AllianceBernstein®

December 2020

Market Update – Fixed Income Trading Liquidity
For the Week Ended 18 December 2020

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 at the end of each week.

Sector	Liquidity Trading Comment	Bid-Ask Spreads

US Treasuries	• Several key themes continued to dominate movements in the rates markets during the week ended December 18:
	  ○ The push and pull around rising covid-19 cases and hospitalizations versus vaccine rollout and distribution. In the past week, price action focused more favorably on vaccine rollout, with interest rates selling off and risk assets continuing to trade well.
	  ○ FOMC policy, which remains accommodative. The Fed did not extend the weighted average maturity of their asset purchases during their meetings which concluded on December 16.
	  ○ Positioning and technical signals suggest investors are neutral duration and favoring curve steepening positions.
	  ○ Flows: The last US Treasury auction cycle of 2020 showed strong demand statistics vs 12-month averages. Of note, Japanese investors have begun buying USD rates at current levels as they are more attractive on a cross-currency basis.
	  ○ Core Europe remains well supported by the ECB liquidity programs, with rates trading within multi-month ranges despite the rally in risk assets globally.
	• The past week was likely the last week of ample market depth to move risk since holiday liquidity is expected to take hold beginning December 21.
	• Federal Reserve bond purchases stand at $80 billion US Treasuries and $60 billion MBS per month.
		Bid-offer spreads for on-the-run and off-the-run US Treasuries and TIPS are have returned to pre-crisis conditions.

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	• Liquidity in nominal Treasuries and TIPS as measured by bid-offer spreads has returned to the width seen before the US election, with on-the-run 10-year and 30-year notes trading ½ and 1 tick wide respectively.	
Investment Grade (IG) Corporates	**US IG** • The week ended December 18 began with a negative tone, but market conditions improved over the course of the week. Spreads on the IG index tightened 5 bp on the week to +100 bp. For context, the index's YTD tight was +93 bp on Jan 22. Buyers returned to the market with $4bn lifted from dealer balance sheets during the week. • As expected, liquidity continues to thin as dealer appetite remains light heading into year end. • Demand from Asia remained muted and the primary market was quiet as expected, with only $3bn in deals pricing. • The technicals remain supportive, as the market saw inflows of $1.7bn and supply is expected to remain muted until January 4. • Bid/ask spreads remain wider than pre-crisis levels. **European IG** • The week ended December 18 saw very light activity despite news flow, with spreads continuing to grind tighter amid solid technicals and macro strength. In general, UK banks outperformed as positive Brexit headlines emerged and many investors are underweight the space. **REIT Preferreds** • Liquidity in the REIT preferred market is typically limited under more normal conditions given the retail nature of the investor base. Current liquidity is better than in March and April but is still not back to normal. • 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 continue to recover.	US IG spreads are generically 1-1.5x wider vs normal market conditions AT1/Preferreds are 1-1.5x wider vs normal market conditions
High Yield (HY) Corporates	**US HY** • Similar to last week, investor focus was on the new issue market during the week ended December 18, as an array of issuers brought 20 deals for a total of $10.96bn notional. Deals continue to be well	Bid/ask spreads vary by issuer but generically: BB-rated securities: 1 point, which is in line

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	oversubscribed (up to 10x). New issuance is expected to slow dramatically through year end. • The HY index spreads moved 6 bp tighter to 378 bp. This compares to March 23 wide levels of 1100 bp and pre-covid-19 tight levels of 341 bp on Feb 13. Energy and lower-rated issuers continue to outperform, with energy bond spreads tightening 13bp to 544 bp and CCC-rated bond index spreads rallying 23 bp to 677 bp. • The CCC-BB spread was 18 bp tighter at 398 bp. This compares to April 6 wide levels of 1139 bp and pre-covid-19 tight levels of 613 bp on February 13. **Euro HY** • The Euro HY market saw mostly sideways trading activity during the week ended December 18, with light secondary market activity. • Two CCC-rated deals came to the primary market, pricing well through initial price guidance and trading up on the break, which further supported the compression trade theme. Investors continue to have appetite for above-market yielding risk. • There was a little more two-way flow, and some of the covid restriction headlines weighed on specific issuers on the margin. • The market is expected to be notably quieter heading into the final couple weeks of the year. **CDX HY** • CDX HY traded better along with macro sentiment during the week ended December 18. The beta compression theme continued with CDX HY outperforming IG. • Trading volumes dipped down heading into the holidays. Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	with normal market conditions B-rated securities: 1 point, which is in line with normal market conditions CCC-rated and below: 1.5points which is in line with normal market conditions CDX HY bid/ask is 1-2x vs normal conditions.
Emerging-Market Debt (EMD)	**Hard Currency EM** • EM credit index spreads closed the week ~13bp tighter during the week ended December 18, driven by positive technicals and a constructive global risk backdrop. Holiday illiquidity – in terms of significantly reduced trading volumes – is in full swing as many market participants have begun their holiday breaks after a tumultuous year. **Local Currency EM** • Liquidity is close to normal.	EM IG sovereigns are back to normal market conditions EM HY sovereigns are back to normal market conditions EM IG corporates are back to normal market conditions

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		EM HY corporates are back to normal market conditions
Asia	**Asia Hard Currency** • Asia hard currency credit spreads ground tighter in thin liquidity during the week ended December 18, the index spread rallied by a modest 2bp. • The primary market slowed, with $1.4 billion in new supply getting priced, which is likely to be the final batch of issuance in 2020. • Liquidity deteriorated due to reduced primary market supply and year-end vacations taken by a number of dealers in the market. **Asia Local Currency** • Liquidity in Asia local currency markets thinned during the week ended December 18, as trading activity subsided into the year-end. • Indonesia government bond yields gapped lower in thin liquidity as foreign investors were seen buying aggressively, and the curve rallied ~15 to 30bp on the week. 10-year benchmark bonds breached the psychological 6% support level. • On December 15, the People's Bank of China surprised the market by conducting CNY950bn in medium-term lending (MLF) versus 600bn in maturities, driving the China government bond yield curve to bull steepen by ~1 to 10 bp over the week.	Asia IG credit is ~1.5 to 2x wider vs. normal market conditions Asia HY credit is ~1.5 to 2x wider vs. normal market conditions Asia local currency debt is ~1.5 to 2x wider vs. normal market conditions
Securitized	**CMBS** • In the CMBS market, demand remained robust for bonds throughout the capital structure during the week ended December 18. The credit curve maintains its flattening bias, as the new issue AAA/AA spread has tightened 15bp since mid-November. Issuance is expected to be nearly finished for the year. Two conduit deals priced during the week, and consistent with other recent new issues, most classes were oversubscribed and priced at or through initial price guidance. In fact, the tightest spread on a 10-year AAA-rated new issue (swaps +71 bp) came on the last new issue of 2020. • Bid/offer spreads remain unchanged. Bid/offer spreads for AAA to A-rated classes have retraced their post-covid-19 widening, while bid/offer spreads for BBB-rated classes remain approximately 2x their pre-covid-19 levels.	

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	• CMBX prices remained largely unchanged week-over-week. Flows seemed dominated by investors and dealers squaring positions before year end. Given the lack of significant flows, the market expectation is that CMBX will generally trade in a narrow band for the remainder of the year. Pockets of increased liquidity can be discovered that temporarily narrow bid/offer spreads, but that liquidity can dissipate quickly. On average, bid/offer spreads have not changed. CMBX A.6, BBB-.6, and BB.6 bid/offer spreads remain approximately 2x their historical averages. **ABS** • The ABS primary market priced one $300mn servicer advance ABS deal during the week ending December 18. ABS year-to-date supply now stands at $175.3 billion compared to $228.5 billion recorded in 2019 over the same time period. • ABS spreads tightened in auto and student loan sectors during the week, on the back of technical momentum. Across ABS asset classes, spreads on AAA-rated senior tranches are currently well through levels where they started 2020, while spreads on most BBB-rated and lower-rated ABS stand wider vs the beginning of the year. • BB-rated subprime auto ABS spreads are currently 260bp vs 205bp to start the year. However, BBB-rated subprime auto ABS are an exception, with indicative spreads currently at swaps+100bp, vs 113bp in the beginning of 2020. **CRTs** • During the week ended December 18, CRT spreads ratcheted tighter as investors looked to put money to work before year end. The CRT sector was playing a bit of catch up with ABS/CLO over the past couple weeks. Generically, last cash flow bonds were a quarter- to a half-point higher and B1 bonds were up 0.5 to one point. The real story of the week was B2 bonds. Pre-covid bonds that were marked in the 80s traded up 10 to 12 points into the mid to high 90s; post-covid bonds were up roughly 5 points. This rally spilled over into the MI CRT segment of the market as well, where B1 bonds were up 4 to 6 points on the week and last cash flow bonds were anywhere from 1 to 3 points higher.	

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	• Secondary market liquidity remains robust. Dealers are actively making two-way markets and the buy and sell flow has been fairly balanced. **Legacy Non-Agency RMBS** • Legacy RMBS have recovered back to pre-crisis levels. After having widened to the 1000-1200 bp range in March, spreads are currently trading inside 200 bp discount margin currently. **CLOs** • The week ended December 18 saw little change to primary spreads. The 5-10bp concession between 5-year and 3-year reinvestment deals remained unchanged. Positive technicals continued to provide tailwinds on the lower-rated tranches (AA to BB). • The secondary market seemed to move in concert with the primary market for all but the BB-rated class. With supply drying up going into year end, demand has been forced into the secondary market. Spreads on BB-rated bonds in the secondary market were generically tighter by 10-15bp this week. • Liquidity remains robust in the CLO market. Bid/ask spreads remain at or around pre-crisis levels. **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	• The repo rate is in the 0.08-0.09% range. SOFR is consistently setting at 0.09%. The T-bill curve was unchanged week-over-week. • The market was waiting for the potential approval of a fiscal stimulus package. Should one be passed, we will see an uptick in T-bill supply in the very near term. Any package less than $1trillion will still result in negative net T-bill supply for 2021 and 2022. This will drag key money market rates towards zero where the Fed will most likely need to step in with adjustments to repo facilities or to the interest rate on excess reserves (IOER). • 1-month LIBOR set at 0.14%, while 3-month LIBOR set at 0.24%. • Government money market funds saw outflows of $16 billion in the 7 days ended December 17. Prime funds saw $19 billion in outflows over the same	

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	period. This was largely due to corporate tax day which was December 15.	
US Municipals	• The technical backdrop in the municipal market remains supportive with the combination of strong inflows and limited supply. With benchmark yields near all-time low levels, investors are moving down the credit spectrum which has caused significant spread compression in mid-grade and high-yield credit over the past few weeks. • In the primary market, new issues were met with strong demand. A few notable examples include the $800mn Connecticut GO deal where books were 4-6x oversubscribed, $1.5bn taxable NY City GO deal at 3-4x oversubscribed, and the $250mn Bard College BB+ deal which was 13x oversubscribed. • Odd lot liquidity has improved, with discounts consistently staying under $1 on average.	
Canadian Market	**Federal** • Liquidity is best in benchmark issues for block sizes of <=CAD25 million; liquidity has improved in off-the-run, high coupon bonds with Bank of Canada (BOC) bond buying. Comments by central bank Governor Macklem that the BOC will buy at least $4 billion of Canadian government bonds per week until the recovery is well underway should continue to support market liquidity. The fact that the BOC will buy more bonds at the long end of the curve should support liquidity at the 30-year part of the yield curve. • The BOC has purchased C$179.6 billion to support liquidity in Government of Canada markets since the purchase program started on March 27 through December 9. Government of Canada bonds are the most liquid securities in capital markets in Canada as seen in the latest (November) Bank of Canada research. **Provincial** • Liquidity is best in benchmark bonds from Quebec, Ontario and British Columbia. • Depending on market tone, concessions may be requested in order for dealers to take less-liquid positions. • Most dealers will not bid aggressively on off-the-run, high coupon provincial issues, they will do agency trades, even with the Bank of Canada's buying program of provincial debt.	Federal: bid/ask typically 5 cents in the 10-year area, but for the long end of the curve, it can be more depending on volatility (risk off markets) and size outstanding. Off the run Canadas can have a wide bid-ask given small outstanding size in these securities. Provincial: concession of +1 bp and more on size > CAD 25 million, particularly at the longer end. In risk-off markets, liquidity is drying up and spreads can widen depending on market tone.

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	• The BOC has purchased C$12.9 billion in par value year to date through December 9 within their provincial buying program to support liquidity. With year-end approaching, liquidity may be affected by reduced personnel during the holiday period and dealers' lack of appetite for increasing their provincial aggregates. **IG Corporates** • The latest Bank of Canada research highlights the lack of liquidity in Canadian corporate bond markets, which can impact pricing; many dealers are maintaining low 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 and telecom companies. • The Bank of Canada's buying program (focused on securities of 5-years or less) should support liquidity for corporate bonds rated BBB and higher. However, the central bank has bought a relatively small amount of corporate securities to date (C$180 million par), indicating the impact is limited. The central bank did not buy bonds last week (as of December 9). BBB- bonds are trading by appointment unless there is a new issue. **Real Return Bonds (RRBs)** • The program to purchase Government of Canada securities in the secondary market – the Government Bond Purchase Program or GBPP – should help liquidity since it includes RRBs. The last auction was held on December 2 with the FTSE index duration extending by a historical amount of over 1.6 years. On that day, the BOC bought a total of C$434mn with a target of C$75 million per line of the 7 Canada RRBs from 2021 to 2047. Even with the central bank buying net C$34 million of Canada RRBs in December, liquidity remains challenging as dealers hold very limited inventories of these RRB securities. It is noteworthy to underline that the central bank was not able to reach its target purchases in RRBs 2047 and only bought $59 million. Trading in Canada RRBs continues to show a chronic lack of liquidity. Trading a block can only be done on an appointment basis.	BBB- corporates are trading by appointment, particularly in the energy sector. Inventories are reduced and dealers are not looking to increase their BBB- exposure. Dealers may refuse to bid in a risk off market with gaps in spreads. Provincial RRBs trading by appointment only. Dealers do not hold these securities on their balance sheet.

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