

Daiwa's View

US long-term interest rate approaching upper end of our estimated range

- Rise in term premium + earlier-than-expected rate-hike expectations?

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Daiwa Securities Co. Ltd.

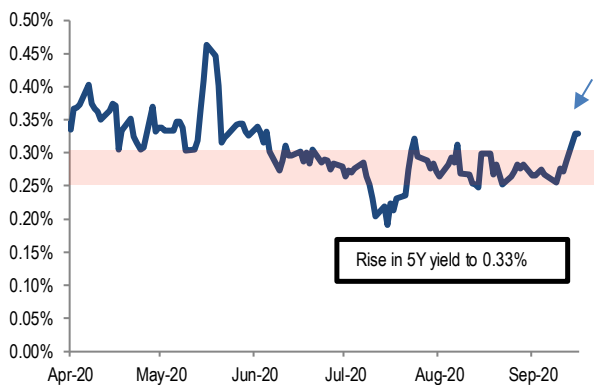
Rise in term premium + earlier-than-expected rate-hike expectations?

US long-term interest rate approaching upper end of our estimated range

Yesterday, the DJIA recovered to the 28,000-point level. In particular, yields were active and surged yesterday—the 10-year yield to around 0.78% (up 7bp) and 30-year yield to 1.58% (up 9bp). As the 10-year yield of 0.78% is close to the upper end (0.8%) of [our estimated range](#), we will provide a brief explanation. In addition, we will also touch on the surge in yields ahead of today's 30-year JGB auction.

First, we break down the US 10-year yield into “initial 5-year yield” and “5-year forward 5-year yield.” Yesterday, the 5-year yield closed at 0.33% (up 4bp) and the 5-year forward 5-year yield stood at 1.24% (up 10bp). The rise in the former exceeded our estimate. Taking this at face value, this means that more market participants have factored in an earlier-than-expected rate hike by the Fed. However, we are skeptical about whether the current level will continue. The latter is within our estimation. However, as the 5-year forward 5-year real interest rate, which is relatively reliable as a substitute variable of the term premium, rose by 6bp (−0.665% → −0.605%). We thus presume that more than half of the rise in yesterday's 10-year US yield stemmed from the surge in the term premium. Movements were somewhat illogical, which appears to have been the aspect amid a series of nervous reactions peculiar to the market prior to the presidential election.

US 5Y Yield (first half of 10Y yield)



Source: Bloomberg; compiled by Daiwa Securities.

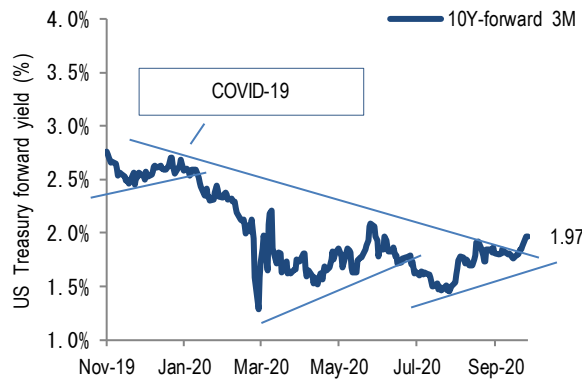
US 5Y-forward 5Y Yield (latter half of 10Y yield)



Source: Bloomberg; compiled by Daiwa Securities.

Another focus of attention is superlong yields. The 10-year forward 3-month yield, which tends to reflect the market's recognition of the neutral interest rate, posted an upside breakout from the triangle formation on the chart. It is highly likely that the rapid downtrend since the start of the COVID-19 pandemic has ended.

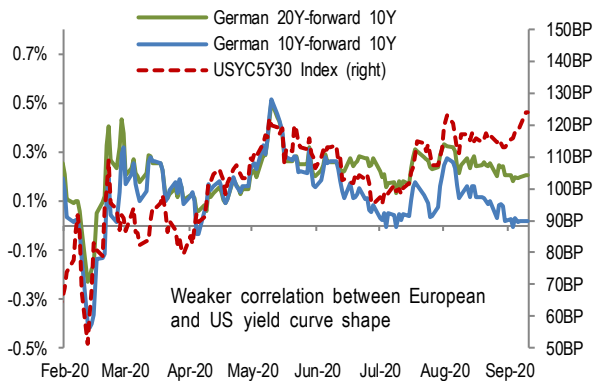
10Y-forward 3M Yield



Source: Bloomberg; compiled by Daiwa Securities.

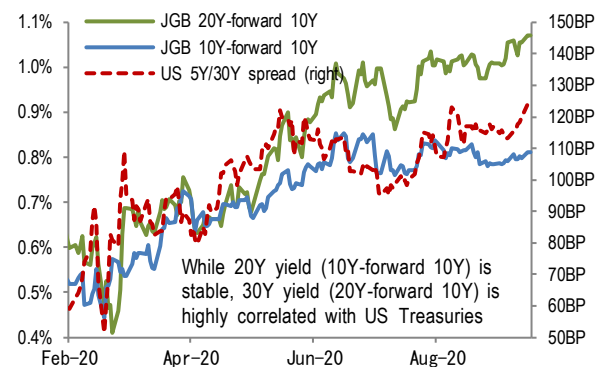
Next, we confirm the correlation between the US yield curve and those of other developed nations. Recently, the correlation between European and US yields has declined, probably because of the difference in the state of the COVID-19 pandemic and Europe-specific factors, including strong expectations for additional easing by the ECB. On the other hand, Japan is in an intermediate position between the US and Europe. The component of the 20-year JGB yield (10-year forward 10-year yield) has a weaker correlation with the 5-year/30-year US yield spread, while the 30-year JGB yield has a stronger correlation with US yields. Given these recent trends, we think that yesterday's widening of the 5-year/30-year US yield spread would serve to make us hesitate to take an aggressive stance toward today's 30Y JGB auction.

European forward 10Y Yields, US 5Y/30Y Spread



Source: Bloomberg; compiled by Daiwa Securities.

JGB forward 10Y Yields, US 5Y/30Y Spread



Source: Bloomberg; compiled by Daiwa Securities.

That said, the timing when other people become cautious provides the chance for purchases at the lowest cost. At around the upper end of the range, discussions on the range breakout grow. As this is seen ordinarily, the outcome will be eventually decided by how confident we are in our policy rate forecasts and their basis of fundamental projections. Yesterday, the 10-year forward 10-year JGB yield was at 0.81%, while the 20-year forward 10-year yield stood at 1.07%. If JGB yields in today's morning session reflect the steepening of US yields, the auction should be held at a correspondingly attractive level in the long run.

JGB Yield Simulation (%)

JGB	10Y	10Y10Y	20Y	20Y10Y	30Y
Current level	0.03	0.81	0.41	1.07	0.62
Up (Fwd 10Y)	0.03	1.01	0.52	1.27	0.77
Down (Fwd 10Y)	0.03	0.61	0.32	0.87	0.50

Source: Bloomberg; compiled by Daiwa Securities.

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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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")

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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).

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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.

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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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