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Weekly Fixed Income Commentary

22 April 2024

Treasury yields rise on hawkish Fed comments

U.S. Treasury yields rose again amid hawkish rhetoric from U.S. Federal Reserve officials and continued strong U.S. economic data. Chair Powell said "recent data have clearly not given us greater confidence" that inflation is on track to return to 2%, signaling that rates are likely to remain higher than previously thought.

HIGHLIGHTS

- **Treasuries and most spread sectors experienced negative total returns.**
- **Senior loans enjoyed positive returns and ABS outperformed versus Treasuries.**
- **Municipal bond yields increased. New issue supply was light at $5.4B and fund outflows were -$1.5B. This week's new issuance is expected to be outsized at $9.4B.**

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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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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 underperformed 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.

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HIGH YIELD CORPORATE SPREADS CONTINUE TO WIDEN

U.S. Treasury yields rose again last week, with the 10-year Treasury yield ending 10 basis points (bps) higher at 4.62%, a fresh year-to-date high. 2-year yields ended 9 bps higher. The moves were predominantly driven by hawkish Fed speak and continued strong economic data. Chair Powell said "recent data have clearly not given us greater confidence" that inflation is on track to return to 2%. Retail sales for March surprised to the upside, rising 0.7% month-over-month in headline terms and 1.1% in core terms. The core measure is running more than 5% year-over-year, the fastest pace in a year. New housing starts were down -14.7% in March, the sharpest monthly decline since early 2020, though that data was overshadowed by the strong consumer and hawkish Fed.

Investment grade corporates retreated, returning -0.72% for the week and lagging similar-duration Treasuries by 14 bps. Spreads widened 3 bps while yields rose 12 bps. Inflows slowed materially to only $900 million, down from the recent average of more than $4 billion per week. The risk-off tone weighed on primary market demand, though corporates still priced more than $34 billion of new paper for the week. The majority came from financials after major U.S. banks exited their earnings blackout period. Overall, new deals came with concessions of 4.5 bps, elevated versus the recent average. At least two issuers held off on planned issuance until conditions calm down.

High yield corporates also weakened, returning -0.58% for the week and underperforming similar-duration Treasuries by -37 bps. Although the asset class was, due to its shorter duration, better insulated from the rise in rates than investment grade, spreads widened by 13 bps. This was the biggest move since January and the fifth straight week of widening. Outflows accelerated at -$3.7 billion, the biggest weekly outflow since March 2023. Senior loans, which saw continued inflows of $153 million, returned 0.07% for the week.

Emerging markets sold off -0.54% for the week, underperforming similar-duration Treasuries by -5 bps. The dollar rallied again. That weighed on emerging markets broadly, including local markets, which returned -0.33%. Outflows returned after two weeks of inflows, with -$145 and -$215 million exiting hard currency and local currency funds, respectively. New issuance was quiet amid the volatility, with slightly less than $3 billion pricing for the week.

MUNI BOND DEMAND REMAINS SOLID

Municipal bond yields ended last week higher. Short-term muni yields rose 4 bps and long-term yields increased 7 bps. Weekly new issuance was light and priced to sell. Fund flows were negative at -$1.5 billion, including exchange-traded outflows of -$815 million. This week's new issue market should be outsized, and deals will again need to be priced to sell to clear the market.

Muni bond yields remain rich to Treasuries, and last week we saw outsized outflows as many investors redeemed funds to pay their taxes. New issuance is expected to remain higher this week, which should keep muni yields elevated. However, overall demand remains solid. This week's large new issue deals should be priced to sell, as dealers want to keep deals moving. They should also be well received, as institutional municipal money managers need large block sizes to retool portfolios toward original mandates. We would see any price dips, like what may come this week, as a potential buying opportunity.

The Board of Regents of the University of Texas System issued $800 million revenue bonds (rated Aaa/AAA). The deal was well received. In fact, some bonds traded in the secondary market at a premium. For example, 4.125% coupon bonds due in 2054 came at a yield of 4.35% and traded in the secondary market at 4.30%. This occurred even though the muni market in general continued to sell off as the week progressed.

The high yield municipal market continued to outperform, as average index yields remained roughly unchanged while Treasury and high grade muni yields increased. High yield muni outflows were a modest-$48 million, but the result was net of concentrated outflows from a single complex who lost management. This week the market is set to address the grand refunding and restructuring of Brightline Florida's existing 2019 debt.

Thanks to their floating-rate coupon and near-zero duration, loans could continue to provide high income and ballast for fixed income portfolios.

In focus

A hot economy, patient Fed could spur senior loans

Following a stellar 2023, senior loans continue to offer both stability and income. Their 2.84% total return handily leads most other fixed income segments, as does their 9.72% yield. And with the Fed likely to delay its pivot to lower rates amid stronger-than-expected U.S. economic data, loans could benefit in a "higher-for-even-longer" rate environment.

On the heels of March's hot inflation report and strong retail sales data, last week Fed Chair Jerome Powell and other Fed officials dialed back expectations for the central bank to begin cutting rates. In January, investors had penciled in up to six rate cuts for 2024. Now they're looking for just one or two. This hawkish backdrop could bode well for senior loans. Thanks to their floating-rate coupon and near-zero duration, loans could continue to provide high income and ballast for fixed income portfolios as the Fed awaits its next move.

Within loans, we are finding attractive opportunities across the credit spectrum. Higher quality issuers (rated B+ and better) continue to offer healthy yields (8%-9%) with relatively low default risks. Meanwhile, we believe volatility will persist and defaults will edge up for lower-rated issuers (B- and below), allowing active managers with a robust credit underwriting process to capitalize on market fluctuations, identify total return opportunities and potentially deliver double-digit portfolio returns.

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U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	4.99	0.09	0.37	0.74
5-year	4.67	0.11	0.46	0.82
10-year	4.62	0.10	0.42	0.74
30-year	4.71	0.08	0.37	0.68

Source: Bloomberg L.P., 19 Apr 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	3.15	0.04	0.18	0.63
5-year	2.78	0.08	0.24	0.50
10-year	2.74	0.07	0.23	0.46
30-year	3.90	0.07	0.22	0.48

Source: Bloomberg L.P., 19 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	68

Source: Bloomberg L.P., Thompson Reuters, 19 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal[5]	3.70	–	6.14	-0.30	-1.02	-1.40
High yield municipal	5.61	204[1]	6.97	-0.04	-0.72	0.78
Short duration high yield municipal[2]	5.27	255	3.64	-0.10	-0.38	1.71
Taxable municipal	5.37	62[3]	7.79	-0.64	-2.71	-2.61
U.S. aggregate bond	5.25	40[3]	6.15	-0.61	-2.36	-3.11
U.S. Treasury	4.81	–	5.88	-0.43	-2.11	-3.04
U.S. government related	5.28	45[3]	5.18	-0.45	-1.80	-2.16
U.S. corporate investment grade	5.71	92[3]	6.87	-0.72	-2.55	-2.94
U.S. mortgage-backed securities	5.50	55[3]	6.28	-0.84	-2.76	-3.78
U.S. commercial mortgage-backed securities	5.75	96[3]	4.27	-0.48	-1.55	-0.72
U.S. asset-backed securities	5.51	53[3]	2.58	-0.11	-0.59	0.08
Preferred securities	7.01	179[3]	4.97	-0.92	-2.44	1.98
High yield 2% issuer capped	8.27	323[3]	3.28	-0.58	-1.64	-0.19
Senior loans[4]	9.72	508	0.25	0.07	0.31	2.84
Global emerging markets	7.42	262[3]	5.95	-0.54	-1.75	-0.25
Global aggregate (unhedged)	4.00	39[3]	6.61	-0.55	-2.23	-4.26

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, 19 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, 19 Apr 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 17 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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