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Weekly Fixed Income Commentary

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Treasury yields start 2025 marching higher

U.S. Treasury yields increased across the curve. Improved U.S. economic data weighed on returns but supported higher-risk market segments.

HIGHLIGHTS

- **Treasuries, MBS, investment grade corporates and preferreds all had negative total returns.**
- **Senior loans had positive total returns, while high yield corporates and emerging markets declined but outperformed similar-duration Treasuries.**
- **Municipal bond yields also were higher. New issue supply was just $6.3B, and fund inflows were $842M. This week's new issuance is outsized at $13B.**

Anders Persson
CIO of Global Fixed Income

Daniel Close
Head of Municipals

Watchlist

- *U.S. Treasury yields increased across the curve toward the top of our forecasted range.*
- *Spread sectors generally 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 HEFTY INFLOWS

U.S. Treasury yields continued rising to start the year, with 10-year yields increasing 16 basis points (bps) for the week to 4.76%, after a 79 bps move in the fourth quarter. 2-year yields increased 10 bps. The latest move has been driven by increased confidence in the economic outlook, heightened concerns about the fiscal and regulatory policy outlook, further reassessment of the U.S. Federal Reserve's likely rate cut path, and marginally higher concern about the path of inflation. Surveys of business activity started the year stronger. The December jobs report showed another strong headline pace of job creation and a drop in the unemployment rate. Consumer price inflation data on Wednesday this week will be the next major catalyst.

Investment grade corporates weakened, returning -0.96% for the week and lagging similar-duration Treasuries by -5 bps. The asset class was negatively affected by the rise in rates, which weighs more on longer-duration asset classes. Despite that, the technical backdrop remained positive, with inflows of $6.3 billion, the biggest weekly increase since mid-November, and above the 2024 average of around $5 billion per week. Supply kicked off the year on solid footing, with almost $65 billion pricing for the week on top of $15 billion over the first two days of January. New issue concessions averaged around 2.6 bps, well below the 2024 average of around 3.6 bps, as investor demand remains strong.

High yield corporates were mixed, returning -0.28% for the week but outperforming similar-duration Treasuries by 9 bps. The move higher in rates hurt performance, but the fact that it was driven by strong economic data ultimately supported the asset class. Senior loans returned 0.20%, benefiting from the same dynamics. High yield funds had a modest outflow for the week of -$27 million. Loan funds saw inflows of $2.2 billion, the biggest weekly inflow since February 2022. Supply was healthy to start the year, totaling around $7 billion in leveraged finance, split almost evenly between high yield bonds and senior loans.

Emerging markets also weakened, returning -0.63% for the week but outpacing similar-duration Treasuries by 16 bps. Spreads tightened across corporate and sovereign segments, led by high yield segments. New issuance was elevated, especially in investment grade, with $51 billion pricing in the asset class, as is typical in January. Outflows continued as well, totaling -$1.3 billion.

THE MUNI MARKET EXPERIENCES RECORD SUPPLY IN 2024

The municipal bond yield curve ended last week higher. Short-term munis rose 8 bps and long-dated yields ended 17 bps higher. New issuance levels were low and deals were placed. Fund flows were positive, including $235 million in exchange-traded fund inflows. New issue supply should be outsized this week. Even though it will be priced to sell, such large supply in one week may be a struggle for the asset class.

The muni market ended 2024 with record new issue supply of approximately $500 billion, and 2025 will likely see similar issuance. We believe the Treasury market will essentially remain range bound in 2025. Since munis are primarily priced based on government yields, munis should also be range bound. However, we expect periods of choppiness when new issue supply outstrips demand. Two silver linings support the muni scenario: Higher yields should attract more investors, and 2025 should see reinvestment income of almost $350 billion, which is typically reinvested into munis.

Conroe Independent School District, Texas, issued $595 million school building bonds (rated Aa1/AAA). The deal included 5% coupon bonds due in 2035 that came at a yield of 3.33%. This is 70% of the 10-year Treasury bond yield.

High yield municipal themes from 2024 appear to be continuing into the new year. Higher embedded yield returns, credit spread compression and active credit selection have been needed to combat general rate volatility. The high yield muni market is offering plentiful opportunities. Yields have increased 11 bps on average compared to 16 bps for long-term AAA municipal bonds, and many focus credits have seen more price stability or price increases on stronger demand. New issue supply is off to an expected slow start. Nuveen is monitoring 11 upcoming deals, less than half of the pace we observed in Q4 2024.

The muni market should see reinvestment income of almost $350 billion in 2025, which is typically reinvested into munis.

In focus

Strong IG issuance should continue in 2025

Investment grade corporate gross issuance ended 2024 around $1.5 trillion, second only to $1.8 trillion in 2020. Forecasts call for similar strength going forward.

The average maturity of new issues rose to 10.3 years, after declining to less than 10 years in 2023. Seventeen percent of issuance had a maturity topping 10 years, the highest share since 2021.

2025 gross issuance forecasts range from flat ($1.50 trillion) to a healthy pickup ($1.75 trillion) compared to last year, driven by increased M&A and a record wave of bond maturities related to the pandemic. Additionally, artificial intelligence will likely continue spurring issuance to fund construction and other capital needs, especially for utilities. We expect non-financials to issue more debt than financials.

The 2025 new issue calendar got off to a strong start, with nearly $65 billion issued during the first full week of January. Monday was the busiest day, with 23 issuers bringing $38 billion in deals. This amount ties for the second largest number of deals in a single day. Books were about three times oversubscribed with minimal new issue concessions.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	4.38	0.10	0.14	0.14
5-year	4.58	0.16	0.19	0.19
10-year	4.76	0.16	0.19	0.19
30-year	4.95	0.14	0.16	0.16

Source: Bloomberg L.P., 10 Jan 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	2.84	0.08	0.02	0.02
5-year	2.95	0.11	0.08	0.08
10-year	3.17	0.13	0.11	0.11
30-year	4.06	0.17	0.16	0.16

Source: Bloomberg L.P., 10 Jan 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	67
30-year AAA Municipal vs Treasury	82
High Yield Municipal vs High Yield Corporate	75

Source: Bloomberg L.P., Thompson Reuters, 10 Jan 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	3.83	–	6.36	-0.95	-0.66	-0.66
High yield municipal	5.61	178[1]	6.92	-1.21	-0.94	-0.94
Short duration high yield municipal[2]	5.17	219	3.77	-0.32	-0.11	-0.11
Taxable municipal	5.38	58[3]	7.64	-1.09	-1.24	-1.24
U.S. aggregate bond	5.09	34[3]	6.09	-0.87	-1.00	-1.00
U.S. Treasury	4.62	–	5.79	-0.76	-0.87	-0.87
U.S. government related	5.11	46[3]	5.26	-0.64	-0.72	-0.72
U.S. corporate investment grade	5.52	80[3]	6.76	-0.96	-1.10	-1.10
U.S. mortgage-backed securities	5.48	46[3]	6.30	-1.06	-1.24	-1.24
U.S. commercial mortgage-backed securities	5.36	78[3]	4.11	-0.49	-0.56	-0.56
U.S. asset-backed securities	4.87	43[3]	2.64	-0.24	-0.30	-0.30
Preferred securities	6.57	153[3]	5.24	-1.55	-0.77	-0.77
High yield 2% issuer capped	7.52	274[3]	3.12	-0.28	0.04	0.04
Senior loans[4]	8.96	472	0.25	0.20	0.30	0.30
Global emerging markets	6.80	211[3]	5.95	-0.63	-0.49	-0.49
Global aggregate (unhedged)	3.83	35[3]	6.55	-0.96	-1.30	-1.30

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, 10 Jan 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, 10 Jan 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 08 Jan 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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