

Outlook for 30Y JGB Auction

Attractive in terms of absolute yield level

- ✓ As tomorrow's auction is likely to be held around the highest yield in FY2020, new 30Y JGBs appear attractive in terms of the absolute yield level. We would like to place solid bids at the level of above 0.65%.
- ✓ In terms of relative value, it is difficult to take an aggressive stance. However, it may be worth considering switching out from the 40Y sector when the 30Y/40Y spread narrows below 2bp, and/or buying asset swaps.

Strategic Memorandum DSTE428
FICC Research Dept.

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Auction Details

Auction Date: February 4, 2021
Issue Date: February 5, 2021
Maturity Date: December 20, 2050
Offering Amount: About 900 billion yen

* New 30Y JGBs will be the first reopening of JX69 carrying a 0.7% coupon.

** On February 3, JX69 traded at 0.660-0.665% (-0.5bp - unch v. previous day's close) and closed at 0.655% (unch).

Exp. Rating on Auction Results

1	2	3	4	5
Failed	Poor	Average	Good	Outstanding

Trading around the highest yield level in FY2020

The previous 30Y JGB auction in January went smoothly at the 0.645-0.650% (0.649-0.653% on compound yield basis) level vs. WI closing at 0.655% on the previous day. Since then, the 30Y JGB yield had edged up. In mid-January, the yield temporarily rose to 0.675%, the highest level since January 2019, during intraday trading. Subsequently, it has mostly moved in the 0.645-0.660% range. This week, the yield is moving at the 0.660-0.665% level. As this is around the highest yield level in FY2020, we can say that 30Y JGBs are attractive in terms of the absolute yield level.

Although caution remains strong about potential upward pressure on yields, upward momentum is unlikely to gain in the immediate future

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 steadily distributed especially in Europe and the US. In Japan, worries about the economy remain strong partly because the government decided yesterday to extend the current state of emergency for another month. Although caution remains strong about potential upward pressure on yields, upward momentum is unlikely to gain in the immediate future because the 10-year JGB yield is now moderately supported at 0.055%. In

such a situation, we summarize key points to think about the bidding stance at tomorrow's auction as follow:

- ✓ **Primary dealers do not appear to be excessively short:** Short-covering by primary dealers may be limited in the 30Y sector. The key to a successful auction tomorrow will likely be the level of demand from investors;
- ✓ **A certain degree of demand is expected from investors:** Regarding investor demand, the amount of “leveling” purchases throughout FY2020 appears to be larger than that in FY2018-2019. As bidding will likely take place around the highest yield level in FY2020 tomorrow with a high probability, auction participants would expect solid bids from investors;
- ✓ **Not cheap on the curve, even more overvalued against swaps:** Our analysis based on data since the previous auction and that over the past three months show that the 30Y sector is not noticeably cheap on the curve. Rather, it is markedly overvalued vs. the 20-24Y sector (Appendix 3). Since the previous auction, 30Y asset swaps have been posting a widening trend. 30Y cash is thus becoming overvalued against swaps (Appendix 4);
- ✓ **US Treasuries are becoming attractive, but investment in foreign bonds appears to be rather slow in Jan-Mar, generally:** Due to the recent rise in yields and a rise in USD/JPY basis swap (less negative), US Treasuries are becoming more attractive for Japanese investors with consideration of hedge cost (Appendix 9). In the Jan-Mar quarter, however, Japanese investors do not appear to have a strong tendency to aggressively accumulate foreign bonds (Appendix 10) partly because it is the last quarter of the fiscal year. The impact on JGB investment by activities in foreign bonds may be limited.

We think about our bidding stance, expecting tomorrow's auction to go smoothly at the level of above 0.65%

All in all, we would like to think about our bidding stance, expecting tomorrow's auction to go smoothly at the level of above 0.65%. As the 30Y sector is not cheap in terms of relative value, it is difficult to take an aggressive stance in building new curve positions. However, it may be worth considering switching out from the 40Y sector and/or buying asset swaps. As the 30Y/40Y spread is currently at around 2bp, the scope for further tightening appears limited. Partly because of an increase in the issuance amount of 40Y JGBs in FY2021, the spread may become wider than 5bp when the yield level edges up further in a slightly longer-term horizon (Appendix 6). Since last December, 30Y asset swaps have been in the widening trend (Appendix 4). Under the environment where it is easy to expect stronger upward pressure on yields, we think that the widening trend may continue for the time being, given potential demand for 30Y JGBs.

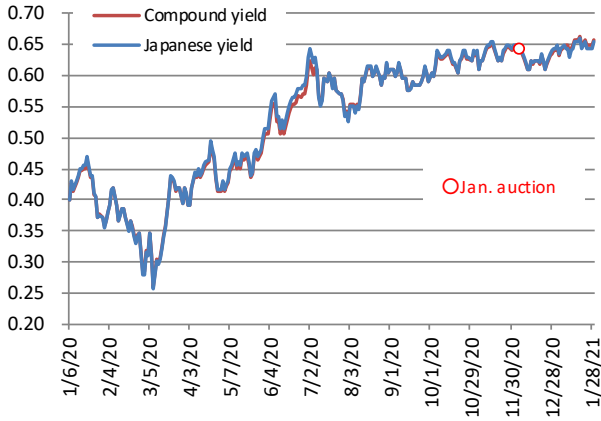
30Y JGB Auction Results

Auction Date	Issue #	Coupon (%)	Maturity	Amt Issued (billion yen)	B/C	Average Accepted Price (Yen)	Lowest Accepted Price (Yen)	Tail (Yen)	Average Accepted Yield (%)	Highest Accepted Yield (%)	Tail (%)	Allotment (%)	Rating	Close on Auction Day (%)
2/4/21	69R	0.6	12/20/50	900*										
1/8/21	69	0.6	12/20/50	973.2	2.98	101.30	101.20	0.10	0.648	0.652	0.004	37.7084	Avg	0.649
12/3/20	68R	0.6	9/20/50	970.7	3.49	98.80	98.75	0.05	0.648	0.650	0.002	82.6720	Avg	0.641
11/10/20	68R	0.6	9/20/50	916.9	3.76	98.91	98.85	0.06	0.643	0.645	0.002	79.7183	Avg	0.641
10/6/20	68	0.6	9/20/50	900.6	3.51	99.04	98.90	0.14	0.638	0.643	0.005	36.1111	Avg	0.640
9/3/20	67R	0.6	6/20/50	985.2	3.50	99.71	99.55	0.16	0.611	0.617	0.006	89.4984	Poor	0.600
8/18/20	67R	0.6	6/20/50	922.0	3.44	99.57	99.35	0.22	0.617	0.625	0.008	26.1213	Poor	0.615
7/7/20	67	0.6	6/20/50	966.7	3.92	99.68	99.60	0.08	0.612	0.615	0.003	29.2307	Good	0.610
6/4/20	66R	0.4	3/20/50	699.3	2.84	96.66	96.55	0.11	0.529	0.534	0.005	33.7612	Avg	0.540
5/14/20	66R	0.4	3/20/50	719.4	3.69	98.69	98.60	0.09	0.449	0.453	0.004	65.4037	Avg	0.455
4/7/20	66	0.4	3/20/50	699.7	3.53	99.29	98.90	0.39	0.426	0.441	0.015	28.6764	Poor	0.445
3/5/20	65R	0.4	12/20/49	720.5	3.65	101.75	101.65	0.10	0.335	0.339	0.004	29.4762	Good	0.345
2/6/20	65R	0.4	12/20/49	701.6	3.73	99.30	99.25	0.05	0.426	0.428	0.002	70.0249	Good	0.420
1/9/20	65	0.4	12/20/49	699.0	3.66	99.18	99.10	0.08	0.430	0.433	0.003	5.2076	Good	0.430

* Amount the Ministry of Finance plans to issue

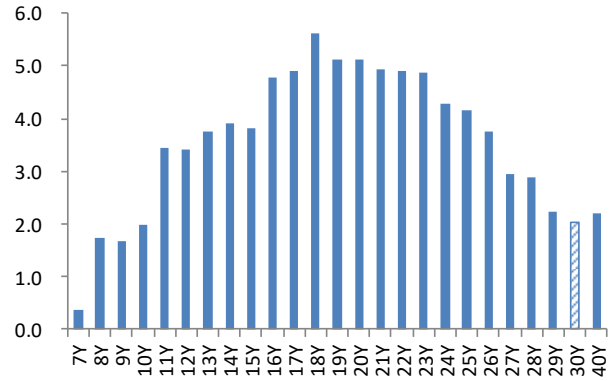
Source: Ministry of Finance (MOF), Daiwa Securities.

Appendix 1: 30Y JGB Yield (%)



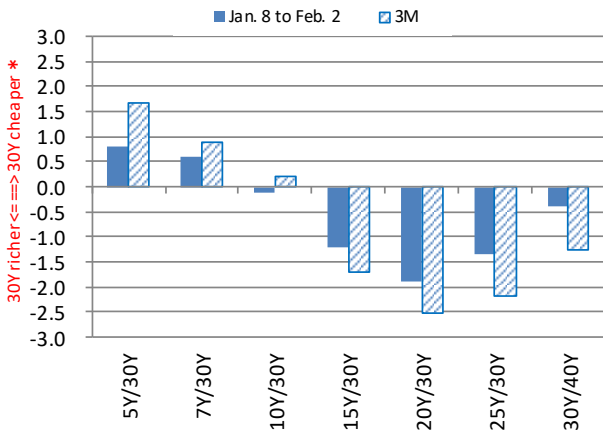
Source: Daiwa Securities.

Appendix 2: JGB Yield Change (bp, Jan. 8 vs. Feb. 2)



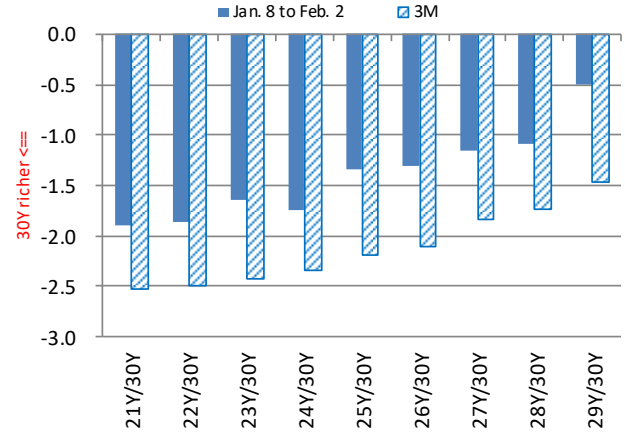
Source: Daiwa Securities.

Appendix 3a: Z-scores of JGB Yield Spreads



Note: For 30Y/40Y, 30Y richer at + and cheaper at - v. 40Y
Source: Daiwa Securities.

Appendix 3b: Z-scores of JGB Yield Spreads



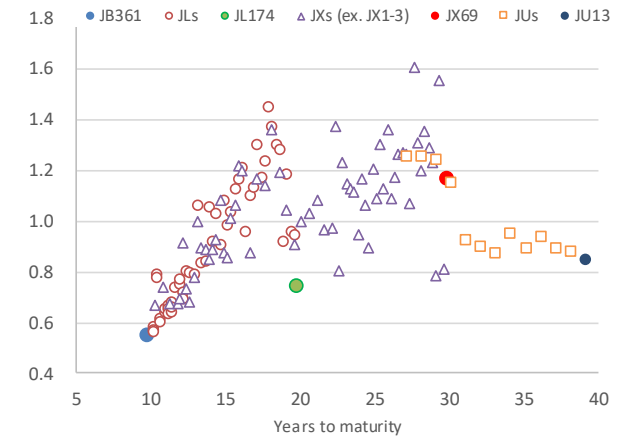
Source: Daiwa Securities.

Appendix 4: 30Y JGB Asset Swap Spread (bp)



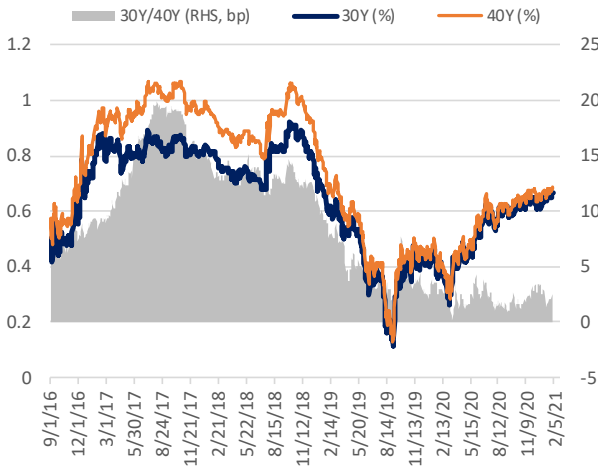
Note: 6M Yen LIBOR basis.
Source: Daiwa Securities.

Appendix 5: JGB 3M Total Return Curve (%)



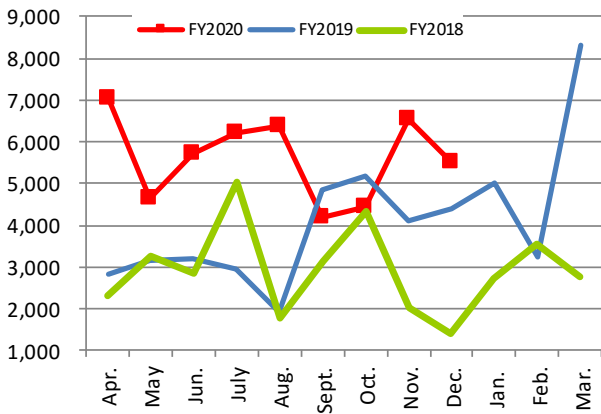
Note: Based on JGB yield curve on Feb. 2, assuming that the yield curve shape does not change and factoring roll-down effect etc.
Source: Daiwa Securities

Appendix 6: JGB 30Y/40Y Spread under YCC



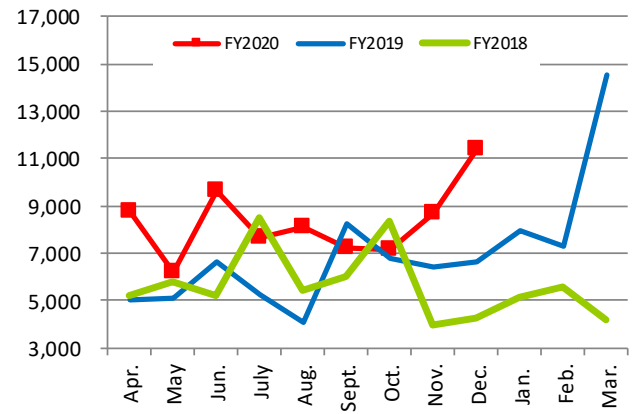
Note: On-the-run issue
Source: Daiwa Securities

Appendix 7a: Trend of Life and Non-life Insurers' Net Purchase of Superlong JGBs (Yen 100M)



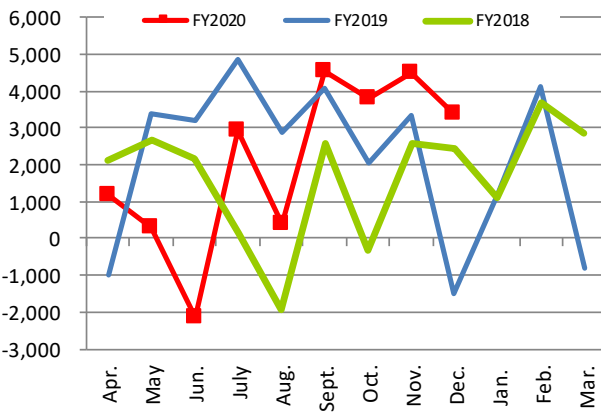
Source: JSDA

Appendix 7b: Trend of Life and Non-life Insurers' Gross Purchase of Superlong JGBs (Yen 100M)



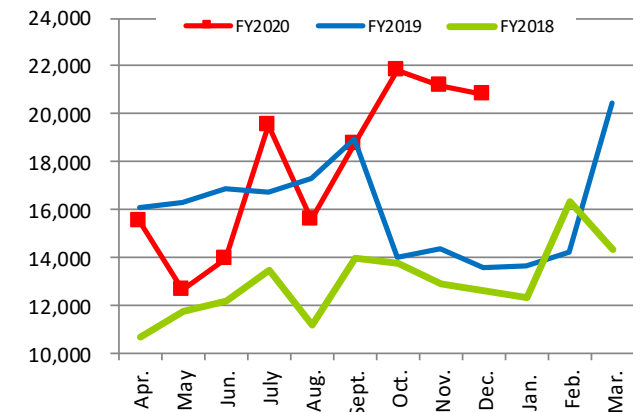
Source: JSDA

Appendix 8a: Trend of Overseas Accounts' Net Purchase of Superlong JGBs (Yen 100M)



Source: JSDA

Appendix 8b: Trend of Overseas Accounts' Gross Purchase of Superlong JGBs (Yen 100M)



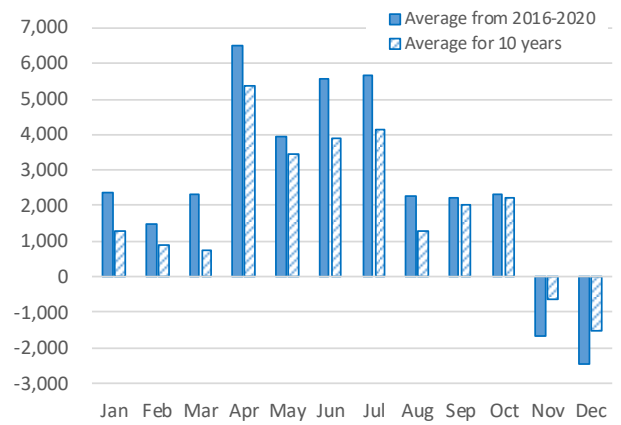
Source: JSDA

Appendix 9: JGB Attractiveness vs. Foreign Bonds for Japanese Investors (%)

		Yield	Rolldown	Hedge Cost	Attractiveness
		①	②	③	①+②+③
Japan	20Y	0.463	3.409	-	0.497
	30Y	0.662	0.806	-	0.670
US	10Y	1.106	8.942	-0.37	0.827
	30Y	1.880	1.194	-0.37	1.524
Australia	10Y	1.054	0.690	-0.17	0.891
	30Y	2.193	2.180	-0.17	2.045
Germany	10Y	-0.559	5.665	0.41	-0.088
	30Y	-0.046	1.302	0.41	0.381
France	10Y	-0.254	7.360	0.41	0.233
	30Y	0.491	1.484	0.41	0.920
Italy	10Y	0.573	10.172	0.41	1.089
	30Y	1.497	2.252	0.41	1.933
Spain	10Y	0.114	9.715	0.41	0.626
	30Y	0.973	2.263	0.41	1.410

Source: Bloomberg, Daiwa Securities

Appendix 10: Trend of Life Insurers' Foreign Bond Purchase (Yen 100M)



Source: JSDA, Daiwa Securities

Explanatory Document of Unregistered Credit Ratings

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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■ Credit Rating Agencies

[Standard & Poor's]

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Credit ratings may change depending on various factors, including issuers' performance, changes in external environment, performance of underlying assets, creditworthiness of counterparties and others. Standard & Poor's conducts rating analysis based on information it believes to be provided by the reliable source and assigns credit ratings only when it believes there is enough information in terms of quality and quantity to make a conclusion. However, Standard & Poor's does not perform an audit, due diligence or independent verification of any information it receives from the issuer or a third party, or guarantee its accuracy, completeness or timeliness of the results by using the information. Moreover, it needs to be noted that it may incur a potential risk due to the limitation of the historical data that are available for use depending on the rating.

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[Moody's]

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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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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.

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.

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Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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