



Investments: The Overreaction of September 2011

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By: Joe the Investor

What happened to the global markets during September 2011, specifically the week of September 19th? There was a series of news releases that occurred in a short period of time, presented in an environment of heightened fear, that initiated the reaction of the markets. What instruments rose during this period? The US dollar and US short term Treasury bills. These were the two beneficiaries of the market events and tend to rise during periods of maximum fear. Keep in mind some important tenets in investing: “Timing is everything”, “Markets tend to discount future news”, and “Don’t Sell in a Market Panic”.

The catalyst for the market slide was the FOMC meeting which took place on September 19 and 20th, 2011. Take note that this meeting was indicated far in advance **(18)**, (numbers in brackets indicate sources of information which are provided at the bottom of this article), and “Operation Twist” was speculated upon weeks ahead of the September meeting **(9)**. Operation Twist is described as the selling of shorter term bonds, and the purchase of longer term bonds to “twist” the yield curve such that long term rates will stimulate economic growth, via more spending **(7)(8)(9)**. The dollar amount was also revealed ahead of the meeting, although only through speculation and only within days of the actual FOMC announcement - \$400 Billion USD **(10) (11)**. When the decision of the Federal Reserve meeting was officially disclosed on Wednesday September 21st, Operation Twist was indeed announced, and the market thought the effect would be lackluster, and initially didn’t move very much **(19) (20)**. Markets tend to react within minutes of a news announcement – especially for something that is unexpected and negative. In this case, the reaction occurred about 30 minutes after the 2:15 pm announcement on Wednesday September 21, and continued on through Thursday and Friday September 22 and 23, 2011 - see chart 3 below **(20)**. Along with Operation Twist, the FED also stated that the US economy was struggling **(5)(6)**. This statement initiated the negative market reaction, but why? Take note that the US economy was struggling for a while; **(1)** a manufacturing index above a level of 50 shows expansion, but 50.6 is close to a contraction for this index. The word recession was stated in this news release, indicating that this idea is not new, and was in focus back in August 2011. Quantitative easing was implemented over the last 3 years (QE1 and QE2 since 2008) to prevent a recession. For more evidence, look at the GDP, housing and unemployment numbers since 2008 as these are all very weak **(21) (22)**. Therefore, Bernanke’s statement was simply reaffirming what was actually happening in the US economy. What **IS** new is the reaction of the markets to his statement.

What else was happening on Thursday September 22 and Friday September 23? Europe. The Greek debt crisis has been going on for some time **(4)**. During these two days, the Eurozone announced that their economy is also weak. Once more, this is not new as the PIGS crisis and the bailout of the Greek debt has been in the news for months **(2)(3)**. The austerity measures that are being implemented in Europe will tend to slow economies down, due to less money available for consumption (i.e. higher taxes, less government spending and reduced pension payments). If the market is factoring in future economic activity, a recession in Europe is very possible and is likely already factored into market prices.

The third news event in this two day period was the data from China that indicated that Chinese growth was slowing down as well. China has been trying to slow down their economy for years due to high inflation **(12)(13)**, and have raised interest rates many times **(12) (13)**. Once more, overreaction to the Chinese economic news was very large even though there was not anything new announced.

If you look at all of these news releases together, you will find that the US Dollar has strengthened because the other alternatives are less appealing. In terms of other available safe havens, the Swiss Franc decided to peg their currency against the Euro at this time **(15)**, which would discourage investment in the Swiss Franc in times of crisis. Also, the CME decided to raise margin limits on gold and silver on Friday September 23, 2011**(14)(17)**. This type of action is usually initiated when metals get overbought, or are rising too quickly. By Friday, gold and silver had plunged more than 10% in two days – see charts 1 and 2 below. **(17)**. Furthermore, once a panic has started, whatever investment has the greatest gains is sold first to meet margin calls **(14)**. In this case, the asset class was gold and silver. This will lead to further weakening of these metals, and more strength in the US dollar.

What is the conclusion? All of these news events were released within a week's time, and the overreaction has been swift even though nothing presented was really that new. The underlying fundamentals of the US economy, the European economy, the Chinese economy and metals have not changed much in the last week. "Don't sell in a market panic" because there is a panic - is the key thing to remember here. Markets tend to overreact in a heightened state of fear, and then correct again to prior levels as the fear passes.

Chart 1

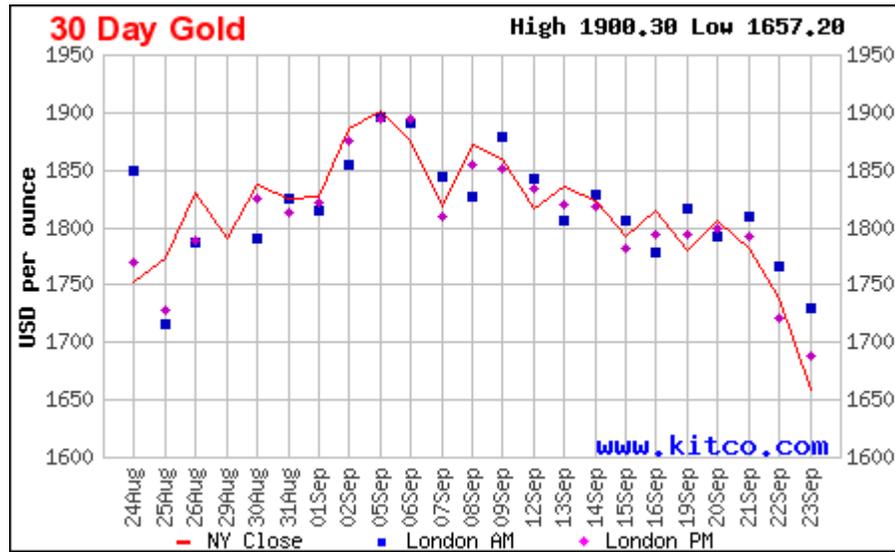


Chart 2



Chart 3



Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what these options are. **Note: This site is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**

News Sources:

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- 5) http://online.wsj.com/article/SB10001424053111903895904576546611494528714.htm?mod=dist_smartbrief
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- 8) <http://currency-blog.com/2011/09/19/usd-weekly-forecast-19th-23rd-september-2011/>
- 9) <http://money.cnn.com/2011/08/19/news/economy/thebuzz/index.htm>

- 10) <http://blogs.wsj.com/marketbeat/2011/09/20/goldman-sees-fed-buying-300-billion-to-400-billion-in-operation-twist/>
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- 17) <http://www.kitco.com/charts/livegoldnewyork.html>
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- 19) <http://blogs.wsj.com/marketbeat/2011/09/21/operation-twist-a-solution-in-search-of-a-problem/>
- 20) <http://finance.yahoo.com/charts?s=GSPC#chart1:symbol=gspc;range=5d;indicator=volume;charttype=line;crosshair=on;ohlcvvalues=0;logscale=on;source=undefined>
- 21) <http://www.tradingeconomics.com/united-states/gdp-growth>
- 22) <http://www.tradingeconomics.com/united-states/unemployment-rate>