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Potential Investment Implications of the Fed's New Lending Program

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The U.S. Federal Reserve (Fed) announced a major series of programs on April 9, timed to coincide with the release of weekly new unemployment claims reaching a record 6.6 million. This new series of programs expanded some existing facilities, introduced new ones, and generally broadened the reach of lending backed by the Fed to proactively reach new areas of the broader U.S. economy.

We believe this should be a positive for equity and credit markets, as well as for the health of the broader U.S. economy. The initial launches of the Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF) on March 23 were new territory for the Fed in facilitating lending to corporations, and in its ability to underwrite actual losses. The Main Street Lending Program introduced on April 9 is unprecedented in that the Fed is essentially expanding lending to non-investment grade companies. Among other things, the programs announced on April 9:

- Address some key concerns from investors with regard to which borrowers would be able to directly benefit from the Fed, no longer limiting access to investment grade corporate borrowers or larger municipal borrowers.
- Include multiple asset classes, including a range of structured products, in a major Fed lending facility (TALF). In addition to providing direct support to these asset classes, this indicates that the Fed is looking to support numerous markets.
- Signal that the Fed is actively monitoring markets and the overall economy, very much leaving open the door to future actions that expand on existing programs, and that the central bank will introduce new mandates as needed.

In our view, the likely market implications are as follows:

- This Fed announcement should be broadly favorable for risk assets, and provides additional relief for many businesses and municipalities that were outside the scope of some of the initial programs. In broadly expanding the scope of eligible borrowers, the new programs will reach smaller companies that fell between the investment grade-based PMCCF and SMCCF, but weren't small enough to be eligible for the generous Small Business Administration loans, as well as municipal borrowers.

- In general, many markets will be impacted. The Main Street Lending program should be a big boost for the high yield and loan markets, and also for small and mid cap companies, where prior announcements seemed to primarily help large cap (predominantly investment grade) companies. Inclusion of downgraded companies in the PMCCF and SMCCF is a huge relief to many lower quality BBB companies, and some fallen angels (such as Ford) have traded significantly higher following the announcement.
- The inclusion of commercial mortgage-backed securities (CMBS) and 'AAA'-rated collateralized loan obligations (CLOs) is a clear positive for structured products, even though it only includes AAA legacy CMBS and new issue AAA CLOs. Some investors had concerns that the Fed was only interested in helping corporate borrowers. This material expansion indicates that the Fed is listening to investors, willing to be proactive and interested in helping to stabilize and support an expanded number of areas of the markets, as needed. We believe that even securities and asset classes not directly impacted are likely to benefit from the combination of relative value versus supported assets, and overall market stabilization.
- In our opinion, this should be a strong positive for small and mid cap equities too, as prior support seemed to favor large cap, investment grade companies. While the support is directly targeted at credit availability, this reduces default risk for many equities, which will likely allow some investors to focus on recovery scenarios.
- The new municipal liquidity facility included in the Fed's announcement should also help with investor confidence overall, we think, in a sector that has been negatively impacted by headline risk and concerns about a short term plunge in revenues.

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