AllianceBernstein®

March 2021

Market Update – Fixed Income Trading Liquidity
For the Week Ended 5 March 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 March 5, global rates were mixed, with German bunds and UK gilts staging a 4-5bp rally, while US Treasury yields sold off by 15 bp in a bear steepening move. • Financial markets remain optimistic on the reopening trade. Friday saw the release of a stronger-than-expected February US employment report. The $1.9trn fiscal spending bill has passed in the US Senate and moves back to the House of representatives for voting on Tuesday. Covid-19 vaccination rates continue to pick up globally in developed markets and case numbers are falling. • Rate volatility as measured by the MOVE index was lower by 8% on the week. • The market continues to push back on the Fed stance of being on hold until 2023. Rate futures have pulled forward the first 25bp of Fed tightening to December 2022 (up from the first quarter of 2023) and the second to June 2023 (up from fourth quarter of 2023). • Fed leadership continued to indicate their desire to let current reflation dynamics play out in the market, provided that the rise in yields does not cause a disorderly tightening in financial conditions. • Federal Reserve bond purchases continue at $80 billion US Treasuries and $40 billion MBS per month. • In the coming week, the market will have to contend with $120bn of US Treasury supply in 3-year, 10-year and 30-year maturities. Market participants are looking to the 10-year auction to alleviate some of the specialness of the 10-year in the repo markets. • Liquidity conditions remain choppy with bid-offer spreads varying widely – particularly around Fed Chair Powell's remarks on Thursday. o While transaction sizes are smaller than they were a few weeks ago, the observable bid-offer has been in line with historical averages in on-the-run bonds for most of the trading session – with the exception of the episodic volatility around Powell's event on Thursday.	

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	○ Transaction costs in off-the-run bonds remain stubbornly wide vs. historical averages. But there has been some improvement in bid-offer spreads - from 12-13 ticks at the February 26 wide levels to 4-5 ticks on March 5, compared with just 2 ticks prior to the current liquidity deterioration earlier in February (a tick is 1/32 of a point). ○ Deep off-the-run bonds where the Fed SOMA (System Open Market Account) holds nearly 70% of the outstanding issue (the capped amount) are less liquid than other bonds as they are no longer eligible for Fed buybacks. • Depth in on-the-run cash 5-year and 10-year Treasuries has improved by 40-45% from the worst levels on February 26.	
Investment Grade (IG) Corporates	**US IG** • The US investment-grade cash bond market drifted wider throughout the week ended March 5, with the index closing 6bp wider week-over-week. The move wider escalated in the latter half of the week with the index closing 4bp wider on Friday. • Supply stole the spotlight with $67bn pricing during the week, overwhelming expectations of $40bn. • The technicals remain supportive, as the market was able to digest the large supply with deals still well oversubscribed despite pricing with minimal concessions. There were signs of supply indigestion towards the latter half of the week with deals beginning to price with larger concessions and lackluster performance on the break. • With the sell-off in interest rates and Treasury curve steepening, credit curves remain flat. The market received another inflow of $5.2 bn; Asia investors remained better sellers. • Supply for the week ending March 5 is expected to be $50bn+, with the wildcard being the anticipated supply from telecom companies following the results of the c-band auction announced last week. **Euro IG** • The euro IG market had a volatile week ended March 5, with eyes remaining fixed on interest rates. The sector continues to demonstrate a resilience to the volatility with price action and liquidity fairly benign on both weaker/stronger days. • After a lighter start to the year, there was heavier supply during the week with ~20bn EUR coming to market, with deals materially less oversubscribed compared with prior weeks. New issue premium crept up and performance on the break was mixed. • After a robust week last week, AT1/corporate hybrids began to take their cue from equities and liquidity felt thin, but better than in the US Treasury market. **REIT Preferreds** • Liquidity in the REIT preferred market is typically limited under more normal conditions given the retail nature of the investor base.	Bid/ask conditions in the IG market are back to normal

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	• 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** • Once again, the high yield market traded in line with the interest rate move. The index spread was flat during the week ended March 5 at 325 bp. The move down in dollar price in rate-sensitive bonds in the latter half of the week was orderly. Most selling later in the week was driven by ETF arbitrage investors; HYG reached a 40bp discount to NAV on Thursday. • The new issue calendar was largely unphased by rate-induced volatility. $11.215bn priced across 18 deals, in line with the 2021 average weekly issuance of $11.1bn. Books continue to be largely oversubscribed (3-8x). Deals mostly traded up 1-3 points on the break. Higher-quality, longer-maturity bonds were no exception. • The spread between CCC and BB-rated bonds was 6bp tighter to 312 bp. **Euro HY** • During the week ended March 5, it was a benign trading week in euro HY. Secondary market activity was not overwhelming and the reaction to interest rate volatility was rather contained. There has been some pressure on larger-cap, BB-rated issuers with higher spread duration as well as some large-cap tighter-spread single-B-rated non-cyclical issuers. But overall selling has not been overwhelming and appears to be mostly ETF-driven. Flows have been negative, so investor cash balances appear to be eroding on the margin. "Real money" investor involvement seems limited and forced selling seems limited as well. **CDX HY** • CDX HY traded better with stocks, finishing the week ended March 5 60 cents higher and outperforming cash for the first time in a long while. • Trading volumes were above recent averages, as is typical in periods of macro volatility. • Bid/ask spreads have declined to pre-crisis levels.	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 CCC-rated and below: 1.5points 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** • For the second week in a row EM Credit played second fiddle to core interest-rate volatility during the week ended March 5 as the JPM EMBI Global Diversified Index widened only 4bp. Under the hood, there were bouts of EM high yield selling by hedge funds and ETFs, while investment-grade bonds continued to face pressure from selling by the Asia buyer base. • EPFR flow data showed a small outflow from EMD overall; within that, hard currency outflows of ~$2bn were the largest seen since March2020.	EM IG and HY sovereigns and EM IG and HY corporates are back to normal market conditions

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	Local Currency EM • The local EM rates market mostly tracked US Treasuries or German bunds. Liquidity is adequate but volatility is to be expected.	
Asia	**Asia Hard Currency** • Primary market activity slowed in Asia credit index during the week ended March 5, with $4bn issued, down from ~8bn the prior week. Nearly all new issues were trading "under water" by the end of the week. • Investment grade spreads outperformed high yield amid the weaker macro sentiment and interest rate volatility. • China IG (+2 to 3 bp) held in better than India IG (+10 to 15bp) during the week. Indonesia/India high yield held in better than China HY property, which was hurt by concerns that China's reflation trade may face increasing headwinds as well as challenges within Local Government Financing Vehicles (LGFVs) in certain provinces. **Asia Local Currency** • Global interest rate pressures weighed on Asia local currency bond yields. • Concern over China LGFVs as well as allusion to gradual stimulus reduction during the annual National People's Congress on Thursday/Friday weighed on China risk assets, with the CSI stock index down 3% on the week, although interest rates were stable. • Another weak Indonesia auction on Tuesday saw sustained pressure on Indonesia government bonds, with 10-year yields now above 6.7%.	Asia hard currency IG and HY credit is back to normal conditions. However, interest rate volatility may cause pressure points to appear. Asia local currency debt is back to normal market conditions
Securitized	**CMBS** • During the week ended March 5, for the second week in a row, CMBS shrugged off broad market volatility to remain little changed. Secondary market flows were modest, with approximately $2bn bonds presented to the market for bid, $1bn fewer than the previous week. One new issue priced, and some classes widened 2-5bp in order for the deal to clear the market. • CMBX performance was mixed week-over-week. Recent vintage series generally outperformed more seasoned vintages. Flows were concentrated at the top of the capital stack. Mezzanine tranches continue to trade sluggishly on limited volume. • Liquidity remains robust for AAA to A-rated CMBS classes while bid/offer spreads for BBB-rated classes remain approximately 2x their pre-covid-19 levels. On average, CMBX bid/offer spreads remain unchanged, with CMBX A.6, BBB-.6, and BB.6 bid/offer spreads approximately 2x their historical averages. **ABS** • The ABS primary market priced eleven deals for the week ending March 5 totaling $8.7bn across aircraft lease, railcar, container, unsecured consumer, private credit student loan and prime and	

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	non-prime auto loan sectors. Year-to-date ABS supply now stands at $45bn compared to $43.7bn recorded over the same period in 2020. For the first time this year, issuance has surpassed the 2020 issuance tally, over the same year-to-date period. The second half of March and first half of April is when the initial COVID-19 outbreak interrupted ABS issuance last year. • This year, quarter-end funding is expected to be heavy and the 2021 issuance pace will likely surpass 2020's pace. The current March supply total for 2021 at $8.7bn already exceeds the full month March 2020 supply of $7.2bn. • Indicative benchmark spreads in the secondary market remained largely unchanged at/near cyclical tight levels during the week. • There are nine ABS deals totaling $5.5bn that are in pre-marketing for the week ahead. **CRTs** • The week ended March 5 was another where the CRT market had difficulty finding footing. Certain profiles – such as investment-grade and short, extension-protected high WAC deals continued to trade well, but anything exposed to a meaningful slowdown in prepayment speeds and therefore a duration extension continued to be weak. • Dealers have made some progress clearing out inventory and that should improve the technical picture going forward. Volumes were down vs the average of the prior two weeks as investors got used to the new normal of slower speeds in the sector. Below investment-grade last cash flow bonds were down around 0.5 points, B1 bonds down ~1 point and B2 bonds down anywhere from 3-5 points. • Freddie Mac placed a 1.2bn new issue last week, with some difficulty. Pricing was widened from the initial guidance, even with an M2 tranche that was investment-grade rated by S&P. The bonds traded poorly on the break. Genworth is marketing a second MI CRT deal in as many weeks. The deal is small and expected to price during the week of March 12. • Secondary market liquidity remained challenged last week. Motivated dealers were willing to engage buyers that were looking for cheap bonds. • Bid/ask spreads widened a bit but remain around pre-covid levels. **Legacy Non-Agency RMBS** • 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. **CLOs** • New issue (including refi/resets) continued to be the focus of the CLO market during the week ended March 5. The level of activity seems to be accelerating given the large number of deals. Deals are	

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	getting done, but it appears that subscriptions are waning. Managers seem willing to accept marginal spread concessions to get deals done or to upsize deals. • AAA-rated spreads for top-tier managers are in the 100 bp area; AA-rated spreads are around 140bp; A-rated are 165bp; BBB-rated are 290-300bp; and BB around 600-650bp. • 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 well supported, given the Fed purchases of $40bn per month. Bid/offer spreads for current coupon bonds are trading at 1-1.5 ticks wide and the rest of the coupon stack is wider by 3-4 ticks.	
Money Market	• An emergency measure put in place during the pandemic to unconstrain dealer balance sheets and improve liquidity by excluding cash and treasuries from the SLR (supplementary leverage ratio) calculation expires March 31st. This has the market concerned about liquidity dislocations around quarter end. • The Treasury General Account (TGA) continued to fall during the week ended March 5. The passing of the $1.9trn fiscal stimulus is expected to result in a near-term T-bill supply increase and a widening of the bill curve. • SOFR set at 0.02%. Repo and T-bills continue to trade towards the lower bound of the corridor. • Effective Federal Funds Rate set at 0.07% • 1-month LIBOR set at 0.106%, while 3-month LIBOR set at 0.183%. • Government money market funds had $4bn of outflows in the 7 days ended March 5. Prime funds had $4bn of outflows over the same period.	
US Municipals	• After last week's sharp negative move, investors in the municipal market used the higher yields to add risk and put excess cash to work during the week ended March 5. The market had a constructive tone all week which seemed to improve as the days wore on, despite periods of US Treasury weakness. For the week, benchmark AAA-rated yields were 6bp lower for 2-year maturities, 8bp for 5-year, and 3bp for 10- and 3-year maturities. ETF buying leant further support towards the end of the week. • In the higher-yielding part of the market, conditions tightened with limited offerings as fund outflows stabilized and turned positive. Most higher-beta issuers were trading unchanged to within 5bp of prior week's levels. New issues in the high yield space saw strong subscriptions and follow through once freed up to trade. • Overall, liquidity was back to strong conditions seen prior to the recent rate sell-off, with most block trades receiving bids through prior evaluations. Odd-lot discounts to round-lot bid side evaluations were generally 0.25 to 1.25 points depending on size.	

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Canadian Market	**Federal** • Liquidity is best in benchmark issues for block sizes of <=CAD25 million. 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$217.7 billion to support liquidity in Government of Canada markets through March 3. • Liquidity at the end of February was limited/difficult with dealers avoiding taking positions in Canadas as volatility resulted in losses, limiting their risk taking on their balance sheet. **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$16.7 billion in par value year to date through March 3 within their provincial buying program to support liquidity. The BOC has cut their maximum weekly take out to $350mn from $500mn and the buying program is done only once per week. Dealers expect this purchase program to mature on May 7, 2021. • A continued rise in crude oil prices from current 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 $10bn 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$210 million par as of March 3), indicating the impact is limited. The BOC has announced that they will cut the maximum size of their tenders under the purchase program, reducing the max amount to C$50mn from C$100mn previously • 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-	Federal: bid/ask was at least 5 cents in the 10-year area, but for the long end of the curve, it remains relatively wider at 15 cents given the recent higher volatility. Off the run, high coupon Canadas were reported to have limited liquidity in this high volatility period with much wider bid-ask 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 risk-off markets, liquidity is drying 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.

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	corporate market. Based on lack of intervention and deputy governor comments it is expected the program will be cancelled on May 7, 2021. **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. • Trading in Canada RRBs continues to show a lack of liquidity. Trading a block can only be done on an appointment basis. • Of note, the last $300mn auction of RRB 0.5% Dec 2050 was done on February 10. On that day the central bank was not able to buy its maximum of 6 Canada RRBs for a total of $450mn with a target of $75mn per line item (from 2026 to 2047 maturities). In December, the BOC bought net $34mn in RRBs compared with $122mn in February (BOC buying program less new supply). • Liquidity remains challenging as dealers hold very limited inventories in RRB securities.	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. Bid-ask is not a reliable indicator for trading.

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