May 2020

Market Update – Daily Fixed Income Trading Liquidity Update 8 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 $7bn per day during the week of May 11 (from $8bn per day the week of May 4). • Two factors were important in the US rates market this week: 1. The US Treasury Refunding Announcement: The announcement on May 6 was higher than the market was expecting across the board, including a new issue of a 20-year bond. In response, the US Treasury curve steepened. 2. Fed Funds Futures (and FOMC OIC) trading with negative yields: A combination of a large initial jobless claims number on Thursday, headlines from congress on China trade wars heading up again, dovish comments from the Fed throwing cold water on market participants' hopes for a "V" shaped economic recovery, as well as some technical factors pushed Fed Funds Futures into negative territory in January 2021 contracts.	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 pushed wider during May 6-8 as heavy new issue supply began to weigh on the secondary market. • New issue supply remains busy with $54 bn in new issues coming to market between May 6 and 8. The market continues to see some companies that issued last month return to the market. Concessions ticked up and investors are being selective by	US IG spreads are generically 4x wider vs normal market conditions AT1/Preferreds are 2-3x wider vs normal market conditions

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Sector	Liquidity Trading Comment	Bid-Ask Spreads
	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. Liquidity tailed off toward the end of the week ending May 8 as holidays in the UK led to lower volumes in the latter half of the week. • 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 were very low in the latter part of the week. **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** • The tone of high yield in recent weeks has been tied to equities—with high yield closely following equity market moves. • On May 8, the US high yield market was generally up, but lagged equities • The new issue market remains topical with $9.8 bn pricing this week. **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.	Spreads are 1 point wider than normal times for BB-rated securities Spreads are 1-2 points wider than normal times for B-rated securities Spreads are 2-4 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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Sector	Liquidity Trading Comment	Bid-Ask Spreads
	• The market continues to see healthy two-way flows but bid/ask spreads remain elevated. **CDX HY** • CDX HY slightly underperformed the broader macro tone, mainly due to heavy supply in both investment grade and high yield markets. • Trading volumes remain light as volatility is at the lowest levels in over a month. • Bid/ask spreads have declined but remain elevated relative to pre-crisis levels.	
Emerging-Market Debt (EMD)	**Hard Currency EM** • Hard currency EM debt traded firm all week, tracking global macro risk as the JP Morgan index tightened ~30bp to close at a spread of 582bp, the first sub-600bp close in 3 weeks and the tightest level since mid-March. • Oil exporters continued to outperform across the index. • As expected, issuance shifted down in quality as Bahrain printed the first large-cap high-yield sovereign deal which was 5x oversubscribed and had a marginal (~5-15bps) new issue premium, an indication of healthy investor risk appetite. • Supply continues to come to market with 5 deals already priced this week, all ~4-7x oversubscribed even with limited new issue premiums. • Liquidity continues to improve as transaction costs have slightly narrowed over the last week. **Local Currency EM** • Local EM rates continue to track macro risk and the moves in currencies. • 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 first new CMBS issue since March priced on Thursday May 7. Demand for all tranches was robust and classes were multiple times oversubscribed. Strong demand led the deal to price well inside of initial guidance. The 10-year AAA-rated tranche tightened 10 basis points, the A-rated class tightened 115 bps, and the BBB-rated class was tighter by 90 bps. • We saw a fair amount of selling in the secondary market in AAA-rated down to A-rated securities. The selling continues to be well absorbed and demand remains firm. • It appears bid/offer spreads have compressed but	

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	remain elevated. CMBS AAA, AA/A, and BBB bid/offer spreads are approximately 3x, 3x, and 4x pre-COVID levels. • Volumes in CMBX.6 remain depressed. As a result, the index is trading in a very narrow range. Due to the lack of transacting, liquidity has not improved, and bid/offer 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 two deals—one student loan and one auto—totaling $1.2bn for the week ending May 8. Year-to-date ABS supply stands at $56.9bn compared to $84.6bn in the previous year. • There is currently $1.2bn in pre-marketing across prime and non-prime auto loan ABS, which will price by the week ending May 15. • Indicative benchmark ABS spreads tightened by 5bp across credit card, 5bp-40bp across nonprime auto loan, and 15bp-80bp across equipment ABS, mostly reflecting better flows in secondary. While FFELP and private credit student loan ABS remained unchanged on the week, prime auto loan ABS tightened, except for 3-year A- and BBB-rated credit widening by 5bp, to reflect the current new issue pricing. **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. • While bid/ask spreads have come in measurably since the peak of the crisis, they were unchanged week over week.	

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	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	
Money Market	• The big story circulating in money markets is that Fed Fund Futures are pricing in negative rates for late 2020 and 2021. However, the majority of the market does not expect this to occur, since Fed Chair Powell has repeatedly stated that setting policy rates below 0% was not an appropriate policy tool. • LIBOR continues to set lower as short-maturity markets stabilize. There was no LIBOR setting on May 8 due to a UK holiday, so 1-month LIBOR remains at 0.20% and 3-month at 0.44%. • The Treasury refunding statement mentioned very little on money markets. The Treasury did state that they will continue to issue Cash Management Bills (CMBs) through at least July and will make weekly announcements on size and tenor every Tuesday and Thursday. Exorbitant T-bill supply is the new	

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	norm. T-bill bid/ask spreads remain 2-3bp. • There is good liquidity in the repo market, with repo rates holding tight in the middle of the 0.00 to 0.10% range.	
US Municipals	• It was a strong and busy week for municipal bonds. The muni/Treasury ratio is still over 200%, which is attracting crossover buyers. That combined with the Fed lending program (which could provide $500bn in short-term relief to State and Local governments) pushed benchmark yields lower as the week progressed, which ended the week 20bp tighter for short maturities and 15bp tighter for longer maturities. • In the primary market, there's still a distinction in demand between higher- and lower-rated credits. Higher rated credits (A- and above, like Penn State University and the NY City Metropolitan Transportation Authority which came with deals this week) are seeing strong demand, while lower-rated credits are still receiving limited interest. • In terms of liquidity, odd lots remain difficult to sell without taking a significant concession from round lot pricing. In general, <1mm pieces are still receiving bids anywhere from 2 to 6 points below round lot bidside evaluations, with the smallest pieces at the top end of that range or wider. • High yield odd lot liquidity remains challenged with it very difficult to solicit a bid. • For context, high grade odd-lots typically trade 0.10-1 points below round lot bid-side 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.	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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- 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. However, the market has improved in telco and bank sectors.
- 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

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