

“What you should know about quantitative easing”

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The financial markets have performed extremely well since the lows in March of 2009. The major indices have gained nearly 100%, but it is important to realize that during the recovery the market has not risen uninterrupted.

One of the influences on the stock market's recovery has been the Federal Reserve and their two rounds of quantitative easing; referred to as QE1 and QE2. Quantitative easing is a program in which the Federal Reserve Bank buys U.S. government securities in an effort to increase the money supply. This in turn promotes lending and liquidity throughout financial institutions.

As I said, QE1 and QE2 tend to have a significant influence on the market. QE1 started in November of 2008 and came to a close in March of 2010. During that time, keeping in mind the market was still declining through March of 2009, the overall effect was a gain of

22%. However, during the post-QE1 months of May to September the market contracted about 16%.

The Federal Reserve decided that another round of quantitative easing was necessary to support the recovery. QE2 began in November of 2010 and, at the time I'm writing this, stands to end in June. QE2 has given the markets a 30% boost since September of 2010.

So, you're probably wondering why I've given you this information. The point is—when the Federal Reserve institutes a policy of easing the financial markets tend to respond positively. However, when that policy comes to a close the following months may see a decline in the market overall. When QE1 came to an end the contraction lasted five months and approached 20%, and there is the possibility of a similar situation unfolding once QE2 ends.

It is important that you or your advisor are aware of these fluctuations and adjust your portfolio as necessary as investors tend to lose focus when the markets are performing well. It's important to have an investment discipline and adhere to it to help navigate the inevitable ups and downs of the equity markets.

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