ALLIANCEBERNSTEIN®

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Market Update – Daily Fixed Income Trading Liquidity Update 19 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. • The week ending June 19 was the calmest trading week since the covid-19 crisis began in the US, with US rates/curve little changed on the week. The US outperformed Germany and the UK. • UK gilts underperformed and sterling curves steepened as the Bank of England left rates unchanged (as expected) but disappointed the market by increasing their asset purchase program by "only" £100bn to £745bn total purchases to be completed by roughly the turn of the year. • The positive tone to risk assets pushed Spanish government bond spreads vs Germany tighter by 10bps and Italian government bond spreads tighter by 9bps. • The "risk on" theme also helped US TIPs. Five-year breakevens traded 11bps higher, mostly following Thursday's strong 5-year TIPs auction.	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) Corporates	**US IG** • US IG cash bonds' performance was very strong during the week ending June 19, primarily on Monday and Tuesday, fueled by the Fed's announcement that they removed the requirement that companies must attest to eligibility for the program and that purchases of corporate bonds will	US IG spreads are generically 2x wider vs normal market conditions AT1/Preferreds are 2-3x wider vs normal market

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	begin on June 16th. • The primary market picked up after the Fed's announcement, with over $50 bn in new issues coming to market in just two days (skewed toward high beta/covid-related issuers), causing some market indigestion. • Bid/ask spreads remain wider than pre-crisis levels. **European IG** • Focus remained on the primary market during the week ended June 19 given heavy issuance volumes. As such, secondary volumes were light and concentrated on trading new issues. • Engagement levels in the secondary market were also low given supply is set to remain fairly heavy creating a less-liquid market. • The liquidity picture changed over the course of the week—initially, post-Fed announcement, the market was much easier to engage as a seller, while after heavy primary issuance in the latter half of the week it turned into a buyers' market. **REIT Preferreds** • 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.	conditions
High Yield (HY) Corporates	**US HY** • Supply was the focus of the US high yield market during the week ended June 19, with $22.8 bn of new issues, a record for the high yield market. All of the deals were multiple times oversubscribed and most priced through initial price guidance. • The most surprising aspect of the new issue supply is the limited cash raise in the secondary market to fund this supply. Either the current buyer base must be larger than pre-covid (perhaps more focus from alternative/opportunistic investors) or cash balances a lot higher than assumed. • While secondary market activity was relatively quiet, the high yield index tightened ~41bps both on yield/OAS to 6.44% and OAS +578	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

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	Euro HY • The new issue market continues to be in focus. There are several deals announced for the week of June 22, and the week ended June 19 was also busy. Deals are generally well-oversubscribed and pricing at the tight end of initial price guidance. But thus far deals have only been higher-quality. There will be a couple single-B rated issuers in the market during the week of June 22 which will be a good test of the lower quality market that has come off recent highs in the past couple weeks as broader macro markets have seen a bit more volatility. **CDX HY** • CDX HY traded mostly in line with the macro tone, but slightly outperformed CDX IG during the week ended June 19. • Trading volumes picked up on the back of heightened volatility. Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	normal conditions.
Emerging-Market Debt (EMD)	**Hard Currency EM** • Hard currency EM debt spreads ground ~15 bps tighter during one of the quietest trading weeks of the year (ending June 19). • Towards the end of the week, tone improved which likely sets the stage for further issuance after a relatively quiet week of supply. • Volatility over the past week seems to have slowed the robust inflows EM had enjoyed over the prior month. • There was little change in liquidity week over week. **Local Currency EM** • Local EM rates fell 5 bps as central banks continue to cut rates across the globe. • Liquidity is close to normal.	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 wider vs normal market conditions
Securitized	**CMBS** • The summer doldrums have reached the CMBS and CMBX markets, as trading activity has dramatically decreased. • Spreads in the CMBS market were little changed week-over-week. Secondary supply was muted. There was one new conduit deal, $550mn in size, which was placed easily. The mezzanine classes were multiple times oversubscribed and tightened 25-50 basis points. The AAA-rated last cash flow tranche was widened 10 bps to s+115 in order to fully place the bonds, but the initial guidance	

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	seemed optimistic given bonds were trading much cheaper in the secondary market. • CMBX levels were mostly unchanged week-over-week on light volume. • Liquidity conditions in both CMBS and CMBX remain the same. CMBS AAA, AA/A, and BBB bid/offer spreads are approximately 2x, 2x, and 3x their historical averages. In the CMBX market, A.6 is ~2x, BBB-.6 is ~3 x and BB.6 ~5x the normal bid/offer spread. **ABS** • The ABS primary market priced eight transactions during the week ending June 19th, totaling $6.7bn across insurance premium (TALF eligible), solar, private credit student loan (TALF eligible), prime auto loan and non-prime auto loan sectors. The deals were heavily over-subscribed and final pricing spreads settled inside the initial guidance. With this, 2020 year-to-date ABS supply stands at $77bn, compared to $118bn over the same period last year. • TALF-eligible ABS supply has been minimal as levered expected returns have come down significantly as traditional investors search for yield in a record low rate environment. • Benchmark ABS spreads remained unchanged on the week across credit card ABS, while the student loan ABS sector saw tightening by 5bp across FFELP and by 5-25bp across the private credit student loan sector. Higher supply in the secondary market drove AAA-rated auto ABS spreads wider, while strong demand pushed subordinated auto ABS spreads tighter by 25-45bp in both prime and nonprime segments. **CRTs** • Liquidity remains robust in the CRT sector as bid/ask spreads continue to shrink. As the market pulls back to par, bid/ask spread has continued to approach pre-crisis levels, with the one exception being large block trades. Sellers who have large pieces to sell seem to be willing to pay wider bid/ask—roughly ¼ to ½ point—to get trades done. This compression is affecting all aspects of the CRT market. **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 at or	

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	around 200 bp discount margin currently. **CLOs** • Significant size has been passing through the CLO market at or around the recent tight spread levels. The top of the CLO stack in particular shows little sign of wear with all this recent volume. Demand remains quite high as most people see the CLO market as having only recovered 60-70% of what it gave up during the crisis. • Bid/ask spreads are all but back to normal, 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	• T-bill issuance remains heavy. The commercial paper to T-bill spread remains narrow at ~10 bps
	• 1-month LIBOR set at 0.185% and 3-month LIBOR set at 0.30%. SOFR set at 0.09%
	• There were $27bn in outflows from government money market funds for the 7 days ended June 19, and $4bn into prime money market funds over the same period.
	• Important areas to watch are:
	  o Potential liquidity pressures at quarter end
	  o US Treasury's $1.6tn cash balance at the Fed and any impact on short-maturity markets should it be spent
	  o July 15 tax date and what impact that may have on money market flows	

US Municipals	• Over the past week, overall market tone has been positive despite sideways moves day to day in benchmark bonds. • High yield has caught a bid as money is being put to work and primary issuance has helped reprice some of the secondary market tighter. • Demand for new issues remains in the 5-12x oversubscribed range. • The odd lot penalty has fallen to 0.5 to 3 points below round lot bid side evaluations.	
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, more in June) is	Federal: bid/ask typically +1 to +2bp but for the long end of the curve, it can be more depending on volatility

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	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, even with the Bank of Canada's buying program of provincial debt (C$2.3bn purchased in May) which 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 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.	 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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