nuveen
A TIAA Company

Separately Managed Accounts **Commentary**

Global Fixed Income

# Intermediate Government

**Marketing communication** | As of 31 Mar 2023

## Bond market overview

The global economy continued to expand and unemployment rates remained low across developed markets. However industrial activity continued to decelerate, and forward-looking indicators weakened further. Fourth-quarter 2022 U.S. gross domestic product (GDP) figures were revised downward twice to 2.6%, while estimates for first-quarter 2023 economic growth also fell to 2.2% annualized (Atlanta Fed's GDPNow model). Inflation continued to run well above the Federal Reserve's long-term target but showed signs of cooling. The Fed's preferred inflation gauge, the core Personal Consumption Expenditures price index (PCE), decelerated in the month of February and over the preceding 12 months to its slowest annual increase since October 2021.

The Fed's efforts to battle inflation were made more difficult by the failure of a few regional U.S. banks during the quarter as concerns increased about broader potential threats to the financial sector. However, quick action by the government and regulators kept contagion risk low, including the opening of a new lending facility to provide funding for banks to meet potential future withdrawals. Following 2022's record-breaking pace, Fed policymakers downshifted to quarter-point hikes in February and March, bringing the federal funds target rate to a 16-year high of 4.75%-5.00% by period end. While Chair Powell acknowledged that recent developments may make it more challenging for households and businesses to borrow going forward, he reiterated the Fed's commitment to bringing inflation under control.

Amid the heightened financial system uncertainty, U.S. Treasury yields were extremely volatile during the quarter. The two-year Treasury yield, which is most sensitive to Fed policy, surged past the 5% level following Powell's hawkish comments in February, but then dropped sharply in March as money flooded into government bonds in a flight to safety. The two-year Treasury ended the period at 4.06% and the yield curve inversion continued as rates on short Treasuries remained higher than longer maturities. The yield on the bellwether 10-year U.S. Treasury, which had surpassed 4% in early March, retraced to end the quarter at 3.48%. The rate rally supported fixed income total returns, which were positive across all major asset classes.

## Portfolio performance

The Nuveen Asset Management Intermediate Government Strategy experienced positive total returns in the first quarter but underperformed the benchmark, the Bloomberg U.S. Intermediate Government Index, on a gross- and net-of-fees basis.

Our underperformance was driven by duration and curve positioning. Our duration positioning detracted from performance as we were positioned slightly shorter than the benchmark and interest rates declined across much of the curve during the first quarter. We were positioned with an overweight to the 10-year part of the yield curve, which detracted from performance as the curve steepened in March in response to the stress in the banking. The modest overweight to agencies had a minimal impact to performance.

During the quarter we reduced our duration underweight by purchasing 4- and 5-year Treasuries in February but remained slightly underweight duration.

Going forward, we continue to expect economic growth to moderate to a below-trend pace. We see heightened risks of recession in the U.S. and Europe later this year, although the magnitude of a downturn should be mild by historical standards. Job growth, which has remained very strong in recent months, is likely to decelerate in the coming quarters. Although inflation has likely peaked, it will probably remain higher than central bank targets throughout 2023, which will drag on consumer spending and prompt further tightening.

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**Performance data shown represents past performance and does not predict or guarantee future results. Page 2 contains additional disclosures integral to this report.**
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We now expect the Fed to hike rates by 25 basis points one more time before ending the tightening cycle by mid-year. The ECB is likely to continue raising rates, although the overall level of rates in Europe will probably remain lower than in the U.S. In China, policymakers are likely to continue pivoting toward reopening and economic policy support.

With the current environment in mind, we intend to reduce our modest underweight in duration and will moderate our curve flattening position given our view that the Fed will complete the tightening cycle in the second quarter. Agency issuance remains light but we will continue to hold more agency debt than the benchmark due to the yield advantage versus Treasuries.

**Important information on risk**

All investments carry a certain degree of risk, including possible loss of principal, and there is no assurance that an investment will provide positive performance over any period of time. It is important to review investment objectives, risk tolerance, tax liability and liquidity needs before choosing an investment style or manager. Fixed income investments emphasize U.S. Government agency debt securities. Debt or fixed income securities are subject to credit risk and interest rates risk. The value of and income generated by debt securities will decrease or increase based on changes in market interest rates. Credit risk refers to an issuer's ability to make interest and principal payments when due.

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**Glossary**

The **Bloomberg Barclays U.S. Aggregate Bond Index** tracks the performance of U.S. investment-grade bonds. The **Bloomberg Barclays U.S. Intermediate Government Index** covers tmeasures the non-securitized component of the U.S. Aggregate Index with maturities of 1 to 9.999 years. **It is not possible to invest directly in an index.**

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