Massive Stimulus Efforts Bring Yields To Historic Lows - Fixed Income Update

The Federal Reserve announced a reintroduction of its Quantitative Easing (QE) program to now include corporate bonds in addition to government agency and Treasury bonds. The program essentially entails the buying of an unlimited amount of bonds in the open market, thus stabilizing prices and volatile trading caused by a dislocation in the market. Intervention in the corporate bond market is an unprecedented action for the Federal Reserve, in addition to initiating programs to ensure sufficient access to credit for public and private entities such as cities, counties, municipalities, as well as corporations.

The incredible demand for short-term government bonds outstripped the supply of Treasury bills issued by the U.S. Treasury in mid-March. When demand exceeds supply by such an extent, short-term rates drop, in turn sending money market rates lower. Assets have been pouring into money market funds as market conditions created a rush away from volatility.

The Fed reduced its key lending rate to 0%-0.25% in March and announced that it would begin buying $700 billion in Treasury and mortgage bonds immediately. The Federal Reserve announced that it would also be buying selected corporate bonds and municipal securities in the open market in order to help stabilize broad fixed income sectors. Buying corporate and municipal bonds deviates from traditional Fed policies as a result of the current extraordinary conditions.

Credit rating firm Fitch, mentioned that its AAA credit rating on U.S. government debt is at risk of being downgraded due to the spontaneous rise in the country's deficit and debt level brought upon by the virus crisis. Lower credit ratings for government debt tend to eventually make it more costly for a nation to borrow funds.

Credit markets also experienced dislocation in March, a term used to describe that bonds aren't trading as they usually do, exhibiting erratic valuations and liquidity constraints.

Some analysts view the increase in long-term Treasury yields as an indicator that economic growth will eventually return, albeit, with some inflationary pressures hinged to it. Other analysts see higher Treasury yields resulting from newly issued government debt along with the already excessive fiscal deficit.

Sources: Federal Reserve, Treasury, Fitch

© PlanRock Investments, LLC. The content above is available for use only by authorized subscribers, clients and where permissible as such. This content is not authorized for resale. Past performance does not guarantee future results. The sources we use are believed to be reliable, but their accuracy is not guaranteed.