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Weekly Fixed Income Commentary

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Sharply higher Treasury yields weigh on returns

U.S. Treasury yields increased across the curve, weighing on returns, but spread sectors broadly outperformed. We expect the U.S. Federal Reserve to cut rates at this week's meeting, but also signal less scope for cuts in 2025.

HIGHLIGHTS

- **Treasuries had negative total returns, while senior loans had positive total returns.**
- **Mortgages, investment grade and high yield corporates, preferreds and emerging markets all had negative total returns, but outperformed similar-duration Treasuries.**
- **Municipal bond yields were slightly higher. New issue supply was $10.8B, and fund outflows were -$316M. This week's new issuance is only $2.5B.**

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Watchlist

- *U.S. Treasury yields increased across the curve, even as markets markets priced in high odds of another Fed rate cut this week.*
- *Spread sectors broadly outperformed Treasuries.*
- *Municipal seasonal supply is drying up, but we should see technical support for the forseeable future.*

INVESTMENT VIEWS

Rates have peaked for this cycle, and attention has pivoted toward the pace and size of rate cuts in response to softer growth and easing inflation.

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

Risk premiums may widen further, with entry points for taxable fixed income likely to become more attractive over the coming quarters. Credit selection remains key as we search for bonds with favorable income and solid fundamentals.

KEY RISKS

- Inflation fails to continue moderating as expected, weighing on asset prices.
- Policymakers unsuccessfully juggle fighting inflation with supporting economies still struggling to gain traction.
- Geopolitical flare-ups intensify around the world.

SENIOR LOANS SEE STRONG FLOWS AND PERFORMANCE

U.S. Treasury yields moved higher last week, with 10-year yields ending 24 basis points (bps) higher at 4.40%. That was their sharpest one-week rise in 14 months. 2-year yields increased by 14 bps. Inflation data mostly met expectations, with core inflation rising 0.3% in November, including a notable slowdown in shelter inflation. However, other core services inflation was higher than anticipated. Separately, the European Central Bank (ECB) cut rates by 25 bps, as expected. President Lagarde's forward guidance was more hawkish than expected, driving an increase in medium-term yields. We expect the Fed to behave similarly, cutting rates at this week's meeting but signaling less scope for cuts in 2025.

Investment grade corporates weakened, returning -1.40% but outperforming similar-duration Treasuries by 22 bps. Spread levels on the investment grade index tightened -3 bps to 75 bps, back to within just 1 bps of their multidecade tights achieved last month. Inflows returned after the U.S. Thanksgiving holiday, as expected, at $5.8 billion. Meanwhile, in the last meaningful week of supply for the year, around $18 billion of new issuance priced. Those deals continued to be met with strong demand, averaging oversubscription rates of 3x and new-issue concessions of 0.7 bps, near the lows of the year. Overall, new issuance totaled just shy of $1.5 trillion in 2024, up 25% versus 2023.

High yield corporates also retreated, returning -0.22% but outperforming similar-duration Treasuries by 26 bps. Senior loans returned 0.24%, their 19th straight weekly gain. High yield funds had outflows of -$257 million, while loan funds had another week of robust inflows at $1.1 billion. The loan asset class has had inflows of more than $20 billion this year, with more than half of that total coming over the last three months. Given the strong flows and performance, companies continue to opportunistically refinance deals, with $101 billion placing last week. High yield saw less activity, with $6.5 billion of supply.

Emerging markets shared in the selloff, returning -0.65% but outperforming similar-duration Treasuries by 71 bps. Spreads compressed across investment grade and high yield segments, in both sovereigns and corporates. Outflows continued, totaling -$1.1 billion. New issuance was light as well, with just two deals pricing, totaling $1.4 billion.

MUNI BOND ISSUANCE SHOULD REMAIN HEAVY IN 2025

The municipal bond yield curve ended the week generally higher. Short-term muni yields rose 7 bps, while long-term rates increased 13 bps. Weekly new issuance was priced to sell and well received. Fund flows turned negative after 23 weeks of positive flows, including -$183 million in exchange-traded fund outflows. New issuance is all but done for the year as we approach the Fed meeting and the holiday season.

The municipal asset class issued a record $500 billion of debt in 2024, and most estimates call for the same amount in 2025. Most of this debt is for infrastructure projects, including airports, toll roads, bridges, ports, etc. Municipalities in general are in solid financial shape, so this outsized supply is not intended to fill municipalities' budget gaps.

Municipals should remain well bid in the short term. $40 billion of reinvestment money entered the asset class on 01 December, and we expect $36 billion to return to the space come 01 January.

Dormitory Authority State of New York issued $2.1 billion state tax revenue bonds (rated Aa1). The deal was well received, and underwriters lowered yields upon final pricing from where the deal was offered.

High yield municipal fund flows remain firmly positive, and well-underwritten deals have been heavily oversubscribed. Net flows totaled nearly $200 million last week, and three larger deals demonstrated the strength of net demand. A land-secured deal for the expansion of a project adjacent to Deer Valley was 25x over subscribed, a senior living deal for a successful network of facilities was 14x over and a new charter school was 11x over. However, the market is showing signs of vigilance, with some weaker deals struggling to clear the market. This week we are monitoring another 16 new issue deals, so it is not time to turn in for the year just yet.

Investment grade corporate spreads tightened nearly back to their multidecade tights reached last month.

In focus

Central banks cut to conclude 2024

We expect the Federal Reserve to match the European Central Bank's (ECB) recent 25 basis point rate reduction when it meets on Wednesday. Such a move would lower the fed funds rate to a range of 4.25%-4.50%

We're anticipating a hawkish cut, with Chair Jay Powell likely to emphasize that the Fed is near the point where pausing cuts would be appropriate, especially if the U.S. economy remains resilient. November data releases have largely been positive: a measure of broad business activity hit a 31-month high, and employers added a forecast-topping 227,000 jobs.

But while Powell may feel better about the health of the labor market, he's likely to be incrementally more concerned about inflation. Headline consumer prices rose 2.7% in November, on track to end the year above target and above the Fed's forecasts from September.

As for the dot plot of rate expectations, we expect few changes to the Fed's outlook, although central bankers could project higher rates than in September.

Across the Atlantic, we expect the ECB to continue cutting rates in 2025, with the deposit rate finishing the year around 1.75%, down from 3% after the December meeting. In Europe, uncertainty around U.S. trade tariffs could weigh on confidence and subsequently shave 0.3% to 0.5% off real GDP growth next year, underpinning our forecast of sub-1% growth in 2025.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.25	0.14	0.09	0.00
5-year	4.25	0.22	0.20	0.40
10-year	4.40	0.24	0.23	0.52
30-year	4.60	0.27	0.24	0.57

Source: Bloomberg L.P., 13 Dec 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

		Change (%)		
Maturity	Yield to worst	Week	Month-to-date	Year-to-date
2-year	2.59	0.07	0.00	0.07
5-year	2.66	0.12	0.05	0.38
10-year	2.86	0.13	0.08	0.58
30-year	3.70	0.13	0.08	0.28

Source: Bloomberg L.P., 13 Dec 2024. **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	80
High Yield Municipal vs High Yield Corporate	74

Source: Bloomberg L.P., Thompson Reuters, 13 Dec 2024. 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

				Returns (%)		
Index	Yield to worst (%)	Spread (bps)	Effective duration (years)	Week	Month-to-date	Year-to-date
Municipal	3.55	–	6.10	-0.87	-0.54	1.99
High yield municipal	5.34	192[1]	6.50	-0.88	-0.62	7.45
Short duration high yield municipal[2]	4.96	226	3.53	-0.54	-0.27	6.12
Taxable municipal	5.07	58[3]	7.70	-1.86	-1.43	2.64
U.S. aggregate bond	4.79	33[3]	6.15	-1.38	-0.93	1.97
U.S. Treasury	4.36	–	5.94	-1.33	-0.95	1.18
U.S. government related	4.83	45[3]	5.32	-1.06	-0.69	2.43
U.S. corporate investment grade	5.17	75[3]	6.93	-1.40	-0.90	3.20
U.S. mortgage-backed securities	5.14	43[3]	6.09	-1.56	-1.03	1.83
U.S. commercial mortgage-backed securities	5.11	81[3]	4.16	-0.72	-0.35	4.89
U.S. asset-backed securities	4.71	44[3]	2.71	-0.34	-0.08	4.99
Preferred securities	6.11	137[3]	5.12	-0.50	-0.52	10.51
High yield 2% issuer capped	7.19	262[3]	3.02	-0.22	0.20	8.87
Senior loans[4]	8.61	466	0.25	0.24	0.42	8.87
Global emerging markets	6.53	212[3]	6.04	-0.65	-0.11	7.75
Global aggregate (unhedged)	3.59	34[3]	6.63	-1.24	-0.98	-0.52

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, 13 Dec 2024. **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, 13 Dec 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 11 Dec 2024.

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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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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