Financial Intelligence
Informa

The Context

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The Context
Inside this week's edition…

Central Bankers Fail to Convince Bond Markets

By Marcus Dewsnap, IGM Head of Fixed Income Strategy

Back to Index Page

So much talk from central bankers last week, it is hard to take it all in. Several points standout for us. The first is that the **ECB** and its Watchers Conference did nothing to assuage concerns about a slowing Eurozone economy. If anything, those speaking compounding worries. The second, from the same conference, was the seed planted by Mario Draghi about negating bad side effects from negative rates (fleshed out a tad more by Praet a day later). Third, several **FOMC**ers suggesting the market is going too far in pricing cuts to Fed Funds.

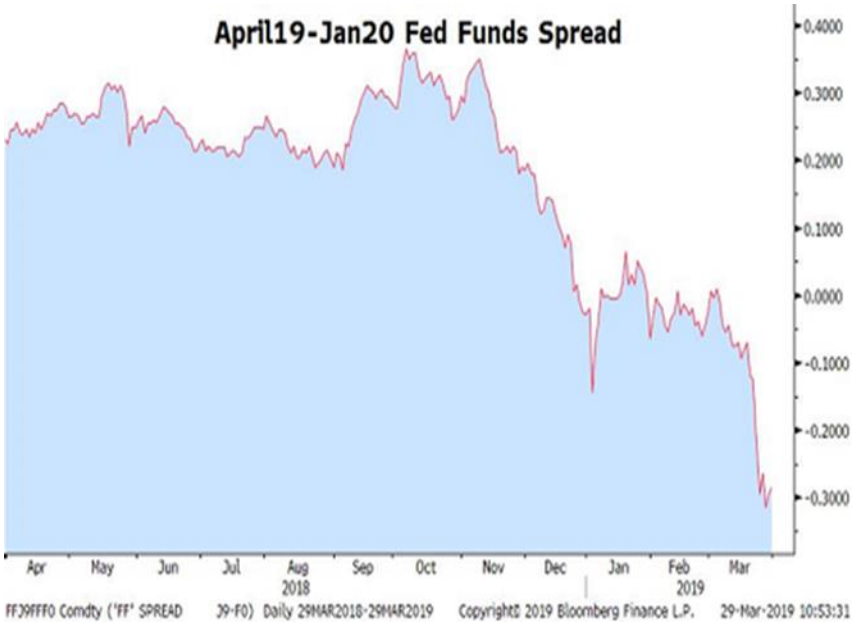
The suggestion from the ECB of tiering rates on excess reserves raises some intriguing possibilities (it is worth noting that the BoJ already does this). The large amount of liquidity ECB policy has created results in banks having to deposit significant amounts at the ECB at -0.4% Depo Rate (indeed, those stronger banks probably deposit more and perhaps perversely are thus penalized more than the weaker institutes). Thus, charging a less onerous rate (MRO?) should help. However, some excess reserves would still need to be charged at -0.4% in order to prevent tighter financial conditions which could come about if money market rates were to rise. An interesting point is raised by Unicredit:

'it would make it possible to cut the depo rate further, ensuring that MM rates follow suit while minimizing the direct negative effect on banks.'

The EUR OIS Curve does not price a Depo Rate cut at any point and there is no suggestion that tiering automatically means a rate cut. However, the mere thought makes this debate more than worth following and any impact on money markets which could then pull down the EGB front-end. All this makes for an interesting set of ECB minutes (Thursday).

FOMCers push back on the markets' rate cut either later this year or Jan2020 at the latest hasn't made much difference. The April19-Jan20 **FED FUNDS SPREAD** is -28bp. This is an 18bp move from -10bp in the last 10-days. The US 10-year yield sits around Effective Funds.

The general gloom and doom about economic prospects and the



markets' view on central bank policy going forward has resulted in a huge increase in negative yielding government debt.

In turn, this is resulting in a reach for yield with duration and USTs in demand, but also safe-havens. Corporate bond issuance continues to receive large orders. VW's 1.8x covered offering, a company not without recent troubles, last Monday is indicative of this. Earlier in March, Sanofi and LVMH sold at negative yields and the decent 10-year Bund auction at a negative yield last Wednesday suggest something of a safe-haven flow element too.

MBS in Limelight as European Securitisation Pipeline Grows

By Anil Mayre, Senior Credit Analyst

Back to Index Page

Activity is picking up in the European ABS space, as more new mandates flowed last week to ensure the quarter ended on a busier note than may have been expected just a few weeks ago. Three new Dutch RMBS were announced last week, alongside more RMBS from Ireland and the UK. Add to that the first CMBS of the year pricing, the announcement of new peer-to-peer UK SME ABS and the printing of a new CLO, and it made for a busier week.

Starting in the Dutch RMBS space, and there are two deals structured to meet STS criteria. These add to VW's German STS-compliant auto ABS that priced two weeks ago.

Two deals have already been registered with European Securities Market Association (ESMA) for STS, but these are private trades. Credit Immobilier de France Developpement (CIFD) closed its French home loans deal on March 21, to win the accolade as the first STS trade. **Private Harmony French Home Loans FCT** was backed by a EUR1.1bn portfolio, and privately placed via BNP Paribas and CACIB. The transaction was aimed at diversifying funding, according to CIFD.

The other STS deal filed with ESMA was a trade receivables ABCP deal.

See here for details on the ESMA site, and here for the CIFD announcement.

Of the new batch, Obvion was the first out, bringing **Storm 2019-I** via Rabobank and JP Morgan. A 4.9-year Triple A note is on offer. The third party verification agent is Prime Collateralised Securities (PCS). Obvion issued four deals in 2018, including two standard Storm transactions in addition to one backed by green mortgages and another structure without an optional redemption date.

The second Dutch deal aiming for STS classification comes from Venn Partners. BNP Paribas (sole lead), Mediobanca and Venn itself are joint arrangers for **Cartesian Residential Mortgages Blue**. Most of the portfolio comes from the Cartesian Residential Mortgages 1 deal that will be called this month.

The third Dutch deal in the pipeline is a non-conforming transaction from Morgan Stanley, called **Delft 2019**. This trade is backed by assets currently in a pre-crisis Lehman deal called EMF-NL 2008-2, which will be redeemed following the new securitisation.

The UK trade sees TwentyFour Asset Management bring its first owner-occupied transaction after three buy-to-let deals between May 2016 and June 2018.

Barley Hill No.1, via Citi and NatWest Markets (arranger), is backed by mortgages that TwentyFour's UKML fund has been warehousing since 2016 from The Mortgage Lender Limited. The portfolio is now over GBP200m and sufficiently large to publicly securitise.

And in Ireland, Bank of Ireland is securitising a pool of predominantly restructured buy-to-let loans as it seeks to continue winding down its non-performing exposures. Lloyds and Morgan Stanley are running **Mulcair Securities**.

In the CMBS market, BAML successfully printed its French CMBS, **Taurus 2019-1 FR**. The EUR237.1m deal was around 3.5x covered.

Changing sectors to ABS, and a SME peer-to-peer transaction was announced via sole lead Deutsche Bank. P2P Global Investments is the seller, and the loans for **Small Business Origination Loan Trust 2019-1** were originated via Funding Circle's marketplace platform.

There was one other new issue in the news last week, as KKR Credit Advisors printed its **Avoca CLO XX** new issue via Morgan Stanley.

Changing Monetary Policy Conditions Could Prove Supportive For EM Local Currency Bonds

By Natalie Rivett, Senior EM Analyst and Ed Blake, Chief FI Technical Analyst

It is not just developed market central banks that have turned dovish this year. Emerging Market central banks are also participating in the global shift away from higher interest rates as the softer economic backdrop squeezes price pressures within the region.

India stands out on this front, having surprised with a 25bp cut to the repo rate in February, to 6.25%, and a shift in the stance to 'neutral' from 'calibrated tightening' to boost the slowing economy. With inflation remaining below the central bank's target there remains scope to cut again and thus fully unwind last year's 50bp of hikes.

Meanwhile, expectations have turned to an unwinding of the tight monetary policy bias in Turkey, with rate cuts a real possibility in the coming months, after the economy was confirmed to have entered a recession in Q4 2018. There is a risk the recession will extend into this year and the government, which should be focused on longer term structural reforms, will step up the pressure on the central bank to boost the economy.

In Russia, further monetary policy tightening now looks off the table and we wouldn't rule out a rate cut as soon as late Q3 now the CBR has opened the door to easing this year amid an improved outlook for inflation. It said at the March 25 meeting that short term pro-inflationary risks have abated, and the acceleration of annual CPI has been curbed by a combination of consumer demand and income dynamics, Rouble strength and the September-December preemptive decisions to increase the key rate.

Brazil, following its first meeting presided by Roberto Campos Neto, has said inflation risks are no longer skewed to the upside and looks to be starting to entertain the possibility of a rate cut. It will not be ready to act in the short-term, but we believe the chances of a rate cut by year-end will rise if data over the coming quarter suggests the economic rebound is not accelerating and if progress is seen on the pension reform front.

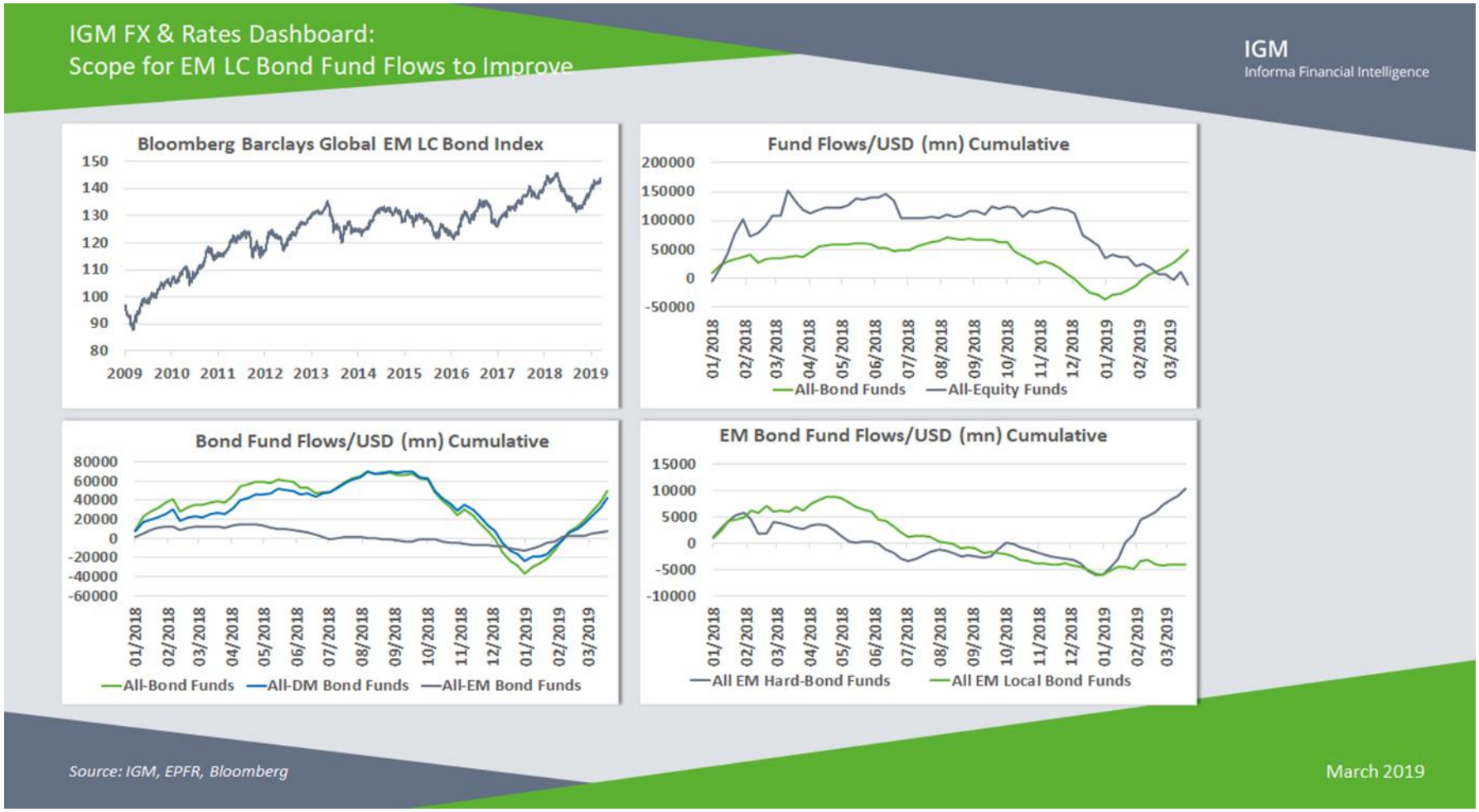
Economic activity has disappointed in Brazil and Mexico and Chile, while inflation has surprised consistently to the downside in Mexico, where we have also seen an emergence of rate cut expectations. At the very beginning of the year the market was expecting 25bp of hikes in twelve months, but the implied policy curve has already started to shift and is now pricing in circa 10bp of cuts within three months, increasing to almost 70bp in twelve months. A rather balanced monetary policy statement from Banxico in February on the risks to inflation and growth suggested to us that policy tightening is over and we would not be surprised to see a dovish monetary policy shift soon.

For Chile, with inflation back within the BCCh's 2-5% target range, we are expecting a pause for the rest of H1 and possibly longer - after two hikes implemented in October and January - amid what the central bank has referred to as a gradual and cautious cycle.

Interestingly, Hungary's central bank was one of only a few in Europe pledging to tighten policy this year and whilst it did so at the March 26 meeting, it still managed to prove surprisingly dovish, even when considering the external environment. The NBH delivered a 10bp increase to the overnight deposit rate to -0.05% and reduced its FX swap programme, but this was not the start of a tightening cycle, according to Governor Matolcsy, who deemed this rate increase a 'one-off' move justified by inflation trends. The central bank also announced a corporate bond purchasing programme, a stimulative measure. Any future decisions will be based on economic data and if the NBH does adopt further tightening measures these are likely to be modest/the minimum required, as monetary policy conditions remain accommodative.

continued page 6

Changing Monetary Policy Conditions Could Prove Supportive For EM Local Currency Bonds – cont'd



continued page 7

Changing Monetary Policy Conditions Could Prove Supportive For EM Local Currency Bonds – cont'd

Back to Index Page

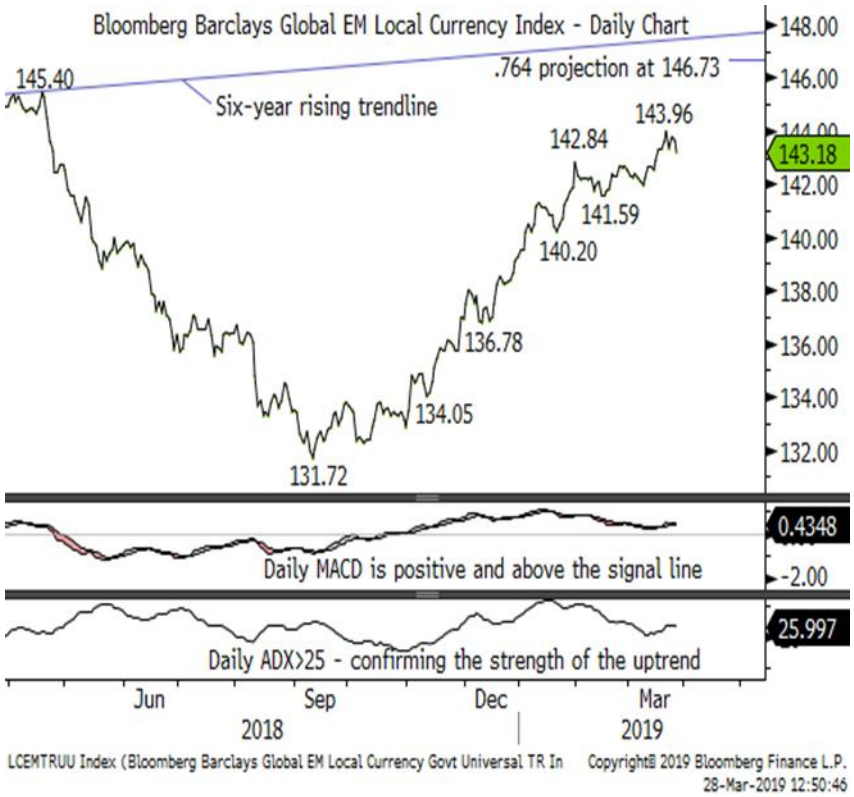
EM Local Currency Bonds Should Prove More Appealing

The softer economic backdrop and notably, the dovish Fed turn this year, has weighed on global bond yields - Germany's benchmark 10-year is at 2.5 year lows below 0% and sub-Japan for the first time since 2016, while the US 3-month/10-year yield curve has inverted, with the 10-year at 15-month lows below 2.40%. This, as this asset class becomes more appealing, and we can see this in the fund flows data. Cumulative flows for all-EPFR tracked bonds have been on an upward trajectory this year, whilst equity fund flows have turned marginally net negative, as can be seen in the prior dashboard.

The improvement in bond fund flows ytd has been driven predominantly by developed market bond funds, rather than EM focused bonds (see the dashboard) and drilling a bit deeper into the flows data, we can see that investors have a clear preference this year for EM bonds with hard currency mandates over local currency bonds this year, in a reversal of last year's trend.

However, with EM central banks also starting to participate in this global shift away from rate hikes, we suggest that monetary policy conditions could prove supportive for EM local currency bonds in H2 and beyond. The Bloomberg Barclays EM Local Currency Index is already approaching the 145.40 record high it reached almost a year ago and we believe this uptrend has scope to continue. The below technical outlook supports, with a reopening of the record peak seen initially exposing 146.73 and perhaps 147.41. Additionally, the fund flows data would suggest this is not a crowded market and we would also look for an improvement on the flows front in due course.

- *Advanced from 131.72 (2018 low – 11 September) to 143.96 (21 March, 11-month high), before ranging*
- *Constructive multi-timeframe studies suggest an upside extension re-opening the 2018 peak at 145.40 (posted 18 April)*
- *Above would initially expose 146.73 (.764x projection of 126.15/145.40 rally from 131.72), perhaps a six-year rising trendline at 147.41*
- *Any near-term corrective easing should hold over the 140.20/141.59 zone (22 January/15 February lows)*



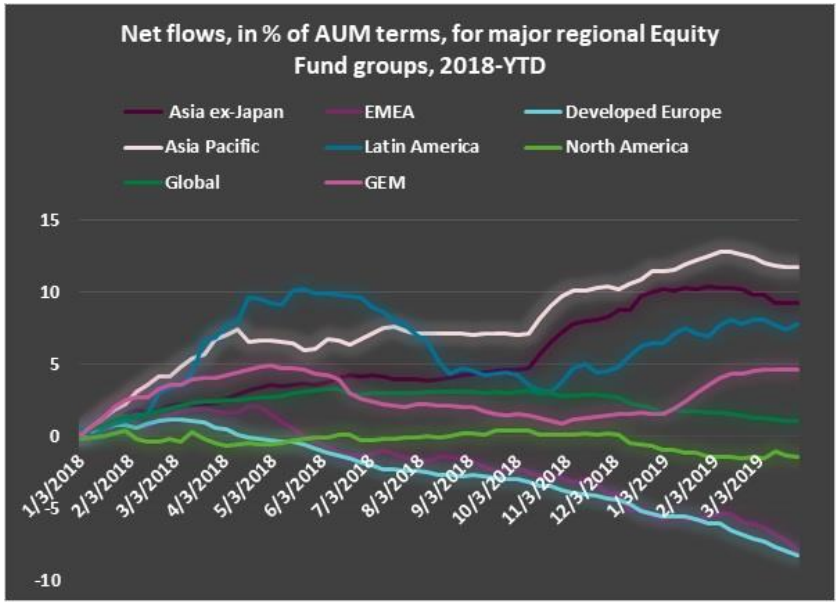
Know The Flows – Connecting The Dots Spells End-of-Cycle For Mutual Fund Investors

By Cameron Brandt, Director, EPFR Research

Back to Index Page

The fourth week of March started with the US Federal Reserve removing the dots from its much perused 'dot plot' and ended with yields on German 10-year sovereign bonds slipping into negative territory for the first time since late 3Q16. In between, the yield curves for three month and 10-year US Treasuries inverted.

A slowing global economy, unresolved trade issues and Europe's current crop of political challenges are among the factors that are driving monetary policymakers and debt markets in the direction they are currently going. It is a direction that mutual fund investors have been going since the year began, selling into equity market rallies and stuffing money into Bond Funds. Year-to-date, cumulative weekly redemptions from EPFR-tracked Equity Funds exceed $70 billion while Bond Funds have absorbed $125 billion.



The pattern is beginning to impose itself on funds dedicated to emerging markets. Emerging Markets Equity Funds, which carried a 17-week inflow streak into mid-February, have posted outflows five of the past six weeks while Emerging Market Bond Funds have attracted fresh money eight of the past nine weeks.

During the week ending March 27 a net $12.4 billion flowed out of Equity Funds and $2.2 billion out of Balanced Funds while Bond Funds absorbed $8.6 billion and Money Market Funds over $25 billion.

At the asset class and single country fund levels, Municipal, Total Return and Mortgage Backed Bond Funds extended their current inflow streaks while Bank Loan Funds chalked up their 19th consecutive outflow. Redemptions from Netherlands and Chile Equity Funds hit 23- and 29-week highs respectively, Turkey Equity Funds recorded their ninth consecutive outflow and investors pulled over $1 billion out of China Equity Funds for the third time year-to-date.

Going into the final days of March only two of the 11 major Sector Fund groups tracked by EPFR managed to attract fresh money as macroeconomic data and signals from fixed income markets poured cold water on the bullish signals that equity indexes have been emitting in recent weeks. The defensive Utilities and Healthcare Sector Funds recorded inflows during the week ending March 27. The other nine groups recorded outflows that ranged from $20 million for Telecoms Sector Funds to $1.5 billion for Financial Sector Funds.

Financial Sector Funds were hit by the revised assumptions about global economic growth, the inversion of US yield curves and the recent central bank retreat from 'normalization' that, for banks, equates with a strong economy and better lending spreads. This fund group has now posted outflows 23 of the past 26 weeks. Longer term, investors remain concerned about more aggressive regulation by Democratic lawmakers in the US House of Representatives, the disruption of established business models by technology companies and the legal risks exemplified by Malaysia's $3.3 billion suit against industry bellwether Goldman Sachs.

China Insight: LGFVs Finally Seeing The Light at The End of The Tunnel

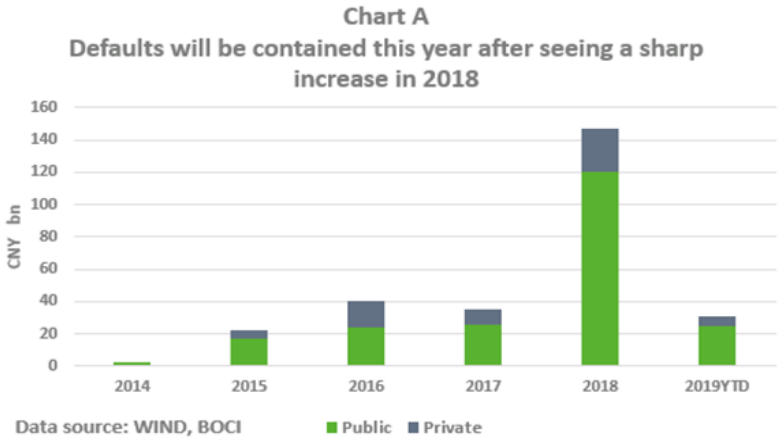
By Tim Cheung, IGM Head of China, Riki Zhang IGM EM Analyst

Since 2H18, the central government has taken measures to support the economy facing internal and external challenges, as well as softened its tone on regulating LGFV debts.

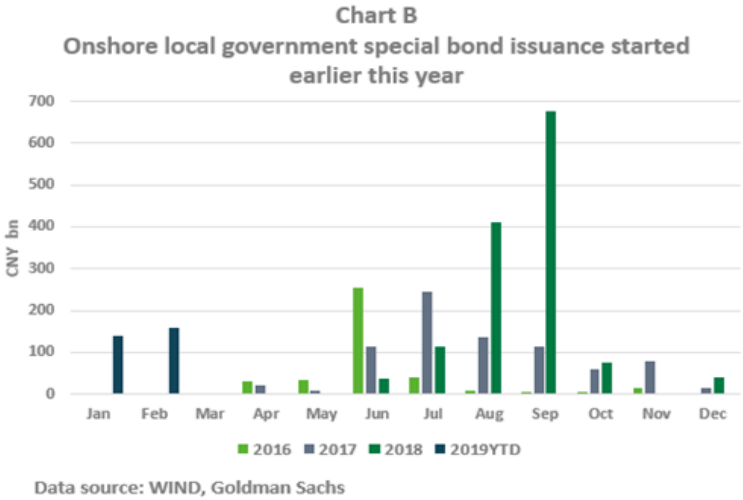
The government work report 2019 encourages the adoption of market approaches to solve the issue of maturing LGFV debt and makes sure that projects financed by such debt are not stopped halfway. More special local government bonds would be issued (CNY2.15tn of special local government bonds will be issued in 2019, up CNY800bn from last year) and the scope of use for such bonds will be moderately expanded.

Besides this, the work report also mentioned to continue the issuance of some local government bonds to replace outstanding debt. In fact, the heavily indebted LGFV sector is going to face mounting maturities this year (as much as CNY500bn onshore and USD9bn offshore).

Allowing LGFVs to roll over their maturities will thus help ease the repayment pressure on the sector, as a result preventing a surge of default risks (chart A) .



We note that local government bond issuance, which in prior years had commenced after May, began in January this year. About CNY300bn worth of local government special bonds were issued in January and February (chart B). The remaining quota of around CNY1.8tn would be issued before September.



An accommodative monetary policy has also helped facilitate LGFV bond issuance. These efforts are already prompting a pick-up in off-budget financing, bolstering infrastructure investment and likely helping overall growth bottom out in Q1 (chart C, next page).

With the above-mentioned easing measures being introduced, investors now feel more optimistic about LGFVs, especially those onshore.

continued page 10

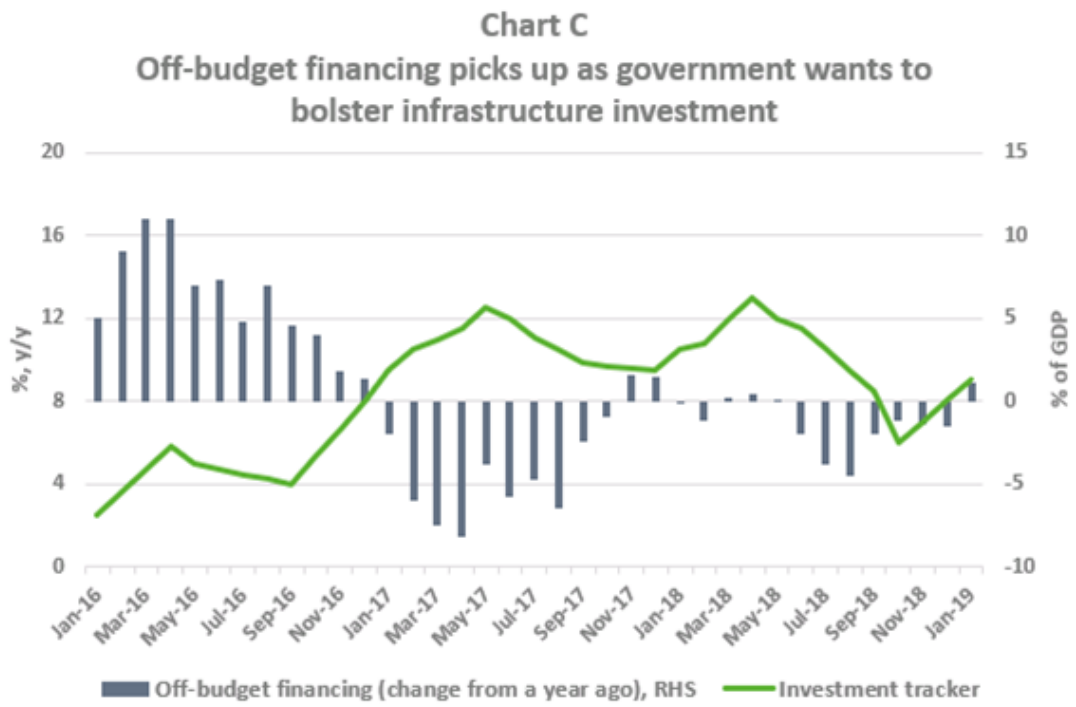
China Insight: LGFVs Finally Seeing The Light at The End of The Tunnel – cont'd

Back to Index Page

First of all, it's reported that Jiangsu Province was considering making Zhenjiang a test city for local debt resolution, in which China Development bank would provide low-cost special loans to replace local hidden debts. Subsequently, some LGFVs in Zhenjiang saw a fall in their financing costs.

Secondly, it's reported that the Shanghai and Shenzhen Stock Exchanges have been given window guidance to relax the acceptance requirements for corporate bond issuance by LGFVs. Specifically, for LGFV bonds issued to repay debt that will mature within 6 months, the issuers will no longer be required to keep their average revenues from local governments below 50% of their total income over the past 3 years (2 years in case of non-public issuance).

We believe the above policies have further confirmed China's easing policy stance and will stand to benefit the investment sentiment on LGFVs.



Data source: Goldman Sachs, CEIC

The following pages are dedicated to Technical Analysis.

IGM's global team of Technical Analysts constantly look for interesting patterns in prevailing price action of a broad range of currency pairs, fixed income and commodity products.

We will highlight the most compelling on these pages.

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BTP 10yr Yield - 2.205/2.345 is Key to Direction Amid Slowing Yield Decline

Technical Analysis by Ed Blake, IGM

Back to Index Page

- The five-month yield decline has slowed during 2019, prompting the current consolidation over 2.420 (18 March base)
- Further dips are possible, but 2.205/2.345 zone should contain the slide allowing the wider recovery to resume
- Above a four-month falling trendline near 2.586 would suggest near-term basing and re-open the 2.898/3.029 zone
- Only below 2.205 would signal a more significant yield decline targeting a 31-month rising trendline at 2.069

STRATEGY SUMMARY

Consider buying dips towards the 2.205-2.345 zone in anticipation of a yield recovery towards 2.898/3.029. Stop and reverse under 2.205

Resistance Levels		
R5	3.205	6 December 2018 high
R4	3.029	2019 peak – 8 February
R3	2.898	21 February 2019 minor lower high
R2	2.809	28 February 2019 high
R1	2.586	13 March 2019 minor range high, near a four-month falling trendline
Support Levels		
S1	2.420	18 March 2019, ten-month low, near 2017 peak at 2.423
S2	2.345	28 May 2018 low
S3	2.205	76.4% retrace of 1.709/3.808 rally
S4	2.069	31-month rising trendline, near 61.8% retrace of the 1.033/3.808 (2016-2018) rally at 2.093
S5	1.867	11 May 2018 low

AUD/JPY – Clearance of 79.82/85 Needed to Resume Higher

Technical Analysis by Andrew Dowdell, IGM

Back to Index Page

- Continues to drift sideways, just shy of the 200-Day MA (approx. 80.35)

- Scope seen for deeper setback, but bulls should look to re-group in the 77.44/08 area, or lower down near 76.33

STRATEGY SUMMARY

Above 79.82/85 signals a bullish resolution, opening 82.21 then 84.03. Below 77.44/08 risks a deeper setback to 76.33, possibly 75.24.

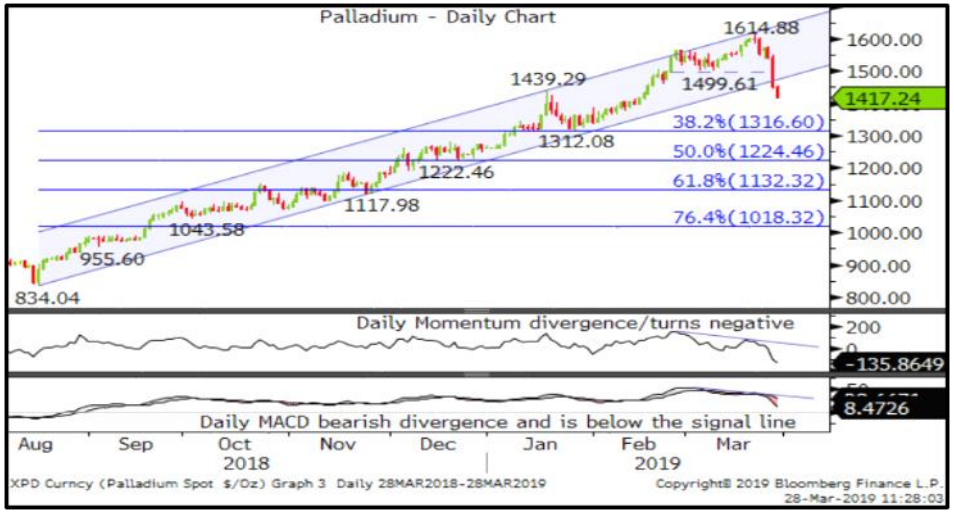
Resistance Levels		
R5	84.03	3 December 2018 high
R4	82.21	13 December 2018 high
R3	80.73	10 December 2018 low
R2	79.85	5 February 2019 high, near the 21 February 2019 high at 79.82
R1	79.42	18 March 2019 high
Support Levels		
S1	77.44	8 February 2019 low
S2	77.08	10 January 2019 low
S3	76.33	38.2% of 70.64-79.85 rally
S4	75.24	4 January 2019 low & 50% of 70.64-79.85 rally
S5	74.16	61.8% of 70.64-79.85 rally

Palladium – Recent Top Highlights Short-Term Risk Towards 1312.08

Technical Analysis by Ed Blake, IGM

Back to Index Page

- Advanced in a seven-month rising channel to last week's 1614.88 record high, before correcting through the channel
- Bearish divergence/deteriorating studies suggest initial downside risk to the 1312.08/1316.60 cluster
- Below risks a near-term corrective extension towards the 1222.46/1224.46 zone, before the uptrend resumes
- Over 1499.61 (recent top trigger) is needed to avert current downside and prime bulls for 1614.88 and above



STRATEGY SUMMARY

Short-term sell for the 1312.08/1316.60 zone. Place a stop and reverse on a break back above the recent top trigger at 1499.61

Resistance Levels		
R5	1784.62	1.382x 451.85/1139.68 from 834.04, near 1.764x 159.00/912.26 from 451.85 at 1780.60
R4	1684.20	1.236x 451.85/1139.68 from 834.04, near 1.618x 159.00/912.26 from 451.85 at 1670.62
R3	1614.88	21 March record high
R2	1578.57	26 March 2019 high
R1	1499.61	8 March 2019 low – recent month-long top trigger
Support Levels		
S1	1384.34	Recent month-long top target (1614.88-1499.61 fall projected down from 1499.61)
S2	1312.08	25 January 2019 low, near 38.2% retrace of 834.04/1614.88 rally
S3	1280.48	19 December 2018 former high
S4	1222.46	14 December 2018 higher low, near 50% of 834.04/1614.88 rally
S5	1188.90	6 December 2018 low, near 16 November 2018 high at 1186.66 and the 200DMA at 1170.96

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