AllianceBernstein®

October 2021

Market Update – Fixed Income Trading Liquidity
For the Week Ended 22 October 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
US Treasuries	• During the week ended October 22, risk assets traded higher again. Energy markets continued to trade higher, with Brent crude higher by 0.8%. Five-year inflation breakevens in the US and UK expanded by 15 and 25 bp respectively. • Interest rates were volatile during the week, with bear flattening momentum continuing. US Treasuries saw the 5s30s curve more than 4bp flatter, Germany was 14bp flatter and the UK was 8bp flatter. The broad themes driving curve movements included hawkish market pricing of central bank moves and inflation expectations moving higher. • Significant issuance came to market, including a 6bn 2053 maturity UK green gilt. • Transaction costs as measured by bid-to-offer spreads have widened in the long end of the US Treasury curve from 1 tick wide to 1+ ticks wide amid recent volatility. Importantly, this widening is not due to dealer balance sheet constraints. • 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. Nominal Treasury bid-ask spreads are trading in line with recent historical averages of 3/8 to 1/2 tick wide in 5-year notes, 1/2 tick wide in 10-year notes, and between 1/2 to 1 tick wide in 30-year notes depending on the size (a tick is 1/32 of a percent). • Liquidity in terms of market depth in on-the-run 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. • 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 ~2-3 ticks wide; longer-maturity TIPS are trading 6-7 ticks wide.	

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	• Federal Reserve bond purchases continue at $80 billion US Treasuries and $40 billion MBS per month.	
Investment Grade (IG) Corporates	**US IG** • The US IG credit market traded sideways during the week ended October 22, underperforming the macro tone. The index closed 1 bp wider week-over-week at 86 bp. • New issue supply overwhelmed expectations as ~$46bn priced during the week, with $14.1bn from US banks and $21bn from the long-awaited Aercap deal. Technicals remain supportive, although selective. Deals were 2.6x oversubscribed on average despite deals pricing with little to negative concession and performed well in the secondary market with the average deal bid 6bp tighter. • Investors sold $3.3bn of bonds across the curve during the week on the back of heavy supply and there continued to be strong buying of long-maturity bonds by Asia investors. The positive momentum on flows accelerated with an inflow of $3.84bn. **EUR IG** • Half-term week and earnings season resulted in slower secondary market volumes during the week ended October 22. Spreads were broadly unchanged/tighter, albeit with modest decompression. However, AT1/hybrid prices moved anywhere from 0.125-1 points lower, impacted by interest rate moves, but there did not seem to be panic selling in the space. • Technicals in Euro IG benefited from light supply. Just EUR4.75bn priced during the week, primarily issued by smaller, more niche names, thus limiting their overall impact on the market. There were modest new issue concessions, ranging from 0-6 bp, and deals performed up to 6 bp tighter. • The start of third quarter 2021 European bank results showed a constructive trend so far, as Nordic banks showed good performance and announced interim dividends/buybacks. **REIT Preferreds** • Liquidity in the REIT preferred market is typically limited under more normal conditions given the retail nature of the investor base. • 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.	Bid/ask conditions in the IG market are back to normal
High Yield (HY) Corporates	**US HY** • It was another unremarkable week in the US HY market during the week ended October 22. The secondary market was generically softer during the week, but outperformed the interest rate moves, with index spreads ending the week 4 bp	Bid/ask spreads vary by issuer but generically:

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	tighter at 285 bp and the yield-to-worst 6 bp wider to 4.22%. The CCC-BB spread difference was 6 bp wider to 335 bp. • The primary market continued to be active with $8.355 bn pricing across 9 deals. • One technical of note during the week: on Wednesday a highly followed model portfolio increased its allocation to a fallen angel ETF, which led to flows into the ETF and pulled prices higher/spreads tighter on fallen angels. **CDX HY** • CDX HY traded a touch weaker, underperforming the macro tone during the week ended October 22. Flows continued to be two-way, driven mainly by positioning in the volatility market. • Daily trading volumes were above average with option expiry on Wednesday.	BB-rated securities: 0.75 point, which is in line with normal market conditions B-rated securities: 0.75 point, which is in line with normal market conditions CCC-rated and below: 1.25 points which is in line with normal market conditions CDX HY bid/ask is in line with normal conditions.
Emerging Market Debt (EMD)	**Hard Currency EM** • It was a volatile week in EM credit during the week ended October 22 with high yield continuing to lag and several idiosyncratic situations threatening contagion risk. Index spreads were a few basis points tighter overall, but high yield de-compressed from investment grade bonds by ~10bp as consensus positioning continued to weigh on HY. • In Turkey, the central bank delivered another dovish surprise interest rate cut of 200bp, and CDS closed the week 15bp wider. • The main focus of the week was Brazil, with the fiscal deficit taking front stage as President Bolsonaro looked to increase social spending (exceeding the spending cap) along with cutting fuel prices to avoid trucker strikes. A number of key technocrats resigned, which disrupted markets, and there were rumors that Economy Minister Guedes was also contemplating resignation. Asset prices bounced late Friday when that resignation did not materialize.	EM IG and HY sovereigns and EM IG and HY corporates are back to normal market conditions
Asia	**Asia Hard Currency** • Asia credit spreads tightened 13bp during the week ended October 22, which more than accounted for the US Treasury rate selloff and drove the index return to 0.1% stronger. • Primary market activity picked up with 14 deals pricing for a total of USD 16 billion. Issuance was focused on high quality issuers in the investment grade sector, including sovereigns, state-owned enterprises, and banks; sentiment around high yield credit remained fragile and vulnerable. However, the China high yield sector staged a meaningful rebound of 2.3% on the back of PBOC commentary guiding banks to continue	Liquidity conditions are normal for Asia hard currency IG credit. HY liquidity is more challenging especially in China HY with spreads 1.5x wider than normal. Liquidity conditions are normal for Asia local currency debt.

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	to lend to the sector. Indonesia and India HY also posted a strong return of over 1%. **Asia Local Currency** • Asia local currency bond markets suffered with yields generally rising by ~5-10 bp, as global rates resumed their march higher. • The New Zealand government bond curve bear flattened by 20-30 bp on the back of a significant upside surprise in 3Q inflation, which dragged regional yield curves higher. • The Indonesian curve bucked the trend and remained flattish on the week as the country benefits from higher commodity prices and the government is running well ahead of its bond issuance program.	
Securitized	**ABS** • The ABS primary market priced fourteen transactions for the week ending October 22 totaling $10.5 bn across aircraft, equipment, timeshare, solar, unsecured consumer, student loans, credit card, auto lease and prime and non-prime auto loans sectors. ABS year-to-date supply now stands at $219.3 bn compared to $159.6 bn and $202.4 bn recorded over the same period in 2020 and 2019, respectively. • Indicative benchmark ABS spreads were largely unchanged during the week. Plain vanilla credit card and equipment spreads tightened 0-3 bp on the week, reflecting strong execution in primary markets and robust secondary market demand. Esoteric ABS tightened ~5bp. • Technicals have been solid and fundamentals remain sound, with positive 3Q21 earning reports for major sponsors. The pandemic recovery remains on track as seen in the resilience of the timeshare ABS sector, both in terms of pricing as well as credit trends. **CMBS** • CMBS new issue supply continues to be robust, particularly in the single asset/single borrower market. Four deals priced during the week, totaling $2.5bn and there are 6 additional single asset/single borrower deals currently in various stages of the marketing process. Levels remain firm and the market has absorbed the supply with little indigestion. Bid/offer spreads have retraced all post-COVID widening. • Recent vintage CMBX (Series 10-14) performance was mixed week-over-week. Outperformance was concentrated at the top of the credit stack, where AAA-rated tranche spreads were unchanged to 1bp tighter. Seasoned series struggled, led by Series 6, where A, BBB- and BB rated classes were wider by 25/32/26 bp respectively. While trading volume is moderate,	

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	bid/offer spreads remain unchanged and have retraced all the post-COVID widening. **CLOs** • New issue CLO supply remains abundant, with numerous issuers coming to market during the week ended October 22. Despite the deluge of new issues, spreads remained firm. Generic primary market clearing levels on the week stood at roughly 110-120 bp for AAA-rated spreads; AA-rated spreads at around 160-165 bp; A-rated at 195-205 bp; BBB-rated at 295-310 bp; and BB-rated at 615-650 bp. • Liquidity remains robust in the CLO market. Bid/ask spreads remain at or around pre-crisis levels. **RMBS** • The RMBS primary market priced $5.2 bn during the week ended October 22. Agency investor deals accounted for a third of the supply. • On Tuesday, Fannie Mae priced the first CAS deal since the first quarter of 2020, with group 1 M1, M2, B1 and B2 classes issued at SOFR + 75, 155, 310 and 600 bp respectively and the deal breaking tighter by ½ point for the M1/M2 classes and greater than ½ point for the B1/B2 classes. • The deal contained several structural changes from the last CAS deal in 2020. Like recent STACR deals, the deal had a 5-year optional redemption date. However, the B3H class, which is retained by Fannie Mae, has a SOFR + 1,500 bp coupon as opposed to 0% in STACR deals. The B3H class is first in line to absorb losses. • Fannie Mae stated that they expect to bring a high LTV deal to the market next month. **Agency MBS** • Bid/ask spreads in Agency MBS remain well supported, given the Fed purchases of $40bn per month. Bid/offer spreads remain tight in the sector. Current coupon bonds are trading at 0.5-1 tick wide and the rest of the coupon stack is wider by 3-4 ticks. Higher coupons trade less frequently.	
Money Market	• During the week ended October 22, the Fed Reverse Repo facility (RRP) usage was ~$1.4-1.5 trn. • 1-month LIBOR set at 0.088%; 3-month LIBOR set at 0.135%. • SOFR set at 0.03% for a couple days (10/19-10/21) which was a surprise, as it is the first time SOFR has set below the Fed floor. This was due to the supply/demand imbalance in short maturities; additional cash from GSEs and specials activity in the repo markets caused SOFR to set lower. This is expected to revert when GSE cash leaves. • Effective Federal Funds Rate set at 0.08%.	

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	• The US Treasury is likely to run out of cash to meet obligations at the newly perceived “X-date” of December 3. The US Congress must raise or suspend the debt ceiling to avoid default. All December maturities have widened, currently trading at 6-10 bps. • Government money market funds had $3 billion of inflows in the week ended October 22. Prime funds were flat over the same period.	
US Municipals	• During the week ended October 22, municipals outperformed US Treasuries early in the week, until Thursday when higher US Treasury yields caused the municipal benchmark to adjust as much as 5 bp wider. The municipal-to Treasury ratios in 2 to 5-year maturities remain near historical low levels and investor offers/bid-wanted lists continue to be focused on this part of the yield curve. • A sizeable $10bn tax-exempt new issue calendar was met with inconsistent demand and many deals were repriced as much as 5-10bp cheaper to get done. • Odd-lot liquidity during periods of weakness has been somewhat challenging, with odd-lot discounts to round lot evaluations ranging from 1.25-1.75 vs the average of 0.5-1 point concessions during normal market conditions.	
Canadian Market	**Federal** • 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.” • The latest BOC balance sheet shows that the central bank continued to support liquidity in Canadian markets (as of October 20). • The Government Bond Purchase Program (GBPP) has resulted so far in $285.356 in net buying (assets minus liabilities minus position at the start of the QE in March 2020). • The BOC was not able to get decent size in high-coupon Canadas in their buying program - they only bought only small size per security showing limited liquidity. Liquidity is better in on-the-run benchmark Canadas. According to the latest BOC research, Federal debt is the most liquid sector within the Canadian fixed income markets. • As the central bank reduces and eventually ends its QE program, liquidity in federal bonds across the yield curve could be impacted.	Federal: bid/ask was at 4 cents in the 10-year area, but for the long end of the curve, it remains relatively wider at up to 12 cents given its higher volatility. For example – the latest ultra-long Canada 2064 bid-ask is at 25 cents, reflecting its liquidity issues given this is not a benchmark. Off-the-run, high coupon Canadas were reported to have limited liquidity given small outstanding size in these securities. Provincial: concession reported to be above average on size > CAD 25 million, particularly at the longer end. In

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	Provincial • Liquidity is best in benchmark bonds from Quebec, Ontario, and British Columbia. • Depending on market tone, concessions may be requested in order for dealers to take less-liquid positions. • Most dealers will not bid aggressively on off-the-run, high coupon provincial issues but will favor agency trades. • The Bank of Canada's Provincial Bond Purchase Program (PBPP) ended in May. Therefore, the central bank does not provide a back stop to the provincial sector. • Given the large borrowing needs of provinces, the new issue calendar is expected to increase trading activity in October. Liquidity is better in on-the-run, current coupon bonds in the provincial sector (compared to off the runs). Provincial bond liquidity could reportedly be negatively affected by big 6 banks' fiscal year end. **IG Corporates** • 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 may not provide bids in some sectors. • Trading is on an agency basis for issuers affected by mergers and acquisitions. • 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. • Dealers expect reduced liquidity during the last week of October due to the big 6 banks' fiscal year end, where trading volumes could be limited amid caps on inventories. **Real Return Bonds (RRBs)** • The program to purchase Government of Canada securities in the secondary market – the Government Bond Purchase Program or GBPP – should provide some temporary liquidity since it includes RRBs. However, trading in Canada RRBs has shown a continued lack of liquidity. • 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 next RRB auction on December 1 will most likely be a re-opening of RRB Canada 2054 bond. The central bank was not able to complete its $280mn RRB target purchase program in September showing challenging liquidity in Canadian RRB markets from tenor of 2041 to 2050. • Liquidity remains challenging, trading by appointment, as dealers hold limited inventories in RRB securities.	risk-off markets, liquidity is drying up and spreads can widen depending on market tone. 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. 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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