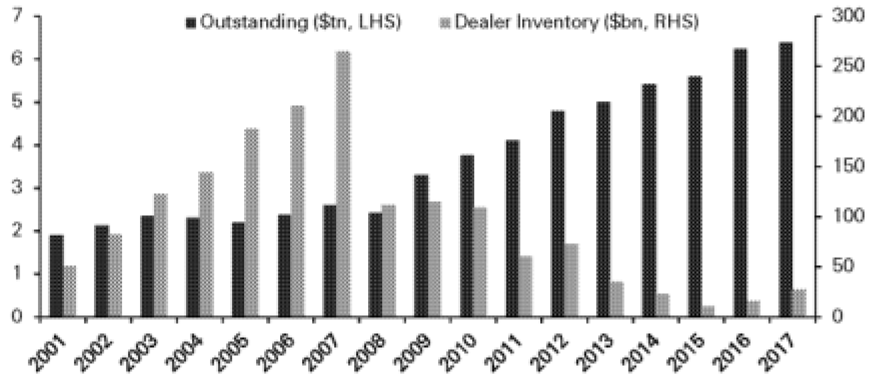
Figure 69: US Dealer Inventory vs. Outstanding size of US IG and HY market




*Note: The inventory series changed from 2013.*
*Source: Deutsche Bank, NY Fed, Bloomberg Finance LP*

The concern is what would happen if the trading environment changed dramatically or if outflows suddenly surged. In fixed income we've lived through a long bull market and a long period where inflows have been strong and consistent.

Events like the "taper tantrum" in 2013 and the energy/oil US credit sell-off in late 2015/early 2016 tested market liquidity but in the former, only for a brief but stressful period, and in the latter only in one sector – albeit an important one. Remember that the taper tantrum was purely a fear of an upcoming taper. The taper didn't actually happen at that point, partly because the market reaction persuaded the Fed to tread carefully. At the time the soft economic and still soft inflation data allowed them to do this. The scenario we are talking about is when we actually see an event (e.g. higher inflation or higher growth) that genuinely forces a retreat from fixed income.

The limited market liquidity has been a persistent worry for investors in recent years but it's fair to say that this concern seemed to be more heightened 2-3 years ago than it is now. Perhaps worry fatigue has set in as this hasn't yet become a major event in this cycle. However as we said above, flows have continued to be positive outside of temporary reversals. The new market structure has yet to be tested in a prolonged period of outflows. It's possible that a lack of liquidity would magnify an existing crisis rather than create one in its own right or perhaps turn a difficult macro situation into a crisis. It certainly merits close attention though.

### ETFs – A help or a hindrance to markets going forward

As traditional liquidity has dried up so trading in products like ETFs have surged. Indeed the growth has been extraordinary. Putting the numbers in perspective, including ETPs (which make up a much smaller percentage), the global AUM of exchange traded products (all asset classes) is now over $4tn. This compares to around $800bn or so in 2008. Around 5,000 separately traded ETFs and nearly 1,900 ETPs are now available which compares to nine years ago when there were 1,600 and 600, respectively. In percentage terms the AUM of ETFs and ETPs has averaged 22% growth annually since 2005 while the number of ETFs and ETPs have grown at 26%. Keep in mind that this includes the financial crisis impacted years of 2008/09.