Andrew Richman, CTFA
Director of Fixed Income,
Managing Director, SunTrust
Advisory Services, Inc.

Chip Hughey, CFA
Head of Fixed Income Strategy
and Services
BB&T Scott & Stringfellow

Michael Skordeles, AIF®
US Macro Strategist,
Director,
SunTrust Advisory Services, Inc.

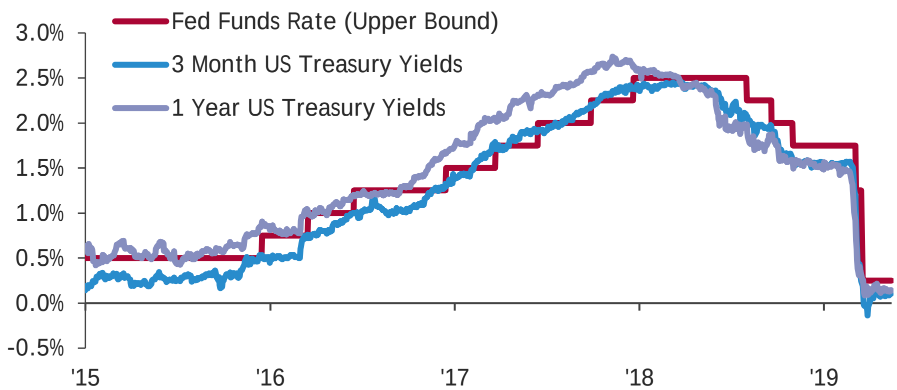
May 14, 2020

ECONOMIC COMMENTARY *from the Investment Advisory Group*

Negative Fed Funds Rate? Don't Be So Positive

- Recent actions by global central banks have reignited the debate about whether the Federal Reserve (Fed) will be next to implement a negative policy rate.
- While a slow, uneven US economic recovery may create spells where the yield on short-term US Treasuries may dip into negative territory, the Fed clearly prefers asset purchases and forward guidance over negative policy rates.
- We believe an extremely high bar exists for the Fed to entertain a negative rate strategy.
- Current Fed policy and short-term rates at the zero bound support our investment grade credit positioning.

The Fed Funds Rate and Short-Term US Treasury Yields



Data Source: SunTrust IAG, Bloomberg

What Happened

The Federal Reserve responded to the economic turmoil brought on by the COVID-19 pandemic by implementing a variety of conventional and non-conventional

Sterling Advisors

monetary policy tools. The Fed's conventional actions included shifting the monetary policy rate. By slashing the Fed Funds target rate over an 11-day span, first by a half percentage point and then by a full percentage point (to a range of 0.00% to 0.25%), the Fed lowered rates to effectively zero. It was the Fed's first return to zero interest rate policy (ZIRP) for the Fed Funds Rate, which controls overnight bank lending rates, since the end of 2015. Also within the conventional policy tools, the Fed began an unlimited quantitative easing (QE) program in late March, buying an uncapped amount of US Treasury and agency mortgage-backed securities. QE creates an enormous source of demand for these bonds, which serves to lower interest rates beyond the overnight rate.

On the unconventional side, the Fed unfurled multiple tools during March and April. It unleashed massive monetary support through an alphabet soup of targeted funding facilities, mostly created using emergency powers under Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary. Among the many facilities created are the Primary Dealer Credit Facility (PDCF), Term Asset-Backed Securities Loan Facility (TALF), Municipal Liquidity Facility (MLF), and the Paycheck Protection Program Liquidity Facility (PPPLF), just to name a few.

Each one targets specific parts of the market that are not functioning properly (or were not at some point during the past few months). Some target direct-to-business lending, while others are liquidity facilities. These actions will provide powerful economic benefits. The Fed can enlarge these programs or create support mechanisms should fissures emerge in economic and financial markets. Based on the Fed's responses over the past 10 weeks, it has demonstrated its commitment to do "whatever it takes."

Our Take

Like much in financial markets, monetary policy is not a one-size-fits-all endeavor. What might be appropriate monetary policy in one country may not be the right strategy in another.

Most global central banks have the single goal of either price stability or fighting inflation. Their various approaches to meet this objective tend to lean heavily upon conventional tools, namely their policy interest rates. Meanwhile, the Fed has a dual mandate—to promote maximum employment and price stability. In pursuit of these mandates, the Fed has boldly used unconventional tools and remains open to innovation. For instance, the Fed could expand its asset purchases in size and scope or use open market operations to keep US Treasury yields within a predetermined range (known as yield curve control).

Throughout its response to the Great Financial Crisis and now COVID-19, the Fed—whether Chair Powell or other Fed officials—appears strongly united against using negative policy rates. This unity likely stems from the fact that the Fed conducted an exhaustive months-long review of policy tools, which concluded in June 2019. From that review, the idea of negative policy rates failed to gain traction among policy makers.

Empirical evidence suggests the economic results for countries that tried negative policy rates have been underwhelming. The long-term effects of negative rates are not well-understood and would likely have negative consequences for the banking sector and America's aging population of savers. Accordingly, while not an impossibility, we believe the likelihood of a negative Fed Funds Rate is remote.

US Treasuries with Negative Yields

With the Fed keeping the federal funds rate at zero (ZIRP), short-dated US Treasuries have abnormally low yields. As recently as March 27, yields on US Treasuries with maturities six month and shorter dipped negative. We've briefly seen this phenomenon before in 2015. Today, short-term US Treasury yields remain within a hair of the zero-bound, and 2-year US Treasury yields are at their lowest point on record.

There are several forces at play:

- ZIRP has recalibrated yields down to ultra-low levels.
- The recent rhetoric surrounding negative policy rates has speculators betting on the Fed implementing negative interest rates, which would presumably lower short-term US Treasury yields even further. In fact, Fed Funds futures show participants are pricing in the possibility of negative policy rates in the US as early as Q1 2021.
- The uncertainty surrounding the US economic recovery from the COVID-19 crisis is creating powerful demand for the safety of US Treasuries across the curve. That is a major suppressant to US yields, which would grow stronger should the outlook for the US economic rebound occur with less force than anticipated.
- Negative sovereign yields remain prevalent around the globe and have stoked powerful overseas demand for the US's positive yields. Further spikes in that demand could push yields on shorter-term US Treasuries negative without Fed policy rates doing the same.

Total Global Negative Yielding Debt (in trillions)

Data Source: SunTrust IAG, Bloomberg

Naturally, the Fed's highly accommodative rate policy—coupled with its massive asset purchase programs—is sparking a reflation debate that could potentially push intermediate and longer-term rates higher (i.e., curve steepening). Additionally, the US Treasury Department is planning to issue trillions of dollars' worth of new debt. The greater supply of government debt should also encourage higher yields (i.e., lower prices). Still, those inflationary forces will take time to emerge. In the near-term, the evaporation of consumer demand and high unemployment, coupled with the enormous appetite for US Treasury debt (domestically and overseas), will create a disinflationary narrative keeping yields range-bound. As global economies begin to recover, we expect the curve to steepen as longer-term rates move higher.

Bottom Line

The Fed has shown a great deal of decisiveness and creativity in its response to the economic impact of the coronavirus pandemic. We expect the Fed to exhaust all other monetary policy options, including innovating new programs, before entertaining negative policy rates.

We believe the Fed is firmly locked on a near-zero Fed Funds Rate for at least the next 12 months, and likely beyond. That will keep the front end of the US Treasury curve anchored and leave little breathing room between those nominal yields and negative territory. This supports our preference for investment grade credit over US Treasuries, particularly in the front end of the curve.

Our expectations of a U-shaped economic recovery increase the probability of negative US Treasury yields returning to the very front of the US Treasury curve. However, when discussing US rates, we need to clearly delineate the difference between negative US Treasury yields and Fed policy rates. Negative US Treasury yields are possible based on a massive demand for quality and market expectations that the Fed could take the Fed Funds Rate negative. Those expectations appear unwarranted. We believe the chance of such a seismic shift in the Fed's approach to rate decisions is highly unlikely.

Disclosures

This material was provided by SunTrust Private Wealth Management for use by BB&T Sterling Advisors.

Advisory managed account programs entail risks, including possible loss of principal and may not be suitable for all investors. Please speak to your advisor to request a firm brochure which includes program details, including risks, fees and expenses.

Investing in the bond market is subject to certain risks, including market, interest rate, issuer and inflation risk; investments may be worth more or less than the original cost when redeemed. The value of most bond strategies and fixed income securities are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and more volatile than securities with shorter durations; bond prices generally fall as interest rates rise, and values rise when interest rates decline

SunTrust Private Wealth Management is a marketing name used by Truist Financial Corporation and the following affiliates: Banking products and services, including loans and deposit accounts, are provided by SunTrust Bank and Branch Banking and Trust Company, both now Truist Bank, Member FDIC. Trust and investment management services are provided by SunTrust Bank and Branch Banking and Trust Company, both now Truist Bank and SunTrust Delaware Trust Company. Securities, brokerage accounts and /or insurance (including annuities) are offered by SunTrust Investment Services, Inc., BB&T Securities, LLC, and P.J. Robb Variable Corp., which are SEC registered broker-dealers, members FINRA, SIPC, and a licensed insurance agency where applicable. Investment advisory services are offered by SunTrust Advisory Services, Inc., GFO Advisory Services, LLC, BB&T Securities, LLC, Sterling Capital Management, LLC, Precept Advisory Group, LLC, and BB&T Institutional Investment Advisors, Inc., each SEC registered investment advisers. BB&T Sterling Advisors, BB&T Investments and BB&T Scott & Stringfellow are divisions of BB&T Securities, LLC. Mutual fund products are advised by Sterling Capital Management, LLC.

While this information is believed to be accurate, SunTrust Banks, Inc., now Truist Financial Corporation, including its affiliates, does not guarantee the accuracy, completeness or timeliness of, or otherwise endorse these analyses or market data.

The opinions and information contained herein have been obtained or derived from sources believed to be reliable, but Truist Financial Corporation makes no representation or guarantee as to their timeliness, accuracy or completeness or for their fitness for any particular purpose. The information contained herein does not purport to be a complete analysis of any security, company, or industry involved. This material is not to be construed as an offer to sell or a solicitation of an offer to buy any security.

Opinions and information expressed herein are subject to change without notice. STIS and/or its affiliates, including your Advisor, may have issued materials that are inconsistent with or may reach different conclusions than those represented in this commentary, and all opinions and information are believed to be reflective of judgments and opinions as of the date that material was originally published. STIS is under no obligation to ensure that other materials are brought to the attention of any recipient of this commentary.

Comments regarding tax implications are informational only. Truist and its representatives do not provide tax or legal advice. You should consult your individual tax or legal professional before taking any action that may have tax or legal consequences.

Investments involve risk and an investor may incur either profits or losses. Past performance should not be taken as an indication or guarantee of future performance.

STIS/STAS shall accept no liability for any loss arising from the use of this material, nor shall STIS/STAS treat any recipient of this material as a customer or client simply by virtue of the receipt of this material.

The information herein is for persons residing in the United States of America only and is not intended for any person in any other jurisdiction.

Investors may be prohibited in certain states from purchasing some over-the-counter securities mentioned herein.

The information contained in this material is produced and copyrighted by Truist Financial Corporation and any unauthorized use, duplication, redistribution or disclosure is prohibited by law.

STIS/STAS's officers, employees, agents and/or affiliates may have positions in securities, options, rights, or warrants mentioned or discussed in this material.

Asset classes are represented by the following indexes. An investment cannot be made directly into an index.

S&P 500 Index is comprised of 500 widely-held securities considered to be representative of the stock market in general.

CN2020-1107 EXP12-2020

Sterling Advisors