ALLIANCEBERNSTEIN®

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Market Update – Daily Fixed Income Trading Liquidity Update 1 April 2020

In the current markets, volatility is at an extreme level and liquidity has become significantly 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 08-09 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 Fed is having a positive effect on liquidity and market functionality. The Fed will lower daily purchases from $75bln to $60bln per day across the curve beginning April 2-3. • There continues to be good "two-way" trading in the market. The second quarter began with strong demand for US Treasuries out of Japan, a rally that continued into the NY close. On April 1, overnight volumes were large, but volumes in the NY session were lower vs recent averages. Flows were muted aside from month-end rebalancing. • Most US Treasury buying comes during the Fed operations. Long bonds continue to trade poorly after the Fed 20- to 30-year maturity purchase operations end at 2pm in NY. • Depth in the US Treasury cash bond market has improved and is about 80% of pre-crisis levels in on-the-run bonds. Large blocks of Treasuries still trade with a liquidity premium. • While still relatively liquid in most contracts, depth in the Treasury futures market is also much lower vs historical averages. Trading in "ultra" contracts is challenging.	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 ~2.5x wider vs pre-crisis. Off-the-run Treasury bonds still trade significantly wider than on-the run bonds, but bid/offer has compressed.
Investment Grade (IG) Corporates	**US IG** • US IG cash bonds traded with a softer tone on April 1, amid another heavy new issue supply day, at $23.5 billion. • Credit curves remain flat but short-maturity bonds continued to normalize as we saw strong demand in short maturities.	US IG spreads are generically 4-5x wider vs normal market conditions AT1/Preferreds are 4-5x wider vs normal market

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	• Bid/ask spreads remain wider than pre-crisis levels. Odd-lot liquidity was challenged, but not to the same extent seen a couple weeks ago. **European IG** • The European IG market continues to see heavy supply, which has come with large concessions, and deals have been multiple times oversubscribed. • We see a continuation of last week's theme, that primary market issuance also helped improve the secondary market where liquidity continues to improve, although volumes are light. • In the AT1 (subordinated financial) market, prices moved higher given a firmer macro tone and a statement from the head of the ECB supervisory board clarifying there were no plans to order banks to suspend AT1 coupons. Liquidity in 2 to 5m size trades remained intact for the major European banks. **REIT Preferreds** • Liquidity in the REIT preferred market is limited under more normal conditions and has become significantly challenged amid the current crisis. • Dealers are not providing balance sheet capacity to support the market and so trades must be done on an agency basis; trading is therefore limited. • On April 1, trading volume continued to be very light relative to the 20-day average.	conditions
High Yield (HY) Corporates	**US HY** • The tone of high yield in recent weeks has been tied to equities—with high yield closely following equities moves. • Broadly the market was down on April 1, on light activity. • ETFs traded cheap to NAV which resulted in some arbitrage trading, but that did not overly pressure the market. • Bid/ask spreads remained unchanged **European HY** • Daily sentiment continues to follow equities and the iTraxx Crossover index, however cash bonds have started to outperform the index, particularly in down markets and in higher-quality credits. • With equity markets under material pressure on April 1 for the first time in about a week, investors that had been putting cash to work in the HY market	High yield spreads are 2 to 3x wider than normal times for BB and B securities and 3 to 5x wider for CCC CDX HY bid/ask is 4-5x vs normal conditions.

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	paused. The market was down, but selling pressure was not overwhelming, with much of the trading seemingly focused on larger-cap issuers. • Encouragingly, hedge fund investors did not seem to be putting on shorts in any meaningful size despite the macro weakness. • Dealer liquidity is minimal and has deteriorated as more participants shift to work from home locations. Dealer balance sheet usage is increasingly restricted with most trades >2million needing to be done on an agency basis. • Overall liquidity remains challenged in both directions (bid/offer) as investor conviction levels are not high and sentiment is skittish around macro moves. • Bid/ask spreads are still wide, but there is a less panicked tone. Sellers are primarily funding outflows or building up cash balances/reducing risk in the anticipation of further outflows/volatility, but outflows appear to have slowed (although remain negative), and cash balances have been built up. The selling pressure we saw from ETFs has also significantly reduced. **CDX HY** • CDX HY traded with a weaker tone on April 1. Synthetics underperformed cash bonds as investors put hedges back on.	
Emerging-Market Debt (EMD)	**Hard Currency EM** • EM followed the global macro risk tone—as has been the case over the last few weeks—and was softer on April 1. • EM continues to exhibit dispersion between oil exporters and non-oil exporters, with exporters underperforming amid weak Brent crude prices. • IG sovereign credit came under pressure today as the recent beta-adjusted outperformance vs HY reversed. • Liquidity and price transparency have improved in sovereigns and quasi sovereigns, albeit still significantly below average. Liquidity in EM corporates remains very challenged; most trading has been in sovereigns and quasi-sovereigns **Local Currency EM** • For the most part, Local EM prices are tracking macro risk and the moves in currencies. • Liquidity has moved towards normalization	Bid/ask spreads have tightened from last week's levels: 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 3x wider vs normal market conditions EM HY corporates are 5x wider vs normal market conditions

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Securitized	**CMBS** • On April 1, the CMBS market was characterized by a wave of selling throughout the capital stack. Conduit AAA through BBB, CMBS IO, and single asset/single borrow bonds were for sale all day. Money managers and insurance companies took advantage of the liquidity to sell positions in AAA- through A-rated securities. • Despite the supply of bonds out for the bid, spreads held in well. A-rated bonds, which have generated little investor demand recently, traded at fair valuations. Liquidity is gradually making its way down the capital stack which helps with price discovery in the secondary market. However, we have not seen a new issue since the beginning of March. • Bid/ask spreads remain elevated: AAA-rated spreads have moderated and are roughly 2x wider vs normal conditions. BBB-rated bonds are roughly 5x wider vs normal conditions, and BB-rated are roughly 7x wider. • Liquidity in the CMBX market continues to improve and bid/ask spreads are narrowing. Series 6 BBB-, considered one of the most liquid mezzanine tranches, now generally trades within a 1.0-1.5 point wide market. Under normal conditions this is as tight as 0.25-0.50 points. However, this is a marked improvement from the 3-5 point wide markets we saw just last week. **ABS** • In ABS, 2-year AAA-rated credit card and prime auto ABS spreads tightened again on April 1. But more subordinated tranches are still experiencing pressure on spreads amid shifts in loss expectations. For example, the basis between a 2-year AAA-rated credit card ABS and a 2-year unsecured consumer loan senior ABS was +60 bps pre-crisis and today is >900 bps. • Secondary markets are the only source of supply. Demand has been focused in higher-quality, shorter average life ABS, with limited trading in lower-quality tranches. But on April 1, subordinate classes finally saw a bit of a clearing level as unsecured consumer loan and subprime auto ABS traded. • While new issues have been sidelined by the market volatility, we expect that TALF 2.0 should help re-start the new-issue market as TALF 1.0 did during the Great Recession. But it may not begin until	

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	May/June and details remain light. **CRTs** • Trading in the CRT market has been significantly challenged, partly because of the challenges in the repo/commercial paper market. • But we have seen better trading conditions in the past several days, with improvement in ability to both buy and sell. • There was a softer tone in the CRT market on April 1, in line with broader risk markets. But there was still good two-way flow, and bid/ask spreads remained roughly 2x normal levels. • Discount margin spreads are still several times their pre-crisis levels. **Legacy Non-Agency RMBS** • Legacy RMBS continues to trade through the recent crisis. Since January spreads have widened from ~ 200bps to now > 1000 bps, but demand for the sector never really faded. **CLOs** • Bid/ask spreads on AAA-rated bonds are approaching normal levels (~1 point); mezzanine bid/ask remains ~3x wider relative to typical levels. • As with other risk assets, the tone in the CLO market weakened on April 1 and spreads widened. **Agency MBS** • Bid/ask spreads vary by coupon, with low coupon (2.5%) TBAs back to historical averages, and the rest of the coupon stack trading much wider, at 2-6x higher vs pre-crisis levels	
Money Market	• The Treasury continues to issue significant amounts of cash management T-bills (CMBs) to begin funding the $2 trillion stimulus. They have announced/auctioned $330 bln so far, and also increased their 1-, 2-, 3-, and 6-month auctions. As expected, these auctions are pushing T-bill yields higher, with 3-month at 0.09% and 6-month at 0.15%. • As we begin a new quarter, we expect dealer balance sheets to open and intraday liquidity to improve. The Fed facilities (MMLF, PDCF and eventual CPFF) should see increased usage and provide much-needed liquidity. Thus far dealer balance sheet capacity has been slow to open, but	

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	we are seeing pockets of liquidity in both CP and repo. • In the meantime, the Fed reverse repo facility (RRP) saw $208 bln in subscriptions on April 1, down somewhat from the prior day. • 1-month LIBOR set higher at 1.016% and 3-month set lower at 1.437%. Recent rises in LIBOR levels reflect short-term funding stresses.	
US Municipals	• Tone in the municipal market—both high grade and high yield—continued to be weak on April 1. • Two investment-grade new issues tried to come to market but could not get done. • Liquidity in high yield municipals remains challenged, with round lots trading by appointment except for the most common liquid issuers where there is a large buyer base. • Odd-lot liquidity is still significantly reduced vs several weeks ago. Odd-lots trade 4-10 points below bid-side evaluations, with some higher-rated, short-duration, bigger sized bonds in the 1-3 point below range. For context, high grade odd-lots typically trade 0.10-1 points below bid-side evaluations under more normal market conditions. High yield odd-lots remain very difficult to sell.	
Canadian Market	**Federal** • Liquidity is best in benchmark issues for block sizes of <=CAD15m; very limited liquidity in off-the-run, high coupon bonds **Provincial** • Liquidity is best in benchmark bonds from Quebec, Ontario and British Columbia, but concessions can be high; very limited liquidity in oil-generating provinces (Newfoundland, Alberta, Saskatchewan) amid sharp decline in Western Canadian Select oil price • Most dealers will not bid on off-the-run, high coupon provincial issues **IG Corporates** • Limited liquidity; many dealers forced to reduce balance sheet inventories, so unable to provide bids in many sectors. • Trading on an agency basis for high-beta issuers. However, market has improved in telco and bank sectors. • Liquidity limited even in higher-quality, senior bank deposit notes	Federal: bid/ask typically +1 to +3bp; can be more depending on volatility Provincial: +2 to +5bp or more on size < CAD 10m

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	Real Return Bonds (RRBs) • Trading "by appointment", similar to private placement market	

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