BUSINESS

Investors' gain is savers' loss

Fed's easing to weaken dollar, keep interest low while boosting inflation

By John Waggoner
USA TODAY

The Federal Reserve is aunching its second ound of quantitative eas- ng, and stock investors should get a rise out of it. But savers and bondholders won't be too happy.

QE2 will pump more money into the system to avert deflation — a period of falling prices.

The Fed's action was widely anticipated, so much of its impact may have already been priced into the markets, says Bill Stone, chief economist at PNC Financial.

Still, QE2 might be good for stocks, because it may force money from bonds and savings accounts into the stock market. Higher household 401(k) balances and brokerage accounts will make people feel wealthier and spend more, stimulating the economy, Stone says.

Higher stock prices make corporate leaders less cautious. "There's nothing that makes a CEO more confident than his stock price going up," says Robert Doll, chief equity strategist for fundamental equities at BlackRock. Other consequences:

■ A weaker dollar. All other things being equal, more greenbacks in the system means a lower value for each dollar. When the dollar falls, U.S. exports are cheaper, which boosts manufacturers. A falling dollar also gives international funds a lift: Gains from abroad rise in value when the dollar drops. But the dollar won't collapse, says Ken Heebner of CGM Mutual.

"There's no alternative currency," Heebner says. Investors have lingering doubts about the euro, the value of China's currency is determined by its government, and the Japanese yen is too narrowly based.

■ Low mortgage rates. Mortgage rates follow Treasury rates, which the Fed aims to keep low through QE2. The average 30-year mortgage rate is 4.23 percent, says mortgage giant Freddie Mac, down from 5.09 percent at the start of 2010.

■ Higher inflation. The Fed is fighting deflation with inflation, and QE2 will probably do just that, eventually. The normal beneficiaries of modestly higher inflation are stocks, commodities and precious metals. If the Fed loses control of inflation, however, stocks will get hurt.

Bond investors won't like the Fed's move. Bond traders view inflation the way Dracula looks at sunlight. When inflation rises, traders push bond prices down and interest rates up.

Income from bonds won't be enough to compensate for falling bond prices, Heebner says. (If you hold a bond to maturity, however, you'll get the face value of your bond when it matures.)

There's no relief in sight for savers. Rates on money market mutual funds and bank CDs track the fed funds rate, which is currently stuck between zero and 0.25 percent.