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June 2020

Market Update – Daily Fixed Income Trading Liquidity Update 5 June 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 $4bn per day during the week of June 8 (from $4.5bn per day the week of June 1). • Interest rates sold off during the week of June 1, led by 30-year bonds. • 3 key areas of focus in the market this week are: 1. Supply: Total gross supply will be $92 bn, with a net cash raise of $69 bn. 2. Technicals: Particularly in 30-year bonds, where 1.75% is a major support level that market participants will be watching. 3. The Fed: On Wednesday the Fed will likely get questions on negative rates and yield curve control (YCC). Market expectations are for the Fed to study YCC further and potentially implement in September.	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' performance was strong during the week of June 1, once again led by high-beta issuers. The US IG index tightened by 28 bps, the strongest one-week performance since mid-April. • New issue supply continues to slow down, but remains elevated compared to last year, with $46 bn in new issues coming to market for the week ending June 5. Most noteworthy is that supply from covid-	US IG spreads are generically 2x wider vs normal market conditions AT1/Preferreds are 2-3x wider vs normal market conditions

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	19-exposed issuers picked up, such as Southwest Airlines and AerCap Holdings. These issuers attracted strong demand, priced through fair values and re-priced existing bonds tighter. • Bid/ask spreads remain wider than pre-crisis levels. **European IG** • The extremely firm macro tone that prevailed during the week of June 1 caused the liquidity picture to be very one-dimensional. Sellers of risk even in previously "unloved" issuers have been able to sell very easily (the higher beta the credit, the better the liquidity). Whereas buyers of risk have had a very challenging time and have had to rely on inventory as opposed to short offers. • Markets re-priced so quickly over portions of the week that the framed context was often stale with trades occurring above those levels. **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 rally continued in the US high yield market during the week of June 1, as equities moved higher and strong technicals pushed high yield higher throughout the week. There was a material bid for higher-yielding bonds leading to beta compression. • The HY index again hit new post-COVID tight spreads of 536bp, 101bp tighter from May 29's mark of 637bp. This compares to the March 23 wide spread level of 1100bp. Pre-Covid-19 tight spread levels were 341bp set on February 13. • The new issue market remains active with $13bn across 17 deals pricing during the week ending June 5. Technicals remain solid with deals very well oversubscribed, pricing tighter than initial price talk and many with little to no new issue premium. **European HY** • As earnings season has picked up, technicals in the	Spreads are 0.75-1.25 point wider than normal times for BB-rated securities Spreads are 1-1.5 points wider than normal times for B-rated securities Spreads are 1.5-2.5 points wider than normal times for CCC-rated and below securities CDX HY bid/ask is 1-2x vs normal conditions.

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	European HY "cash" market have been remarkably firm. Many companies have beaten low expectations for the quarter and have anecdotally pointed to improving business conditions in May. In addition, several equity/PE sponsors have put up capital to support businesses through the downturn – a positive signal. As a result, earnings season overall has been a tailwind for the market as investors rush to cover underweights in issuers/sectors post-earnings release. • Overall market technicals are therefore very well supported, with positive flows (on average ~150mn inflows every week for the last several weeks in Euro HY) and overall under-risked investors. • The new issue market picked up during the week of June 1. Thus far, issuance has come only from high quality BB and non-cyclical single-B-rated issuers. These deals have priced with little new issue premium and mixed performance. • Liquidity remains thin but volumes have been healthy and there are still pockets of two-way flow in the market. • Bid/ask spreads remain elevated relative to longer-term norms in Euro HY despite overall volatility coming down at the margin. **CDX HY** • CDX HY performed strongly, up 5 points week over week ended June 5. Beta compression was the main driver. The ratio of HY/IG has compressed back to 6.4x, which has not been seen since mid-April. • Trading volumes picked up as flows were more two-way at local highs. Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	
Emerging-Market Debt (EMD)	**Hard Currency EM** • Hard currency EM debt spreads moved tighter over the week ending June 5, with spreads on the JP Morgan EMBI Global Diversified tightening ~55 bp, to close the week at ~460 bps, ~260 bp inside the crisis wide levels and ~170 bp wide of YTD tight levels. • Beta compression was a key theme as the high yield index was 100bps tighter vs. the investment grade index which was 25bps tighter. Investors re-entered high yield assets as risk sentiment was positive, there was profit-taking on last month's IG strength and a sell-off in core interest rates. • Dealers continued to struggle to maintain inventory.	EM IG sovereigns are back to normal market conditions EM HY sovereigns are 1.5x wider vs normal market conditions EM IG corporates are 1.5x wider vs normal market conditions EM HY corporates are 2x

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	The EMB ETF premium hit a 6-week high of ~1.45%. Flows (per EPFR) swung to the largest inflow seen since the covid-19 crisis • Liquidity continues to improve as transaction costs have slightly narrowed over the last week. **Local Currency EM** • Local EM rates followed developed-market rates slightly higher over the week ending June 5. • Liquidity is close to normal	wider vs normal market conditions
Securitized	**CMBS** • As in many credit markets, CMBS rallied aggressively during the week of June 1. AAA-rated classes tightened 30 bp week-over-week. AS, AA and A classes were also well bid. Senior AAA-rated tranches are now trading comfortably in the swaps + low 100 bp range, but still trade 20-30 bps wide of pre-covid-19 levels. • While bid/offer spreads in CMBS remain wide, liquidity is improving. Bid/offer spreads are approximately 2x, 2x, and 3x their historical averages for AAA, AA/A and BBB rated tranches respectively. • CMBX series 6 put in strong performance on above-average trading volume. CMBX A6, BBB-6 and BB6 rallied 4, 7 and 8.5 points respectively, amid demand from short coverers and investors looking to add risk. Bid/offer spreads compressed with the increased liquidity but remain wider than pre-covid-19 levels. Bid/offer spread for A.6 is ~2x, BBB-.6 is ~3 x and BB.6 is ~4x the normal bid/offer spread. **ABS** • The ABS primary market entered June on strong footing, as nine transactions totaling $5.6bn priced, including timeshare, private credit student loan, equipment, unsecured consumer, prime and non-prime auto loan deals. The deals priced through their initial spread guidance and recorded heavy oversubscription levels. For example, BBB-rated non-prime auto ABS subordinated tranches printed at swaps +430-450bp and BB-rated tranches priced at 700-725bp versus guidance north of 500bp and 725bp respectively. Year-to-date ABS issuance is at $67.5bn compared to $105.3bn recorded over the same time period last year. • ABS spreads tightened significantly on strong technical momentum in secondary markets. While	

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	the bulk of the activity was in the primary market, plain-vanilla ABS continued to trade well in secondary markets, driving indicative benchmark ABS spreads back to pre-pandemic levels. The AAA 3-year credit card ABS narrowed to swaps +25bp from +50bp week over week, versus +24bp at the end of February and a wide of +200bp in mid-March. Reflecting the primary market strength, indicative BBB subprime auto ABS spreads now stand at 325bp on BBB and 525bp on BB, 105bp and 155bp tighter, respectively, versus the prior week. **CRTs** • The recovery rally continued in the CRT market this week and picked up speed, particularly in the lower-priced part of the market. B/B1/B2 tranches continued their march toward par. • Bid/ask spreads remain somewhat elevated from what were very low levels before the covid-19 crisis began. **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** • The entire CLO stack saw spreads grind tighter during the week ending June 5. • Several new issues are starting to come to market around where the secondary market is trading • New issue AAA-rated deals are easily getting done at spreads of 170 bps • Bid/ ask spreads are almost back to 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	• Net new Treasury issuance is starting to put pressure on front-end rates and repo financing. Subscriptions into Fed open market repo operations (OMO) reached $106 bn on Friday June 5. This trend is likely to continue, but repo is unlikely to break 0.10% as long as the OMO are in place. • T-bill auctions cheapened 1-2 bps week over week.	

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	• 3-month LIBOR is setting lower but continues to lag bank commercial paper. 3-month LIBOR set at 0.31% while 3-month bank CP is clearing in the 0.20-0.25% area. • The market is focused on the June 10 FOMC meeting for details on the Fed's next potential monetary policy tool—Yield Curve Control (YCC). There is much speculation on the potential mechanics, targeted tenor, and rate cap.	
US Municipals	• After going unchanged for 7 consecutive days, yields in the municipal market rose on June 5 for the first time since the muni rally began in early May. The back up in US Treasuries caused the Muni/Treasury ratios to drop significantly (2-, 5- and 10-year all below 100% as of June 8). • Despite the rate selloff during the week and a soft tone on Friday June 5, the muni market is supported by a very strong technical picture with back-to-back weeks of inflows and large upcoming principal and coupon payments outweighing expected supply. • Primary market deals have done well with another week of heavy over-subscriptions including high yield. There was significant spread tightening in mid-grade and quality high-yield issuers, driven by historic low benchmark yields, a strong technical backdrop, and states beginning their reopening phases. • Odd lot liquidity improved slightly week-over-week. On average, high-grade odd lots are receiving haircuts of 1-2 points below round lot bidside evaluations for lots less than 100k. Larger odd lots saw 0 to 1 point concession. High yield odd lots remain challenging to sell. Overall, odd lot liquidity has improved significantly during the recent rally, but concessions have not returned to pre-crisis levels.	
Canadian Market	**Federal** • Liquidity is best in benchmark issues for block sizes of <=CAD25mn; limited liquidity in off-the-run, high coupon bonds but the Bank of Canada buying program (C$21.9 bn+ in May) is helping 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.	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 25mn, particularly at the longer end

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	• 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. • The Bank of Canada's buying program of provincial debt (C$2.3bn purchased in May) should support liquidity. **IG Corporates** • Limited liquidity; 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. • The Bank of Canada's buying program of corporate debt (5 years or less) should support liquidity in that market for BBB and higher-rated securities. However, in its first purchases, the central bank only bought C$21.5mn in corporate securities, indicating the impact is minimal. BBB- bonds are trading by appointment. **Real Return Bonds (RRBs)** • The C$400mn RRB auction of the long Canada 0.5% Dec. 2050 on May 27 supported liquidity in the benchmark RRB bond. • The program to purchase Government of Canada securities in the secondary market – the Government Bond Purchase Program or GBPP – should help liquidity since it will include RRBs. The program began on May 27. The BoC bought a total of C$700m with C$100m per line of the 7 Canada RRBs from 2021 to 2047. Even with the central bank buying net C$300m of Canada RRBs, liquidity remains challenging as dealers hold very limited inventories, if any, of these RRB securities. Trading a block can only be done on an appointment basis.	Large bid/ask spread on BBB- corporates, which are trading by appointment in many cases and as wide as 25 bp in certain cases. Provincial RRBs trading by appointment only. Dealers do not hold these securities on their balance sheet.

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