nuveen
A TIAA Company

Weekly Fixed Income Commentary

11 February 2019

Treasury yields decline due to global growth concerns

U.S. Treasury yields declined last week, led by the 5-year maturity. The European Commission reduced its forecasts for global growth, sparking investor anxiety. Further dovish commentary from the Federal Reserve (Fed) brought a focus to inflation expectations.

HIGHLIGHTS

- **Commercial mortgage-backed and investment grade corporate bonds produced the best returns.**
- **Municipal bonds rallied for the second consecutive week, helped by strong demand.**
- **High yield corporate returns were modestly positive, despite spreads widening.**

Bill Martin
Head of Taxable Fixed Income

John Miller
Head of Municipals

GLOBAL GROWTH CONCERNS DRIVE TREASURY YIELDS DOWN

U.S. Treasury yields rose slightly midway through last week before global growth concerns dragged yields lower.[1] On Thursday, the European Commission cut its 2019 economic growth forecast, and the 10-year German Bund yield declined to the lowest level since October 2016.[1] U.S. Treasury rates followed global yields lower, led by the 5-year maturity, with additional declines on Friday as the outlook for a U.S./China trade deal deteriorated.[1] Rates finished the week lower across all maturities.[1]

Anxiety regarding global growth stoked a risk averse market sentiment last week. Despite modestly positive total returns, most non-Treasury sectors underperformed similar-duration Treasuries.[1] Commercial mortgage-backed securities and investment grade corporates performed best and outperformed Treasuries.[1] Negative risk sentiment hurt preferred securities and high yield corporates on a relative basis, although both sectors posted slightly positive total returns. Likewise, emerging markets underperformed with a slightly positive total return. The global aggregate sector was the only sector with a negative total return for the week, dragged down by a nearly 1% loss in the European region.

The Fed's dovish comments caused an intense market focus on inflation. The Fed statement referred to "lower market-based measures of inflation compensation" as well as "muted inflation pressures." We should note, however, that several market-based measures of inflation, including the Fed's 5-year Forward Inflation Expectation Rate, have steadily increased in 2019 since bottoming to begin the year. On Wednesday, investors will closely watch the consumer price release.

Municipal bonds may remain more expensive than their taxable counterparts due to elements of tax reform.

DEMAND FOR MUNICIPALS DRIVEN IN PART BY CHANGES IN TAX CODE

Municipal bonds rallied for the second consecutive week, following the path of U.S. Treasuries.[1] New issuance totaled $6.1 billion last week, and was readily absorbed.[2] Weekly fund flows were strong again at $1.149 billion.[3] This week's new issue supply is expected to be $6.4 billion and should be readily absorbed.[2]

The fixed income markets continue to have a strong tone, primarily due to the Fed's announcement that it intends to slow the pace of rate hikes. The municipal market has received an additional boost from continued strong demand for tax-exempt bonds. We believe fixed income markets will remain stable until we see more signs of impending inflation.

The state of Hawaii issued $575 million general obligation bond (rated Aa1/AA+).[4] Strong interest in the deal allowed underwriters to lower yields before final pricing. This deal exemplifies the current municipal market. Many experts cite that high grade tax-exempt bonds are historically expensive versus their taxable counterparts, but demand for municipals remains strong. We believe municipal bonds may remain more expensive than their taxable counterparts due to tax reform that reduced many tax deductions for high income investors, including reducing state and local tax (SALT) exemptions.

High yield municipal bond yields continued to decline last week, but again did not keep pace with the faster declines in high grade yields.[1] Credit spreads widened as a result, after narrowing in the first three weeks of January.[1] However, high yield municipal bonds have outperformed Treasuries year to date.[1] High yield municipal bond fund flows saw a net inflow of $295 million last week and $1.6 billion year to date.[3] This is a stark contrast to -$2.8 billion of net outflows during the fourth quarter of 2018.[3]

INVESTMENT GRADE CORPORATES CONTINUE TO BUILD ON GAINS

Investment grade corporate bonds were well-bid last week amid favorable supply and demand factors.[1] The asset class outperformed both safe-haven U.S. Treasuries and high yield corporate bonds.[1] Investment grade credit has not posted a weekly loss since early December.[1] Light issuance and steady investor appetite continued to provide key support last week.[2] Eight issuers came forward to price $10.35 billion of new debt.[2]

High yield corporates lagged their investment grade counterparts for the third straight week.[1] High yield experienced only modestly positive performance, as spreads widened and late-week losses partly offset earlier gains.[1] A drop in oil prices led high yield bonds lower on Thursday and Friday, putting a significant dent in the energy sector's full-week performance.[1] From a trading perspective, most of the attention was on the primary market, where new issues totaling $7 billion were offered.[2]

Investment grade credit has not posted a weekly loss since early December.

Emerging markets (EM) debt eked out a small gain, helped by continued fund flows, but hindered by a stronger U.S. dollar versus major EM currencies and diminishing hopes for a quick trade deal between the U.S. and China.[1] Both sovereign and corporate new supply was subdued.[2] Asia was particularly quiet last week, with much of the region observing the Chinese New Year. Secondary market trading in Venezuelan sovereign bonds was severely curbed given further U.S. sanctions.

In focus

High yield corporates offer income and appreciation potential

Following a volatile fourth quarter in 2018, we believe high yield corporates are well-positioned for attractive returns in 2019.

Investors withdrew nearly $50 billion from U.S. high yield funds in 2018.[5] Redemptions accelerated in the fourth quarter due to growing investor concerns over an impending global recession. In a year of light new issuance, a liquidity crunch further exacerbated high yield underperformance.

Returns rebounded in January to nearly pre-fourth quarter levels, and the sector currently sits among the top performing fixed income asset classes year to date.[1]

We believe this positive performance trend has the potential to continue in 2019, particularly as market expectations for future Fed rate increases continue to diminish.

Sector fundamentals remain strong. Net leverage ratios continued to decrease in 2018 and default rates are expected to remain well below historical averages, at 3.2% as of December 2018.[6] More specifically, we think high yield issuers appear to be well-positioned to weather potentially slower economic growth in 2019. Interest coverage margins are improving and crude oil prices have stabilized after a precipitous fall in the fourth quarter.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	2.47	-0.04	0.01	-0.02
5-year	2.45	-0.06	0.01	-0.07
10-year	2.64	-0.05	0.01	-0.05
30-year	2.98	-0.04	-0.02	-0.03

Source: Bloomberg L.P. As of 8 Feb 2019. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	1.61	-0.03	-0.04	-0.17
5-year	1.70	-0.06	-0.06	-0.24
10-year	2.12	-0.05	-0.05	-0.16
30-year	2.97	-0.05	-0.05	-0.05

Source: Bloomberg L.P. As of 8 Feb 2019. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	81
30-year AAA Municipal vs Treasury	100
High Yield Municipal vs High Yield Corporate	71

Source: Bloomberg L.P., Thompson Reuters. As of 8 Feb 2019. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	2.55	–	6.35	0.30	0.27	1.02
High Yield Municipal	4.91	210[7]	8.94	0.31	0.30	0.97
High Yield Municipal, ex Puerto Rico	4.89	208[7]	7.85	0.25	0.24	0.89
Short Duration High Yield Municipal[8]	4.24	240	3.79	0.14	0.14	0.79
Short Duration High Yield Municipal, ex Puerto Rico[8]	4.13	229	3.67	0.07	0.07	0.69
U.S. Aggregate Bond	3.16	47[9]	5.94	0.38	0.13	1.20
U.S. Treasury	2.57	–	6.21	0.41	0.13	0.60
U.S. Government Related	3.24	68[9]	5.41	0.34	0.22	1.22
U.S. Corporate Investment Grade	3.89	126[9]	7.28	0.46	0.32	2.68
U.S. Mortgage-Backed Securities	3.31	36[9]	4.65	0.27	-0.06	0.74
U.S. Commercial Mortgage-Backed Securities	3.26	74[9]	5.27	0.63	0.31	1.36
U.S. Asset-Backed Securities	2.91	42[9]	2.11	0.21	0.13	0.60
Preferred Securities	4.96	204[9]	4.96	0.08	0.17	5.35
High Yield 2% Issuer Capped	6.89	422[9]	3.66	0.17	0.29	4.83
Senior Loans[10]	7.31	477	0.25	0.28	0.31	2.62
Global Emerging Markets	5.46	288[9]	5.72	0.09	0.11	3.30
Global Aggregate (unhedged)	1.93	52[9]	7.05	-0.23	-0.48	1.03

7 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **8** 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. **9** Option-adjusted spread to Treasuries. **10** 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. As of 8 Feb 2019. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. 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. All indices are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 8 Feb 2019. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 6 Feb 2019. **5** Morningstar. **6** Wells Fargo Securities, Moody's.

Any reference to municipal 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.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy or sell securities, 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 advisors.

A word 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. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Preferred securities are subordinated 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, default risk and adverse economic developments. The value of convertible securities may decline in response to such factors as rising interest rates and fluctuations in the market price of the underlying securities. Senior loans are subject to loan settlement risk due to the lack of established settlement standards or remedies for failure to settle. These investments are subject to credit risk and potentially limited liquidity, as well as interest rate risk, currency risk, prepayment and extension risk, and inflation risk

Investors should contact a tax advisor regarding the suitability 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.

This information represents the opinion of Nuveen, LLC and its affiliates and is not intended to be a forecast of future events and or guarantee of any future result. Information was obtained from third party sources which we believe to be reliable but are not guaranteed as to their accuracy or completeness. There is no assurance that an investment will provide positive performance over any period of time.

The investment advisory services, strategies and expertise of TIAA Investments, a division of Nuveen, are provided by Teachers Advisors, LLC and TIAA-CREF Investment Management, LLC. Nuveen Asset Management, LLC, Symphony Asset Management LLC and NWQ Investment Management Company LLC are registered investment advisers and affiliates of Nuveen, LLC.