Daiwa's View

US presidential debate starts

➢ High-yield bond trends warrant attention

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Daiwa Securities Co. Ltd.

US presidential debate starts

High-yield bond trends warrant attention

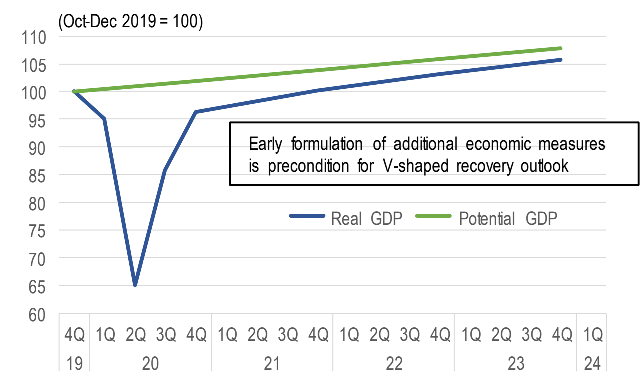
The first face-to-face TV debate for the US presidential election starts at 10:00am JST. With less than 40 days to go until the November 3 election, this debate is an important opportunity not only for presidential candidate Joe Biden to solidify his reportedly dominant position, but also for President Donald Trump to attempt a rebound in his approval ratings amid news reports that he is lagging behind.

This debate is also significant from the perspective of the fourth round of additional economic measures, upon which the market is placing great importance. As previously pointed out, the formulation of additional economic measures after the presidential election in November or after the beginning of next year is becoming a major issue, and the details and scale of the measures will be greatly influenced by the results of the presidential and congressional elections.

In particular, attention should be given to the fact that the formulation of additional economic measures at a relatively early stage is included in the preconditions of economic projections by many economists (including Fed officials). In the case of a collapse of a V-shaped recovery, which assumes the early formulation of additional economic measures, the economy would face higher downside risk from the Oct-Dec quarter onwards.

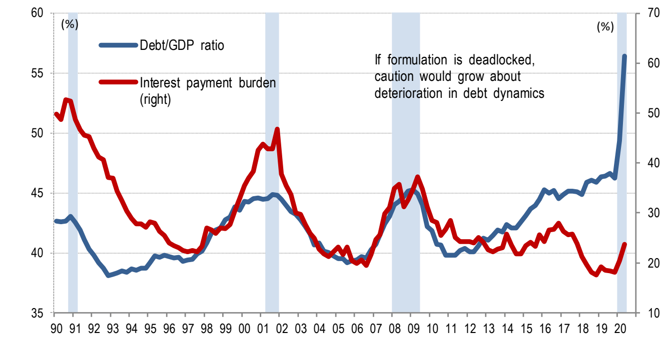
In such a scenario, the indirect impact of debt dynamics warrant more attention than before. From this perspective, trends in high-yield bonds are what should be the main focus of attention now. With about six months having passed since the outbreak of the COVID-19 pandemic, corporate financial capacity has been weakening. Under the circumstances, a downward revision to the economic recovery outlook may have a stronger negative impact on companies with more fragility.

FOMC's US Economic Projections (median, quarterly)



Source: Fed; compiled by Daiwa Securities.
Note: For 2020, actual data used for 1Q and 2Q, latest Atlanta Fed's GDPNow for 3Q.

Ratio of Debt Outstanding to GDP and Interest Payment Burden at Non-financial Corporate Division

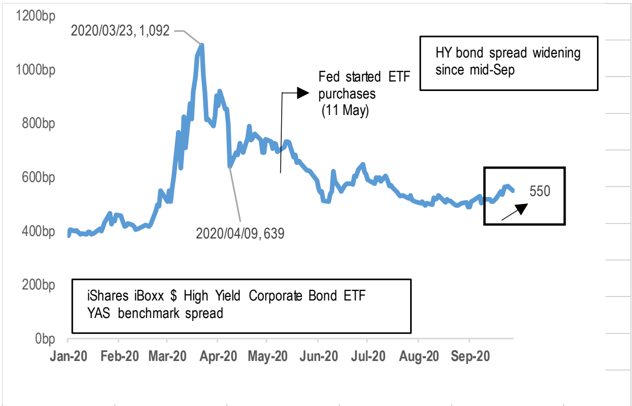


Source: Fed; compiled by Daiwa Securities.
Note: Ratio of interest payment burden = Net interest paid / (Pretax income + Net interest paid).

We should note that the US high-yield bond spread has been widening since mid-September. This coincided with the spread of disappointment over additional economic measures. The fact that those two things occurred at the same time is probably not a coincidence.

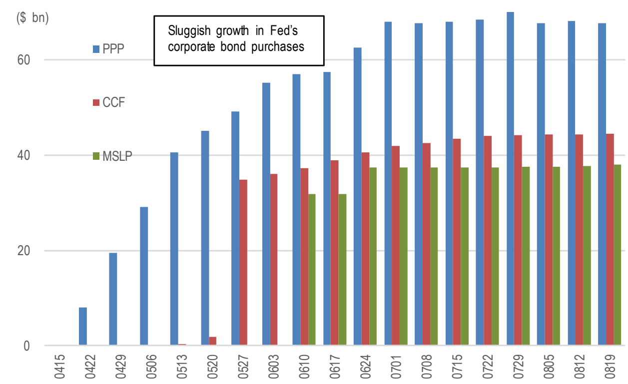
Until recently, high-yield bonds had performed well, backed by the introduction of the corporate credit facility by the Fed and the resulting recovery in confidence. This month, however, the Fed started to show a more bubble-cautious stance than before. Points have also been increasingly made regarding the outflow of funds in terms of money flow, while escalating conflict between the two parties is clouding the outlook for an early formulation of economic measures. This appears to be reflecting growing market awareness of the possibility of a shift from a liquidity crisis to a solvency crisis caused by the setback of a recovery of debt dynamics due to a delay in fiscal spending.

High-yield Bond Spread (HYG)



Source: Bloomberg; compiled by Daiwa Securities.

Amount of Assets Held via Fed's Emergency Programs



Source: Fed, Boston Fed, Bloomberg; compiled by Daiwa Securities.

Equity holdings give the right to claim a company's residual assets, but the liquidation of corporate bonds take preference over stocks. Therefore, even if US yields, which are a foundational element, enjoy extraordinarily stable movements, the negative impact of widening of the credit spread, another factor having a major impact on corporate fundraising costs, would spread to across-the-board risk assets, including stock prices. If a delay in economic measures were to serve as a factor in destabilizing risk assets, a likely trigger for this could be widening of the high-yield bond spread, in our view.

Daiwa Securities

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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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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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- 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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