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Fixed income closes the year with broad gains

Fixed income markets posted modest gains last week despite thin holiday liquidity. Emerging markets led performance for the year, while munis remained well supported heading into 2026. U.S. data releases showed shutdown-related distortions across employment and inflation figures.

HIGHLIGHTS

- **Treasuries, investment grade and high yield corporates, preferreds, taxable munis, MBS, emerging markets and senior loans all advanced.**
- **Municipal bond yields were essentially unchanged once again. New issue supply was \$9.2B, and fund inflows were \$400M. This week brings no new issuance of note.**



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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES.

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Watchlist

- *10-year Treasury yields decreased again last week and remain close to our year-end forecast.*
- *Spread sectors generally outperformed versus similar-duration Treasuries amid mostly steady economic data.*
- *We expect the technical environment for municipal bonds to continue improving in 2026.*

INVESTMENT VIEWS

We believe fixed income **yields generally present a very attractive entry point**, creating compelling income opportunities.

Downside economic risks are material, despite strong fundamentals, with tariffs likely to compress consumer spending and weigh on business fixed investment. But a U.S. recession is not our base case.

Risk premiums may widen further, with entry points likely to become more attractive over the coming quarters. Duration is likely to reassume its role as a growth hedge.

KEY RISKS

- Tariffs further undermine consumer and business confidence, raising prices while weighing on sentiment and activity.
- Inflation fails to continue moderating as expected, weighing on asset prices.
- Geopolitical flare-ups intensify around the world.

EMERGING MARKETS LEAD FIXED INCOME WITH OUTPERFORMANCE

U.S. Treasury yields fell last week, with the 10-year ending 4 basis points (bps) lower at 4.15%. Despite thin year-end liquidity, several central banks moved: The European Central Bank held steady, the Bank of England cut 25 bps and the Bank of Japan hiked 25 bps. Two months of catch-up U.S. jobs and inflation data were released after being delayed by the federal shutdown. Labor markets appeared slightly weaker (unemployment rising to 4.6%) and inflation softer (core up 2.6% year-over-year), though shutdown effects likely distorted both the actual data and collection methods. We estimate unemployment is overstated by roughly 0.1 percentage point and inflation understated by at least 0.1 percentage point. After adjusting for these distortions, the data align with our prior forecasts.

Investment grade corporates returned 0.28% for the week, lagging similar-duration Treasuries by 4 bps. The asset class is on track to finish 2025 up 7.5%, beating similar-duration Treasuries by 108 bps. Preferreds returned 0.24% and are tracking toward a 6.6% annual return, outperforming Treasuries by 38 bps. Investment grade corporate supply was light, with only one \$1 billion deal pricing – oversubscribed 5x. Full-year 2025 supply reached just under \$1.6 trillion, up 6.7% from 2024.

High yield corporates returned 0.22%, outperforming similar-duration Treasuries by 2 bps. Senior loans returned 0.05%. Both are on track for strong 2025 returns: 8.2% for high yield bonds and 5.7% for senior loans. Supply remained light at \$1.9 billion in high yield, while inflows totaled a healthy \$800 million.

Emerging markets outperformed again, returning 0.32% and beating similar-duration Treasuries by 2 bps. For 2025, EM is up 10.9% and has outperformed Treasuries by 454 bps – the strongest showing across major fixed income asset classes. Supportive fundamentals, the dollar's biggest annual decline since 2017 and improved technicals drove performance. With another \$1.5 billion flowing into EM funds last week, full-year inflows reached \$28.8 billion.

THE MUNI MARKET REMAINS WELL BID DUE TO STRONG DEMAND

The muni yield curve ended the week essentially flat. Short-term yields fell 2 bps while the rest of the curve held steady. Light new issuance was well received, including \$644 million flowing into exchange-traded funds. While this week has no notable new issuance, 2025 total supply reached \$575 billion – 13% higher than 2024.

The muni market remains well bid due to strong Treasury performance and favorable muni supply/demand dynamics. New issuance has ended for the year, but dealers expect approximately \$50 billion in reinvestment flows on 01 January. Thus, we think munis should remain well bid through mid-January. Looking ahead, most firms project 2026 new issuance around \$600 billion, which could create buying opportunities.

New York City Transitional Finance Authority issued \$1.8 billion in tax-secured subordinated revenue bonds (rated Aa1/AAA). Strong demand prompted underwriters to lower yields across the board at final pricing.

High yield municipal bond funds continue absorbing moderate tax-loss selling that is dampening demand. New issues remained well subscribed. The week's standout deal, a storm-resistant and energy-efficient hotel development in the U.S. Virgin Islands, tightened 12.5 bps after final pricing. Buckeye Tobacco has attracted buyers at current yields after severe underperformance, though tobacco bonds have clearly fallen out of market favor.

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In focus

The ECB pauses and reflects

The European Central Bank kept its policy rate at 2.0%, a move widely anticipated by markets, while reconfirming the likely end of its easing cycle.

In its policy statement, the ECB offered few additional insights compared to prior versions, repeating that policymakers are “not committed to a particular rate path.” During her post-meeting press conference, ECB President Christine Lagarde noted that the outlook for inflation “continues to be more uncertain than usual on account of the still-volatile international environment.”

In its latest macroeconomic projections, the ECB expects headline inflation to edge “somewhat” below 2% in 2026-2027 before hitting its medium-term target (2%) in 2028. Core inflation (less food and energy costs) should fall as wage pressures and services inflation moderate. As for GDP, the ECB noted that the eurozone economy “is proving to be more resilient than expected.” With that in mind, policymakers expect GDP growth of 1.2% next year and 1.4% in 2027-2028 amid rising household incomes and government spending.

Looking ahead, we anticipate one 25 bps rate hike by the ECB in 2026. Most developed markets central banks are at or near the end of their easing cycles. For European fixed income, we prefer spread products (such as investment grade bonds) versus duration and overweights in debt issued by select peripheral countries.

U.S. Treasury market

Maturity	Change (%)			
	Yield	Week	Month-to-date	Year-to-date
2-year	3.48	-0.04	-0.01	-0.76
5-year	3.69	-0.05	0.10	-0.69
10-year	4.15	-0.04	0.13	-0.42
30-year	4.83	-0.02	0.16	0.04

Source: Bloomberg L.P., 19 Dec 2025. Performance data shown represents past performance and does not predict or guarantee future results.

Municipal market

Maturity	Change (%)			
	Yield to worst	Week	Month-to-date	Year-to-date
2-year	2.41	-0.02	-0.03	-0.41
5-year	2.43	0.00	0.02	-0.44
10-year	2.76	0.00	0.01	-0.30
30-year	4.24	0.00	0.08	0.34

Source: Bloomberg L.P., 19 Dec 2025. Performance data shown represents past performance and does not predict or guarantee future results.

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	66
30-year AAA Municipal vs Treasury	88
High Yield Municipal vs High Yield Corporate	84

Source: Bloomberg L.P., Thompson Reuters, 19 Dec 2025. 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.

For more information, please visit nuveen.com.

Performance: Bloomberg, L.P. Issuance: J.P. Morgan, 19 Dec 2025. Fund flows: Lipper. New deals: Market Insight, MMA Research, 17 Dec 2025.

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 ERIISA-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: S&P UBS Leveraged Loan Index; CLO AA: J.P. Morgan Collateralized Loan Obligation AA Index; CLO BB: J.P. Morgan Collateralized Loan Obligation BB Index; global emerging markets: Bloomberg Emerging Market USD Aggregate Index; global aggregate: Bloomberg Global Aggregate Unhedged Index.

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Characteristics and returns

Index	Yield to worst (%)	Spread (bps)	Effective duration (years)	Returns (%)		
				Week	Month-to-date	Year-to-date
Municipal	3.61	–	6.73	0.08	-0.08	4.07
High yield municipal	5.59	166 ¹	7.65	-0.15	-0.41	2.28
Short duration high yield municipal ²	5.79	323	3.74	0.03	-0.21	3.14
Taxable municipal	4.82	56 ³	7.69	0.42	-0.64	7.57
U.S. aggregate bond	4.33	27 ³	6.01	0.34	-0.35	7.09
U.S. Treasury	3.89	–	5.90	0.30	-0.49	6.15
U.S. government related	4.30	39 ³	5.33	0.23	-0.23	7.75
U.S. corporate investment grade	4.84	79 ³	6.85	0.28	-0.49	7.46
U.S. mortgage-backed securities	4.65	22 ³	5.70	0.48	0.01	8.36
U.S. commercial mortgage-backed securities	4.43	74 ³	3.87	0.28	-0.03	7.58
U.S. asset-backed securities	4.12	53 ³	2.85	0.22	0.12	5.73
Preferred securities	6.01	169 ³	5.53	0.24	0.29	6.62
High yield 2% issuer capped	6.63	275 ³	2.83	0.22	0.21	8.24
Senior loans ⁴	7.84	455	0.25	0.05	0.46	5.70
Collateralized loan obligations, AA	4.93	134 ³	0.25	0.12	0.35	5.75
Collateralized loan obligations, BB	10.42	675 ³	0.25	0.21	0.63	8.63
Global emerging markets	5.75	177 ³	6.02	0.32	0.24	10.90
Global aggregate (unhedged)	3.53	28 ³	6.37	0.00	-0.21	7.66

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 Standard & Poor's, 19 Dec 2025. 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.

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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. These risks may be magnified in emerging markets. 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. Any investment in collateralized loan obligations or other structured vehicles involves significant risks not associated with more conventional investment alternatives.

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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