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Weekly Fixed Income Commentary

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Dovish central banks push Treasury yields lower

U.S. Treasury rates fell last week across the yield curve, led by 5- and 10-year maturities. The European Central Bank (ECB) surprised markets with a new round of stimulative bank financing, and U.S. Federal Reserve (Fed) officials indicated the Fed will likely hold firm on rates at the March meeting. These dovish actions helped spark a risk-off mode for financial markets, benefiting Treasuries and other government bonds.

HIGHLIGHTS

- **Investment grade corporate bonds recorded their best week since late January.**
- **Municipal bonds performed well last week, as yields moved generally lower.**
- **High yield corporates posted a moderate loss for only the second time in the past 11 weeks.**

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TREASURY YIELDS DECLINE WITH EUROPEAN RATES

U.S. Treasury yields fell last week across the yield curve, led by 5- and 10-year maturities.[1] The biggest decline occurred on Thursday when the European Central Bank (ECB) surprised the market with its dovish actions. The ECB slashed its 2019 growth forecast, pushed off its forecast for a policy rate hike and announced a new series of low-cost loans to its banking sector. The unexpected announcement of a new round of bank financing pushed European rates lower, and Treasuries followed. The February payroll report came in much weaker than expected, adding only 20,000 jobs. Market reaction was muted, with weakness in job growth offset by rising wages.

All U.S. sectors delivered positive total returns, except the high yield, preferred and senior loan sectors.[1] All sectors underperformed similar-duration Treasuries as spreads widened.[1] The credit sectors posted the weakest relative returns, led by the high yield sector.[1] The underperformance of the high yield sector was broad-based, but led by the lower quality buckets.[1] The global aggregate sector posted a positive total return and only marginally underperformed Treasuries.[1] The European sector posted the strongest relative performance.[1]

Several Fed officials indicate that the committee likely intends to keep the fed funds rate unchanged at the March meeting and perhaps longer. Fed officials cited muted inflation and heightened downside risks from slowing global growth and policy uncertainty as reasons to take a wait-and-see approach. The market has currently priced in virtually a zero percent chance of a rate hike in 2019. The Fed will provide a new round of forecasts, including the forecast for the path of the fed funds rate.

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MUNICIPAL DEMAND CONTINUES TO OUTPACE SUPPLY

Municipal bonds performed well last week, as yields moved generally lower.[1] The new issue calendar was light at $5 billion and deals were well subscribed.[2] Fund flow totaled nearly $800 million.[3] New issuance is expected to be undersized again at just $4 billion.[2]

Municipal yields declined 7 to 11 basis points across the intermediate and longer range of the yield curve last week.[1] Demand continues to outpace the level of supply from the primary market. As the April 15 tax deadline draws closer, high-income earners are getting a clearer picture of their individual tax bills, which should continue to support the tax-advantaged nature of the municipal market.

The state of California issued $2.3 billion general obligation bonds (rated Aa3/AA-).[4] Much of the deal was structured in longer maturities that were well received. Secondary market trading has been strong with some bonds trading as much as 10 basis points lower in yield.

High yield municipal bond fund flows continued at a very strong pace last week at $374 million, and performance has been strong year to date.[1,3] We can see a clearer performance picture when breaking it down into rates, ratios and spreads. General long-term interest rates (30-year U.S. Treasury) have been generally flat, municipal-to-Treasury yield ratios have contracted from 100% to 96% (worth 13 bps of outperformance) and credit spreads have tightened by 8 bps on average.[1] Combining the three components leaves a net yield decrease of -21 bps (0-13-8=-21). We believe credit spreads could have tightened further with more supply. However, with fund flows continuing to build and seasonal supply expected to pick up soon, we expect accelerated spread tightening in the coming months.

INVESTMENT GRADE CORPORATES SHINE IN A RISK-OFF WEEK

Investment grade corporate bonds recorded their best week since late January, outperforming all taxable sectors except Treasuries.[1] A shaky equity market and heavy supply took a modest toll on investment grade spreads, however, which widened slightly during the week.[1] Credit-specific headlines triggered more severe idiosyncratic widening among some large issuers. Overall, the asset class continues to benefit from strong demand and the Fed's dovish tilt.

High yield corporates posted a moderate loss for only the second time in the past 11 weeks.[1] Global growth fears and February's surprisingly downbeat jobs report dimmed investor sentiment. Fund flows were -$2 billion, after a combined $10 billion of inflows in January and February.[3] Given the week's risk-off tone, CCC-rated issues fared substantially worse than higher quality (BB and B) bonds.[1]

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Emerging market (EM) debt returns inched lower despite a ninth straight week of inflows.[1] Sovereign spreads widened, mostly due to high-yield bonds.[1] Trading was orderly, with no signs of panicked selling. Lower-beta (less volatile) countries outperformed. Corporate EM spreads also gapped wider amid risks associated with Turkey. Local rates were resilient in the face of currency weakening following the ECB's dovish March 7 meeting. Last week's laggards included the South African rand, Russian ruble and Mexican peso.

In focus

ECB out-doves the Fed with new stimulus

The European Central Bank (ECB) surprised markets last week by taking an even more dovish stance than expected. While a continuation of accommodative monetary policy was a foregone conclusion, ECB President Mario Draghi took it a step further.

Draghi announced not only a delay in rate hikes until at least 2020, but also fresh stimulus in the form of very low-interest-rate loans to eurozone banks. He also shared newly downgraded growth forecasts. These moves come only three months after the ECB ended its long-running bond-buying program and confirmed it was still eyeing a resumption of rate hikes in mid-2019.

If a dovish policy U-turn by a major central bank that anticipates economic slowing (but not a recession) sounds familiar, it is. The ECB's action, though more drastic, was thematically similar to the Fed's January 30 statement eliminating any mention of further U.S. rate increases.

Financial markets have already priced in zero chance of a hike at the Fed's March 20 meeting and will have to wait until then to learn if Chair Jerome Powell and his colleagues, like their ECB counterparts, have materially revised their economic or policy outlook. We're not convinced they have, but we expect the Fed to provide clarifying details on plans to shrink its balance sheet. Whether market reaction will be positive or negative will depend on the details.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	2.46	-0.09	-0.05	-0.03
5-year	2.43	-0.13	-0.08	-0.08
10-year	2.63	-0.13	-0.09	-0.06
30-year	3.01	-0.11	-0.07	0.00

Source: Bloomberg L.P. As of 8 Mar 2019. **Past performance is no guarantee of future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	Month-to-date	Year-to-date
2-year	1.58	0.00	0.00	-0.20
5-year	1.67	-0.01	0.00	-0.27
10-year	2.06	-0.07	0.04	-0.22
30-year	2.89	-0.11	0.09	-0.13

Source: Bloomberg L.P. As of 8 Mar 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	79
30-year AAA Municipal vs Treasury	96
High Yield Municipal vs High Yield Corporate	72

Source: Bloomberg L.P., Thompson Reuters. As of 8 Mar 2019. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	2.51	–	6.24	0.40	0.32	1.62
High Yield Municipal	4.87	215[5]	9.45	0.77	0.67	1.89
High Yield Municipal, ex Puerto Rico	4.82	210[5]	7.71	0.74	0.65	1.79
Short Duration High Yield Municipal[6]	4.09	227	3.80	0.35	0.36	1.60
Short Duration High Yield Municipal, ex Puerto Rico[6]	4.02	220	3.64	0.33	0.35	1.46
U.S. Aggregate Bond	3.14	46[7]	5.93	0.68	0.48	1.49
U.S. Treasury	2.57	–	6.18	0.79	0.54	0.74
U.S. Government Related	3.23	66[7]	5.44	0.60	0.41	1.58
U.S. Corporate Investment Grade	3.86	123[7]	7.33	0.66	0.50	3.08
U.S. Mortgage-Backed Securities	3.29	36[7]	4.60	0.57	0.42	1.12
U.S. Commercial Mortgage-Backed Securities	3.22	70[7]	5.26	0.64	0.43	1.89
U.S. Asset-Backed Securities	2.88	38[7]	2.12	0.21	0.15	0.91
Preferred Securities	4.41	161[7]	4.66	-0.08	0.25	7.19
High Yield 2% Issuer Capped	6.74	404[7]	3.56	-0.46	-0.42	5.81
Senior Loans[8]	7.02	449[7]	0.25	-0.02	-0.02	3.89
Global Emerging Markets	5.52	293[7]	5.73	-0.03	-0.22	3.78
Global Aggregate (unhedged)	1.91	48[7]	7.07	0.25	0.00	0.94

5 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **6** 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. **7** Option-adjusted spread to Treasuries. **8** 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. As of 8 Mar 2019. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. 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. All indices are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 8 Mar 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 6 Mar 2019.

Any reference to municipal 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.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

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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 advisor regarding the suitability 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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