

And, we are hardly alone in this assessment. As Stephen Williamson, Vice President at the Federal Reserve Bank of St. Louis, noted in a recent review, taking a broader historic perspective:

*"The theory behind QE is not well-developed ... Evidence in support of Bernanke's view of the channels through which QE works is at best mixed... Much of the work on the quantitative effects of QE consists of event studies, whereby researchers look for effects on asset prices close to the date of an announced QE intervention. ... All of this research is problematic, as it is atheoretical. There is no way, for example, to determine whether asset prices move in response to a QE announcement simply because of a signaling effect, whereby QE matters not because of the direct effects of the asset swaps, but because it provides information about future central bank actions with respect to the policy interest rate. Further there is no work, to my knowledge, that establishes a link from QE to the ultimate goals of the Fed –inflation and real economic activity."*<sup>8</sup>

Given such doubt, it is no wonder that the Fed is hoping for a return of more normal times – when it could count on well-understood tools to do the job.

### 3. Consequences for investors

In 1976, the economist Robert Barro argued that an activist monetary policy gains much of its effectiveness from confusing people, clouding signals to market participants. That can secure tranquility for a while and perhaps provide a temporary boost to output. However, that stability comes at the cost of even greater variance later on.<sup>9</sup> Eventually, you might expect inflation, GDP and also financial markets to become more volatile.

Given how much QE appears to have relied on market expectations, it is hard to say if such a tipping point has already been reached. Over the past year, the investment environment has clearly been getting trickier. In the past, correlations across different asset classes were generally such that you could reap decent returns without taking too much risk, using diversification effects to mitigate the downside risks. Now things are different.

This is especially true if we compare the period between 2010 and 2015 with the recent market turmoil. Lately, many unusual correlations have cropped up that you might not have expected. For example, major equity indices have tended to move in sync with the oil price. This might seem justifiable for the S&P 500 Index, but is less understandable for the German Dax, which does not include a single major oil producer. In any case, correlations between oil and the S&P 500 Index have historically tended to be negative, which also makes more economic sense.

Worse still, many old correlations have been swept aside. Volatility is increasing.

<sup>8</sup> Williamson, Stephen D., "Current Federal Reserve Policy Under the Lens of Economic History: A Review Essay", Federal Reserve Bank of St. Louis Working Paper Series, Working Paper 2015-015A, pp. 8-9. <https://research.stlouisfed.org/wp/2015/2015-015.pdf>

<sup>9</sup> Barro, Robert J.: Rational Expectations and the Role of Monetary Policy. *Journal of Monetary Economics*; pp. 1-32, January 1976;

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