Has Quantitative Easing Boosted Underlying Equity Markets?

The Comparisons To The "World-Ex" Benchmarks Are Surprising

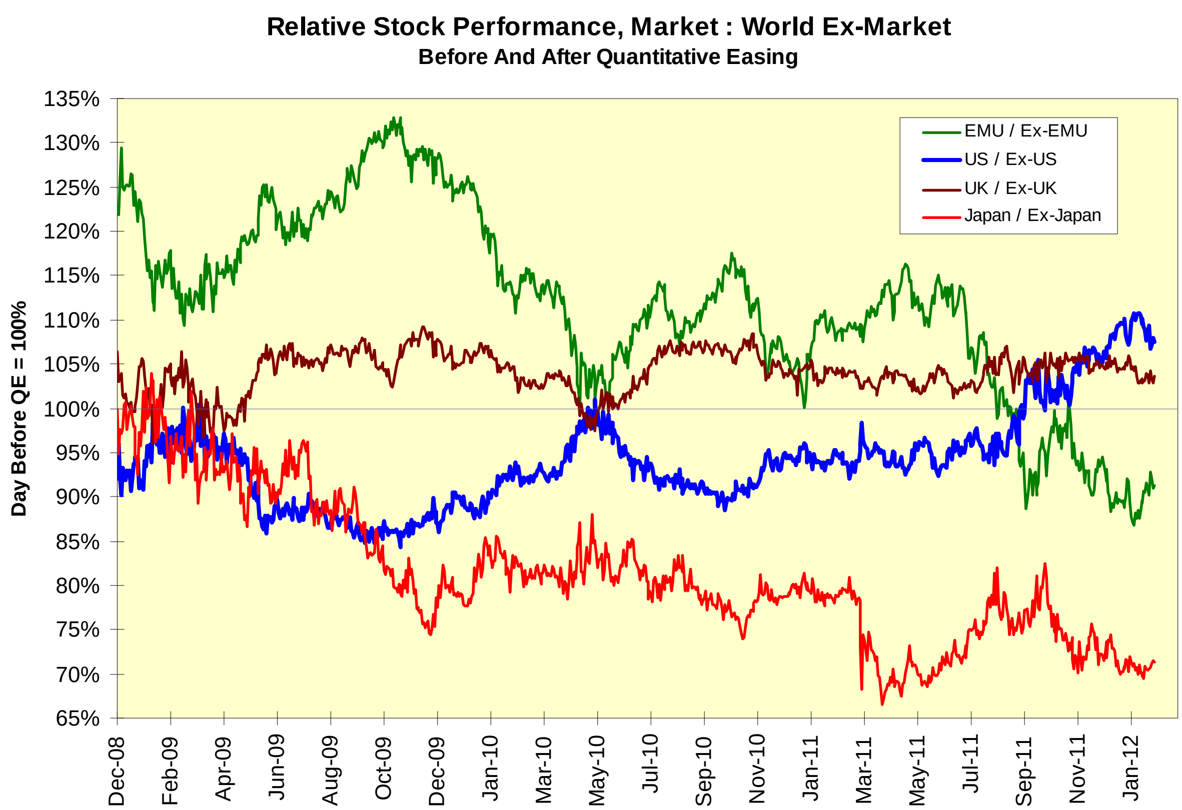
One of the favorite rhetorical tricks of policymakers in recent years is to argue things would have been much worse had they not donned cape-and-tights and came a-riding with the Seventh Cavalry to rescue us (from their previous mistakes). As an aside, no one in my knowledge pulled this stunt more frequently than the Communist Party of the Soviet Union: For forty years after World War II, Soviet television extolled the mighty deeds of the Red Army in driving the Germans out from deep within Russia while ignoring the blunders that put the Germans deep into Russia.

Ex Marks The Spot

One of the items passing for received wisdom in financial commentary is money-printing redounds to the benefit of risky financial markets if for no other reason than it is far easier for fresh cash to be swapped for a piece of paper than to create new plant and equipment. This is one of the principal reasons why all of the monetary stimulus has been so ineffective at creating employment: Factories, mines, mills and fast-food joints employ people; stock certificates do not.

Yet if we compare the performance of countries engaging in official quantitative easing in recent years to their complement; i.e., the U.S. versus the World Ex-U.S. as compiled by MSCI-Barra in USD terms, we do not see regular outperformance by the SQE (Society of Quantitative Easers). Perhaps this is why they argue the counterfactual things would have been worse but for their actions above and beyond the call of duty.

If we map the total returns of four SQE members, the U.S., U.K., Japan and the EMU before and after a selected QE date, we find only the U.S. since November 2011 has advanced on its World Ex-U.S. bogey. The selection of QE dates presented a bit of a problem as Japan began QE in March 2001 and re-initiated it in December 2008. Both the U.S. and U.K. have had multiple rounds, and officially the EMU has not engaged in the practice despite having begun it on a de facto basis in May 2010 with one of its bailouts of Greece. I used December 2008 for Japan, March 2009 for the U.S. and U.K. and May 2010 for the EMU. It is tough keeping up with this crowd.



The policy has not helped either Japan or the EMU to-date. The U.K. has outperformed the World Ex-U.K., but that measure has flat-lined since August 2010. If I ran this chart six months ago, I would have had to put the U.S. down into the "failure to launch" column.

The moral of the story is or should be simple: Investors can be fooled for a while by money illusion but learn quickly this is Potemkin prosperity, an illusion. If you want to create real economic value, stop destroying the value of your currency and raising the specter of future inflation; both of those deter real investment. On the fiscal side, stop excoriating capital formation and promising higher taxes. There are no magic bullets, and the quicker policymakers realize this, the better off we all will be.