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Weekly Fixed Income Commentary

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Risk-off sentiment pushes Treasury yields to fresh 2019 lows

Deteriorating U.S./China trade relations moved Treasury yields to new lows for the year last week, led by longer maturities. The uncertainty triggered a flight to quality. The Federal Reserve (Fed) stated that it will remain patient on rates, and many are suggesting the Fed's next move will be a rate cut.

HIGHLIGHTS

- **High yield corporates performed worst, followed by senior loans. Both sectors posted negative total returns.**
- **The municipal bond market was listless, but maintains a constructive fundamental tone.**
- **The global aggregate sector outperformed Treasuries, as both the Asian and European markets enjoyed higher returns than the U.S.**

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ESCALATING TRADE WAR DRIVES TREASURY YIELDS TO 2019 LOWS

Treasury yields hit new lows for the year last week on Thursday amid deteriorating U.S./China trade relations.[1] Investors continue to wrestle with a trade war's potential impact on the U.S. economy and Fed policy. This uncertainty fostered risk-averse market sentiment that spurred increased demand for U.S. Treasuries and drove rates lower. The decline was most pronounced Wednesday and Thursday, with yields down 9 to 11 basis points (bps) over the two days.[1] Longer maturities led the decline, but the 5-year Treasury yield is down the most for the year, dropping nearly 40 bps.[1]

The broad risk-off tone weighed on non-Treasury sectors. No U.S. sector outperformed the Treasury market, and the highest risk again suffered negative total returns.[1] The high yield market performed worst again last week, followed by senior loans, and both sectors posted negative total returns.[1] Only the commercial mortgage-backed and asset-backed sectors outperformed similar-duration Treasuries.[1] However, despite the weak relative returns of non-Treasuries recently, all sectors remain ahead of Treasuries for the year thanks to the remarkably strong performance early in 2019.[1] The global aggregate sector outperformed Treasuries, as both the Asian and European markets enjoyed higher returns than the U.S.[1]

The markets continue to forecast a Fed rate cut in 2019 and the recent escalation of trade worries fueled that outlook. The market-based probability of a policy rate cut this year increased last week, reaching nearly 80%. One Fed official commented that he would endorse cutting rates if inflation remained persistently below the Fed's target.

MUNICIPAL BONDS MAINTAIN A SOLID UNDERLYING TONE

The municipal bond market and the Treasury market were listless last week, but each still has a constructive fundamental tone.[1] New issue supply in the pre-holiday week was $5.2 billion and was readily absorbed.[2] Fund flows were positive for the 20th straight week at $1.5 billion.[3] New issue supply is expected to be only $2.7 billion this week due to the Memorial Day holiday.[2] It should be readily absorbed.

The Fed stated that it is resolved to remain "patient" on interest rates, indicating little likelihood of a rate increase in 2019. In fact, many are starting to suggest that the Fed's next move will actually be to cut short-term interest rates. As a result, fixed income markets remain generally strong. Although the municipal market was weaker at times last week, it maintains a solid underlying tone. We believe any price weakness could present a buying opportunity.

The state of North Carolina issued $600 million grant anticipation revenue vehicle bond (rated NR/AA).[4] The deal was expensive to start, and yields were lowered upon final pricing because of the high quality of this credit and the fact that investors could buy large block sizes.

High yield municipal bond fund flows accelerated into the strongest weekly pace since January 2017, as investors added $580 million to the asset class last week.[3] Technical factors are driving the market, and that pressure appears to be building. This week's holiday-shortened new issue supply calendar will not provide relief. Only a handful of smaller deals are pricing, with no deal offered above $50 million in par and most are non-rated.[2] Deals are scattered across land secured, charter schools and industrial development sectors.

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EMERGING MARKETS WEATHER U.S./CHINA TRADE CONFLICT

Emerging markets (EM) debt recorded another weekly gain, overcoming worries about the U.S./China trade war.[1] Sovereign, corporate and local currency markets all posted positive returns.[1] India was a standout performer, as that market was bolstered by the reelection of Prime Minister Narendra Modi. The Indian rupee led strengthening EM currencies, which also included the Russian ruble, Chinese yuan and South African rand.

High yield corporate bonds fell for the third week in a row.[1] Spreads held steady, but high yield bond funds suffered outflows for the fourth time in five weeks.[3] Lower-quality tiers underperformed higher-rated issues, reflecting last week's risk-off tone. Oil prices tumbled nearly 7%, hurting the high yield energy sector especially hard. Despite high yield's recent declines, the asset class remains one of the top-performing taxable fixed income sectors year to date, with a total return exceeding 8%.[1]

Investment grade corporates outpaced their high yield counterparts for the third consecutive week.

Investment grade credit proved more resilient than high yield. Continued strong demand and only incrementally wider spreads (+1 bp) helped investment grade corporate bonds outpace their high yield counterparts for the third consecutive week.[1] More than three-quarters of investment grade sectors produced positive returns.[1] Among the areas of the market that appear least exposed to current trade tensions are cable/satellite, media/entertainment and telecommunications.

In focus

Corporate debt: solid supply, mixed demand

U.S. investment grade and high yield corporate debt as a percentage of gross domestic product (GDP) has been rising since 2011. At 46.8%, the ratio now sits close to its all-time high.[1,5] The supply of bonds and loans has grown, with issuers taking advantage of persistently low interest rates and favorable economic conditions that have helped limit defaults.

On the demand side, investment grade bond funds have enjoyed net positive flows in 16 of the past 17 weeks.[3] This may be due partly to an aging investor population, including baby boomers in or nearing retirement who choose to reduce equity holdings in favor of more conservative bond investments.

In contrast, after a fast start to the year, net flows into high yield bond funds have been negative in four of the past five weeks.[3] A struggling U.S. stock market and diminished risk appetites have taken a toll on the asset class, which often performs in sympathy with equities.

Current market technicals aside, mounting corporate debt has sparked worries of a potential bond bubble. We're not overly concerned in this regard, since much of the new issuance over the past decade has been used for stock buybacks, helping companies manage their balance sheets more effectively. Last week, Federal Reserve Chair Jerome Powell noted that rising debt levels could pose a danger should the economy weaken. But he also said the business sector remains "quite healthy" overall.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	2.17	-0.04	-0.10	-0.33
5-year	2.12	-0.05	-0.16	-0.39
10-year	2.32	-0.07	-0.18	-0.36
30-year	2.75	-0.07	-0.18	-0.26

Source: Bloomberg L.P. As of 24 May 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	1.43	-0.03	-0.14	-0.35
5-year	1.46	-0.03	-0.17	-0.48
10-year	1.72	0.00	-0.14	-0.56
30-year	2.42	0.02	-0.13	-0.60

Source: Bloomberg L.P. As of 24 May 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	74
30-year AAA Municipal vs Treasury	88
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters. As of 24 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

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	Month-to-date	Year-to-date
Municipal	2.14	–	5.48	0.05	0.98	4.29
High Yield Municipal	4.54	230[6]	8.13	0.07	1.05	5.52
High Yield Municipal, ex Puerto Rico	4.46	222[6]	7.74	0.08	1.12	5.16
Short Duration High Yield Municipal[7]	3.82	227	3.80	0.11	0.76	3.75
Short Duration High Yield Municipal, ex Puerto Rico[7]	3.76	221	3.68	0.09	0.76	3.52
U.S. Aggregate Bond	2.85	47[8]	5.78	0.27	0.85	3.84
U.S. Treasury	2.28	–	6.28	0.38	1.15	3.00
U.S. Government Related	2.90	61[8]	5.51	0.32	0.81	4.14
U.S. Corporate Investment Grade	3.57	122[8]	7.43	0.14	0.50	6.24
U.S. Mortgage-Backed Securities	3.03	43[8]	3.76	0.19	0.73	2.85
U.S. Commercial Mortgage-Backed Securities	2.86	64[8]	5.27	0.35	1.09	4.58
U.S. Asset-Backed Securities	2.50	30[8]	2.17	0.30	0.69	2.45
Preferred Securities	4.14	153[8]	4.50	0.04	0.32	10.16
High Yield 2% Issuer Capped	6.36	393[8]	3.46	-0.10	-0.66	8.07
Senior Loans[9]	6.54	442	0.25	-0.04	-0.04	5.39
Global Emerging Markets	5.31	301[8]	5.87	0.19	0.31	6.18
Global Aggregate (unhedged)	1.73	48[8]	7.02	0.43	0.80	2.71

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 24 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, 24 May 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 22 May 2019. **5** Bureau of Economic Analysis, Federal Reserve.

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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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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