

Daiwa's View

Volatility downtrend becoming clear

- We may have already entered a new Goldilocks market

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Daiwa Securities Co. Ltd.

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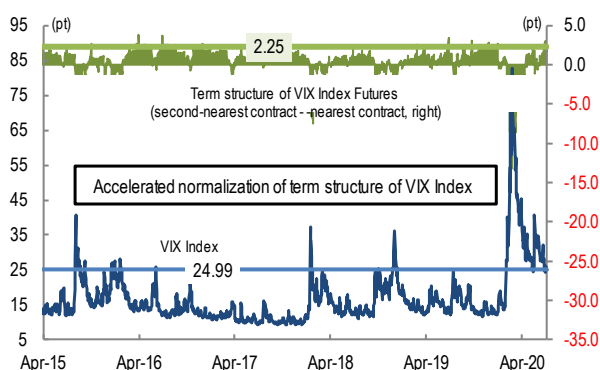
At the beginning of the week, US stocks rebounded, partially recouping a decline at the end of last week. Yields also rose in the same way. Meanwhile, recent moves that have been becoming trends, such as dollar depreciation (euro appreciation) and lower volatility, have continued. Yesterday, the euro (EUR/USD) advanced to 1.175 backed by strong factors, both [political](#) and [economic](#).

However, volatility of risk assets is low. At the end of last week, the volatility index for US bonds (MOVE) declined to 42.48, setting a record low. With respect to US stocks as well, the VIX Index again fell below 25. The downtrend in volatility is clear for both stocks and bonds.

Data also implies a further decline in the future. The term structure of VIX Futures and speculative investors' short open interest in VIX Futures are often useful signals when thinking about the market over the next several months. The term structure of VIX Futures (spread between August and September contracts) has now improved to 2.25pt. Speculative investors' short open interest in VIX Futures also increased to 95,000 units, clearly confirming a shift to an uptrend in short open interest.

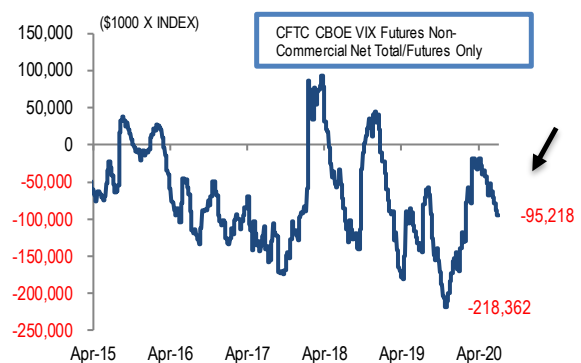
These figures indicate an increase in the number of investors forecasting a decline in volatility in the future. Currently, many headlines are about risk-off concerns due to the resurgence of US-China tensions, but we should keep in mind that the actual data implies the opposite developments.

VIX Index and VIX Index Futures



Source: Bloomberg; compiled by Daiwa Securities.

VIX Futures Positions by Speculative Investors



Source: Bloomberg; compiled by Daiwa Securities.

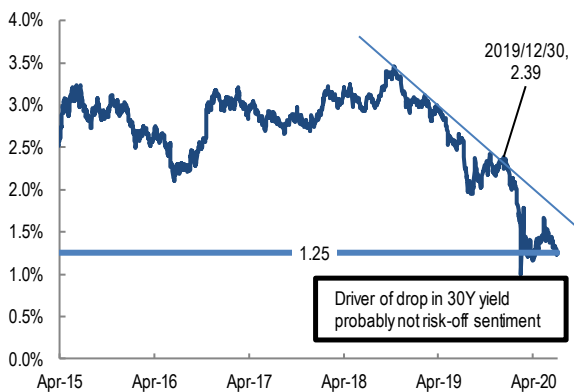
Some say that the decline in the 30-year US yield to the mid-1.2% level is a product of risk-off sentiment. Although this explanation is possible on a single-day basis, the yield decline is not consistent with other risk assets in the longer term. On the contrary, we can say that the yield decline has been increasingly marked amid the current risk-on situation.

We think that the yield decline may be justified, given (1) the drop in the MOVE Index to a record low and (2) the increasing probability that volatility will remain low over the long term due to the Fed's easing stance. In short, we may have already entered a new Goldilocks market.

Under the circumstances, the Fed is expected to shift from crisis response mode (support for private-sector financing) to ordinary response mode, which focuses on inflation, as early as the July FOMC meeting (28-29 Jul), or the September meeting at the latest. This may be the time to shift our investment stance from crisis response mode to the "return vs. volatility" valuation yardstick used during normal times.

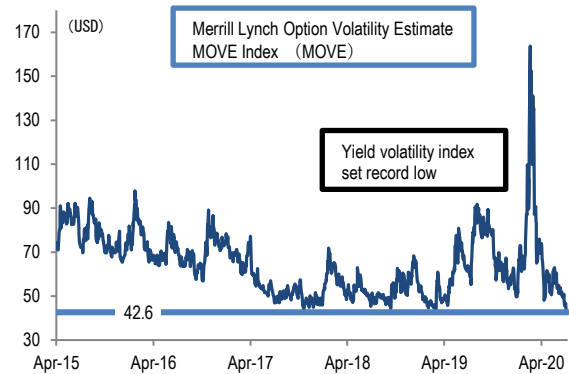
If we assume that across-the-board risk premium has started to be compressed due to further monetary easing and lower volatility, investment in superlong JGBs may be becoming attractive day by day as they still have wide risk premium owing to "concerns about increased issuance." While it is true that there are concerns about increased issuance, it is also true that the risk premium due to those concerns is a relative phenomenon that has materialized in the context of the current market environment.

30Y US Treasury Yield



Source: Bloomberg; compiled by Daiwa Securities.

US Bond Volatility Index



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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- 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.

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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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