Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

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Comparing Fed and Congress Stimulus to 2008

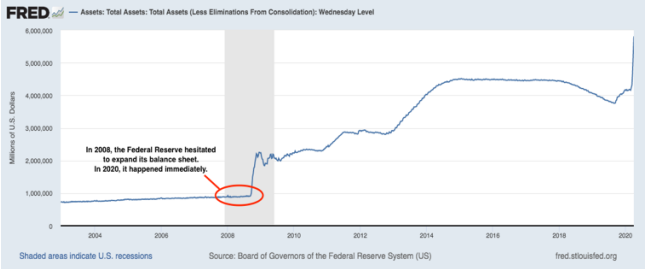
Many readers may not recall this detail specifically, but when the financial crisis first took hold in the fall of 2007, the Federal Reserve and Congress's initial response was to do very little and nothing, respectively.

The Fed made modest rate cuts in late 2007 and into 2008, but the full force of quantitative easing (QE) and lending facilities did not arrive until March 2008 – about five months into the financial crisis. Congress did not pass the American Recovery and Reinvestment Act – which committed about $800 billion in fiscal spending across various areas of the economy – *until February 2009.*[1] The bill represented meaningful action, but it is also true that the recession ended just a month later. Better late than never?

To be fair, the scale of the 2008 global financial crisis was unprecedented, and the Federal Reserve and Congress were working with virtually no playbook and "on the fly." No one knew exactly how to manage the most complex credit/liquidity freeze the world has ever known. Some of the stimulus bore fruit and generated positive results, while other actions fell flat. At the end of the crisis, however, a common refrain was that our institutions were essentially writing the playbook needed to battle the next crisis effectively and efficiently.

Well, the next crisis has arrived, and the Federal Reserve and Congress waited just weeks (instead of months or years) to take actions that far exceed the measures taken during the 2008 financial crisis. There was basically no debate – as there was in 2008 – about whether or not the Federal Reserve should offer lifelines to corporations or whether Congress should act to cushion households with cash payments and increased unemployment benefits. It all just happened, and fast.

The Federal Reserve Expanded Its Balance Sheet Almost Immediately



Source: Federal Reserve Bank of St. Louis[2]

The Fed's current actions take it farther afield from its 2008 tactic of cutting interest rates progressively over time and buying government securities to inject liquidity into the financial system. In the current crisis, interest rates went almost straight to zero and the Fed deployed never-before-used tactics:[3]

- Committed to a virtually *unlimited* QE program;
- Created a new facility to buy investment grade corporate bonds and bond ETFs;
- Relaxed bank capital rules to encourage more lending;
- Added extra liquidity to aid money markets, commercial paper and muni debt;
- Essentially became the "lender of last resort," extending loans directly to businesses large and small.

The hundreds of billions of dollars of liquidity available to help industry can also reportedly be leveraged ten times by the Fed through various lending facilities, which implies an astounding $7 trillion of available funds – or almost 10 times the stimulus provided in 2008-2009 to fight the Great Recession. There are signs the credit markets are already beginning to stabilize in the wake of Fed action. Large-cap companies like Oracle and CVS Health Corp. have borrowed money at a record pace, and in all some $104 billion of investment-grade bonds (a record) were sold last week – pointing to strong demand. The previous record for investment-grade bonds was made the previous week, at $73 billion. Mortgage rates have also come down and even companies with higher credit risk, like Carnival Cruises, have been able to access the debt markets to raise cash.[4]

On the federal government side, I mentioned before that the American Recovery and Reinvestment Act of 2009 committed some $800 billion of fiscal spending, which seemed like an exorbitant sum of money at the time. Within weeks of the current crisis, Congress passed the $2 trillion CARES Act, which equates to 9.5% of GDP. There are other aspects of the bill as well designed specifically to help households:[5]

- Required Minimum Distributions (RMDs) are optional for 2020;
- Early 401(k) withdrawals without penalty are permitted in certain cases;
- Many households will soon receive 'helicopter money' via checks in the mail;
- $500 billion in loans and business assistance programs for big companies;
- Small businesses will have access to a separate $350 billion facility.

Bottom Line for Investors

While this type of economic crisis is unprecedented, the fiscal and monetary responses to support the economy are also unprecedented – even when considering what the Federal Reserve and Congress did in 2008-2009. Alleviating the hardship from job losses and maintaining liquidity in the financial system is crucial, and for now, the government and central bank responses look adequate, in my view.

The wild card here is that with all of the stimulus deployed so quickly and profoundly, we have effectively increased the probability that a powerful wave of pent-up demand is ready to be unleashed once the virus is contained. Time will tell when that moment arrives, but I'm confident this fiscal and monetary stimulus will still be in the economy long after the virus is gone.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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[1] Barron's, March 24, 2010. https://www.barrons.com/articles/feds-response-to-the-crisis-echoes-but-vastly-exceeds-2008-51585049400

[2] Board of Governors of the Federal Reserve System (US), Assets: Total Assets: Total Assets (Less Eliminations From Consolidation): Wednesday Level [WALCL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/WALCL, April 6, 2020.

[3] Forbes, March 31, 2020. https://www.forbes.com/sites/michaelcannivet/2020/03/31/stay-agile-investing-in-the-ides-of-march/#4714fb671faf

[4] The Wall Street Journal, April 6, 2020. https://www.wsj.com/articles/credit-markets-show-signs-of-stabilizing-after-historic-fed-intervention-11586165402

[5]Forces, March 31, 2020. https://www.forbes.com/sites/michaelcannivet/2020/03/31/stay-agile-investing-in-the-ides-of-march/#4714fb671faf

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