

Daiwa's View

US yields hit record lows since start of fiscal year

- CPI and Jackson Hole conference non-events?
- JGBs likely to test level below 0.07%

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Daiwa Securities Co. Ltd.

CPI and Jackson Hole conference non-events?

US yields hit record lows since start of fiscal year

Yesterday, the 10-year US Treasury yield declined and closed at the 1.53% level, the lowest since the beginning of this fiscal year. As stock prices remained largely flat, the cause of the lower yields was not risk-off sentiment.

What is noted is the fact that the MOVE 3-month Index, which shows the implied volatility on 3-month Treasury options, is declining steadily, alongside the yield level. The drop in this index, whose period covers the Jackson Hole conference slated for August, talks eloquently about the fact that the market has started to think that this conference is regarded as a non-event. The implementation of tapering in 2022 has already become consensus (although there are minor debates about timing). There is a possibility that the market has digested the "tapering" factor.

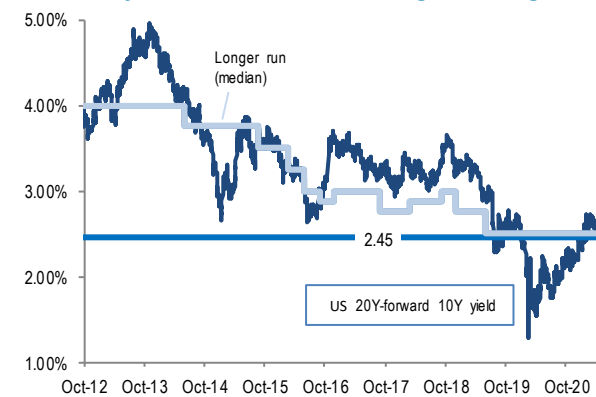
As the long end of the curve has been edging down, the 20-year forward 10-year yield fell to 2.45% yesterday, significantly below the Fed's longer-run projection of 2.5%. Here, however, we need to gauge why the yield reached this level. In the New York Fed's surveys in April, primary dealers and market participants estimated the longer-run target federal funds rate (median) at 2.31% and 2.00%, respectively. Also, from our viewpoint in our report that the structural factor that caused the decline in the equilibrium interest rate (r^*) is solid, we are not unconformable with the 20-year forward 10-year yield moving at around 2.25-2.5%. I have the impression that the long end has started to return to the normal range amid a decline in excessive expectations for inflation.

10Y US Treasury Yield



US Treasury Volatility Index (MOVE 3M)



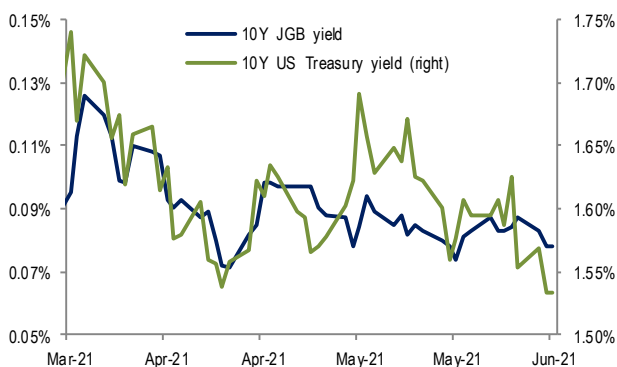
US Treasury 20Y-forward 10Y Yield, Longer-run Target Federal Funds Rate


Source: Bloomberg; compiled by Daiwa Securities.

Yesterday, 5-year inflation expectations (BEI) and the 5-year forward 5-year BEI declined to 2.37% and 2.27%, respectively, although the CPI data is slated to be released on the 10th. The market appears to regard the CPI statistics also as a non-event. The reality is that the market has fully factored in high figures due to the base effects. In addition, we obviously lack evidence to conclude whether inflation is “temporary” (this issue has aspect of theological argument). If yields remain flat and the volatility continues to decline amid the lack of a final conclusion about fundamentals, an optimal investment strategy would be “spread crashing” (carry and roll-down trade) due to a lack of alternatives.

JGBs likely to test level below 0.07%

While overnight US yields hit record lows since the beginning of this fiscal year, today's key point for JGBs is whether the 10-year yield will fall below 0.07%, a resistance level since the outset of the fiscal year. As the recent correlation between the Japanese and US long-term yields was slightly weak, we may see “no correlation in the downward stage because there was no correlation in the upward stage.” However, the left-hand chart below obviously shows the existence of a certain degree of correlation between Japanese and US yields from a long-term viewpoint. When US yields rose in May, JGB yields did not follow suit. This has already been digested in the series of developments because JGBs did not follow the subsequent downtrend of US yields. During this period, a globally common element of lower bond volatility may have increased its contribution. Moreover, regarding 20-year JGBs, which are attracting attention, we have confirmed a recovery of the correlation between the 10-year US yield and 10-year/20-year JGB spread since March 2021. Therefore, a certain degree of downward pressure is expected.

10Y JGB Yield, 10Y US Treasury Yield


Source: Bloomberg; compiled by Daiwa Securities.

10Y/20Y JGB Spread, 10Y US Treasury Yield


Source: Bloomberg; compiled by Daiwa Securities.

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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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The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moody.com/pages/default_ja.aspx))

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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

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

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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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