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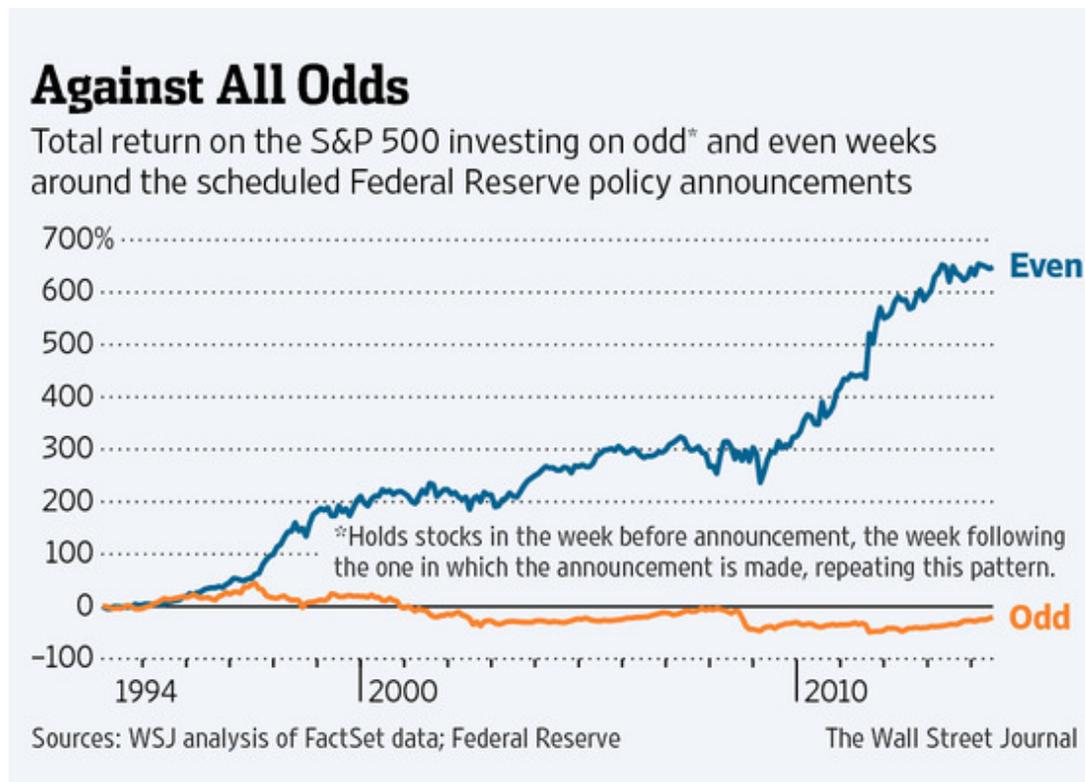
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HEARD ON THE STREET

Making Money With the Fed: Don't Get Mad, Get Even

By JUSTIN LAHART

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In these postcrisis days, it is taken for granted that the Federal Reserve exerts a powerful influence on the stock market. But that influence may be getting exercised at far more regular intervals than either investors or the Fed itself suspect.

Consider the following investing strategy: On the day before a Fed policy announcement, buy the stocks in the S&P 500 index. Sell them a week later, and buy them again the following week. Stick with that pattern until the Fed next meets.

Sound ridiculous? A portfolio run this way since early 1994, when the Fed's policy-setting committee began publicly announcing interest rate decisions, would have returned about 650%. That is significantly better than the S&P 500's total return over the entire period of about 505%.

The pattern of stocks performing better in even weeks of the Fed cycle—the week of the policy-setting meeting, two weeks after it, and so on—is persistent. Given financial markets' complexity, though, it is possible to find many interesting, significant-seeming patterns that are really just matters of chance.

But there may be more at work here, think economists Anna Cieslak of Northwestern University and Adair Morse and Annette Vissing-Jørgensen of the University of California Berkeley.

The pattern appears robust, with clear peaks and valleys in returns during even and odd weeks that appear statistically significant. Splitting the data into three subperiods—1994 through 2000, 2001 through 2007 and 2008 onward—they found the pattern still held. International stock returns follow it as well.

What might be driving it? One possibility is the Fed itself.

The dates for the eight policy-setting meetings the Fed sets each year come at different times of the month, and have moved around over time, so they haven't regularly lined up with economic releases or corporate earnings reports (The next one, for example, comes at the end of this month.) Moreover, the economists found that volatility in the federal-funds futures market, where investors bet on the course of the Fed's overnight target rate, follow the same pattern.

Neither reports from the Fed nor speeches and testimony from Fed officials follow the pattern. But since 2001, the Fed's Board of Governors discount-rate meetings have tended to fall into the biweekly cycle.

The purpose of these is to consider discount-rate requests from regional Federal Reserve Banks, but they also host discussions on the economy and policy, the economists say. They also note that before 1994, when the Fed more frequently adjusted rates between policy meetings, it disproportionately made those adjustments during the biweekly cycle.

So one scenario goes like this: Board members tend to gather on even weeks after the Fed's rate-setting meeting to talk things over. The content of those discussions makes its way into financial markets, maybe through news reports, maybe through people in business, finance or academia that the Fed talks to, maybe through some combination of sources. As a result, investors have greater certainty on the direction of policy, and stocks rise.

Without more evidence of exactly how that might be happening, it is hard to determine whether this is the real story, or if the pattern the economists have identified is simply a remarkably persistent fluke. Anyone hoping to take advantage of the pattern might find its results don't live up to its past performance. But if it continues to make money, the importance of figuring out exactly what is driving it will intensify.

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