ALLIANCEBERNSTEIN®

May 2020

Market Update – Daily Fixed Income Trading Liquidity Update 12 May 2020

In the current markets, volatility has been elevated and liquidity has become reduced across many fixed income instruments including government bond markets. Liquidity management has been a heightened focus for AllianceBernstein for years, as we recognized the reduced liquidity in the marketplace after the 2008-2009 financial crisis. We view liquidity management as a business imperative.

In an effort to provide timely updates for our clients on fixed income market trading liquidity, we have developed the following update, aggregated from our traders towards the end of the New York trading day.

Sector	Liquidity Trading Comment	Bid-Ask Spreads
US Treasuries	• The open-ended bond purchase program enacted by the US Federal Reserve (Fed) is having a positive effect on liquidity and market functionality. The Fed has reduced their purchases of US Treasuries to $7bn per day during the week of May 11 (from $8bn per day the week of May 4). • Global developed-market government bonds rallied on May 12, driven by a combination of record government bond supply that was well-received by the market and an equity market selloff amid negative covid-19 headlines (LA County stay-at-home orders extended for the next 3 months; Dr. Fauci's Senate testimony about re-opening the economy slowly) • The U.S auctioned a record $32bn new 10-year note ($5bn larger than last time) at 0.70% yield to a very strong end user demand. • Inflation breakevens had little reaction to the -0.8% April CPI print that was widely expected to be terrible. Breakevens did weaken into the market close, as the beta of inflation has been very closely tied to the re-opening in the economy.	Bid-offer spreads for on-the-run benchmark 2- through 10-year US Treasury notes has improved significantly and are in line with pre-crisis conditions. For the 30-year note, bid/ask is ~2x wider vs pre-crisis. Off-the-run Treasury bonds still trade significantly wider than on-the run bonds, but bid/offer has compressed. TIPs bid/ask is 2-3x wider vs pre-crisis levels
Investment Grade (IG) Corporates	**US IG** • US IG cash bonds, particularly shorter-maturity bonds, traded with a very firm tone on May 12, outperforming the broader macro tone and the synthetic market. • New issue supply remains busy with $34.6 bn in new issues coming to market on May 11 and 12. The market continues to see some companies that issued last month return to the market. Some of this	US IG spreads are generically 3-4x wider vs normal market conditions AT1/Preferreds are 2-3x wider vs normal market conditions

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	activity is to refinance shorter-maturity debt since all-in yield levels are attractive from an issuer's standpoint. Concessions ticked up and investors are being selective by issuer/deal. • Bid/ask spreads remain wider than pre-crisis levels. **European IG** • Supply levels have begun to pick up in the European IG market, with both well-known and niche issuers continuing to tap primary markets. • The decent uptick in primary market activity is diverting attention from the secondary market, causing liquidity to drop a bit there. • Liquidity in the AT1 (subordinated financial) market remains incredibly technical and very bond-/issuer-specific. In spots such as core high-quality issuers, bid/offer spreads were back to pre-selloff levels, but in more niche and second-tier names where dealers have no agenda, it remains wide. Volumes have been very low. **REIT Preferreds** • Liquidity in the REIT preferred market is limited under more normal conditions, but has improved from 1-1.5 months ago. • Dealers are only providing balance sheet capacity on select issuers, so for many issuers, trades must be done on an agency basis; trading is therefore limited. • Trading volume is trending low since valuations have recovered a good amount.	
High Yield (HY) Corporates	**US HY** • The tone of high yield in recent weeks has been tied to equities—with high yield closely following equity market moves. • On May 12, the US high yield market was generally up, but certain names were quoted lower with equities heading into the market close • The secondary market remains quiet as the focus remains on the new issue market. There have been ~$5bn in new issues priced during the first two days of the week (May 11-12). **European HY** • Daily sentiment has dislocated somewhat between cash bonds and equities/the iTraxx Crossover index. After several weeks of outperformance in cash bonds, the market has begun to lag modestly.	Spreads are 0.75-1.25 point wider than normal times for BB-rated securities Spreads are 1.5-2 points wider than normal times for B-rated securities Spreads are 3 points wider than normal times for CCC-rated and below securities CDX HY bid/ask is 2-3x vs normal conditions.

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	• The first signs of new issuance have highlighted the constructive market tone. • Idiosyncratic risk is in focus as potential defaults/restructurings loom. • Technicals remain broadly constructive, as flows are generally positive, investors are more conservatively positioned and primary issuance remains light. • The market continues to see healthy two-way flows but bid/ask spreads remain elevated. **CDX HY** • CDX HY slightly underperformed the broader macro tone, driven primarily by the announcement that the Fed was able to begin buying credit ETFs on May 12. • Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	
Emerging-Market Debt (EMD)	**Hard Currency EM** • It was a firm start to the week for hard currency EM debt as JP Morgan EMBI Global Diversified index spreads hit the tightest levels in two-months, but sentiment then faded at the end of Tuesday, May 12 as EM tracked global macro and equity sentiment weaker. • Issuance remained robust with ~$6bn in new issues over May 11-12, across a range of high-quality quasi-sovereign and corporate issuers, with deals well-subscribed even in the face of limited new issue premia. • Liquidity continues to improve as transaction costs have slightly narrowed over the last week. **Local Currency EM** • Local EM rates have begun to compress towards low developed-market rates as dovish central banks across emerging markets cut rates. • Liquidity is close to normal	EM IG sovereigns are 1.5x wider vs normal market conditions EM HY sovereigns are 2x wider vs normal market conditions EM IG corporates are 2x wider vs normal market conditions EM HY corporates are 3x wider vs normal market conditions
Securitized	**CMBS** • Given the strength of the first new issue last week, it is no surprise that the second, which launched Monday May 11, was also well-received. The deal was mostly pre-placed at spreads tighter than the previous offering. • In the secondary market, the top of the capital structure continues to trade well. The market for lower-quality tranches is beginning to generate some interest. Trades are occurring at somewhat less-distressed prices, but investors are assessing collateral using relatively severe downside scenarios.	

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	• Bid/offer spreads have compressed but remain elevated. CMBS AAA, AA/A, and BBB bid/offer spreads are approximately 3x, 3x, and 4x pre-COVID levels. • Volumes in CMBX.6 remain depressed and are expected to remain so until the latest remittance data, which has begun to be published, is digested. Given the low transaction volume, liquidity remains unchanged. Bid/offer spread for CMBX A.6 is ~2x, BBB-.6 is ~3 x and BB.6 ~5x the normal bid/offer spread. **ABS** • ABS saw a quiet start to the week with $1.3bn trading in the secondary market over the two days ending May 12, compared to the 20-day *daily* average of $1.1bn. • Spreads continue to tighten despite limited new issuance. Volkswagen Auto Loan and Verizon Cell Tower priced their securitizations tighter relative to initial price thoughts. We expect additional deals this week from student loan and unsecured consumer loan programs and expect pre-marketing of new subprime and prime auto loan deals to begin later this week. • On May 12, the Fed posted an updated TALF Term Sheet and accompanying FAQ. The Term Sheet is similar in substance to April's with no significant changes around Eligible Borrower and Eligible Collateral. The update remains silent as to when TALF will 'become operational' but the Fed left September 30, 2020 as the program end date (which they can extend). **CRTs** • The CRT market continues to plug along. The wall of money looking to invest in the space seems to be driving spreads tighter. This technical seems to have moved in one direction since early April. • Investment-grade rated last cash flow bonds seem particularly well bid. Spreads have tightened the most in these bonds, which ended the week in the low 300 bp range. Newer vintage last cash flow bonds that do not have the benefit of the investment-grade rating are not far behind. They are currently trading in the 400-500 bp range. • Equity tranches are trading in the 800-1100 bp range. B1 bonds with some credit enhancement are at the tighter end of that range and older Bs that	

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	represent the 0-100 slice of 2015 and 2016 deals trade just north of 1000 bp. • While bid/ask spreads have come in measurably since the peak of the crisis, they were unchanged week over week. **Legacy Non-Agency RMBS** • Legacy RMBS continues to trade through the recent crisis. Since January spreads have widened from ~ 200bp to now in the 1000 bp range, but demand for the sector never really faded. **CLOs** • Primary market issuance is the real news in the CLO market. The new issue calendar has opened up for top- and mid-tier managers. • With AAA-rated tranche spreads well inside 200 bp for better enhanced deals, it makes sense for managers to tap the market. At the same time, these levels are still historically wide, making AAA-rated CLO tranches very attractive for banks, money managers, and insurance company investors alike. • The AA- and A-rated tranches have also been oversubscribed on these new deals. • The BBB- and BB-rated tranches have been retained by managers as the market for these securities has not come back. Too many questions remain about loan rating downgrades and how far up the stack that will affect losses and in turn spreads. • Bid/ ask spreads on AAA/AA/A rated bonds have come back to normal; mezzanine bid/ask remains elevated at roughly 2x normal. **Agency MBS** • Bid/ask spreads in Agency MBS have returned to pre-crisis levels, driven tighter by the combination of Fed buying and increased investor interest. Bid/offer for lower coupon bonds is just ½ of a tick wide.	
Money Market	• LIBOR continues to set lower as short-maturity markets stabilize. 1-month LIBOR set at 0.184% and 3-month at 0.424%. Prime money market funds saw $48bn of inflows during the 7 days ending May 11, while government money market fund inflows have slowed. This has been driving 3-month LIBOR lower. • T-bill and repo rates have widened but remain within their recent corridor. • Focus remains on Fed Funds futures trading with negative yields in late 2020/2021, which has been	

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	driven primarily by technical factors. Fed speakers this week have reaffirmed their view that negative rates in the US are not an appropriate policy tool. The market awaits Chair Powell's comments in a speech on May 13.	
US Municipals	• Short-maturity municipal bonds continue to outperform longer-maturity debt. • Purdue University came to the new issue market with a deal that tightened 12-16bp amid double digit subscription demand. Lower-quality issuers remain opportunistic and wait for particularly strong days, as they have more trouble getting deals done. • Odd lot liquidity is a tale of two worlds – high-quality, shorter-maturity debt can be sold with lower concessions than we've seen recently, while longer-dated and/or lower-quality bonds continue to see deep haircuts vs round lot bidside evaluation. <1mm pieces are still receiving bids anywhere from 1 to 6pts below round lot bidside evaluations. • High yield odd lot liquidity remains challenged with it very difficult to solicit a bid. • For context, high grade odd-lots typically trade 0.10-1 points below round lot bid-side evaluations under more normal market conditions.	
Canadian Market	**Federal** • Liquidity is best in benchmark issues for block sizes of <=CAD25m; limited liquidity in off-the-run, high coupon bonds but the Bank of Canada buying program will help liquidity in the sector. **Provincial** • Liquidity is best in benchmark bonds from Quebec, Ontario and British Columbia • Concessions are requested so dealers will take less liquid positions. • Very limited secondary-market liquidity in oil-generating provinces (Newfoundland, Alberta, Saskatchewan) with Western Canadian Select oil price trading at low levels. • Most dealers will not bid on off-the-run, high coupon provincial issues, they will do agency trades. They may not bid for provincial issuers where they have existing balance sheet positions. • The Bank of Canada's C$50bn buying program of provincial debt should support liquidity. **IG Corporates** • Limited liquidity; many dealers are maintaining low	Federal: bid/ask typically +1 to +2bp but for the long end of the curve, it can be more depending on volatility Provincial: concession of +1 to +2bp and more on size > CAD 25m, particularly at the longer end

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	balance sheet inventories, so will not provide bids in many sectors. • Trading on an agency basis for high-beta issuers. The market has improved in sectors such as banks. However, there was limited dealer appetite for telecom credits after the new BCE 10- and 30-year issue came to market on May 11. • The Bank of Canada's buying program of corporate debt should support liquidity in the secondary markets for BBB and higher-rated securities; BBB- are trading by appointment. **Real Return Bonds (RRBs)** • Trading "by appointment", similar to private placement market	

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