The Jackson Hole Effect

Samuel Morse's first telegraph message in 1844 was, "What hath God wrought;" this exclamation carried with in an implicit recognition the world had changed permanently and in an instant. This is a more common occurrence in financial markets than most of us think; our minds are conditioned toward the gradual and evolutionary and not the catastrophic and revolutionary.

Ben Bernanke's speech in Jackson Hole on August 27th was, however, another example of a revolutionary and catastrophic (in all senses of the word) change. This gives us the opportunity to compare markets before and after to see which ones have been influenced the most by the simple declaration everyone on this planet and quite possibly Mars can be a billionaire if only we had enough paper and ink on hand.

Before And After

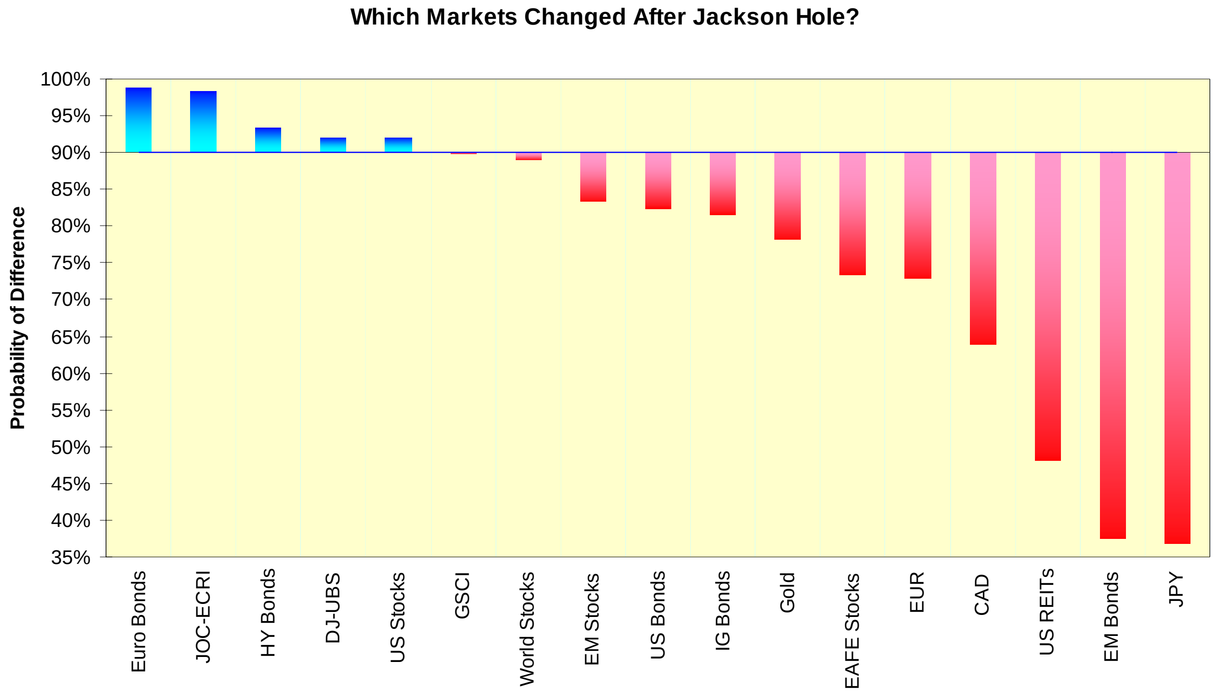
If you are going to compare two periods you need four dates, the starting and ending points for both periods. The ending date for period 2 is set at the date of this writing, November 10, 2010, and the two middle dates are given, August 26 and 27. The choice to start the first period is somewhat arbitrary; let's use the May 10, 2010 date when the European Monetary Union backstopped Greece and in good Dutch style stuck its collective finger in the dike.

The table below presents the correlation matrix of returns for the total returns of sixteen different markets since May 10th; positive correlation cells have a blue background and negative correlation cells have a yellow background.

Post-May 10, 2010 Correlation Of Returns

	World Stocks	US Stocks	EAFE Stocks	EM Stocks	US Bonds	IG Bonds	HY Bonds	Euro Bonds	EM Bonds	DJ-UBS	S&P-GSCI	Gold	US REITs	Euro	Yen	Can. Dlr.
World Stocks	1.000															
US Stocks	0.907	1.000														
EAFE Stocks	0.888	0.614	1.000													
EM Stocks	0.782	0.567	0.841	1.000												
US Bonds	0.456	0.518	0.293	0.306	1.000											
IG Bonds	0.332	0.434	0.154	0.146	0.958	1.000										
HY Bonds	0.591	0.404	0.665	0.767	0.177	0.043	1.000									
Euro Bonds	0.227	0.271	0.134	0.099	0.463	0.461	0.142	1.000								
EM Bonds	0.600	0.389	0.698	0.799	0.135	0.080	0.952	0.013	1.000							
DJ-UBS	0.632	0.542	0.582	0.532	0.294	0.215	0.416	0.125	0.404	1.000						
S&P-GSCI	0.720	0.641	0.641	0.611	0.393	0.319	0.475	0.230	0.450	0.865	1.000					
Gold	0.098	0.092	0.068	0.060	0.126	0.125	0.110	0.105	0.119	0.410	0.280	1.000				
US REITs	0.795	0.909	0.503	0.462	0.438	0.373	0.304	0.203	0.305	0.485	0.608	0.105	1.000			
Euro	0.496	0.492	0.402	0.177	0.135	0.139	0.065	0.094	0.056	0.295	0.348	0.011	0.177	1.000		
Yen	0.372	0.464	0.193	0.356	0.553	0.485	0.238	0.234	0.222	0.120	0.207	0.152	0.356	0.146	1.000	
Can. Dlr.	0.792	0.846	0.551	0.549	0.481	0.408	0.323	0.209	0.319	0.561	0.659	0.125	0.549	0.514	0.396	1.000

Now let's do the before-and-after comparison of whether the average returns shifted significantly at the 90% confidence level. The chart below presents the sixteen markets above plus the non-investable Journal of Commerce-Economic Cycle Research Institute's raw materials index.



Five markets were shifted significantly by the Jackson Hole pronouncement: The Pan-European sovereign bond index, the JOC-ECRI raw materials index, U.S. high-yield bonds, the Dow Jones-UBS commodity index and U.S. stocks.

Equally telling is what did not change significantly before and after: The excess carry returns for three major currencies, emerging market bonds and U.S. REITs. The promise of never-ending cash did not change behavior. Moreover, the emerging market and EAFE stocks that have been receiving so much attention of late were not kicked into high-gear by Jackson Hole; they were already moving higher and did not accelerate much after the fact.

The real question is how persistent the Jackson Hole shock will be. The principle of diminishing returns applies in most financial affairs; while the first pass overhead of the money-dumping helicopters has had significant effects on U.S. stocks, investable commodity indices and high-yield bonds, subsequent episodes might be less impressive. In fact, they might be counterproductive if and when long-term interest rates and inflation expectations start to rise.