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# Magnified coronavirus fears send Treasury yields toward zero

*Financial markets continued struggling to assess the broader implications of the spreading coronavirus. The 10-year U.S. Treasury yield breached 1% for the first time ever on Tuesday, before closing the week at 0.76%.<sup>1</sup> The Federal Reserve (Fed) stepped in on Tuesday, cutting policy rates by 50 basis points (bps) in order to “support accommodative financial conditions.”*

## HIGHLIGHTS

- **Falling yields supported positive total returns for all sectors except high yield corporates and senior loans.**
- **Only taxable municipals were able to match the weekly total return of Treasuries.**
- **Emerging markets debt reversed the prior week’s loss, although spreads continued to widen.**



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## U.S. TREASURY YIELDS PLUNGE TOWARD ZERO

**The 10-year U.S. Treasury yield breached 1% for the first time ever on Tuesday,** on continued concerns over the potential economic effects of the coronavirus outbreak.<sup>1</sup> It fell further to close the week at 0.76%, and all Treasury yields have now fallen more than 1% for the year.<sup>1</sup> Brief moments of optimism came from stronger U.S. economic data and a surging Democratic nominee viewed as more “market-friendly.” The Fed cut rates by 50 bps to “support accommodative financial conditions.” It voiced concerns that the impact from the virus caused a material reassessment of its outlook and prompted the first inter-meeting rate cut since 2008. The markets took little solace from the Fed action, and rates continued dropping as a risk-adverse market tone fueled demand for high quality Treasuries.

**A powerful risk-off sentiment caused nearly all sectors to underperform Treasuries,** although total returns were mixed.<sup>1</sup> Falling yields supported positive total returns for all sectors except high yield corporates and senior loans.<sup>1</sup> Only taxable municipals were able to match the weekly total return of Treasuries, and have now returned almost 11% for the year compared to 8% for Treasuries.<sup>1</sup> Preferred securities join high yield corporates and senior loans as the only sectors suffering negative total returns for 2020.<sup>1</sup> However, all sectors have dramatically lagged similar-duration Treasury performance.<sup>1</sup>

**Even with last week’s Fed rate cut, markets expect additional cuts at the March 18 meeting.** Market-based probabilities for rate cuts in March now reflect more than 2.5 cuts at the next meeting, or a decrease of 65 bps in the policy rate.

***Municipal bond weekly fund flows turned negative for the first time in 60 weeks, with outflows of -\$250 million.***

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## MUNICIPAL FLOWS TURN NEGATIVE

**The municipal market rallied last week, but lagged Treasuries.**<sup>1</sup> New issue supply totaled \$8.5 billion and was well received.<sup>2</sup> Weekly fund flows turned negative for the first time in 60 weeks, with outflows of -\$250 million.<sup>3</sup> This week’s new issuance is expected to be \$12.3 billion (\$2 billion taxable), which should be well received.<sup>3</sup>

**The fixed income market is anticipating a very gloomy outcome to the coronavirus crisis.** The 10-year Treasury bond yield closed Friday at an all-time low 0.71%.<sup>1</sup> The Fed lowered the fed funds rate by 0.50% last week, and indicated it will continue to lower rates to near zero if warranted.

**High grade tax-exempt municipal bonds are trading cheaper than their taxable U.S. Treasury counterparts.**<sup>1</sup> However, these very low municipals yields have yet to pique the interest of crossover buyers. Extreme transparency from world leaders on the status of the outbreak is needed to assess the fair value of Treasury and municipal bond yields.

**The state of Maryland,** a very respected municipal bond issuer, issued \$750 million in tax-exempt general obligation bonds (rated AAA).<sup>4</sup> The 10-year bond yielded less than 1%, but still offered higher yields than Treasuries. We’re watching whether crossover buyers continue buying high grade tax-exempt bonds, as they are trading cheaper than U.S. Treasuries.

**High yield municipal bond yields were nearly unchanged last week.**<sup>1</sup> The market is finding relative stability from substantial liquidity after a period of historical flows and bond redemptions. In contrast to high yield corporates, the high yield municipal market has limited exposure to the energy sector. The asset class experienced its first week of net outflows in nearly 60 weeks at -\$128 million.<sup>3</sup> We believe high beta, highly liquid areas of the high yield municipal market will likely feel the effects of continued market distress more than small- to medium-sized project finance deals with longer-term pro forma development projections.

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## INVESTMENT GRADE CREDIT WEATHERS ANOTHER WEEKLY STORM, BUT DEMAND DROPS

**Investment grade corporates gained for the eighth consecutive week**, despite further spread widening and volatility-inducing headlines.<sup>1</sup> Trading was orderly in the first half of the week, with sentiment temporarily boosted by the Fed's surprise rate cut. The tone shifted as investors assessed the global economic impact of the coronavirus, concluding that far more monetary easing will be needed. Against this backdrop, weekly investment grade fund flows turned sharply negative at -\$1.1 billion.<sup>3</sup>

**High yield corporate bonds continued to struggle last week** as interest rates collapsed and spreads widened by another 50 bps.<sup>1</sup> The asset class saw massive daily price swings, performing in sympathy with an extremely volatile U.S. stock market. Within high yield, the highest-quality tier (BB rated) posted positive results, but overall returns were dragged down by the negative performance of lower-rated (CCC) issues. Outflows from high yield bond funds of -\$5.1 billion were the heaviest since March 2017, while the past two-week stretch of -\$9.5 billion is the largest on record.<sup>3</sup>

***Outflows from high yield corporate bond funds of -\$5.1 billion were the heaviest since March 2017.***

**Emerging markets (EM) debt reversed the prior week's loss.**<sup>1</sup> Spreads widened, but by far less than in the previous week. On the down side, hefty outflows of -\$4.7 billion proved difficult for dealers to digest amid severely limited risk appetites.<sup>3</sup>

## *In focus*

# **Coronavirus prompts early Fed rate cut**

*The Fed surprised markets last Tuesday by lowering the fed funds target rate by 50 bps, to 1%-1.25%. It was the Fed's first inter-meeting rate cut since the 2008 financial crisis. While maintaining that "the fundamentals of the U.S. economy remain strong," the Fed also acknowledged that the coronavirus presents "evolving" risks to its outlook.*

The Fed had been widely expected to reduce rates at its March 18 meeting in anticipation of a virus-driven economic deceleration, but it felt the need to act sooner to assuage investors' concerns. Markets took little solace from the Fed's move, however. The 10-year U.S. Treasury yield closed below 1% for the first time in history, hitting a record low 0.76% on March 6, while U.S. equity volatility spiked during the week.<sup>1</sup>

Although interest rate cuts can help ensure that markets function properly and liquidity remains ample, this latest round of Fed easing is unlikely to effectively restore disrupted global supply chains or counter other specific economic shocks that could occur should the impact of the virus widen.

Nonetheless, we expect the Fed to cut by at least another 50 bps when it meets on March 18. The central bank has recently avoided delivering hawkish surprises, and there's no reason to think news about the outbreak will improve before then.

## U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	Month-to-date	Year-to-date
2-year	0.51	-0.40	-0.40	-1.06
5-year	0.61	-0.33	-0.33	-1.08
10-year	0.76	-0.39	-0.39	-1.16
30-year	1.29	-0.39	-0.39	-1.10

Source: Bloomberg L.P. As of 6 Mar 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	0.53	-0.20	-0.20	-0.51
5-year	0.57	-0.16	-0.16	-0.52
10-year	0.86	-0.07	-0.07	-0.58
30-year	1.46	-0.06	-0.06	-0.63

Source: Bloomberg L.P. As of 6 Mar 2020. **Past performance is no guarantee of future results.**

## Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	116
30-year AAA Municipal vs Treasury	117
High Yield Municipal vs High Yield Corporate	53

Source: Bloomberg L.P., Thompson Reuters. As of 6 Mar 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	1.21	–	5.06	0.26	0.26	3.38
High Yield Municipal	3.34	207 <sup>5</sup>	5.86	-0.24	-0.24	4.37
Short Duration High Yield Municipal <sup>6</sup>	2.79	210	3.31	-0.36	-0.36	2.38
Taxable Municipal	1.99	113 <sup>7</sup>	9.75	2.85	2.85	10.95
U.S. Aggregate Bond	1.37	60 <sup>7</sup>	6.01	1.88	1.88	5.71
U.S. Treasury	0.72	–	7.23	2.81	2.81	8.12
U.S. Government Related	1.52	82 <sup>7</sup>	6.26	1.79	1.79	5.54
U.S. Corporate Investment Grade	2.22	144 <sup>7</sup>	8.41	1.96	1.96	5.75
U.S. Mortgage-Backed Securities	1.53	66 <sup>7</sup>	1.83	0.48	0.48	2.23
U.S. Commercial Mortgage-Backed Securities	1.58	95 <sup>7</sup>	5.38	0.89	0.89	5.38
U.S. Asset-Backed Securities	1.07	55 <sup>7</sup>	2.17	0.52	0.52	2.43
Preferred Securities	3.66	237 <sup>7</sup>	4.97	0.70	0.70	-0.28
High Yield 2% Issuer Capped	6.36	550 <sup>7</sup>	3.57	-0.45	-0.45	-1.82
Senior Loans <sup>8</sup>	6.15	544	0.25	-0.96	-0.96	-1.78
Global Emerging Markets	4.59	384 <sup>7</sup>	6.46	1.30	1.30	2.66
Global Aggregate (unhedged)	0.90	53 <sup>7</sup>	7.37	2.47	2.47	4.48

<sup>5</sup> Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. <sup>6</sup> 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. <sup>7</sup> Option-adjusted spread to Treasuries. <sup>8</sup> 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 6 Mar 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](http://nuveen.com).

**1** Bloomberg L.P. **2** The Bond Buyer, 6 Mar 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 4 Mar 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%.

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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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