Daiwa's View

Yields are recently viewed as surging, but …

➢ Quite calm

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Daiwa Securities Co. Ltd.

Quite calm

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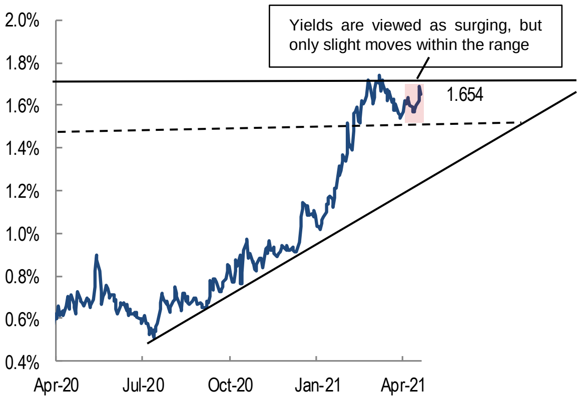
Following the surprising April CPI, PPI also exceeded the market estimate (+0.3%) at +0.6% m/m. However, the 10-year US Treasury yield declined to 1.65% yesterday, while stock prices bounced back. The decline appears to have been influenced by further diminishment of speculation on the start of tapering discussions at the June FOMC meeting following the remark by Fed governor Christopher Waller that "The May and June jobs report may reveal that April was an outlier, but we need to see that first before we start thinking about adjusting our policy stance."

Recently, yields are viewed as surging, but price movements in the bond market appear to be calm from my point of view. Although it is true that the 10-year yield rose from 1.6% to 1.7% after the release of the CPI data at a slightly fast pace, the move was completely within the range (left-hand chart below). What was more striking was that Treasuries were solidly bought back at a level far below the upper limit of the range (its highest price in March: 1.78%).

A sense of 'coolness' is also strong regarding the 10-year OIS. For example, in the New York Fed's survey conducted before the March FOMC meeting, expectations for the average federal funds rate over the next ten years (median) were 1.50% among primary dealers and 1.28% among market participants. Of course, we should check the results of the survey conducted before the April FOMC meeting to be released next week. However, an instant high OIS of around 1.47% can be seen as within 'ordinary price movements.'

10Y US Treasury Yield



Source: Bloomberg; compiled by Daiwa Securities.

Survey by New York Fed (before Mar FOMC meeting)

Primary dealers

2c) In addition, provide your estimate of the longer run target federal funds rate and your expectation for the average federal funds rate over the next 10 years.

	Longer Run	10-yr Average FF Rate
25th Pctl	2.13%	1.25%
Median	2.25%	1.50%
75th Pctl	2.50%	1.79%

Market participants

2c) In addition, provide your estimate of the longer run target federal funds rate and your expectation for the average federal funds rate over the next 10 years.

	Longer Run	10-yr Average FF Rate
25th Pctl	1.75%	0.95%
Median	2.00%	1.28%
75th Pctl	2.50%	1.50%

Source: Extracted from New York Fed materials.

When we divide the 10-year yield into the 5-year forward 5-year yield and 5-year yield, calmness can also be seen here. The 5-year forward 5-year yield was supported at around 2.55%, which is close to the longer-run target federal funds rate. With the 5-year yield, which rose to around 1% (0.9% in OIS) in March, standing at 0.82% (0.72% in OIS), the situation is far from the panic seen in March, despite the April CPI and PPI. The stability in the 5-year yield appears to be largely caused by the Fed official's message regarding a "temporary surge in inflation."

Breakdown of 10Y Yield (5Y yield, 5Y-forward 5Y yield, %)

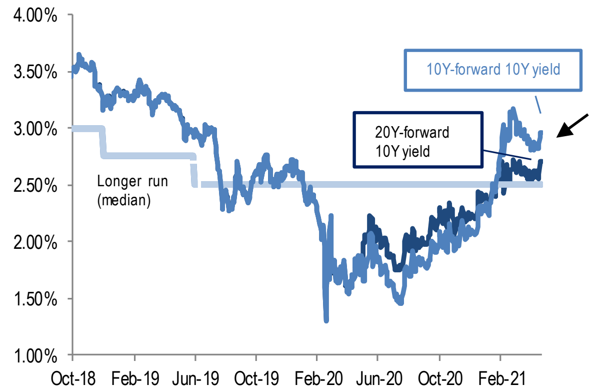
UST	5Y	5Y OIS	5Y5Y	5Y5Y OIS	10Y
Current level	0.82	0.72	2.56	2.14	1.65

Source: Bloomberg; compiled by Daiwa Securities.

In the 30-year sector, as well, which is showing the weakest performance on the curve, there were purchases at a level above 2.4% alongside steady trading volume, indicating investors' calm view in terms of fundamentals. This buy-on-dip was seen when the 10-year forward 10-year yield and the 20-year forward 10-year yield rose to 3% and 2.75%, respectively, a level that could be described as longer run plus something extra. We have the impression that this was a well-calculated move, also given the fact that this week's supply/demand conditions were weak due to large-scale corporate bond issuance in this zone coupled with a delta supply via an auction for 30-year US Treasuries.

Market prices are currently factoring in a rise in the longer-run target federal funds rate. However, in the aforementioned survey by the New York Fed (right-hand chart on previous page), estimations for the longer-run target federal funds rate (median) were 2.25% among primary dealers and 2.00% among market participants. On a questionnaire basis, the estimated longer-run rate is dominated by a decline rather than a rise. Frankly, it is disadvantageous to bet on a substantial rise in the longer-run target federal funds rate based on a current rate of 2.5%. This is probably why buy-on-dips are seen.

Longer Run Target Federal Funds Rate, Forward 10Y Yield



Source: Bloomberg; compiled by Daiwa Securities.

JGBs also posted strong bear steepening yesterday (20-year yield of 0.46% [+2.5bp] and 30-year yield of 0.67% [+3.5bp]) led by the superlong zone, coupled with the 30-year JGB auction and caution about a surge in yields after the release of the US CPI. That said, a dip is formed when anxious sentiment emerges. In order to turn this anxiety into an investment opportunity, it is important to envisage the true value in terms of fundamentals. When adopting an investment stance during rising yields, we need to solidly buy on dips without unnecessarily lifting up high prices or pursuing higher prices. Yesterday's US Treasury bond market was an example of this.

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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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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%.

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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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