MV CAPITAL MANAGEMENT

MV Capital Management Weekly Market Flash

Hello Goodbye: QE at Home and Abroad

October 31, 2014

QE is dead. Long live QE.

As the week opened, the single thing on which nearly all market pundits agreed was that the Fed would announce the end to its bond-buying program, known as QE3, at the conclusion of its Open Market Committee meeting on Wednesday. Sure enough, the Fed did just that. But QE was far from done for the week. As we on the Atlantic Seaboard slept on Thursday night, another stimulus story was playing out far across the Pacific. Bank of Japan Governor Haruhiko Kuroda, in an announcement that caught analysts by surprise, raised the annual target monetary base in his country by ¥80 trillion ($720 billion), about 33% higher than the previous target increase.

Not to be left out, the Eurozone today is contemplating the latest set of sub-1% inflation data in advance of next week's European Central Bank meeting. Expectations continue to grow that a more full-throttle stimulus program will be needed to deal with the Continent's ongoing economic woes. In short, QE in its various forms and manifestations is going to be with the world for some time to come, even as the Fed (for now) hangs up its cleats.

A Tale of Two Economies

It seems simplistic to divide the world into two economies. China is nothing like Europe which is nothing like Australia or Japan. But increasingly it does seem like there is US and ROW: the United States and the Rest of the World. Here at home things are more or less fine, thank you very much. On the heels of the Fed's QE-ending announcement came word that U.S. GDP grew by 3.5% in the 3rd quarter, above the 3.0% consensus estimate. We are set to see out 2014 with unemployment below 6%, growth above the forecast long term average, and sub-2% inflation that gives the Fed plenty of maneuvering room in how and when to deal with interest rates next year. In this context it is not hard to ascribe the stock market's recent pullback to a technically-driven flash in the pan.

By contrast, GDP growth has been contracting in Japan this year. Europe is on the edge of deflation. China still posts growth numbers Europeans could only dream about, but it, too, is below-trend. Australia's commodity-intensive economy is marking time. Brazil is struggling to hit 3% growth targets. And so what we are seeing is policy divergence. The U.S. is carefully moving away from stimulus, while other markets face the need to keep the monetary taps flowing. The Bank of Japan's latest surprise announcement is unlikely to be the last QE salvo.

Arigato (Thank You), Kuroda-san

There is more to the Japanese announcement than the new monetary base target. The Government Pension Investment Fund of Japan is the world's largest institutional investor, with over $1.2 trillion in assets under management. A Reuters report this morning indicates that GPIF plans to reallocate its target allocation weight for equities from 12% to 25%, amounting to potentially $150 billion of new demand for Japanese and global shares. The Nikkei stock index jumped 4.8% overnight, and world markets are giddy as we close out October.

Markets generally like stimulus, at least in the short term. A favorable outlook for the holiday season here at home along with stimulus abroad could facilitate a nice tailwind as we see out the year. But there are a great number of X-factors at play that we believe are likely to make for very interesting times in 2015.

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