Daiwa Securities

Daiwa's View

Comeback of Goldilocks market?

➢ Requirements have been satisfied one by one

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Daiwa Securities Co. Ltd.

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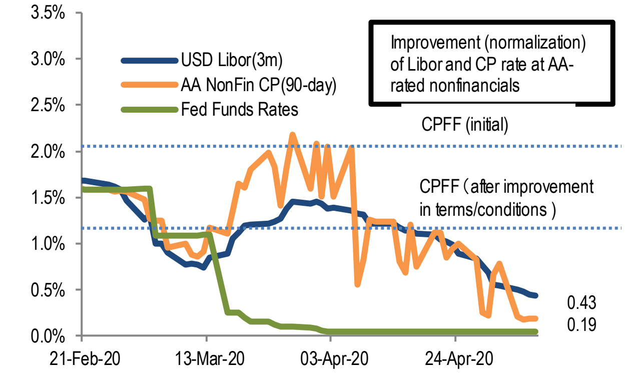
Economic indicators are hitting record lows, and the pace of economic recovery is very slow. Looking at stock prices, meanwhile, the Nasdaq Index recouped all its losses for the year and overall stock prices are increasingly solid, although sectors hit by lockdowns look dismal.

In such a situation, some market-related indicators have started to normalize. For example, the 3-month CP interest rate at AA-rated nonfinancials improved to 0.19% (left-hand chart below). In March-April 2020, the rate remained high at around the backstop line (Commercial Paper Funding Facility [CPFF]) provided by the Fed. However, it has now fully benefitted from reduction of the federal funds rate (zero interest rate). The 3-month US Libor, which is closely correlated with this market, has also declined to 0.43%. It appears that normalization of these indicators with low credit risk reflects remarkable improvement in fund liquidity in the US market.

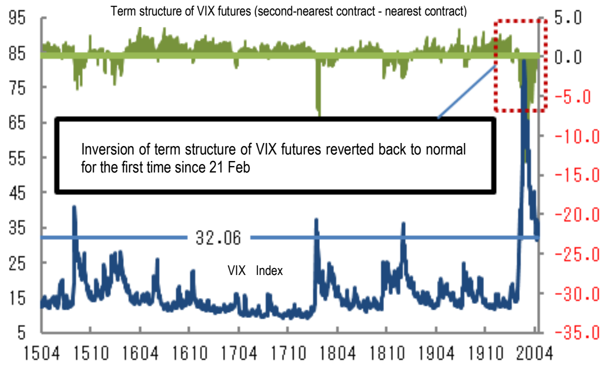
Yesterday, the inversion of the term structure of VIX futures also reverted back to normal, which has not been seen since 21 February (right-hand chart below). The inversion of the term structure of VIX futures, dubbed the "fear index," indicates that near-term fear is greater than worries in the unknown future. The normalization of this, alongside the decline in the VIX itself, implies stabilization of market sentiment.

Chart: CP Rate at AA-rated Nonfinancials and US Libor



Source: Bloomberg; compiled by Daiwa Securities.

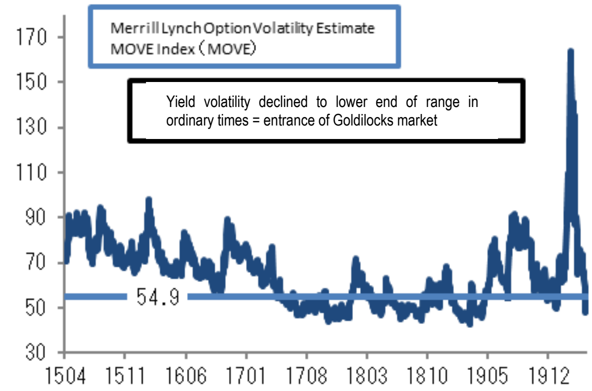
Chart: VIX and Term Structure of VIX Futures



Source: Bloomberg; compiled by Daiwa Securities.

The decline in bond volatility is also noteworthy. The MOVE Index, which surged to 163.7 on 9 March, has now declined to 54.9. This level should be described as the entrance of the Goldilocks market, rather than a return to ordinary times. The phenomenon of interest rates remaining low and stable is the necessary condition for expansion of yield hunting. We thus can say that one requirement for the Goldilocks market has been satisfied.

Chart: US Bond Volatility Index

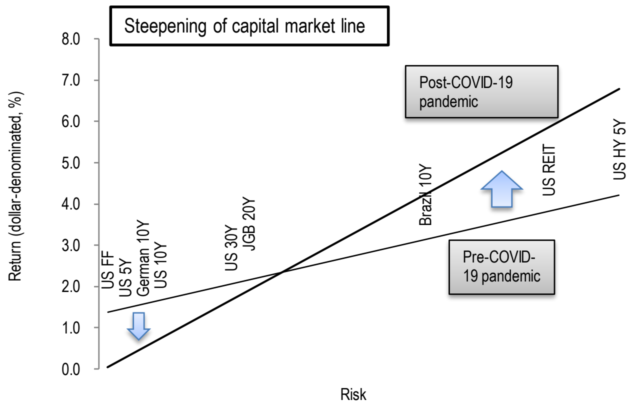


Source: Bloomberg; compiled by Daiwa Securities.

At the beginning of this year, I listed "[how far capital market line will flatten]" as one focus of attention in 2020. In reality, the capital market line has steepened remarkably due to the COVID-19 crisis (Chart below). However, steepening of the capital market line is slowing amid the decline in interest rate volatility and decline in the corporate CP procurement cost to the lower 0% range. This is probably the result of an increase in the number of people thinking that "now may be the bottom," while sellers have been reducing their selling pressure.

In response to the COVID-19 pandemic, the federal funds rate—the starting point of the capital market line—was lowered to zero. Therefore, if we see Goldilocks-like yield hunting and further flattening of the capital market line, the gain in risk asset prices would be greater than before. This opinion may seem premature, but it is also a fact that waiting too long entails a risk of losing profits.

Chart: Capital Market Line (pattern diagram)



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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February 2020

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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), Daiwa Securities Living Investment Corporation (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 Y10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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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.
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