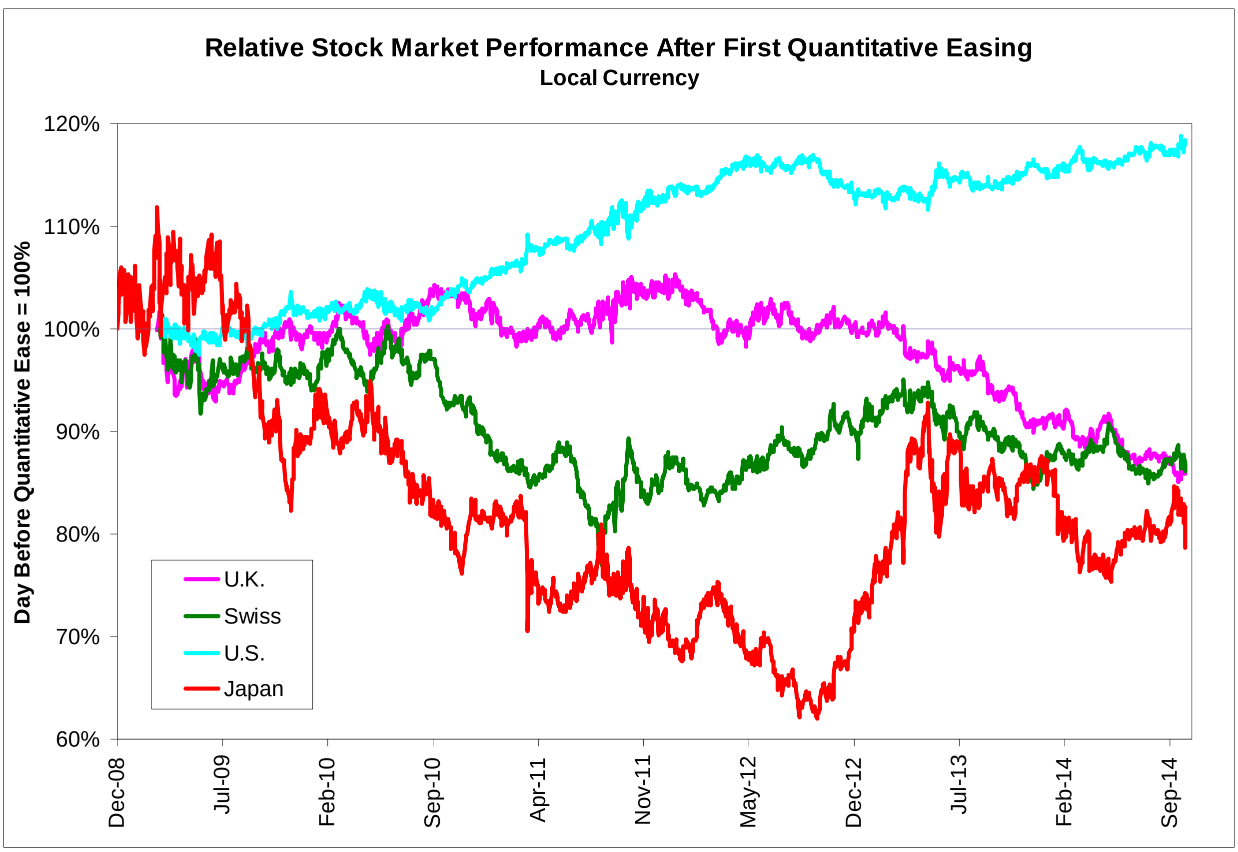
You Can Never Stop The QE Music

Somewhere in most of our lives we encountered CPR training or something else that gave us the short-lived fantasy we could be the ones to save the damsel in distress or whomever. If you paid attention, you would have learned once you start administering CPR, you cannot stop until one of three things happens, two of which happen to be good; either you save the potential victim or a trained professional arrives and relieves you of the burden.

Now replace the damsel in distress (ever see a "damsel?" Me neither) with the economy and the fantasy-driven savior with a central bank of your choice and try to rearrange the letters in 'CPR' to form 'QE' and you get something similar. Japan has been at this tawdry game since March 2001, which pretty much means everyone who was bar-mitzvahed in Tokyo this year has never known a world without near-zero interest rates and all sorts of extraneous yen overflowing from one of those high-tech toilet bowls you find in their insanely overpriced hotels such as The Deflation Inn.

Relative Post-QE Performance

How have the national stock markets of countries engaging in quantitative easing or in the Eurozone's case something similar beginning in May 2010 fared in local currency terms relative to the MSCI World index? If we index the British, Swiss, American and Japanese markets to the day preceding their central bank's action, only the U.S. has outperformed the World index in local currency terms, by 18.3%. All of the other markets have failed to match the World index with Japan, the U.K. and Switzerland underperforming by 21.4%, 13.7% and 12.9%, respectively.



The U.S. has been the most consistent beneficiary of its own quantitative easing policy, with emphasis on "consistent." While both Switzerland and Japan have engaged in singular episodes of massive monetary creations, the former to stem have inflows from the Eurozone and the latter to arrest domestic deflationary pressures, the U.S. has been reasonably consistent in following QE1 with QE2 and then QE3 followed by a slow tapering of QE3. It is instructive how quickly relative performance peaked after the initiation of QE. For Japan and Switzerland, the dates were March 5, 2009 and March 16, 2009, both more than five and one-half years ago and both preceding the initiation of QE in the U.S. British relative performance peaked on January 3, 2012. The U.S. peaked relative to the World index on October 8, 2014.

These early relative peaks and the recent U.S. peak underscore the principle that QE, once begun, must be maintained and the market must continue to expect it for equity markets to continue their advance. It will be interesting to see if the U.S. backtracks on its expected interest rate hikes for 2015 if it continues to be the only practitioner of QE with an outperforming stock market.

Near-zero interest rates get embedded in the system very quickly as borrowers take on greater debt levels and find them easier to service. Uncle Sam remains the largest borrower. We have seen, graphically, at how quickly global markets can throw a hissy-fit when a central bank such as the ECB does not follow through on its QE tease. Once they begin, and I think they will, they should follow the U.S. example and never stop or even talk about stopping. It is one of the good outcomes, per our CPR analogy. Stopping creates a bad outcome, and really, who wants to have a distressed damsel on their hands?