



A P O L L O N

Market and Research Review
May 13, 2020



FIXED INCOME INDEX UPDATES

- FIXED INCOME INDEXES TYPICALLY REBALANCE MONTHLY, BASED ON SET RULES AND GUIDELINES
- AT THE MARCH MONTH-END REBALANCE, TWO MAJOR INDEX PROVIDERS DECIDED NOT TO FOLLOW THEIR REBALANCE GUIDELINES, ICE AND BLOOMBERG BARCLAYS
- ICE DECIDED NOT TO REBALANCE DOWNGRADED HOLDINGS OUT OF THEIR INVESTMENT GRADE INDEXES
- BLOOMBERG BARCLAYS REBALANCED THE DOWNGRADED ISSUES OUT, BUT KEPT SECURITIES SHORTER THAN ONE YEAR IN THE WIDELY USED U.S. AGGREGATE BENCHMARK
- THE INDEX PROVIDERS SOUGHT OPINIONS FROM THEIR ADVISORY COUNCILS
- THIS WAS THE FIRST TIME THE PROVIDERS HAVE DECIDED TO *BREAK THE RULES*

WHAT TO THINK ABOUT?

- WHAT DOES THIS MEAN FOR POTENTIAL FUTURE DOWNGRADES?
 - THE THREE MAJOR DOWNGRADES IN MARCH (OCCIDENTAL, FORD AND DELTA) ACCOUNTED FOR APPROXIMATELY 1.2 PERCENT OF THE BLOOMBERG BARCLAYS INVESTMENT GRADE CORP INDEX ON 2/29
 - BBB RATED ISSUES ACCOUNT FOR OVER 50 PERCENT OF THE IG CORP INDEX
 - APPROXIMATELY \$2 TRILLION OF THE BBB UNIVERSE AT RISK OF BEING DOWNGRADED
- HAVE THE INDEX PROVIDERS SET A BAD PRECEDENT, OR IS THIS A ONE-TIME EVENT?
- SHOULD THE INDEX PROVIDERS BE RESPONSIBLE FOR SUPPORTING MARKET LIQUIDITY?
- CONFLICTS OF INTEREST BETWEEN THE PROVIDERS AND THEIR PAYING CUSTOMERS?

RECENT FED PURCHASES IMPACT ON THE AGG

Sample Table	March 31, 2020		April 24, 2020		Change	
	Market Value (\$billions)	Market Value (%)	Market Value (\$billions)	Market Value (%)	Market Value (\$billions)	Market Value (%)
Treasury	9,747	40.9	8,974	38.4	-773	-2.5
Gov't Related	1,396	5.9	1,373	5.9	-23	0.0
Corporate	5,739	24.1	6,099	26.1	360	2.0
Securitized	6,948	29.2	6,948	29.7	0	0.5
Total	23,829	100.0	23,394	100.0		

- BLOOMBERG BARCLAYS INDEXES ARE ADJUSTED FOR THE FED'S SYSTEM OPEN MARKET ACCOUNT ("SOMA")
- AS A RESULT OF RECENT PURCHASES RELATED TO THE VARIOUS LIQUIDITY PROGRAMS RECENTLY ANNOUNCED, THE WEIGHT OF TREASURIES IN THE U.S. AGGREGATE INDEX DECLINED BY APPROXIMATELY 2.5 PERCENT
- WILL THE AGG GET "RISKIER" OVER TIME DUE TO INDEX RULES, FED PURCHASES AND NEW ISSUANCE?
 - THE FED HAS ANNOUNCED \$2+ TRILLION IN LIQUIDITY MEASURES THIS YEAR
 - RECORD NEW ISSUANCE LEVELS IN RECENT MONTHS AND OVER \$765 BILLION SO FAR THIS YEAR

Source: Bloomberg Barclays, Income Research + Management. Past performance does not indicate future performance.

KEY TAKE AWAYS

- **ACTIVE MANAGER OPPORTUNITIES**

- ACTIVE MANAGERS AREN'T BEHOLDEN TO INDEX RULES AND REBALANCING
- OPPORTUNITIES MAY ARISE DUE TO DISCREPANCIES BETWEEN AN AGENCY RATING AND A MANAGER'S VIEW ON THE VIABILITY OF THE CREDIT
- ACTIVE MANAGERS HAVE THE ABILITY TO DETERMINE THE BEST RISK-REWARD AND RELATIVE VALUE TRADES

- **PASSIVE INVESTING NOT A PASSIVE EXERCISE**

- BOTH THE RESULT OF FOLLOWING AND NOT FOLLOWING THE RULES IMPACTS INDEX CONSTRUCTION
- OVER TIME, SECTOR, DURATION AND RISK PROFILE CAN CHANGE A RESULT AND MAY HAVE UNINTENDED IMPACTS ON THE INTENDED ALLOCATION

TALF – WHAT IS IT?

- **TERM ASSET-BACKED SECURITIES LOAN FACILITY (TALF) PROGRAM**
- REPURPOSED AND ADAPTED PROGRAM IMPLEMENTED BY THE NEW YORK FEDERAL RESERVE TO SUPPORT CONSUMER-BASED AND SMALL BUSINESS ASSOCIATION LENDING PROGRAMS IN THE ASSET-BACKED SECURITIES MARKET
- **ELIGIBLE BORROWERS**
- ALL U.S. COMPANIES THAT OWN ELIGIBLE COLLATERAL AND MAINTAIN AN ACCOUNT RELATIONSHIP WITH A PRIMARY DEALER
- **THE FED'S ROLE**
- PROVIDE NON-RECOURSE FUNDING TO ANY ELIGIBLE BORROWER OWNING ELIGIBLE AAA ABS COLLATERAL, LEVERAGE VARIES BY ASSET TYPE
- **PROGRAM DETAILS**
- ANNOUNCED IN MARCH 2020 WITH A PROGRAM SIZE OF \$100 BILLION.
- INVESTOR CAPITAL IS COMBINED WITH A LOAN FROM THE NY FEDERAL RESERVE (LEVERAGE) TO PURCHASE HIGH QUALITY ASSET-BACKED SECURITIES. INVESTORS EARN THE DIFFERENCE BETWEEN THE YIELD ON THE SECURITY AND THE COST OF THE LOAN.
- EXPECTED TO BEGIN IN MID/LATE MAY OR EARLY JUNE AND GO THROUGH SEPTEMBER BUT COULD GET EXTENDED DEPENDING ON THE MARKET.

TALF 1.0 VS. TALF 2.0

	TALF 1.0	TALF 2.0
Eligible Investors	Accredited Investors; Qualified Purchases	Same
Lender	NY Federal Reserve	Same
Financing Term	3-Year, Non-Recourse	Same
Financing Rate	2 or 3 Year Libor+100 bps	Variable, based on asset type and reference rates
Eligible Collateral	Government guaranteed student loans and loan servicing. CMBS was included later in the program	No government guaranteed student loans and service advance receivables. Adding existing conduit CMBS and Static CLOs
Collateral Credit Quality	AAA rated securities by two ratings agencies	Same

- VERY SIMILAR TERMS TO 2008, EXCEPT FOR FINANCING RATE DIFFERENCES, GOVERNMENT BACKED STUDENT LOANS ARE EXCLUDED, AND THE INCLUSION OF LEGACY CMBS AND STATIC CLOS.

Sources: TCW, Federal Reserve announcements of the final terms related to TALF 1.0 (August 2009) and preliminary terms for TALF 2.0 (April 9, 2020). Terms are subject to change pending release of final details from the NY Federal Reserve.

TALF 2.0 OPPORTUNITY SET - HAIRCUTS

Sector	Subsector	ABS Average Life (Years)							Finance Rate
		0-1	1-2	2-3	3-4	4-5	5-6	6-7	
Auto	Prime retail lease	10%	11%	12%	13%	14%	--	--	Ref Rate +125 bps
Auto	Prime retail loan	6%	7%	8%	9%	10%	--	--	Ref Rate +125 bps
Auto	Subprime retail loan	9%	10%	11%	12%	13%	--	--	Ref Rate +125 bps
Auto	Auto / Motorcycle / Other RV	7%	8%	9%	10%	11%	--	--	Ref Rate +125 bps
Auto	Commercial and Gov Fleets	9%	10%	11%	12%	13%	--	--	Ref Rate +125 bps
Auto	Rental Feels	12%	13%	14%	15%	16%	--	--	Ref Rate +125 bps
Credit Card	Prime	5%	5%	6%	7%	8%	--	--	Ref Rate +125 bps
Credit Card	Subprime	6%	7%	8%	9%	10%	--	--	Ref Rate +125 bps
Equipment	Loans & Leases	5%	6%	7%	8%	9%	--	--	Ref Rate +125 bps
Floorplan	Auto	12%	13%	14%	15%	16%	--	--	Ref Rate +125 bps
Floorplan	Non-Auto	11%	12%	13%	14%	15%	--	--	Ref Rate +125 bps
1) For auto, credit card, equipment, floorplan, and premium finance ABS, the weighted average life must be five years or less. For other new-issue eligible collateral, haircuts will increase by one percentage point for each additional year (or portion thereof) of average life beyond five years. For legacy CMBS with average lives beyond five years, base dollar haircuts will increase by one percentage point of par for each additional year (or portion thereof) of average life beyond five years. No securitization may have an average life beyond ten years. 2) For SBA Pool Certificates (7(a) loans), the interest rate will be the top of the federal funds target range plus 75 basis points. For SBA Development Company Participation Certificates (504 loans), the interest rate will be 75 basis points over the 3-year fed funds overnight index swap ("OIS") rate. 3) For all other eligible ABS with underlying credit exposures that do not have a government guarantee, the interest rate will be 125 basis points over the 2-year OIS rate for securities with a weighted average life less than two years, or 125 basis points over the 3-year OIS rate for securities with a weighted average life of two years or greater.									
Source: Federal Reserve as of April 9, 2020. Haircuts and finance rates subject to change.									
Leveraged Loan	Static CLO	20%	20%	20%	20%	20%	21%	22%	SOFR +150 bps
Commercial Mtg.	Legacy & Conduit	15%	15%	15%	15%	15%	16%	17%	Ref Rate +125 bps

Source: Federal Reserve, Subject to change

POTENTIAL RISKS AND CONSIDERATIONS

- CREDIT RISK – POTENTIAL FOR LOSSES IN THE UNDERLYING LOANS THAT ARE LARGE ENOUGH TO ERODE THE CREDIT ENHANCEMENT OF THE SECURITY
- EXTENSION RISK – CASH FLOWS EXTEND BEYOND 3-YEAR FINANCING WINDOW
- PRICE ON ASSET BALANCE BELOW PAR AT MATURITY OF 3-YEAR TALF LOAN
- SPREAD LEVELS AT WHICH SECURITIES ARE ISSUED
- RISK OF CHANGES TO TALF PROGRAM
- RISK OF CHANGES TO LOAN TERMS
- LIQUIDITY CONSIDERATIONS (3-YEAR CAPITAL LOCK)



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