

Narratives Shaping the Market



COVID-19

- Bad news: increased cases, rising hospitalizations, economic damage
- Good news: vaccine development, lower than anticipated mortality rate, business reopenings



2020 Election

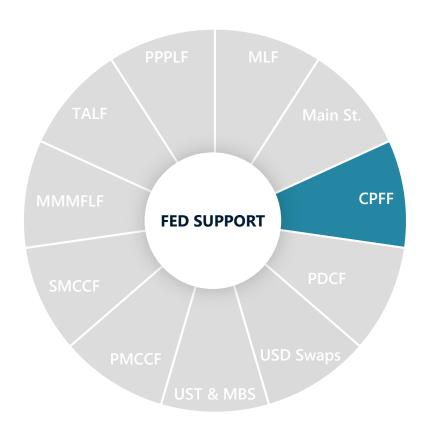
- Too close to call
- Meaningful for tax policy, banking regulation, healthcare, environmental policy



Fed Support & Liquidity

- Unprecedented programs
- Result has been "asset inflation" that will keep a floor on equity prices and risk metrics

Commercial Paper Funding Facility

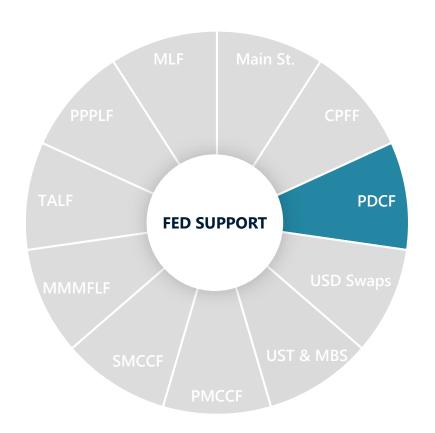


- Created March 17, 2020, as one of the first programs
- Supports liquidity & meets funding needs for issuers
- Reduced borrowing costs for companies rated A1/P1/F1 or better
- Reduced 3mL levels from a 2020 high of ~1.45% to 0.2765%*

* Source: Bloomberg as of 7/7/2020

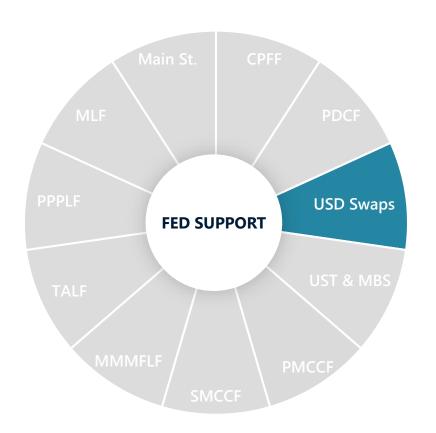


Primary Dealer Credit Facility



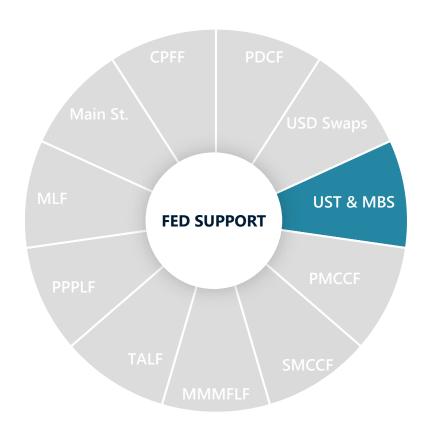
- Created March 17, 2020, to lend to primary dealers; not currently subscribed
- Supported smooth market functioning as repo markets were breaking down
- Collateralized loans for overnight and term funding (90 days)

U.S. Dollar Swap Facility



- Created March 19, 2020, to increase USD liquidity globally
- Investors outside the U.S. were liquidating USTs to raise dollar reserves
- Reduced the strain on dollar funding markets
- Lowered currency hedging costs for foreign investors -> more overseas demand in rates and credit products

Purchases of Treasuries and Agency MBS

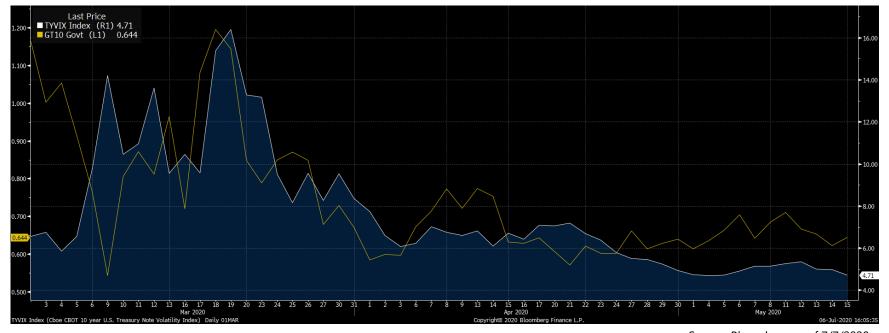


- "QE Infinity" has increased Fed holdings of UST and Agency MBS by \$3 trillion since March*
- Provides liquidity for smooth market functions and transmission of monetary policy
- Brought yields lower and quickly reduced volatility
- Caused significant "asset inflation" in risk markets as yields on lower risk assets compressed

* Source: Bloomberg as of 7/7/2020



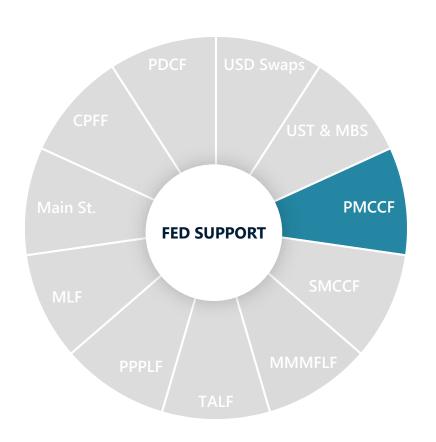
CBOT 10yr VOL vs. 10yr UST Rate, 3/1/2020 - 5/15/2020



Source: Bloomberg as of 7/7/2020



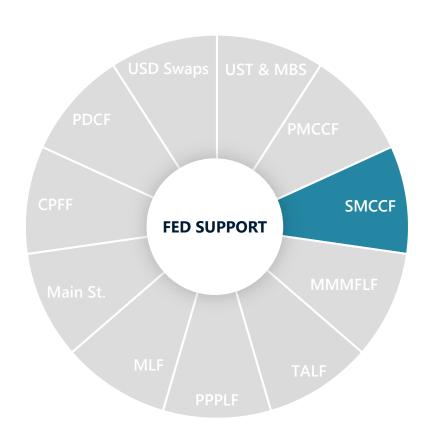
Primary Market Corporate Credit Facility



- Created March 23, 2020, and amended in April and June as a backstop lending facility
- Provides investment-grade and "fallen angel" companies (IG-rated as of 3/22/2020) access to credit to continue operating
- Includes syndicated loans and corporate bonds with a maturity of 4 years or less
- 100 basis point facility fee paid by the borrower on top of the issuerspecific pricing for the PMCCF share of the issuance

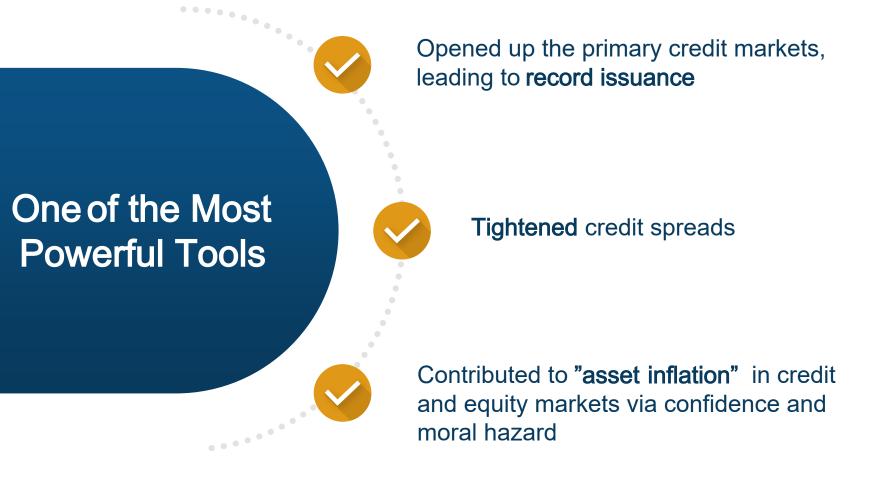


Secondary Market Corporate Credit Facility



- Created March 23, 2020, and amended in April and June to create liquidity for secondary corporate bonds
- Supports the flow of credit to large employers, including IG issuers and fallen angels
- Funded with \$75 billion from the Treasury, leveraged approx. 10 to 1
- Started with broad market ETFs; has shifted to a broad portfolio of individual corporate bonds

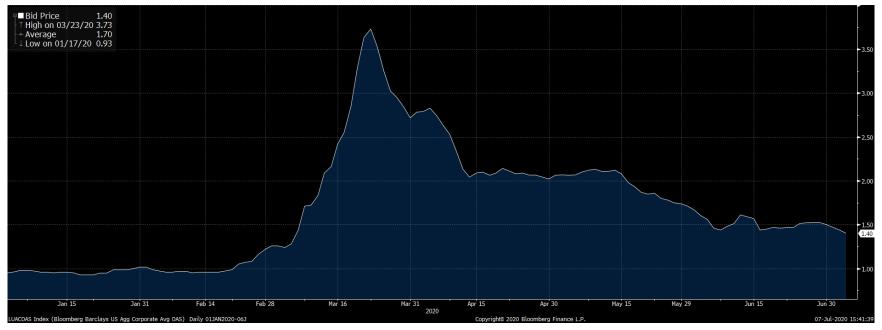
Secondary Market Corporate Credit Facility



* Source: Bloomberg as of 7/7/2020

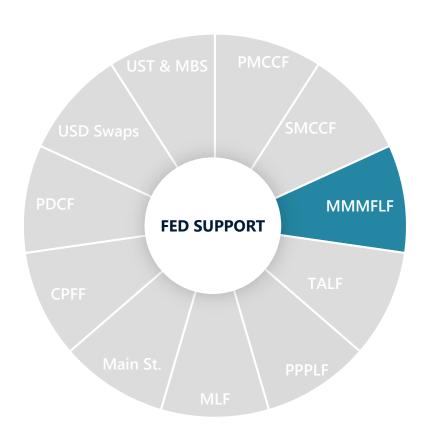


Bloomberg Barclays US AG Corp OAS Spread



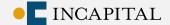
Source: Bloomberg as of 7/7/2020

Money Market Mutual Fund Liquidity Facility

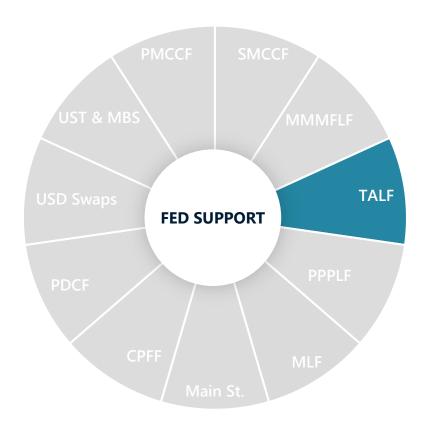


- Created March 18, 2020, to support the money market industry; expanded to include municipal money market securities
- The Federal Reserve Bank of Boston is authorized to make loans to financial institutions secured by high-quality assets to meet redemption needs
- Utilized at the height of the crisis; open now only as a backstop
- Total assets of \$32.46B as of 5/31/2020*

* Source: Bloomberg as of 7/7/2020

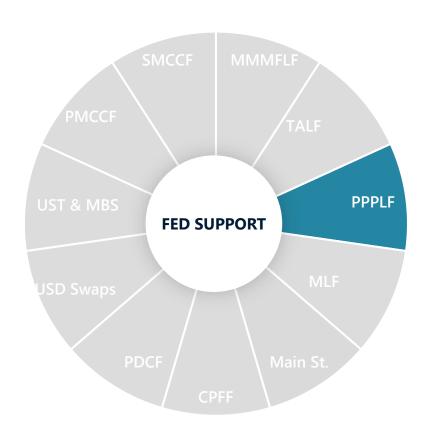


Term Asset-Backed Securities Loan Facility



- Created March 23, 2020, to provide liquidity in ABS such as student loans, auto loans, and credit card loans
- Fed will lend against AAA-rated ABS
- Up and running, but no closed transactions
- Has improved weather in the market as a whole -> sharply tighter ABS spreads

Paycheck Protection Program Liquidity Facility

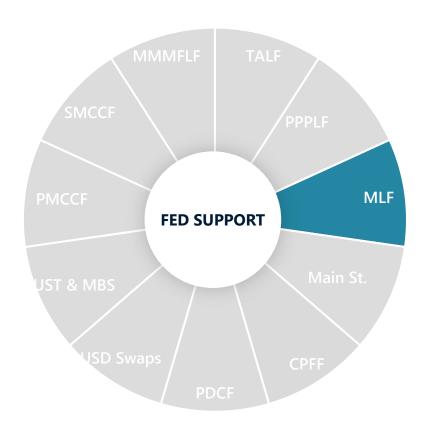


- Created April 9, 2020, to support the flow of funds to banks making PPP loans via the Small Business Administration
- The Federal Reserve Bank of Minneapolis will make loans to qualified financial institutions secured by PPP loans
- Intended to free up credit for banks to make more PPP loans during the rush of April 2020
- \$54.775B in PPP collateralized loans as of 5/31/2020*

* Source: Bloomberg as of 7/7/2020



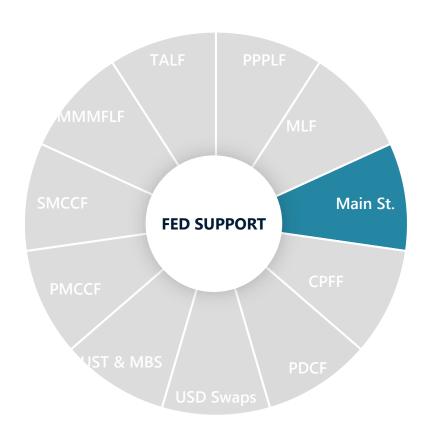
Municipal Liquidity Facility



- Created June 3, 2020 to support lending directly to U.S. municipalities
- Funded with \$35B from the CARES
 Act, can be leveraged to purchase up to \$500B of eligible notes
- As of 6/4/2020, one issuer had used the facility, with total collateral pledged of \$17.5B
- Current pricing isn't attractive to most issuers; this is a backstop



Main Street Lending Program



- Created June 8, 2020, to support lending to small- and medium-sized businesses
- Funded with \$75B from the CARES Act, can be leveraged to purchase up to \$600B in loans
- Program is open for lender registration, but as of 6/24/2020, no participations had been purchased
- Look for this program to be extended past its original end date of 9/30/2020

Main Street Lending Program

Fed provides financing

Lenders retain participation

Businesses with fewer than 15,000 employees & 2019 revenues of \$5B or less

Eligible borrowers can take loans:

- Up to 5 years in maturity
- Deferral of principal payments for 2 years
- Deferral of interest payments for 1 year



Are Negative Rates on the Horizon?

Zero Interest Rate Policy (ZIRP) has heightened the debate of using negative rates in the U.S.

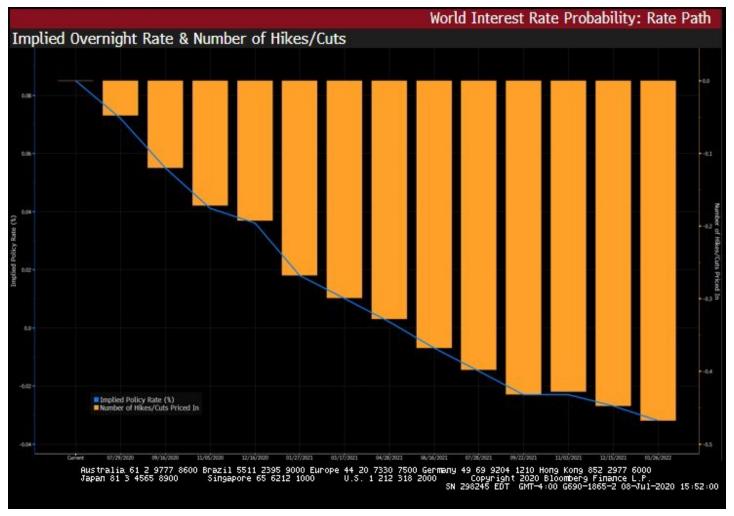
Futures have priced negative rates primarily due to hedging considerations

Concerns remain that the Fed doesn't have adequate dry powder to combat a prolonged recession

Fed has been clear that the costs of negative rates outweigh the benefits for the U.S. for now

They may not be able to control some rates going lower, as UST bills did in mid-March

U.S. Policy Rate Forward Curve as of 6/30/2020



Source: Bloomberg as of 6/30/2020



Implied Policy Rate (%)



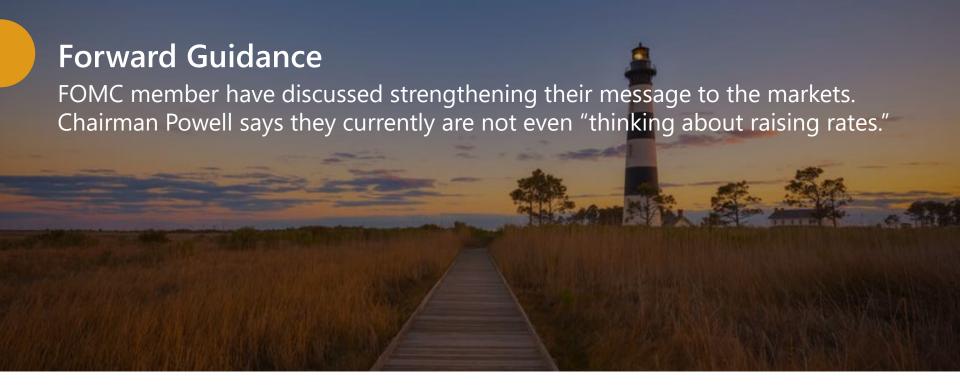
Increases liquidity in the financial system

Lower cost of debt incentivizes investing & risk-taking

Lower debt service costs to a wide range of borrowers

Causes distortions in financial markets
Hurts savers by lowering returns on
risk-free investments
Problematic for the banking system





Two options for more explicit forward guidance:

- Calendar based: rate level commitments focused on future dates
- Outcome based: rate level commitments until economic levels reach desired outcomes; e.g. inflation over 2.0% or unemployment under 5.0%

Yield Curve Control or Yield Caps

The topic continues to circulate among Fed officials and economists.

Massive levels of government borrowing could lead to higher long-term yields.

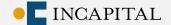


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Caps yields, potentially without having to purchase as many securities, keeping more dry powder on the balance sheet

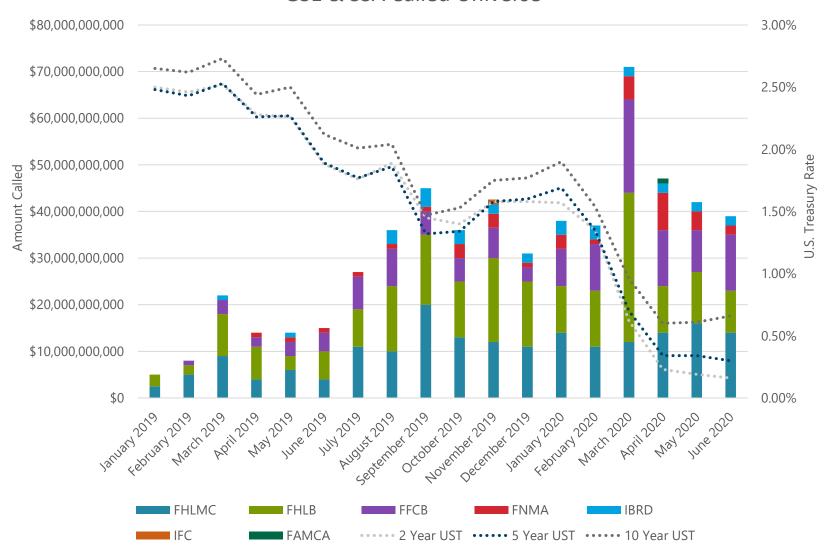
Lowers volatility, leading to tighter spreads on products such as corporate bonds, Agency debentures, Agency MBS Forces the Fed to defend stated cap levels

Loss of market makers in Treasuries due to depressed trading volumes



Called Bonds

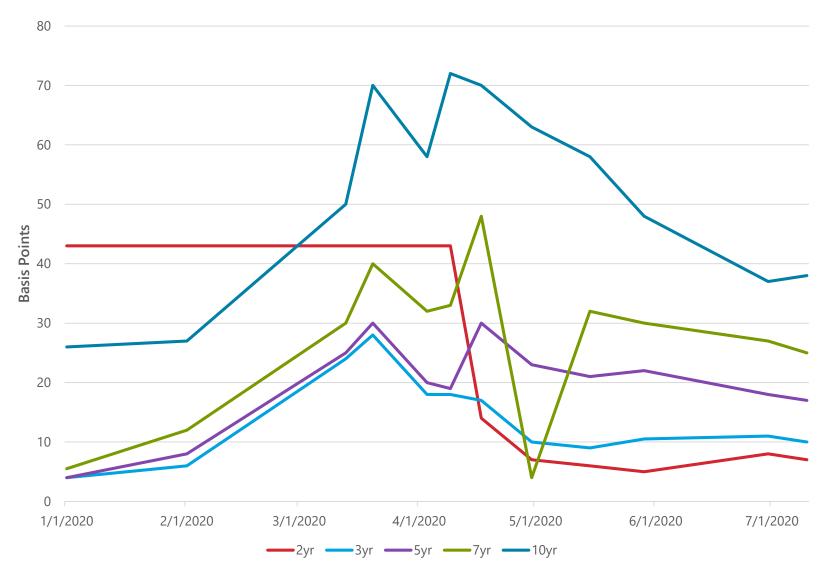
GSE & SSA Called Universe



Source: Bloomberg as of 7/17/2020



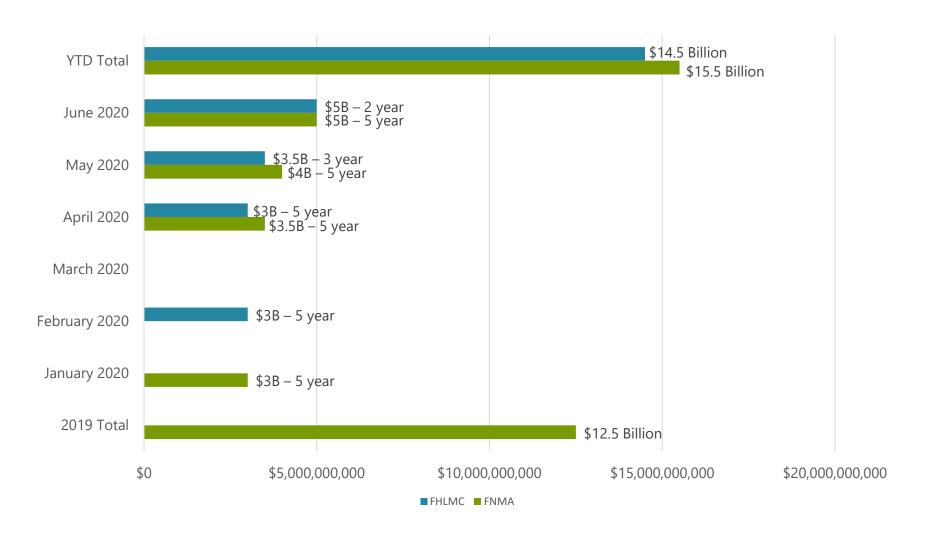
Bullet Curve



Source: Bloomberg as of 7/18/2020



Benchmark Issuance



Source: Bloomberg as of 6/30/2020



New Issue Callable Coupon Indications

Assumes \$25mm Notional

Coupon Indications for Quarterly Call U.S. Agencies ("Bermudan")							
<u>Lock</u>	2yr	2.5yr	3yr	3.5yr	4yr	4.5yr	5yr
NC 3m	0.24	0.3	0.4	0.46	0.54	0.63	0.71
NC 6m	0.24	0.3	0.4	0.46	0.54	0.62	0.7
NC 9m	0.24	0.3	0.4	0.45	0.53	0.61	0.68
NC 1yr	0.24	0.3	0.38	0.45	0.52	0.6	0.67
NC 2yr			0.31	0.38	0.45	0.52	0.59
NC 3yr							0.51

Coupon Indications for 1x Call U.S. Agencies ("Euro")							
<u>Lock</u>	2yr	2.5yr	3yr	3.5yr	4yr	4.5yr	5yr
NC 6m	0.22	0.27	0.32	0.37	0.43	0.49	0.54
NC 1yr	0.23	0.29	0.34	0.4	0.44	0.53	0.55

UST, GSE Bullet, Swap Spot									
<u>Term</u>	UST Spot	GSE Description	GSE Yield	GSE Spread	Swap Rate	Swap Spread			
2yr	0.1529	FHLB 0 1/4 06/03/22	0.2160	6.3	0.2185	6.375			
3yr	0.1851	FNMA 0 1/4 07/10/23	0.3190	13.4	0.2303	4.304			
5yr	0.3055	FNMA 0 1/2 06/17/25	0.4814	17.6	0.3408	3.5			
7yr	0.4931	FNMA 1 7/8 09/24/26	0.6378	14.5	0.4734	-1.93			
10yr	0.6447	FNMA 7 1/4 05/15/30	0.9809	33.6	0.6322	-1.38			

Source: Bloomberg as of 7/21/2020



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