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Weekly Fixed Income Commentary

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Trade concerns continue pressuring Treasury yields lower

U.S. Treasury yields declined again last week, with the yield difference between the 3-month T-bill and the 10-year Treasury note inverted further. Market expectations for a Federal Reserve (Fed) rate cut at the September meeting are high. However, the magnitude of that expected policy move is still in question.

HIGHLIGHTS

- **The highest risk sectors underperformed, with high yield corporates falling the most followed by preferred securities and senior loans.**
- **Municipal bond prices rallied, yet underperformed the strong Treasury market.**
- **The global aggregate sector posted the strongest performance for all non-Treasury sectors.**

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TREASURY RATES CONTINUE TO FALL

U.S. Treasury yields closed lower again last week largely due to a significant drop on Monday.[1] Continued concerns over trade pushed rates down 12 to 14 basis points (bps) to begin the week.[1] Yields moved little throughout the remainder of the week, with most maturities vacillating both directions.[1] However, the 2-year Treasury yield increased every day following Monday, significantly flattening the yield curve.[1] The yield difference between the 3-month T-bill and the 10-year Treasury note inverted further, with the short maturity yield exceeding the longer maturity by more than 30 bps.[1] There was little new economic data and few Fed speakers during the week, but there was issuance of 3-, 10- and 30-year Treasuries.

The Treasury market led performance again in another risk-off week.[1] The highest risk sectors underperformed, with high yield corporates falling the most followed by preferred securities and senior loans.[1] Only these three asset classes suffered negative total returns for the week.[1] The global aggregate sector nearly matched U.S. Treasury returns and posted the strongest performance for all non-Treasury sectors.[1]

Market expectations for a Fed rate cut at the September meeting remain high. However, the magnitude of that expected policy move is still in question. At the beginning of the week, market-based probabilities reflected greater than a 37% chance of a 50 bps cut at the next Fed meeting. By the end of the week, that probability dropped to about 22%, with a 78% chance of a 25 bps cut. Fed communications reflect uncertainty about the path of future monetary policy adjustments.

Municipal fund flows were a robust $2.4 billion, marking 31 consecutive weeks of positive flows.

STRONG MUNICIPAL FUND FLOWS CONTINUE

Municipal bond prices rallied last week, yet underperformed the strong Treasury market.[1] Municipal new issue supply was outsized at $14.7 billion and readily absorbed.[2] Fund flows were a robust $2.4 billion, marking 31 consecutive weeks of positive flows.[3] This week's new issue supply is expected to be $6.2 billion.[2]

The tone for municipal bonds and fixed income in general remains positive. The municipal bond rally, like the Treasury rally, indicates that the Fed is expected to continue cutting short-term rates. Most investors anticipate two additional cuts in 2019, for a total of three cuts for 75 basis points. The main catalyst for the rally is the continued trade war between the U.S. and China, which is negatively affecting both economies and should begin to impact the rest of the world.

CommonSpirit Health, one of the nation's largest health care providers, issued $5.8 billion of tax-exempt and taxable bonds (rated Baa1/BBB+), including $3.1 tax-exempt bonds for Colorado, Washington, Kentucky and Tennessee.[4] The deal was well received, underwriters lowered yields upon final pricing and the deal broke to a major premium in the secondary market. This deal epitomizes the continuing need for higher yielding bonds that are an attractive size.

High yield municipal bond yields decreased last week, but less than U.S. Treasuries and high grade municipals.[1] This shift makes high yield municipal bonds even more attractive in a lower-rate environment. High yield municipals experienced the largest week of inflows year to date, adding $635 million.[3] The BBB-rated Commonspirit $5.7 billion mega deal received a whopping $40 billion in orders, as the Puerto Rico Aqueduct and Sewer Authority (PRASA) entered agreements to restructure $1 billion of federal loans.[4] As a result, Puerto Rico's water system can acquire access to EPA loans to finance its capital improvement plan.

INVESTMENT GRADE CORPORATES BUILD ON YEAR-TO-DATE GAINS

Investment grade corporate bonds extended their string of positive returns to four consecutive weeks and now lead all taxable fixed income categories so far this quarter.[1] While investment grade spreads widened modestly last week, the asset class benefited from strong market technicals.[1] Investors continued to seek both higher yields and higher quality amid increased central bank dovishness and the growing prevalence of negative-yielding bonds.

High yield corporates finished at the bottom of the pack and with an identical return (-0.31%) for the second week in a row.[1] Spreads widened by 18 bps last week and are 44 bps wider for the month to date.[1] Fund outflows totaled $4.1 billion, the largest one-week withdrawal since last October and the eighth-largest on record.[3] Crude oil prices entered bear-market territory, falling slightly more than 20% from their April peak. The weakness in oil weighed heavily on the energy sector, which realized losses exceeding 2%.

High yield corporate spreads widened by 18 bps and are 44 bps wider month to date.

Emerging markets (EM) debt recorded another weekly gain, its 16th of the past 19 since the end of the first quarter.[1] U.S. dollar-denominated EM bonds performed well as the dollar strengthened versus major EM currencies, including the South African rand, Indian rupee and Russian ruble. The Chinese yuan extended its decline from the prior week's devaluation but held up better than might have been expected under some worst-case scenarios.

In focus

Preferred securities launch a comeback

The preferred sector has posted an impressive return of nearly 14% year to date, topping all other fixed income sectors.[1] The majority of the 2019 total return is due to price appreciation, after the sector ended 2018 with a price decline of nearly 10%.[1] Preferreds have more than recovered this year, with 10.3% of 2019 total return coming from price appreciation.[1]

Additional price return for the broader asset class may be limited. However, we believe the $1,000 par segment of the market shows potential, offering considerably more yield and spread than the $25 par segment. If this relationship contracts, preferred strategies with an allocation to the $1000 par segment may have greater price appreciation potential.

Setting price returns aside, the preferred sector has historically generated attractive coupon income compared to other fixed income sectors, some which may be tax-advantaged.

We expect the preferred sector will be well-supported through the remainder of 2019, given strong issuer fundamentals, especially in the bank sector, and negligible net supply expected in the latter half of the year.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	1.65	-0.06	-0.22	-0.84
5-year	1.58	-0.08	-0.25	-0.93
10-year	1.75	-0.10	-0.27	-0.94
30-year	2.26	-0.12	-0.27	-0.76

Source: Bloomberg L.P. As of 9 Aug 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	0.95	-0.06	-0.12	-0.83
5-year	0.98	-0.07	-0.13	-0.96
10-year	1.33	-0.11	-0.19	-0.95
30-year	2.01	-0.13	-0.23	-1.01

Source: Bloomberg L.P. As of 9 Aug 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	76
30-year AAA Municipal vs Treasury	89
High Yield Municipal vs High Yield Corporate	68

Source: Bloomberg L.P., Thompson Reuters. As of 9 Aug 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	1.70	–	5.37	0.64	1.07	7.07
High Yield Municipal	4.14	234[5]	7.56	0.78	1.27	8.70
High Yield Municipal, ex Puerto Rico	4.06	226[5]	7.74	0.71	1.13	8.17
Short Duration High Yield Municipal[6]	3.68	258	3.61	0.40	0.57	5.56
Short Duration High Yield Municipal, ex Puerto Rico[6]	3.67	257	3.37	0.37	0.54	5.25
U.S. Aggregate Bond	2.30	47[7]	5.77	0.57	1.32	7.75
U.S. Treasury	1.73	–	6.62	0.88	1.91	7.07
U.S. Government Related	2.38	63[7]	5.74	0.80	1.49	8.00
U.S. Corporate Investment Grade	2.99	120[7]	7.79	0.56	1.35	11.96
U.S. Mortgage-Backed Securities	2.47	46[7]	2.73	0.09	0.39	5.00
U.S. Commercial Mortgage-Backed Securities	2.28	64[7]	5.29	0.56	1.54	8.48
U.S. Asset-Backed Securities	2.00	33[7]	2.13	0.30	0.74	3.92
Preferred Securities	3.40	134[7]	4.39	-0.21	-0.11	13.80
High Yield 2% Issuer Capped	6.07	415[7]	3.20	-0.31	-0.64	9.86
Senior Loans[8]	6.14	463	0.25	-0.22	-0.25	5.98
Global Emerging Markets	4.75	300[7]	6.07	0.48	0.58	11.11
Global Aggregate (unhedged)	1.31	47[7]	7.17	0.82	1.43	6.78

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 9 Aug 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, 9 Aug 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 7 Aug 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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