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Weekly Fixed Income Commentary

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Treasury yields decline; markets await the Fed

U.S. Treasury rates declined modestly last week, led by 10-year maturities and followed by 5- and 2- year yields. Markets focused on deteriorating Brexit negotiations and mixed U.S. economic data. Markets expect no policy changes when the U.S. Federal Reserve (Fed) meets this week.

HIGHLIGHTS

- **Higher risk areas enjoyed the strongest returns, led by emerging markets and high yield corporates.**
- **Municipal bonds traded sideways, in line with U.S. Treasuries.**
- **The global aggregate sector outperformed the U.S., supported by strong returns in Europe.**

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TREASURY RATES FALL MODESTLY

Treasury yields finished last week slightly lower for all maturities except the 30-year, which remained unchanged.[1] After several shifts, Treasury yields closed Thursday nearly unchanged for the week.[1] Friday's move determined the week's change, with a modest decline in rates.[1] The 10-year Treasury led the way lower, followed by 5- and 2-year maturities.[1] Additional supply of long Treasuries and weak demand supported 30-year Treasury yields, which did not fall in line with shorter maturities.[1] Markets focused on the evolving Brexit negotiations and U.S. economic data. U.S. data showed resilient consumer and economic growth, but dominant themes included softer manufacturing and production, along with continued disappointing price readings.

Risk sentiment was positive last week, although it was not accompanied by rising Treasury yields as is usually the case. All fixed income sectors posted positive total returns for the week and outperformed similar-duration Treasuries.[1] The higher risk areas enjoyed the strongest returns, led by emerging markets and high yield corporates.[1] Preferred securities added to their market-leading 2019 performance, experiencing positive total returns in 10 of 11 weeks this year.[1] The global aggregate sector outperformed the U.S., with strong returns in Europe overwhelming soft performance in Asia.[1]

Markets are not expecting a rate increase at this week's Fed meeting. In fact, investors anticipate the Fed's forecast will reflect fewer additional future hikes. Current market-based measures actually indicate more than a 30% probability of a rate cut in 2019. We believe this outlook is too aggressive and do not project a Fed rate cut, barring a significant deterioration in U.S. economic data.

Last week marked the eighth week of substantial and positive municipal bond fund flows.

THE MUNICIPAL MARKET NEEDS MORE SUPPLY

Municipal bonds traded sideways last week, in line with U.S. Treasuries, with both markets ending the week with firm tones.[1] New issue supply totaled $6.3 billion and was readily absorbed.[2] Fund flows were positive yet again, at $1.6 billion.[3] This week's supply is expected to be a meager $3.6 billion and should be readily absorbed.[2]

The municipal bond market continues to be driven by recent records in supply and demand. New issue supply is nearly 50% lower so far in 2019 than in 2013 through 2017. 2018 was an outlier, as the year began with overhang of $60+ billion issued in December 2017.[4] Demand continues to be strong, with last week marking the eighth week of substantial and positive fund flows. The municipal market simply needs more supply to meet demand. Demand comes partially from individual tax payers feeling the effect of reduced deductions for state and local taxes (SALT) as they file their income taxes.

Lower Colorado River Authority, Texas issued $393 million transmission contract revenue bonds.[5] Strong demand allowed underwriters to increase the par amount of the deal by $22 million bonds and lower yields by 3 to 7 basis points upon final pricing.

High yield municipal bond yields decreased in line with AAA-rated municipals last week.[1] We believe credit spreads would likely tighten further if trading volume were sufficient to allow competition to price in actual demand for credit risk. High yield municipal fund flows totaled $387 million last week, building on already historically strong technical strength.[3] In this market, access to supply is highly valuable and highly discriminatory.

CORPORATE CREDIT AND EM DEBT EXTEND 2019 GAINS

High yield corporate bonds bounced back from a negative week.[1] The asset class was among the top performers in the taxable space, bolstered by strong inflows, favorable equity market sentiment and light overall new issuance. High yield spreads narrowed, and more than $1 billion entered the space.[1,2] There was little difference in returns across quality tiers, as BB, B and CCC rated securities performed essentially in lockstep.[1]

Investment grade corporates delivered positive returns for the ninth time in the past 11 weeks, and now lead all taxable sectors for the month of March.[1] Investment grade fund flows exceeded $2 billion for the third consecutive week, indicating there is plenty of cash available to put to work.[3] Spreads tightened modestly despite heavier-than-expected new supply ($28 billion from 19 issuers).[1,2]

BB, B and CCC rated securities performed essentially in lockstep.

Emerging markets (EM) improved on their already solid 2019 performance.[1] Sovereign, corporate and local currency returns were supported as global growth concerns dissipated and the U.S. dollar weakened against nearly all EM currencies. Gains were led by the Argentine peso (+3%), reflecting central bank measures introduced to fight stubbornly high inflation in that country. EM bond funds denominated in hard currencies experienced their tenth straight week of inflows.

In focus

Preferred securities: looking up in 2019

Preferred securities have outperformed all other fixed income asset classes so far in 2019, after declining dramatically in the fourth quarter of 2018 and ending last year down -4.5%.[1]

We think outflows were the primary culprit last year, despite supportive supply and solid fundamentals. Banks, the sector's biggest issuer, had generated back-to-back quarters of strong earnings and passed stress tests more stringent than during the financial crisis. From a supply standpoint, the U.S. preferred market shrank by about $8 billion last year. At the same time, by some measures the sector experienced the largest outflows on record in the fourth quarter.

Preferred performance has turned around in 2019, thanks to strong inflows and tightening credit spreads. We believe the rally still has legs.

Valuations remain attractive and technicals may provide a tailwind. Supply should remain light, as banks will likely need to raise little, if any, capital this year. As a result, supply could stay flat or even shrink, while demand remains robust.

Yields remain attractive, and we believe potential for price return remains. Although the sector returned -4.5% last year, the price return was -9.9% while income contributed +5.4%. In 2019, prices have recouped only a portion of that decline, returning 6.5%.[1]

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	2.44	-0.02	-0.08	-0.05
5-year	2.40	-0.04	-0.12	-0.12
10-year	2.59	-0.04	-0.13	-0.10
30-year	3.01	0.00	-0.07	0.00

Source: Bloomberg L.P. As of 15 Mar 2019. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.58	0.00	0.00	-0.20
5-year	1.70	0.03	-0.03	-0.24
10-year	2.04	-0.02	0.06	-0.24
30-year	2.85	-0.04	0.13	-0.17

Source: Bloomberg L.P. As of 15 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	94
High Yield Municipal vs High Yield Corporate	74

Source: Bloomberg L.P., Thompson Reuters. As of 15 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	2.49	–	6.13	0.17	0.50	1.80
High Yield Municipal	4.85	217[6]	9.33	0.24	0.91	2.14
High Yield Municipal, ex Puerto Rico	4.79	211[6]	7.65	0.28	0.93	2.07
Short Duration High Yield Municipal[7]	4.06	224	3.76	0.23	0.59	1.83
Short Duration High Yield Municipal, ex Puerto Rico[7]	3.98	216	3.60	0.25	0.60	1.71
U.S. Aggregate Bond	3.11	45[8]	5.93	0.23	0.71	1.72
U.S. Treasury	2.55	–	6.19	0.13	0.67	0.87
U.S. Government Related	3.17	63[8]	5.45	0.34	0.75	1.92
U.S. Corporate Investment Grade	3.81	120[8]	7.34	0.36	0.86	3.46
U.S. Mortgage-Backed Securities	3.26	36[8]	4.53	0.23	0.65	1.35
U.S. Commercial Mortgage-Backed Securities	3.19	70[8]	5.26	0.26	0.68	2.15
U.S. Asset-Backed Securities	2.86	39[8]	2.17	0.10	0.25	1.01
Preferred Securities	4.20	146[8]	4.62	0.53	0.78	7.76
High Yield 2% Issuer Capped	6.54	388[8]	3.48	0.73	0.31	6.59
Senior Loans[9]	6.99	450	0.25	0.20	0.09	4.00
Global Emerging Markets	5.40	283[8]	5.75	0.74	0.52	4.55
Global Aggregate (unhedged)	1.89	48[8]	7.06	0.43	0.43	1.37

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 15 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, 15 Mar 2019. **3** Lipper Fund Flows. **4** MMA Strategist, 11 Mar 2019. **5** Market Insight, MMA Research, 13 Mar 2019.

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.

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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A word on risk

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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