August 2012

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Impact of Quantitative Easing

I know this will appear to many as another article where Paul bangs on about Quantitative Easing (QE). However, I make no apologies for it; they are my favourite two letters when combined together. Again this probably further endorses your view of me as someone who is geeky enough to have favourite letters. The reason we should all embrace the benefits of QE, I have been documenting and discussing with you all for a long time now.

Anecdotally, I have been talking about how QE operates like a penny drop machine. These are very popular at the fun fair and seaside resorts. Within QE operations, money has been printed and dropped in the slots, bouncing around the economy, with unknown outcomes. The only science behind it being that if enough money is printed and thrown in the slots, eventually the oscillating levels will, by the sheer weight of money, result in the "profitable" drop into the collection tray. This is the increase in economic output which is the anticipated outcome. The penny drop machine analogy seems to work, because if you ask Mervyn King or Ben Bernanke which path through the financial markets it would take before depositing the coin in the slot, their answer would be 100% conjecture.

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This month saw a publication by the Bank of England (BoE) as to the worth and effect of QE. In it they disputed the downside effect of how it has resulted in the worst time ever in history to retire. This has resulted because the purchase of 1/3rd of the UK Gilt Market by the BoE has pushed yields down to all time lows. These yields are used to calculate annuity rates and have led to the lowest annuity rates ever. The report suggested that if you held gilts in the first place the rise in value attributed by the price of gilts would counter the knock on effect of a resulting lowered gilt yield. I have never seen a client who has been 100% invested in UK Gilts and would think they were foolish to ever be invested like that.

The fall in gilt yields has benefitted many of you who have accepted Cash Equivalent Transfer Values (CETV) from final salary pension plans. The rise in the transfer values offered by the schemes and the rise in the scheme liabilities has increased the deficits in these schemes. This occurred at a time when they were suffering significant deficits in the first place.

I have always said, and it has been fairly clear to see, this money created by QE has found its way into the stock market. There has been a clear correlation between QE and stock market rallies. Now John Ralfe, an independent pensions consultant, has conducted research to determine how beneficial QE has been to the stock market. Writing in the Financial Times (30th August 2012, page 26) he claims that the FTSE 100 would today be stood at 4,000 if it had not been for QE. At the time of writing the FTSE 100 is 5,750.

As I have suggested above, QE was never designed to boost the stock market but, like dropping a cup of water, the water will flow to an equilibrium position. The money produced by QE has flowed along a path of least resistance to an asset class that offered value and consequently offered a good opportunity for risk adjusted returns.

On 4th March 2009 (the day my son was born) and the day before QE was launched, the FTSE 100 stood at 3,646. In January 2010, at the end of the first round of QE, the FTSE 100 had risen to 5,188. This was a 42% gain – John claims had it not been for QE the market would have stood at 4,323.

As QE2 began 21 months later, the market stood at 5,544; only 7% higher. We are now on the third round of QE and again the markets have, up to now, benefitted again from the stimulus measures.

We anticipate today that Ben Bernanke will signal the US version of QE3 as they look to deal with a slowing economy and stubborn unemployment rate. This is partly the reason why we remain optimistic for equities for the rest of the year.

The value of your investment and any income from it may go down as well as up. You may not get back the original amount you invested.
Tax treatment is dependent upon individual circumstances and may be subject to change in the future.

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