

## Outlook for 40Y JGB Auction

### Placing bids to take minimum amount of JU13 tap necessary

- ✓ JU13 tap may fail to gain popularity in the current bond-unfriendly environment. We think about our bidding stance to take minimum amount of JU13 tap necessary, carefully watching demand from investors at the current level of around 0.7%.

Strategic Memorandum DSTE425  
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### Auction Details

**Auction Date:** January 26, 2021  
**Issue Date:** January 27, 2021  
**Maturity Date:** March 20, 2060  
**Offering Amount:** About 500 billion yen

\* New 40Y JGBs will be the fourth reopening of JU13 carrying a 0.5% coupon.

\*\* On January 25, JU13 traded at 0.695-0.700% (unch - +0.5bp v. previous day's close, 0.674-0.679% on compound yield) and closed at 0.700% (+0.5bp).

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

### 0.7% (Japanese yield basis) seems to be a strong support level

After the previous 40Y JGB auction went well at the 0.680-0.685% (+0.5 - +1.0bp vs. previous day's close, 0.661-0.665% on compound yield basis) on November 25, the 40Y JGB yield mostly moved at the 0.690-0.700% level. In early December, the yield temporarily declined to 0.63% on an intraday basis amid the firmness of the JGB market. Since then, the 40Y JGB yield had also been on an uptrend, while the JGB market had softened. Since last week, the number of transactions at 0.700-0.705% has been increasing. As we have the impression that demand is robust at that level, around 0.7% seems to be a strong support level for 40Y JGBs.

### Caution remains strong about upward pressure on bond yields

We check the environment surrounding the JGB market. In the US, Mr. Joe Biden was inaugurated as the President of the United States with the Democratic Party taking control of both the Senate and House of Representatives. Under President Biden, both of "good yield increase" (rise in potential growth rate and economic growth, which outpaces the potential growth rate) and "pernicious yield increase" (fiscal deterioration, rise in inflation rate without economic expansion) appear possible. Excessive concerns about an economic downturn may let up partly because Covid-19 vaccines appear to be being distributed steadily in Europe and the US. In Japan, speculations on the BOJ's "monetary policy assessment" are likely to increase toward March. Following last week's Monetary Policy Meeting, market participants further recognize that the assessment items include the side

effects of the long-term interest rate, which has remained low and stable, on market functions, and therefore long-term JGB purchase operations may be reviewed. We can say that upward pressure on JGB yields is likely to persist under this environment. In such a situation, we summarize key points to think about the bidding stance at tomorrow's auction as follows:

- ✓ **The level of investor demand should be carefully checked:** Ahead of the introduction of capital regulations based on an economic value, potential demand for 40Y JGBs appears strong. As 40Y JGBs are issued bimonthly in relatively small amounts, such demand can be expected to some extent. However, investors may have been able to buy the necessary amount in the yield upward stage since mid-December. The degree of investor demand at a familiar level needs to be carefully checked;
- ✓ **Not cheap on the curve, and difficult to bet on further flattening from the current level:** Our analysis based on data since the previous 40Y JGB auction shows that the 40Y sector is not cheap in the long-superlong zone of the yield curve at the current level. Rather, it is noticeably overvalued vs. the 20Y sector (Appendix 5a). Among 40Y JGBs, JU13's richness vs. JU1-2 is notable (Appendix 5b). As the flattening of the 20-40Y zone since the beginning of January is unlikely to proceed from the current level, it is difficult to aggressively move, such as switching;
- ✓ **Supply of superlong JGBs to continue every week until 20Y JGB auction in February:** Starting from last week's 20Y JGB auction (Jan 19), superlong JGBs are slated to be auctioned every week (total amount from tomorrow's 40Y JGB auction is around 3.1tn yen). However, the total purchase amount by the BOJ is not so large, we may see the prolonged anxiety about the downside of superlong JGBs, rather than expectations for the upside;
- ✓ **The level of support from short-covering is uncertain..**

#### Placing bids to take minimum amount of JU13 tap necessary

All in all, it is difficult to take an aggressive stance at tomorrow's auction. We would like to think about our bidding stance to take only the necessary amount, carefully watching demand from investors at the current level of around 0.7% in the current market environment.

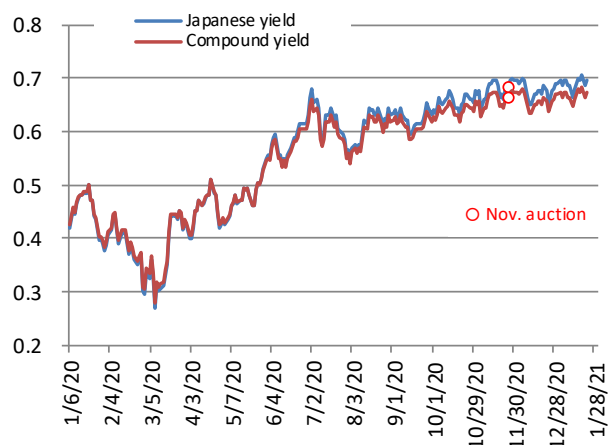
#### 40Y JGB Auction Results

Offer Date	Issue#	Nominal Coupon (%)	Maturity Date	Issue Size (100M yen)	B/C	Highest Accepted Yield (%)	Allotment (%)	Issue Price (yen)	Yield on the previous day (%)***	30Y/40Y on the previous day (bp)**	Yield at close on the auction day (%)**	30Y/40Y at close on the auction day (bp)**	
1/26/21	13R	0.5	3/20/60	500**					0.674	2.1			
11/25/20	13R	0.5	3/20/60	530.6	2.67	0.665	21.4007	94.30	0.657	2.1	0.665	2.4	Good
9/24/20	13R	0.5	3/20/60	544.1	2.65	0.610	86.3557	96.15	0.604	1.8	0.608	1.8	Avg
7/28/20	13R	0.5	3/20/60	505.3	3.11	0.575	3.4161	97.34	0.586	1.4	0.577	1.5	Good
5/26/20	13	0.5	3/20/60	509.9	3.06	0.505	93.4959	99.82	0.465	2.3	0.504	2.9	Avg
3/26/20	12R	0.5	3/20/59	415.1	2.66	0.450	30.5135	101.79	0.439	2.5	0.453	3.5	Avg
1/28/20	12R	0.5	3/20/59	404.2	2.86	0.400	95.9031	103.62	0.371	3.0	0.406	3.0	Avg
11/25/19	12R	0.5	3/20/59	455.0	3.50	0.460	73.5926	101.44	0.472	3.9	0.444	3.5	Good
9/25/19	12R	0.5	3/20/59	455.6	2.69	0.435	46.0000	102.36	0.401	5.4	0.425	6.8	Poor
7/23/19	12R	0.5	3/20/59	399.6	3.02	0.425	25.1445	102.73	0.415	3.9	0.415	4.9	Poor
5/28/19	12	0.5	3/20/59	404.5	3.87	0.535	84.4117	98.75	0.560	5.6	0.541	5.1	Good
3/26/19	11R	0.8	3/20/58	413.3	3.50	0.610	8.9655	106.58	0.584	7.2	0.617	7.2	Poor
1/29/19	11R	0.8	3/20/58	399.5	3.79	0.740	10.2272	102.04	0.746	9.3	0.746	9.3	Good
11/27/18	11R	0.8	3/20/58	449.2	3.85	0.940	57.2420	95.41	0.943	12.5	0.934	12.1	Good

\* Issue amount planned by Ministry of Finance \*\* Based on WI for new JU series; as of Jan. 22 close for the Jan-2021 auction

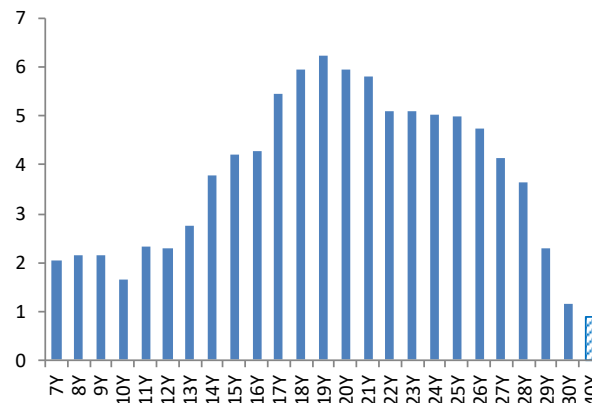
Source: Ministry of Finance (MOF), Daiwa Securities.

### Appendix 1: 40Y JGB Yield (%)



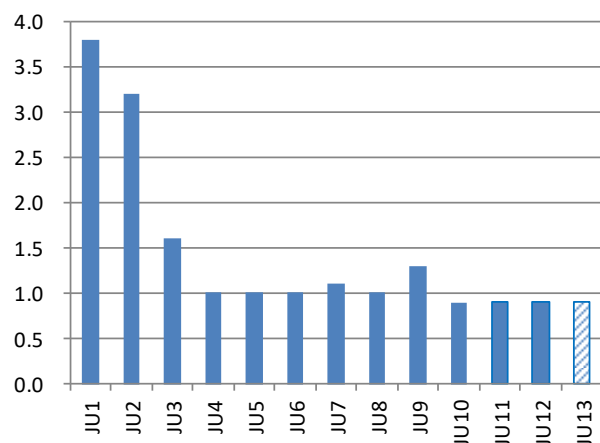
Source: Daiwa Securities.

### Appendix 2: JGB Yield Change (bp): Nov. 25 vs. Jan. 22



Source: Daiwa Securities.

### Appendix 3: 40Y JGB Yield Change: Nov. 25 vs. Jan. 22



Source: Daiwa Securities.

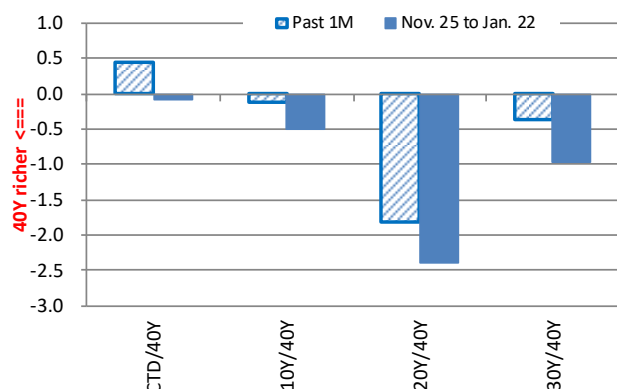
### Appendix 4: BOJ Holding and Market Outstanding of 40Y JGBs

(Yen billions)

	MOF Issue Size	BOJ Holding	% of BOJ Holding	Market Outstanding
JU1	1,069.4	296.2	27.7%	773.2
JU2	1,350	78	5.8%	1,272
JU3	1,384	200	14.5%	1,184
JU4	2,000	235	11.8%	1,764
JU5	1,964	147	7.5%	1,817
JU6	2,004	934	46.6%	1,071
JU7	2,184	1,069	48.9%	1,115
JU8	2,337	1,263	54.0%	1,074
JU9	3,836	1,552	40.5%	2,284
JU10	3,429	1,178	34.4%	2,251
JU11	2,713	490	18.1%	2,223
JU12	2,878	100	3.5%	2,778
JU13	2,090	0	0.0%	2,090

Source: Bank of Japan, Daiwa Securities.

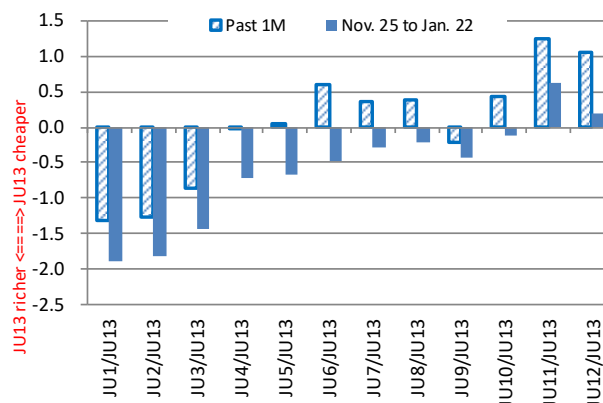
### Appendix 5a: Z-score I



Note: On-the-run and CTD basis

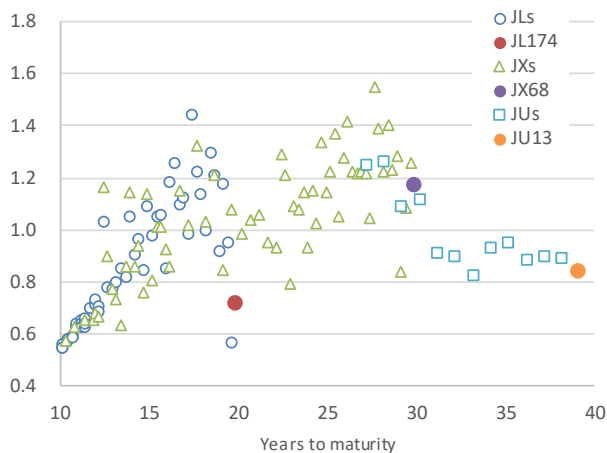
Source: Daiwa Securities.

### Appendix 5b: Z-score II



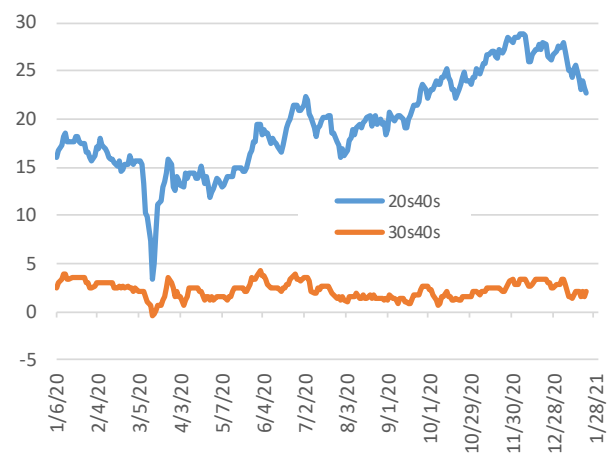
Source: Daiwa Securities.

Appendix 6: JGB Total Return Curve (3M, %)



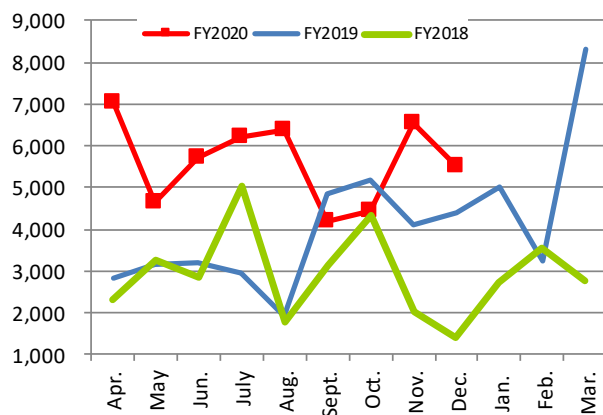
Note: Based on the Jan-22 JGB yield curve; factoring in roll-down effect etc.  
 Source: Daiwa Securities.

Appendix 7: JGB 20Y/40Y and 30Y/40Y Spreads (bp)



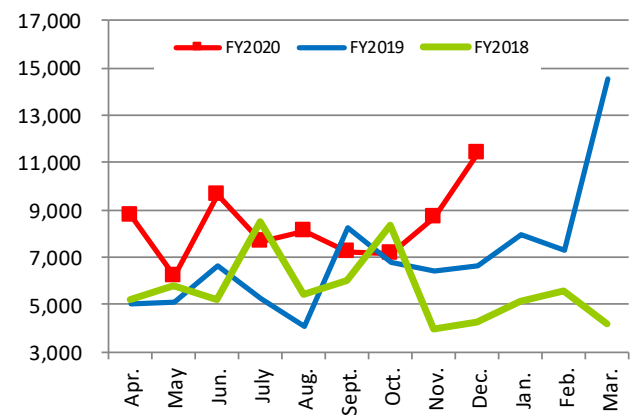
Note: On-the-run basis  
 Source: Daiwa Securities.

Appendix 8a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



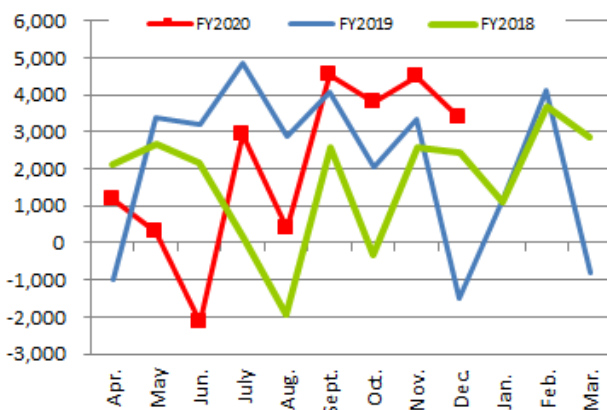
Source: JSDA

Appendix 8b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



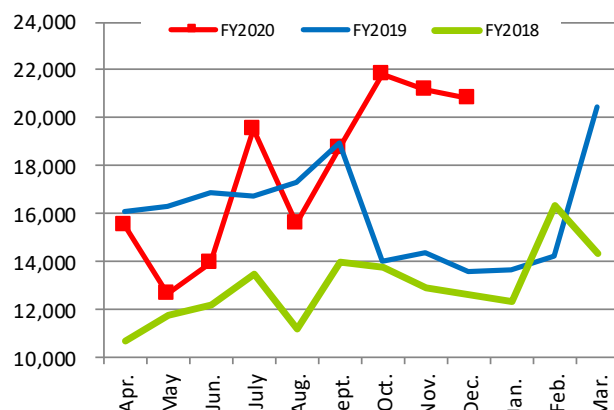
Source: JSDA

Appendix 9a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 9b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

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In order to ensure the fairness and transparency in the markets, Credit Rating Agencies became subject to the Credit Rating Agencies' registration system based on the Financial Instruments and Exchange Act. In accordance with this Act, in soliciting customers, Financial Instruments Business Operators, etc. shall not use the credit ratings provided by unregistered Credit Rating Agencies without informing customers of the fact that those Credit Rating Agencies are not registered, and shall also inform customers of the significance and limitations of credit ratings, etc.

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- 2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
- 3) Prohibition of the ratings in cases where Credit Rating Agencies have a close relationship with the issuers of the financial instruments to be rated, etc.
- 4) Duty to disclose information (preparation and publication of rating policies, etc. and public disclosure of explanatory documents).

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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), Nippon Healthcare Investment Corporation (3308), Japan Rental Housing Investments (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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- 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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