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Weekly Fixed Income Commentary

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Treasury yields rise as banking concerns ease

U.S. Treasury yields rose as conditions in the banking sector continued to stabilize and investor concerns receded. Investor focus should return to the macroeconomy this week, with releases of the latest labor market data and the JOLTS survey.

HIGHLIGHTS

- **Treasuries, agencies, MBS, ABS and taxable municipals all had negative total returns amid the rise in rates.**
- **Total and excess returns were positive for investment grade and high yield corporates, preferreds, emerging markets and senior loans.**
- **Municipal bond yields remained essentially unchanged. New issue supply was $5.4B with outflows of -$194M. This week's new issuance is expected to be $6.1B.**

Anders Persson
CIO of Global Fixed Income

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Watchlist

- *U.S. Treasury yields rose after several weeks of declines.*
- *Spread assets rebounded as banking sector concerns eased.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

"Higher for longer" emerges as a theme, as the Fed battles to control inflation. Higher interest rates are likely to cause additional volatility.

The underlying growth outlook remains healthy, thanks to strong consumer balance sheets and solid levels of businesses investment. This combination should keep corporate defaults low.

Treasury yields are likely to fall this year, and we expect the 10-year Treasury yield to end 2023 around 3.25%.

We favor selectively taking on risk in this environment of attractive prices and yields. Credit selection is key as we search for bonds with favorable income and solid fundamentals.

KEY RISKS

- Inflation fails to moderate as expected, weighing on asset prices.
- Policymakers tighten too rapidly, undermining the global economic expansion.
- Geopolitical flare-ups: China, Russia, Turkey, Iran.

INVESTMENT GRADE CORPORATE DEMAND STABILIZES

U.S. Treasury yields increased last week, with the 10-year yield rising 9 basis points (bps) to 3.47%. There was little economic data from major economies last week, and the focus remained on the banking sector, where conditions continued to stabilize. This week, the focus should return to the economy. Updated U.S. labor market data will be released, including the latest JOLTS survey on job openings and the nonfarm payrolls report on job creation and wages.

Investment grade corporates rallied strongly last week, returning 0.15% and outperforming similar-duration Treasuries by 21 bps. After several weeks of substantial outflows, the asset class stabilized with a marginal ($77 million) inflow. The new issue market came back to life, with 26 companies bringing $24 billion of new deals. Issuance for the month was a bit softer than expected at around $100 billion, roughly -16% less than anticipated. That supply was skewed toward higher-quality issuers, with 65% rated single-A or better, as lower-quality issuers chose to remain on the sidelines. We expect issuance to pick up in April, including from lower-quality issuers.

High yield corporates also performed well, returning 1.73% and surpassing similar-duration Treasuries by 229 bps. Within the asset class, higher-rated segments continued to outperform, led by BB-rated companies. The high yield asset class saw another outflow of -$2.1 billion, while loan funds lost another -$712 million. Senior loans returned 0.89% for the week. Both markets saw quiet new issue calendars. However, conversations are picking up as the macro and financial backdrop stabilizes, and we expect issuance to accelerate in April.

Emerging markets rallied, returning 0.48% for the week and outpacing similar-duration Treasuries by 106 bps. As in the U.S. corporate market, high yield sovereigns outperformed investment grade, with the former tightening -23 bps versus -9 bps for the latter. The same compression dynamic prevailed in emerging markets corporates. Local currency bonds also gained, returning 1.25%, as the dollar softened amid the broader easing in financial risks. The new issue market reopened strongly, with more than $10 billion pricing for the busiest week of the month.

MUNICIPAL BONDS SHOULD REMAIN WELL BID

Municipal bond yields remained essentially unchanged last week. New issue supply was priced to sell and well received. Fund flows remained negative. This week's new issuance includes general obligation bonds from the state of California.

U.S. banking system woes appear to be contained for now. This caused the Treasury market to sell off, as investors took profits from the flight-to-quality rally. This should allow the U.S. Federal Reserve to focus on fighting inflation.

We expect fixed income in general to remain range bound with a good tone. Municipal bonds should remain well bid, as munis didn't experience the run up in the flight-to-quality trade. Money remains on the sidelines waiting to be deployed in the tax-exempt space. Also, new issuance appears muted for the foreseeable future.

New York City, New York, issued $950 million general obligation bonds (rated Aa2/AA). The deal was priced to sell and well received. The deal included 4% coupon bonds due in 2050 that came at a yield of 4.31%. Those bonds traded at a premium in the secondary market at 4.22%.

High yield municipal bond yields fell -13 bps on average in March, while high grade yields decreased by -26 to -32 bps. As a result, high yield muni credit spreads increased by 15 bps, totaling 258 bps. Short-duration high yield spreads sit at 308 bps on average. Only 37 bps separate short-duration and long-duration yields, at 5.31% vs 5.68%, respectively. Inflows totaled $148 million last week. New issuance remains very light. Brightline bonds are rallying with increased trading volume as testing is completed at the Orlando airport station and investors consider significant increases in backstop reserve commitments.

Brightline municipal bonds are rallying with increased trading volume.

In focus

Fixed income 2Q outlook improves

Nuveen's Global Investment Committee (GIC) highlighted some of its best fixed income ideas in our 2Q outlook.

Fixed income market conditions have improved since the end of 2022, despite the banking sector turmoil. Credit fundamentals look healthy, inflation has moderated and global economic growth remains solid. We believe investors should consider emphasizing credit risk over duration risk. Valuations overall are closer to fair value, though the GIC sees medium- to longer-term income generation opportunities, including:

Senior loans offer compelling yields (~10%), and high yield corporates offer value, particularly among higher-quality names.

High yield municipals provide idiosyncratic opportunities in areas such as specialty transportation.

Preferred securities have come under heightened scrutiny given their outsized exposure to the financials sector. Nonetheless, we remain constructive on the U.S. bank sector, including regional banks. Select names appear attractively valued.

Emerging markets debt has become slightly more in favor for the GIC. China's economy has strengthened since the country dropped its Covid restrictions, and a weaker U.S. dollar should provide an additional tailwind.

U.S. Treasury market

Maturity	Yield	Change (%) Week	March 2023	Year-to-date
2-year	4.03	0.26	-0.79	-0.40
5-year	3.58	0.17	-0.61	-0.43
10-year	3.47	0.09	-0.45	-0.41
30-year	3.65	0.00	-0.27	-0.32

Source: Bloomberg L.P., 31 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

Maturity	Yield to Worst	Change (%) Week	March 2023	Year-to-date
2-year	2.38	-0.02	-0.57	-0.22
5-year	2.22	-0.02	-0.42	-0.30
10-year	2.27	-0.02	-0.32	-0.36
30-year	3.30	-0.05	-0.26	-0.28

Source: Bloomberg L.P., 31 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	65
30-year AAA Municipal vs Treasury	90
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 31 Mar 2023. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg High Yield Municipal Index divided by the yield-to-worst for the Bloomberg High Yield Corporate Index. **Performance data shown represents past performance and does not predict or guarantee future results.**

Characteristics and returns

Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Returns (%) Week	March 2023	Year-to-date
Municipal	3.25	–	6.10	0.25	2.22	2.78
High yield municipal	5.68	258[1]	7.74	0.00	1.55	2.73
Short duration high yield municipal[2]	5.31	308	4.05	0.21	0.95	2.22
Taxable municipal	4.79	107[3]	8.31	-0.18	2.49	5.21
U.S. aggregate bond	4.40	57[3]	6.33	-0.46	2.54	2.96
U.S. Treasury	3.83	–	6.28	-0.55	2.89	3.00
U.S. government related	4.43	59[3]	5.40	-0.34	2.34	2.88
U.S. corporate investment grade	5.17	138[3]	7.25	0.15	2.78	3.50
U.S. mortgage-backed securities	4.51	63[3]	5.93	-0.88	1.95	2.53
U.S. commercial mortgage-backed securities	5.20	142[3]	4.52	-0.71	1.09	1.81
U.S. asset-backed securities	4.94	85[3]	2.83	-0.40	1.30	1.86
Preferred securities	7.42	288[3]	4.72	2.11	-4.75	1.50
High yield 2% issuer capped	8.54	457[3]	3.68	1.73	1.06	3.57
Senior loans[4]	9.99	609	0.25	0.89	-0.10	3.11
Global emerging markets	7.36	358[3]	6.19	0.48	1.24	2.15
Global aggregate (unhedged)	3.54	54[3]	6.81	-0.37	3.16	3.01

1 Yield difference between the Bloomberg High Yield Municipal Index and the 20-year AAA MMD scale. **2** 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. **3** Option-adjusted spread to Treasuries. **4** 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, 31 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.** Unless otherwise noted, the index is Bloomberg. 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.

For more information, please visit nuveen.com.

Performance: Bloomberg, L.P. **Issuance:** The Bond Buyer, 31 Mar 2023. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 29 Mar 2023.

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.

Representative indexes: municipal: Bloomberg Municipal Index; **high yield municipal:** Bloomberg High Yield Municipal Index; **short duration high yield municipal:** S&P Short Duration Municipal Yield Index; **taxable municipal:** Bloomberg Taxable Municipal Bond Index; **U.S. aggregate bond:** Bloomberg U.S. Aggregate Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index; **U.S. government related:** Bloomberg U.S. Government-Related Index; **U.S. corporate investment grade:** Bloomberg U.S. Corporate Index; **U.S. mortgage-backed securities;** Bloomberg U.S. Mortgage-Backed Securities Index; **U.S. commercial mortgage-backed securities:** Bloomberg CMBS ERISA-Eligible Index; **U.S. asset-backed securities:** Bloomberg Asset-Backed Securities Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield 2% issuer capped:** Bloomberg High Yield 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index; **global emerging markets:** Bloomberg Emerging Market USD Aggregate Index; **global aggregate:** Bloomberg Global Aggregate Unhedged Index.

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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 professional regarding the appropriateness 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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