Investment Strategy Update

For inquiries related to this article, please contact:

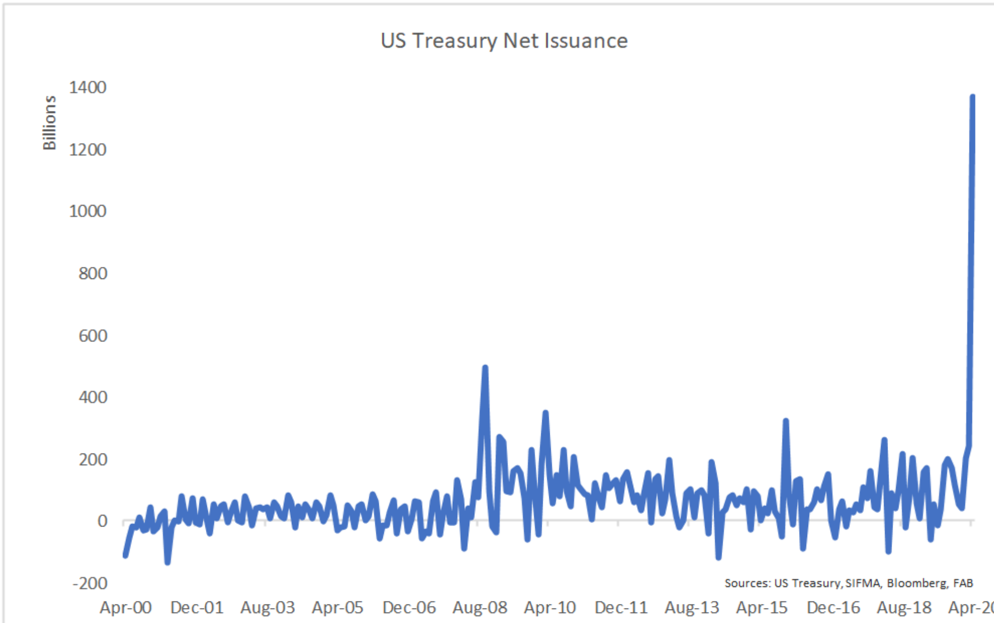
Alain.Marckus@bankfab.com
Christofer.Langner@bankfab.com

First Abu Dhabi Bank

11 June, 2020

Fed to buy fewer bonds just as Treasury sells more of them

- **The Federal Reserve has indicated it will reduce the pace of asset purchases after adding US$ 3 trillion to its balance sheet in three months.**
- **The central bank committed to buying at least US$120 billion a month of US Treasuries and mortgage-backed securities.**
- **Average mortgage-backed security issuance in the past three years has been US$145 billion a month .**
- **Treasury issued a record amount of bills and notes with a lot more to come as stimulus programs are funded.**
- **FAB AAC remains overweight high quality investment grade bonds.**



The Federal Reserve in not "even thinking about thinking about raising interest rates." That sentence, uttered by Chairman Jerome Powell, perhaps, is the summary of yesterday's Federal Open Market Committee meeting conclusion. Despite the promise of low rates for a very long time, the market started a minor correction yesterday that seemed to continue today.

News outlets sought a narrative in the economic projections of the Fed governors, which showed a much longer road to recovery than is perhaps priced into the market. The median projection of Fed economists showed the US economy not going back to its current level of output until the end of 2022, with a 6.5% contraction for the full year of 2020. The Fed sees unemployment remaining at 9.3% and to still be at 5.5% by 2022. That would entail a level of demand destruction which may not be fully priced into stock prices right now.

There was some mention too of concerns related to a second wave of infections as the number of people diagnosed with the Covid-19 virus took a turn for the worse in several US states which have started to reopen their economies. Texas reported 2,504 new cases on Tuesday, its highest one-day total since the pandemic began, Florida reported 8,553 new cases last week, its largest number in a seven-day period and California saw the highest number of hospitalizations since 13 May. To be sure, the increase also comes as most states have ramped up testing, still that could unsettle some investors.

However, investors could also be focusing on the fact that going forward the liquidity injection into markets may not be enough to make up for the amount of debt issuance coming up as a result of fiscal stimulus. In April, the US Treasury sold a net US$1.37 billion of new notes, the highest monthly amount in history. That happened as the Fed was buying up to

The US Treasury issued nearly US$1.4 billion of debt in April, a record, with more to come

US$75 billion of Treasuries a day, outpacing issuance. So the net result was more money going into the system even as there was more debt.

The Fed has, however, been slowing the pace of its bond-buying, although Chairman Powell committed to continue to buy at least US$80 billion of Treasuries and US$40 billion of mortgage-backed securities a month. The average issuance of mortgage-backed securities over the past three years is US$145 billion and last month the US Treasury sold

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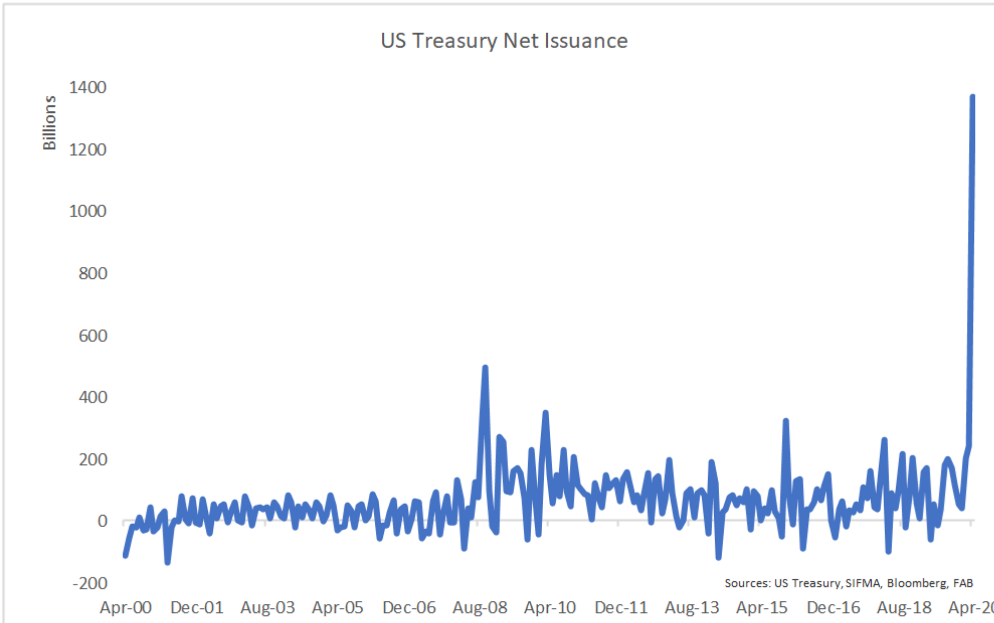
The Fed is buying fewer US Treasuries as more are being sold



- **♦ The Federal Reserve has indicated it will reduce the pace of asset purchases after adding US$3 trillion to its balance sheet in three months.**

- **♦ The central bank committed to buying at least US$120 billion a month of US Treasuries and mortgage-backed securities.**

- **♦ Average mortgage-backed security issuance in the past three years has been US$175 billion a month.**

- **♦ The US Treasury issued a record amount in April, with a lot more to come as stimulus programs are funded.**

- **♦ FAB AAC remains overweight high quality investment grade bonds.**

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News outlets sought a narrative in the economic projections of the Fed governors, which showed a much longer road to recovery than is perhaps priced into the market. The median projection of Fed economists showed the US economy not going back to its current level of output until the end of 2022, with a 6.5% contraction for the full year of 2020. The Fed sees unemployment remaining at 9.3% and to still be at 5.5% by 2022. That would entail a level of demand destruction which may not be fully priced into stock prices right now.

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Investors could also be focusing on the fact that going forward the liquidity injection may not be enough to make up for the amount of debt issuance coming up as a result of fiscal stimulus. In April, the US Treasury sold a net US$1.37 billion of new notes, the highest monthly amount in history. That happened as the Fed was buying up to US$75 billion of Treasuries a day, outpacing issuance. So the net result was more money going into the system even as there was more debt.

The US Treasury issued nearly US$1.4 trillion of debt in April, a record, with more to come

The Fed has, however, been slowing the pace of its bond buying, though Chairman Powell committed to continue to buy at least US$80 billion of Treasuries and US$40 billion of mortgage-backed securities a month. The average issuance of mortgage-backed securities over the past three years is US$175 billion and the US Treasury still needs trillions in funding. If the Fed is not buying those bonds, money will have to leave other assets to buy them. Perhaps, that is starting unsettle some investors. In any case, if it gets too bad, the Fed will come to the rescue.

بنك أبوظبي الأول
FAB
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