

Daiwa's View

Fateful January

- Two trend lines to cross

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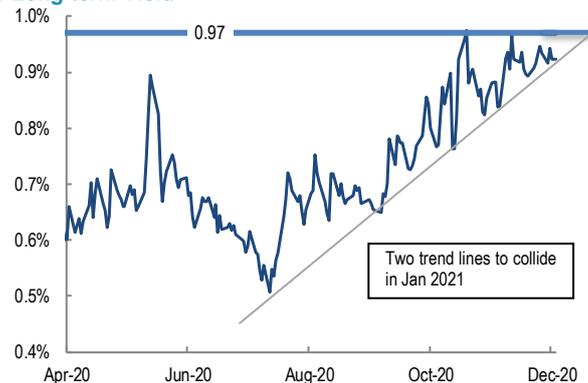
Daiwa Securities Co. Ltd.

Two trend lines to cross

Fateful January

Since the 10-year US yield hit a bottom at 0.51% on 3 August, its “lower limit” has been edging up at a pace of around 10bp/month. On the other hand, the yield has encountered resistance at 0.97% since the US presidential election in November. We thus can confirm that the “upper limit” remains in a flat trend. The two trend lines regarding these upper and lower limits are expected to cross around mid-January (triangle formation). As the fact that these two trend lines are incompatible is an axiom, the US long-term yield faces a crucial time in January 2021.

US Long-term Yield



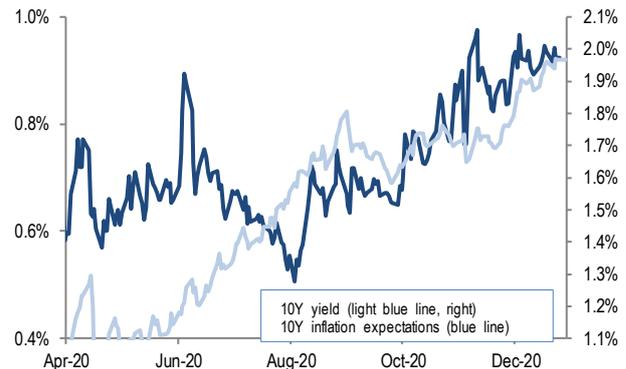
Source: Bloomberg; compiled by Daiwa Securities.

One reason behind the rise in yields at the relatively fast pace of 10bp/month was the fact that the expected timing regarding the Fed's rate hike was moved forward (left-hand chart on next page). In addition, the background behind the yield encountering resistance at just below 1% is probably the fact that the expected rate-hike timing has been moved forward to a point where it cannot be easily moved up any more. While the Fed projects that the policy rate will remain unchanged until the end of 2023, the market has already factored in a rate hike at the beginning of 2024.

In addition, the yield uptrend since August was mainly driven by a rise in market-based inflation expectations (rise in market-based inflation expectations and moving forward of expected rate-hike timing are consistent). However, as inflation expectations have already risen to 1.97%, the hurdle to maintain the upward pace is rising. From now, an upside breakout of the US long-term yield appears to require the condition that (1) the rate-hike timing is substantially moved forward due to an overshooting of the inflation rate or (2) the rate-hike pace accelerates significantly.

US Long-term Yield, 3Y-forward 3M OIS


Source: Bloomberg; compiled by Daiwa Securities.

US Long-term Yield, 10Y Breakeven Inflation Rate


Source: Bloomberg; compiled by Daiwa Securities.

In this respect, the y/y rise in US inflation is expected to temporarily overshoot the target from March 2021 onward, as our senior economist Kenji Yamamoto has pointed out. However, this is likely to be just a temporary phenomenon due to the base effects, reflecting the turbulence in prices at the initial stage of the COVID-19 pandemic (incl. drop in crude oil prices). Of course, the chance is not zero that market participants will misunderstand it as a full-fledged overshoot of the inflation rate. At this point, however, the Fed obviously does not project that such an overshooting trend will continue because (1) the core PCE for 2021 is projected at 1.8% in the Summary of Economic Projections at the December FOMC meeting and (2) the Fed projected that the policy rate would be unchanged until the end of 2023. If a premature rise in yields emerges due to an incorrect recognition, the Fed is likely to contain premature steepening of the yield curve via responses including exercising the option of a lengthening of maturities.

When we reflect the impact of gradual approaching of “the day (= lift off),” maintaining the forward guidance’s outlook that interest rates are unchanged until the end of 2023, the yield is expected to rise by around 1bp/month. Our forecast for the yield at end-2021 (1.06%), shown in [our 24 December report](#), reflects this pace of the rise in yields. Our main scenario for future developments is that the fast pace of yield rises of 10bp/month will face its final stage and then slow down to around 1bp/month.

In the case that the current market’s optimistic rate-hike outlook is revised, the chance of a downside breakout of the yield is not zero. In January 2021, a Senate runoff election in Georgia and the start of the Biden administration are scheduled for the 5th and 20th, respectively. Once the political transition is completed, the Chinese government’s stance toward the new administration is likely to become apparent. Keeping in mind that January is the timing when the trends can change easily as the two trend lines cross, we intend to scrutinize the expected impact of these changes in the situations.

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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")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

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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 ¥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).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

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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.

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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