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Weekly Fixed Income Commentary

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# Treasury yields decline amid global trade concerns

*U.S. Treasury yields declined slightly last week after a sharp reversal in the outlook for a U.S./China trade deal. Short-maturity yields declined the most, causing the yield curve to steepen. The Federal Reserve (Fed) continues to focus on the positive, including improving U.S. economic data, easier financial conditions and an improving growth outlook in China.*

## HIGHLIGHTS

- **The higher risk sectors – including high yield corporates, senior loans and preferred securities – suffered negative total returns.**

- **The municipal market rallied, along with U.S. Treasuries.**

- **The global aggregate sector posted the highest total return for the week.**

**Bill Martin**
*Head of Global Fixed Income*

**John Miller**
*Head of Municipals*

## TRADE FEARS SPARK MODEST RISK-OFF YIELD DECLINES

**Treasury yields declined last week after a sharp reversal in the outlook for a U.S./China trade deal.**[1] Tweets from President Trump sparked renewed policy concerns, which festered throughout the week. A soft 10-year Treasury auction briefly pushed rates higher on Wednesday before they continued their descent.[1] Although the deterioration in trade relations was dramatic, the market reaction was muted, with yields only 3 to 7 basis points (bps)lower.[1] Short-maturity U.S. rates declined the most, causing a modest steepening in the yield curve.[1]

**All U.S. taxable fixed income sectors posted lower total returns than Treasuries last week,** and all sectors other than asset-backed securities underperformed similar-duration Treasuries.[1] However, most sectors enjoyed positive total returns, with only the higher risk sectors suffering negative total returns. High yield corporates performed the worst, followed by senior loans and preferred securities.[1] Investment grade corporate spreads widened and the sector significantly underperformed Treasuries, although longer durations helped the sector deliver a modestly positive total return.[1] Non-U.S. markets also underperformed similar-duration Treasuries, but strong returns in Asia region helped the global aggregate sector post the highest total return of any fixed income sector.[1]

**Fed officials continue to focus on positive developments.** Strengthening U.S. economic data, easier financial conditions and an improving growth outlook for China were cited as supporting the case for a possible rate increase in 2019. However, market-based probabilities still reflect a higher likelihood of a rate cut than an increase this year.

***The taxable-equivalent yield on municipal bonds is well above U.S. Treasury bonds and broadly higher than the rates on similar structure U.S. corporate bonds.***

## MUNICIPAL TECHNICAL IMBALANCE BOOSTS PERFORMANCE

**The municipal bond market rallied last week,** along with U.S. Treasuries.[1] Longer-term municipals in particular dramatically outperformed Treasuries.[1] New issue supply totaled $6.5 billion and was readily absorbed.[2] Fund flows were positive for the 18th straight week at $1.5 billion.[3] This week's new issue supply is expected to increase to $7 billion and should be readily absorbed.[2]

**Municipals continued their solid 2019 performance,** mainly due to declining interest rates and a supply/demand imbalance. Continued tepid new issue supply is no match for the outsized demand. We expect a net-negative supply of $46 billion over the next four months,[2] while fund inflows of $33.6 billion represent the best year to date start since the data series began in 1992.[3]

**Municipal yields appear historically rich versus Treasuries,** but JPMorgan reports that "...using the top federal tax bracket, the taxable-equivalent yield on municipal bonds is well above U.S. Treasury bonds and broadly higher than the rates on similar structure U.S. corporate bonds..."[4]

**The Commonwealth of Massachusetts** issued $700 million bonds backed by a limited-tax general obligation, in four separate deals (rated AA or NR).[5] Massachusetts often comes to market, and some believed the bonds should have been priced cheaper to be completely placed to long-term investors. However, bond desks that own the deals are confident the balances will be sold as reinvestment money continues to increase over the next several months.

**High yield municipal bond yields are declining,** but to a lesser extent than AAA municipal yields due to limited high yield supply.[1] As a result, market yields offer investors wider credit spreads over both AAA municipals and Treasuries with increasing relative value.[1] High yield fund flows continue, increasing competition for limited supply. Investors added $429 million in net flows last week, taking the year-to-date total to $7 billion.[3]

## HIGH YIELD CORPORATES DECLINE, A RARITY IN 2019

**High yield corporate bonds suffered their first negative week since early March** and only the third of this year.[1] High yield spreads widened by more than 20 bps, and lower-quality (CCC) bonds posted a larger loss than higher-quality (B and BB) securities.[1] Among sectors, steel and diversified media held up best, while autos, chemicals and tech performed worst.[1] Declining crude oil prices also weighed on the high yield asset class. The primary market was resilient, with nearly $12 billion in new issuance representing 17 deals.[2]

**Investment grade credit recorded a modest gain.**[1] Support came from fund flows, which were positive for the 15th consecutive week.[3] On the down side, spreads widened, and U.S./China tariff uncertainty drove intraday volatility. New supply was heavy, with 13 companies issuing more than $50 billion in debt.[2] Another $60-$80 billion is scheduled to come to market in May.[2] This additional supply, coupled with ongoing trade worries, is likely to weigh on sentiment.

***Investment grade credit fund flows were positive for the 15th consecutive week.***

**Emerging markets (EM) debt finished slightly in the red.**[1] ETF flows were the primary driver of weakness in the EM sovereign space. Turkish government spreads widened after authorities overturned the results of Istanbul's mayoral election following the defeat of a candidate from the ruling party. Argentina bucked the negative sovereign trend amid signs of potential improvement in that country's political and economic situation.

*In focus*

# Corporate credit has been resilient amid volatility

*The recent rally in risk assets has reversed in recent days due to renewed fears over U.S./China trade negotiations. But corporate credit has been resilient, with performance of both corporate high yield and senior loans down only nominally.[1]*

This solid performance is consistent with prior periods of volatility, such as the fourth quarter of 2018. Corporate debt has held up better than other asset classes because it holds a more senior position in a company's capital structure and it benefits from a more U.S.-oriented issuer base.

Many investors consider corporate credit as part of a fixed income allocation. In reality, corporate high yield and senior loans may have more in common with equities, as both asset classes have a positive correlation to stocks. Further, their underlying risks may be more akin to equities, as they all depend on stable or strong economic conditions to drive performance.

For investors who believe the U.S. economy remains strong, but are concerned about potential equity volatility, corporate credit may be a way to achieve equity-like risk with lower volatility and higher current income.

## U.S. Treasury market

| | | Change (%) | | |
|---|---|---|---|---|
| Maturity | Yield | Week | Month-to-date | Year-to-date |
| 2-year | 2.27 | -0.07 | 0.00 | -0.22 |
| 5-year | 2.26 | -0.06 | -0.01 | -0.25 |
| 10-year | 2.47 | -0.06 | -0.04 | -0.22 |
| 30-year | 2.89 | -0.03 | -0.04 | -0.13 |

Source: Bloomberg L.P. As of 10 May 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 | 1.53 | -0.04 | -0.04 | -0.25 |
| 5-year | 1.56 | -0.07 | -0.07 | -0.38 |
| 10-year | 1.75 | -0.09 | -0.11 | -0.53 |
| 30-year | 2.43 | -0.09 | -0.12 | -0.59 |

Source: Bloomberg L.P. As of 10 May 2019. **Past performance is no guarantee of future results.**

## Yield ratios

| | Ratio (%) |
|---|---|
| 10-year AAA Municipal vs Treasury | 71 |
| 30-year AAA Municipal vs Treasury | 84 |
| High Yield Municipal vs High Yield Corporate | 73 |

Source: Bloomberg L.P., Thompson Reuters. As of 10 May 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 | 2.20 | – | 5.49 | 0.49 | 0.61 | 3.92 |
| High Yield Municipal | 4.59 | 232[6] | 8.16 | 0.46 | 0.58 | 5.02 |
| High Yield Municipal, ex Puerto Rico | 4.53 | 226[6] | 7.74 | 0.50 | 0.67 | 4.62 |
| Short Duration High Yield Municipal[7] | 3.90 | 230 | 3.80 | 0.28 | 0.38 | 3.37 |
| Short Duration High Yield Municipal, ex Puerto Rico[7] | 3.84 | 224 | 3.68 | 0.30 | 0.40 | 3.15 |
| U.S. Aggregate Bond | 2.94 | 46[8] | 5.85 | 0.31 | 0.25 | 3.22 |
| U.S. Treasury | 2.38 | – | 6.27 | 0.48 | 0.38 | 2.21 |
| U.S. Government Related | 3.00 | 61[8] | 5.56 | 0.29 | 0.17 | 3.47 |
| U.S. Corporate Investment Grade | 3.62 | 117[8] | 7.42 | 0.14 | -0.02 | 5.69 |
| U.S. Mortgage-Backed Securities | 3.11 | 43[8] | 4.01 | 0.23 | 0.33 | 2.44 |
| U.S. Commercial Mortgage-Backed Securities | 2.99 | 66[8] | 5.26 | 0.43 | 0.26 | 3.72 |
| U.S. Asset-Backed Securities | 2.63 | 35[8] | 2.18 | 0.25 | 0.17 | 1.92 |
| Preferred Securities | 4.23 | 156[8] | 4.60 | -0.16 | -0.04 | 9.77 |
| High Yield 2% Issuer Capped | 6.33 | 382[8] | 3.47 | -0.51 | -0.49 | 8.25 |
| Senior Loans[9] | 6.67 | 438 | 0.25 | -0.18 | -0.10 | 5.32 |
| Global Emerging Markets | 5.31 | 291[8] | 5.88 | -0.03 | 0.07 | 5.92 |
| Global Aggregate (unhedged) | 1.79 | 48[8] | 7.04 | 0.53 | 0.48 | 2.39 |

**6** Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **7** 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. **8** Option-adjusted spread to Treasuries. **9** 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 10 May 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, 10 May 2019. **3** Lipper Fund Flows. **4** Municipal Markets Weekly, JPMorgan, 10 May 2019. **5** Market Insight, MMA Research, 8 May 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%.



### 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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