nuveen
A TIAA Company

Third quarter 2024 outlook

# Moving beyond cash


**Anders Persson**
*CIO of Global Fixed Income*

**Tony Rodriguez**
*Head of Fixed Income Strategy*


*With the highest starting yields in 15 years, many fixed income sectors already produce more income than cash. And these sectors offer the opportunity for price appreciation once the U.S. Federal Reserve starts cutting rates, while the yield on cash will simply decline. We advocate a multisector approach that takes selective risk in credit sectors. Active management remains critical, as credit spreads are likely to widen in the coming months.*

## KEY TAKEAWAYS:

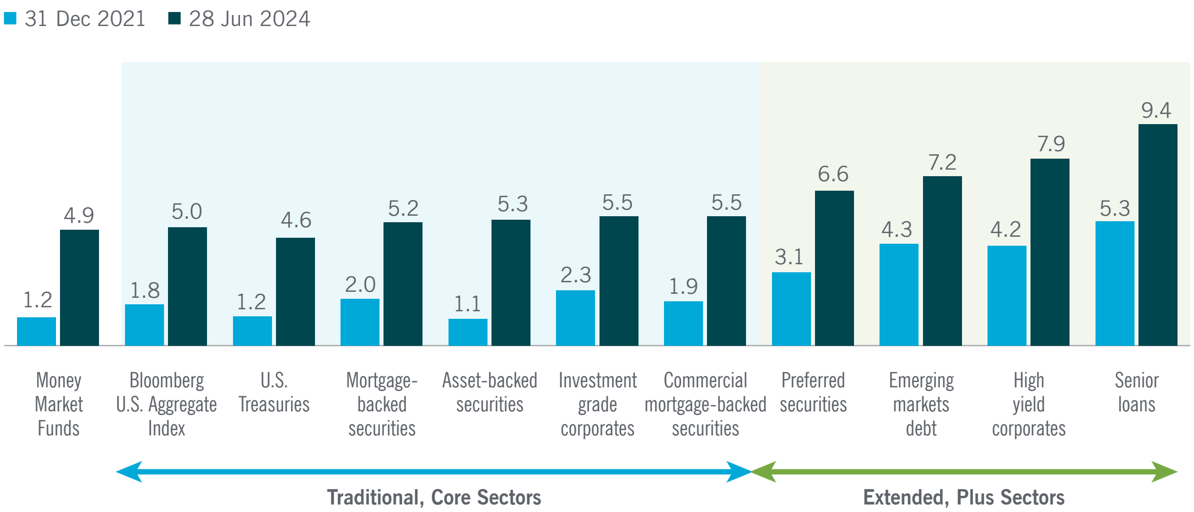
- Non-cash fixed income yields are more closely tied to intermediate-term rates, which tend to be more stable as the yield curve reshapes.
- Non-cash fixed income sectors may experience price appreciation as rates decline because their duration is greater than zero.
- We see attractive opportunities in the preferred securities market and in BB rated high yield and senior loans.

## YIELDS PRESENT THE BEST STARTING POINT IN MORE THAN 15 YEARS

Higher U.S. Treasury rates and wider credit spreads have significantly enhanced income potential (Figure 1). This may bode well for non-cash returns, since income has primarily determined fixed income returns over time.[1] In addition, because non-cash sectors are sensitive to declining rates, price appreciation is possible once the Fed begins cutting rates. Positioning portfolios for an eventual rate decline helps take advantage of those return-building yields now.

## Figure 1: Many fixed income sectors offer more income than cash

*Yield-to-worst (%)*




Data sources: Bloomberg, L.P., Credit Suisse, Morningstar Direct. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: money market funds:** average 7-day yield of all funds in the Morningstar Prime Money Fund category; **broad bond market:** Bloomberg Aggregate Index; **U.S. Treasuries:** Bloomberg U.S. Treasury Index; **mortgage-backed securities:** Bloomberg U.S. MBS Index; **asset-backed securities:** Bloomberg ABS Bond Index; **investment grade corporates:** Bloomberg U.S. Investment Grade Corporate Index; **commercial mortgage-backed securities:** Bloomberg CMBS Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **emerging markets debt:** Bloomberg EM USD Aggregate Index; **high yield corporates:** Bloomberg U.S. HY 2% Issuer Capped Index; **senior loans:** Credit Suisse Leveraged Loan Index.

## STARTING YIELD ULTIMATELY DRIVES FIXED INCOME RETURNS

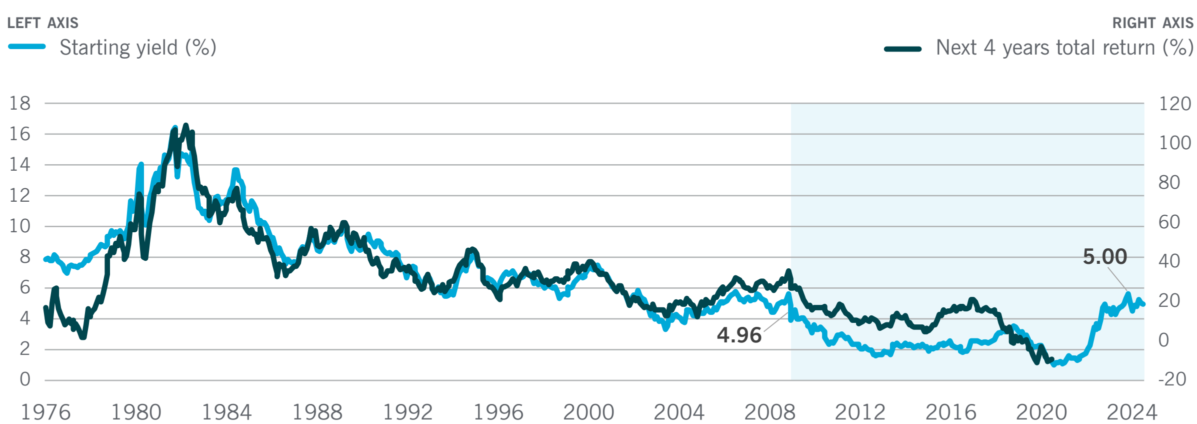
Because most fixed income returns over time come from income, attractive starting yields have been highly correlated with future total returns. See how the starting yield of the broad bond market has historically indicated total return over the next four years (Figure 2).

Non-cash fixed income sectors have two additional advantages in a declining rate environment:

**Less volatile yields.** Non-cash fixed income yields are more closely tied to intermediate-term rates, which tend to be more stable as the yield curve reshapes. Conversely, cash yields decline in lockstep with Fed rate cuts.

## Figure 2: Attractive starting yields are highly correlated with future total returns

*Starting yield versus total return over the next four years*



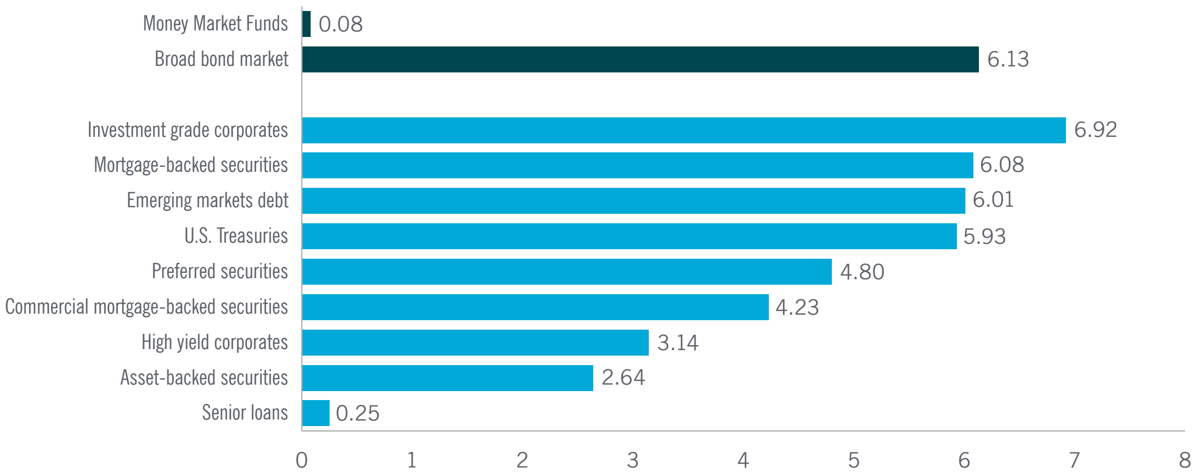

Data sources: Bloomberg, L.P., 01 Jan 1976 – 28 Jun 2024. **Past performance does not predict or guarantee future results.**



OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

### Figure 3: Non-cash sectors offer dramatically longer duration profiles

*Effective duration (years)*




Data sources: Bloomberg, L.P., Credit Suisse, Morningstar Direct, 28 Jun 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: money market funds:** effective duration of all funds in the Morningstar Prime Money Fund category; **broad bond market:** Bloomberg Aggregate Index; **investment grade corporates:** Bloomberg U.S. Investment Grade Corporate Index; **mortgage-backed securities:** Bloomberg U.S. MBS Index; **emerging markets debt:** Bloomberg EM USD Aggregate Index; **U.S. Treasuries:** Bloomberg U.S. Treasury Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **commercial mortgage-backed securities:** Bloomberg CMBS Index; **high yield corporates:** Bloomberg U.S. HY 2% Issuer Capped Index; **asset-backed securities:** Bloomberg ABS Bond Index; **senior loans:** Credit Suisse Leveraged Loan Index.

**Price appreciation.** Non-cash fixed income sectors may experience price appreciation as rates decline because their duration is greater than cash, which is near zero (Figure 3). Recall that interest rates and bond prices move in opposite directions. For each 1% decline in interest rates, a fixed income asset should appreciate 1% for each year of duration, all else being equal. For example, if rates decline 1% over the next year, the broad bond market should appreciate (0.01 * 6.13 yrs = 0.0613 = +6.13%).

> *Non-cash fixed income sectors may experience price appreciation as rates decline because their duration is greater than zero.*

## 2024 FIXED INCOME INVESTMENT THEMES

As we build portfolios, we are incorporating these main themes:

1. **Higher current yields** present the best starting point in 15+ years.
2. **Higher-for-longer** rates offer continued income opportunities.
3. **Declining longer-term rates** offer compelling total return opportunities.
4. **Managing credit risk** actively and selectivity is critical as the economy slows.
5. **Diversification** is paramount in uncertain markets.

## Consider these investment ideas

| STRATEGY | | THEME 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|---|
| **Multisector bond** | Broadly diversified, multi-sector bonds across investment grade and high yield securities offering potential for high income and reduced interest rate sensitivity | X | X | X | X | X |
| **Core plus** | Traditional U.S. fixed income with up to 30% in higher yielding plus bond sectors, which provide diversification and potential for additional return | X | X | X | X | X |
| **Core impact** | Core U.S. fixed income focused on impact and ESG leadership with goal of providing favorable returns versus the broad bond market | X | X | X | X | X |
| **Preferred securities** | Preferred and other income producing securities offering attractive income potential, qualified dividend income and risk/reward balance | X | | X | X | |
| **Senior loans** | Below investment grade senior loan securities with the potential for reduced interest rate sensitivity and high income | X | X | | X | |

## OUTLOOK

### *Credit spreads are likely to widen*

We continue to expect growth to moderate moving forward, to a below-trend pace. The risk of outright recession in developed markets has receded substantially. Job growth will likely moderate further in the months ahead and presents upside risks to the unemployment outlook. Inflation has peaked but will likely remain "too high" relative to central banks' targets this year. Nevertheless, the policy focus will likely shift from too-high inflation toward too-low growth.

We believe the Fed is done hiking rates, and we anticipate 50 bps of rate cuts this year.

The European Central Bank has started cutting rates, and we anticipate a second cut later this year. In China, policymakers are likely to continue with their fiscal policy support, though substantial monetary easing is unlikely.

We continue to favor spread sectors and credit risk in asset allocation, with an up-in-quality bias within asset classes. We believe credit spreads are likely to widen in the coming months, presenting more attractive entry points for risk taking. That said, we see attractive opportunities in the preferred securities market and in BB rated high yield and senior loans. We do not see much further upside for long-end yields.

**For more information, please visit us at nuveen.com.**

**Endnotes**

**Sources**

1 From 31 Jan 1976 to 28 Jun 2024, 100% percent of annualized total return of the Bloomberg U.S. Aggregate Bond Index was derived from coupon return, as opposed to price appreciation.

**Inflation:** U.S. Bureau of Labor Statistics Consumer Price Index for All Consumers. **Employment:** Bloomberg, L.P., Bureau of Labor Statistics, Nuveen. **Global debt and yields:** Bloomberg, L.P.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Performance data shown represents past performance and does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

**Important information on risk**

Investing involves risk; principal loss is possible. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk, and income risk. As interest rates rise, bond prices fall. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity, and differing legal and accounting standards. These risks are magnified in emerging markets. Preferred securities are subordinate to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Certain types of preferred, hybrid or debt securities with special loss absorption provisions, such as contingent capital securities (CoCos), may be or become so subordinated that they present risks equivalent to, or in some cases even greater than, the same company's common stock. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments. Non-investment-grade and unrated bonds with long maturities and durations carry heightened credit risk, liquidity risk, and potential for default.



Nuveen, LLC provides investment solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.



nuveen
A TIAA Company

GWP-3674332PG-Q0624P 1556084