Viaggio Wealth Partners

KESTRA INVESTMENT MANAGEMENT

Markets in a Minute
Quantitative Easing: What Is It and How Does It Work?

As the Federal Reserve Bank begins to dial back its pandemic-era stimulus measures, the risks of a policy misstep increase. But the central bank seems keenly aware that it must pull off a careful balancing act.

At the start of the pandemic, the Federal Reserve resuscitated a powerful (and relatively new) monetary policy tool — "quantitative easing". What is it and how does it work?

- Quantitative easing can go by many names: QE, increasing the money supply, monetary accommodation or printing money. Whatever the name, the mechanics are the same: The Fed buys bonds.
- QE differs from the Fed's more-traditional tool of increasing and decreasing the Fed funds rate, which impacts very short-term loans. Instead, quantitative easing influences longer-term interest rates more indirectly.
- The targeted outcome for QE is lower interest rates and more economic activity. With more demand for bonds, bond prices increase, yields fall and bond investors have more cash. With more cash in their pockets and bonds less attractive, investors will typically buy riskier assets, such as lower credit-quality bonds or stocks.
- Under the latest round of QE, the Fed has been buying $120 billion per month in government-backed securities. With this buying spree, the Fed's assets have more than doubled since the start of the pandemic, climbing to $8.5 trillion (37% of GDP) in the third quarter.

(see next page)

As a monetary policy tool, QE is a fairly new experiment, first used by Japan in 2001. It wasn't until the global financial crisis struck in 2008 that some of the world's largest central banks embraced QE after other expansionary policy tools (think ultra-low, short-term interest rates) had reached their limits:

- In the U.S., the Fed announced its first-ever round of QE in November 2008. By October 2014, it had launched a total of four rounds, adding nearly $4 trillion to the money supply and its balance sheet.
- The Swiss National Bank began a quantitative easing program in the wake of the financial crisis such that the bank's balance sheet grew to be larger than the Swiss economy at 115% of GDP.
- The UK's Bank of England launched a similar QE program to mitigate the economic fallout from Brexit, with mixed success.

What's next for the Fed's stimulus programs?

- After first hinting at it last spring, the Fed announced in November that economic conditions had improved enough for it to slow, or taper, the monthly pace of its asset purchases.
- The Fed is scaling back its asset purchases by $15 billion per month, which would bring the latest round of QE to an end by June 2022. It's worth noting that tapering doesn't involve the sale of assets: Rather, it entails gradually reducing purchases to zero.
- Once the Fed's QE program is wound down in 2022, it will then look to turn off its more-traditional stimulus by raising rates, but it may do so less swiftly than markets were anticipating earlier this year because of the potential risks posed by the new COVID-19 variant, Omicron. Long-term Treasury yields, which reflect long-term growth and inflation expectations, sank last week as investors sought safety in government bonds.

(see next page)

VIAGGIO WEALTH PARTNERS

KESTRA INVESTMENT MANAGEMENT

How will recent tapering of bond purchases and any subsequent rate hikes affect the U.S. economy and the markets?

- Higher rates should slow the red-hot housing market as borrowing becomes more expensive and dampen fixed-income returns. Yields, as measured by the 10-year Treasury, usually rise during periods of QE and fall as the Fed slows asset purchases. (For more insight on housing-market trends, watch Money with Murphy Episode 10.)
- By telegraphing policy changes well in advance of implementation, the Fed has so far avoided a repeat of the 2013 taper tantrum — a minor market sell-off triggered by then-Chair Ben Bernanke's mere suggestion that tapering would soon begin. Chairman Powell has said the episode "left scars on anybody who was working at the Fed at that time," which included him.

As they begin to withdraw stimulus, Fed officials are bound to feel as if they're piloting a freighter. Changing tack (or shifting policy) is certainly harder than doing more of the same given the higher degree of uncertainty. Yet the central bank must often change course before the full economic impacts of its policies are felt. Sudden moves or miscalculations may trigger volatility, as the Fed learned in 2013. But so far, the central bank seems committed to a market-friendly approach. Earlier this month, the White House also gave investors a sense of stability when it nominated Powell for a second term.

Important Disclosures

The opinions expressed in this commentary are those of Kestra Chief Investment Officer Kara Murphy and/or Viaggio Wealth Partners and may not necessarily reflect those held by Kestra Advisor Services Holdings C, Inc., d/b/a Kestra Holdings, and its subsidiaries, including, but not limited to, Kestra Advisory Services, LLC, Kestra Private Wealth Services, LLC, Kestra Investment Services, LLC, Kestra Investment Management, LLC, Bluespring Wealth Partners, LLC, and Grove Point Financial, LLC. The material is for informational purposes only. It represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. It is not guaranteed by any entity for accuracy, does not purport to be complete and is not intended to be used as a primary basis for investment decisions. It should also not be construed as advice meeting the particular investment needs of any investor. Neither the information presented nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. This material was created to provide accurate and reliable information on the subjects covered but should not be regarded as a complete analysis of these subjects. It is not intended to provide specific legal, tax or other professional advice. The services of an appropriate professional should be sought regarding your individual situation. Kestra Advisor Services Holdings C, Inc., d/b/a Kestra Holdings, and its subsidiaries, including, but not limited to, Kestra Advisory Services, LLC, Kestra Private Wealth Services, LLC, Kestra Investment Services, LLC, Kestra Investment Management, LLC, Bluespring Wealth Partners, LLC, and Grove Point Financial, LLC does not offer tax or legal advice. Viaggio Wealth Partners is not affiliated with Kestra Advisor Services Holdings C, Inc., d/b/a Kestra Holdings, and its subsidiaries, including, but not limited to, Kestra Advisory Services, LLC, Kestra Private Wealth Services, LLC, Kestra Investment Services, LLC, Kestra Investment Management, LLC, Bluespring Wealth Partners, LLC, and Grove Point Financial, LLC.