# Daiwa's View

## Caution about second wave of COVID-19 infections

- Transmission path of second wave to US financial market may differ from that of first wave

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### Caution about second wave of COVID-19 infections

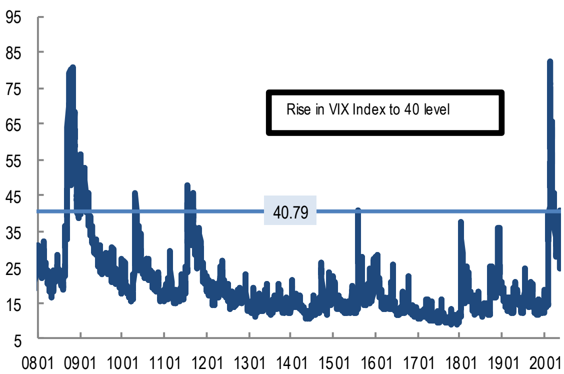
**Transmission path of second wave to US financial market may differ from that of first wave**

Yesterday, the market saw the DJIA plummet by 1,861 pt, alongside a sharp rise in the VIX Index to 40.9. Given the large price fluctuations, we can think that this is the initial move regarding the caution about a second wave of coronavirus infections. As reopening the economy and further infections are two sides of the same coin, signs of a second wave of the coronavirus in major regions have been reported. The situation where people were in close proximity to others at demonstrations since the George Floyd incident also appears to have served as a factor to strengthen the image of the virus spreading.

If the second wave of virus infections becomes serious, will it follow the developments similar to the first wave? I do not encourage getting careless, but the market is unlikely to follow the same path (liquidity crisis → distress sale of superior assets). There are very few people who are not cautious about a second wave. In addition, huge safety nets by governments and central banks have already been prepared.

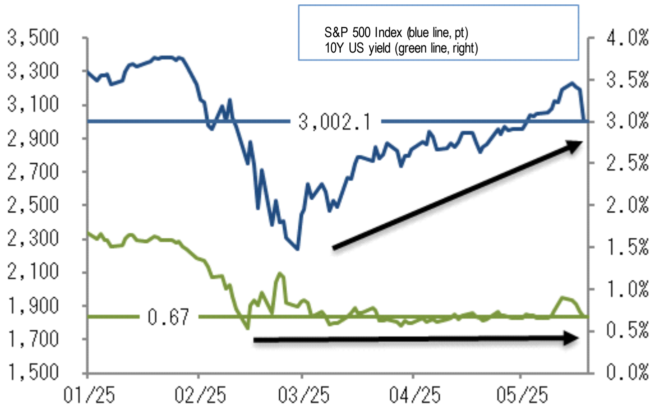
On the other hand, one issue that should be watched more than in the case of the first wave would be spillover to the solvency issue. If we face another lockdown due to a second wave, this will be definitely addressed by measures in combination with fiscal spending. Due to the first wave, the capacity of private-sector companies has already been exhausted. Moreover, room for further easing at central banks has almost disappeared after responses to the first wave. Therefore, dependence on fiscal measures is expected to rise in the case of a second wave.

**Chart: VIX index**




*Source: Bloomberg; compiled by Daiwa Securities.*

**Chart: US Stock Price and Long-term Yield**

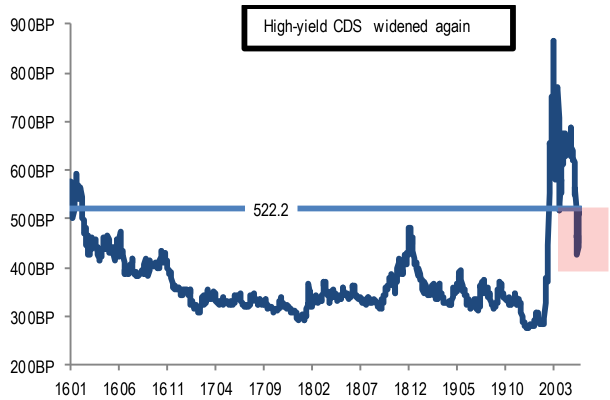



*Source: Bloomberg; compiled by Daiwa Securities.*

As is widely known, the pandemic is putting very strong stress on corporate financing. Although the Fed will not run out of ammunition regarding its support measures, the number of defaults of speculative grade companies, which are excluded from the Fed's support schemes, is expected to increase if the crisis is prolonged. Yesterday, the North American High Yield CDS index sharply widened from 448 to 522bp, indicating that caution about solvency is intensifying again.

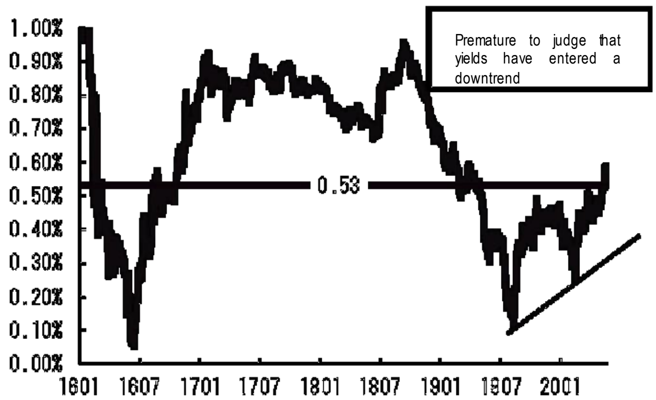
If the government continues to support the worsened solvency at speculative grade companies and SMEs, attention will shift to the nation's solvency risk. It is exaggerating to assume a solvency crisis at advanced nations, but pressure on further issuance of government bonds will strengthen fairly certainly. Going forward, the market may not continue to post the conventional structure (risk off = yield declines) as seen yesterday.

**Chart: CDX North American High Yield Index** (5Y)




*Source: Bloomberg; compiled by Daiwa Securities.*

**Chart: 30Y JGB Yield**




*Source: Bloomberg; compiled by Daiwa Securities.*

Since the COVID-19 crisis, JGBs have been experiencing "underestimation of the size of fiscal measures → more-than-expected size of fiscal measures and additional JGB issuance → rise in superlong yields." Of course, as BOJ governor Haruhiko Kuroda declared that "we will buy the necessary amount of JGBs to stabilize the yield curve at a low level," yields in the 0- to 10-year zone, which are under the yield curve control policy, will not rise beyond the BOJ's acceptable range. Meanwhile, yields in the superlong zone, where there are stable investors, would be largely entrusted to the market as long as the yield curve is formulated in a manner consistent with the 10-year yield target of around 0%.

If concerns appear about global expansion of fiscal spending due to a second wave of the virus (of course, this will not happen right away) "yield declines due to risk-off sentiment" seen last night may be short-lived. Regarding the superlong zone, which is easily affected by such speculation, we recommend (1) selling on a rally at an early timing and (2) a dip-buying stance prior to the further issuance of JGBs that will start in three weeks. It would be unnecessary to chase higher prices in this obvious phase of additional JGB issuance.

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**[Standard & Poor's]**

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**[Moody's]**

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February 2020

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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 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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* 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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