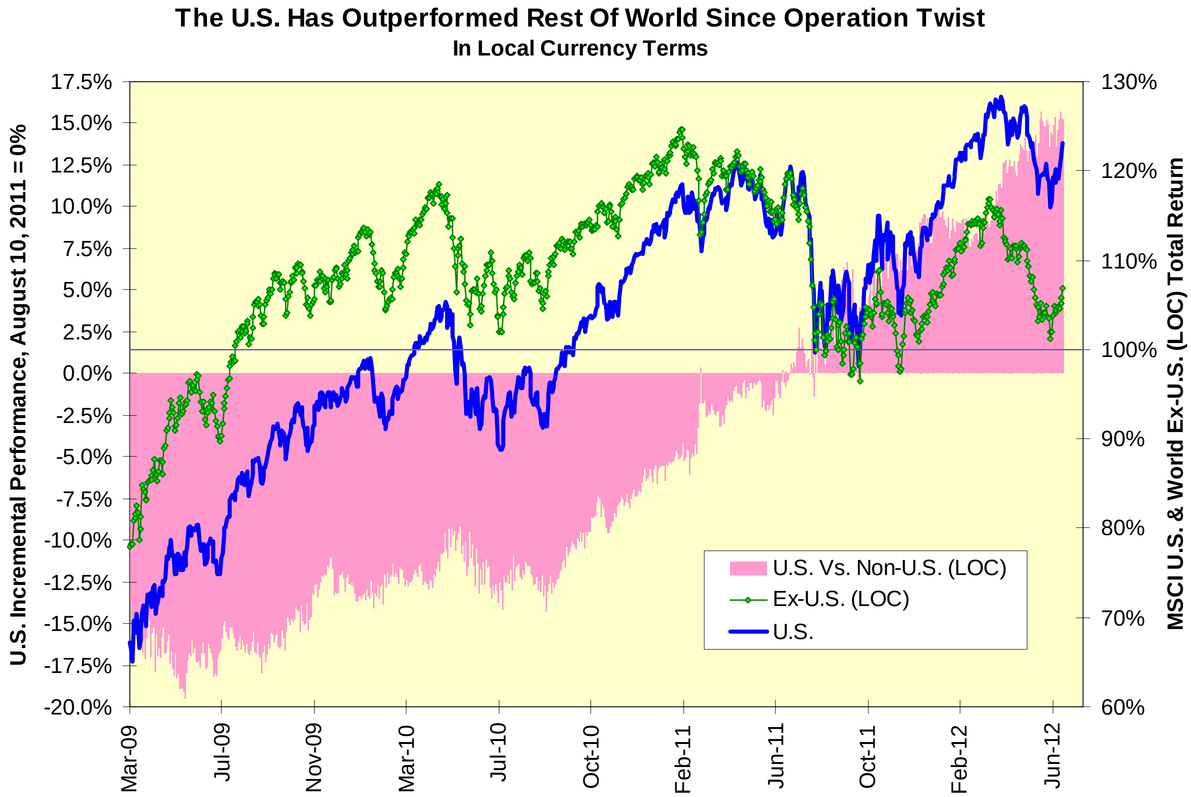
Twist Thy Neighbor As Thyself

U.S. Equities Unintentional Beneficiary Of Monetary Easings

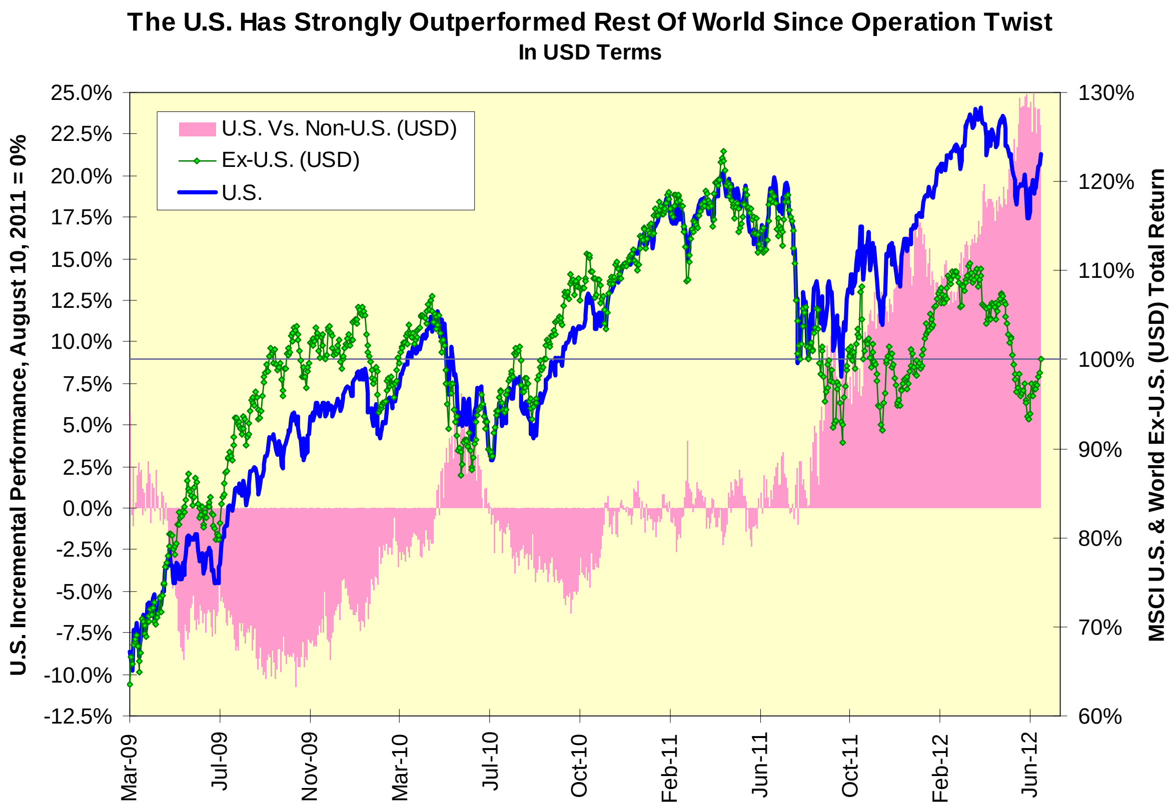
If you hear the words, "Ready! Fire! Aim!" the chances are there is a central banker somewhere on the loose. They would never admit to the idea anything they do might have unintentional consequences; that would destroy the carefully cultivated aura of omniscience believed primarily by central bankers themselves. This is a crowd, after all, willing to take credit for higher asset prices but never a weaker dollar or higher commodity prices.

Operation Bogart

Billiards players have to call their shots in advance, a rule known to be enforced via the vigorous use of a cue stick every now and then. Do you recall Ben Bernanke standing in the fresh mountain air of Jackson Hole two Augusts ago and calling the following shot: "The U.S. is going to Bogart the world's equity returns in local currency terms as the result of QE2?" No? Hmm; the U.S. gained 32.8% since then while the rest of the world gained 0.6%. Only about 5.25 percentage points of that differential can be explained by dollar weakness.



Well, how about last August when Operation Twist came upon the scene; did he proclaim, "The U.S. will gain 23.1% in USD terms; the rest of the world shall gain squat, a piddling little 0.1%?" The answer here surely is, "No" as well; but that is what happened in both cases.



Non-Deterministic Outcomes

My principal criticism of monetary policy over the years has been the inability of anyone, myself included, to map out causal outcomes in advance. If I take my car to a mechanic to address a steering problem, I do not want to have to hear how turning the wheel clockwise might produce a left turn or throw the car into reverse. And yet we repeatedly allow central bankers to state in advance they will create a wealth effect, as in QE2, or how twisting the yield curve will stimulate output and employment by lowering borrowing costs. Nothing of the sort happened.

What we did receive was massive equity outperformance in the U.S. This has been a benefit to investors, although not to those who decided in QE2 to remain with the QE1 strategy of investing in emerging markets or in global stocks through vehicles such as the iShares Emerging Markets or EAFE trusts (EEM and EFA). American investors have been tilting away from equities and toward bonds over the past five years, and within equities they have favored international over domestic. Who knew the big relative gainer coming out of the latest two round of money-printing and yield curve-twisting would be none other than plain old domestic vehicles like the Standard & Poor's Depository Trust (SPY)? The answer, alas, was certainly not the Federal Reserve.