SKY HARBOR
CAPITAL MANAGEMENT

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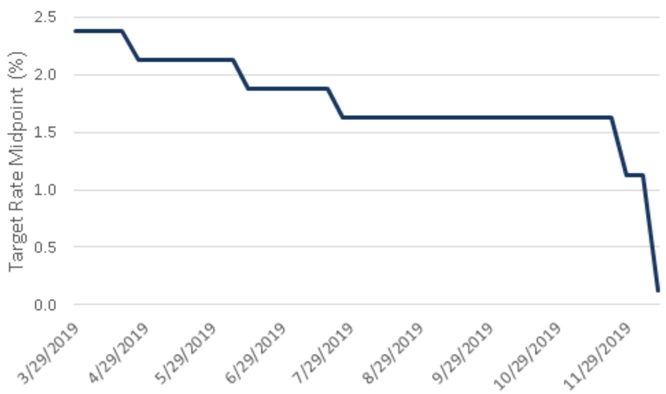
Mid-Weekly Briefing

SKYView: Stimulus

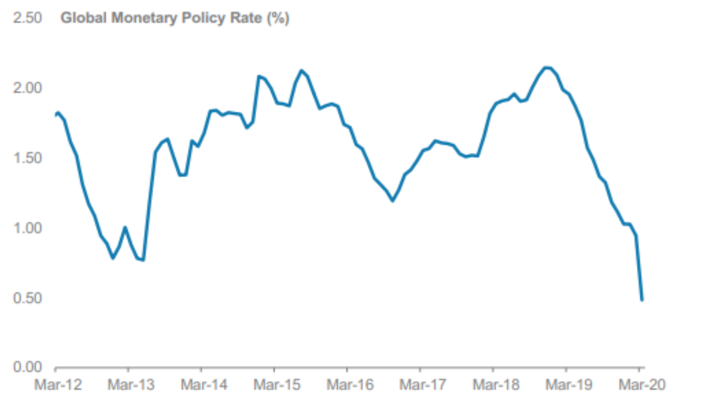
The coronavirus continues to send shockwaves throughout global markets, prompting central bankers and politicians to devise plans for an economic backstop. Given uncertainty surrounding the length and degree of social distancing measures – the impact of which has ground many parts of the economy to a halt - monetary and fiscal policy measures now appear to be pivotal in boosting sentiment. With various stimulus plans being discussed, we have decided to summarize recent announcements in this (mid)-*Weekly Briefing*.

On Sunday, March 15, the FOMC announced an emergency rate cut (essentially reducing the Fed Funds rate to 0), and implemented a new round of quantitative easing (approximately $700bn of asset purchases, including Treasuries and mortgage-backed securities). These moves, along with the actions of many other central banks around the globe, have contributed to a 54 bps decline in the global weighted average policy rate since December '19, as outlined in a recent report by Morgan Stanley[1]. At present, **the global weighted average monetary policy rate is the lowest since the global financial crisis**.

Fed Funds Target Rate (mid) Has Declined Sharply...
weekly data, trailing 1 year



...And Global Monetary Policy Rates Lowest Since Global Fin. Crisis
PPP-based GDP-weighted average



Source: SKY Harbor, Bloomberg, Morgan Stanley, Haver Analytics, and IMF; global monetary policy rates are PPP-based GDP-weighted averages for economies under Morgan Stanley coverage

The US monetary policy response to stabilize the economy has been sizeable above and beyond cutting rates to zero. The Fed injected liquidity into repo markets, implemented $700bn in quantitative easing, cut the discount window primary rate, reduced the required reserve ratio, and extended the discount window. Additionally, the Fed has begun to boost the flow of credit to households and businesses via the Commercial Paper Funding Facility (CPFF) and will now provide overnight and term funding via the Primary Dealer Credit Facility (PDCF). A more detailed timeline is provided below:

US Monetary Policy Response: Magnitude and Timeline
measures already in effect and under consideration

Date	Focus
3-Mar	Fed cuts rates by 50 bps
12-Mar	Fed announces $1.5 trillion in repo operations
15-Mar	Fed cuts rates by 100 bps (zero at the lower bound); announces $700bn of QE; announces discount window primary rate cut of 150 bps; cut the required reserve ratio by 10pts; opened up swap lines with ECB, BoJ, BoE, BoC and Swiss National Bank
17-Mar	Fed announces (1) Commercial Paper Funding Facility (CPFF) to support flow of credit to households and businesses; (2) Primary Dealer Credit Facility (PDCF) for overnight and term funding with maturities up to 90 days (available as of March 20, 2020)
18-Mar	Federal Reserve Board broadens program of support for the flow of credit to households and businesses by establishing a Money Market Mutual Fund Liquidity Facility (MMLF)

Source: Morgan Stanley, JP Morgan

Additionally, the Fed announced on March 23 that it would buy high grade US corporate bonds in the secondary market (a first), and that it has constructed a program to support primary issuance in that market. While details are not yet complete, both programs will focus on buying bonds on the short end (as they are geared toward counteracting near-term disruptions caused by the coronavirus), will start with $100bn of theoretical buying power, and could be used to buy up to 10% of the debt of any high grade issuer. Issuers need to be rated BBB- by at least one rating agency (if they have three ratings, at least two have to be BBB-), have "material" operations in the US, and maturities need to fall in the zero to five year range for secondary market purchases (zero to four range for primary issuance). The exact timing and ultimate size of the program is yet to be determined, but could grow if Congress approves a larger budget for the Treasury Exchange Stabilization Fund.

[1] Morgan Stanley Global Economics (19 March, 2020); retrieve at https://ny.matrix.ms.com/eqr/article/webapp/rw/Uuid/79cb2716-6973-11ea-bb01-7fc93074ea0c/GLOBAL_20200319_0000.pdf?format=renditionpdf&fn=GLOBAL_20200319_0000.pdf#navpanes=1&toolbar=1&pagemode=none

The US fiscal response, by comparison, has lagged, with Democrats blocking a $2 trillion proposal introduced earlier this week that had the support of key Republicans and the Treasury Secretary (through the time of writing this piece). **The situation remains fluid, however, and we expect some sort of stimulus package to gain bipartisan support in the coming days**. An overview of implemented measures and those under consideration that are likely to materialize are highlighted below:

US Fiscal Policy Response: Magnitude and Timeline

measures already in effect and under consideration

Date	Focus	Amount ($ bn)	% of 2019 GDP
6-Mar	spending bill for virus vaccine and to assist local and state governments	8	0.04%
11-Mar	three-month tax holiday for individuals and small/medium businesses; low interest loans for impacted companies	50	0.20%
13-Mar	$50bn of government funding upon President Trump declaring a national emergency	50	0.20%
17-Mar	The Treasury to provide $10bn of credit protection to the Federal Reserve in connection with the CPFF from the Treasury's Exchange Stabilization Fund (ESF)	--	--
18-Mar	$100bn package for sick leave, childcare leave, etc. passed by Congress	100	0.50%
18-Mar	The Treasury to provide $10bn of credit protection to the Federal Reserve in connection with the MMLF from the Treasury's Exchange Stabilization Fund (ESF)	--	--
potential	Congress is considering a large stimulus package (rumor is $1 to $2.5 trillion) to households and businesses, including $50bn assistance to airline industry and $500bn for small businesses	1,000 to 2,500	4.7% to 11.7%
potential	supplemental funding request of $45.8bn to Dept. of Health & Human Services, the Veterans Admin., and Defense Dept.	45.8	0.20%
	Total	**$1,254 to $2,754**	**5.8% to 12.8%**

Source: Morgan Stanley, SKY Harbor

Arguably the most important line item among fiscal policy measures highlighted above is the potential for a sizeable stimulus package to materialize out of Congress. While the timing, size, and particulars of a deal are yet to be determined, the following table highlights items commonly believed to be among the measures undergoing debate in the legislature:

Hypothetical Stimulus Package

items under consideration

Focus	Amount ($ bn)
Cash payments to US households (means tested and based on family size and income)	~ $500 bn
Bridge loans, business interruption insurance, etc. for small businesses	~ $350 bn
Paid sick leave, school lunches, Medicaid increases, housing & student debt relief, etc.	~ $250 bn
"Slush Fund" for distressed industries (including $50bn for airlines)	~ $500 bn
"Medical Surge" payments (including $75bn for hospitals)	~ $250 bn
Expanded authority of Federal Reserve	
Total	**~ $1,850 bn**

Source: Cowen, SKY Harbor

Additionally, a recent report done by Cowen[2] argues that the estimated $500bn industry "slush fund" could achieve 10x1 Fed leverage at the US Treasury, boosting the package to an amount nearly equal to 10x the size of stimulus measures approved in 2009. As a reminder, the American Recovery and Reinvestment Act of 2009 was the fiscal stimulus plan approved by Congress and signed by President Obama in February of that year. The Congressional Budget Office (CBO) had originally estimated the program would lead to an additional $787bn in budget deficits, though the figure was later augmented to ~ $831bn.

Conclusion

Both monetary and fiscal policy measures conducted to combat the economic destruction brought on by the coronavirus have been substantial, and in some cases unprecedented. Such measures, as well as the anticipation of a sizeable stimulus package from Congress, have rightly (in our view) boosted investor sentiment. Coupled with findings from our most recent *Weekly Briefing* (which highlighted the strength of historical high yield returns following the crossing of 900 bps OAS levels) we find that the case for US high yield has become increasingly attractive.

[2] Cowen DC Download (23 March, 2020); retrieve at https://cowen.bluematrix.com/sellside/EmailDocViewer?encrypt=fb0100b2-f5af-474b-9382-237d0765ec7f&mime=pdf&co=Cowen&id=world-cowen-morningnotesdistribution@cowen.com&source=mail

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