

Industry Group Returns And QE Whatever

A Monty Python [sketch](#) involving Michael Palin as a pretender to King Louis XIV has the rogue snapping, "...when you're King of France, you've got better things to do than go around all day remembering your bloody number!" Those were the days, when every French king was a Louis and every British king was a George. Now we are in an age when all public finances both here and abroad seem to involve a QE plus a number; the key difference between us and earlier monarchies is we do not seem to have better things to do than going around remembering our bloody number.

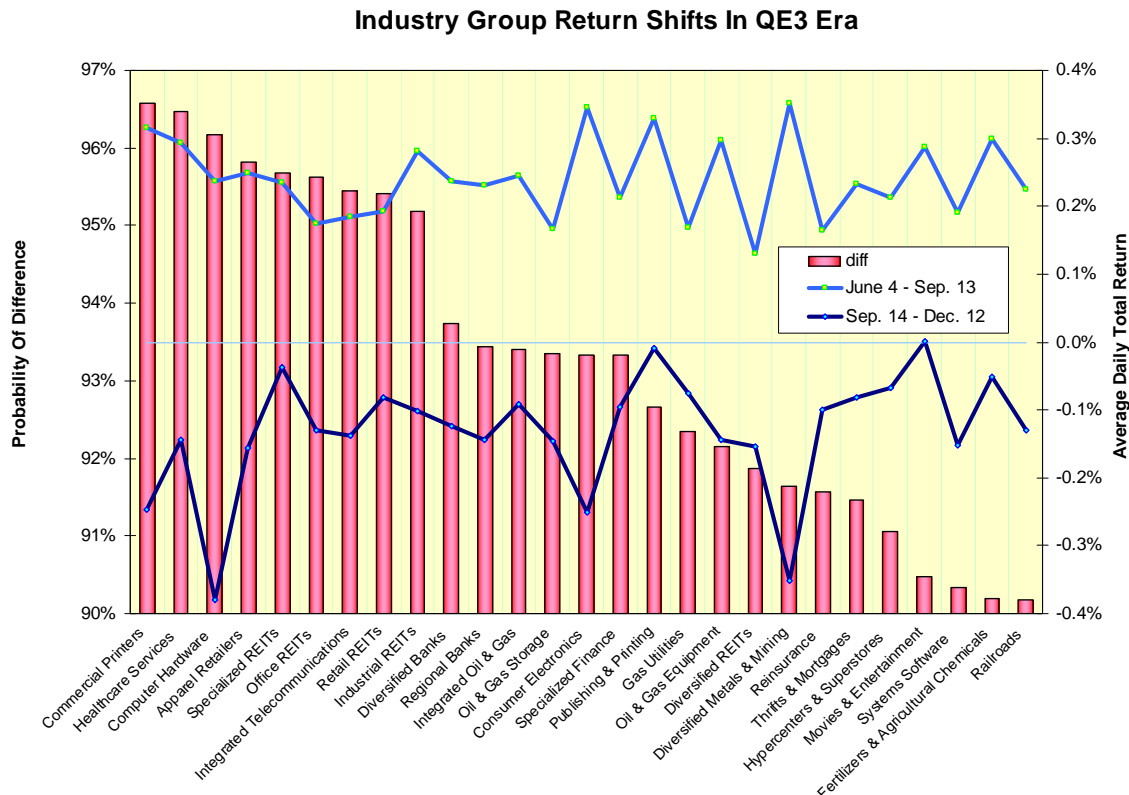
Was last week's FOMC decision to add a fresh \$45 billion per month of Treasury purchases to its \$40 billion per month of mortgage purchases QE4, an extension of QE3 or the conclusion of the June modification of Operation Twist? This is important to those of us, myself especially, who must measure market responses to all of this madness.

The Known QE3

Let's stipulate the QE3 era began after the release of the May employment report at the start of June, involved what I will call an "anticipation period" until the September FOMC meeting announcing the mortgage purchases and then a defined "execution period" through the December 12th FOMC meeting. How did industry group returns change between the anticipation and execution periods?

A total of 27 groups' behavior shifted at a 90%+ confidence level between the two periods. More tellingly, each one of these shifts was from a higher to a lower return. This is consistent with the broad market rising 14.99% during the anticipation period versus a decline of -1.90% during the execution period. Restated, the real effect of QE3 was to shift future returns back in time to the anticipation period. Some might consider this an accomplishment; I consider it an unnecessary distortion.

The list of groups whose returns shifted significantly is dominated by financial groups in general and REITs in particular.



I must add the distribution of industry group return shifts was very asymmetric. Only five groups, Automotive Retailers, Footwear, Casinos & Gambling, Coal & Consumable Fuels and HR & Employment Services, had equivalent returns at a 90%+ confidence interval. If there is a pattern here it escapes me.

Looking Forward

The markets, much like captive orcas, jump about and dance to their central banking trainers. It is all great fun for the tourists until one of the orcas gets good and angry and decides to turn one of those trainers into a chew-toy. Then everyone remembers they actually were dealing with wild animals with only a veneer of domestication.

It will be the same for markets. The central bankers now think they are being oh-so-clever by putting pretend targets up on the board and promising they will end the money-printing when those targets are hit. If the return shifts above convey any lesson it is the wild animal of the markets discounts moves very well and shifts returns forward in time. Once investors get the idea the magic 6.5% unemployment number or 2.5% inflation number will be hit, they will sell off in anticipation. That will not be a happy day when it arrives.