ALLIANCEBERNSTEIN®

March 2020

Market Update – Daily Fixed Income Trading Liquidity Update 31 March 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. On March 31, volumes and 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. Moving large blocks of Treasuries takes more time than usual. • 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 5-year US Treasury notes are 2x wider vs pre-crisis conditions. For the 10-year note, bid/ask is ~3x wider vs pre-crisis. Off-the-run Treasury bonds may trade significantly wider than on-the run bonds.
Investment Grade (IG) Corporates	**US IG** • US IG cash bonds traded with a positive tone on March 31, amid another heavy supply day. • New issue supply was $13 bn on March 31, across 13 issuers. Demand continues to be strong, with deals ~7x oversubscribed. Despite negative new issue concessions, new deals closed with tighter spreads on average • 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 conditions

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	• Bid/ask spreads remain wider than pre-crisis levels but have trended tighter; the offer side is particularly challenging. **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 March 31, trading volume was very light at ~70% of the 20-day average. Volumes were focused on hotels/leisure/malls	
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. • High yield cash bonds were relatively quiet on March 31, with mixed performance • 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. • 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.	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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	• Overall liquidity remains challenged in both directions (bid/offer) as investor conviction levels are not high and sentiment is skittish around macro moves. • Cash bond markets have stabilized with investors left "better buyers" looking to deploy cash they've raised. 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 March 31. Synthetics underperformed cash bonds as investors put hedges back on.	
Emerging-Market Debt (EMD)	**Hard Currency EM** • EM continues to exhibit dispersion between oil exporters and non-oil exporters, with exporters underperforming amid weak Brent crude prices. • 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
Securitized	**CMBS** • The last new issue in the CMBS market priced March 11th. In the secondary market, the tone remains firm for the highest quality securities. AAA-rated senior securities trade well and spreads continue to tighten. Mezzanine classes, whether in the conduit or single asset/single borrower markets, struggle to find a bid. • AAA-rated single asset securities continue to trade well. A large BWIC (bid wanted in competition) of	

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	mostly AAA- and AA-rated prime office and Class A mall properties traded well, with most bonds receiving bids above par. This is the first such list in some time and the execution levels should be a positive for the market. • 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 another +10bp, ending the quarter ~+90 bp. But more subordinated tranches are still experiencing pressure on spreads amid shifts in loss expectations. • For the last day of the quarter, the market remained in a holding pattern. Secondary markets are the only source of supply, but volumes remained light. Demand has been focused in higher-quality, shorter average life ABS, with limited trading in lower-quality tranches. • 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 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. • CRT prices have rallied – beginning with investment-grade last cash flow (lower tranche) bonds, and now moving to below-investment-grade on-the-run last cash flow bonds and seasoned equity (B1) bonds as well. However, discount margin spreads are still	

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	several times their pre-crisis levels. • Bid/ask spreads have tightened but remain roughly 2x normal. **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** • After challenged liquidity in recent weeks, trading has improved in AAA-rated tranches. Liquidity in lower-quality tranches remains challenged. • Bid/ask spreads on AAA-rated bonds are approaching normal levels (~1 point); mezzanine bid/ask remains ~3x wider relative to typical levels. • Higher-quality managers have begun exploring the new issue market, looking to come with shorter-maturity deals, although spreads may need to tighten further to get a deal done. **Agency MBS** • Agency MBS spreads are tighter week-over-week. • 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 has started issuing "cash management" T-bills (CMB) to begin funding the $2 trillion stimulus—this wasn't expected until after quarter-end. They have announced/auctioned $290 bln so far, and also increased their 1-month and 2-month auctions. Supply should continue to increase. As expected, these auctions are widening the government money market curve. • Beginning April 1, dealer balance sheets should open up and intraday liquidity should improve. The Fed facilities (MMLF, PDCF and eventual CPFF) should see increased usage and provide much-needed liquidity. In the meantime, the Fed reverse repo facility (RRP) saw $285 bln in subscriptions on March 31. • LIBOR set higher: 0.99% on 1-month, 1.45% on 3-month. Recent rises in LIBOR levels reflect short-term funding stresses. • No material difference in the CP market challenges. Most paper trading remains primarily overnight or	

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	one-week term, and mainly high-quality issuers. • The Fed announced a temporary repo facility for Foreign Central Banks (FIMA). This will allow certain foreign institutions to repo US Treasuries in exchange for USD, reducing the need for foreign banks to sell their Treasury holdings to raise dollars, reducing volatility in the Treasury markets in times of stress.	
US Municipals	• Tone in the municipal market continued to be weaker on March 31, as AAA benchmark yields rose as much as 15bps in the 15-30 year range. • Concessions were large on high-grade trades and liquidity was more challenged in high-grade bonds than in the past few days. • There were two investment-grade deals – one for an airport and one in the tobacco sector – that could not get done today even after adjusting yields higher. • In the HY market, the tone was even weaker, as sellers from mutual funds and ETFs struggled to get bids amid thin risk appetite. • 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 traded 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	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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	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 **Real Return Bonds (RRBs)** • Trading "by appointment", similar to private placement market	

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