



# The Fed cut its benchmark interest rate and instituted largescale asset purchases

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In a surprise move, the Federal Reserve cut its benchmark interest rate to 0 – 0.25% on Sunday and instituted largescale asset purchases.

Although the initial criticism may be that the Fed has done a combination of the right things at the wrong time – I argue that by making as much finance available as possible makes sense in this market.

## **An “ounce of prevention is worth more than a pound of cure”**

As financial conditions have recently tightened, with MNCs drawing down letters of credit, investment-grade credit spreads widening and cashflows starting to seize up for small businesses – it all makes sense that the Fed took an “ounce of prevention is worth more than a pound of cure” course of action – although in this instance, it was a tone of prevention.

What I’m most concerned about is COVID-19’s damage to the real economy – Main Street. Time will tell what the negative impact the COVID-19 will have on businesses and workers in the US and EU.

I argue that investors should care less about what the market’s response to the Fed’s recent actions but instead tune in to what specific policies are being implemented to buffer the economy against the downward COVID-19 shock.

The Fed’s recent aggressive actions will have a more significant impact on the average worker and Main street businesses affected by the coronavirus.

The important thing is for governments and central banks to protect household and corporate cash flows. By cutting interest rates close to 0 and re-starting quantitative easing, the Fed is ensuring that financial institutions have the cash and liquidity to lend support to businesses and people affected by the outbreak. This is critical and both the Fed and Bank of England are helping with this.

## **More fiscal stimulus needed**

In addition, governments need to give corporate tax holidays/rebates and improve safety nets for workers (sick pay etc). Again, both UK and US are moving in this direction - we expect the Congress to pass a strong fiscal stimulus bill shortly that addresses many of these issues – which should be a boost to the markets.

Keep in mind that COVID-19 is an exogenous, systematic shock to the entire global economy - that’s why credit and asset markets are in such turmoil. This is reflected in collapsing bond yields and inflation expectations, widening credit spreads and volatile equity markets. Investors are right to look for a strong fiscal and monetary response, globally, since we are all in this together.

In order for confidence to be restored to the markets, we are watching for the US and EU governments to employ the following policy prescriptive:

1. Collaborative public health measures to get the outbreak under control, ramping up testing, ventilators, mobile ICUs and vaccination efforts;
2. More monetary easing to keep banks liquid and markets functioning, including dollar swap lines to other major central banks as in the GFC;
3. More fiscal – dollops of dollars financed by quantitative easing in the short term, to keep people, SMEs and major corporations liquid enough to survive.

### **Investment implications**

I think that predicting short term moves in markets is difficult and becoming a fool's errand. The looming increase in new infection cases in the US and EU will ultimately overwhelm the Fed and other central banks' announcements in the near-term.

The COVID-19 has a serious threat in pushing the global economy towards recession levels if governments do not enact strong containment and economy policies. I still think that it's possible for the US economy to have a V-shaped recover given the recent aggressive monetary and fiscal policies.

Lower oil prices and interest rates will be supportive to consumers around the world. Risk assets such as US high yield and equities are becoming more attractive as they have come down sharply from their premium multiples just a month ago.

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