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INSIGHTS WEBINAR SUMMARY

Unprecedented Global Stimulus and U.S. Policy Impacts on Fixed Income

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April 30, 2020

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Massive Global Government Stimulus Measures

- Arif Husain noted that the government stimulus in the coronavirus pandemic differs from stimulus measures in the global financial crisis (GFC) in four major ways:
  1. The pace of central bank and government action has been much faster in the current crisis than in the GFC.
  2. The magnitude of the current stimulus is much greater—about double the amount of stimulus from the GFC.
  3. The breadth of the current stimulus measures is much wider, covering areas such as investment-grade corporate bonds.
  4. The pandemic stimulus is truly global, with even some emerging markets central banks starting QE programs.
- The recent measures are similar to those of the GFC in that the government funding must eventually be paid back in some form, and central banks do not want to keep interest rates near zero and maintain virtually unlimited QE forever.
- The U.S. budget deficit may reach 20% of GDP, but the U.S. can finance it by printing money (unlike Italy, for example). The bond markets are signaling the potential for the "Japanification" of the U.S., but Husain maintains that Japan's economy has positive attributes, like low unemployment.

Some U.S. Government Stimulus Programs Working Better Than Others

- Katie Deal observed that state and local governments are applying their stimulus funding to implement measures to "flatten the curve" of the pandemic.
- Almost US$160 billion of direct payments to taxpayers have been distributed so far, which has led to an uptick in consumer spending on food and home supplies.
- However, some of the tools used to get stimulus funding into the economy do not have the needed infrastructure. For example, in the first 14 days of U.S. CARES Act lending to businesses, the Small Business Administration tried to process about 14 years of its typical case load.
- Tensions have developed between the state and federal governments, with states worried about the potential for a second wave of the virus, while the White House favors a rapid economic recovery by the end of the year.

Fed Program to Buy Investment Grade Corporates Supports Liquidity

- Steve Boothe noted that the credit spread on investment-grade corporates is currently about 200bp versus about 270bp at the end of March.
- The Fed's primary and secondary credit facilities, which will allow the central bank to acquire investment-grade corporates (and certain fallen angels) with maturities of five years or less has been responsible for the improvement in liquidity and narrowing of spreads.
- However, the Fed has not yet started to purchase investment-grade debt. Also, Boothe observed that the goal of the program is to boost liquidity, not help debt issuers that might otherwise become insolvent. He believes it is possible that the market could be overestimating the beneficial effects of the Fed's program.
- The Fed's willingness to support the corporate bond market is not unlimited. An eventual announcement from the central bank to taper its corporate purchases could trigger more volatility.

The Role of High-Quality Government Bonds as Safe Havens

- Going into the current crisis, yields on 10-year German bunds were meaningfully negative. However, they still performed well in the March sell-off, illustrating the benefits of diversification into safe haven assets.
- Notably, U.S. Treasuries sold off rapidly at one point in March, casting some doubt on their usefulness as a safe haven diversifier in times of market stress.
- Husain thinks that the unusual selling pressure on U.S. Treasuries may have prompted the Fed to take more aggressive action to support overall market liquidity, and Treasuries soon reverted to their typical safe haven behavior.
- According to Husain, the role of safe-haven government debt may be worth re-evaluating when the global economy recovers and the potential for inflation returns.

Risks for State and Local Governments

- The mechanism for getting funds to state and local governments does not seem to be working well, and the process is unclear, according to Deal.
- Letting state and local government funding lapse would be particularly devastating for the U.S. economy.
- Legislators assembled the CARES Act in an unusually bipartisan fashion. Deal is now seeing a slow return to partisanship and will become concerned if that trend accelerates.

Global Diversification in Investment-Grade Corporate Bonds

- For diversification within the investment-grade corporate sector, Boothe suggests looking outside the U.S. Bonds from Asian technology companies in particular tend to be less correlated with U.S. corporates and also provide attractive yield/carry.
- Boothe has not written off all U.S. energy sector credits, noting that the U.S. shale industry is very strategic for the government.
- Unlike in the GFC, banks are part of the solution for the current economic crisis, making the bonds of some U.S. and UK banks attractive.

Effects of the Public Health Crisis on the Presidential Election

- Deal noted two "red herrings" about November's presidential election: that the election could be postponed (virtually impossible) or that someone other than Joe Biden will end up as the Democratic party's nominee (very unlikely).
- The variables most likely to determine the outcome of the election are party unification, turnout, and presidential approval rating. Turnout will be the most important of these factors. The effects of the pandemic have made turnout very difficult to predict, with states weighing the use of mail-in ballots.

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