AllianceBernstein

August 2021

## Market Update – Fixed Income Trading Liquidity
## For the Week Ended 20 August 2021

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 | • The global developed market interest rate complex rallied modestly during the week ended August 20, with the US Treasury curve bull flattening—the 5s30s curve was 7bp flatter week-over-week. The price action was attributable to the pulling forward of FOMC tapering and rate hike expectations and a combination of risk-off drivers, including China technology sector regulations and the global spread of the covid-19 delta variant. These concerns have led to concern about 2H2021 growth, and growth proxies such as equities, commodities, and inflation breakevens sold off during the week.<br>• Trading volumes are expected to drift lower in the typical summer seasonal pattern.<br>• Liquidity in terms of market depth in on-the-run cash 5-year and 10-year Treasuries has improved 80-90% from the challenges seen in February 2021. Market depth in the 30-year part of the curve has improved ~80% since February.<br>• Observable bid-offer spreads are in line with historical averages in the most liquid bonds. Transaction costs in off-the-run bonds are wider but have improved meaningfully since late February.<br>• In TIPS, on-the-run bond bid-offer spreads are 1-2 ticks wide during the most liquid parts of the day; off-the-run bonds in 5-10 year maturities are ~4 ticks wide; longer-maturity TIPS are trading 8-10 ticks wide.<br>• Federal Reserve bond purchases continue at $80 billion US Treasuries and $40 billion MBS per month. | |
| Investment Grade (IG) Corporates | **US IG**<br>• The US IG market leaked wider during the week ended August 20, on the back of macro volatility, with index spreads moving 3 bp wider week-over-week. Relative to the prior week, supply was light, with just under $10 bn pricing during the week. | Bid/ask conditions in the IG market are back to normal |

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| | • Trading volumes were light, down 15-20% relative to the past 4-5 weeks and engagement is expected to be low as Labor Day weekend approaches.<br>• On the back of the US Treasury curve flattening after the FOMC minutes, the 10s30s credit curves steepened a touch.<br>• Overnight flows were quiet during the week, but Asia investors continued to be net buyers of long-maturity bonds.<br>• There were $4.3 billion in inflows during the week.<br><br>**Euro IG**<br>• European IG spreads continued to be fairly immune to broader macro volatility, trading modestly wider during the week ended August 20 with low trading volumes in the height of the summer lull.<br>• The calendar was also light, but supply is expected to increase in coming weeks.<br><br>**REIT Preferreds**<br>• Liquidity in the REIT preferred market is typically limited under more normal conditions given the retail nature of the investor base.<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. | |
| High Yield (HY) Corporates | **US HY**<br>• There was a summer mindset during the week ended August 20 in the US High Yield market. Secondary activity was very quiet with most activity limited to recent new issues and select idiosyncratic situations.<br>• US HY index spreads ended the week 3 bp wider week-over-week to 312 bp. The CCC-BB spread difference was 16 bp wider to 319 bp.<br>• New issuance slowed materially with $5.025 bn pricing across 7 deals, down from $14bn the prior week.<br><br>**Euro HY**<br>• In the week ended August 20, trading volumes continued to be very light amid the August summer lull. Overall, there was minimal price action, but prices drifted lower.<br>• Bid-ask spreads remain unchanged and in line with normal market averages.<br><br>**CDX HY**<br>• CDX HY traded weaker along with the macro tone during the week ended August 20. Amid the macro volatility, hedging activities weighed on the market on the margin.<br>• Trading volumes were above the 30-day average amid the volatility. | Bid/ask spreads vary by issuer but generically:<br><br>BB-rated securities: 0.75 point, which is in line with normal market conditions<br><br>B-rated securities: 1 point, which is in line with normal market conditions<br><br>CCC-rated and below: 1.5points which is in line with normal market conditions<br><br>CDX HY bid/ask is in line with normal conditions. |

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| | • Bid/ask spreads have declined to pre-crisis levels. | |
| Asia | **Asia Hard Currency**<br>• During the week ended August 20, Asia credit index spreads tightened 2 bp and the index returned 0.5%, assisted by a bull-flattening rally in US Treasury bonds.<br>• Primary market activity remained slow with USD 4.3 billion pricing vs 2.4 billion the previous week.<br>• Bonds issued by Huarong Asset Management rallied by as much as 13 points on news of a material capital injection by a consortium of state-owned entities.<br>• China high yield property bonds remained volatile as earnings season progressed with single-B-rated bonds underperforming.<br><br>**Asia Local Currency**<br>• Asia local currency bond yields were generally lower following the downward movement of global interest rates.<br>• China government bond yields resumed their grind lower with yields declining by ~2-4bp over the week as economic releases continued to surprise to the downside, this time on retail sales and industrial production.<br>• Korea treasury bonds rallied ~3-6bp due to a meaningful correction in equities, with the KOSPI selling off 3.5% on analyst reports of a potential downturn in semiconductor prices as well as the ongoing outbreak of the delta variant in the country. | Liquidity conditions are normal for Asia credit.<br><br>Liquidity conditions are normal for Asia local currency debt |
| Securitized | **ABS**<br>• The ABS primary market priced six transactions for the week ending August 20 totaling $5.3bn across consumer loans, tax liens and prime and non-prime auto loans sectors. ABS year-to-date supply now stands at $169.4bn compared to $111.2bn and $150.5bn recorded over the same period in 2020 and 2019, respectively.<br>• The current year-to-date issuance supply pace for ABS has been the highest on record since the financial crisis. Despite the abundance of supply, indicative benchmark spreads continue to remain at or near cyclical tights – with the exception of some cheapening in Consumer and Commercial spreads (+3bp to +5bp across AAA to BBB and +25bp for BB) and Esoteric spreads (+3 to +5bp across AAA to BBB and +10bp for BB).<br>• The forward calendar has no deals pre-marketing. ABS issuance is expected to wrap up for the year before any taper event by the Fed, and as such, issuance activity is expected to be concentrated in September and October.<br>• Recent performance trends have been within expectations. In general, consumer ABS pools remain at/near record low losses, while delinquencies have trended up slowly. Payment | |

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| | and prepayment rates remain elevated as consumers continue to pay down debt.<br><br>**CMBS**<br>• During the week ended August 20, the CMBS curve steepened. At the top of the capital stack, AAA-rated spreads were unchanged. BBB-rated classes were 3bp wider. No new issues priced, and only one single asset/single borrower (SASB) deal is expected to price in the near term.<br>• The technical backdrop remains positive, although macro volatility and continued fears of the economic impact of the delta variant are potential headwinds.<br>• Bid/offer spreads in AAA to A rated tranches have retraced their post-COVID widening, while BBB rated classes remain 2x the historical average.<br>• In contrast to the limited flows in CMBS, there was volatile price action in CMBX, particularly series 6 BBB-. Prices fell nearly 2.25 points on Tuesday, driven by hedge fund investor shorts but by end of week had recovered half the losses. Liquidity can be challenging at times, however CMBX bid/offer spreads remain unchanged and have retraced their post-COVID widening.<br><br>**CRTs**<br>• The technicals in the CRT market continued to improve during the week ended August 20, with Freddie Mac taking the remainder of August off from issuance. A small MI deal from Enact (Genworth MI) is expected during the week of August 23.<br>• Secondary market liquidity is robust, and bid/ask spreads remain tight, around pre-covid levels.<br><br>**Legacy Non-Agency RMBS**<br>• Legacy RMBS continue to trade well. After having widened to the 1000-1200 bp range in March 2020, spreads are currently trading inside 200 bp discount margin.<br><br>**CLOs**<br>• Generic primary market clearing levels on the week stood roughly at 114-119 bp for AAA-rated spreads; AA-rated spreads at around 160-165 bp; A-rated at 200-210 bp; BBB-rated at 295-310 bp; and BB at 600-650 bp.<br>• Liquidity remains robust in the CLO market. Bid/ask spreads remain at or around pre-crisis levels.<br><br>**Agency MBS**<br>• Bid/ask spreads in Agency MBS remain well supported, given the Fed purchases of $40bn per month. Current coupon bonds | |

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| | are trading at 0.5-1 tick wide and the rest of the coupon stack is wider by 2-2.5 ticks. | |
| Money Market | • The Fed Reverse Repo facility (RRP) usage was around $1 trn.<br>• 1-month LIBOR set at 0.084%; 3-month LIBOR set at 0.129%.<br>• SOFR set at 0.05%. The Effective Federal Funds Rate set at 0.09%.<br>• There was some concern around late October/early November US Treasury maturities as investors believe the government will run out of "extraordinary measures" and potentially default on its debt. Congress must raise or suspend the debt ceiling to avoid default.<br>• Government money market funds had $11 billion of outflows in the week ended August 20. Prime funds had $3bn of outflows over the same period. | |
| US Municipals | • In the week ended August 20, the benchmark AAA municipal bond curve was unchanged on the week, outperforming US Treasuries by 1bp in short maturities, and underperforming by as much as 8bp in longer maturities.<br>• Demand continues to be focused on short-maturity bonds.<br>• Municipal high yield continues to be supported with a strong technical picture of inflows, robust investor cash balances and insufficient supply, leading even the lowest quality deals to be heavily oversubscribed.<br>• There has been some repricing in mid-grade bonds – reportedly due to valuation as these bonds had begun to trade at/near high-grade bond valuations.<br>• Liquidity remains strong, with odd lot discounts to round lot bid side levels ranging from 0.25 to 1 point depending on size and rating. | |
| Canadian Market | **Federal**<br>• Liquidity is best in benchmark issues for block sizes of <=CAD25 million. Bank of Canada (BOC) is "buying at least $2 billion of Canadian government bonds a week until the recovery is well underway.'' It should continue to support market liquidity. "Purchases of longer-maturity bonds have a greater impact, dollar-for-dollar spent, by removing more term risk from markets and putting downward pressure on term premiums. Lower term premiums imply lower GoC bond yields, all other things equal."<br>• The latest BOC balance sheet shows that the central bank continued to support liquidity in Canadian markets (as of August 18).<br>• The Government Bond Purchase Program (GBPP) has resulted so far in $257.49bn in net buying (assets minus liabilities minus position at the start of the QE in March 2020). As expected, there was a reduction of QE bond buying to $2bn per week after the July BOC meeting. | Federal: bid/ask was at 5 cents in the 10-year area, but for the long end of the curve, it remains relatively wider at up to 12 cents given the recent higher volatility. Off the run, high coupon Canadas were reported to have limited liquidity in volatile periods with much wider bid-ask given small outstanding size in these securities. For example – the latest ultra-long Canada 2064 bid-ask is at 35 cents, |

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| | • According to the latest BOC research, Federal debt is the most liquid sector within the Canadian fixed income markets.<br>• Looking ahead, the central bank has gone into silent mode with a federal election on September 20, providing limited feedback to investors on Canadian capital market liquidity.<br><br>**Provincial**<br>• Liquidity is best in benchmark bonds from Quebec, Ontario, and British Columbia.<br>• Depending on market tone, concessions may be requested in order for dealers to take less-liquid positions.<br>• Most dealers will not bid aggressively on off-the-run, high coupon provincial issues but will favor agency trades.<br>• The Bank of Canada’s Provincial Bond Purchase Program (PBPP) has ended. Therefore, the central bank does not provide a back stop to the provincial sector. Reduced trading activity during summer months could hinder liquidity.<br><br>**IG Corporates**<br>• The latest Bank of Canada research highlights the limited liquidity in Canadian corporate bond markets, which can impact pricing; many dealers are maintaining low balance sheet inventories, so will not provide bids in some sectors such as telecommunications, pipelines, and transportation.<br>• Trading is on an agency basis for issuers affected by mergers and acquisitions.<br>• The Bank of Canada had a buying program (focused on securities of 5-years or less) to support liquidity for corporate bonds rated BBB and higher. As expected, the BOC has ended this Corporate Bond Purchase Program (CBPP) in May 2021.<br>• Lower corporate supply in summer months could lead to reduced secondary market liquidity and lower trading volumes – there was not a single new corporate bond issue during the week ended August 20.<br><br>**Real Return Bonds (RRBs)**<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.<br>• Trading in Canada RRBs continues to show a continued lack of liquidity. Trading a block can only be done on an appointment basis.<br>• Finance Department documents indicate that Canada will issue only C$1 billion in RRBs in the current fiscal year with four auctions. This will result in net negative supply (BOC buying program plus maturities less new supply). The last $400m RRB auction in the RRB Canada 2054 bond reflected the net negative supply with a $316m buyback RRB program and estimated $800m + in coupon payments on June 1. | reflecting its liquidity issues given this is not a benchmark.<br><br>Provincial: concession reported to be above average on size > CAD 25 million, particularly at the longer end. In risk-off markets, liquidity is drying up and spreads can widen depending on market tone.<br><br>BBB- corporates are generally trading by appointment, particularly in the energy sector. Inventories are reduced and dealers are not looking to increase their BBB- exposure. Dealers may refuse to bid in a risk off market with gaps in spreads.<br><br>Provincial RRBs trading by appointment only and activity is rare. Dealers do not hold these securities on their balance sheet. Bid-ask is not a reliable indicator for trading. |

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| | • Liquidity remains challenging, trading by appointment, as dealers hold very limited inventories in RRB securities. The next RRB auction is expected in September 2021. | |

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