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Weekly Fixed Income Commentary

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Bond markets roiled by coronavirus fears

Risk-off sentiment hit a crescendo last week. U.S. Treasury yields continued their freefall early on, fueled by investor concerns about the COVID-19 virus.[1] Yields ended the week higher for all maturities beyond 2 years, led by the longest maturities.[1] On Sunday, the Federal Reserve (Fed) enacted emergency measures, including reducing the federal funds rate and purchasing Treasuries and agencies in an attempt to support the smooth functioning of the fixed income markets.

HIGHLIGHTS

- **Investment grade corporate bonds suffered their biggest weekly loss on record.**
- **The municipal market faced extreme liquidity challenges, along with U.S. Treasuries.**
- **Emerging markets debt turned negative for the year after posting the week's largest loss among taxable fixed income sectors.**

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POTENTIAL FOR FISCAL STIMULUS LIFTS TREASURY YIELDS

U.S. Treasury yields rose for all maturities beyond 2 years last week, led by the longest maturities.[1] The drop in yields hit unprecedented levels on Monday, with all segments of the yield curve closing below 1%.[1] Monday's decline was offset the following day, as markets speculated that the federal government would step in with a fiscal aid package. The Fed again intervened by purchasing Treasuries across maturities and expanding its repurchase agreement (repo) capacity. The Fed reacted to poor liquidity and volatile trading for Treasury securities, as the 30-year yield swung 109 basis points (bps) during the week.[1] Yields generally moved higher for the remainder of the week, although financial conditions deteriorated sharply.[1] The 2-year Treasury yield ended the week lower, as markets priced in a return to 0% Fed rate policy.[1]

All sectors endured negative total returns last week, dramatically lagging similar-duration Treasuries.[1] Spreads widened as markets doubted that Fed policy responses would minimize economic damage.[1] Emerging markets, investment grade corporates and high yield corporates experienced total returns below -7% for the week.[1] Preferred securities and senior loans were close behind with significantly negative returns.[1] All of these sectors have negative total returns year to date, while the Treasury sector is up more than 6%.[1]

On Sunday, the Fed enacted several emergency measures, citing disrupted economic activity and significantly eroded financial conditions. It reduced the federal funds rate to a range of 0% – 0.25% and will also once again begin purchasing Treasuries and agencies in an effort to support the smooth functioning of the fixed income markets.

The 30-year Treasury yield swung 109 basis points during the week.

MUNICIPAL MARKET STRUGGLES WITH LIQUIDITY

The municipal market faced extreme liquidity challenges last week, along with U.S. Treasuries.[1] The new issue market shut down by the end of the week. Municipal fund flows were negative for the second week at -$1.8 billion.[2] New issuance is expected to be $7.7 billion this week, and deals may be pulled if the market remains disjointed.[3] Tax-exempt municipal yields increased by 25 bps on Wednesday and 50 bps on Thursday.[1]

A state of emergency has been declared in the U.S., so it should be no surprise that fixed income markets are in gridlock. No relevant benchmarks exist to assess fair value in any fixed income market. However, the U.S. government has pledged trillions of dollars in liquidity to maintain order, and on Sunday the Fed moved short-term rates to zero and announced other measures. Once the government has been able to "bend the curve" of virus outbreaks, we believe we will see greater stability in financial markets.

The State of California issued $2 billion general obligation bonds (rated Aa2/AA-).[4] The 2035 maturity was issued as 5% bonds yielding 1.50%. The same bonds retraded in block size later in the week at 1.93%, reflecting the general fixed income selloff.

The high yield municipal bond market saw unprecedented volatility and outflows last week, along with an acute period of rapid liquidity deterioration. Liquidity and performance firmly returned on Friday from institutional cross over buyers, causing yields and credit spreads to snap lower.[1] Last week's market adjustments were purely a response to liquidity risk premiums, in sympathy with a larger liquidity run on risk assets, which led to volatility beyond levels realized in 2008. We see this as a potential buying opportunity, particularly in this low rate environment. High yield municipal credit spreads widened 40 bps on average last week, on top of municipal yields rising 90 bps higher, for a 1.50% adjustment in one week.[1]

NO RESPITE FOR RISK ASSETS AS SPREADS WIDEN TO MULTIYEAR HIGHS

Investment grade corporate bonds suffered their biggest weekly loss on record.[1] Coronavirus headlines and plummeting oil prices caught up to the asset class, which previously had shown resilience with eight consecutive weeks of positive returns.[1] Last week, spreads widened by more than 70 bps to a more than seven-year high.[1] The energy sector experienced the most extreme price action as a Russian/Saudi oil price war threatened to exacerbate global oversupply in the face of severely diminished demand.

High yield corporates extended their losing streak to three weeks as spreads widened to +727 bps, their biggest gap since early 2016 and more than double their level at the beginning of this year.[1] Spreads in the energy sector were particularly hard hit, ending the week at well over +1,800 bps.[1] Overall, lower-quality (CCC) issues significantly lagged B and BB credits, in line with the prevailing risk-off climate.[1] Last week's outflows from high yield bond funds (-$4.9 billion) were the fifth largest on record.[2]

Lower-quality high yield corporate issues significantly lagged B and BB credits, in line with the prevailing risk-off climate.

Emerging markets (EM) debt performance turned negative for the year after posting the week's largest loss among taxable fixed income sectors.[1] EM spreads hit their widest levels in more than eight years amid intensified coronavirus fears, plummeting oil prices, a strong U.S. dollar and evaporating market liquidity. Redemptions from EM funds totaled $4.6 billion.[2]

In focus

Muni/Treasury ratios rise to historic levels

For the first part of 2020, municipal market performance was strong. But as the coronavirus crisis deepened, investors feeling liquidity pressure started withdrawing money from municipal bond funds. The resulting price decline was swift. With U.S. Treasury yields grinding lower, municipal-to-Treasury yield ratios have suddenly risen to historic levels.

Liquidity is still available — but at a higher yield. In our view, municipal markets are in the midst of a technical mismatch. Having said that, today's lower prices and higher yields are already starting to correct this mismatch. Fundamentals have not changed for most municipalities — what has changed is investor sentiment.

In general, municipal bonds tend to be high quality and defaults are rare. Before the crisis hit, municipal credit health was perhaps the strongest it had been since the financial crisis. Municipalities have ample cash, have experienced credit upgrades and enjoyed solid revenue growth. The good news is that municipal credit health is starting from a strong position.

The current municipal market price drop is due to short-term technical dislocations, and credit fundamentals remain sound. We believe opportunities exist — assuming you know where to look. The municipal market is starting to build a new base of demand at these lower prices. The selloff has been rapid and sharp, and the outlook is mixed, but we trust our long-term focus on fundamentals.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.49	-0.02	-0.42	-1.08
5-year	0.72	0.11	-0.22	-0.97
10-year	0.96	0.20	-0.19	-0.96
30-year	1.54	0.25	-0.14	-0.85

Source: Bloomberg L.P. As of 13 Mar 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	1.12	0.59	0.39	0.08
5-year	1.20	0.63	0.47	0.11
10-year	1.61	0.75	0.68	0.17
30-year	2.32	0.86	0.80	0.23

Source: Bloomberg L.P. As of 13 Mar 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	171
30-year AAA Municipal vs Treasury	149
High Yield Municipal vs High Yield Corporate	58

Source: Bloomberg L.P., Thompson Reuters. As of 13 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

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	2.07	–	5.55	-4.27	-4.02	-1.03
High Yield Municipal	4.76	263[5]	9.35	-8.67	-8.90	-4.68
Short Duration High Yield Municipal[6]	4.07	268	4.02	-4.14	-4.49	-1.85
Taxable Municipal	2.38	136[7]	9.70	-3.93	-1.19	6.59
U.S. Aggregate Bond	1.91	89[7]	6.08	-3.17	-1.35	2.36
U.S. Treasury	0.92	–	7.07	-1.93	0.82	6.03
U.S. Government Related	1.89	102[7]	5.91	-3.63	-1.90	1.71
U.S. Corporate Investment Grade	3.18	216[7]	7.92	-7.21	-5.39	-1.88
U.S. Mortgage-Backed Securities	2.29	105[7]	3.02	-1.18	-0.70	1.03
U.S. Commercial Mortgage-Backed Securities	2.01	117[7]	5.33	-2.41	-1.54	2.84
U.S. Asset-Backed Securities	1.44	84[7]	2.15	-0.67	-0.16	1.74
Preferred Securities	5.12	330[7]	5.17	-6.89	-6.24	-7.15
High Yield 2% Issuer Capped	8.28	727[7]	4.01	-7.15	-7.56	-8.84
Senior Loans[8]	8.06	739	0.25	-5.32	-6.23	-7.01
Global Emerging Markets	6.00	504[7]	6.03	-7.76	-6.56	-5.31
Global Aggregate (unhedged)	1.27	74[7]	7.31	-3.83	-1.45	0.47

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 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.

1 Bloomberg L.P. **2** Lipper Fund Flows. **3** The Bond Buyer, 13 Mar 2020. **4** Market Insight, MMA Research, 11 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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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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