

27 January 2020

Treasury yields fall sharply on global health concerns

U.S. Treasury yields fell significantly last week, due to fears over the coronavirus outbreak in China. Longer maturities led the way and the yield curve flattened considerably. Growth concerns caused market-based expectations of a Federal Reserve (Fed) rate cut in 2020 to rise, now reflecting possibly more than one cut.

HIGHLIGHTS

- **The investment grade corporates sector's total return was driven by its longer duration.**
- **Municipal bond prices closed stronger, following Treasury markets.**
- **The launch of the new 20-year Treasury bond should drive more demand for that segment of the yield curve.**



Bill Martin
Head of Global Fixed Income



John Miller
Head of Municipals

TREASURY YIELDS FALL SHARPLY ON GLOBAL HEALTH FEARS

U.S. Treasury yields declined significantly last week, led by longer maturities.¹ Global health concerns dominated the market's focus. The coronavirus outbreak in China fueled a flight to quality that stoked strong investor demand for U.S. Treasuries. Yields for all maturities fell every day of the holiday-shortened week.¹ The yield curve flattened considerably, reflecting lower future growth expectations. Similar to the 2002/2003 SARS epidemic, the fear is that the current outbreak could hurt economic activity and ultimately slow global growth. The yield difference between 2- and 10-year Treasuries has declined 15 basis points (bps) so far this year, and 8 bps last week.

Global fears caused market sentiment to deteriorate, resulting in a strong risk-off tone. Falling yields supported positive total returns, but only the taxable municipal and investment grade corporate sectors outperformed U.S. Treasuries.¹ The investment grade corporate sector's total return was driven by its longer duration, although it underperformed similar-duration Treasuries.¹ Its duration has extended beyond 8 years, which is the longest for the index since its inception in 1989.¹ The cautious market tone hurt the higher-risk sectors the most, with high yield corporates suffering the worst performance and a negative weekly total return. Commercial mortgage-backed and asset-backed securities both outpaced similar duration Treasuries. Falling yields supported positive returns in the Asian and European regions.

Growth concerns caused market-based expectations of a Fed rate cut in 2020 to rise. Markets now indicate the Fed could be inclined to cut rates more than one time this year.

High yield municipal new issue deals are heavily oversubscribed.

MUNICIPAL BONDS ARE WELL BID

Municipal bond prices closed stronger last week, following Treasuries.¹ New issue supply totaled \$8.3 billion and was well received.² Fund flows were positive for the 55th consecutive week at \$2 billion.³ This week's new issue supply is expected to total \$8.5 billion (\$5.5 billion tax exempt, \$3 billion taxable).² It should be well received.

Fixed income continues to rally. This week's catalyst was the coronavirus in China. The market fears the crisis will depress the Chinese economy in particular and – if the disease continues to spread past China's borders – the broader global economy. Thus we saw additional buying as investors locked in current yields. The market impact will remain uncertain until the virus can be better contained. Municipal bonds continue to be very well bid in this environment.

The University of Houston System issued \$321 million revenue and refunding bonds (rated Aa2/AA).⁴ This public university system comprises four separate and distinct universities in Texas, among other holdings. The deal was priced with a “volatile” vs. defensive coupon structure. The 30-year bonds were priced as 3% coupons at a 2.75% yield. This is yet another example of investors buying bonds offering the largest tax-exempt income return, regardless of how these bonds may react in a market sell off.

High yield municipal bond spreads contracted last week, due to strong technical factors. Fund flows totaled \$490 million.³ New issue deals remain heavily oversubscribed, and competition for secondary supply is driving spreads tighter for some of the largest issuers. High yield municipal credit spreads now stand at +205 bps on average, which is 12 bps tighter year to date, but still 37 bps wider than the most recent tight of +168 bps at the end of third quarter 2018.¹ If the current technical environment remains (as we expect), the market should retest that level. Thirteen high yield municipal deals are expected to price this week, representing \$1.1 billion in par for an average deal size of \$84 million.²

FLIGHT TO QUALITY TAKES A TOLL ON RISKIER ASSETS AMID VIRUS OUTBREAK

High yield corporate bonds snapped a nine-week winning streak as coronavirus fears sent investors flocking to U.S. Treasuries and other higher-quality securities.¹ The resulting drop in Treasury yields was more pronounced at the longer end of the curve, exacerbating the pain inflicted on high yield bonds, which tend to have shorter durations. Overall, high yield spreads gapped 36 bps wider last week.¹ Fund flows stayed positive, but were less than half the prior week's level.³ With risk out of favor, lower-rated (CCC) credits lagged higher-quality (B and BB) issues.

Investment grade corporates posted the week's best return among non-municipal sectors.¹ The asset class benefited from two characteristics that its high yield counterparts lack: long duration and, by definition, investment grade quality. Credit spreads widened by only 2 bps last week.¹ Fund flows remained favorable at \$5 billion.³ In the primary market, 14 issuers brought nearly \$18 billion in new deals, which were met with healthy demand.²

Investment grade credit spreads widened by only 2 bps last week.

Emerging markets (EM) debt gained for the seventh week in a row despite virus-driven volatility.¹ Returns were modest, however, and on a relative basis, closer to the bottom of the pack than to the top. Positive flows into EM bond funds continued, allowing the market to absorb the week's ample new issuance, although secondary spreads widened somewhat as the week progressed.^{2,3}

In focus

They're back! New 20-year U.S. Treasuries

The U.S. government needs more long-term financing amid projections of ongoing trillion-dollar deficits. As a result, the Treasury Department announced it will begin issuing 20-year bonds again after a 34-year hiatus.

The decision to launch new 20-year Treasuries comes as no surprise. What was unexpected, though, was the timing of the announcement. With the government being adequately financed through 30 September — the end of its fiscal year — an announcement later in the year seemed more likely.

These bonds should continue to bring focus to the 15- to 25-year portion of the curve, which traditionally has garnered far less attention than the more-liquid 10- and 30-year segments. More details (auction size, auction date and any plans to issue less of other maturities) may be forthcoming at the Treasury's next quarterly refunding announcement on 5 February.

Investors have reacted to the news by bidding up the 20-year portion of the Treasury curve. In addition, we think 20-year corporate bond issuance will pick up, continuing a recent trend of issuers' extending debt profiles thanks to the low-interest-rate environment. Subsectors with heavy capex programs and longer liability streams — including energy, health care, technology and diversified manufacturing — are most likely to produce supply.

U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	Month-to-date	Year-to-date
2-year	1.50	-0.06	-0.08	-0.08
5-year	1.51	-0.12	-0.19	-0.19
10-year	1.69	-0.14	-0.23	-0.23
30-year	2.13	-0.15	-0.26	-0.26

Source: Bloomberg L.P. As of 24 Jan 2020. Past performance is no guarantee of future results.

Municipal market

Maturity	Yield to Worst	Change (%)		
		Week	Month-to-date	Year-to-date
2-year	0.85	-0.05	-0.19	-0.19
5-year	0.86	-0.05	-0.23	-0.23
10-year	1.23	-0.06	-0.21	-0.21
30-year	1.88	-0.06	-0.21	-0.21

Source: Bloomberg L.P. As of 24 Jan 2020. Past performance is no guarantee of future results.

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	72
30-year AAA Municipal vs Treasury	88
High Yield Municipal vs High Yield Corporate	70

Source: Bloomberg L.P., Thompson Reuters. As of 24 Jan 2020. 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	1.53	–	5.22	0.38	1.42	1.42
High Yield Municipal	3.70	201 ⁵	6.41	0.40	1.96	1.96
Short Duration High Yield Municipal ⁶	2.95	197	3.53	0.28	1.08	1.08
Taxable Municipal	2.78	106 ⁷	9.53	1.71	2.84	2.84
U.S. Aggregate Bond	2.14	40 ⁷	5.86	0.79	1.30	1.30
U.S. Treasury	1.64	–	6.61	1.03	1.50	1.50
U.S. Government Related	2.26	60 ⁷	5.96	0.76	1.30	1.30
U.S. Corporate Investment Grade	2.66	95 ⁷	8.03	1.06	1.81	1.81
U.S. Mortgage-Backed Securities	2.35	41 ⁷	2.79	0.20	0.51	0.51
U.S. Commercial Mortgage-Backed Securities	2.23	66 ⁷	5.31	0.91	1.61	1.61
U.S. Asset-Backed Securities	1.82	31 ⁷	2.15	0.31	0.66	0.66
Preferred Securities	2.72	88 ⁷	4.46	0.13	1.06	1.06
High Yield 2% Issuer Capped	5.29	356 ⁷	3.05	-0.43	0.28	0.28
Senior Loans ⁸	5.94	445	0.25	0.01	0.77	0.77
Global Emerging Markets	4.73	306 ⁷	6.26	0.22	1.12	1.12
Global Aggregate (unhedged)	1.34	38 ⁷	7.16	0.59	0.44	0.44

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 24 Jan 2020. 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 Jan 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 22 Jan 2020.

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 Taxable Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. **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%.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her advisors.

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.

This information represents the opinion of Nuveen, LLC and its affiliates and is not intended to be a forecast of future events and/or guarantee of any future result. Information was obtained from third party sources which we believe to be reliable but are not guaranteed as to their accuracy or completeness. There is no assurance that an investment will provide positive performance over any period of time.

The investment advisory services, strategies and expertise of TIAA Investments, a division of Nuveen, are provided by Teachers Advisors, LLC and TIAA-CREF Investment Management, LLC. Nuveen Asset Management, LLC, Symphony Asset Management LLC and NWQ Investment Management Company LLC are registered investment advisers and affiliates of Nuveen, LLC.