

Daiwa's View

Is upward pressure on yields weakening?

- Stage appears to be shifting from “higher stock prices + higher yields” to “higher stock prices + stable yields”

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Daiwa Securities Co. Ltd.

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Is upward pressure on yields weakening?

While the CNN's Fear & Greed Index rose to a level that indicates “extreme greedy” market sentiment, US stocks again set record highs yesterday (DJIA topped 30,000 points). Although market experts were concerned about the decision to discontinue the Fed's five emergency lending programs due to Treasury Secretary Steven Mnuchin's request to return unused funds, the North American Investment Grade CDX Index has been consistently strong even after the confusion about such programs. Yesterday, the Index declined to the 51bp level, within range of the lowest level since the global financial crisis. This move proves that the market is becoming independent from the Fed, which is likely to prevent momentum toward the facility resumption from growing (putting aside lip service by NY Fed's John Williams).

Meanwhile, the US long-term yield rose to around 0.88% (up 3bp) yesterday. Of course, the direction of bonds is “selling” in the risk-on market dominated by greed. However, we note the fact that the 10-year US yield was unable to exceed 0.9% or even 1%, despite the situation where US stocks set record highs. Looking at forward yields, for example, the 10-year forward 3-month US yield stayed at around 2%. As such, upward pressure on yields is obviously weakening compared to early November (right-hand chart below: 2.15% logged on 10 Nov).

Also in other developed nations, we can point out the similar phenomenon with this “weakening of upward pressure on yields in the risk-on stage.” From a greater viewpoint, we thus have the impression that the stage is shifting from “higher stock prices + higher yields” to “higher stock prices + stable yields.” Stable yields may be spurring a stock rally.

Fear & Greed Index

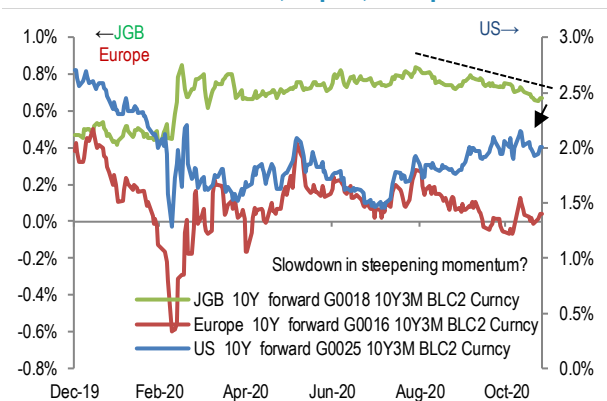
Fear & Greed Index

What emotion is driving the market now?



Source: Extracted from CNN website.

10Y-forward 3M Yield in US, Japan, Europe



Source: Bloomberg; compiled by Daiwa Securities.

Also in Japan, the 10-year forward 3-month yield stood at 0.82% on 6 July when concerns about the additional JGB issuance hit a peak and 0.75% before the US presidential election. However, the yield has now declined to 0.67%. The period of the 20-year JGB yield remaining low at the 0.3% level appears to be lengthening, despite the Nikkei Stock Average setting a 29-year high and media reports on expansion of the size of the third supplementary budget. One of the background factors is probably that the market is increasingly anticipating further prolongation of the low interest rate environment.

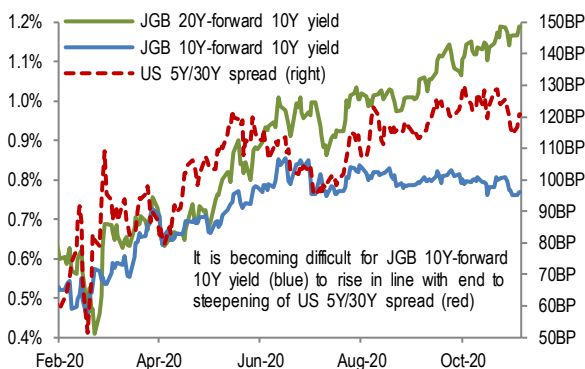
In fact, in his statement yesterday at the Committee on Financial Affairs of the House of Councillors, BOJ governor Haruhiko Kuroda said that “prolonged downward pressure on financial institutions’ profits might lead to a gradual pullback in financial intermediation, given the existing factors—such as the prolonged low interest rate environment and the declining population—as well as the recent impact of COVID-19,” and “the vulnerability of the financial system could increase, mainly due to the search for yield behavior” as “risks to the financial side from a somewhat long-term perspective¹.”

◆ **Statement by BOJ governor Haruhiko Kuroda at Committee on Financial Affairs, House of Councillors (24 Nov 2020)**

• With regard to risks to the financial side from a somewhat long-term perspective, prolonged downward pressure on financial institutions’ profits might lead to a gradual pullback in financial intermediation, given the existing factors—such as the prolonged low interest rate environment and the declining population—as well as the recent impact of COVID-19. On the other hand, under these circumstances, the vulnerability of the financial system could increase, mainly due to the search for yield behavior. These risks are judged as not significant at this point, mainly because financial institutions have sufficient capital bases. However, it is necessary to pay close attention to future developments.

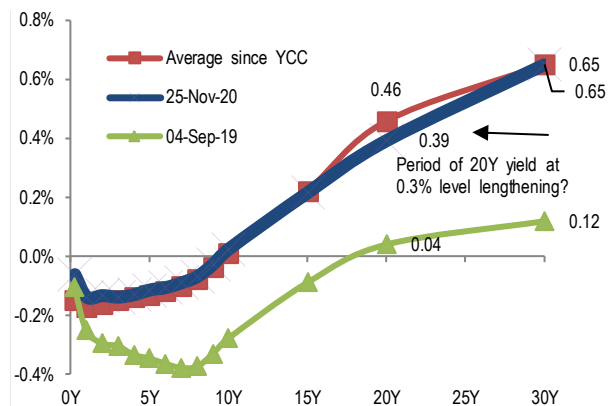
The content of the above statement is linked with the [“Special Deposit Facility to Enhance the Resilience of the Regional Financial System”](#) introduced on 10 November somewhat suddenly, and the behind-the-scenes details have been becoming apparent. His statement let us recognize the aspect that the facility was introduced in line with the future direction of monetary policy—“prolonged easing + prudence policy.” In the JGB market, flattening pressure has been increasing since the announcement of this facility on 10 November and the 20-year yield has been staying at the 0.3% level, although this may be a coincidence or the impact of US Treasuries. In any case, if we see stronger speculation on prolongation of the low interest rate policy, this would serve as a flattening factor for JGBs.

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



Source: Bloomberg; compiled by Daiwa Securities.

JGB Yield Curve



Source: Bloomberg; compiled by Daiwa Securities.

¹ Of course, he believes that these risks are not high at the moment.

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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")

The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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[Fitch]

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Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

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).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

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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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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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