dollar weighed on performance. However, hard currency funds returned to inflows of $27 million.

MUNICIPAL BONDS PROVE RESILIENT

Municipal bond yields ended last week slightly higher. Short-term yields rose 7 bps and the long end increased 5 bps. The new issue calendar was outsized and priced to sell. Fund flows were positive for the third consecutive week, including $118 million into exchange traded-funds. This week's new issue supply should be priced to sell and well received.

The muni market proved quite resilient last week, selling off slightly versus the hefty Treasury sell off. Also, the new issue supply calendar was outsized, and many deals broke to premiums in the market. The reasons remain the same: Outsized levels of cash (and short-term holdings) need to be reinvested further out on the yield curve. This demand is stronger than the current new issue calendar. We expect munis to remain well bid for the foreseeable future.

Dormitory State of New York (DASNY) issued $2.9 billion personal income tax revenue bonds (rated Aa1). The deal was well received, but some bonds traded slightly cheaper in the secondary market from where they were issued. For example, 4% coupon bonds due in 2054 came at a yield of 4.22% and traded in the secondary market at 4.25%. This reflects a large size of the issue and the selloff in the U.S. Treasury market.

High yield municipal net inflows of $279 million kept the high yield market firmly bid last week and generating positive returns. New issuance is expected to be light again this week and limited to non-rated, off-the-run project finance deals. The final confirmation hearing for the Puerto Rico Electric Power Authority (PREPA) bond debt restructuring will come to a close in the coming days. This is a watershed moment for a multi-year process, potentially setting the path for significantly different recoveries across bond holders.

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In focus

The economy cools as the Fed readies rate cuts

Recent U.S. economic data has been consistent with a further, steady slowdown in growth and inflation. As a result, we expect the Fed to pause again this week before initiating rate cuts around midyear.

February's Consumer Price Index (CPI) readings were warmer than expected, with headline and core CPI (excluding food and energy prices) each rising +0.4% month-over-month. However, the report's details were benign. Shelter costs moderated after jumping in January, and other core services prices, a focus of recent inflation concerns, cooled as well. Overall, we believe CPI will decelerate over the next few months.

Other data releases, including February's nonfarm payrolls report, have affirmed the economy's gentle deceleration. Although headline job creation (+275,000) topped forecasts, downward revisions to December and January reduced initial estimates by 167,000. Other labor market metrics, such as last month's hiring rate, quits rate, and unemployment claims, have also steadily weakened. Perhaps most encouragingly for the Fed, which is seeking to navigate an economic soft landing, average hourly earnings rose just +0.1% in February, its slowest rate in over two years.

In our view, while the Fed is almost certain to pause this week, Chair Jerome Powell will likely signal further incremental progress toward policy easing. We still expect four rate cuts in 2024, starting around midyear.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.73	0.25	0.11	0.48
5-year	4.33	0.28	0.08	0.48
10-year	4.31	0.23	0.06	0.43
30-year	4.43	0.18	0.05	0.40

Source: Bloomberg L.P., 15 Mar 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	2.78	0.07	0.04	0.26
5-year	2.45	0.05	0.01	0.17
10-year	2.45	0.05	-0.01	0.17
30-year	3.62	0.05	0.03	0.20

Source: Bloomberg L.P., 15 Mar 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	57
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters, 15 Mar 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	3.39	–	6.06	-0.07	0.34	-0.04
High yield municipal	5.49	219[1]	6.92	0.16	1.04	1.36
Short duration high yield municipal[2]	5.13	270	3.64	0.11	0.58	1.85
Taxable municipal	5.13	65[3]	7.91	-1.46	0.04	-1.13
U.S. aggregate bond	4.96	39[3]	6.24	-1.23	-0.04	-1.72
U.S. Treasury	4.54	–	6.05	-1.25	-0.25	-1.84
U.S. government related	5.02	45[3]	5.29	-0.90	-0.04	-1.15
U.S. corporate investment grade	5.42	89[3]	6.98	-1.00	0.26	-1.42
U.S. mortgage-backed securities	5.16	48[3]	6.20	-1.51	0.01	-2.07
U.S. commercial mortgage-backed securities	5.49	99[3]	4.31	-0.94	0.02	-0.04
U.S. asset-backed securities	5.28	53[3]	2.65	-0.41	0.07	0.25
Preferred securities	6.59	157[3]	4.64	-0.27	0.23	3.73
High yield 2% issuer capped	7.82	302[3]	3.20	-0.24	0.48	0.77
Senior loans[4]	9.37	504	0.25	0.28	0.65	2.34
Global emerging markets	7.23	270[3]	6.04	-0.54	0.41	0.23
Global aggregate (unhedged)	3.83	38[3]	6.68	-1.29	0.25	-2.38

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, 15 Mar 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, 15 Mar 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 13 Mar 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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