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Weekly Fixed Income Commentary

09 September 2024

The Treasury yield curve un-inverts, for now

U.S. Treasury yields moved lower as U.S. economic data indicated further slowing, especially in the labor market. The shape of the yield curve now shows a positive slope for the first time since July 2022.

HIGHLIGHTS

- **Treasuries, investment grade and high yield corporates, MBS, taxable munis, preferreds, senior loans and emerging markets all experienced positive total returns.**

- **Municipal bond yields declined. New issue supply was $8.2B, and fund inflows were $963M. This week's new issuance is $12.7B.**

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Watchlist

- *10-year U.S. Treasury fell last week as job creation slowed further.*
- *Spread sectors generally gained, but lagged the substantial rally in Treasuries.*
- *Increased seasonal supply should provide an attractive entry point for municipal bonds.*

INVESTMENT VIEWS

Rates have probably peaked for this cycle, as attention pivots toward 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.

INVESTMENT GRADE CORPORATE ISSUANCE REMAINS BUSY

U.S. Treasury yields fell further last week, with the 10-year yield ending -19 basis points (bps) lower at 3.71%. The 2-year yield fell more sharply, down -27 bps, resulting in a positively sloping yield curve for the first time since July 2022. The bond market rally progressed throughout the week, as a series of U.S. economic data came in broadly weaker than expected. ISM manufacturing data and overall job openings were lower than expected. On Friday, headline job creation was also lower than expected, at 142,000 in August. There were downward revisions to prior months, taking the recent trend to a new cyclical low. However, the unemployment rate fell by -0.1 percentage points (pp) to 4.2% after the 0.2 pp increase in July. Overall, the economy remains in expansion, but downside risks to the labor market continue to intensify.

Investment grade corporates advanced again, returning 1.27% for the week, but underperformed similar-duration Treasuries by -35 bps. After an active August, the new issuance market was busy again to start September, with $80 billion pricing over the U.S. holiday-shortened week. That deluge of supply was well digested, with average oversubscription rates of 3.8x resulting in tight concessions of 2.2 bps, well below the year-to-date average of 3.7 bps. The technical backdrop was supported by a surge of inflows, with $7.5 billion entering the market for the week, a sizeable increase from the year-to-date pace of around $5 billion per week.

High yield corporates also gained, returning 0.25% for the week, but lagged similar-duration Treasuries by -53 bps. Senior loans returned 0.16%. Both asset classes experienced small outflows for the week, of -$48 million and -$38 million for high yield bonds and senior loans, respectively. That marked the sixth straight week of outflows for loan funds, though the magnitude has moderated recently. Issuance remained busy, though not to the same degree as in investment grade markets, with $7.7 billion pricing in high yield and $20 billion in loans.

Emerging markets rallied 0.52% for the week, but lagged similar-duration Treasuries by -90 bps. Local markets returned 0.33%. Emerging markets debt had another week of outflows, with -$429 million exiting the market, around 85% from hard currency funds. Meanwhile, the new issuance market reopened with $21.4 billion pricing, mostly from investment grade issuers and the corporate space.

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HIGH YIELD MUNICIPAL BOND ISSUANCE IS EXPECTED TO PICK UP

The municipal bond yield curve ended lower last week. Short- and long-term yields both declined -8 bps. New issuance was robust, even with the U.S. holiday. Deals were priced to sell and well received. Fund flows were positive for the tenth consecutive week, although exchange-traded flows were negative at -$17 million. This week's new issuance is large, and dealers will likely struggle to place such a big calendar.

The municipal market may come under pressure, but should remain relatively stable due to support from the Treasury market. Outsized muni new issuance should continue, but reinvestment money is trending lower, at only $23 billion in September. That amount should easily be spent this week. Muni yields may come under pressure, but the market should attract new investors as the municipal-to-Treasury yield ratio cheapens. Also, short-term rates have declined dramatically, so investors will be pushed further out on the yield curve to reach income objectives.

The North Texas Tollway Authority issued $1.1 billion revenue bonds, including $451 million first tier bonds (rated Aa2/AA-). The deal included 5.25% coupon bonds maturing in 2044 that came at a yield of 3.59% and traded in the secondary market at 3.56%.

High yield municipal bond yields decreased on pace with high-grades last week. High yield inflows totaled $350 million last week, bringing the 2024 total to more than $11 billion. This represents more than 50% of all muni fund flows this year. New issuance is expected to pick up between now and the U.S. election. We are tracking at least 12 deals this week across various sectors. American Dream grant revenue bonds (aka sales tax bonds) moved another 6.5 pts higher last week on better demand after payments have resumed on back-dated debt service. Bond prices have risen by nearly 20 pts since the development.

The muni market should attract new investors as the municipal-to-Treasury yield ratio cheapens.

In focus

Muni bonds have offered strong post-election returns

As some investors remain unsure about the impact of the upcoming U.S. presidential election, we looked at average muni bond returns in the one year following the past seven elections.

High yield municipal bonds returned 7.3% on average, outpacing investment grade municipals at 5.6% and 1-3 month U.S. Treasuries at 2.0% over this period.

We anticipate a similar experience this year, as high yield munis should deliver strong performance due to attractive yields and additional duration, which should support total return heading into a declining interest rate environment. Elevated yields, strong fundamentals and a technical environment still offering discounted pricing provides a unique opportunity.

Investors may take advantage of the 8.58% taxable-equivalent yield available ahead of an expected meaningful decline of issuance after the election, providing an attractive entry point to capitalize on technical dynamics keeping yields elevated. While uncertainty surrounds election outcomes and future policy, post-election returns since 1996 have provided positive investor experience. We expect this to continue.

Data source: Bloomberg, L.P., taxable-equivalent yield, 06 Sep 2024; average one-year post election return,1996 – 2020. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: 1-3 month Treasuries:** Bloomberg U.S. Treasury Bills: 1-3 Months; **investment grade municipals:** Bloomberg Municipal Bond TR Index; **high yield municipals:** Bloomberg High Yield Municipal TR Index. Taxable-equivalent yields are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary.

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U.S. Treasury market

Maturity	Yield	Change (%) Week	August 2024	Year-to-date
2-year	3.65	-0.27	-0.34	-0.60
5-year	3.49	-0.22	-0.21	-0.36
10-year	3.71	-0.19	-0.13	-0.17
30-year	4.02	-0.18	-0.11	-0.01

Source: Bloomberg L.P., 06 Sep 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Municipal market

Maturity	Yield to worst	Change (%) Week	August 2024	Year-to-date
2-year	2.37	-0.08	-0.40	-0.15
5-year	2.34	-0.08	-0.33	0.06
10-year	2.63	-0.08	-0.11	0.35
30-year	3.52	-0.08	-0.08	0.10

Source: Bloomberg L.P., 06 Sep 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	71
30-year AAA Municipal vs Treasury	87
High Yield Municipal vs High Yield Corporate	72

Source: Bloomberg L.P., Thompson Reuters, 06 Sep 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

Index	Yield to worst (%)	Spread (bps)	Effective duration (years)	Returns (%) Week	August 2024	Year-to-date
Municipal	3.37	–	6.15	0.51	0.79	1.81
High yield municipal	5.23	199[1]	6.58	0.56	1.18	7.12
Short duration high yield municipal[2]	5.15	268	3.22	0.31	1.05	5.45
Taxable municipal	4.56	69[3]	7.90	1.75	1.27	5.63
U.S. aggregate bond	4.21	39[3]	6.23	1.29	1.44	4.40
U.S. Treasury	3.72	–	6.20	1.38	1.28	4.01
U.S. government related	4.27	51[3]	5.53	1.01	1.34	4.34
U.S. corporate investment grade	4.76	98[3]	7.18	1.27	1.57	4.80
U.S. mortgage-backed securities	4.47	41[3]	5.67	1.26	1.61	4.58
U.S. commercial mortgage-backed securities	4.60	98[3]	4.24	1.06	1.23	5.99
U.S. asset-backed securities	4.38	65[3]	2.78	0.72	0.97	4.79
Preferred securities	5.98	167[3]	4.72	0.66	2.60	9.56
High yield 2% issuer capped	7.24	322[3]	2.94	0.25	1.63	6.55
Senior loans[4]	8.22	498	0.25	0.16	0.60	6.01
Global emerging markets	6.43	268[3]	6.24	0.52	2.10	6.85
Global aggregate (unhedged)	3.34	40[3]	6.72	1.23	2.37	3.12

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, 06 Sep 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, 06 Sep 2024. **Fund flows:** Lipper. **New deals:** Market Insight, MMA Research, 04 Sep 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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