THE OMNIVEST MARKET VIEW

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The Wealth Effect of Quantitative Easing

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While there is a raging debate as to whether quantitative easing will produce jobs and economic growth, there should be no debate as to the wealth effect associated with quantitative easing so far.

Since March 18th 2009, when the Federal Reserve first engaged in quantitative easing by announcing that it would purchase $750 billion of agency MBS and $300 billion of Treasury securities, the US financial markets have appreciated significantly. The S&P 500 Index from March 18th 2009 to present has gained approximately 105%. At the same time, the Treasury market has gained 15%, investment grade corporate bonds 54% and high yield bonds 111%.

Investors who have followed the Fed would have clearly benefited from the Fed's efforts to stimulate economic growth by focusing on asset prices. Hidden beneath the total return numbers has been the substantial change in borrowing costs throughout America.

In March of 2009, the average cost of the yield borrower was an astounding 19.6% and has since fallen to slightly below 7.0%. Investment grade borrowers were faced with an 8.0% borrowing cost which has now fallen to slightly below 3% and the cost of a 30-year fixed rate mortgage has fallen from 5.15% to 3.51%.

While the financial markets have improved substantially, the labor market has proven to be lackluster. In March of 2009, the U6 Unemployment rate (total unemployed plus all marginally attached workers plus total part time workers) stood at 15.7% and is currently only at 14.7%; a key reason why Fed Chairman Ben Bernanke has extended quantitative easing and, more importantly, why the Chairman did not assign an end date to asset purchases.

At this point in time, investors have a more difficult investment decision to make with yields at extraordinary low levels. It is our view that low quality assets will continue to outperform the high quality assets. Without a doubt, agency MBS (mortgage backed securities) yielding less than 1.5% should be avoided and instead, investors should focus on private label distressed MBS. In the corporate market, investors should continue to focus on the high yield sector with yields hovering near 7%.

It is also our view that equities will provide the best total return over the next six to twelve months. We fully well anticipate that the S&P will reach new highs, if not late this year, early next year. Global Central Bank easing will keep interest rates at unattractive levels allowing equities to remain very competitive with traditional fixed income investments. Dividends may be interesting, but should not be the only impetus for shifting from fixed income to US equities. Valuations are still reasonable and thereby should support further gains for the US equity markets.