



Fed's Bernanke Has Shown His Hand: No Rate Hikes! Should Equity Investors Celebrate?

On Monday, Chairman Ben Bernanke provided an economic update at the Economic Club of Washington. In our view, the key takeaway from his speech is the non-conventional tightening mechanisms the Fed intends to use when economic conditions warrant a tighter monetary stance. While such mechanisms imply a prolonged period of low interest rates, history shows that a trading-range environment for the stock market remains the most likely scenario next year.

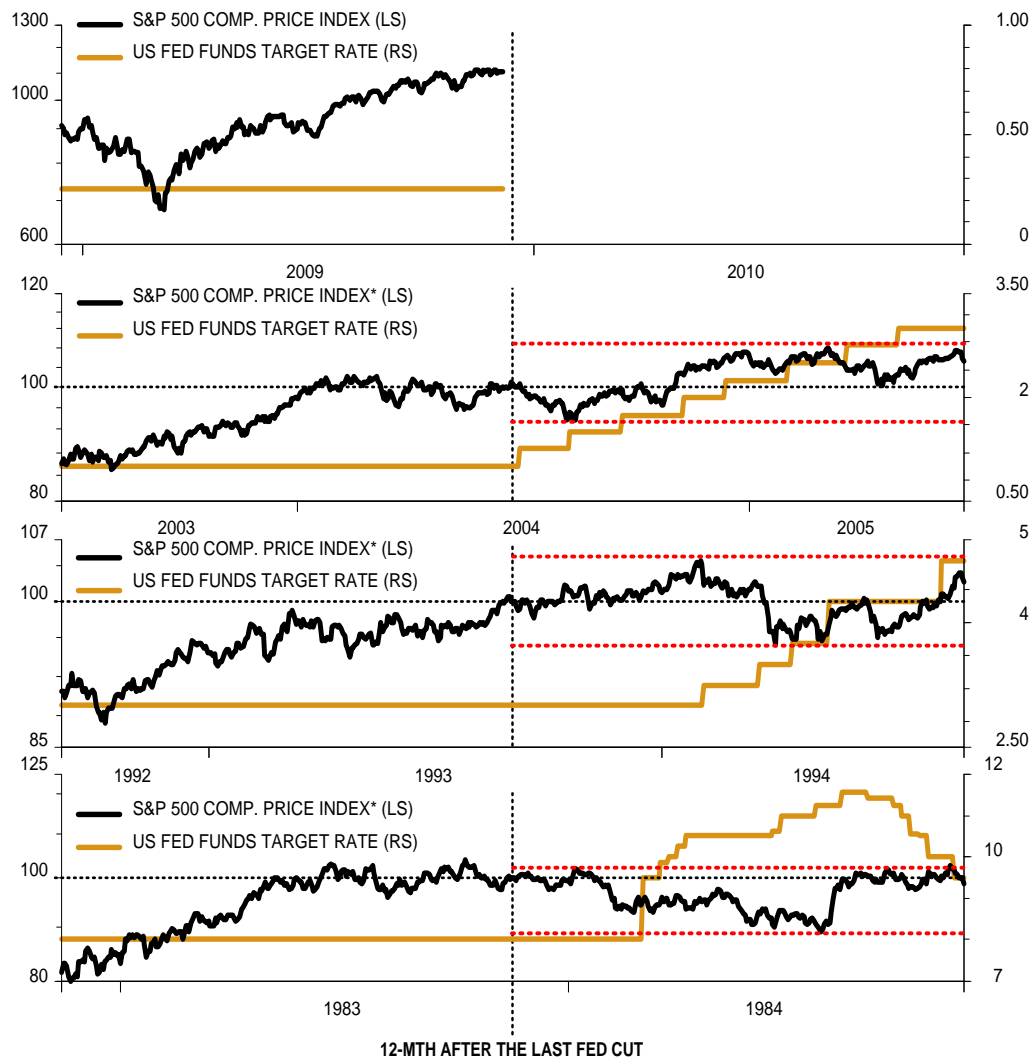
It may be just our imagination, but after reading [Ben Bernanke's speech](#) a few times, it seems that the next US monetary tightening cycle will be initiated through Japanese-like monetary mechanisms as opposed to conventional rate hikes. Indeed, the Fed spent a great deal of time explaining how it can apply upward pressure on short-term interest rates by: 1) raising rates on banks' balances sitting at the Fed, 2) using reverse repurchase agreements, and/or 3) reducing the size of the Fed's balance sheet. The net result is a prolonged period of low interest rates. Also, as in the 70s and 80s, US monetary aggregates could become the mean to gauge the Fed's monetary bias. But what does it mean for equity investors?

It has been 12 months since US Fed funds were cut to 25bps. A similar status quo on short-term rates was seen in 2003-2004 (12 months), 1993-1994 (16 months) and 1983-84 (17 months). Interestingly, these episodes are all post-recession periods and the chart at right shows that the stock market has tended to behave erratically 12 months after the last Fed cut. Obviously the apprehension of higher interest rates is what causes market choppiness, with the possibility of double-digit corrections.

But the key here is that history suggests a trading-range strategy for equity investors in 2010, where stock market weakness is bought and strength sold. This is a view we have expressed and supported in recent strategy wires to justify a neutral equity stance in our tactical asset allocation.

Bottom line: Consistent with the Fed's views, investors have priced out Fed rate hikes for the next year. However, this does not necessarily represent a green flag for equities. History suggests that prolonged periods of low interest rates have translated into much market choppiness. Accordingly, a trading strategy of selling strength and buying weakness may be optimal in 2010.

EQUITY MARKET: A RANGE-BOUND SCENARIO FOR 2010?



* REBASED TO 100 12 MONTHS AFTER THE LAST FED CUT

Source: Dundee Securities Corp., Thomson Datastream

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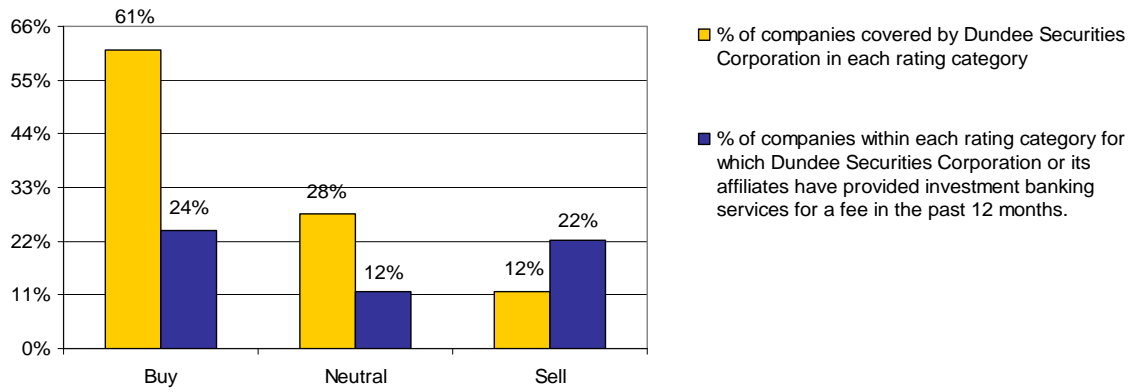
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Dundee Securities Equity Research Ratings



As at March 31, 2009

Source: Dundee Securities Corp.