

Daiwa's View

Risk-off is imminent

- Both at home and abroad, grounds for Japan-specific bear steepening are weakening

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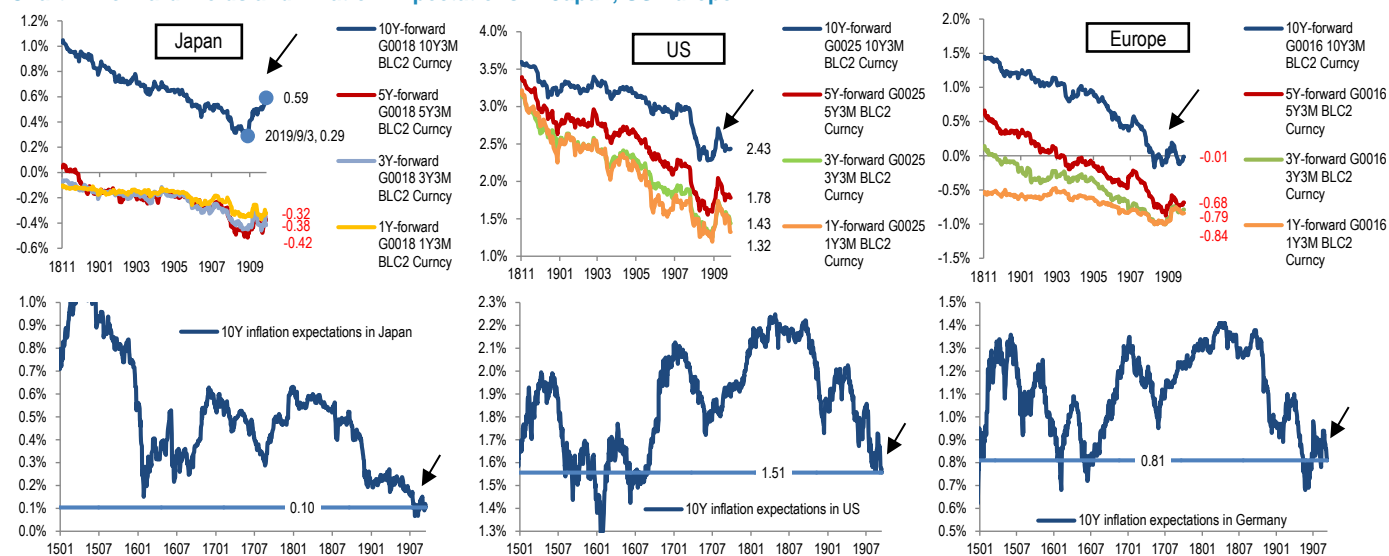
Daiwa Securities Co. Ltd.

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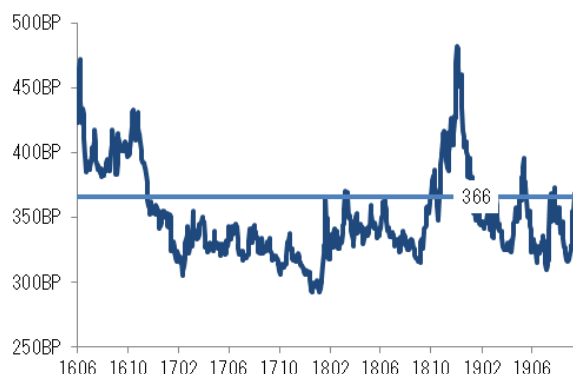
Since BOJ governor Haruhiko Kuroda stated on 5 September that superlong yields have “fallen a bit far,” the 10-year forward 3-month JGB yield (which reflects superlong components) has risen by around 30bp from 0.29% to 0.59% (Chart 1). On the other hand, European and US forward yields started to retreat after hitting a peak on 13 September. Now, they have already returned to the levels of nearly a month earlier. Comparison of 3-month forward yields in Japan, the US, and Europe shows that the ongoing bear steepening in Japan is quite peculiar.

Chart 1: Forward Yields and Inflation Expectations in Japan, US Europe

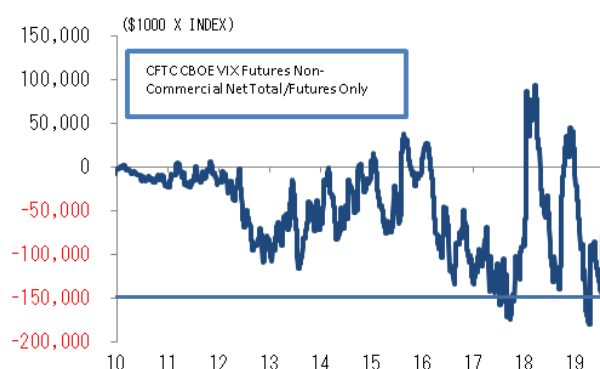


Source: Bloomberg; compiled by Daiwa Securities

Will the bear steepening continue? Of course, various factors are involved in this issue. However, at the very least, the current risk asset conditions show that pressure for bear steepening is diminishing. This is because the CDX North American High Yield CDS Index, which serves as a ‘canary in the coal mine,’ has reached 366bp, a warning line for the past three years. On the other hand, open interest of VIX futures in the non-commercial division is approaching the deepest level of negative territory in the past three years. This means that speculative investors are being overly careless with regards to increasing market volatility (Chart 3).

Chart 2: North American High Yield CDS Index (5Y)


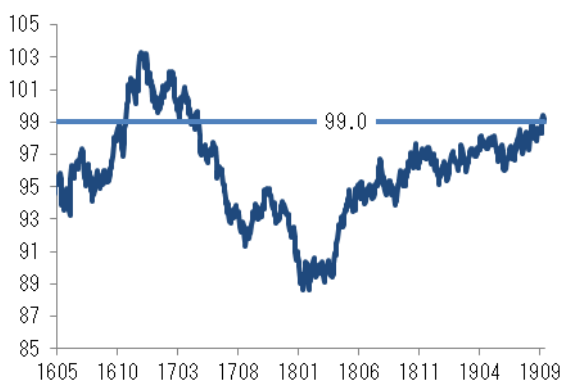
Source: Bloomberg; compiled by Daiwa Securities.

Chart 3: Open Interest of VIX Futures In Non-Commercial Division


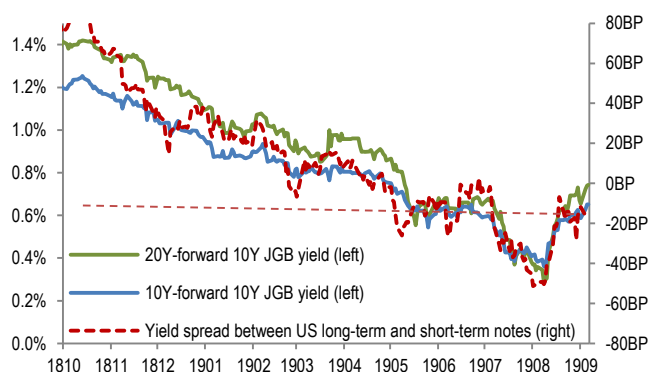
Source: Bloomberg; compiled by Daiwa Securities.

Recently, some Fed officials have prophylactically signaled a postponement of a rate cut at the end of this month. If the Fed does not cut rates in this situation, it would be increasingly difficult to deny the possibility that relatively large risk-off will occur. In particular, if we see further progress in appreciation of the dollar (which is at its strongest level since 2017), it would become an unignorable risk factor for not only inflation but also the economy, as indicated by Chicago Fed president Charles Evans' warning.

As the combination of dollar appreciation and risk-off may create strong appreciation pressure on the yen, this would have a dovish impact on the BOJ ahead of its Monetary Policy Meeting on 30-31 October for reexamination of economic/price projections. Both at home and abroad, grounds for continuation of Japan-specific bear steepening are gradually weakening.

Chart 4: Dollar Index


Source: Bloomberg; compiled by Daiwa Securities.

Chart 5: 10Y JGB Forward Yields and Yield Spread Between US Long-term and Short-term Notes


Source: Bloomberg; compiled by Daiwa Securities.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies.
As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITS: Daiwa Office Investment Corporation (8976), Nippon Healthcare Investment Corporation (3308), Japan Rental Housing Investments (8986).
- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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