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Weekly Fixed Income Commentary

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Treasury yields rise on improving trade, shifting Fed outlook

U.S. Treasury yields rose dramatically last week, led by longer maturities. Several maturity ranges experienced their largest weekly increase since late 2016. Investor sentiment was bolstered by an improving outlook for U.S./China trade and near certain expectations for another Federal Reserve (Fed) rate cut this week.

HIGHLIGHTS

- **Senior loans and high yield corporates delivered the best performance with positive total returns.**
- **The municipal market sold off sharply, but remains fundamentally sound.**
- **The global aggregate index outperformed U.S. markets thanks to outperformance in Europe.**

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TREASURY YIELD INCREASE ACCELERATES

U.S. Treasury yields increased substantially last week.[1] Longer maturities led the way, and several maturity ranges experienced their largest weekly increase since late 2016.[1] The increase was bolstered by an improving outlook for U.S./China trade relations. As the week progressed, market expectations for additional Fed rate cuts diminished, which also put upward pressure on rates. Heavy corporate bond issuance and Treasury auctions weighed on markets, pushing yields up even further. U.S. economic data continues to indicate that domestic growth is outpacing other developed countries, although it also reflects modestly slowing growth.

A positive risk tone supported strong relative performance for non-Treasury sectors, but sharply higher yields dragged down total returns.[1] Senior loans and high yield corporates delivered the best performance with positive total returns. All other sectors posted negative total returns, but only the investment grade corporate sector underperformed Treasuries.[1] However, even investment grade corporates outperformed when adjusting for duration.[1] In fact, asset-backed securities was the only sector that underperformed similar-duration Treasuries.[1] The global aggregate index outperformed U.S. markets based on outperformance of the European region, although total returns were still negative.[1]

Market-based probabilities adjusted to reflect fewer future Fed rates cuts. Probabilities of a cut at this week's meeting fell slightly from 100% to 97%. More significantly, the probability of a cut in October declined from 63% to 40%. Market expectations reflect three or four additional cuts through the end of 2020.

We do not see U.S. interest rates going negative, but we expect rates to remain lower for longer.

MUNICIPAL MARKET REMAINS FUNDAMENTALLY SOUND

Both municipals and Treasury bonds sold off sharply last week, closing Friday with weak tones.[1] The municipal new issue calendar was $10 billion and priced to sell.[2] Municipal weekly fund flows were positive for the 36th straight week at $930 million.[3] This week's calendar is expected to be large at $10 billion.[2]

The fixed income market, including municipals, remains fundamentally sound. We believe the recent selloff is a reversal of a flight-to-get-invested rally. Investors bought fixed income out of fear that U.S. rates would be pulled down to zero, along with the rest of the world. These fears now seem unfounded.

Municipal demand remains strong. Yields are cheaper than two weeks ago, which institutional investors are viewing as a buying opportunity. We do not see U.S. interest rates going negative, but we expect rates to remain lower for longer.

The state of Washington issued $700 million general obligation bonds (rated Aaa/AA+).[4] Bonds remained in dealers' accounts right after purchase, with some remaining bonds trading almost 20 basis points cheaper than where the deal was purchased. We believe this was a function of general interest rates continuing to sell off as the week progressed.

High yield municipal bond yields retraced back to levels not seen since July.[1] High yield municipal bond yields increased 17 bps last week, while the 10- and 30-year U.S. Treasury bond yields increased 34 bps. High yield municipal credit spreads contracted as a result. Credit spreads average 217 bps over AAA-rated municipals, 30 bps wider than this time last year.

Investors added $279 million to high yield municipal bond funds last week, taking the year-to-date total to $14.3 billion.[3] Fourteen high yield municipal bond deals are expected to price this week, with only two pricing more than $50 million in par.[2] Eleven of the deals are coming as non-rated and thus require independent credit research.

HIGH YIELD CORPORATES ADD TO 2019 GAINS

High yield corporate bonds extended their string of positive returns to four consecutive weeks.[1] The asset class benefited from fund inflows of $1.9 billion, the highest weekly amount since June.[3] Optimism surrounding the U.S./China trade talks and expectations for Fed rate cuts bolstered sentiment. September issuance hit $18.2 billion, of which 75% has been used for refinancing.[2] On a quality basis, lower-rated (CCC) bonds topped BBs and Bs, trimming their year-to-date underperformance.[1]

Investment grade corporates logged their largest decline of the year.[1] Four of their eight negative weeks in 2019 have come in the third quarter. Another post Labor Day week of strong demand was met by hefty levels of new supply: 35 issuers printed $29 billion of debt.[2] Overall, U.S. corporate bonds continue to benefit from healthy profit margins in the face of declining revenues, rising labor costs and trade uncertainty.

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Emerging markets (EM) debt saw its winning streak snapped at three weeks, despite conciliatory trade gestures by the U.S. and China.[1] More volatile EM currencies outperformed, such as the Russian ruble and South African rand. Yields on Turkish government bonds plunged following a 325-basis-point interest-rate cut by the country's central bank. Net fund flows totaled $312 million, mostly in local markets and currencies.[3]

In focus

Outlook and opportunities for the rest of 2019. And beyond.

We think the world is in for a prolonged period of low (and in many cases negative) interest rates. We're not ready to call for a U.S. or global recession, but we think sluggish growth and monetary policy easing will put downward pressure on rates.

Overall, this means we continue to advocate a more defensive stance and suggest positioning portfolios for a continued slow-but-positive growth environment.

Within taxable fixed income, this leads us to favor credit sectors over government bonds (especially given the current rate backdrop), but with an important caveat: We continue to focus on selectivity and more defensive areas. For example, within U.S. credit sectors, we prefer areas of the market more insulated from trade tensions and also think a move up in quality within high yield makes sense. Additionally, we continue to like select emerging markets debt investments as well as preferred securities.

For municipals, lower interest rates, supply/demand factors and credit health have all been positive drivers of returns and we expect those trends will continue. Given our constructive outlook, we think it makes sense to stick with longer duration positioning within municipals. And while credit health broadly has been solid, we continue to emphasize the importance of credit research and careful selectivity.

U.S. Treasury market

Maturity	Yield	Change (%) Week	Month-to-date	Year-to-date
2-year	1.80	0.26	0.30	-0.69
5-year	1.75	0.32	0.37	-0.76
10-year	1.90	0.34	0.40	-0.79
30-year	2.37	0.35	0.41	-0.64

Source: Bloomberg L.P. As of 13 Sep 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	1.26	0.21	0.25	-0.52
5-year	1.29	0.22	0.26	-0.65
10-year	1.52	0.24	0.30	-0.76
30-year	2.13	0.23	0.29	-0.89

Source: Bloomberg L.P. As of 13 Sep 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	80
30-year AAA Municipal vs Treasury	90
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters. As of 13 Sep 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	1.92	–	5.29	-1.09	-1.24	6.27
High Yield Municipal	4.13	145[5]	7.31	-0.87	-1.00	8.82
Short Duration High Yield Municipal[6]	3.59	223	3.57	-0.37	-0.37	5.86
U.S. Aggregate Bond	2.46	46[7]	5.82	-1.66	-1.81	7.13
U.S. Treasury	1.91	–	6.54	-2.13	-2.34	6.09
U.S. Government Related	2.50	58[7]	5.70	-1.57	-1.69	7.59
U.S. Corporate Investment Grade	3.12	116[7]	7.72	-2.22	-2.46	11.13
U.S. Mortgage-Backed Securities	2.64	45[7]	3.11	-0.46	-0.45	5.05
U.S. Commercial Mortgage-Backed Securities	2.51	68[7]	5.27	-1.63	-1.78	7.43
U.S. Asset-Backed Securities	2.18	34[7]	2.17	-0.56	-0.55	3.70
Preferred Securities	3.54	134[7]	4.47	-0.77	-0.32	14.65
High Yield 2% Issuer Capped	5.69	361[7]	3.11	0.19	0.46	11.51
Senior Loans[8]	6.42	471	0.25	0.32	0.40	6.37
Global Emerging Markets	5.01	309[7]	6.06	-0.97	-0.49	10.21
Global Aggregate (unhedged)	1.43	43[7]	7.18	-0.98	-1.13	6.21

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 13 Sep 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, 13 Sep 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 11 Sep 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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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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