Special Report

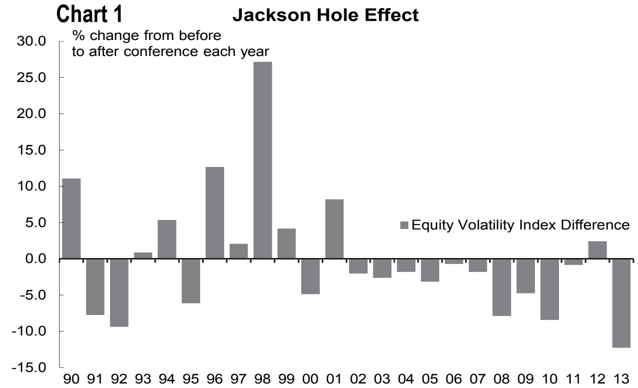
Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Fed's Jackson Hole Symposium Could Shake Up Markets

- **Volatility is usually affected by the Fed's annual symposium, and it could easily happen again this year.**

The Federal Reserve's annual Jackson Hole symposium clearly matters to markets, and volatility trades surrounding the event stand a chance at paying off handsomely. Developing a mechanistic directional trading strategy ahead of the annual Fed symposium, however, is probably unwise as opposed to evaluating each year's context. A reasonable case can be constructed for why this year's event could give rise to adverse effects on stocks and Treasury prices and put a bid to the USD. This view strengthens in the context of how we think the Fed debate will progress over the rest of the year.

Chart 1 **Jackson Hole Effect**

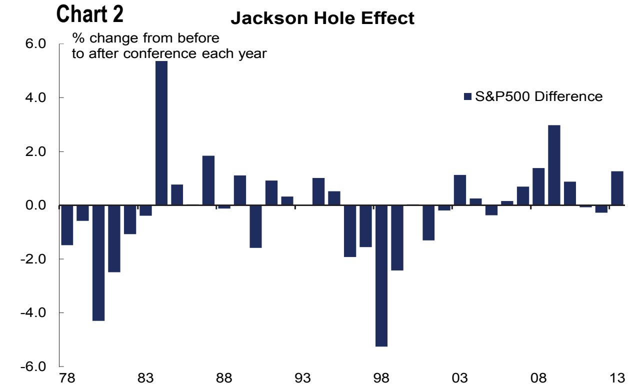


Source: Kansas City Federal Reserve, Bloomberg, Scotiabank Economics.

Effects On Volatility

On average since 1990 (as far back as we have VIX), **Jackson Hole has sparked a 6% change (using absolute values) in the VIX measure of equity market volatility** between the day before the symposium commences and the first trading day after it ends. Some years have resulted in massive increases in volatility (like 1998 at +27%) and some witness very little change (chart 1), and so we also want to consider the median change which also turns out to be sizeable at almost 5%. I don't know of too many annual events with known timing that can give rise to such potential effects on volatility.

Chart 2 **Jackson Hole Effect**

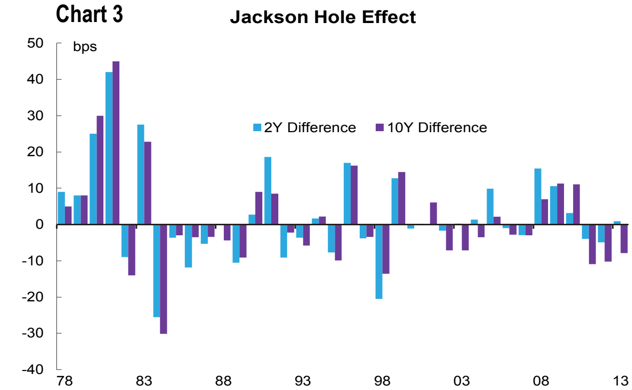


Source: Kansas City Federal Reserve, Bloomberg, Scotiabank Economics.

Effects On Stocks

As for stock valuations, chart 2 shows that they were the most vulnerable to Jackson Hole (JH) developments in the late 1970s and the mid-1990s — both of which saw the Fed turn toward more restrictive monetary policy as it may be about to now. Material stock effects still emerge over more recent years. The JH risk facing stocks this year is probably skewed to lower valuations.

Chart 3 **Jackson Hole Effect**



Source: Kansas City Federal Reserve, Bloomberg, Scotiabank Economics.

Effects On Treasuries

Treasuries were the more vulnerable asset class in the early years of the Jackson Hole symposium measured

Scotiabank Economics

Scotia Plaza 40 King Street West, 63rd Floor
Toronto, Ontario Canada M5H 1H1
Tel: (416) 866-6253 Fax: (416) 866-2829
Email: scotia.economics@scotiabank.com

by changes in yields on 10 year and 2 year Treasuries before and after the event (chart 3). Measured this way, the peak JH effects were in the early 1980s when Fed Chairman Volcker was wrestling inflation lower and when Jackson Hole arguably mattered more before the Fed went on its long journey toward greater openness. Back then, a ticket to JH was more likely to matter to bond land. Measured another way (chart 4), the potential changes to Treasuries coming out of modern day Jackson Hole symposiums matter more in relation to the day's starting level on yields. The JH risk facing Treasuries this year is probably skewed toward a cheapening bias.

Effects On The USD

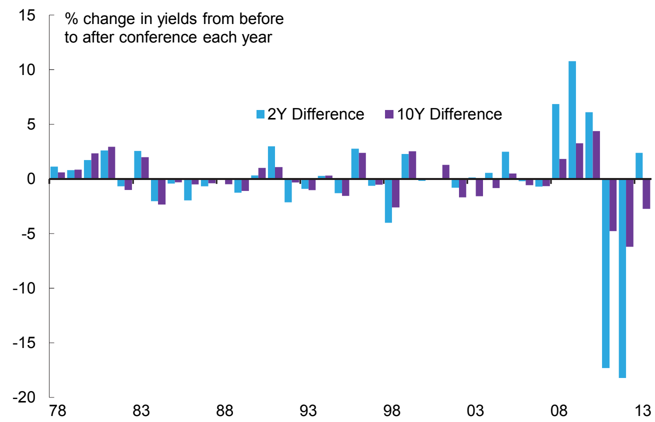
Currency markets appear to have been more sensitive to developments at Jackson Hole over the past decade including years stretching before the crisis (chart 5). USDCAD has fallen (USD depreciated) more often than not following Jackson Hole over the past decade. This is the short-lived announcement effect of Fed measures, whereas the sustained effects on the USD by any measure over the crisis period do not support the view over the years that the Fed has been debasing the currency (chart 6). The JH risk facing the USD this year is probably tilted toward at least short-lived appreciation.

On The Way Toward More Exit Talk 'Later In The Year'

In the current year's context, we could be setting up for gradually more hawkish references at this year's Jackson Hole symposium and the September 16th-17th FOMC meeting. Recall that at the July FOMC, Chair Yellen said "...and hope we will be able to come back with a full description, or let's think of it as a revised set of exit principles, later this year." The part about "later this year" has us figuring on the September FOMC partly because this dialogue would likely need a press conference which would rule out the October FOMC, and partly because it might make the most sense to hold this dialogue before the bond purchase program ends which is likely in October. The back-up risk, however, clearly remains December should the Fed decide to wait until after concluding bond purchases before having a fuller dialogue on what's next. Either way, we think volatility centered upon Fed actions is poised to pick up over the remainder of the year, and it's possible that the Fed could use Jackson Hole to gradually begin this dialogue and thus build upon a somewhat more hawkish FOMC statement in July.

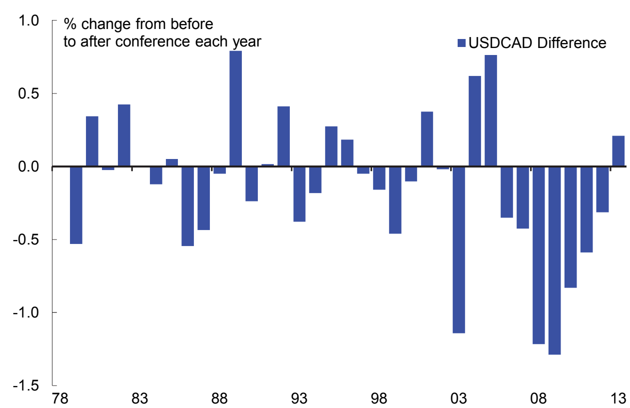
Special thanks to Andrew Gorsky in our research group for his assistance.

Chart 4 **Jackson Hole Effect**



Source: Kansas City Federal Reserve, Bloomberg, Scotiabank Economics.

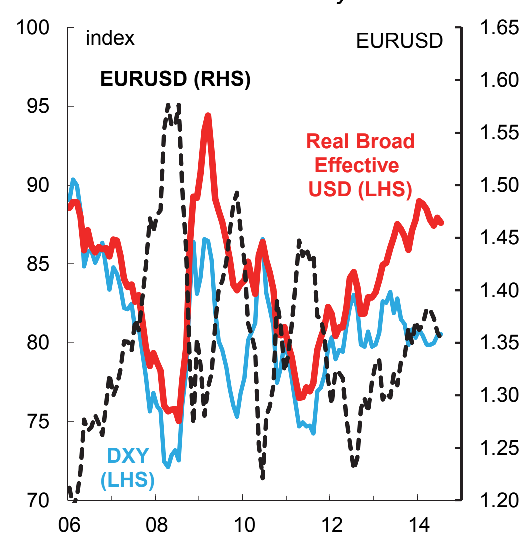
Chart 5 **Jackson Hole Effect**



Source: Kansas City Federal Reserve, Bloomberg, Scotiabank Economics.

Chart 6 **What USD Debasement?**

USD Flat Across Variety of Metrics



Source: Bloomberg, Scotiabank Economics.