

Daiwa's View

At first glance, reflation trade appears to return but...

- No sense of panic like before the presidential election

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp



Daiwa Securities Co. Ltd.

No sense of panic like before the presidential election

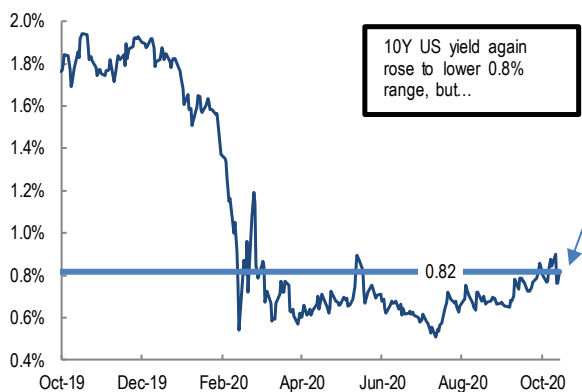
At first glance, reflation trade appears to return but...

Reflecting the favorable result of the jobs report, the 10-year US yield rose to 0.83% at one point in the US market at the end of last week. Following the release of the report, Senator Mitch McConnell said that signs of US economic recovery justified the Republican Party's argument that a smaller COVID-19 aid bill was more appropriate. As this remark curtailed the gain, the yield closed at 0.815%.

Apparently, the bear steepening trend seen before the US presidential election has come back. However, the US bond volatility index (MOVE) sharply dropped back to a level below 40, despite the fact that it had surged from the 30 level to 60 level since the beginning of October. It appears the market is not showing a sense of panic like it did before the presidential election.

Concerns of a bad rise in yields have probably diminished. Mr. Joe Biden is reported to have won the presidential election. (He declared victory last weekend.) Meanwhile, the Republican Party is expected to have a majority in the Senate and an unexpected increase the number of seats in the House, meaning that negotiations between the Democratic and Republican parties will remain important. Reflecting this dynamic change, the market is changing and responding to remarks by Senator McConnell who is governing the Senate¹, rather than President Trump.

10Y US Yield



Source: Bloomberg; compiled by Daiwa Securities.

US Bond Volatility Index

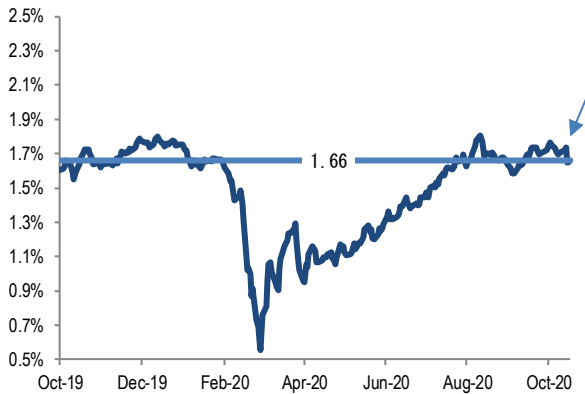


Source: Bloomberg; compiled by Daiwa Securities.

¹ This is also good news in terms of downgrade risk at developed nations, which is our concern. S&P pointed out the risk of bloated government spending as a reason for downgrading—"The main point to see here is where do we see the trajectory going forward. If we see the trajectory as establishing more of a different structural pattern, then you are going to see some (rating) movements there." To cope with this risk, Mr. Biden is likely to provide an environment in which he will exercise his ability to coordinate things within the party (against left-wing radicals).

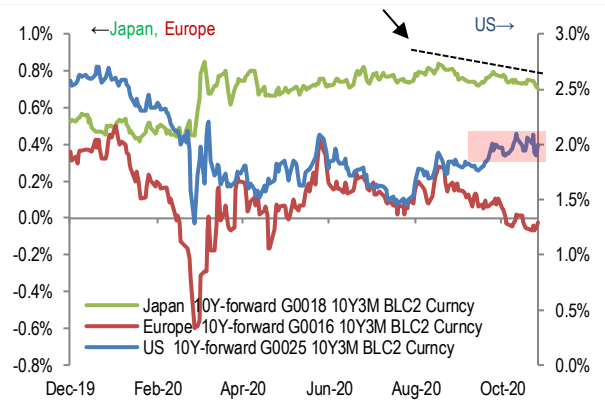
If the rise in yields was a reflection of the favorable jobs report, inflation expectations may have risen. However, with 10-year US inflation expectations (BEI) having risen little, we can say that the rise in yields at the end of last week was driven by a rise in the real interest rate. As shown by a drop in bank share prices (KBW Bank Index) amid the five consecutive days of gain in the NASDAQ Index, there are no signs of a full-fledged recovery of the reflation trade that was seen before the presidential election. The 10-year forward 3-month US yield also suggests a pause in the uptrend and a shift to a stage in which the yield moves at around 2%, which is estimated to be close to the current neutral interest rate in the US (blue line in right-hand chart below).

10Y US Inflation Expectation Rate



Source: Bloomberg; compiled by Daiwa Securities.

10Y-forward 3M Yield in Japan, US, Europe



Source: Bloomberg; compiled by Daiwa Securities.

With regard to JGBs, as well, the uptrend in the 10-year forward 3-month JGB yield let up in September, and the yield has been edging down since then (green line in right-hand chart above). We have the impression that the impact of European yields (ECB's additional easing) is gradually increasing in the space between falling European yields and rising US yields. Assuming the uptrend in US yields has almost stopped, the market will also be aware of the accumulation of the stock effect due to global expansion of QE (RBA, BOE, ECB, and Fed?).

That said, JGBs have their own supply/demand factors. During the weekend, Hiroshige Seko, upper house LDP Secretary-General recognized that around Y30tn would be necessary for a third supplementary budget. The NHK (Japan Broadcasting Corporation) reported that Prime Minister Yoshihide Suga is likely to instruct the budget to be compiled around 10 November. Market sensitivity to this is inevitable because the 30-year JGB auction is slated for that day. In that sense, we may have a dip-buying chance in the short term.

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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.

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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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