AllianceBernstein®

May 2020

Market Update – Daily Fixed Income Trading Liquidity Update 15 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 $6bn per day during the week of May 18 (from $7bn per day the week of May 11). • Market depth on 10-year US Treasuries is averaging 47% of the normal market depth observed from February 2019- February 2020 (pre-Covid) levels. • Two important technicals during the week ended May 15 are: 1. Large buying in longer maturities across interest rates, securitizations, and credit from Asia-based investors 2. Large amounts of government supply related to covid-19 stimulus measures. This supply was well-received with demand statistics exceeding their 12-month average subscription levels in the 3-, 10-, and 30-year Treasury auctions	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 traded mostly sideways on May 15. Shorter-maturity bonds continued to trade with a firm tone. • New issue supply slowed down, with $23.6 bn in new issues coming to market between May 13 and 15. The market continues to see some companies that issued last month return to the market. Some of this activity is to refinance shorter-maturity debt	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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	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. USD-denominated AT1s are proving to be more liquid than EUR-denominated AT1s. **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** • On May 15, the US high yield market was mixed, on light volumes • New issues were the primary focus of the week ending May 15, with $14.6bn pricing, and $7.5bn pricing on Wednesday May 13 alone. There was some new deal fatigue on Thursday morning, but that eased by the end of the week, with new issues generally closing above levels where they were issued. The new issue calendar is expected to remain active during the week of May 18, as more companies seek to increase liquidity. • The Fed announced that they had bought $305mn of credit ETFs this week as part of their Secondary Market Corporate Credit Facility. This proved to be a non-factor in the market, as the broader macro tone overshadowed the purchases	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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	• Bid/ask spreads remain unchanged **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. • 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 both the broader macro tone and CDX IG, as cash supply weighed on synthetics and Fed buying of ETFs seemed to support IG more than HY. Trading volumes also continue to support IG more than HY. • Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	
Emerging-Market Debt (EMD)	**Hard Currency EM** • It was a volatile week for hard currency EM debt as spreads on the JP Morgan EMBI Global Diversified index tracked the violent stock swings more so than in the past several weeks. • The week of May 11 was the first week without sovereign new issue supply since the end of March. Corporates and quasi-sovereigns have filled the void, printing ~$8bn over 4 deals with books 4-10x oversubscribed and deals on average ~20 bps tighter on the week. • 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** • The highest-rated CMBS bonds remain well-supported. 10-year, 30% enhanced, AAA-rated senior securities have seen their spreads settle into	

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	the swaps+150-160 bp area. The next class in the stack, the junior AAA with 18%-20% credit enhancement, has found support at s+200-225 bp. For context, these classes traded at s+80 bp and s+100 bp in February. Despite the firm tone of the senior tranches, bid/offer remains stretched at 3x pre-COVID levels. Mezzanine tranches have yet to find consistent support, but pockets of liquidity exist for specific collateral profiles. AA/A and BBB bid/offer spreads remain at approximately 3x and 4x pre-COVID levels. • Remittance reports are being published and CMBX investors are paying close attention to any data pertaining to malls and retailers. Volumes in CMBX.6 remain depressed and are expected to remain so until the latest remittance data 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** • The ABS primary market priced four transactions totaling $2.1bn for the week ending May 15 across the private credit student loan, marketplace lending, prime auto loan and subprime auto loan sectors. This brings the year-to-date issuance to $59 bn compared to $90.5bn over the same period last year. These new issues were well subscribed and most priced at the lower end of the initial price guidance range. There are three securitizations pre-marketing for the week beginning May 18, including prime and subprime auto and equipment. • ABS indicative benchmark spreads tightened 5bp on the week across credit card, equipment and FFELP student loan ABS. New-issue levels influenced secondary-market levels across prime auto loan ABS (spreads flat to 10bp tighter on the week) and private credit student loan ABS (spreads 30-45 bp tighter on the week). **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	

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	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 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 0.17% and 3-month at 0.38%. Prime money market funds saw	

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	$50bn of inflows during the 7 days ending May 14, which has been driving 3-month LIBOR lower. • On Wednesday May 13, Fed Chair Powell reiterated that negative rates were not an appropriate policy tool. He stated that the FOMC feels that current policy tools are working and that there are more tools in the tool kit if need be. Powell mentioned that this is one of the few things "all" FOMC participants agreed on and cited other reasons against negative policy rates including mixed evidence of their effectiveness and disrupting the intermediation process (hurting banks). Other "Fed-speak" this week reinforced Powell's message. • Government money market fund demand has slowed. Dealers are flush with supply. Repo has climbed to 0.05-0.06% as dealers start to pay up to fund inventory. We're seeing the pendulum swing as dealers are now going to the Fed's open market repo operations (at 0.10%) for financing.	
US Municipals	• The municipal market continued its strong performance, with benchmark yields tightening 15bps week over week ending May 15. • Very short maturity, high-grade paper was very well bid as buyers are looking for cash substitutes. • High-quality new issues this week saw double-digit subscriptions, but many potential new issuers remain on "day-to-day". Much of the market's focus was on the $800mn Illinois new issue, which came with varying maturities out to 2045. The deal was upsized by $50mn and longer maturities came tighter than initial price guidance and traded up on the break. It was a similar story with NY City Transitional Finance Authority, which like Illinois was a name that had thin buying interest in the secondary market but significant demand for the new issue. • It appears that investors are wary of putting levels on bonds in the secondary market but are able to take comfort in being part of a crowd of investors in a new issue. • Friday May 15 was quiet as the market traded tighter another ~4bps on light volumes, with dealer selling outpacing dealer buying by 2.5x. • Odd lot liquidity remains challenged compared to historic averages, with bids on smaller-sized odd lots trading at 1-4 points below round-lot bidside evaluations. Higher-quality odd lots, especially in shorter maturities, trade 0-2 points below round lot	

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	bidside evaluations. High yield or even lower-quality investment grade odd lot bids remain well below round lot bidside evaluations. For context, high grade odd-lots typically trade 0.10-1 points below round lot bidside 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 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	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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