AllianceBernstein

September 2020

## Market Update – Fixed Income Trading Liquidity
## For the Week Ended 11 September 2020

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 at the end of each week.

| Sector | Liquidity Trading Comment | Bid-Ask Spreads |
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| US Treasuries | • Global developed-market interest rates "bull flattened" for the second week in a row during the week ended September 11. The US outperformed most countries with the exception of the UK.<br>• The highlight of the week was the selloff in the growth stock complex along with the ECB meeting that focused on the negative impact of the pandemic on inflation dynamics, developments to the exchange rate and the balance of risks still skewing to the downside.<br>• There were no meaningful changes on the liquidity front from the prior week. Federal Reserve bond purchases stand at $80 bn US Treasuries and $60 bn MBS per month. | Bid-offer spreads for on-the-run US Treasuries has improved significantly and are in line with pre-crisis conditions.<br><br>Off-the-run Treasury bonds that are not in cheapest-to-deliver futures baskets are still trading with bid/ask spreads 2-3x wider than pre-covid-19 levels.<br><br>TIPs bid/ask is 1.5x wider vs pre-crisis levels |
| Investment Grade (IG) Corporates | **US IG**<br>• US IG cash bonds were a touch weaker during the week ended September 11. The index was marked 2 bp wider, outperforming the broader macro tone despite heavy supply.<br>• The Fed's weekly report showed that the Fed purchased $34 million for its secondary market purchase program (SMCCF) between September 2-8. This was well below the pace when the program began when the Fed bought an average of $1.4bn/week for the first seven weeks.<br>• Primary market activities picked up after the Labor Day holiday in the US, with $69 billion in IG supply coming to market for the week ending | US IG spreads are generically 2x wider vs normal market conditions<br><br>AT1/Preferreds are 2x wider vs normal market conditions |

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| | September 11. Demand remains strong for IG paper, particularly on high-beta deals, with the average oversubscription ticking up to 3.7x<br>• Bid/ask spreads remain wider than pre-crisis levels.<br><br>**European IG**<br>• Secondary volumes remained very light with the focus on supply. While supply wasn't as heavy as it could have been, the amount that did print was well received, with books multiple times oversubscribed. Of note, even when secondary market follow-through was lackluster, it did not stop subsequent deals from following a similar game plan.<br>• During the weakness in the latter half of the week ended September 4, liquidity remained fairly light (with not as many participants transacting) as new issue participation and trading remained the focus of the market.<br><br>**REIT Preferreds**<br>• Liquidity in the REIT preferred market is limited under more normal conditions but has improved from 2-3 months ago.<br>• 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.<br>• Trading volume is trending low since valuations continue to recover. | |
| High Yield (HY) Corporates | **US HY**<br>• Focus in the US HY market was on new issue during the week ended September 11, with $16bn in new deals pricing across 19 issuers in the 4 days following the holiday weekend. Above-market-yielding new issues outperformed, while sub-4% yielding deals struggled. Use of proceeds was skewed towards refinancing, with $6.7bn out of the $16bn that priced last week going to pay off bonds. This left little focus on secondary market trading but strong technicals supported the USHY market even on down equity days.<br>• The index spread was 8bp wider on the week, to 496bp. This compares to March 23 wide levels of 1100 bp and pre-covid-19 tight levels of 341 bp on Feb 13 and post-covid-19 tight levels of 471 bp on August 3. | Bid/ask spreads vary by issuer but generically:<br><br>BB-rated securities: 0.75-1.25 points, which is 0-0.25pt wider versus normal market conditions<br><br>B-rated securities: 1-1.5 points; 0 to 0.5pt wider vs normal<br><br>CCC-rated and below: 1.5-2.5 points; 0 to 1pt vs normal |

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| | • The CCC-BB spread was 9 bps tighter to 601 bp. This compares to April 6 wide levels of 1139 bp and pre-covid-19 tight levels of 613 bps on February 13.<br>• CCC-BB ex-energy was 3 bps tighter to 489 bp, which remains at pre-covid-19 levels. This compares with April 6 wide levels of 946 bp.<br><br>**Euro HY**<br>• The primary market has come into focus within Euro HY, bringing a pause to the technical strength seen in some parts of the market. It appears to be more of a buyer's strike than a need for funds to raise cash, given the reports of net inflows and since the new issue supply was the first seen in about a month.<br>• Primary market deal performance was mixed, with tighter-trading, BB-rated deals pricing with minimal concessions and trading around re-offer levels, while above-market-yielding, B-rated deals performed well, trading up >1 point on average.<br>• Secondary market technicals were generally similar, with stronger demand for single-B rated issues, where supply is expected to be limited and investors are generally less exposed. Several lower-credit-quality issuers saw positive reaction to earnings/headline-related updates, which brought some general strength to other wider-trading issuers.<br>• Another worthwhile technical that has developed is the deep bid for distressed Euro HY assets. There have been a number of restructuring headlines in recent weeks, with the issuers' debt being aggressively bought by the distressed community, and prices retracing to pre-restructuring headline levels (and in several cases trading better).<br><br>**CDX HY**<br>• CDX HY traded lower with equities during the week ended September 11.<br>• Trading volumes began to pick up as the market heads to the roll.<br>• Bid/ask spreads have declined but remain elevated relative to pre-crisis levels. | CDX HY bid/ask is 1-2x vs normal conditions. |
| Emerging-Market Debt (EMD) | **Hard Currency EM**<br>• EM credit index spreads continued their grind tighter during the week ended September 11, | EM IG sovereigns are 1.25-1.5x wider vs |

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| | tightening another 7 bps, driven by persistent inflows into the asset class.<br>• Secondary market activity was relatively muted as supply took center stage with over $8bn in new issues coming to market, across 10 deals in Latin America and CEMEA. Latin American HY corporates were the lion's share of the issuance, with deals well subscribed and breaking up ~1 point on average.<br><br>**Local Currency EM**<br>• Liquidity is close to normal. | normal market conditions<br><br>EM HY sovereigns are 1.25-1.5x wider vs normal market conditions<br><br>EM IG corporates are 1.25-1.5x wider vs normal market conditions<br><br>EM HY corporates are 1.25-1.5x wider vs normal market conditions |
| Asia | **Asia Hard Currency**<br>• Asia hard currency credit spreads were generally weaker over the week ended September 11, with spreads 5 to 15 bp wider.<br>• Asia high yield also traded lower, down 1-3 points on smaller volumes.<br>• Liquidity was normal, although volume was on the low side as market participants await further new issues.<br><br>**Asia Local Currency**<br>• Asia local currency debt markets had a turbulent week, with higher-beta/carry markets underperforming, while low-beta Singapore and Thailand were better bid.<br>• Indonesian bonds sold off 20bp and the currency weakened as covid-19 concerns picked up amid Jakarta reinstating social restrictions.<br>• In Malaysia, Bank Negara Malaysia held the Overnight Policy Rate unchanged at 1.75%. The Bank's statement was interpreted as less dovish and Malaysia Government Securities (MGS) yields finished the week 6 to 19 bps higher. | Asia IG credit is ~1 to 1.2x wider vs. normal market conditions<br><br>Asia HY credit is ~1 to 1.5x wider vs. normal market conditions<br><br>Asia local currency debt is ~1 to 1.2x wider vs. normal market conditions |
| Securitized | **CMBS**<br>• The CMBS market is expecting two new conduit deals to be announced during the week beginning September 14. The additional supply is expected to be welcomed by the market, as there has been a dearth of new issuance.<br>• The secondary market remains well-supported. A strong bid has emerged for seasoned mezzanine | |

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| | tranches and demand at the top of the capital stack persists.<br>• In CMBS, AAA bid/offer spreads have retraced the post-COVID widening, while AA/A and BBB-rated classes remain 2x their historical average.<br>• CMBX.6 continues to trade heavy as flows remain depressed. Dealers remain flat risk in most tranches. Liquidity is expected to remain challenged until trading volumes increase or risk-taking returns. Bid/offer spreads are slowly moderating, with A.6 and BBB-.6at approximately 2x and BB.6 at ~3x their normal bid/offer spread.<br><br>**ABS**<br>• The ABS primary market priced nine transactions for the week ending September 11 totaling $5.6bn across container lease, floorplan, auto fleet, non-prime auto loan and private credit student loan sectors. ABS year-to-date supply now stands at $122bn compared to $163.9bn recorded in 2019 over the same time period. Spreads held firm to slightly tighter during the week under heavy new issuance volume. Oversubscription levels and tighter-than-guidance pricing spreads continued to suggest strong demand.<br>• In the secondary markets, ABS continued to trade through comparable new issue benchmarks. With ABS spreads having mostly recovered since late March and all-in funding yields at record lows, we are seeing a resurgence of new issues from the smaller ABS sectors. Secondary spreads tightened 2-5bp across fixed prime auto loan, 0-20bp across subprime auto loan, 1-20bp across equipment, 2-5bp across stranded assets and 2bp across floating credit card ABS.<br>• The Manheim Used Vehicle Value index established a new all-time high at 163.7 for the month of August (indexed to 100 in Jan. 1995), surpassing the previous record of 158.0 in July.<br>• In the week ahead, thirteen deals are premarketing for a total of $8.8 bn and 3 issuers that have filed 15G forms.<br><br>**CRTs**<br>• The Labor Day holiday did not stand in the way of volumes picking up during the week ended September 11. CRTS are mostly unchanged on the week, with the exception being B1 bonds. After a swift rebound from the covid-19 crisis selloff, | |

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| | demand for B1s tapered off towards the end of June and July. B1s were mostly range-bound in August but the two weeks bookending Labor Day saw demand spike for these bonds and spreads tightened 50 bp.<br>• The other headline of note during the week was Fitch's downgrade of 18 fixed severity bonds, with most going from investment grade to below investment grade. Fitch sited the potential for cash flow disruption spiking due to Covid-19. Spreads have not responded much to the news and demand for the bonds seems unchanged. Liquidity remains robust in all subsectors within CRTs.<br><br>**Legacy Non-Agency RMBS**<br>• 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 around 200 bp discount margin currently.<br><br>**CLOs**<br>• The CLO market has performed very well. Spreads are closing in on pre-crisis levels. Top-tier managers are pricing at 125 bp (ask) for AAA-rated bonds and 165 bp (ask) for AA-rated bonds. This is within 5 to 10 bp of pre-crisis levels for significantly shorter structures (given these are 3-year non-call 1 vs 5-year non-call 2).<br>• Liquidity remains robust, especially at the top of the capital stack where blocks are trading with very little if any size discount. Bid/ask spreads have now cured to pre-crisis levels.<br><br>**Agency MBS**<br>• 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 | • Government money market funds saw outflows of $14 billion in the 7 days ending September 11. Prime funds saw outflows of $7bn over the same period. The commercial paper market has fared well despite headlines of some asset managers converting their prime funds into government funds. Incremental supply from prime fund pull backs is expected to be absorbed by other investors (SMAs, pensions, state/local, corporates, etc.) | |

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| | • LIBOR tightened week over week: 1-month LIBOR set at 0.15% and 3-month LIBOR set at 0.24%. | |
| US Municipals | • During the week ended September 11 the municipal market had a slower start after the long weekend, with very little activity in the beginning of the week. On the week, the muni AAA benchmark yield tightened 2bp in the front end (2025 and in) and widened 1bp in longer bonds (2029 and longer). The ratio of muni to US Treasury yields was roughly constant over the week with the front end <100% and the long end ~110-112%.<br>• Flows into municipals continue to be positive. Supply is generally expected to be lower in September/October versus recent history given the busier than usual summer and with the recent increased taxable municipal issuance.<br>• The primary market priced $8.3bn in new issues, split $4.9bn in tax-exempt and $3.3bn in taxable. Tone in high quality municipals was modestly softer, with the volume of bid wanted increasing and the balance of dealer buying slightly more than dealer selling mid-week for the first time in a while. Despite that, demand for lower-quality investment-grade and high-yield issuers was strong, with the $578mn BBB LBJ infrastructure deal seeing double-digit subscriptions and healthy subscriptions for other "spreadier" names as well. The NY MTA announced a $900mn long bond competitive deal in the coming week. The last deal they brought competitively for shorter-maturity bonds ended up using the Fed's Municipal Liquidity Facility program rather than selling to the market.<br>• Odd lot discounts to round lot bid-side evaluations were 1 to 1.25 points for 5 to 15k size and 0.5 to 0.75 points for odd lots < 1 mn. | |
| Canadian Market | **Federal**<br>• Liquidity is best in benchmark issues for block sizes of <=CAD25 million; liquidity has improved in off-the-run, high coupon bonds with Bank of Canada (BOC) bond buying. Comments by central bank Governor Macklem that the BOC will buy at least $5 billion of Canadian government bonds per week until the recovery is well underway should continue to support market liquidity. The fact that the BOC will buy more bonds at the long end of the curve should support liquidity at the 30-year part of the yield curve. | Federal: bid/ask typically +0.5 bp but for the long end of the curve, it can be more depending on volatility (risk off markets) and size outstanding. Off the run Canadas can have a 10 bp bid-ask given small outstanding size in these securities. |

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| | • The BOC has purchased C$122.3 billion to support liquidity in Government of Canada markets since the purchase program started on March 27 through September 9. | |
| | **Provincial**<br>• Liquidity is best in benchmark bonds from Quebec, Ontario and British Columbia.<br>• Concessions are requested so dealers will take less-liquid positions.<br>• Secondary-market liquidity in oil-generating provinces (Newfoundland, Alberta, Saskatchewan) has improved with WTI around US$37 per barrel.<br>• 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.<br>• The BOC has purchased C$8.2bn in par value year to date through September 9 within their provincial buying program to support liquidity. | Provincial: concession of +1 bp and more on size > CAD 25 million, particularly at the longer end |
| | **IG Corporates**<br>• Limited liquidity, particularly during risk-off trading days; many dealers are maintaining low balance sheet inventories, so will not provide bids in many sectors.<br>• Trading on an agency basis for high-beta issuers. The market has improved in sectors such as banks and telecom companies.<br>• The central bank has bought a relatively small amount of corporate securities to date (C$150 million par), indicating the impact is limited. The central bank did not buy additional bonds in recent weeks (as of September 9). BBB- bonds are trading by appointment unless there is a new issue. The corporate calendar is more active in September, which should promote corporate market liquidity. | BBB- corporates are trading by appointment, particularly in the energy sector. Inventories are reduced and dealers are not looking to increase their BBB- exposure. Dealers estimate bid/ask could be as high as +20bps on BBB- |
| | **Real Return Bonds (RRBs)**<br>• The C$400 million RRB auction of the long Canada 0.5% Dec. 2050 on September 2 provided liquidity in the benchmark RRB bond for a limited period in the benchmark RRB bond.<br>• The program to purchase Government of Canada securities in the secondary market – the Government Bond Purchase Program or GBPP – should help liquidity since it includes RRBs. The program began on May 27. The BOC bought a total of C$700mn with C$100mn per line of the 7 Canada | Provincial RRBs trading by appointment only. Dealers do not hold these securities on their balance sheet. |

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| | RRBs from 2021 to 2047. Even with the central bank buying net C$400mn 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. | |