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Weekly Fixed Income Commentary

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Treasury yields rise on surprising inflation data

U.S. Treasury yields rose again last week after U.S. inflation data surprised to the upside, sparking a reassessment of near-term U.S. Federal Reserve rate cuts. The market is now pricing only 1.8 total cuts this year. Escalating geopolitical tensions in the Middle East also impacted risk sentiment.

HIGHLIGHTS

- **Treasuries and most spread sectors experienced negative total returns.**
- **Senior loans had positive returns, and IG corporates, CMBS and ABS outperformed versus similar-duration Treasuries.**
- **Municipal bond yields ended the week essentially unchanged. New issue supply was $8.3B and fund inflows were $414M. This week's new issuance is expected to be undersized at $5.4B.**

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 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 in the Middle East or around the world.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

LOAN FUNDS EXPERIENCE ROBUST INFLOWS

U.S. Treasury yields rose across the curve last week, as consumer price data for March surprised to the upside. 10-year yields rose 12 basis points (bps) to new year-to-date highs, ending at 4.52%. 2-year yields also rose, up 15 bps. Core consumer prices rose 0.4% month-over-month, with a surprising 0.7% increase in the supercore measure of core services excluding housing. Investors have reassessed the near-term outlook for Fed rate cuts. The first cut is now priced for July, from June before the CPI print. Additionally, the market is pricing only 1.8 total cuts this year, down from 2.6 at the start of the week and more than 6 to start the year. Risk sentiment was impacted by escalating geopolitical tensions in the Middle East. Oil prices spiked as part of the broader risk-off move.

Investment grade corporates weakened, returning -0.68% but outperforming similar-duration Treasuries by 2 bps. Yields increased 13 bps for the week, which prompted buyers to step in at these higher levels. Spread levels were flat for the week near their recent lows, at 89 bps for the IG market overall. Supply was somewhat less than expected amid the move higher in rates, with a total of just over $19 billion pricing for the week. Continuing the theme of this year, those deals were met with very strong demand. Oversubscription rates were around 4.5x on average, leading to 2.6 bps of new issue concession, below the year-to-date average.

High yield corporates also sold off, returning -0.58% for the week and lagging similar-duration Treasuries by -20 bps. Senior loans gained 0.09%, benefiting from the move higher in rates due to their floating rate nature. Yield levels for the loan asset class rose 21 bps for the week, to 9.59%, a fresh year-to-date high. Supply in both markets continued at a healthy pace – $5.7 billion in high yield and $8.4 billion in loans – though that is likely to decelerate moving forward amid the move higher in rates. High yield funds had outflows of -$476 million, though loan funds experienced robust inflows of $676 million.

Emerging markets returned -0.76%, and the asset class underperformed similar-duration Treasuries by -14 bps. Spreads were generally tighter across sovereign markets, by around 6 bps, but the move higher in rates weighed on returns. The asset class experienced its second consecutive weekly inflow for the first time since last July, with $972 million entering the hard currency market. Issuance was muted, with only $4 billion of new deals pricing.

MUNI BOND SUPPLY IS READILY DIGESTIBLE

Municipal bond yields sold off last week, but essentially recovered by week's end. Short yields ended the week unchanged, and long yields rose 2 bps. New issue deals were priced deals to clear the market. Funds flows were positive, and exchange-traded funds also saw inflows of $809 million. This week's new issue is undersized, but should still be priced to sell as underwriters look to keep new issuance moving.

Muni yields rose after Wednesday's hot U.S. CPI number. And munis rallied Friday after the flight to quality in U.S. Treasuries, following early indications of mounting conflict in the Middle East. We expect muni bonds to remain well bid, as demand remains strong. Weekly reporting municipal funds have seen eight consecutive weeks of positive flows, and we expect this trend to continue. Supply continues to be readily digestible as institutional managers retool portfolios. Munis remain rich compared to Treasuries, but they continue to remain well bid.

The state of California issued $600 million tax-exempt various purpose general obligation bonds (rated Aa2/AA-). The initial demand was tepid, but Friday's fixed income rally pulled some of the California bonds to premiums to where the deal was purchased. For example, 5% coupon bonds maturing in 2039 came at a yield of 3.25% and traded in the secondary market at a slight premium of 3.22%.

The high yield municipal market remains firmly bid. While fund flows remain positive but stunted, the real impact comes from the routine oversubscription of new issue deals. This week we are monitoring 10 high yield muni deals offering just $500 million of par supply.

Emerging markets experienced their second consecutive weekly inflow for the first time since July 2023.

In focus

ECB prepares to pivot

Although some European Central Bank (ECB) policymakers were ready to lower interest rates from an all-time high of 4% at last week's meeting, the ECB paused for the fifth straight time while signaling that rate cuts are ahead. We expect the ECB to begin with a 25 bps rate reduction in June, followed by 75 bps of additional easing by year-end.

The ECB's confidence for cutting was bolstered by further evidence of declining price pressures in the eurozone. In March, year-over-year headline consumer price inflation fell to 2.4%, just above the central bank's 2% target. Also, high borrowing costs have weighed on the region, with business activity, according to PMI surveys, contracting for nine straight months through February.

In its policy statement, the ECB noted that if "inflation is converging to the target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction." This marked the ECB's first reference to lower rates since it began tightening policy in 2022 amid soaring inflation.

The ECB's decision came the day after the U.S. reported hotter-than-forecast CPI data (+3.5%) for March, which prompted investors to scale back expectations for the Fed to begin lowering the fed funds rate. But ECB President Lagarde pushed back on the notion that the central bank wasn't prepared to cut rates unless the Fed did so, too, stating that "We are data dependent, not Fed dependent."

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.90	0.15	0.28	0.65
5-year	4.56	0.16	0.35	0.71
10-year	4.52	0.12	0.32	0.64
30-year	4.63	0.08	0.29	0.60

Source: Bloomberg L.P., 12 Apr 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	3.11	0.00	0.14	0.59
5-year	2.70	0.02	0.16	0.42
10-year	2.67	0.01	0.16	0.39
30-year	3.83	0.02	0.15	0.41

Source: Bloomberg L.P., 12 Apr 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	83
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters, 12 Apr 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[5]	3.64	–	6.11	-0.08	-0.72	-1.11
High yield municipal	5.59	208[1]	6.95	0.16	-0.68	0.82
Short duration high yield municipal[2]	5.23	259	3.63	0.00	-0.28	1.82
Taxable municipal	5.28	65[3]	7.83	-0.58	-2.09	-1.98
U.S. aggregate bond	5.14	39[3]	6.20	-0.70	-1.76	-2.52
U.S. Treasury	4.73	–	5.96	-0.62	-1.68	-2.62
U.S. government related	5.19	45[3]	5.24	-0.58	-1.35	-1.72
U.S. corporate investment grade	5.59	89[3]	6.94	-0.68	-1.84	-2.24
U.S. mortgage-backed securities	5.36	49[3]	6.24	-0.91	-1.93	-2.96
U.S. commercial mortgage-backed securities	5.61	92[3]	4.27	-0.53	-1.07	-0.24
U.S. asset-backed securities	5.41	50[3]	2.56	-0.22	-0.48	0.19
Preferred securities	6.82	165[3]	4.91	-1.33	-1.53	2.93
High yield 2% issuer capped	8.06	310[3]	3.23	-0.58	-1.07	0.39
Senior loans[4]	9.59	505	0.25	0.09	0.23	2.77
Global emerging markets	7.30	259[3]	6.00	-0.76	-1.22	0.29
Global aggregate (unhedged)	3.91	39[3]	6.65	-0.99	-1.69	-3.73

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, 12 Apr 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, 12 Apr 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 10 Apr 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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