

Situation Room

Getting past the risk spike

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A combination of (1) the absence of additional bank failures; and (2) an in-line CPI report for February has allowed markets to retrace a fair amount of the move from last week and Monday March 13. Equity risk outperformed (VIX retraced 35%), while regional bank equities and rates vol underperformed (rates vol retraced 6%). Therefore, it makes sense that IG spreads ended up in the middle, including LQD spread (22% retracement), CDX IG (28% retracement) and big six US banks (31%). Our base case is that systemic contagion will be avoided. In that scenario the market should continue to re-trace. However, given lower yields, higher rates volatility, and a recent IG default, we do not expect IG spreads to fully re-trace the recent widening in the near term

February CPI in line

The CPI report for February came in close to expectations (see [US Watch: February CPI inflation: About as expected](#)). That helped lower the recent spike in risks. The lack of an upward surprise in inflation should give the Fed more time to assess the impact on financial stability and growth from recent bank stress.

However, details under the hood were less positive. Core services ex. shelter CPI – which has been the Fed's focus – increased to +0.50% MoM in Feb-23 from the recent low of +0.26% in Nov-22. On the other hand, core goods inflation, which was expected to be weak, did in fact decelerate to flat MoM in February from +0.1% MoM in January.

Daily credit snapshot

No IG new issue supply priced in the market today. S&P 500 closed +1.68%, 10-year Treasury yields +10bps, CDX IG -5.8bps, CDX HY +\$0.78pts, and cash bond spreads quoted from 4 to 10bps tighter today, LQD closed 8bps tighter today.

Daily dealer inventories update

-\$655mn (notional), -\$40,000 (DV01) today. Maturities and sectors inside.

Daily foreign demand tracker

We track dealer-to-affiliate volumes on Trace that are correlated with foreign buying.

14 March 2023

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See page 6 for a list of common abbreviations used in the report.

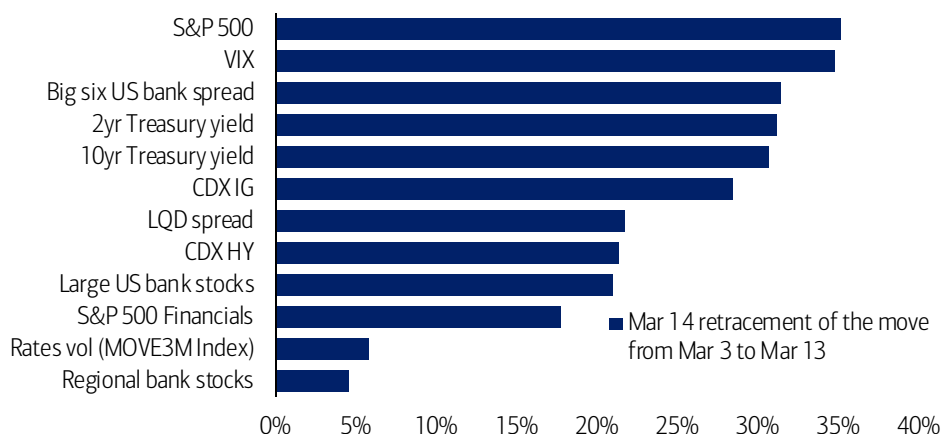
Research Overview – The Situation

Getting past the risk spike

A combination of (1) the absence of additional bank failures; and (2) an in-line CPI report for February has allowed markets to retrace a fair amount of the move from last week and Monday March 13. Equity risk outperformed (VIX retraced 35%), while regional bank equities and rates vol underperformed (rates vol retraced 6%). Therefore, it makes sense that IG spreads ended up in the middle, including LQD spread (22% retracement), CDX IG (28% retracement) and big six US banks (31%). Our base case is that systemic contagion will be avoided. In that scenario the market should continue to re-trace. However, given lower yields, higher rates volatility, and a recent IG default, we do not expect IG spreads to fully re-trace the recent widening in the near term.

Figure 1: March 14 retracement of the move from Mar 3 to Mar 13.

S&P 500, VIX and big six US banks have re-traced the most, while regional bank stocks, rates vol and S&P 500 financial stocks have re-traced the least.



Source: BofA Global Research, Bloomberg.

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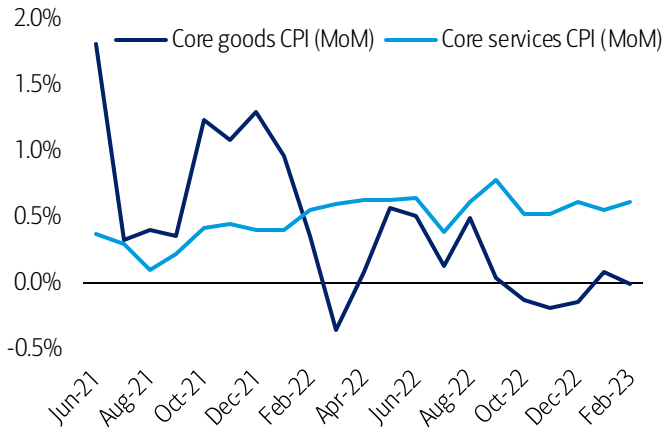
February CPI in line

The CPI report for February came in close to expectations (see [US Watch: February CPI inflation: About as expected](#)). That helped lower the recent spike in risks. The lack of an upward surprise in inflation should give the Fed more time to assess the impact on financial stability and growth from recent bank stress.

However, details under the hood were less positive. Core services ex. shelter CPI – which has been the Fed's focus – increased to +0.50% MoM in Feb-23 from the recent low of +0.26% in Nov-22 (Figure 3). On the other hand, core goods inflation, which was expected to be weak, did in fact decelerate to flat MoM in February from +0.1% MoM in January (Figure 2).

Figure 2: Core goods inflation moderated in February

Core goods inflation slowed to flat MoM in Feb from +0.1% in Jan.

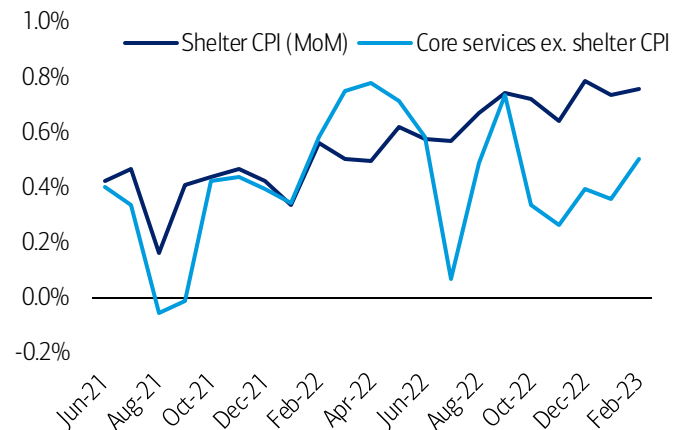


Source: BofA Global Research, Bureau of Labor Statistics, Haver.

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Figure 3: Core services CPI ex. shelter accelerated in February

Core services CPI ex. shelter was +0.5% MoM in Feb, up from +0.3% MoM in Jan.



Source: BofA Global Research, Bureau of Labor Statistics, Haver.

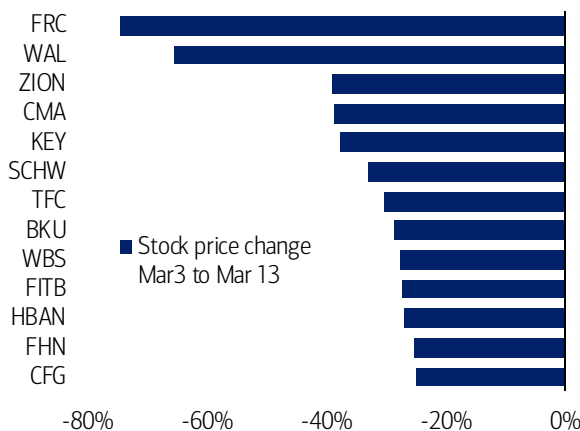
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Bank selloff re-tracing

Notably, regional banks that underperformed the most through yesterday March 13 also rallied the most today on March 14. Figure 4 below plots equity price change from March 3 to the peak of the recent selloff on March 13. Figure 5 plots how prices rebounded today on March 14 relative to the prior move lower. On the other hand, some regional bank stocks declined further today, although by a more modest amount.

Figure 4: Biggest bank / finance equity price declines through Mar 13

FRC, WAL and ZION stocks declined the most through Mar 13, among public bank / finance issuers in the IG index.

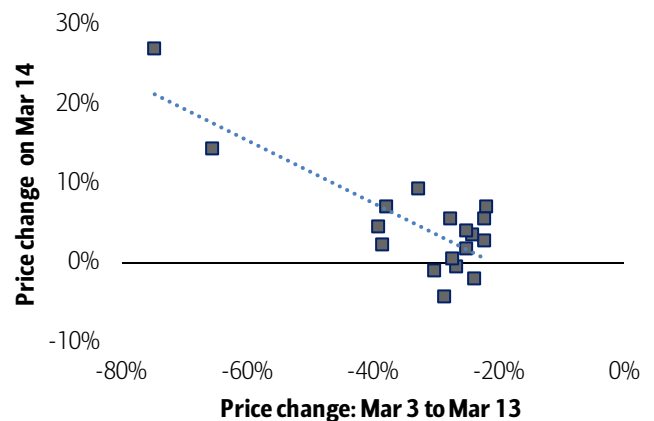


Source: BofA Global Research, Bloomberg.

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Figure 5: Regional bank / finance equities rebounded today

Stocks outperformed today on March 14 for issuers that underperformed through March 13.



Source: BofA Global Research, Bloomberg.

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Credit Strategy

Daily credit snapshot

No IG new issue supply priced in the market today.

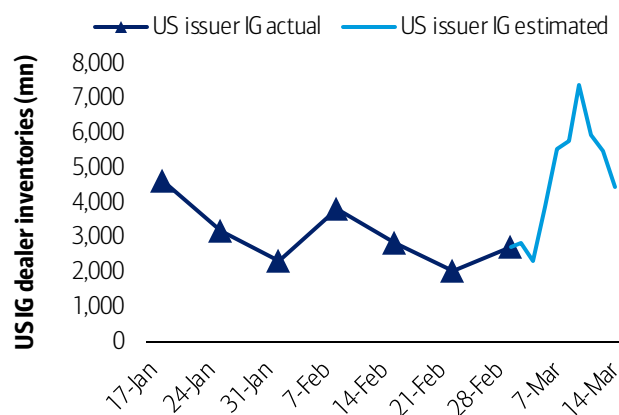
S&P 500 closed +1.68%, 10-year Treasury yields +10bps, CDX IG -5.8bps, CDX HY +\$0.78pts, and cash bond spreads quoted from 4 to 10bps tighter today, LQD closed 8bps tighter today.

Daily dealer inventories update

Below we estimate dealer inventories for the IG corporate bonds based on TRACE data. The actual inventories of US issuer bonds based on NY Fed survey, as well as the estimated change since the latest Fed report are plotted in Figure 6 and Figure 7. We estimate the corresponding DV01 equivalent in Figure 7. More details by sector and maturity are available in Figure 8 and Figure 9. Finally, note that the data for the current date is through about 4:40 p.m. Eastern Standard Time.

Figure 6: Estimated dealer inventories of IG corporate bonds.

We estimate IG dealer inventories of US issuer bonds increased to \$4.4bn currently from \$2.7bn on Mar-01.



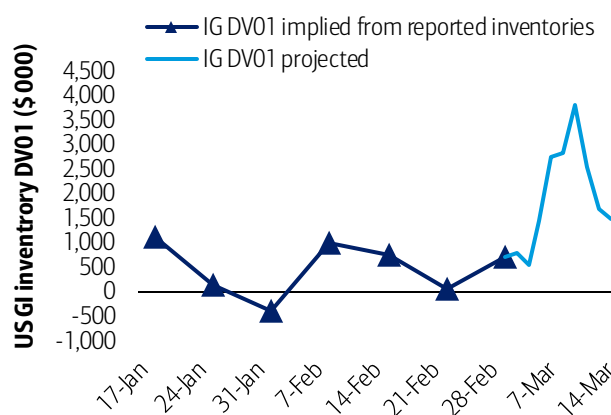
Note: data for US issuer bonds only, maturities 13M or longer. Actual dealer inventory data is from Primary Dealer Statistics survey by the NY Fed. The subsequent change in inventory is estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE, Federal Reserve

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Figure 7: Estimated dealer inventory DV01 for IG corporate bonds.

We estimate IG dealer inventory DV01 of US issuer bonds increased to \$1.5mn currently from \$0.7bn on Mar-01.



Note: data for US issuer bonds only, maturities 13M or longer. Actual dealer inventory data is from Primary Dealer Statistics survey by the NY Fed. The subsequent change in inventory is estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE, Federal Reserve

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Figure 8: Estimated changes in IG dealer inventories by maturity and broad sector.

We estimate IG dealer inventories declined -\$655mn today and declined -\$972mn over the prior week.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 14-Mar-23 (\$mn)			
	14-Mar	13-Mar	1 W	2 W	4 W	14-Mar	13-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
High grade (13M+)	-655	-416	-972	3,520	9,204	-40	-876	-1,224	1,497	5,329	11,720	12,375	7,738	31,833
<3yr	-232	498	264	740	1,576	-53	87	26	131	277	1,319	1,551	1,224	4,094
3-5yr	-792	14	-999	274	747	-283	-49	-433	-14	166	1,864	2,656	1,516	6,036
5-11yr	-56	-500	250	2,392	5,507	-86	-339	19	1,368	3,195	4,911	4,967	2,755	12,632
11+yr	425	-428	-487	115	1,374	382	-576	-836	12	1,692	3,627	3,201	2,242	9,070
Fin	658	-194	61	2,265	5,190	395	-414	-278	1,057	2,388	5,842	5,184	2,842	13,868
Non-Fin	-1,313	-222	-1,032	1,255	4,014	-434	-462	-946	440	2,941	5,878	7,191	4,895	17,964
Fixed	-623	-441	-964	3,453	9,123	-54	-883	-1,226	1,439	5,270	11,642	12,265	7,625	31,533
Floating	-32	25	-8	67	80	14	7	2	59	59	78	110	112	300
US issuers	-1,037	-493	-1,091	1,019	4,091	-213	-857	-1,273	123	2,861	9,210	10,248	6,305	25,763
DM Yankees	328	93	70	2,098	4,138	153	-8	13	1,140	1,939	2,197	1,869	1,306	5,372
EM Yankees	55	-16	49	403	975	20	-11	35	234	530	313	258	127	697

Note: data for maturities 13M or longer. Changes in inventories are estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE.

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Figure 9: Estimated changes in IG dealer inventories by sector.

We estimate today IG dealer inventories increased \$507mn for Banks/Brokers and declined -\$63mn for Energy.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 14-Mar-23 (\$mn)			
	14-Mar	13-Mar	1 W	2 W	4 W	14-Mar	13-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
Aerospace/Defense	-119	2	-210	-280	-35	-102	4	-200	-234	-85	61	180	106	347
Automobiles	-137	14	-22	266	614	-74	-6	-41	32	132	129	266	186	581
Banks/Brokers	507	-112	173	1,251	3,008	423	-343	-109	429	974	4,668	4,161	2,108	10,937
Basic Materials	-99	-85	-176	23	344	-10	-93	-27	9	93	664	763	413	1,840
Commercial Services	32	-32	-9	-22	-150	22	-30	-19	9	-66	88	56	54	198
Energy	-63	78	289	824	1,153	-17	25	217	533	688	581	645	484	1,710
Finance	20	-57	-142	237	862	-2	-55	-131	97	528	569	549	416	1,535
Food, Bev. & Bottling	-59	-48	65	215	-11	79	-62	126	215	36	297	356	268	921
Health Care	-170	17	-48	-39	-27	-67	-129	-352	-320	330	1,144	1,314	866	3,324
Industrial Products	-130	-11	-193	32	194	-109	-1	-198	-24	212	132	263	158	553
Insurance	80	18	60	591	669	-30	13	-21	409	433	357	277	123	757
Media & Entertainment	-88	-84	-98	189	380	-11	-58	-56	192	302	364	452	318	1,135
REITs	51	-44	-31	185	651	3	-29	-16	121	454	248	197	195	640
Retail	-194	-38	-89	-78	155	-104	8	19	-80	-29	287	481	328	1,096
Technology	-190	-17	-12	273	210	-57	-19	-44	174	466	760	950	597	2,307
Telecom	-22	43	40	-88	171	47	-27	39	-83	156	427	449	285	1,161
Tobacco	6	-25	-80	-29	83	11	-21	-31	-12	33	79	73	100	252
Transportation	2	9	-88	-141	-80	20	17	-69	-144	-95	146	144	191	481
Utilities	-46	10	-327	-76	701	-40	-32	-259	49	568	673	719	474	1,865
Other	-34	-54	-75	187	311	-21	-38	-51	124	200	45	79	69	193

Note: data for maturities 13M or longer. Changes in inventories are estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE.

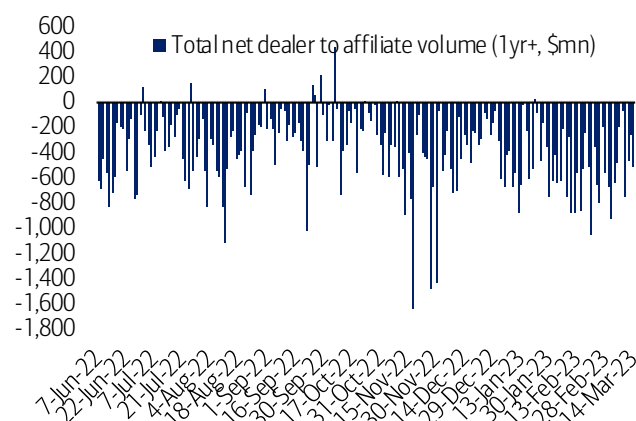
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Daily foreign demand tracker

We believe net dealer-to-affiliate volumes from Trace are correlated with foreign buying of US HG corporate bonds, i.e., negative numbers mean foreign investor buying (US dealers taking down inventory in favor of foreign affiliates). For supporting material see our “primer” on tracking foreign inflows (See: [Credit Market Strategist: One year round-trip in spreads 15 July 2016](#)). Figure 10 shows the overall daily dealer-to-affiliate volumes while Figure 11, Figure 12 and Figure 13 show subsets of this data. In particular Figure 11 shows net dealer-to-affiliate volumes for longer maturity (12+ years) bonds, Figure 12 displays volumes reported to Trace before 8am NY time (biased toward Asian buying) and Figure 13 shows the subset of net trades reported between 8am and noon (biased toward European buying).

Figure 10: Net dealer buying from affiliate (1yr+)

Figure shows inconsistent overall foreign buying of US IG corporate bonds for some time.



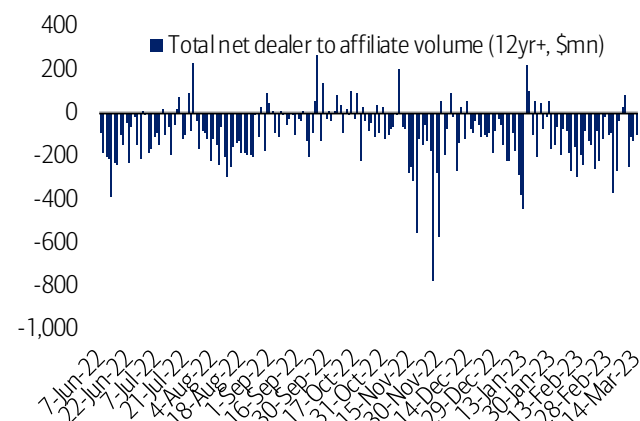
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Figure 11: Net dealer buying from affiliate (12yr+)

Foreign buying of longer maturity US IG corporate bonds has been consistent this year



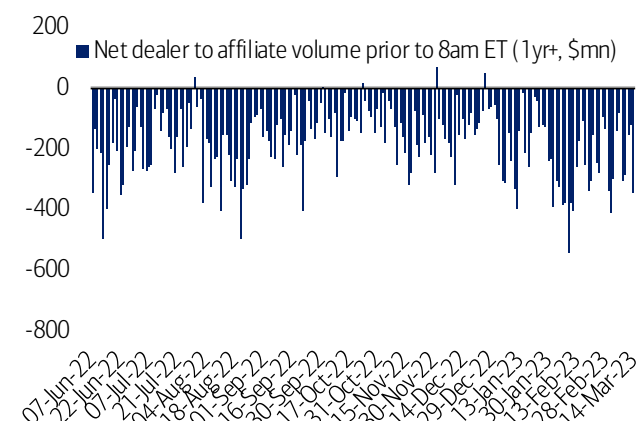
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Figure 12: Net dealer-to-affiliate trading volumes before 8am ET

Foreign buying before 8am NY time is dominated by Asia and has been consistent this year



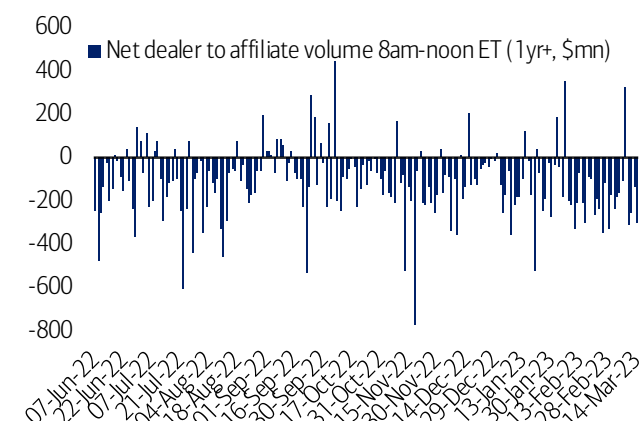
Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.

Source: BofA Global Research, TRACE

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Figure 13: Net dealer-to-affiliate trading volumes 8am - noon ET

Foreign buying 8am-noon NY time is dominated by Europe and has been inconsistent this year



Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.

Source: BofA Global Research, TRACE

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Common abbreviations:

IG: Investment Grade
 HG: High Grade
 LQD: iShares iBoxx \$ Investment Grade Corporate Bond ETF
 DV01: Dollar value of a basis point
 CDX IG: The Markit CDX North America Investment Grade Index
 CDX HY: Markit CDX North America High Yield Index
 ECB: European Central Bank
 QE: Quantitative Easing
 CSPP: corporate sector purchase programme
 Unched: Unchanged
 CPI: Consumer Price Index
 FOMC: The Federal Open Market Committee

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