ALLIANCEBERNSTEIN®

February 2021

Market Update – Fixed Income Trading Liquidity
For the Week Ended 5 February 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 February 5, US 10-year rates sold off and steepened by 10 bp in 2s10s and 5s30s. The US Treasury-German bund spread traded 3bp wider. • Developed market interest rates sold off across the board with the UK the worst performer following a more hawkish than expected MPC meeting. Supply from Europe also seemed to pressure longer maturities. • The highly anticipated US Treasury refunding announcement on Wednesday came in line with market expectations, as nominal Treasury coupon issuance was left unchanged relative to the prior quarter. TIPS issuance will continue to increase at a gradual rate of $1bn/auction for the upcoming quarter. • Federal Reserve bond purchases continue at $80 billion US Treasuries and $40 billion MBS per month. • The developed market rates complex is at the peak liquidity of the past two years. Depth is high in both cash and futures markets. Facilitating large risk transfers can be done without "paying up" for the liquidity. Bid-offer spreads continue to grind tighter.	Bid-offer spreads are trading in line with pre-covid levels. Bid-offer spreads continue to grind tighter, with 10-year notes trading ½ of a tick wide and 30-year notes also trading as tight as ½ of a tick (1 tick = 1/32nd).
Investment Grade (IG) Corporates	**US IG** • The US investment-grade cash bond markets traded firmly on the back of the strong macro tone and back-up in interest rates during the week ended February 5. • Similar to last week, investors remain cautious in their purchases at current valuations, as the US IG market largely underperformed moves in equities this week. • Supply took the spotlight as $54bn priced during the week, more than the $30bn expected. There was limited spillover effect in the secondary markets, illustrating that cash remains on the sidelines. Composition of new issue supply saw a greater proportion (40%) in longer maturities, versus 14% in January. Increased long end supply paired with muted flows from Asia due to Lunar New Year led to modest 10/30 credit curve steepening during the week despite the sell-off in interest rates.	Bid/ask conditions in the IG market are back to normal

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	• Strong demand persists in the primary market, as the market saw another robust inflow of $6.15bn during the week and dealers were net lifted of $2bn in bonds, mostly intermediate maturities. • Supply for the week ending February 12 is expected to be in the ~$25 to 30bn range. **European IG** • During the week ended February 5, there was strong performance across the board given the macro backdrop. Supply tempered the performance of certain subsectors (notably hybrids), but overall there was a grab for beta, causing bid-side liquidity to be better than offer-side. • Italian financials rallied across the capital structure on the news that Mario Draghi accepted a mandate to form a government. • Also of note, the market began to push back on the ESG premium – similar to the third quarter of 2020 when a significant supply of ESG-oriented bonds came at aggressive price levels. For example, the hybrid sustainability bond from Telefónica that came 20bp through existing spread curves ended the week below reoffer pricing despite a sustained market rally. • In the AT1 market, demand for stronger structures persisted, however there was some weakness in longer call/low reset, more recent vintage deals given the interest rate move – as these structures offer worse convexity and also amid the publishing of some negative sell-side research. **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.	
High Yield (HY) Corporates	**US HY** • Similar to the prior week, the primary market continued to be in focus during the week ended February 5, as 16 deals priced, totaling $7.4bn notional. New issues continued their recent trend of generally pricing 50 to 75 bp inside initial price talk, with order books heavily oversubscribed (up to 13x). Secondary market strength returned to new issues, with most trading up 1-3 points on the break. • Secondary market spreads continued to grind tighter, supported by positive technicals. $12.7 of cash came into the market from coupons, calls and tenders during the week – about twice the volume of new issuance, of which 60% has been refinancing. • High yield index spreads were 12 bp tighter to at 340bp. The spread between CCC and BB-rated bonds was 23bp tighter to 333 bp. Energy outperformed the broader index on the back of a continued rally in crude oil and natural gas.	Bid/ask spreads vary by issuer but generically: BB-rated securities: 1 point, which is in line with normal market conditions B-rated securities: 1 point, which is in line with normal market conditions

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<tr><th>Sector</th><th>Liquidity Trading Comment</th><th>Bid-Ask Spreads</th></tr>
<tr><td></td><td>Euro HY
During the week ended February 5, focus remained on primary market supply. High-yielding new deals were significantly oversubscribed, tightening ~100bp from initial price talk and performing well on the break.
The secondary market saw beta compression, but volumes did not seem overwhelming. There was more two-way flow in some tighter-spread BB-rated bonds, but liquidity remained fine.
CDX HY
CDX HY traded 1.3 points better, in line with the macro tone during the week ended February 5.
Trading volumes were around average, and flows were more supportive than in previous weeks.
Bid/ask spreads have declined to pre-crisis levels.</td><td>CCC-rated and below: 1.5points which is in line with normal market conditions

CDX HY bid/ask is in line with normal conditions.</td></tr>
<tr><td>Emerging-Market Debt (EMD)</td><td>Hard Currency EM
During the week ended February 5, EM credit continued its recent momentum, as the EMBI Global Diversified Index spreads tightened ~12bp on the week to ~340bp. As core interest rates rose and global macro risk rallied, the high yield/investment-grade beta compression trend accelerated with high yield trading ~30bp tighter on the week vs IG ~5bp tighter.
Ecuador rallied 10 points ahead of Sunday’s presidential election following the dramatic underperformance of the country over the previous few months. Panama 30-year bonds traded down ~3-4points on Wednesday following Fitch’s surprise downgrade to BBB- and negative outlook.
The Latin America corporate new issue market continued its torrid pace to start the year with 5 deals pricing with average new issue concessions of 15bp, books 7x oversubscribed, and deals trading up ~1.5points on the break.
Inflows continued into the sector, with anecdotal evidence of investors adding high yield exposure.
Local Currency EM
Liquidity is close to normal.</td><td>EM IG and HY sovereigns and EM IG and HY corporates are back to normal market conditions</td></tr>
<tr><td>Asia</td><td>Asia Hard Currency
Asia credit index spreads tightened 4bp during the week ended February 5, but the total return of the index registered a modest gain of +0.1% due to a significant bear steepening of US Treasury yields.
Primary market activity remained busy with $12.6bn in deals coming to the market, led by Alibaba’s $5bn jumbo issuance across 4 tranches.
China investment-grade bonds performed particularly well as some of the sanctioned issuers as well as higher-beta issuers in the asset management and TMT sectors rallied by ~10 to 20bp.</td><td>Asia IG credit is ~1 to 1.5x wider vs. normal market conditions

Asia HY credit is ~1 to 1.5x wider vs. normal market conditions</td></tr>
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	• Asia high yield spreads were overall unchanged as macro conditions remained constructive yet the ongoing headlines about China Fortune Land weighed on investor sentiment in the China property sector. **Asia Local Currency** • Liquidity in Asia local currency markets was generally constructive during the week ended February 5, supported by two-way flows. • One exception was India, where the union budget released on Monday surprised materially to the upside in terms of fiscal deficit and bond issuance numbers; this triggered a sharp selloff in bonds with the 5-year benchmark selling off as much as 30bp. • In Korea, Treasury bond yields have touched new year-to-date highs this week after the weak 30-year and 50-year auctions; 10-year and 30-year KTB yields neared 1.8% and 2.0% respectively.	Asia local currency debt is ~1 to 1.5x wider vs. normal market conditions
Securitized	**CMBS** • During the week ended February 5, CMBS performance was mixed, as levels at the top of the capital structure were little changed but mezzanine tranches tightened 5 bp. Lack of significant conduit supply continues to create a positive technical backdrop for the sector and valuations remain near their 52-week tight levels. • Bid/offer spreads remain unchanged: spreads for AAA to A-rated classes have retraced their post-covid-19 widening, while bid/offer spreads for BBB-rated classes remain approximately 2x their pre-covid-19 levels. • Like the cash market, CMBX remained little changed at the AAA level, while BBB- and BB rated classes outperformed. Tightening in mezzanine classes continues to be driven by short cover interest. Bid/offer spreads remain unchanged. CMBX A.6, BBB-.6, and BB.6 bid/offer spreads remain approximately 2x their historical averages. **ABS** • The ABS primary market priced eight deals for the week ending February 5 totaling $5.8bn across unsecured consumer loans, containers, railcar, equipment and prime and non-prime auto loan sectors. Year-to-date ABS supply now stands at $19bn compared to $23.4bn recorded over the same period in 2020. • ABS spreads held firm during the week, with primary and secondary markets seeing healthy flows. Strong demand has kept new issues well oversubscribed, even with tightening spreads and upsizing. Currently, demand has yet to abate with spreads already at or through record tight levels. On AAA prime auto ABS, negative spreads on new issue tranches (outside of the money market A-1 tranche) have not been seen since 2007. • The forward calendar is quickly filling up, with ten ABS deals totaling $5.3bn currently in pre-marketing.	

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	CRTs • The week ended February 5 saw spreads grind modestly tighter from the prior week. The bigger story of the week was about volume, as roughly $1.7bn moved through the CRT market. This was the second week in a row with more than $1.5bn going through TRACE, which hasn't been since covid-19 struck in the first quarter of 2020. • No new issues priced during the week, but the first high-LTV STACR deal of 2021 is expected to be announced soon, and there are also 2 MI deals from Genworth being discussed. • Secondary market liquidity remains robust and there is good two-way flow in all aspects of the CRT market. Bid/ask spreads have normalized around pre-covid levels. **Legacy Non-Agency RMBS** • Legacy RMBS have recovered back to pre-crisis levels. After having widened to the 1000-1200 bp range in March, spreads are currently trading inside 200 bp discount margin currently. **CLOs** • The week ended February 5 continued to be busy in the CLO market. The secondary market continues to pull the primary market tighter. As other securitized markets have recently tightened, investors have begun to rotate into CLOs, particularly mezzanine classes, to pick up yield. • Liquidity remains robust in the CLO market. Bid/ask spreads remain at or around pre-crisis levels. **Agency MBS** • Bid/ask spreads in Agency MBS remain at the tighter end of their range in terms of OAS relative to US Treasuries, given the supportive Fed purchases of $40bn per month. Bid/offer spreads remain at historical tight levels at just ½ of a tick wide.	
Money Market	• The US Treasury will be reducing their Treasury General Account (TGA) from the current $1.67 trillion to $800 billion by the end of Q1 and $500 billion by Q2 according to their refunding statement. They plan to achieve this by cutting T-bill issuance beginning in mid-February. This has driven front-end interest rates lower. Exacerbating the issue are the Federal Reserve's QE purchases and the expiration of the debt ceiling suspension (in August 2021). T-bills were 5-7bp tighter on the news. • SOFR set at 0.02%, which is the lowest level since March 2020. The Fed is expected to step in with adjustments to the Reverse Repurchase or Interest on Excess Reserves (IOER) rates. • 1-month LIBOR set at 0.121%, while 3-month LIBOR set at all-time lows of 0.195%.	

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	• Government money market funds saw $7bn of outflows in the 7 days ended February 5. Prime funds had $8bn of outflows over the same period.	
US Municipals	• The technical backdrop in municipal bonds continued to be supportive, with steady inflows into the market over the past three months. Additionally, new supply was light in January 2021 – down 20% compared with January 2020. The lack of supply does not appear to be changing, as the 30-day visible supply is roughly 30% lower vs the 1-year average. • Despite the strong technicals, municipal/Treasury ratios are near all-time low levels, and some hesitancy has become evident among high-grade buyers, especially in longer maturities, with the expectation that yields will continue to rise. In turn, investors have moved down in credit quality, shifting mid-grade and high-yield spread levels lower, to near—and in some sectors through—pre-pandemic levels. • In the primary market, new issues continue to see strong demand across the credit spectrum, with deals heavily oversubscribed. • Odd-lot liquidity has improved with discounts to round-lot bid side evaluations consistently in the $0.70 to $1.00 range.	
Canadian Market	**Federal** • 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 $4 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. • The BOC has purchased C$204 billion to support liquidity in Government of Canada markets since the purchase program started on March 27 through February 3. Government of Canada bonds are the most liquid securities in capital markets in Canada as seen in the latest (November) Bank of Canada research. (Note: BOC figures can be revised) **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, they will do agency trades, even with the Bank of Canada's buying program of provincial debt. • The BOC has purchased C$15.4 billion in par value year to date through February 3 within their provincial buying program to support liquidity. A continued rise in crude oil prices from current	Federal: bid/ask typically 5 cents in the 10-year area, 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 wide bid-ask given small outstanding size in these securities. Provincial: concession of +1 bp and more on size > CAD 25 million, particularly at the longer end. In risk-off markets, liquidity is drying

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	levels could help liquidity in provinces where oil revenues will be pushed upward – Alberta, Saskatchewan and Newfoundland. **IG Corporates** • The latest Bank of Canada research highlights the lack of liquidity in Canadian corporate bond markets, which can impact pricing; 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. • The Bank of Canada's buying program (focused on securities of 5-years or less) should support liquidity for corporate bonds rated BBB and higher. However, the central bank has bought a relatively small amount of corporate securities to date (C$200 million par as of February 3), indicating the impact is limited. BBB- bonds are trading by appointment unless there is a new issue. • Recent conversations with the deputy BoC governor indicated that they view the bond-buying program as a "back-up" facility. They do not see a current need to intervene to provide liquidity to the BBB- corporate market. **Real Return Bonds (RRBs)** • 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 last auction was held on December 2 with the FTSE index duration extending by a historical amount of over 1.6 years. On that day, the BOC bought a total of C$434mn with a target of C$75 million per line of the 7 Canada RRBs from 2021 to 2047. Even with the central bank buying net C$34 million of Canada RRBs in December, liquidity remains challenging as dealers hold very limited inventories of these RRB securities. We expect a re-opening of the Canada Benchmark 2050 bond on Feb 10 where once again that day, the Bank will try to buy $75mn per line of the 6 Canada RRBs from 2026 to 2047. • Trading in Canada RRBs continues to show a chronic lack of liquidity. Trading a block can only be done on an appointment basis.	up and spreads can widen depending on market tone. 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 may refuse to bid in a risk off market with gaps in spreads. Provincial RRBs trading by appointment only. Dealers do not hold these securities on their balance sheet.

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