Has QE come to an end?

In March 2009 the UK government embarked on a journey into the unknown when it started a process called Quantitative Easing in which it helped monetary conditions by buying gilts with money it had created. It wasn't the first central bank to do this. The Federal Reserve of the USA had already started and later on both the ECB and the Bank of Japan undertook similar programmes. China also helped by liberally financing all-sorts of infrastructure and building projects.

These actions were in response to the financial crisis of 2008 which left most large international banks with huge losses which effectively brought lending to an abrupt halt and caused economies to stall. QE was the government response to restart growth. It has taken a long time to work and bank lending is still lacklustre but it did have the effect of increasing asset prices, most obviously bonds but also property and equities as well as commodities and classic cars amongst others.

However, by the middle of last year it was plain that this effort was running out of steam. First, commodity prices fell and then, towards the end of last year and into the first few months of this year, equity markets weakened accompanied in some places by lower property prices.

Equity markets bottomed on the 11th of February and, as is so often the case, it was the sectors everyone hated that did best in the subsequent recovery. This time it was commodity producers. Oil and mining stocks were flashing "buy" signals at that time on a variety of measures and their subsequent rise must have discomfited lots of sub-editors and professional commentators who had written the sectors off for good.

One consequence of this has been that value funds have suddenly returned to the top of the relative performance league tables having languished at or near the bottom for most of the last seven years.

It seems that QE effectively pushed money into the higher risk areas of a variety of markets because it gave the biggest boost to investors who already had access to debt and now were suddenly paying a lot less. This boost to liquidity went, as might be expected, to the least liquid parts of a variety of asset classes such as emerging markets, high-end properties and small cap growth equities. However, it seems the effect on the underlying economies has been less transformational.

QE, it is to be hoped, is a one-off event. But now that the surge in asset prices is dissipating, because of the lack of external rocket fuel to propel them ever higher, the markets are left contemplating what is left. French Bank Société Générale put it very well about a year ago when it pointed out that in the previous three years the MSCI World Index had risen by 38% but reported profits had only increased by 3%. Back in the normal world once again assets have to sustain themselves on the cash they generate, not on their attraction as a trophy for others to aspire to own.

In the years when QE reigned the underlying business conditions had not dramatically improved, but the prices investors were prepared to pay for them had. That was an environment that favoured growth and momentum investors and disadvantaged value investors who looked through the noise to get a flavour of what they were actually buying. Although it is still very early there are signs that tilt changed mid-way through the first quarter as evidenced by the poor performance of a number of hedge funds favouring growth and momentum but investment strategies that are biased to value have done better.

Whether this change in investment style marks the end of QE is almost impossible to say. But it is very welcome news to value investors everywhere who have suffered for seven years while others have prospered from embracing more and more risk.