June 2020

Market Update – Daily Fixed Income Trading Liquidity Update 12 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 committed to purchasing a minimum of $80bn US Treasuries and $40bn MBS every month, with possibilities to increase should circumstances change for the worse. While the market liquidity function has improved markedly since the Fed started emergency-related purchases, they stand ready to re-engage with larger daily operations should a second covid-19 wave hit. • The week ending June 12 witnessed a large risk reversal that saw US Treasuries rally 20 basis points, the 5s30s US Treasury curve flatten by 7 basis points, and stocks fall by 4.8% on the week. The risk-off move was driven by a surprise uptick in covid-19 cases in the US which caused investors to rethink the timing and pace of reopening and speculate about a potential dreaded "second wave" in the fall. • Besides the reversal in risk tone, the key takeaway for most macro market participants was the FOMC meeting, where there were no major surprises. The Fed did not announce or even hit of committing to Yield Curve Control (YCC). The Fed did reiterate their ultra-dovish stance, focus on full employment and price stability - promising to continue supporting the US economy until the labor market recovers from the Coronavirus pandemic, which will likely take a few years.	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. Bid/ask for the 30-year note, is now also in line with pre-crisis levels. Off-the-run Treasury bonds still trade significantly wider than on-the run bonds, but bid/offer has compressed. TIPs bid/ask is at least 2-3x wider vs pre-crisis levels, and trade by appointment at certain points during the week.
Investment Grade (IG)	**US IG** • US IG cash bonds' performance was weaker during	US IG spreads are generically 2x wider vs

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Corporates	the week ending June 12, in line with the macro picture. The US IG index widened by 13 bps on the week. Despite the move wider in spreads, flows stayed constructive and high-beta bonds held up well. • New issue supply continues to slow down, with $26.4 bn in new issues coming to market for the week ending June 12. Most noteworthy are three REIT deals that came with spreads 20 to 30 bps tighter vs. existing curves and performed well in the secondary market. The REIT sector had lagged the broader market rally but outperformed over the past week despite the weaker market tone. • Bid/ask spreads remain wider than pre-crisis levels. **European IG** • Liquidity remained challenged during the week ended June 12 as a nervous sell-side were wary of buying bonds given the weak macro tone and how quickly valuations had tightened in the prior few weeks. Initially there was a buyers' strike amid the softer macro tone, however the picture improved with stabilization later in the week. **REIT Preferreds** • The week ended June 12 saw the first REIT preferred deal since the covid-19 crisis hit. With a coupon of 4.625%, the deal from PSA was the lowest ever coupon for a REIT preferred deal. The deal traded off after coming to market amid weaker macro tone. • Liquidity in the REIT preferred market is limited under more normal conditions but has improved from 2-3 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 continue to recover.	normal market conditions AT1/Preferreds are 2-3x wider vs normal market conditions
High Yield (HY) Corporates	**US HY** • The US high yield market traded lower during the week ended June 12, in line with other risk assets. The majority of the selling appeared to be from hedge fund, momentum and ETF arbitrage investors, with "real money" investors largely on the sidelines. • The HY index was 75 bp wider to 611bp. This compares to the March 23 wide spread level of 1100bp. Pre-covid-19 tight spread levels were 341bp	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

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	set on February 13. • Despite weakness in the secondary market, the new issue market remains active with $10.1bn deals pricing during the week ending June 12 across 18 issuers. Technicals remain solid with deals upsized and multiple times oversubscribed and pricing on the tighter end of initial price talk. **Euro HY** • The new issue market has come into focus with a busy calendar. Deals are pricing with spreads well inside initial price guidance, and with mixed performance, but book oversubscription indicates healthy cash balances from the investor base. • Fund flows notably picked up during the week ending June 12, further supporting the notion that cash is coming into the market. • Weak price action last week after the US FOMC meeting did not seem to have material flows behind it. Aside from some retail/ETF selling and select hedge fund flows, it appeared to be more of a buyers' strike with "real money" investors seeming largely willing to buy the dip, notably in higher-quality issuers. • Some of the compression trade witnessed over the last several weeks unwound amid the volatile macro environment. This repricing felt healthy given how far the market had run, as opposed to strong risk-off sentiment. • Overall, liquidity remains relatively thin and prices can gap when macro volatility increases, but underlying technicals in the market seem intact. Supply is expected to remain robust over the next few weeks ahead. **CDX HY** • CDX HY traded weaker along with the macro tone, but slightly outperformed CDX IG during the week ended June 12. • Trading volumes picked up on the back of heightened volatility. Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	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.
Emerging-Market Debt (EMD)	**Hard Currency EM** • Hard currency EM debt took a step back during the week ending June 12, with spreads on the JP Morgan EMBI Global Diversified widening ~25 bp following Thursday's global macro risk-off move. Latin America was hit particularly hard hit.	EM IG sovereigns are back to normal market conditions EM HY sovereigns are

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	• The EMB ETF traded at a discount for the first time since March. • On the technical front, EM had a light week of supply with <$1.5bn in deals coming to market with books 5-7x oversubscribed. • Liquidity continues to improve as transaction costs have slightly narrowed over the last week. **Local Currency EM** • Local EM rates followed the risk off move and rose ~10 bps over the week ended June 12. • Liquidity is close to normal	1.5x wider vs normal market conditions EM IG corporates are 1.5x wider vs normal market conditions EM HY corporates are 2x wider vs normal market conditions
Securitized	**CMBS** • The rally in CMBS stalled last week as most sectors were unchanged to only marginally tighter. AAA-rated last cash flow bonds, which rallied aggressively month to date, were little changed week/week. Despite the less bullish tone of the market, liquidity remained robust at the top of the capital stack. In mezzanine classes, A- and BBB-rated classes continue to trade to very conservative collateral assumptions, bisecting the market into bonds with no or minimal expected principal losses and those that are anticipated to take significant losses. AA-rated bonds are in high demand as even under draconian stress scenarios they are expected to avoid losses given their credit enhancement and they offer significantly more yield than a AAA-rated bonds. Bid/offer spreads are approximately 2x, 2x, and 3x their historical averages for AAA, AA/A and BBB rated tranches respectively. • CMBX responded to weakness in the macro risk markets as anticipated and sold off at the end of the week. By Friday, BBB-.6 was lower by 4 points and BB.6 was lower by 5 points. At times liquidity was challenged, leading to large price movements on few transactions. Week over week, bid/offer spreads remain the same. 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 continued to see strong demand for the week ending June 12. Four deals totaling $2.6bn priced across equipment, private credit student loan, auto leases and nonprime auto loan ABS, with mostly high oversubscription levels and final pricing through the initial spread guidance.	

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	This brings the 2020 year-to-date ABS supply to \$70bn compared to \$111bn over the same period last year. There are four issuers pre-marketing for the week of the June 15, two of which are TALF-eligible (insurance premium finance transaction and a private student loan deal which came subject by the issuer). • In the secondary market, benchmark subprime auto ABS spreads tightened 10-50bp across the spectrum, with AAA-rated 2-year bonds at swaps +55bp and BBB-rated 3-year bonds at +275bp. Spreads across other sectors remained unchanged on the week, after recording significant tightening in the prior week. • The Fed announced future TALF subscription dates: June 17 will be the first, followed by July 15 and 30, August 4 and 19 and September 15 and 29. **CRTs** • The recent recovery rally in the CRT market took a pause during the week ended June 12. Investment grade and below-investment-grade last cash flow bonds finished the week unchanged, while B/B1/B2 bonds traded down on the week along with other risk markets. Volume was light. • Bid/ask spreads remain somewhat elevated from what were very low levels before the covid-19 crisis began. **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. **CLOs** • The entire CLO stack saw spreads grind tighter during the week ending June 12. • 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 165 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.	

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Money Market	• At Wednesday's FOMC meeting, the Fed guided that rates will be low until at least 2022. The highly anticipated Yield Curve Control (YCC) was not implemented. • The Fed is raising the rate on their overnight open market repo operations (OMO) to IOER+5bp (or 0.15%). This is the facility for primary dealers to get financing via repo – dealers submit Treasury or MBS collateral to the Fed in exchange for cash. The Fed would like the market to be less reliant on their funding and take more of a backstop role. This should widen repo rates, Fed Funds and T-bills 3 to 5 bps. • T-bill issuance remains heavy and auctions have tailed (come with wider yields than the market expects)1-2 bps. The commercial paper to T-bill spread has narrowed to 10 bps due to a lack of commercial paper supply. Prime funds are generally opting to buy T-bills instead of credit. • 1-month LIBOR set at 0.19% and 3-month LIBOR set at 0.30%.	
US Municipals	• Over the past week, shorter-maturity municipal bond yields widened (1-2yr benchmark bonds 5-6bp wider) and longer-maturity bonds tightened (6-10yr benchmark bonds 1-4bp tighter and 11+ yr bonds 5-9bp tighter), largely moving with rates. The ratio of muni benchmark yields vs treasury yields started the week < 100% for short and intermediate maturities but is now > 100% for all parts of the curve. • Municipals have seen five straight weeks of inflows, and investors appear to have significant cash to put to work. Inflows continue in both high quality and high yield funds. • $11bn in new issues priced during the week ending June 12. There was strong investor demand across high quality, mid-grade, and high yield issuance. The bulk of the demand was for issuers that had some additional spread to them, such as A rated Clark County NV and BBB+ rated Frederick Health System MD, both of which were heavily oversubscribed (16x and 30-35x respectively). The summer note season has begun and last week saw a $3.5B Dormitory Authority of the State of NY Personal Income Tax 9-month Revenue Anticipation Note, 5x oversubscribed. • The upcoming calendar includes very little true high yield, and so demand for high yield in both secondary and primary markets should continue to	

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	be solid. • Odd lot liquidity remains challenged vs. pre-pandemic levels; however, it is improving each week. During the week ended June 12, average haircuts on odd lots were 1-3pts below round lot bid side evaluations. Tuesday and Friday in particular saw strong bids for odd lots, averaging <1pt for 50k+ odd lots.	
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. • Limited secondary-market liquidity in oil-generating provinces (Newfoundland, Alberta, Saskatchewan) with oil prices trading at low levels. • Most dealers will not bid aggressively 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, particularly during risk-off trading days; 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	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 Large bid/ask spread on BBB- corporates, which are trading by appointment in many cases. Provincial RRBs trading by appointment only. Dealers do not hold these securities on their balance sheet.

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	benchmark RRB bond for a limited period. • 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.	

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