Early Assessment Of Quantitative Easing

Will my epitaph read, "Here lies a hard-money guy in a soft-money world?" No, and for a different reason than you may think. It is not so much I do not like trying to solve every problem with a printing press, I do not like the opposite, the Federal Reserve trying to slow the economy down by withdrawing liquidity, either. The evidence the Federal Reserve or any other central bank can fine-tune the economy, either alone or in concert, simply does not exist. The older I get, the more I am convinced Milton Friedman had it right: The one objective of monetary policy should be to match the growth rate of the money supply to the long-term capacity curve of the economy.

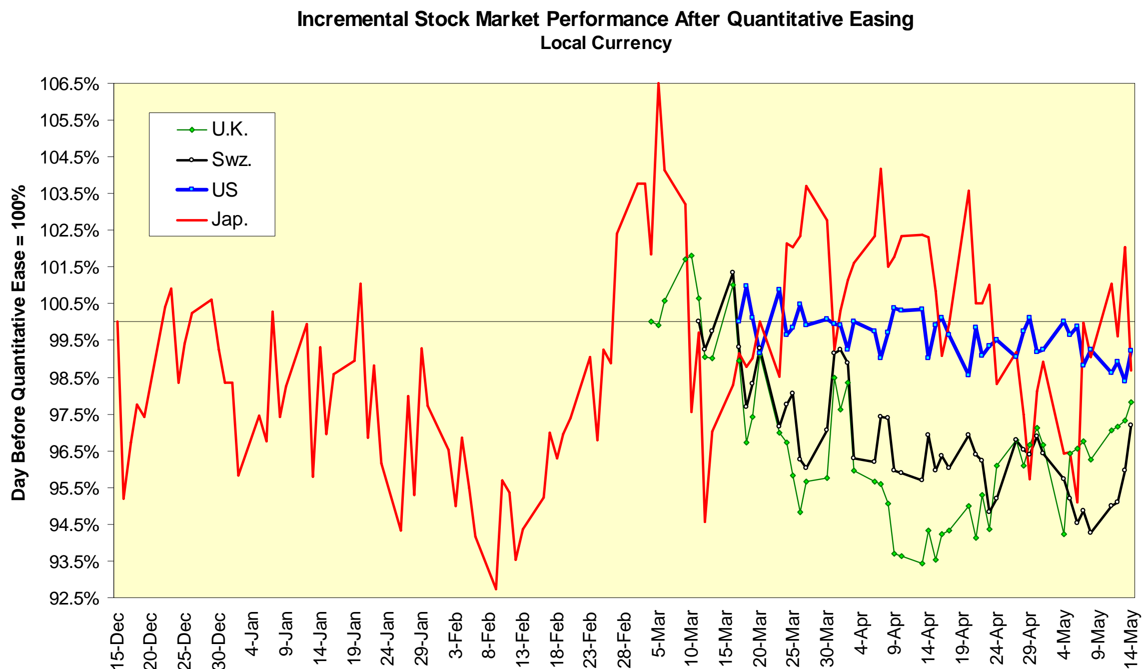
A *RealMoney* reader e-mailed me shortly after the March 18th announcement of quantitative easing and implored me to stop moralizing and give my opinion on whether the excess money could create the sort of financial market bubble he so enjoyed in the late 1990s. His question was fitting and proper, my response was it could give the markets a kick as excess money tends to find its way into financial assets before it moves into real assets, and we did rally for another month.

But here is the question: We have three cases of major central banks engaging in quantitative easing this year and a surprising one in December 2008. Concurrent with the December 16, 2008 FOMC meeting and the cut of the target federal funds rate to the 0-0.25% range, the Bank of Japan quietly went back to its policy of quantitative easing first begun in March 2001 and abandoned in May 2006. The Bank of England and Swiss National Bank went to quantitative easing this past March 5th and 12th, respectively.

Dare To Compare

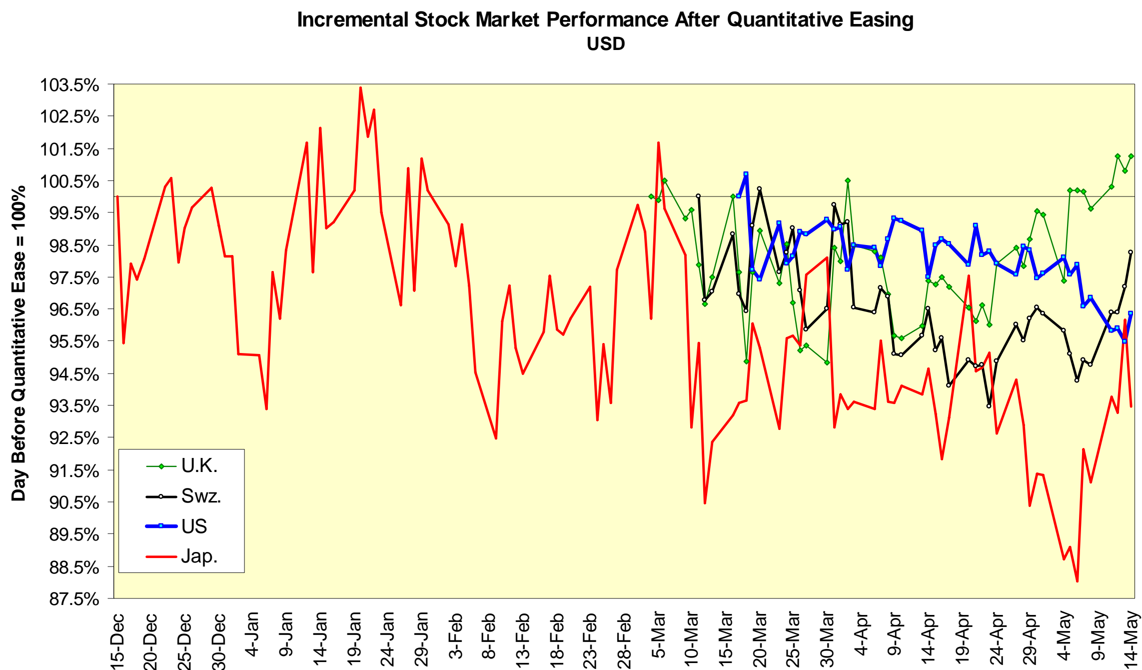
This gives us an opportunity to assess whether these four quantitative easing moves led to over- or underperformance relative to the world as a whole by the respective national stock markets. The Morgan Stanley Capital International total return indices will be used both on a local currency and a U.S. dollar basis. All four comparisons will be reindexed to the day before their central bank actions.

First, let's use the local currency case, which is not the one a U.S. investor would be interested in for a typical mutual fund or ETF holding. As an aside, the base for the MSCI World index in local currency terms must be a monster to maintain; congratulations are in order to some unsung group of heroes somewhere.



The outcome is surprising. All four national markets have underperformed the World index at last reading. The Japanese market outperformed briefly between mid-February and early March as the yen weakened, but it lost those gains quickly. The U.S. market has drifted lower with respect to the World index even as we gained in nominal terms.

Now let's shift the comparison to a U.S. dollar basis, the one you most likely would encounter. Only the U.K. market is outperforming the rest of the world in USD terms and there by a trivial 1.3%. The U.S. has drifted lower with respect to the rest of the world, and both Japan and Switzerland have underperformed the World index in USD terms since their respective quantitative easing dates.



Other Markets

The table below represents a smattering of other U.S. markets and how they have performed since quantitative easing was announced.

Total Returns Since March 18, 2009

Dollar Index	-1.85%
Govt. Master	-1.12%
Gold	4.50%
Inv. Grade	6.15%
U.S. REITs	17.53%
High Yield	19.12%

The two best-performing categories, by a wide margin, have been high-yield bonds and U.S. REITs. If we return to the maxim inflation benefits debtors and lower-quality balance sheets, this makes sense. Both markets increased in response to expectations of future inflation. Gold rose, but rose nowhere near as much: Gold by itself has no balance sheet and no debt to repay beyond its cost of carry. It benefits from inflation, but it is not a low-quality asset.

The dollar's decline over the period has been trivial, and we still are in a period where currencies are trading for reasons different than expected interest rate and inflation differentials. The surprise in the table is the negative total return on the Merrill Lynch U.S. Government Master index. Only the federal government could announce a program to buy $300 billion of its own bonds out of thin air and watch the prices decline.

The net effect of American quantitative easing has been to reward low-quality debtors at the expense of the government. The net effect of all quantitative easing on stock markets has been underperformance as investors conclude the measures undertaken will lead to higher inflation in the future. Prosperity, so far as anyone can determine, involves real wealth creation via work, savings, investment and productivity. If it could be achieved via a printing press, Zimbabwe would be a nice place to live today.