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Separately Managed Accounts

Global Fixed Income

Flexible Income

Marketing communication | As of 31 Dec 2024

- **In the fourth quarter, the Flexible Income Strategy outperformed its benchmark, the Bloomberg U.S. Aggregate Bond Index, on a gross- and net-of-fees basis.**
- **Longer-dated Treasury yields rose during the quarter amid solid economic data and still-sticky inflation. The bellwether 10-year Treasury yield jumped 77 basis points, to 4.58%.**
- **Total returns across fixed income were broadly negative, with the Bloomberg U.S. Aggregate Bond Index returning -3.06%. Longer-duration sectors like mortgage-backed securities (-3.16%) were among the worst performers. Outside the benchmark, high yield corporates (+0.17%) and preferred securities (-1.65%) were relative bright spots.**

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Market review

The U.S. economy continued to demonstrate resilience in the fourth quarter. On the positive side, employers added 212,000 and 256,000 jobs in November and December, respectively, and weekly unemployment claims declined. More broadly, the service sector of the economy kept humming, as output stayed firmly in expansion territory. At the same time, manufacturing activity contracted, and the housing market remained challenged by limited supply and still-high mortgage rates.

The Federal Reserve lowered the federal funds rate by 25 basis points (bps) in both November and December, bringing the rate down to a range of 4.25%-4.50%. Fed watchers deemed the central bank's December dot plot hawkish, as it projected only 50 bps of cuts for 2025, compared to 100 bps in the Fed's September outlook. In addition, the Fed's forecast for its preferred inflation barometer, the core Personal Consumption Expenditures (PCE) Price Index, showed the index would finish 2025 at 2.5%, a less optimistic view than the 2.2% level projected in September. Chair Jerome Powell stated that the December decision was a "closer call" than prior cuts and suggested it will be "appropriate to move cautiously" when considering additional rate reductions.

While yields on Treasury bills declined, those on longer-dated securities rose. For example, the 10-year Treasury yield ended the quarter 77 basis points higher at 4.58%. Meanwhile, the yield on the 2-year Treasury note — which is especially sensitive to near-term monetary policy — closed the quarter up 59 bps, to 4.25%, as the Fed penciled in fewer rate cuts. Higher rates weighed on total returns across most fixed income asset classes but supported shorter-duration segments like senior loans and, to a lesser extent, high yield corporates. The Bloomberg U.S. Aggregate Bond Index posted a -3.06% return for the quarter.

Flexible Income

Portfolio review

The Nuveen Flexible Income Strategy returned -1.28% (gross of fees) and -1.58% (net of fees) in the fourth quarter, outperforming the Bloomberg U.S. Aggregate Bond Index, which returned -3.06%. (The composite net-of-fees returns represent the deduction of the maximum applicable fee from the gross-of-fees returns.) On a relative basis, the strategy's allocation to higher spread and shorter duration asset classes such as high yield corporate bonds and preferreds was the main contributor to relative performance. These exposures benefited from tighter credit spreads over the period, aided by positive fundamentals given the strong growth backdrop and robust investor demand for income-producing assets. At quarter-end, current yield and yield-to-worst for representative account were 5.16% and 5.03%, respectively.

The strategy's allocation to preferreds was the largest contributor to returns for the quarter. The portfolio's overweight to fixed-to-floating rate preferreds, which are shorter in duration, was beneficial amid the rise in interest rates. We also saw a "catchup" rally in the lower quality, undervalued names that gained from the market's rise following the Trump victory. High yield corporate bonds posted positive relative returns due to positive credit fundamentals as default rates remained low. The asset class was also aided by supportive market technicals, as investor demand remained high given attractive all-in yields.

Investment grade corporate bonds sold off and represented the largest detractor from returns in the portfolio as the markets priced in less monetary easing in 2025, which drove rates higher in December. In terms of security selection, the portfolio's overweight in higher-yielding BBB-rated credits helped as the higher spread cushioned against the impact from rates.

Performance in common stocks was another laggard. Despite the large runup in November, the hawkish turn in December's Federal Reserve meeting shook equity markets, which wrestled with the new expectations of fewer rate cuts next year. This gave way to concerns about frothy market valuations and the outlook for corporate earnings amid a potentially slowing economy.

Portfolio positioning

We favor maintaining broad diversification across asset classes, with an up-in-quality tilt in security selection that focuses on companies with strong balance sheets, sound capital structures and durable free-cash-flow generation. Strong economic growth and upside risks to inflation from policies by the new presidential administration are likely to keep yields higher for longer. In the current environment, we continue to find opportunities to enhance the portfolio's income.

We are mindful of stretched valuations and remain active in rotating into areas that offer better risk/reward. During the quarter, the team reduced exposure in investment grade bonds as investment grade credit spreads reached an all-time tight in November. We exited out of several positions that traded very tight and no longer compensated us based on the risk. We reallocated into names in high yield corporates that not only offered a higher coupon and spread with B+ to B credit profiles, but also room for spread compression where the underlying businesses are positioned to see free cash flow inflect higher.

We maintained our allocation in preferreds from the prior period and continue to be overweight in fixed-to-variable rate and $1000 par securities. Corporate hybrid securities, which are mainly comprised of non-bank issuers, saw a meaningful increase in issuance during the calendar year as issuers took advantage of the change in Moody's rating methodology that began assigning 50% equity treatment to these securities. The team has been opportunistically adding to this space since early 2024, but we have begun scaling back as new deals reflect tighter pricing due to strong demand.

Finally, we made some adjustments in our equity allocation by de-risking out of several names that experienced strong appreciation and repositioned into investments where the valuations looked more attractive and the businesses more defensive.

Outlook

In the near-term, there have been few signs of the U.S. economic engine slowing down. This, combined with potentially inflationary policies from the new presidential administration, is likely to provide a floor on Treasury yields going meaningfully lower from current levels. Considering the resilient macroeconomic backdrop and uncertainties surrounding government policy, the Federal Reserve will remain data dependent and likely take a cautious approach, aiming to ensure that upside risks to inflation remain subdued.

As proven in the last year, accurately prognosticating the number of rate cuts over a period of time has been an undertaking of folly by market participants. Rather than assigning a specific number of cuts, our view is that the path to neutral is unlikely to be a straight line. The Fed will be closely watching the impact of fiscal and regulatory policy on growth and inflation, and we anticipate the bias is for fewer cuts rather than more based on the current set of data.

We anticipate a full renewal of the Tax Cuts and Jobs Act of 2017, which would provide a tailwind to growth starting in late 2025. Higher tariffs will more than likely increase consumer prices, as will reduced immigration, which could trigger higher wage growth. Both policies are likely to drag on GDP growth as well. The mitigant to this outlook is the probability that neither is likely to fully reflect campaign rhetoric given a very slim House majority by Republicans.

We expect corporate credit spreads to remain mostly range-bound in the first half of 2025, with a bias toward widening in the second half. The technical environment is supported by elevated all-in yields, which should remain solid throughout the year. While valuations are stretched, strong demand from domestic and foreign buyers are likely to keep credit spreads tight relative to historical levels.

A surge in M&A activity, driven by optimism around deregulation and potential tax cuts, could drive another year of robust corporate bond issuance while potentially weakening credit metrics due to the uptick in borrowing. In the high yield market, issuers generally have strong balance sheets, and par-weighted bond default rates are projected to be below the long-term average. However, we are closely monitoring the impact of higher-for-longer yields on their financial flexibility, especially the issuers that have relatively weaker credit profiles.

We believe investors may be rewarded from focusing on yield and maximizing income to drive portfolio returns. That said, investors should remain vigilant, as macro uncertainties will likely cause performance to vary widely among sectors and issuers. Diligent credit underwriting and emphasis on downside protection are important prerequisites to take advantage of relative value opportunities and generate alpha in this environment. As market conditions evolve, we continue to look for investment candidates that possess impending catalysts to drive free cash flow higher, while offering attractive coupons and spread.

For more information contact: 800.752.8700 or visit nuveen.com

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All investments carry a certain degree of risk of loss and there is no assurance that an investment will provide positive performance over any period of time. Debt and fixed income securities are subject to market risk, credit risk, interest rate risk, call 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 subordinate 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 and adverse economic developments. Concentration in the financial services sector may involve greater exposure to adverse economic or regulatory occurrences. Equity investments are subject to market risk, common stock risk, covered call risk, short sale risk, and derivatives risk. Value style investing presents the risk that the holdings or securities may never reach their full market value because the market fails to recognize what the portfolio management team considers the true business value or because the portfolio management team has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other style investing during given periods.

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Glossary

The **Bloomberg U.S. Aggregate Bond Index** tracks the performance of U.S. investment-grade bonds. **It is not possible to invest directly in an index.** Clients should consult their financial professional regarding unknown financial terms and concepts.

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