# The Fed's Credit-Purchase Programs May Be a Game Changer

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**THE US FEDERAL RESERVE (FED) HAS ADOPTED A "WHATEVER IT TAKES" STANCE TO SUPPORT THE AILING US ECONOMY AMID THE ONGOING COVID-19 CRISIS. In broad terms, the extraordinary steps taken by the Fed over the past several weeks include (but are not limited to):**

- Conventional monetary easing (i.e., cutting interest rates to near zero);
- Regulatory guidance designed to encourage banks to continue lending; and
- Large-scale asset purchases, both on and off the Fed's balance sheet.

While many of the tools the Fed has unveiled harken back to ones used during the global financial crisis, its off-balance sheet purchases go well beyond anything done then, providing up to US$2.3 trillion of liquidity to corporate-bond, asset-backed security, and municipal-bond issuers.

In addition, while not yet implemented, the newly created Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF) are US$500 billion and US$250 billion programs, respectively. They allow the Fed to purchase short-dated maturities with investment-grade ratings as of March 22, 2020 and ratings of at least BB- on the purchase date.

I see three important implications of these two programs for credit markets:

- They may eliminate the tail risk of companies downgraded to below-investment-grade status—so-called "fallen angels"—not gaining access to financing and thereby risking debt default and/or bankruptcy.
- The Fed has become an enormous buyer of credit. The US$750 billion of buying power represents 42% of the outstanding universe of five-year or "under-maturity" nonbank, investment-grade corporates (**FIGURE 1**). Even if the Fed buys only a fraction of that, it sends a strong signal to the market, which may adjust accordingly.
- The support of lower-grade credit may have positive liquidity and spread-tightening spillover effects on the entire investment-grade bond market, of which around 50% is rated BBB as of this writing.

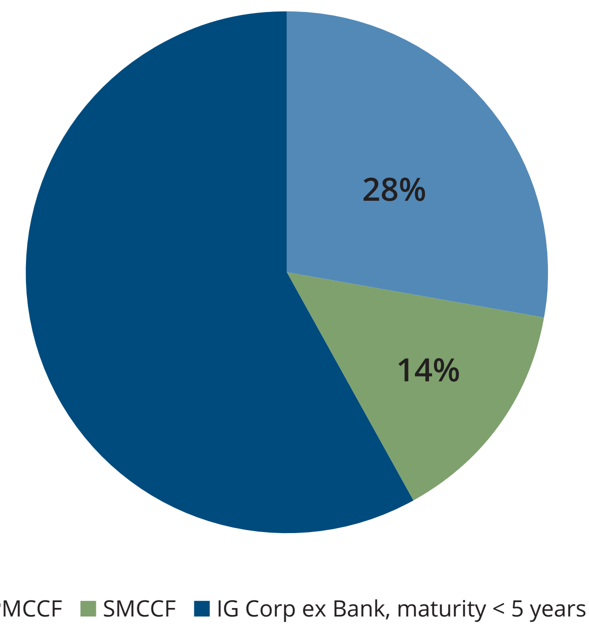
## Key Points

- The Fed has taken extraordinary steps to support the ailing US economy amid the ongoing COVID-19 crisis.
- The Fed's unprecedented recent actions may have avoided a Great Depression-type scenario in which market liquidity would have all but vanished.
- Investors should consider following the Fed's lead as buyers of credit. While credit spreads have tightened since the programs were announced, they are still quite wide by historical standards.

FIGURE 1

**Potential Fed Purchases Through the PMCCF and SMCCF Are Important Backstops for Credit**

Size of Fed Programs Relative to Eligible Market




Source: Barclays. As of 4/23/20. We estimated the eligible market to be valued at US$1.8 trillion, which was the outstanding universe of five-year or shorter maturities, excluding banks, in the investment-grade corporate bond market out of a total of US$6.35 trillion.

Bottom Line: I believe the Fed's unprecedented recent actions may have avoided a Great Depression-type scenario in which market liquidity would have all but vanished.

## Investment Implications

- I believe investors should consider following the Fed's lead as a buyer of credit. While credit spreads have tightened since the programs were announced, they are still quite wide by historical standards. I continue to view investment-grade and higher-quality high yield values in today's markets.
- A caveat: The Fed isn't buying all credit. While most forms of credit should indirectly benefit from Fed purchases, it should be noted that lower-quality high yield does not directly benefit, nor do bank loans or lower-quality structured credit in these particular programs. The Fed could also take further steps to expand the size or scope of its announced facilities.



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