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Weekly Fixed Income Commentary

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Treasury yields decline on renewed coronavirus fears

U.S. Treasury yields fell last week, led by longer maturities. This flight-to-quality rally was driven by fears that the coronavirus may cause a larger-than-expected drag on global economic growth. Market expectations for Federal Reserve (Fed) rate cuts in 2020 reflect roughly 1.8 cuts, which would translate to 46 basis points of easing.

HIGHLIGHTS

- **All U.S. sectors, except preferred securities, posted positive total returns last week.**
- **Taxable municipals benefited from a long duration, and was the only sector to outpace Treasuries.**
- **The global aggregate sector trailed U.S. markets, dragged down by the Asia Pacific region.**

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RENEWED VIRUS CONCERNS DRIVE TREASURY YIELDS LOWER

U.S. Treasury yields fell last week, led by longer maturities, as markets assessed broader impacts from the coronavirus.[1] Virus-related illnesses and deaths outside of China stoked fears of a larger-than-anticipated drag on global economic growth. The 30-year Treasury yield reached an all-time low on Friday, when U.S. economic data – which had been encouraging all week – was unexpectedly soft.[1] Falling longer-maturity yields flattened the yield curve, with the difference between 10- and 2-year Treasury yields reaching its lowest level since early October 2019.[1]

All U.S. sectors, except preferred securities, posted positive total returns last week.[1] However, most sectors trailed the surging Treasury market.[1] The taxable municipal sector benefited from its relatively longer duration, and was the only sector to outpace Treasuries with the highest total return for the week.[1] The risk-off market tone was difficult for non-Treasury sectors, and only commercial mortgage-backed and asset-backed securities outperformed similar-duration Treasuries.[1] Preferred securities suffered the worst performance and was the only sector with a negative weekly total return.[1] The global aggregate sector trailed U.S. markets, dragged down by negative returns in Asia Pacific.[1]

Market-based probabilities for Fed rate cuts increased last week. Market expectations now reflect a higher likelihood that the Fed will need to cut interest rates, which could spur growth and offset the negative economic impact from the coronavirus. By the end of the week, probabilities reflected roughly 1.8 cuts in 2020, which would translate to 46 basis points (bps) of easing.

U.S. Treasuries and municipal bonds traded at historic lows last week.

MUNICIPAL YIELDS MAY HAVE BOTTOMED

Municipal bonds and U.S. Treasuries traded at historic lows last week, but both markets ended the week with traders taking profits.[1] New issue supply in the holiday-shortened week totaled $5.8 billion and was well received.[2] Fund flows of $1.7 billion marked the 59th consecutive positive week.[3] New issuance is expected to be $13.8 billion this week ($4.2 billion taxable).[2] This outsized supply may slightly stress the market, but we think it will be readily absorbed with minor price concessions.

The 30-year Treasury bond yield hit a historic low last week, on a flight-to-quality rally driven by continued coronavirus concerns.[1] While we believe the virus outbreak is serious, we think the economic effects should be relatively well contained. Thus, we think rates have bottomed and may continue to sell off from these historically low levels. The same story holds true for municipal bond yields, which also reached an all-time low last week. Municipals are currently very expensive, and this week's supply should test the strength of demand. We believe municipal yields should sell off also from their all-time lows, but also see interest at slightly cheaper levels.

The **District of Columbia** priced $1 billion income tax-secured revenue bonds (rated Aa1/AAA).[4] The bonds were well received, and yields were lowered as much as 15 bps upon final pricing. This was an opportunity for investors to buy large blocks of ultra-high-grade bonds with higher after-tax yields than U.S. Treasuries.

High yield municipal bond credit spreads widened last week.[1] High yields could not keep pace with the precipitous drop in U.S. Treasury and AAA municipal yields, which broke key resistance levels.[1] High yield municipal inflows continued at a historic pace, adding $480 million in net inflows.[3] The high yield municipal market will be keenly focused on the $5.2 billion refunding deal for Buckeye Tobacco, along with 11 other deals this week.[4]

INVESTMENT GRADE CORPORATES SHOW RESILIENCE AMID VIRUS CONCERNS

Investment grade corporate bonds showed positive returns for the sixth week in a row.[1] Spreads widened modestly, but remained below 100 bps.[1] Demand proved resilient, with $4 billion flowing into investment grade funds.[3] The primary market was active despite the Presidents' Day-shortened trading week, as 21 issuers priced more than $30 billion in new deals.[2] Sentiment shifted from optimism to caution on growing concerns about the economic impact of the coronavirus.

Emerging markets (EM) debt extended its winning streak to 11 weeks.[1] Despite last week's muted appetite for risk, an underlying bid for high-quality EM debt was evident in continued positive fund flows (+$1.7 billion).[3] The U.S. dollar was bolstered by a flight to safety amid ongoing coronavirus fears, leaving most EM currencies negative. The South Korean won led the decline following news that the number of confirmed cases of the virus in the country had doubled in 24 hours.

Despite a risk-off backdrop, lower-quality bonds outperformed their higher-rated counterparts.

High yield corporates eked out a small gain, but delivered among the week's lowest total returns.[1] The asset class started the week with a firm tone, but the broader coronavirus narrative later sparked volatility. Spreads widened for the first time in three weeks, and outflows from high yield bond funds totaled $40 million.[1,3] Even against this risk-off backdrop, lower-quality (CCC) bonds outperformed their higher-rated (B and BB) counterparts.[1]

In focus

BBB/BB spreads tighten as investors seek higher yields

In 2019 and thus far in 2020, corporate bonds known as "crossover credit" have received tremendous inflows from the global investment community. Crossover credit refers to debt rated on the border between investment-grade (BBB) and high yield (BB).

With yields on U.S. Treasuries and government-issued securities nearing all-time lows, many investors are seeking a higher total return while balancing downside risk. These higher quality, higher yielding corporate bonds also come with low implied default rates.[5]

Sectors rated BBB and BB have become more expensive by most measures, with tighter (yet relatively attractive) spreads.[1]

Individual credit selection has become paramount, especially in the current late cycle environment. Although the rating agencies imply that BBB downgrade rates should remain steady in the near term, credit markets are currently pricing significant amounts of BBB debt similar to high yield.[1]

As global investors increase allocations to highest quality high yield, the BBB/BB spread has compressed substantially.[1] We continue to see attractive risk/reward opportunities in BBB corporates that offer similar spreads to many BB credits. These opportunities are company specific, and may be uncovered with in-depth fundamental analysis.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	1.36	-0.07	0.04	-0.22
5-year	1.32	-0.09	0.01	-0.37
10-year	1.47	-0.12	-0.04	-0.45
30-year	1.92	-0.12	-0.09	-0.48

Source: Bloomberg L.P. As of 21 Feb 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.84	-0.03	0.01	-0.20
5-year	0.85	-0.03	0.01	-0.24
10-year	1.14	-0.04	-0.01	-0.30
30-year	1.76	-0.06	-0.04	-0.33

Source: Bloomberg L.P. As of 21 Feb 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	78
30-year AAA Municipal vs Treasury	93
High Yield Municipal vs High Yield Corporate	69

Source: Bloomberg L.P., Thompson Reuters. As of 21 Feb 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	1.40	–	5.10	0.55	0.54	2.35
High Yield Municipal	3.54	197[6]	5.68	0.86	1.04	3.53
Short Duration High Yield Municipal[7]	2.77	183	3.40	0.34	0.69	2.23
Taxable Municipal	2.57	103[8]	9.63	1.22	1.06	5.29
U.S. Aggregate Bond	1.97	42[8]	5.90	0.57	0.53	2.47
U.S. Treasury	1.47	–	6.78	0.77	0.48	2.93
U.S. Government Related	2.08	59[8]	6.05	0.68	0.69	2.85
U.S. Corporate Investment Grade	2.52	99[8]	8.14	0.63	0.80	3.16
U.S. Mortgage-Backed Securities	2.19	45[8]	2.53	0.21	0.35	1.05
U.S. Commercial Mortgage-Backed Securities	2.02	64[8]	5.30	0.66	0.44	2.94
U.S. Asset-Backed Securities	1.64	28[8]	2.16	0.23	0.17	1.17
Preferred Securities	2.75	102[8]	4.70	-0.13	0.83	2.05
High Yield 2% Issuer Capped	5.16	359[8]	3.17	0.09	1.18	1.21
Senior Loans[9]	5.83	453	0.25	0.08	0.17	0.70
Global Emerging Markets	4.62	313[8]	6.38	0.58	1.17	2.73
Global Aggregate (unhedged)	1.22	38[8]	7.21	0.15	-0.70	0.56

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 21 Feb 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, 21 Feb 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 19 Feb 2020. **5** BofA Merrill Lynch.

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%.

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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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