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Weekly Fixed Income Commentary

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Inflation data hold Treasury yields steady

U.S. Treasury yields were generally unchanged last week as U.S. inflation data met expectations. U.S. Federal Reserve Chair Powell reiterated that the central bank doesn't "need to be in a hurry to cut."

HIGHLIGHTS

- **Total returns were positive for Treasuries, agencies, taxable munis, investment grade and high yield corporates, mortgages, senior loans and emerging markets.**
- **Preferreds had negative returns, but still outperformed similar-duration Treasuries.**
- **Municipal bond yields remained range bound. New issue supply was $9.0B and fund inflows were $447M. This week's new issuance is expected to be $5.0B.**

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Watchlist

- *The 10-year U.S. Treasury yield remained unchanged last week, but we expect yields to decline slightly over the course of the year.*
- *Spread assets were mixed but generally 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.

SENIOR LOANS CONTINUE LONG STRETCH OF POSITIVE PERFORMANCE

U.S. Treasury yields remained generally unchanged last week, with the benchmark 10-year yield ending at 4.20% for the holiday-shortened week. 2-year yields rose 3 basis points (bps) while the 30-year yield fell -3 bps. Overall, Treasuries returned 0.23% for the week. After markets closed, PCE inflation data on Friday met expectations, with the core measure rising 0.26% month-over-month. Encouragingly, the supercore measure of core services ex-housing moderated back to 0.2% after a jump of 0.7% in January. Separately, Fed Chair Powell spoke on Friday and reiterated that it will likely be appropriate to cut rates later this year, but the central bank doesn't "need to be in a hurry to cut."

Investment grade corporates gained for the week, returning 0.25%, though the asset class lagged similar-duration Treasuries by -5 bps. The new issue market remained heavy, with $25 billion pricing. Demand remained robust, with average new issue concessions staying tight at 3 bps. Overall, the first quarter saw almost $530 billion of new issue in the high grade corporate market, by far the most ever. The pace should slow somewhat in April, as many issuers have merely been accelerating plans to issue new bonds. Consensus expectations are for around $100 billion for the month, down from $142 billion in March.

High yield corporates also advanced, returning 0.10% for the week and outperforming similar-duration Treasuries by 2 bps. Senior loans returned 0.13%. Both markets continued to see healthy new issuance, though the vast majority remained skewed toward refinancings. High yield saw $6.5 billion of new supply while loans had $7.4 billion. Senior loans have now had positive returns for 10 straight months; excluding the post-Covid rally, that marks the best stretch since 2018.

Emerging markets gained 0.20% for the week, though they lagged similar-duration Treasuries by -4 bps. The asset class was helped by the relative placidity in U.S. rates, with 10-year yields trading flat for the week. The dollar was also nearly flat for the week. Many emerging markets were closed on Thursday and Friday, muting activity.

MUNI BOND YIELDS RISE WITH OUTSIZED NEW ISSUANCE

Municipal bond yields advanced slightly for the second consecutive week. 2-year munis ended 13 bps higher, while 30-year yields rose 3 bps. Weekly new issue supply was outsized once again and priced to sell. Dealers welcomed receiving large blocks of bonds and most deals broke to premiums in the secondary market. Fund flows remained positive. This week's new issue supply is expected to be lower after the long weekend.

Muni yields remain well bid, but they have also risen slightly over the last few weeks due to outsized new issue supply. This supply has allowed institutional investors access to large blocks of bonds to reposition portfolios back to stated mandates. Even with the slight sell off, munis remain rich to taxable bonds. However, the macro demand for munis still exceeds macro supply. We believe munis should remain well bid for the foreseeable future, and we would look at any selloffs as potential buying opportunities.

The state of California issued $2.6 billion general obligation bonds (rated Aa2/AA-). The deal was very well received and broke to premiums across the yield curve in the secondary market from where the bonds were issued.

High yield municipal fund flows remain positive, supporting strong demand for new issuance. New issues were heavily oversubscribed last week, and demand for secondary market opportunities – which are becoming increasingly scarce – is equally strong. We expect light new issuance this week.

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In focus

Inflows return to muni funds

Municipal bond open-end funds are back in vogue as investors seek to take advantage of income, spread and total return opportunities in the tax-exempt market.

Open-end municipal fund inflows through February totaled $7.14 billion,[1] with an additional $2.4 billion coming in during the first three weeks of March.[2] This represents a shift from outflows of nearly -$170 billion over the previous two years.[1]

Investors have capitalized on more attractive distribution rates, as funds have repositioned portfolios after meaningful tax loss harvesting opportunities, resulting in increased embedded yields. Additionally, open-end funds tend to be positioned further out on the yield curve, where flows have been focused. Investment grade intermediate and long duration bond funds have received inflows of more than $5.1 billion this year, whereas short funds have seen outflows.[1] As the Fed appears ready to begin cutting interest rates, investors have enjoyed additional duration and the yield it can provide.

High yield municipals are also favored, providing historically strong fundamentals and higher yields. This combination – along with a neutral to dovish Fed policy – has boosted investors' confidence and prompted inflows of $3.5 billion through the end of February.[1]

1 Data source: Morningstar, 29 Feb 2024.
2 Data source: Investment Company Institute.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	March 2024	Year-to-date
2-year	4.62	0.03	0.00	0.37
5-year	4.21	0.03	-0.03	0.37
10-year	4.20	0.00	-0.05	0.32
30-year	4.34	-0.03	-0.04	0.32

Source: Bloomberg L.P., 29 Mar 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	March 2024	Year-to-date
2-year	2.97	0.13	0.23	0.45
5-year	2.54	0.07	0.10	0.26
10-year	2.51	0.04	0.05	0.23
30-year	3.68	0.03	0.09	0.26

Source: Bloomberg L.P., 29 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	60
30-year AAA Municipal vs Treasury	85
High Yield Municipal vs High Yield Corporate	72

Source: Bloomberg L.P., Thompson Reuters, 29 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	March 2024	Year-to-date
Municipal	3.49	–	6.07	-0.16	0.00	-0.39
High yield municipal	5.50	214[1]	6.92	0.10	1.19	1.51
Short duration high yield municipal[2]	5.12	263	4.60	0.05	0.83	2.10
Taxable municipal	5.01	64[3]	7.93	0.35	1.30	0.10
U.S. aggregate bond	4.85	39[3]	6.21	0.23	0.92	-0.78
U.S. Treasury	4.43	–	6.04	0.23	0.64	-0.96
U.S. government related	4.91	46[3]	5.27	0.13	0.76	-0.37
U.S. corporate investment grade	5.30	90[3]	7.01	0.25	1.29	-0.40
U.S. mortgage-backed securities	5.04	49[3]	6.08	0.23	1.06	-1.04
U.S. commercial mortgage-backed securities	5.33	96[3]	4.32	0.16	0.91	0.84
U.S. asset-backed securities	5.19	55[3]	2.63	0.08	0.49	0.68
Preferred securities	6.44	155[3]	4.68	-0.22	1.00	4.53
High yield 2% issuer capped	7.66	299[3]	3.15	0.10	1.18	1.47
Senior loans[4]	9.30	509	0.25	0.13	0.83	2.52
Global emerging markets	7.04	264[3]	6.05	0.20	1.72	1.53
Global aggregate (unhedged)	3.74	39[3]	6.66	0.17	0.56	-2.07

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, 29 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, 29 Mar 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 27 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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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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