nuveen
A TIAA Company

Weekly Fixed Income Commentary

21 November 2022

Treasury yields rise amid positive economic data

U.S. Treasury yields rose and the curve flattened in response to positive U.S. economic data and hawkish comments about monetary policy from U.S. Federal Reserve officials.

HIGHLIGHTS

- **Total returns were positive for Treasuries, agencies, investment grade and high yield corporates, taxable munis, MBS, ABS, preferreds, senior loans and emerging markets.**
- **Municipal bond yields declined further. New issue supply was $8.5B, with inflows of $605M. This week's new issuance should be light at $1.3B.**

Anders Persson
CIO of Global Fixed Income

John Miller
Head of Municipals

Watchlist

- *10-year Treasury yields rose and the yield curve flattened.*
- *Spread assets appreciated.*
- *Net-negative supply should provide some support to municipal bonds.*

INVESTMENT VIEWS

Accommodative interest rate policy remains a key market support. While investors continue to focus on more hawkish Fed policy, overall rates are likely to remain relatively low even after several rate hikes.

The underlying growth outlook remains healthy, as consumers have strong balance sheets, businesses are reinvesting and Covid recedes. This should keep defaults low.

Treasury yields have risen this year, but the pace of long-term increases should remain relatively modest.

We favor a risk-on stance, focused on credits with durable free cash flow and solid balance sheets across a wide range of sectors. Mid-quality rating segments appear particularly attractive. Essential service municipal bonds also look compelling.

KEY RISKS

- Inflation fails to moderate as expected, negatively affecting asset values.
- Policymakers remove accommodation too rapidly, undermining the global economic expansion.
- The Russia/Ukraine conflict continues to escalate.
- Covid-19 cases increase, or new variants emerge.

EMERGING MARKETS PERFORMANCE REMAINS STRONG

U.S. Treasury yields ultimately ended higher and the curve flattened last week, in response to U.S. economic data and hawkish comments from Federal Reserve officials. Producer price inflation mirrored the prior week's consumer price dynamic, with a strong miss to the downside. Core producer prices were flat in October, versus 0.3% expected. That helped Treasury yields to rally in the first half of the week, but comments from Fed officials caused markets to reverse by the end of the week. Front-end yields ended the week higher, with the 2-year yield up 20 basis points (bps). In particular, regional Fed President Daly, a noted dove on the committee, referenced a policy rate as high as 5.25%, well above current market pricing for the peak rate. President Bullard, a hawk, referenced a policy rate as high as 7%.

Investment grade bonds rallied again, returning 1.24% for the week and beating similar-duration Treasuries by 98 bps. Yields declined -12 bps, and are now down -65 bps from the year-to-date highs reached in mid-October. Investment grade funds saw inflows of $272 million, while new issuance met expectations at around $26 billion. Those deals came with concessions of around 7 bps, down from elevated levels earlier this year. Next week, the calendar will likely be light with the U.S. Thanksgiving holiday on Thursday.

High yield corporates gained as well, returning 0.70% and outperforming similar-duration Treasuries by 81 bps. Senior loans rallied, up 0.20% for the week, as CLOs reportedly picked up their buying ahead of year-end. Loan funds saw an outflow of -$180 million, while high yield funds received $2.9 billion of inflows. Those inflows more than offset new issuance, which totaled around $2 billion in the high yield asset class.

Emerging markets continued their recent strong performance, gaining 1.75% and beating similar-duration Treasuries by 164 bps. Within the asset class, high yield continued to pace gains, outperforming investment grade names. Hard currency funds saw their first inflows since August, with $290 million entering the asset class. In local currency, China-focused funds had outflows of -$349 million, but ex-China funds saw inflows of $195 million, also the first inflows since August. The new issue market opened more substantially, with seven deals totaling $8.5 billion coming to market, with elevated concessions of 15-20 bps.

MUNICIPAL MARKET FLOWS TURN POSITIVE

Municipal yields rallied last week. The 10- and 30-year bonds declined 26 bps and 29 bps, respectively. Weekly fund flows finally turned positive after 14 weeks of outflows, with $605 million flowing into mutual funds and $1.8 billion into exchange-traded funds.

The last few weeks of tax-exempt municipal performance have been extraordinary. On 17 October, the yield on a 30-year tax-exempt AAA bond stood at 4.16%. These bonds closed Friday yielding 3.59%, a rally of 57 bps. This week alone, the 30-year yield declined 29 bps. Yields are still much higher than at the beginning of the year. Year to date, 2-year AAA yields have increased 251 bps, 5-year rates are up 222 bps, 10-year rates are 188 bps higher, and 30-year rates have risen 210 bps.

However, a solid tone remains, as yields are much higher and the new issue market remains muted. Yields will likely remain range bound through the end of the year, but with a constructive bias. We expect 2023 will be a good year for fixed income in general and municipal bonds in particular.

The Metropolitan Nashville Airport Authority, Tennessee, issued $602 million airport revenue bonds, both AMT and non AMT (rated A1). The entire deal was well received, and bonds traded at a premium in the secondary market. For example, a 5.5% coupon bond due in 2052 came at a yield of 4.87% (AMT) and traded in the secondary market at 4.84%.

High yield municipals have seen a very firm tone take hold since a bottom formed on 25 October. This week showed the first positive flows since August. Major liquidity indicators like Buckeye Tobacco have rallied as much as 80 bps, and new issue deals are gaining heavier subscriptions. In short, the market feels firm and aggressively bid, as investors are offered highly attractive yields to compound going forward.

Investment grade corporate yields are down -65 bps from the year-to-date highs reached in mid-October.

In focus

A potential Fed pause offers time to reset

Aggressive central bank policy has stifled investor enthusiasm across markets and asset classes. The Fed has raised rates 375 bps since March, a nearly unprecedented pace of tightening done to combat persistent inflation amid continued strength in the labor market and consumer spending.

Given the extraordinary impact on markets, investors continue to keep cash on the sidelines as they wait for a market bottom. However, the latter part of a rate hike cycle has historically provided an attractive forward return environment for fixed income investors.

Soon after the Fed's last two hiking cycles ended in 2006 and 2018, investors benefited from looser financial conditions, especially in intermediate- to long-duration investments.

Investors should consider their allocation plans, as the pace of Fed rate hikes appears to be decelerating and potentially pausing in early 2023.

It is virtually impossible to time the market and enter at the absolute bottom. The recent aggressive decrease in Treasury rates following a weaker-than-expected inflation report exemplifies how quickly sentiment can change and yields can decline.

Thus, we suggest reallocating to fixed income markets by dollar-cost averaging over time to lower the average cost and reduce the impact of volatility on portfolios.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.54	0.20	0.05	3.80
5-year	4.01	0.07	-0.22	2.75
10-year	3.83	0.02	-0.22	2.32
30-year	3.93	-0.09	-0.24	2.03

Source: Bloomberg L.P., 18 Nov 2022. **Past performance does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	2.75	-0.26	-0.43	2.51
5-year	2.81	-0.23	-0.43	2.22
10-year	2.91	-0.23	-0.48	1.88
30-year	3.59	-0.29	-0.53	2.10

Source: Bloomberg L.P., 18 Nov 2022. **Past performance does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	77
30-year AAA Municipal vs Treasury	92
High Yield Municipal vs High Yield Corporate	67

Source: Bloomberg L.P., Thompson Reuters, 18 Nov 2022. 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. **Past performance does not predict or guarantee future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.72	–	6.20	1.90	3.66	-9.67
High yield municipal	5.88	250[1]	7.80	2.60	4.79	-13.81
Short duration high yield municipal[2]	5.61	277	4.31	1.15	2.18	-6.35
Taxable municipal	5.29	125[3]	8.18	0.66	2.89	-19.02
U.S. aggregate bond	4.73	53[3]	6.22	0.48	2.40	-13.69
U.S. Treasury	4.22	–	6.12	0.13	1.48	-13.03
U.S. government related	4.83	59[3]	5.24	0.36	1.82	-11.97
U.S. corporate investment grade	5.50	135[3]	7.16	1.24	3.57	-16.68
U.S. mortgage-backed securities	4.72	52[3]	5.88	0.39	2.95	-12.38
U.S. commercial mortgage-backed securities	5.45	130[3]	4.64	0.06	1.44	-11.98
U.S. asset-backed securities	5.47	99[3]	2.78	0.01	0.41	-5.47
Preferred securities	7.44	263[3]	5.03	0.29	2.81	-14.54
High yield 2% issuer capped	8.84	452[3]	3.95	0.70	1.07	-11.58
Senior loans[4]	10.67	630	0.25	0.20	1.04	-1.47
Global emerging markets	7.92	374[3]	6.05	1.75	4.18	-17.91
Global aggregate (unhedged)	3.62	54[3]	6.81	0.51	4.07	-17.20

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, 18 Nov 2022. **Past performance 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, 18 Nov 2022. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 16 Nov 2022.

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.

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 financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Performance data shown represents past performance and does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

Important information 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 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.

Nuveen provides investment advisory solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.