Discussion of:

"Active Monetary or Fiscal Policy and Stock-Bond Correlation"

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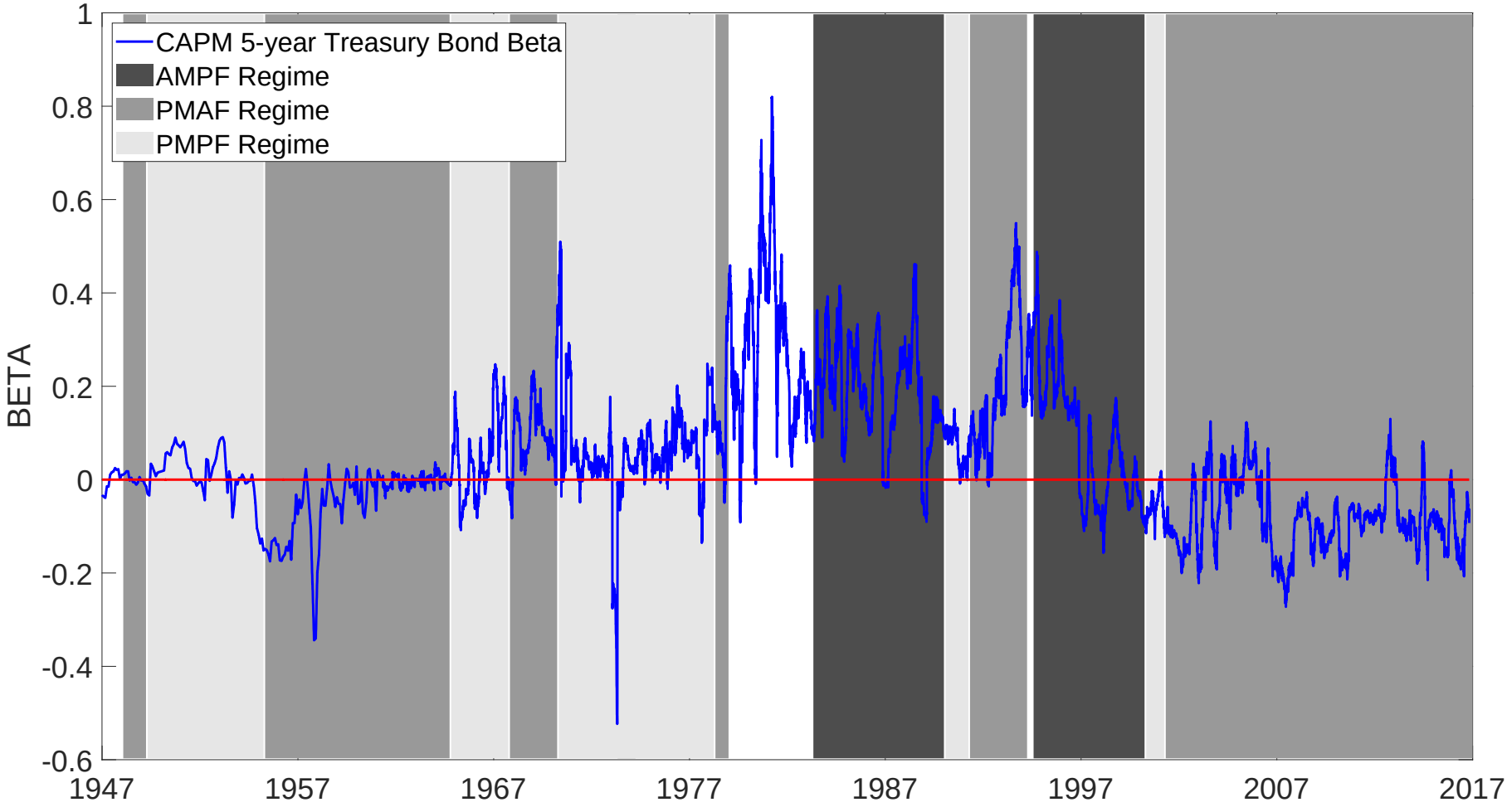
Background



- ✓ This paper provides an explanation that rationalizes the time-varying correlation between stock and bond returns for the US.
- ✓ A model with active/passive monetary and fiscal policy regimes.

What Do We Learn?

- ✓ **Active Monetary & Passive Fiscal Policy (AMPF)**
  - The key driver is the permanent technology shock,
  - The resulting stock-bond correlation is positive.
- ✓ **Passive Monetary & Active Fiscal Policy (AMPF)**
  - The primary driver is the marginal efficiency of investment shock,
  - The implied stock-bond correlation is negative.
- ✓ **Passive Monetary & Fiscal Policy (AMPF)**
  - Both technology & monetary policy shocks dominate the marginal efficiency of investment shock,
  - The implied stock-bond correlation is positive.
- ✓ **Active Monetary & Fiscal Policy (AMPF)**: no equilibrium.

My First Reaction

"An excellent paper, a rich model and interesting implications"

Comment I

On the negative stock-bond correlation

- ✓ The stock-bond correlation has been persistently negative since the financial crisis. Other PMAF regimes display a positive correlation.

- ✓ Was monetary policy really passive over the last decade?

  Yes if you consider an inflation-targeting policy under financial stability

  Perhaps No if you consider an inflation-targeting policy under financial instability

- ✓ The Taylor rule ignores how the Fed deals with financial instability
  - An augmented rule where the Fed takes into account the deterioration in the balance sheet of financial intermediary and responds with a loose monetary policy,
  - This would allow you to possibly explore a different channel.

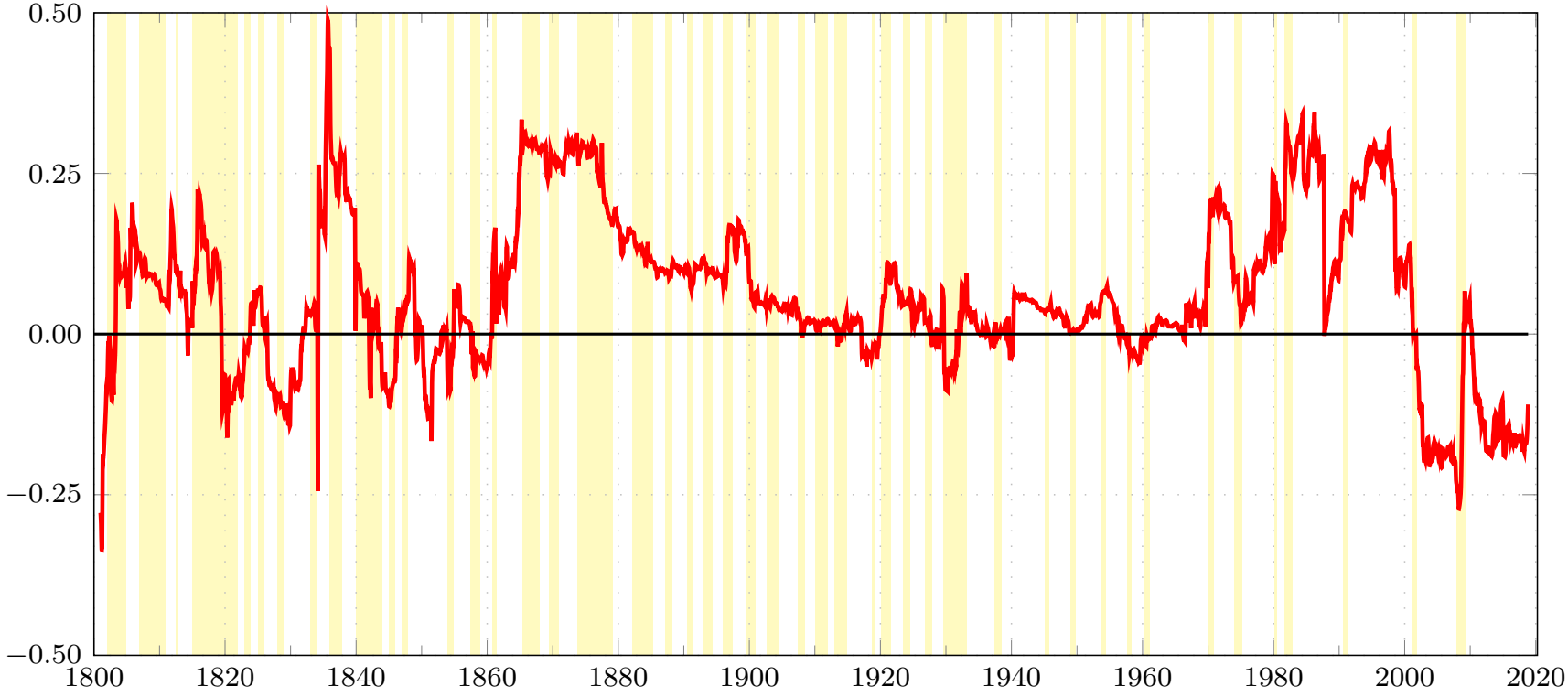
Comment I (cont'd)

On the negative stock-bond correlation

- ✓ The post-crisis strong negative stock-bond correlation due to QE
  - Low Fed Funds rate drove bond yields $\downarrow$ and stock prices $\uparrow$,
  - A decline in the supply of bonds due to QE pushes bond prices up,
  - Low bond yields force investors to migrate towards the stock market seeking better yields thus moving up stock prices.
- ✓ What's the next?
  - The Fed has changed its stance on rates after the stock market tumbled in December 2018 and an interest hike is unlikely
  - The change in the monetary policy has been pushing the stock market up,
  - The increased bond supply due to the extra deficit is likely to push bond yields up as investor demand higher compensation for risk,
  - Will the stock-bond correlation move into a positive territory?

Comment II

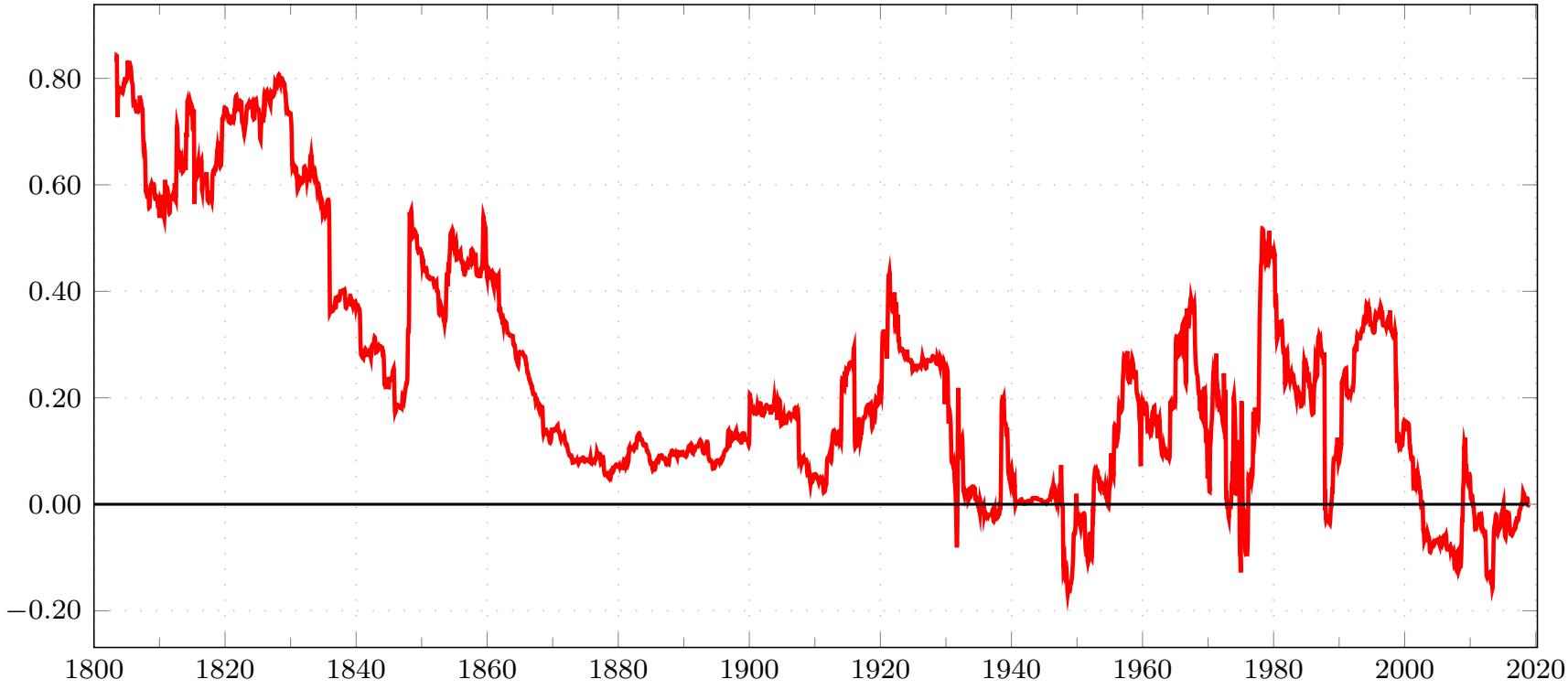
A long-span sample



- ✓ A simple Kalman Filter with time-varying betas using monthly data,
  - A positive correlation during the 1800, especially in the second half,
  - Can you categorize this period as AMPF regime?
  - Data are from Global Financial Data

Comment III

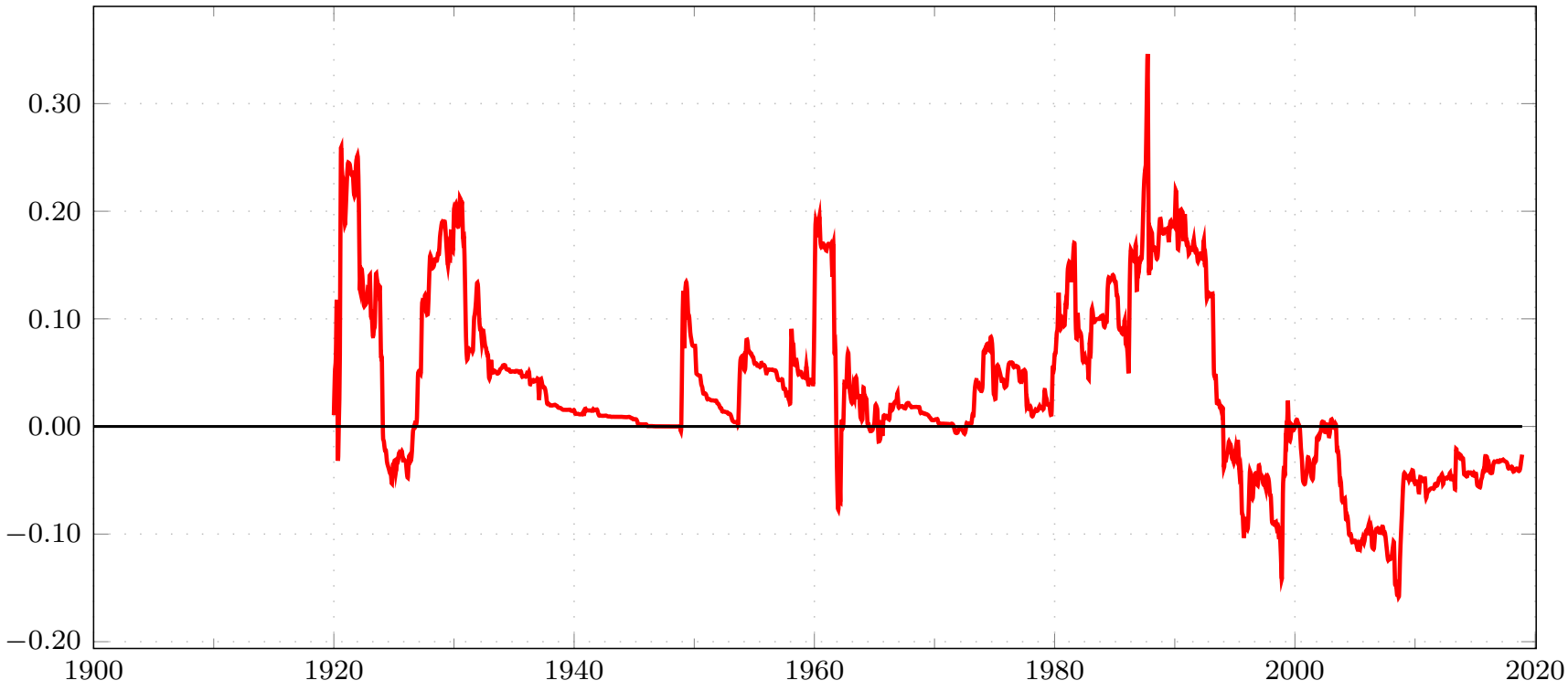
Does your story fit other countries?



- ✓ A simple Kalman Filter with time-varying betas using monthly data,
  - The stock-bond correlation for the UK is mostly positive, with the exception of the last decade.

Comment III (cont'd)

Does your story fit other countries?



- ✓ A simple Kalman Filter with time-varying betas using monthly data,
  - The stock-bond correlation for Japan is mostly positive, with the exception of the last 3 decades.

Comment IV

How big is the gain for investors?

- ✓ A negative correlation implies that
  - Bonds are a good hedge against an equity market sell-off,
  - Can you quantify in the model the diversification benefit for investor?

Other Comments

- ✓ Flight-to-safety and flight-to-liquidity?
  - An open-economy model with capital flows?
- ✓ Can you exploit the stock-bond correlation in the cross-section?
  - Stocks that are more sensitive to permanent technology shocks?
  - Stocks that are more sensitive to marginal efficiency of investment shocks?
  - Pro-cyclical vs counter-cyclical stocks? Different sensitivity to expected aggregate cash-flows

Conclusion

- ✓ It is an interesting paper with lots of new results.
- ✓ I have enjoyed very much reading it.
- ✓ I look forward to reading the revised version of this paper.
- ✓ I will definitely add it to my reading list.

Thank you!