

Daiwa's View

Changing action at central banks

- Responding to change in focus from liquidity to solvency

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Daiwa Securities Co. Ltd.

Responding to change in focus from liquidity to solvency

Changing action at central banks

On 29 May, the Fed announced [the details](#) of assets held under section 13(3) of the Federal Reserve Act. It was surprising that the central bank aggressively purchased not only investment grade ETFs but also high-yield ETFs. The target list of the Fed's SMCCF does not include individual issues that belonged to the junk grade up to 22 March ([refer to our previous report](#)). However, it was confirmed that this rule is not strictly applied in the case that the "corporate bond index" partially includes such ineligible junk bonds¹. For example, major car rental firm Hertz went bankrupt among the issues indirectly held by the following ETFs. However, the Fed is taking the stance of not seeing individual bankruptcies as a particular problem.

Chart: Disclosure of Assets Held by Fed Pursuant to Section 13(3) of Federal Reserve Act

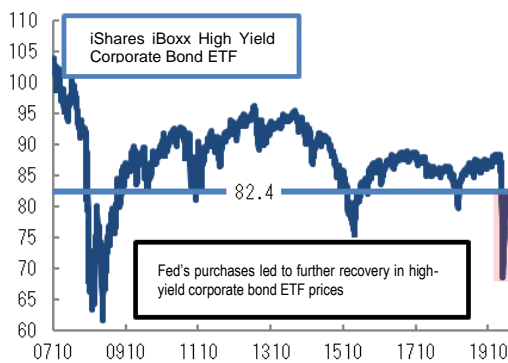
Ticker	Fund Name	Shares Purchased	Market Value as of May 19, 2020 (US \$)
ANGL	VanEck Vectors Fallen Angel High Yield Bond ETF	410,585	11,106,324.25
HYG	iShares iBoxx High Yield Corporate Bond ETF	1,255,084	100,657,736.80
HYLB	Xtrackers US Dollar High Yield Corporate Bond ETF	240,996	11,006,287.32
IGIB	iShares Intermediate-Term Corporate Bond ETF	997,134	57,973,370.76
IGSB	iShares Short-Term Corporate Bond ETF	1,639,301	88,341,930.89
JNK	SPDR Bloomberg Barclays High Yield Bond ETF	905,284	89,532,587.60
LQD	iShares iBoxx US Dollar Investment Grade Corporate Bond ETF	2,521,892	326,282,386.96
SHYG	iShares 0-5 Year High Yield Corporate Bond ETF	171,837	7,175,913.12
SLQD	iShares 0-5 Year Investment Grade Corporate Bond ETF	198,064	10,208,218.56
SPIB	SPDR Portfolio Intermediate Term Corporate Bond ETF	1,942,325	69,030,230.50
SPSB	SPDR Portfolio Short Term Corporate Bond ETF	1,339,345	41,613,449.15
USHY	iShares Broad US Dollar High Yield Corporate Bond ETF	104,979	3,884,223.00
USIG	iShares Broad US Dollar Investment Grade Corporate Bond ETF	616,593	35,922,708.18
VCIT	Vanguard Intermediate-Term Corporate Bond ETF	2,483,885	228,095,159.55
VCSH	Vanguard Short-Term Corporate Bond ETF	2,776,786	226,196,987.56

Source: Fed; compiled by Daiwa Securities.

Partly helped by aggressive purchases by the Fed, the iShares iBoxx High Yield Corporate Bond ETF recovered to \$82.4, alongside a rebound of the S&P/LSTA US Leveraged Loan 100 to \$92.58 (charts on next page). The rise in these prices improves financing at junk companies, which should substantially reduce risk on CLO and mitigate burdens on the financial system. As the high correlation between high-yield corporate bonds and the stock market is well known, the risk-on trend is likely to be solid.

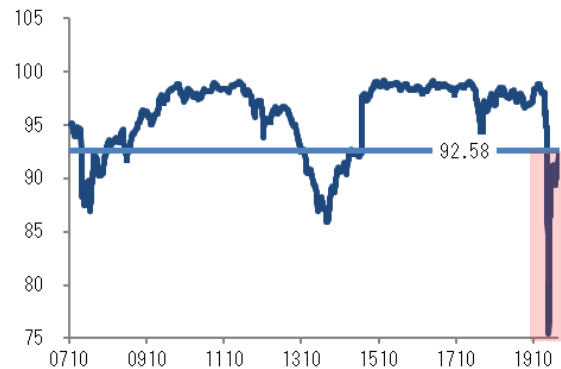
¹ Of course, Fed is strictly examining whether ETFs to be purchased largely satisfy eligibility requirements.

Chart: US High Yield Corporate Bond ETF Price (\$)



Source: Bloomberg; compiled by Daiwa Securities.

Chart: S&P/LSTA US Leveraged Loan 100 (\$)



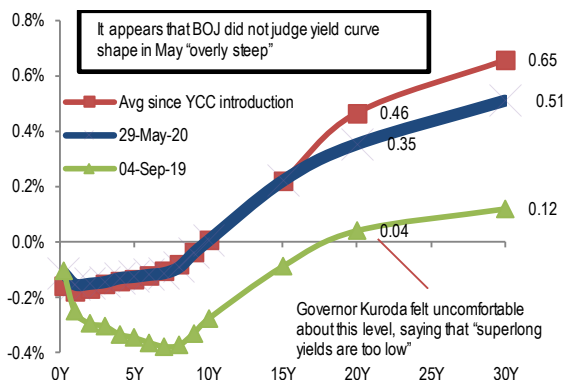
Source: Bloomberg; compiled by Daiwa Securities.

Regarding US Treasury purchases by the New York Fed, on the other hand, it was announced at the end of last week that [the amount would be reduced from \\$5bn/day to \\$4.5bn/day](#). Reflecting a recovery of market functions, the purchase amount under the New York Fed's QE has been decreasing. The latest announcement indicates further reduction. Irrespective of the purpose, the fact remains that the pace of absorbing the duration from the market will slow due to the contraction of QE by the New York Fed. The 5-year/30-year US yield spread is continuing to recover, hitting a bottom at 20bp in 2018. It has recently exceeded 110bp. Steepening pressure has been put by fiscal spending and the bottoming-out of business sentiment, and this structure has not run its course. Therefore, we should assume that the spread could widen to around 150bp.

Also in Japan, the [Monthly Schedule of Outright Purchases of Japanese Government Bonds for June 2020](#) was announced at the end of last week. The offer amount in the 3- to 5-year zone and the 5- to 10-year zone was increased by around Y150-200bn/month each in line with expectations (based on median of range). Meanwhile, it was somewhat surprising that there was no change to the number of offers or offer amounts in the superlong zone (10- to 25-year zone and over 25-year zone). In [the JGB issuance plan after the second supplementary budget](#), the issuance is to be mainly added in the short-term and intermediate zone. However, due to great expansion of [the aggregate amount of the extra budget](#), the monthly issuance amount of superlong JGBs is to be increased by Y200bn for 20-year JGBs and by Y100bn for 30-year JGBs from July.

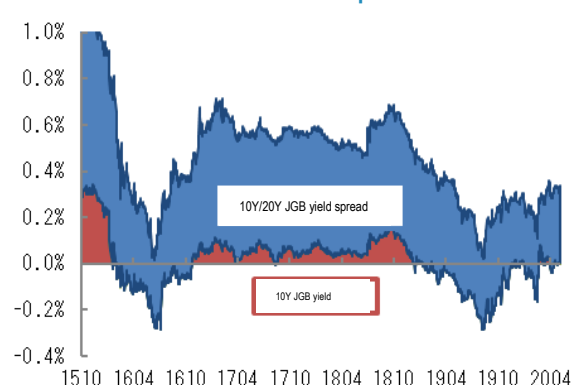
The fact that the BOJ did not change the monthly purchase schedule in the superlong zone is notable as a difference with the intermediate and long-term zones in its handling. The monthly schedule can be seen as a signal that the BOJ does not judge that the current yield curve is "overly steepening." In that sense, market participants may be aware of an upward shift in the dip-buying level in the current market—i.e., 0.35% for 20-year JGBs, 0.5% for 30-year JGBs, and 0.55% for 40-year JGBs. That said, the 10-year JGB yield needs to stay in positive territory so that the 10-year/20-year yield spread will exceed 35bp stably. The hurdle is still high (chart below). In the near term, dip-buying of 20-year JGBs at 0.35% is recommended.

Chart: JGB Yield Curve



Source: Bloomberg; compiled by Daiwa Securities.

Chart: 10Y JGB Yield and 10Y/20Y Spread



Source: Bloomberg; compiled by Daiwa Securities.

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

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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), 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 ¥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%.

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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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- 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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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

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