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What Fed Move Means for Investors

By Jonnelle Marte

The Federal Reserve announced Wednesday that it will extend its bond-buying program, Operation Twist, through the end of the year – a move experts say could have far-reaching implications for investors.

Citing slower household spending, weaker job growth and lower inflation, Fed chairman Ben Bernanke said the central bank would continue the program, started last August, which involves selling shorter-dated bonds that mature in less than three years and using the proceeds to buy longer-dated Treasury bonds. In the first round of the program, which was scheduled to end this month, the Fed sold $400 billion of short-term bonds; it will sell another $267 billion in bonds this time around.

Experts say the strategy, which is meant to encourage more borrowing by lowering long-term rates, could have a ripple effect across the markets, affecting everything from bonds to stocks – even gold. In the short term, quantitative easing programs tend to boost investor confidence, leading to a rally in stocks. Longer-term, experts say the program could lower bond yields for corporate bonds and Treasurys. “There are a lot of areas that their policy tends to impact,” says Brian Jacobsen, chief portfolio strategist for Wells Fargo Funds Management.

To be sure, the Fed has swayed markets less and less with each round of quantitative easing, analysts say, meaning the effects of this program could be muted. For instance, while Treasury yields rose following the announcement of QE1, QE2 and Operation Twist, the increase diminished with each round, says Anthony Valeri, a fixed income strategist for LPL Financial. Some other forces, like investors’ concerns over the European debt crisis, may have a larger impact on bond and stock markets, advisers say.

That said, experts say investors should expect some market movements. Here are a few of the likely consequences for investors, and the strategies experts say may be warranted.

Stocks

Equity markets tend to rally during periods of quantitative easing, but the boost may be short-lived, says George Kiraly, an adviser with LodeStar Advisory Group in Short Hills, N.J. That’s especially the case if investors believe the Fed’s efforts aren’t enough to substantially help the economy, he says. Indeed, the Dow Jones Industrial Average dropped about 90 points immediately following today’s announcement but bounced back in afternoon trading.

Gold

Precious metals like gold tend to pop following quantitative easing from the Fed since bond-buying programs can lead to higher inflation expectations. But advisers say investors hoping to take advantage of this potential boost should tread carefully. Kiraly only recommends buying gold if it tops $1,640 an ounce. Because gold has been trading in a range between $1,500 and $1,640 an ounce (today it’s near $1,620), if it breaks above that range, it could be a sign of upward momentum for the yellow metal, he says.

High yield bonds

Unlike Treasurys, stocks and gold, high-yield bonds don’t normally get an immediate boost when the Fed starts a bond-purchasing program. Corporate bond yields actually increased – and prices dropped– following the start of QE2 and Operation Twist, a sign that investors viewed the bonds as riskier, says Valeri. But over the intermediate to long term, those corporate bond yields came down after QE1, QE2 and QE3 as investors gained confidence in the economy and became more comfortable taking on risk and prices rose.