AllianceBernstein®

May 2020

Market Update – Daily Fixed Income Trading Liquidity Update 27 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 $5bn per day during the week of May 26 (from $6bn per day the week of May 18). • Global rates markets continue to be dominated by supply, central bank actions, and re-opening proxies such as oil and/or vaccine developments. • Fed funds markets are no longer pricing in negative rates through the 2021 maturity dates. In speaking engagements over the past week, the Fed has given rates investors clarity that negative interest rates are not planned to be used for at least the next year.	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 stayed firm, particularly short-maturity and high-beta bonds. A "beta compression" theme dominated last week (ending May 22). • New issue supply continues to slow down compared to previous weeks, with $24 bn in new issues coming to market on May 26 and 27. Of note there were two preferred deals in the market which attracted decent demand.	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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<tr><th>Sector</th><th>Liquidity Trading Comment</th><th>Bid-Ask Spreads</th></tr>
<tr><td></td><td>Bid/ask spreads remain wider than pre-crisis levels. European IG There continues to be dislocation in the markets with liquidity very thin in covid-19 exposed names or in the crossover space, where names can go from “bid-less” or “offer-less” very quickly and create large moves in either direction.
Supply levels have been elevated 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 and subject to the whims of the macro tone. 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.</td><td></td></tr>
<tr><td>High Yield (HY) Corporates</td><td> US HY The US high yield market was firm on May 27, despite fluctuations in equities. Covid-19-impacted issuers and cyclical sectors continue to outperform.
The new issue market remains active with another $1.5bn pricing on May 27, and $5.455 bn for the week to date. Technicals remain solid with deals multiple times oversubscribed and pricing at the tight end of the expected range. An additional $3.2 bn is expected to come to market this week (ending May 29).
Bid/ask spreads remain unchanged European HY </td><td> 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 </td></tr>
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	• 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. • There has been no new issuance and overall secondary volumes have felt exceptionally light with a focus on credit-specific situations/earnings. • 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 traded well on May 27, recouping some of the underperformance vs stocks and CDX IG from last week. • Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	CDX HY bid/ask is 2-3x vs normal conditions.
Emerging-Market Debt (EMD)	**Hard Currency EM** • It was a very quiet start to the week in hard currency EM debt with spreads on the JP Morgan EMBI Global Diversified grinding ~15 bps tighter following a global macro risk rally on the heels of states and countries beginning to re-open. • Issuance continues to be robust as 2 more corporate deals were 5x oversubscribed with whispers of more HY and IG sovereign issuance around the corner. • Tuesday May 27 saw a slight softening in risk tone, but underlying sentiment remains strong and this weakness is characterized more by a lack of buying than actual selling. • Liquidity continues to improve as transaction costs have slightly narrowed over the last week. **Local Currency EM** • Local EM rates continue to trade well, converging towards low developed-market 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 markets in both CMBS and CMBX appeared to stall heading into the Memorial Day holiday weekend. Traders had limited appetite to add risk, resulting in a stagnant market. Most transactions that occurred in the cash market were at the top of the capital stack which remains well supported.	

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	• In both CMBS and CMBX, liquidity remains fragile. Bid/offer spreads in CMBS remain unchanged. AA/A and BBB bid/offer spreads remain at approximately 3x and 4x pre-COVID levels. • Transaction volume in CMBX series 6 was average, resulting in little price movement since Tuesday's close. Single A, BBB- and BB prices were unchanged, +0.25 points and +0.50 points respectively. Bid/offer spreads for A.6 is ~2x, BBB-.6 is ~2 x and BB.6 ~4x the normal bid/offer spread. **ABS** • The ABS primary market priced three transactions totaling to $1.5bn during the week ending May 22 across equipment, prime auto loan and subprime auto loan sectors. This brings the year-to-date issuance to $66.0bn compared $104.9bn over the same period last year. All the new issue deals were well-subscribed and most priced at the lower end of the initial price guidance range. • There is one securitization pre-marketing for the short post-holiday week beginning May 26 (Santander Auto Receivables), and three subprime auto lenders have filed "15G" forms, signaling potential future issuance. • ABS indicative benchmark spreads saw relatively strong performance across most sectors during the week ending May 22. One sector that has been lagging any tightening in spreads is rental car ABS, and on last Friday evening Hertz filed for chapter 11 bankruptcy. **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 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.	

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	• 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	• T-bill auctions have begun to "tail" this week – which means they are coming with wider yields than the market expects. The market continues to be saturated with the continuous supply. Government money market fund participation at auction was low as they are beginning to see slight outflows (albeit still immaterial). The dealer community has also backed off from aggressively bidding auctions as they are flush with inventory. • The Fed's repo financing for primary dealers saw $25-35bln in subscriptions at 0.10%, mostly weighted to MBS collateral. There are many dealers	

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	looking to do late-day repo, a shift from the intraday liquidity picture just a few weeks ago. • There is a lag in where 3-month LIBOR is setting (bouncing around 0.36-0.37% level) vs where 3-month bank CP is clearing (0.20-0.25% area). LIBOR rose for a couple days after hitting recent lows last Wednesday. • Fed fund futures have reversed their view of negative rates in 2020 and 2021.	
US Municipals	• The rally in the municipal market took a break on May 27 as benchmark yields were unchanged. However, the overall tone was still firm. • An all-time low level in MMD yields in 1-5 year maturities appears to be pushing participants to extend duration and/or move down the credit spectrum. Mid-grade credits have continued to grind tighter over the past few weeks • In high yield, there are some encouraging signs as outflows have all but subsided and benchmark credits traded up as funds begin to redeploy cash back into the space. • High-grade odd lot penalties have continued to decrease with average haircuts of 0.5-2 points below round lot bidside evaluations, which is much closer to historical norms. Lower-rated credits are still somewhat challenging to sell; however, we are beginning to see the discounts decreasing.	
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 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. • 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 C$50bn buying program of provincial debt should support liquidity. **IG Corporates**	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 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

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	• 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 $21.5mn in corporate securities, indicating the impact is minimal. BBB- bonds are trading by appointment. **Real Return Bonds (RRBs)** • The official announcement of a $400mn RRB auction of the long Canada 0.5% Dec. 2050 on May 27 should support 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 $700m with $100m per line of the 7 Canada RRBs from 2021 to 2047. Even with the central bank buying net $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.	by appointment only. Dealers do not hold these securities on their balance sheet.

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