Corporate Risk Management at the Offset of a Global Pandemic

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These temporary solutions as seen in recent Open Market Policy and Government is unprecedented while considering the risk of fixed income securities, rate products, and the State of the Economy. Treasury Bonds decline in value interest rates move higher; however, in this case is an indicator that domestic credit risk presents a higher probability that its issuer may potentially be unwilling or unable to meet its financial obligations. This is focal point however is something that will be at the expense of Corporations. Contrary to what has been deemed as a period of inflation, this is a misleading statement which is evident as consumer prices have not materially changed. The only inflated area of the economy, in my purview, is the overall stock market, which is most likely the effect of corporate debt issuance, bailout packages, and the artificial monetary policies which have flooded the economy with cash in 2020. This is cause for an increase in our domestic market, however will be short lived. The rise in our respective indices (DOW, S&P, Nasdaq, etc.) represents "inflation", but not the Economic term.

Investment-grade ("IG") Corporations exhibited a near two-fold expansion of issuance in 2020, namely debt instruments, convertible notes, and other synthetic products which amounted to an additional $1.177 trillion in debt – in addition to the four trillion dollars of bailout funds courtesy of the Federal Reserve. The underlying CREDIT RISK of these IG corporations will cause an eventual decrease in their equity values, as it will be more expensive to use debt instruments to buoy their operations.

When the option to issue debt becomes nonsensical, the traditional approach historically leads to a secondary offerings and dilution of equity; and thus, a decrease in the aforementioned indices. IG bond yields today are are offset by their respective stock prices, which have been "INFLATED" as a result of the short-term crutches of the Fed, and further overloaded by the cash from the issuance of debt, a 54% increase from the previous year[1] in the US, which also represents 68.5% of Worldwide Investment-Grade Corporate Bond Issuance .

The institutions who are counterparty to their derivative contracts may become unwilling, or unable to meet their financial obligations to pay the scheduled coupons which is cause to assume secondary offerings will be used, or alternative measures which I believe will serve as the outcome in the months which ensue. This is largely in part due to the 160 million people (nearly 50% of the population) who rely on $1400 economic impact payments – which IN FACT

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[1] *sources: Dealogic, Moody's Analytics*

represents the consumers in our Nation. By definition, “inflation” would be inconsequential and the term should be used loosely – the American consumer has vaporized in the wake of unemployment, homelessness, and a true Pandemic of what should be understood as an Economic stagnation of consumers.

Historically, corporations will not fail to deliver on their debt obligations – and typically respond by issuing stock, derivatives, or alternatively to maintain credibility and lower financing rates. The actual consumer has vaporized into shelters, unemployment and I would assume the retail investors of stock, generally, will follow suit. In this case, I would have to assume that an adjustment to the workforce would is the appropriate way to manage these unusual circumstances as the implied effects of stagnation will prove in corporate earnings in the wake of the Pandemic.

Issuing stock to a population of consumers that is at fifty percent capacity will not be effective, and will also dilute existing shareholders equity – therefore the synthetic growth observed in 2020 should be overlooked and it should be expected that an extended period will lapse prior to a stabilized Economic system in the United States. An increase in CREDIT RISK and higher yields in treasury markets leverage the risks of the Federal Reserve’s decisions and also the added complexity of Government shutdowns and delays in their forward commitments have all been observed, which is concerning as the true effects of this bailout is not an economic impact, absent on the impact of an even larger exposure undertaken as represented below in our Nation’s debt.

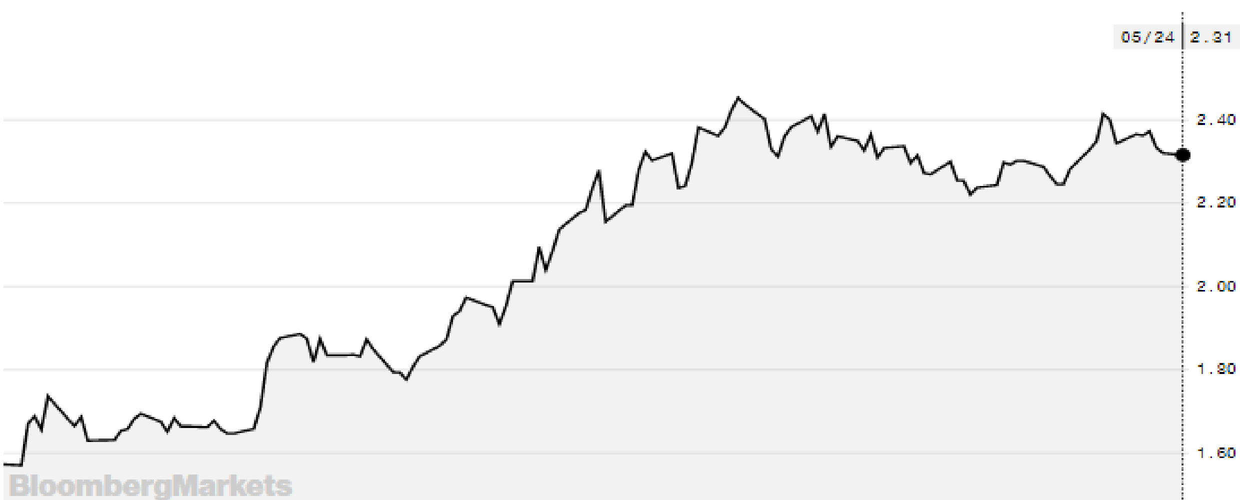
As an indicator of what to expect in the near future, the default rate in high-yield (“HY”) corporate debt obligations has nearly doubled YoY and continues beyond the 8.4% overall default rate in 2020, up from 2019’s 4.3%. The volatility of equity prices in HY corporations is more volatile and less predictable, which suggests an increase in CDS spreads. A failure in the IG space has not fully emerged, and is easier to identify as the transparency of their value is publicly available information, as the status of their operations can be observed in their stock prices (which are inflated). Certain preliminary indicators in the random gyrations of Viacom (VIAC), Discovery (DISCA) “randomly” exhibited decreases in their stock prices to the excess of 50%. More prominently, as of the 14th of May, Amazon.com Inc. CEO Jeff Bezos sold roughly $6.7 billion of Amazon sales which were prearranged through a 10b5-1 trading plan, according to filings with the SEC.

In happenstance, and beyond the scope of these hints in equity markets, the more recent volatility in synthetic currency markets (better known as “cryptos”) of Bitcoin, Ethereum and tens of thousands of other synthetic currencies which have recently appeared have capsized and represents a much bigger problem, because this represents trillions of dollars in real currency assets which have vaporized - seemingly overnight.

The principle here is what I would deem as “term issuer risk”, beyond the control of the US Federal Reserve as the current valuations of securities are artificial. This is ironic while considering the losses observed in synthetic currency markets as the value of Bitcoin has fallen by more than 50% YTD and represents a loss of over $1.5 trillion dollars[2], and experienced more than two third of this loss[3] on Wednesday May 19TH. The US bailout is not over, and the challenges of our Corporations, workforce and careful management of balance sheet. The Debt on the balance sheets of the Federal Reserve Banks has truly inflated to a point where I cannot express an opinion of how or when this can be normalized. The growth in the table below represents an exponential rate of growth which stems from the Global Financial Crises we experienced in 2008 — however in this case is significantly larger (roughly the log 21 of 2) with respect to the era of predatory lending, unprecedent unemployment rates, and a pandemic which was caused by a failure of our financial institutions to identify and disclose the underlying value of their assets.

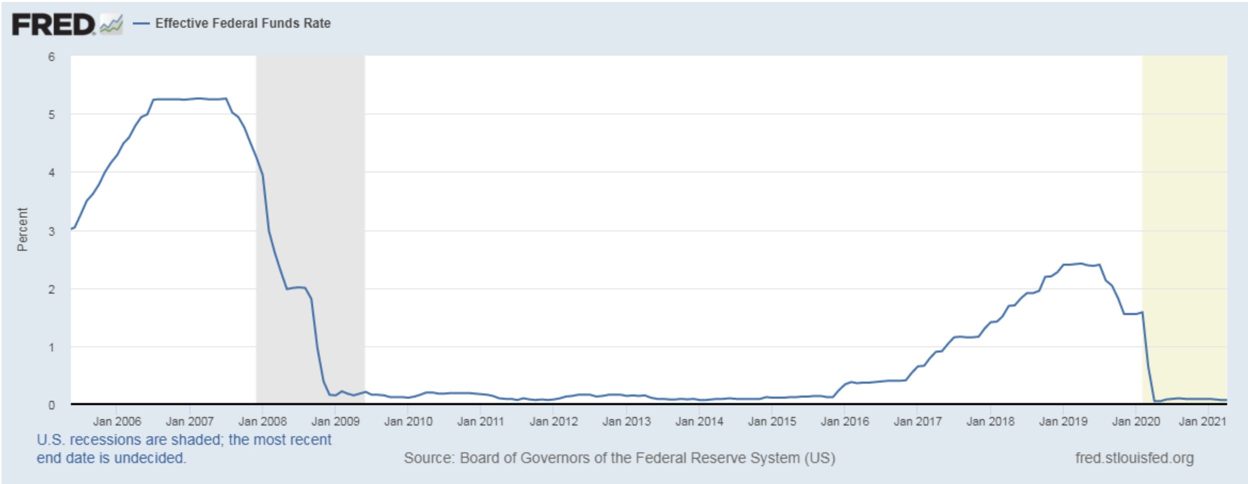
Despite the terrible things that have happened in the past, hopefully our Corporations will not circumvent the scrutinized controls implemented in 2008, and follow the guidance of its current regulators[4], adjust to changes in Monetary Policy and prudently manage the inflated state of the current Economy.

The underlying cause for “inflation” as seen in the rise of “real interest rates” is purely a result of credit risk, conversely to adjustments in Fed Funds. This risk is something that should be seasonally adjusted and under the assumption of the implied effects of a capsizing market and volatility, increasing rates in this non-traditional movement which has been celebrated as an “Economic Boom”. As a majority, our Nation suffers as individuals, and the market will follow suit unless the third principle in the Appendix continues.

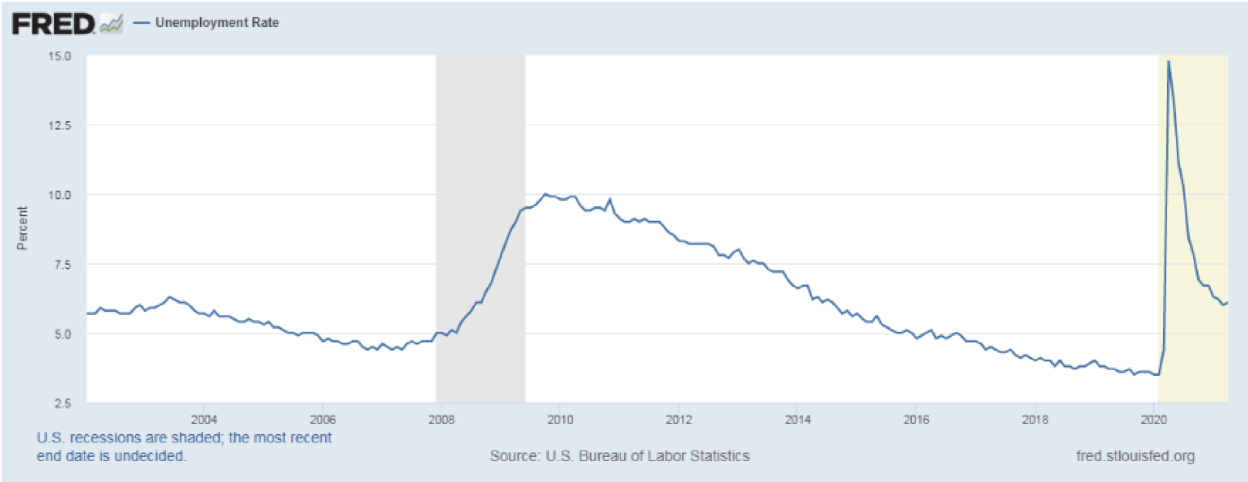


[2] Bloomberg LP: May 24, 2021 at 7:06 a.m. EDT
[3] https://www.cnn.com/2021/05/22/investing/crypto-crash-bitcoin-regulation/
[4] https://fred.stlouisfed.org/series/UNRATE

I. FED FUNDS



II. UNEMPLOYMENT RATE



III. FEDERAL DEBT HELD BY FEDERAL RESERVE BANKS