Daiwa's View

US Treasuries bought back at mid-0.9% level

- Getting difficult to react to positive surprises

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Daiwa Securities Co. Ltd.

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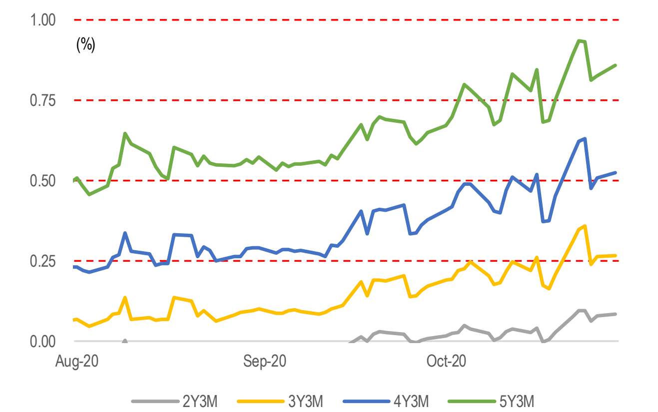
Getting difficult to react to positive surprises

Yesterday, we had additional pleasing news regarding Moderna's COVID-19 vaccine. US stocks (S&P 500 Index) naturally set a record high. In such a situation, US Treasuries were bought back immediately after an initial reaction of heavy sell-offs, which was a striking move in yesterday's market. The US long-term yield reached 0.93% at one point, and then it was immediately bought back to around 0.905%

This move is consistent with the fact that the volatility indices (MOVE Index, etc.) have been stable amid a series of positive newsflow. One background factor is probably the aspect that it is becoming difficult to factor in an earlier rate hike by the Fed. Looking at OIS futures as well, the rise in the 3-year forward rate was quite limited (0.355%→0.360%). As we already reported, the market's expectation for the timing of the start of a rate hike has been brought forward to "within three years." From now on, the Fed's forward guidance is likely to produce a powerful effect in this territory.

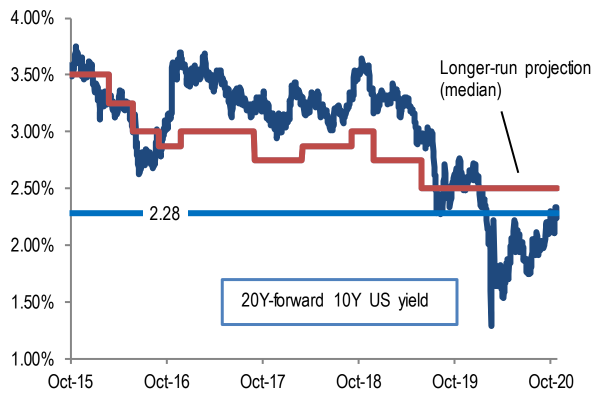
Regarding superlong yields, which is one side of the two ends of the yield curve, the 20-year forward 10-year yield rose to 2.28% and approached the reference point of the theoretical upper limit of the longer-run projection (median, currently 2.5%) in the dot chart. In other words, both ends of the US yield curve are approaching the upper limit of near-term theoretical values, apparently meaning less room to react to positive surprises. Going forward, inflation-related positive surprises would be necessary for a major rise in yields, rather than vaccine-related positive surprises.

Moves Factoring in Rate Hike (OIS futures – Effective federal funds rate)



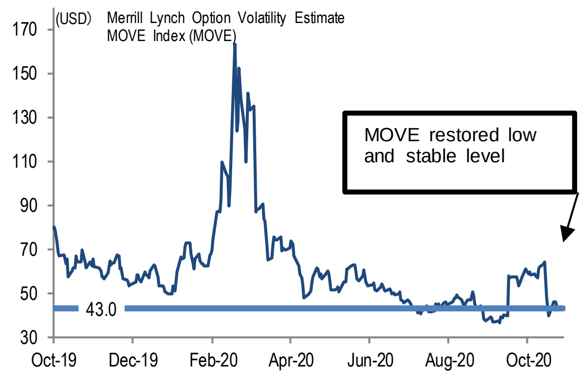
Source: Bloomberg; compiled by Daiwa Securities.
Note: Bloomberg's S0042FS data used as OIS futures.

20Y-forward 10Y US Yield, Longer-run Projection (median)



Source: Bloomberg; compiled by Daiwa Securities.

Yield Volatility Index (MOVE)



Source: Bloomberg; compiled by Daiwa Securities.

10Y US Inflation Expectations

Source: Bloomberg; compiled by Daiwa Securities.

In addition, BOJ policy board member Takako Masai made a speech at a meeting with local leaders yesterday. I will leave detailed commentary to BOJ watchers, but I will comment briefly on this speech because some comments have implications to the market.

First, we note the remark that "it is necessary to assume that monetary easing will be prolonged further." As an example, she admitted that the amount outstanding of ETFs held by the BOJ has increased to a considerable extent since the introduction of the purchase program ten years ago, saying that "it will become increasingly important to discuss how to maintain the effects of monetary easing while ensuring the sustainability of the policy, including in terms of increasing flexibility in ETF purchases and developing the market further." While a risk-taking stance is increasing in the market, with the Nikkei Stock Average reaching 25,906, discussions on a more flexible approach may proceed regarding ETF purchases by the central bank, which reduces risk premium via direct intervention.

Regarding the special deposit facility to support regional financial institutions that engage in business integration, she explained that it was a prudence policy to ensure the stability of the financial system, clearly saying that "we did not give particular consideration to the side effects of prolonged monetary easing."

In this regard, I have no doubt that the special deposit facility is focusing on prudence. However, all policies definitely entail side effects. There is no need for arguing regarding whether this facility will have a positive or negative effect on the side effect issue at regional financial institutions. In addition, it is true that the side effect issue at regional financial institutions has been recognized as a constraint condition for additional easing (prolonged easing). (In the first place, the idea that the prudence issue and the side effect issue at regional financial institutions are independent phenomena cannot be true, in my view.)

In this sense, the special deposit facility is likely to create (slight) changes, like the one that enables the BOJ to conduct prolonged easing (additional easing) compared to before, although this is a secondary effect, rather than the primary purpose. If the special deposit facility improves "prudence" and enables the BOJ to continue with the 0% target for the 10-year JGB yield as a result, this would serve as a flattening factor for the yield curve.

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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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Other Disclosures Concerning Individual Issues:
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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- 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.
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