AllianceBernstein

July 2021

Market Update – Fixed Income Trading Liquidity
For the Week Ended 2 July 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	• Liquidity in terms of market depth in on-the-run cash 5-year and 10-year Treasuries has improved meaningfully from the challenges seen in February 2021. • Observable bid-offer spreads are in line with historical averages in on-the-run bonds. Transaction costs in off-the-run bonds are wider but have improved meaningfully since late February. TIPS bid offer spreads widened out 2 ticks last week vs. normal levels. • 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 market was quiet during the week ended July 2. Credit, both cash and synthetics, underperformed stocks heading into the long holiday weekend. But the technical remain resilient as new YTD tight spread levels were again set on Wednesday (+80bp), a level not reached since 2005. The index closed Friday 1bp wider week-over-week at +82bp. • Supply was front-loaded and underwhelmed expectations of $15-20 billion as $10.5 billion priced throughout the week. Relative to recent weeks, demand was robust with new issues 4.3x oversubscribed on average despite pricing with -2.75bp new issue premium on average. For the month of June supply overwhelmed expectations of ~100bn as ~135bn priced. • In the secondary market, flows were balanced and higher-beta, shorter-maturity bonds were better bid. Overnight flows remained relatively muted heading into month/quarter end, but there was longer-maturity bond selling by domestic investors in the latter half of the week. • The positive momentum on flows accelerated with $3.4 billion in inflows during the week. • In the week ahead, supply is expected to stay light and be in the range of $15-20 billion. Expectations for supply in the month of July are $70-80 billion (5-year average ex-2020 is ~92bn).	Bid/ask conditions in the IG market are back to normal

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	Euro IG • Euro and GBP IG spreads were unchanged to 1bp tighter with low trading volumes during the week ended July 2. • Flows were two-way at the beginning of the week, but the tone firmed up on Thursday with some better buyers. The airlines sector underperformed due to increased concerns about the Delta variant. • Beta compression remains a theme. The market saw modest curve flattening, with longer maturities outperforming on the week. • Supply remained light at ~8bn EUR. Book coverage was relatively low for most deals, between 1x and 3x, and new issue premiums crept up averaging around 5bp. Most deals performed well in the secondary market. **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** • During the week ended July 2, US HY market spreads were 8 bp tighter week-over-week to 267 bp. The CCC-BB spread difference was 5 bp tighter to 264 bp. • The secondary market continued to skew better bid throughout the week, particularly in longer-duration and higher-quality bonds. • In the primary market $3.175 billion pricing across 6 deals. New issues continue to face the same positive demand technicals seen all year. **Euro HY** • In the week ended July 2about the focus remained on primary market supply. Subscriptions suggest investor cash balances are healthy. Underlying technicals are constructive. • The secondary markets remained heavier although seemed to find firming footing as investors are noticing the underperformance of Euro HY vs US HY in recent weeks. **CDX HY** • CDX HY was unchanged, underperforming both the macro tone and cash bonds during the week ended July 2. • Trading volumes were below the 30-day average heading into the holiday weekend. • Bid/ask spreads have declined to pre-crisis levels.	Bid/ask spreads vary by issuer but generically: BB-rated securities: 0.75 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.

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Emerging Market Debt (EMD)	**Hard Currency EM** • During the week ended July 2, EM credit continued to drag its feet with index spreads closing the week 11 bp wider as supply indigestion began to surface. Thematically, beta continued to decompress as EM HY underperformed EM IG by another 5bp, making the 3-week decompression ~25bp. EM high yield continues to be one of the worst-performing risk assets across the market, underperforming generic global macro risk – for examples, underperforming USHY by ~30bp over the previous 3 weeks. • Supply continues to flood the market, highlighted by Qatar Petroleum's 12.5bn, 4-tranche "mega deal" which was 3.5x oversubscribed with healthy crossover investor interest and bonds trading around reoffer on the break. **Local Currency EM** The local EM rates market mostly tracked US Treasuries. Liquidity remains adequate but volatility is to be expected.	EM IG and HY sovereigns and EM IG and HY corporates are back to normal market conditions
Asia	**Asia Hard Currency** • Asia credit primary market issuance was solid at USD 9.2 billion, skewed towards IG (~70%) vs HY (~30%). • Indonesia and Philippines sovereign debt was wider 5-10bp over the week and Sri Lanka leaked lower • Non-China investment-grade bonds were firm, although there was some weakness spilling over from high yield • The China HY property sector continued to be weak with bond ranging from 0.5 to 2 points lower in cash price. Liquidity on the bid side is more challenging. **Asia Local Currency** • Liquidity in Asia local currency bonds continues to b enormal despite the rise in covid cases across South East Asia. •	Liquidity conditions are normal for Asia credit Liquidity conditions are normal for Asia local currency debt
Securitized	**CMBS** • During the week ended July 2, CMBS spreads were little changed week-over-week, as activity was muted prior to the long holiday weekend. • In the primary market, one new issue priced. Spreads on most mezzanine classes needed to be widened in order the place the bonds before liquidity worsened heading into the weekend. The widening is a reversal of the recent trend of mezzanine classes pricing through initial price guidance. • Bid/offer spreads in AAA to A rated tranches have retraced their post-COVID widening, while BBB rated classes remain 2x the historical average. • CMBX trading volume was very low resulting in little price movement. Recent vintage BBB- and BB tranches performed best, while seasoned mezzanine classes lagged. Bid/offer spreads in CMBX have retraced their post-COVID widening.	

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	ABS • The ABS primary market had no new issuance during the week ended July 2. ABS year-to-date supply now stands at $126.1 billion. • Indicative benchmark spreads remained relatively unchanged for the week. **CRTs** • During the week ended July 2, last cash flow bonds were generically unchanged. B2 bonds remained a focus of investors and continued their march higher even through the quarter end technical pull back seen in last cash flow bonds. Volumes were muted given the impending holiday. • Secondary market liquidity is robust and bid/ask spreads remain tight, 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** • Generic primary market clearing levels on the week stood roughly at 115-116 bp for AAA-rated spreads; AA-rated spreads at around 165 bp; A-rated at 205-210 bp; BBB-rated at 305-310 bp; and BB at 625-675 bp with top tier managers pricing at par and lower quality managers needing OID (original issue discount) to print deals. • 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. Current coupon bonds 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) saw record usage of $991 billion ahead of quarter end. • 1-month LIBOR set at 0.102%; 3-month LIBOR set at 0.135%, a new record low. • SOFR set at 0.05%. The Effective Federal Funds Rate set at 0.10%. • Government money market funds had $37 billion in outflows in the week ended July 2. Prime funds were flat over the same period.	
US Municipals	• In the week ended July 2, municipal benchmark spreads were 1-2bp tighter and the overall tone felt firmer than the previous week. The shift was due to a supportive technical landscape: investors have extra cash to put to work from July 1 principal and interest payments and light supply ahead of the holiday weekend. Both	

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	high grade and high yield new issues continue to be met with strong demand. • Odd lot penalties have returned to the post-pandemic average range of 0.5 to 0.75 point.	
Canadian Market	**Federal** • Liquidity is best in benchmark issues for block sizes of <=CAD25 million. Bank of Canada (BOC) is ''buying at least $3 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." • Looking at the latest BOC balance sheet we can see that the central bank continued to support liquidity in Canadian markets (as of June 30). • The Government Bond Purchase Program (GBPP) has resulted so far in $257 in net buying (assets minus liabilities minus position at the start of the QE in March 2020). Many banks are expecting a reduction of QE bond buying to $2bn per week after the next BOC meeting. • According to the latest BOC research, Federal debt is the most liquid sector within the Canadian fixed income markets. **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) has ended. Therefore, the central bank does not provide a back stop to the provincial sector anymore. **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 some sectors. • Trading on an agency basis for high-beta issuers. • The Bank of Canada had a $10bn 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 end this Corporate Bond Purchase Program (CBPP) on May 25, 2021. **Real Return Bonds (RRBs)**	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 15 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 25 cents reflecting its liquidity issues given this is not a benchmark. 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.

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	• 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 continued lack of liquidity. Trading a block can only be done on an appointment basis. • In the aftermath of the federal budget there were indications that Canada will issue only C$1 billion in RRBs in the current fiscal year with four actions. 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. • Liquidity remains challenging as dealers hold very limited inventories in RRB securities.	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. Bid-ask is not a reliable indicator for trading.

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