

What a Long Strange Trip It's Been

A year ago, the coronavirus crisis nearly shuttered global markets. Volatility reigned and liquidity dried up as markets went full risk-off. Just over a decade after the calamitous Great Recession, another long and painful dislocation in the financial markets seemed inescapable as investors surveyed the wreckage wrought by March 2020.

What a difference a year has made. Following unprecedented responses from governments and central banks, the markets have snapped back and last March seems like the distant past.

In this post, Tradeweb examines in charts how markets have responded, adapted and normalized to the ongoing global pandemic, through the prism of the U.S. Treasuries market.

31 March 2021

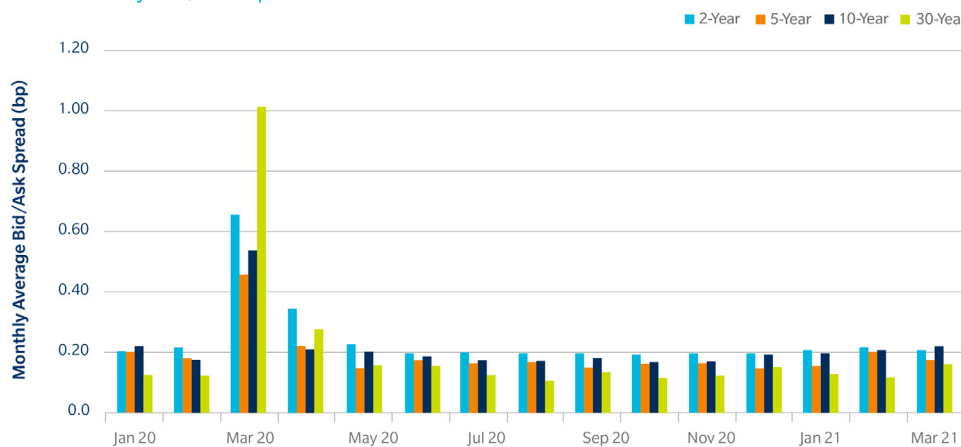
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LIQUIDITY CRUNCH, AND THEN NORMALIZATION

During the peak of the pandemic crisis, liquidity dried up significantly across markets. This was particularly noticeable in the Treasury market, where closing bid/ask spreads for the long bond averaged over a full basis point during the month of March 2020, compared to its current level, which is below 0.2bp. On March 16th, 2020, the spread was more than 3bp.

This was in stark contrast to what we saw during the global financial crisis (GFC), when widening of bid/ask spreads was led by the front-end of the curve. In November 2008 – the worst month for liquidity in the long bond during the global financial crisis, as measured by bid/ask spreads – the spread averaged 0.5bp.

U.S. Treasury Bid/Ask Spreads



UNPRECEDENTED VOLATILITY

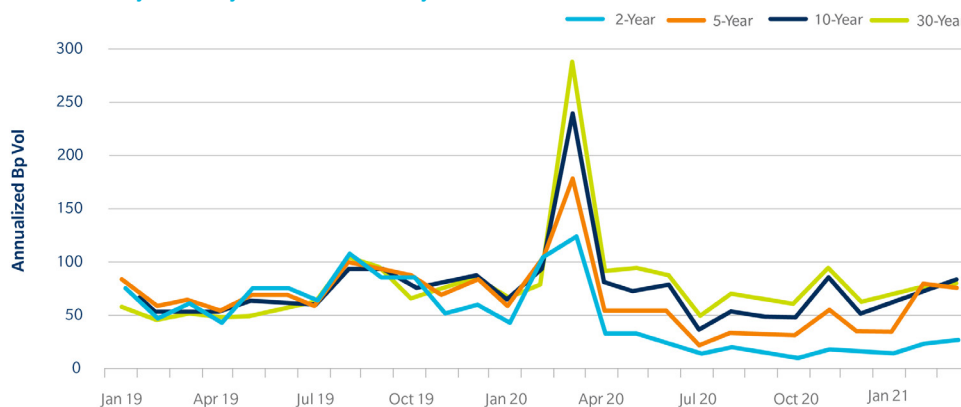
Part of the reason for the significant widening of bid/ask spreads in the back-end of the curve was the unprecedented and historic volatility in the sector. Unlike during both the dotcom bubble and the GFC, when volatility was highest in the front-end, the bond sector was significantly more volatile during the latest crisis, easily eclipsing previous records.

U.S. Treasury Monthly Realized Volatility (Annualized Bp Vol)

Period	Month	2-Year	5-Year	10-Year	30-Year
Dotcom	Oct 01	241	194	126	123
GFC	Sep 08	336	284	195	157
Pandemic	Mar 20	121	174	236	284
Current	Mar 21	20	65	72	70
YoY Change		-101	-110	-164	-213

Nonetheless, following unprecedented policy response, market volatility quickly returned to levels generally seen prior to the pandemic, with the front-end volatility falling further as a result of absolute low yield in the sector and the Fed's dovish policy response.

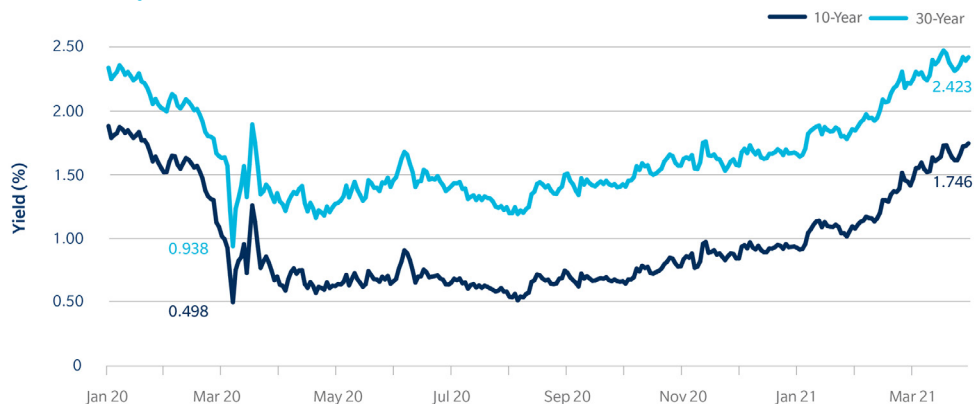
U.S. Treasury Monthly Realized Volatility



YIELDS LOOK AHEAD

March 2020 saw Treasury yields set record lows, with the 10-year note falling below 0.50% and the 30-year bond falling below 1.00%. The decades long rally in bonds has been truly extraordinary, given there are still old bonds trading in the market with coupons above 8%. However, since hitting these lows, 30-year yields have more than doubled while 10-year yields have more than trebled.

U.S. Treasury Yields



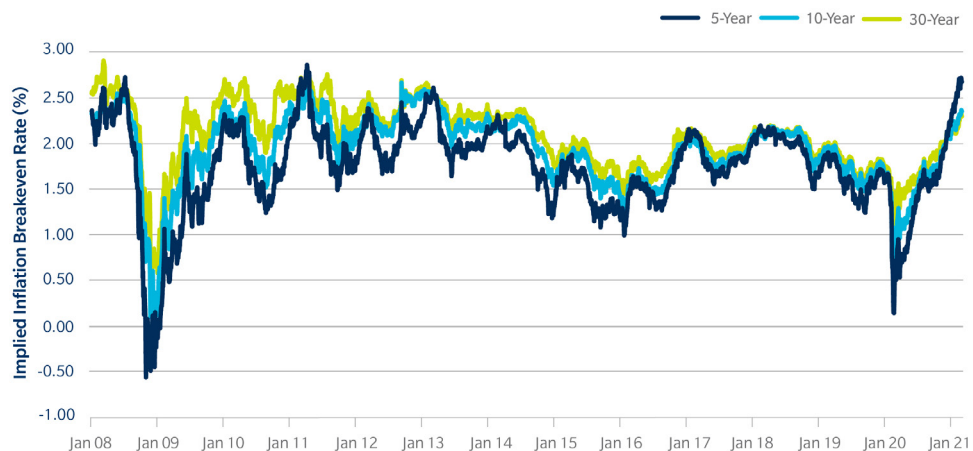
Additionally, the comparison of yields at the start of 2021 versus the start of 2020 shows a significant divergence. The first quarter of 2021 has seen long-term yields rise over 75bps, largely returning to pre-crisis levels. In comparison, the first quarter of 2020 saw a significant decline in yields across the curve, with yields falling over 100bp across the board. In Q1 2020, long-term Treasuries had their largest declines since the third quarter of 2011.

Quarterly Change in Yield (bp)

	2-Year	3-Year	5-Year	5-Year	10-Year	30-Year
Q1 2020	-133.3	-130.5	-130.5	-126.3	-121.1	-102.2
Q2 2020	3.9	18.1	57.9	77.4	83.4	78.1

Similar to the GFC, much of the early recovery in yields has been driven by rising inflation expectations, as noted by TIPS breakeven rates, which are now at their highest levels in years, particularly towards the front-end of the curve.

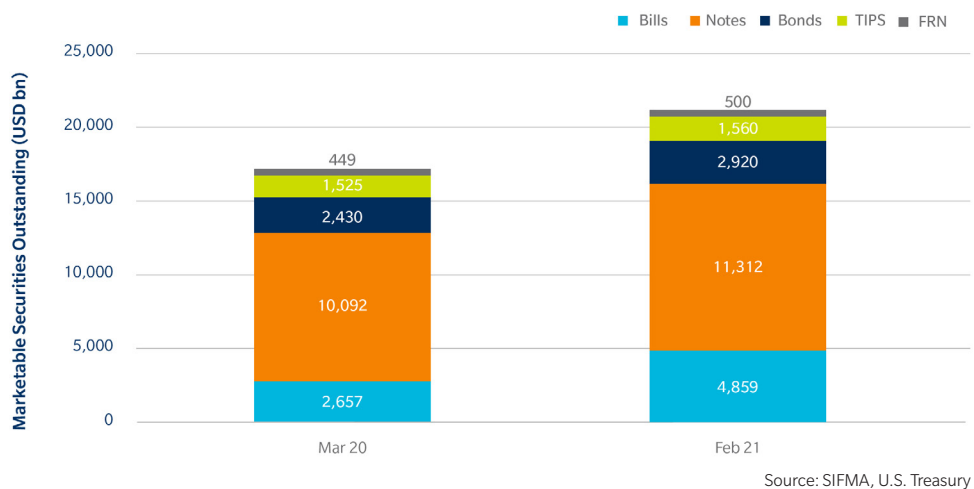
U.S. TIPS Inflation Breakeven



One of the more obvious effects of the COVID-19 crisis was the explosion in issuance, a topic which we have covered in a series of pieces here, here and here.

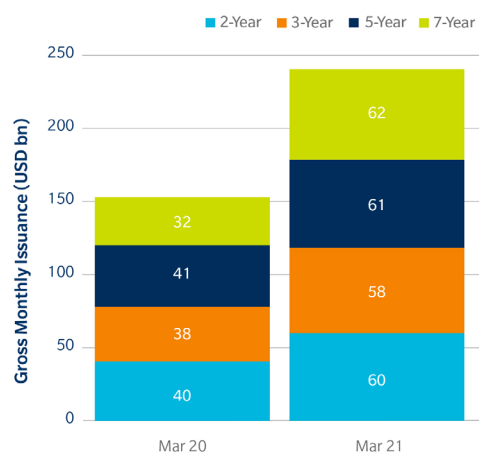
In the past year U.S. Treasury debt outstanding has increased ~24%, with most of that coming in the form of bills (up 89%). The bond sector, too, has also seen significant growth (up 21%)¹.

U.S. Treasuries Outstanding

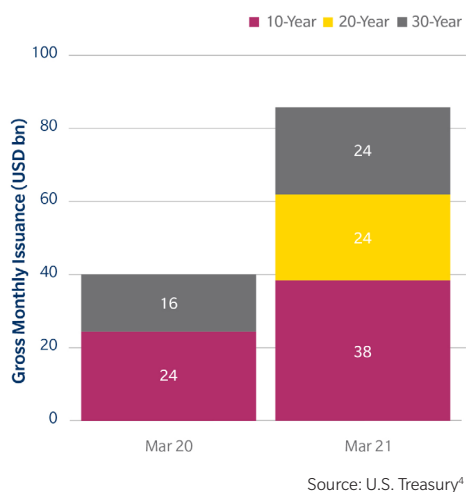


What is even more remarkable is the pace of issuance in the long-tenor debt: the U.S. Treasury issued \$86 billion (bn) of such debt in March, more than double the pace of last March. There are now as many bonds issued on a monthly reopening –\$48bn² – as there were for all of 2008.³

Front-End and Belly Issuance



Long-End Issuance

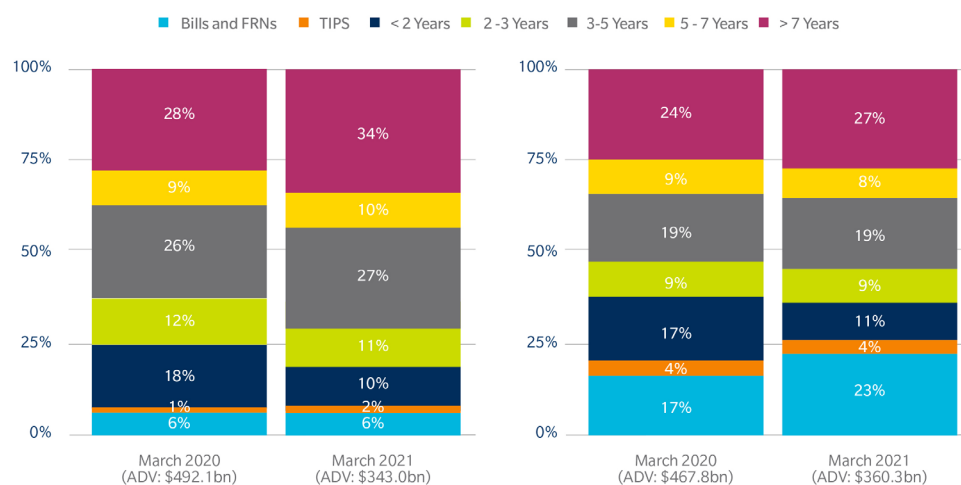


In March of last year, FINRA started publishing U.S. Treasury trading data for the first time, giving the market a look at a more complete breakdown of trading activity.

One year later, overall volumes are down 27% from that first month. However, in both client segments (ATS/IDB and D2C⁵), the percentage of activity in longer-term securities (> 7 years) has risen more than 3 percentage points, with those gains largely coming at the cost of trading of shorter-term notes (<2 years). Additionally, dealer-to-customer trading saw a significant boost in activity in Bills, which now represent 23% of overall volumes.⁶

ATS & Interdealer TRACE Activity

Dealer to Customer TRACE Activity



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WHAT A DIFFERENCE A YEAR MAKES

By almost every measure March 2020 was an unprecedented month for global markets. In the U.S. Treasury market, historically wide bid/ask spreads were further complicated by record low yields and wild volatility. In response, global governments and central banks, acting in a coordinated fashion, provided extraordinary support, driving record issuance. Although the pandemic is not over yet and global economies are still very much recovering, market conditions this month hold in stark contrast to where they were last year.

¹ Calculations based on SIFMA U.S. Treasury Securities Statistics. February 2021 vs. March 2020.

² Currently, there are \$54bn in total 20-year and 30-year bonds issued on quarterly new issuance months and \$48bn for each of the two subsequent reopenings each quarter.

³ Calculations based on U.S. Treasury most recent quarterly refunding statement and SIFMA U.S. Treasury Securities Statistics

⁴ Issuance based on auction date, not settlement date.

⁵ FINRA TRACE data divides U.S. Treasury trading into two client segments: (1) Alternative Trading Systems [ATS] & Interdealer [IDB], which generally aligns the historical wholesale dealer-to-dealer activity; and (2) Dealer to Customer [D2C], which generally aligns with activity of market end-users.

⁶ Calculations based on average daily volumes for the first four complete weeks of March 2021 vs March 2020.

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