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The End of QE: Should investors be concerned?

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Every year the Chair of the US Federal Reserve gathers his or her fellow central bankers along with leading economists at Jackson Hole to discuss the state of the world's finances. This year was no different, except of course, like meetings the world over, it was held virtually across the internet, saving the planet a dose of CO2, if not the occasional dose of hot air.

Central bankers are not natural publicity seekers. Like journalists, if they themselves are the story, something is wrong. But, of course, many things have gone wrong in recent decades, not least, the virus epidemic that brought economic activity to a virtual cessation.

Consequently, as we all now know, central banks have deployed everything they have in the toolkit to support economic growth culminating in the provision of staggering amounts of Quantitative Easing, which is to say, the creation of huge amounts of freshly minted money, albeit by the stroke of a keyboard rather than by the whirr of the printing press.

It is quite clear though, that the bankers have been somewhat surprised by the strength and resilience of the recovery from the pandemic and, perhaps, not a little surprised by the success of their own policies, compounded as they have been, with the rediscovery of active fiscal policy by governments also mobilised to limit the damage from Covid.

To date, with the benefit of lessons learned following the financial crisis of a decade ago, official policy has been successful in steering economies through the Charybdis of the pandemic.

At their conference, central bankers would have observed: rising business and consumer confidence; low and falling unemployment and strongly rising property markets in economies as diverse as the US, Germany, UK, and Japan. Most importantly, they would be observing rising inflation which, somewhat paradoxically to those of us who are children of the 1960s and 70s, has been the object of central bank policy for some time.

In short, they would see a world economy in a strong upswing from the impact of the virus.

This success comes with a price tag: strong economies need less official support.

Much of the Jackson Hole conference was devoted to discussion surrounding the reduction, cessation, and withdrawal of unconventional monetary policy. Central bankers dearly want to retreat behind their thick institutional walls and return to the relative obscurity that envelops them like a child's comfort blanket.

For markets, it means that they will have to be weaned off their dependence on central bank money and face competitive capital markets for the first time in some years. This is what lay behind the "taper tantrum" when markets reacted very negatively to Ben Bernanke's attempt to slow the supply of central bank money to financial markets before Covid erupted.

So, how worried should investors be about this likely turn in central bank policy?

There is one good example of the long-run role of a central bank in the macro-economic stabilisation of the public finances and that is the story of the British Empire.

Isaac Newton is said to have lost his fortune in the South Sea Bubble of 1720, a warning to all that even the best and brightest can be sucked into a financial mania. The Bank of England expanded its balance sheet to over 20% of GDP (a

similar amount to today) to support the economy following the crisis.

It took 189 years for the Bank's balance sheet to return to where it was immediately prior to the pricking of the bubble. In other words, the Bank removed the then equivalent QE at a rate of 0.75% per annum.

We think that there is an important lesson there for investors.

A recovering economy will result in the ending of unconventional policy and central banks will wish to unburden their balance sheets. But this need not result in a major financial shock since, unlike you and me, the holding period of an asset for a central bank is virtually limitless.

There will, doubtless, be dire headlines when the time comes, but if policy is carefully calibrated, economies can survive and thrive even as official support is withdrawn. The end of Quantitative Easing would normally be a cause for some celebration; it means economies are back on their own two feet. The sheer scale of the priming of the global economy with liquidity, however, means it is best to take a balanced view: if volatility rises, good quality companies will become cheaper to own and if it doesn't, good quality companies will continue to benefit from their improved competitive positions following the Pandemic. We don't pretend that there will not be asset price volatility and even corporate casualties, but it is our belief that our focus on quality businesses will enable our investment strategies to weather the storm.

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