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Weekly Fixed Income Commentary

23 September 2019

Treasury yields decline, but stop short of a broader risk-off move

U.S. Treasury yields dropped significantly last week, led by longer maturities. As expected, the Federal Reserve (Fed) cut rates, although future guidance regarding policy was unclear. Repo markets experienced an extraordinary spike in overnight rates, and an attack on a Saudi oil facility promoted general market uneasiness.

HIGHLIGHTS

- **Investment grade corporates in particular outperformed, posting a higher total return than Treasuries.**
- **The municipal market traded higher, and remains fundamentally sound.**
- **Emerging markets debt enjoyed its best week since June.**

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TREASURY YIELDS DECLINE AS THE FED CUTS RATES

U.S. Treasury yields fell significantly last week, led by longer maturities.[1] Short maturity yields actually closed higher on Wednesday after the Fed policy adjustment. Markets interpreted the Fed's comments to reflect a lower probability of multiple near-term cuts.[1] 10- and 30-year Treasury yields fell every day, with the largest drops occurring on Friday and Monday.[1] The most significant developments happened early in the week, as overnight repo markets experienced an extraordinary spike in rates and a Saudi oil production facility suffered a terrorist attack. General market uneasiness supported Treasuries and pressured yields lower, but stopped short of a pervasive risk-off tone.

Several non-Treasury sectors posted relatively strong performance, despite the Saudi attack and repo market upheaval.[1] Investment grade corporates in particular outperformed Treasuries.[1] Mortgage-backed, commercial mortgage-backed and preferred securities joined investment grade corporates in outperforming similar-duration Treasuries.[1] All sectors posted positive total returns for the week, although emerging markets debt and high yield corporates significantly underperformed similar-duration Treasuries.[1]

The Fed rate cut last week was largely expected. However, the additional policy projection information provided interesting insight into the divergence of opinions at the Fed. Policy expectations for the remainder of 2019 showed that 7 members expected one more cut to be appropriate, 5 believed there would be no rate adjustments needed and 5 expected a rate hike. Market-based expectations reflect a 2/3 probability that there will be another policy rate cut before year end.

We believe municipals represent value, and would view any further cheapening as a buying opportunity.

THE MUNICIPAL MARKET REMAINS FUNDAMENTALLY SOUND

Both the municipal bond and Treasuries markets traded higher last week, as some buyers interpreted the recent dramatic sell off as a buying opportunity.[1] The new issue calendar was $ 9.7 billion last week, priced to sell and well received.[2] Fund flows were positive for the 37th straight week, at $203 million.[3] This week's new issue supply is expected to be $7.1 billion and should be well received.[2]

The fixed income market in general is fundamentally sound. The European Central Bank lowered rates two weeks ago, and the U.S. Fed lowered rates last week. Inflation appears muted, and the Fed will likely continue to cut rates as needed. The municipal market, while fundamentally sound, is underperforming Treasuries. New issue supply has picked up dramatically and reinvestment moneys (through called bonds) has declined. We believe municipals represent value and would view any further cheapening as a buying opportunity.

South Carolina State Ports Authority issued $381 million tax-exempt and AMT revenue bonds (rated A1/A+, except those insured by Assured Guaranty).[4] By Friday's close, bonds were trading richer, reflecting market strengthening as the week progressed. This deal epitomizes what municipal investors are seeking: hard assets (a port) secured by project revenues.

High yield municipal bond yields decreased last week, in line with municipal high grades, but lagged the larger decreases in U.S. Treasury yields.[1] As a result, high yield municipal credit spreads remained attractive year over year and versus historical tights.[1] However, the municipal-to-Treasury yield ratio increased materially, making all municipals look more attractive than they have in while relative to taxable fixed income.[1] Investors produced only the second week of high yield municipal outflows in 2019 last week, driven by investors swapping out of open-end funds into a new closed-end fund.[3] Outflows have since turned back into inflows.[3]

INVESTMENT GRADE CORPORATES BOUNCE BACK

Investment grade corporate bonds notched their highest one-week return of the year (+1.35%) after posting their worst (-2.22%) the prior week.[1] The asset class outperformed all taxable fixed income sectors and has now delivered positive results in eight of the last 10 weeks.[1] Primary issuance eased but still reached $20.6 billion, bringing the month-to-date total to nearly $121 billion.[2] Demand also remained robust, with deals significantly oversubscribed.

High yield corporates continued their winning ways, logging a fifth straight weekly gain.[1] Spreads have tightened 34 basis points thus far in September amid a rally in equities, a steep increase in global interest rates, the most active primary market conditions since 2017 and hefty retail inflows.[1] Last week's fund flows hit $3.3 billion, marking a seven-month high.[3] In terms of quality, credits rated B handily outperformed BBs and CCCs.[1]

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Emerging markets (EM) debt enjoyed its best week since June.[1] Although the recent attack on Saudi Arabia's oil fields dampened sentiment to start the week, risk appetite improved as the damage was less severe than originally feared. New corporate issuance perked up, especially in Latin America.[2] EM central banks from Brazil and Indonesia joined the U.S. Fed in cutting rates, leading to a weaker real and rupiah, respectively. The Russian ruble benefited from higher oil prices.

In focus

A divided Fed takes out insurance

As expected, the Federal Reserve followed July's 25 bps interest rate cut by lowering its target fed funds rate another 25 basis points, to 1.75% – 2.00%. The Fed viewed this action as prudent to ensure the U.S. growth cycle continues. Weak global growth and trade-related uncertainty pose risks to the U.S. economy.

The Fed's economic outlook softened slightly since the last meeting. The Fed now forecasts GDP growth to slow from 2.2% in 2019 to 2% in 2020, and to below 2% in 2021-2022. In the near term, the Fed believes unemployment and core inflation will hold firm.

The closely watched "dot plot" showed an unusual level of division among the 17 members of the Federal Open Market Committee—the group within the Fed that sets monetary policy. Five members didn't think last week's action was warranted. Of the 12 who did, only 7 expect one more rate cut in 2019. None foresee more than one additional rate reduction though 2022 and beyond.

The U.S. boasts a strong jobs market and generally healthy levels of inflation. Based on its mandate alone—full employment and price stability—we doubt the Fed will trim interest rates again this year. However, failure to meet the new standards that Chair Jerome Powell and his colleagues have laid out at recent meetings—stable global growth and reduced trade-policy uncertainty—could prompt the Fed to cut rates before year-end.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	1.69	-0.12	0.18	-0.80
5-year	1.60	-0.15	0.21	-0.91
10-year	1.72	-0.18	0.23	-0.96
30-year	2.16	-0.21	0.20	-0.85

Source: Bloomberg L.P. As of 20 Sep 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	1.25	-0.01	0.24	-0.53
5-year	1.28	-0.01	0.25	-0.66
10-year	1.47	-0.05	0.25	-0.81
30-year	2.07	-0.06	0.23	-0.95

Source: Bloomberg L.P. As of 20 Sep 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	84
30-year AAA Municipal vs Treasury	95
High Yield Municipal vs High Yield Corporate	73

Source: Bloomberg L.P., Thompson Reuters. As of 20 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	1.91	–	5.24	0.14	-1.10	6.43
High Yield Municipal	4.09	220[5]	6.94	0.45	-0.56	9.30
Short Duration High Yield Municipal[6]	3.54	221	3.50	0.19	-0.19	6.06
U.S. Aggregate Bond	2.33	46[7]	5.78	0.88	-0.95	8.07
U.S. Treasury	1.80	–	6.58	0.96	-1.40	7.11
U.S. Government Related	2.41	60[7]	5.75	0.80	-0.90	8.45
U.S. Corporate Investment Grade	2.98	114[7]	7.82	1.35	-1.14	12.64
U.S. Mortgage-Backed Securities	2.49	45[7]	2.79	0.35	-0.10	5.42
U.S. Commercial Mortgage-Backed Securities	2.39	68[7]	5.26	0.76	-1.03	8.25
U.S. Asset-Backed Securities	2.11	36[7]	2.19	0.21	-0.35	3.92
Preferred Securities	3.16	111[7]	4.34	0.65	0.32	15.39
High Yield 2% Issuer Capped	5.57	359[7]	3.07	0.23	0.69	11.77
Senior Loans[8]	6.34	473	0.25	0.04	0.44	6.41
Global Emerging Markets	4.94	314[7]	6.11	0.65	0.16	10.93
Global Aggregate (unhedged)	1.35	43[7]	7.19	0.50	-1.01	6.33

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 20 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, 20 Sep 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 18 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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