Daiwa Securities

Daiwa's View

Short-cover rally pushed down yield to below 1.6%

➢ Retreat from overshoot in Feb-Mar

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Daiwa Securities Co. Ltd.

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Retreat from overshoot in Feb-Mar

March US retail sales were quite strong, jumping by 9.8% m/m, and the Philadelphia Fed Manufacturing Index rose to 50.2, recording its highest level since 1973. Meanwhile, the US yield declined substantially to 1.52% (down 11bp) at one point (closing at around 1.58%). Following the day before yesterday, yields slid substantially after the announcement of strong economic data. With US stock prices rising, the credit market was also in a tightening trend. Therefore, the cause of falling yields was probably not risk-off sentiment. The following remain a matter of speculation. But short positions were crowded in a situation where all market participants shared the outlook for higher yields. Then, short covering appears to have amplified due to triggers (this time, market failed to follow strong economic indicators).

Based on the above speculation we hit on the idea that *International Transactions in Securities* (released yesterday) was the trigger for increased short-covering yesterday. Of course, we need to discount the fact that this data includes rebalancing (from stocks to bonds), which reflects the stock rally. However, foreign bond investment by Japanese investors during 4-10 April was confirmed at above Y1.7tn, showing the possibility that Japanese investors turned aggressive about investing in foreign bonds at the start of the new fiscal year.

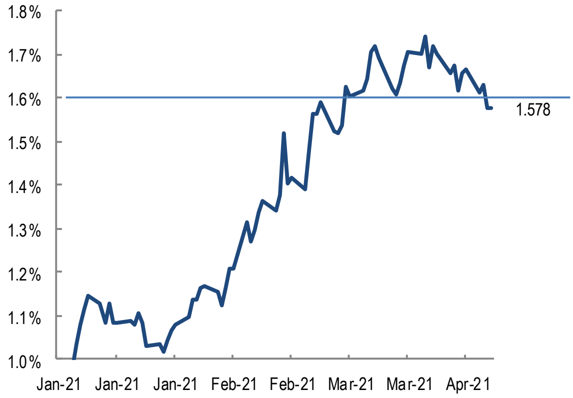
International Transactions in Securities (Y bn)

	Foreign bond investment by residents	Equity/investment funds investment by residents
09-Apr-21	1714.4	-623.3
02-Apr-21	375.1	-199.0
26-Mar-21	201.3	-367.9
19-Mar-21	554.5	-274.7
Avg for past 4 weeks	174.9	-287.4

Source: MOF; compiled by Daiwa Securities.

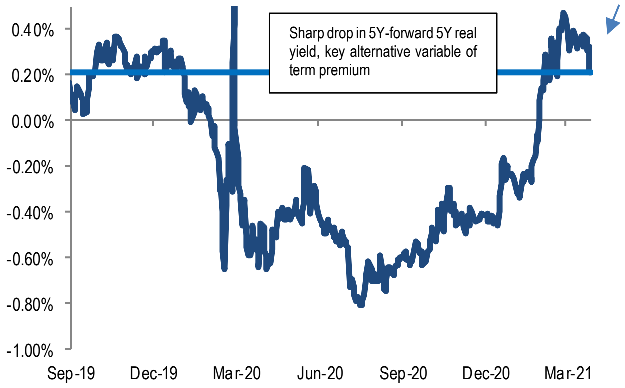
We imagine the flow as follows: Although the market's yield outlook was skewed to an upward one, Treasury auctions have been favorable since the beginning of April. While market participants were uncomfortable with the lack of yield reactions to positive economic indicators, Japanese investors' foreign bond investment data froze their blood. Then, as yields again did not react to even the strong retail data, it appears to have finally induced short cover. From a different viewpoint, we can interpret that yields retreated from the overshoot in February and March. The situation allowed us to project that yields would temporarily decline to around 1.4-1.5% amid the unchanged outlook for higher yields, once yields retreat from the overshoot led by the term premium. That said, it is true that we were surprised by the speed and degree of corrections.

10Y US Treasury Yield



Source: Bloomberg; compiled by Daiwa Securities.

5Y-forward 5Y US Treasury Real Yield



Source: Bloomberg; compiled by Daiwa Securities.

◆ **IMF still recommends 5-year yield target?**

In his interview with Bloomberg on 14 April, Ranil Salgado, the IMF mission chief for Japan, commended the BOJ's March assessment, saying that the new adjustments were "good innovations for the monetary policy framework. … If in the future further adjustments are needed, one option we suggested last year could be shifting the yield curve target to five years."

Regarding the Article IV consultation for Japan, there is the actual result that the IMF's proposal for resetting targets of monetary policy in June 2016 led to the introduction of the yield curve control policy in September 2016. We are thus especially focused on this consultation. However, as the IMF was scheduled to implement this year's consultation for Japan in the latter half of this year, the remarks on monetary policy at this timing were somewhat surprising.

In 2019, the IMF referred to the five-year yield target among the wide range of proposals for monetary policy. If it is repeating the same opinion this time, it would still be thought that this option has substantial merit even after the assessment meeting. Of course, the IMF's proposal is offered under the condition that if in the future further adjustments are needed, and an immediate shift is not proposed. However, this serves as a factor for an intellectual exercise when the BOJ conducts the next assessment.

For example, in the case that the yield curve remains in a narrow range for prolonged periods due to a decline in market functions via the increase in stock effects of BOJ's JGB holdings, it would be easy to imagine that this option would have a positive impact both on steepening of the yield curve and improvement in functions of the JGB market. It would takes several years for this. However, a certain degree of attention should be paid to avoid being tripped up by unexpected changes in the phase of yield declines amid the decline in market functions.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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February 2020

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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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- 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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