

Title: **MONETARY POLICY DRIVERS OF BOND AND EQUITY RISKS**

Speaker: **Caroline E. Pflueger, University of British Columbia**

Importance: Why this matters:

Federal Reserve policy can be divided into three regimes: pre-Volcker 1960-1978, Volcker/Greenspan 1978-2001 and neo-Keynesian 2002-present. Each regime creates different investor environments. Thus the ability of Treasury bonds to hedge economic and equity risks has huge implications for investors.

Investigation: "Speaker analyzed XXX data to address the questions yyy, zzz, etc."

Authors gathered standard US economic and fed policy data from 1960 to the present, and data from other economies to evaluate how these different regimes resulted in different responses to macroeconomic shocks and changes in monetary policy.

Innovation: Are there new techniques of interest in the data or approach to the problem?

The authors create a structural macroeconomic model with parameters that describe:

- How much the Fed worries about recessions and cuts rates to prevent them;
- How much the Fed worries about inflation and raises rates to prevent it;
- How gradually the Fed moves when it changes rates.

These variable manifest quite differently in the three regimes, and in how the economy responds to shocks due to money supply, short-term monetary considerations and inflation target (long-term monetary) considerations.

Insights: 1-2-3, what are the three most important things the speaker offered?

1. Not surprisingly, changes in the guiding philosophy of the Fed cause remarkably different economic activity and financial results.
2. Asset allocation exercises often treat the risks of asset classes as stable, even if the expected returns are thought to vary over time.
3. Bond risks and correlations with the stock market have moved over time, and depend on macroeconomic shocks and the stance of monetary policy.
4. While there is no reason to expect any immediate change, investors must keep a careful eye out for a change in the bond beta back towards the historical norm.
5. You can't rely on Treasuries being negatively correlated with stocks.

Audience rating: **3.84**