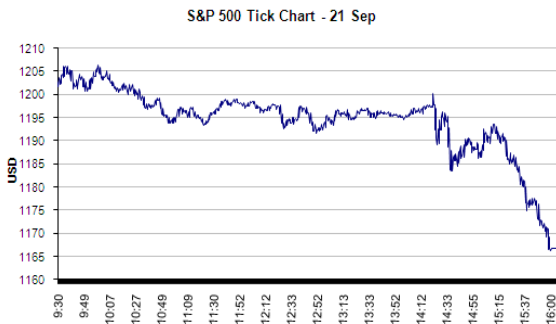


# Market Watch

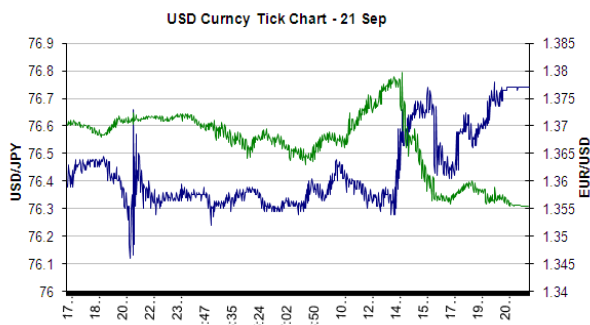
22 September 2011

## FOMC's 'Operation Twist'

### Intra-day Charts



Source: Standard Chartered, Bloomberg



Source: Standard Chartered, Bloomberg

### What is "operation twist"?

- The FOMC delivered its 'Operation Twist' yesterday, to extend the maturity of its Treasury holdings. It will be selling USD400bn of shorter term USTs (3Y and below) and buying the same amount of longer dated paper (6Y and above).
- The Fed's 'twist' program will continue through to June 2012.
- The split of purchases will be 32% (6-8yrs), 32% (8-10yrs), 4% (10-20yrs), 29% (20-30yrs) and 3% TIPS.
- Of significance is that the Fed will be buying a significant percent of the outstanding public supply of long dated (20-30yrs) treasury bonds, perhaps as much as 25%. The impact on yields will thus be significant.
- The amount and the weighting towards longer dated paper looks to be above market expectations .
- The Fed also announced that it would be reinvesting the principal from its maturing mortgage backed securities into new mortgaged backed paper.
- The Fed has not changed interest rates on reserves, at 25bps.
- The Fed's statement continues to highlight the weakness in the economy and the labor market but that inflation 'appears to have moderated since earlier in the year'.
- Of note is the Fed now highlights 'there are **significant** downside risks to the economic outlook, **including strains in global financial markets**'.

**Market response:** Following the release, the equity markets fell whilst the yield spread between long and short dated paper narrowed. 30yr bond yields are now close to their all time lows.

### Our comment:

- **Long term yield could fall even further.** Given the limited liquidity of long dated paper we expect the 'twist' will drive long dated yields down even further. Whilst we don't see the action as having a significant effect on the underlying economy it will, on the back of lower long dated borrowing costs, drive further speculative investment.
- **Fixed rate mortgage costs will fall** on the back of this action, to the benefit of mortgage holders and by implication the US consumer.
- Our colleagues at Standard Chartered Research, expect investors are 'likely to refocus on the myriad of risks now at play' and that 'near term headwinds for the US dollar' should fall. They thus expect a near term rally in the USD.

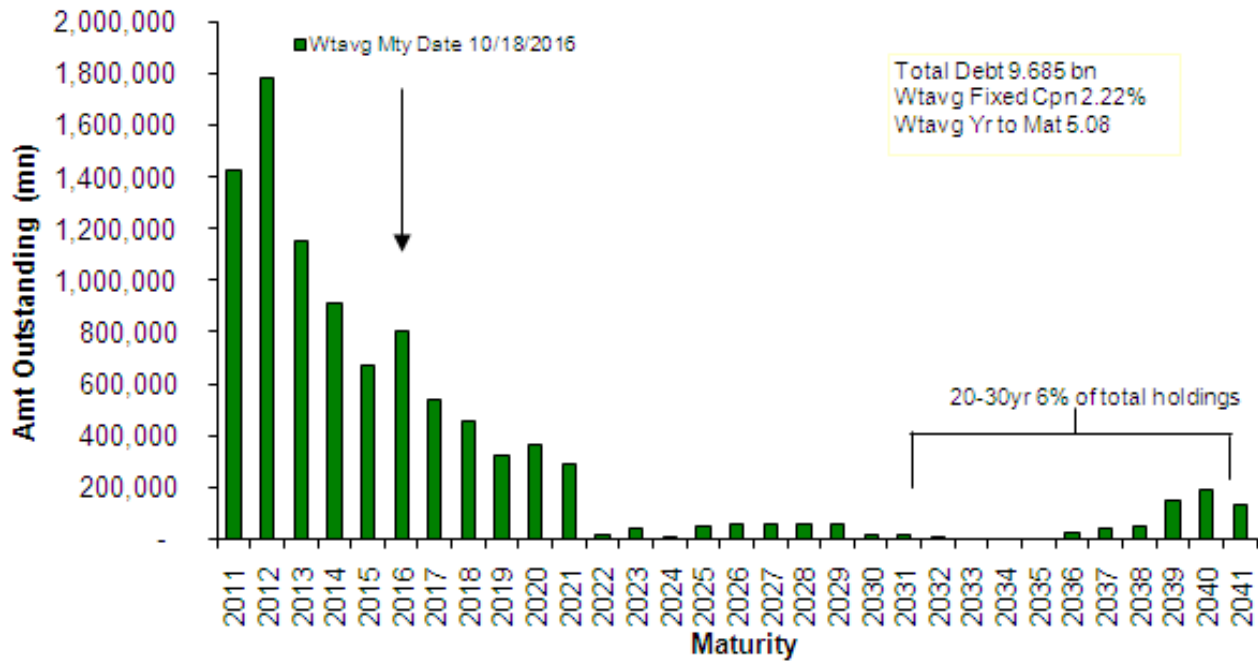
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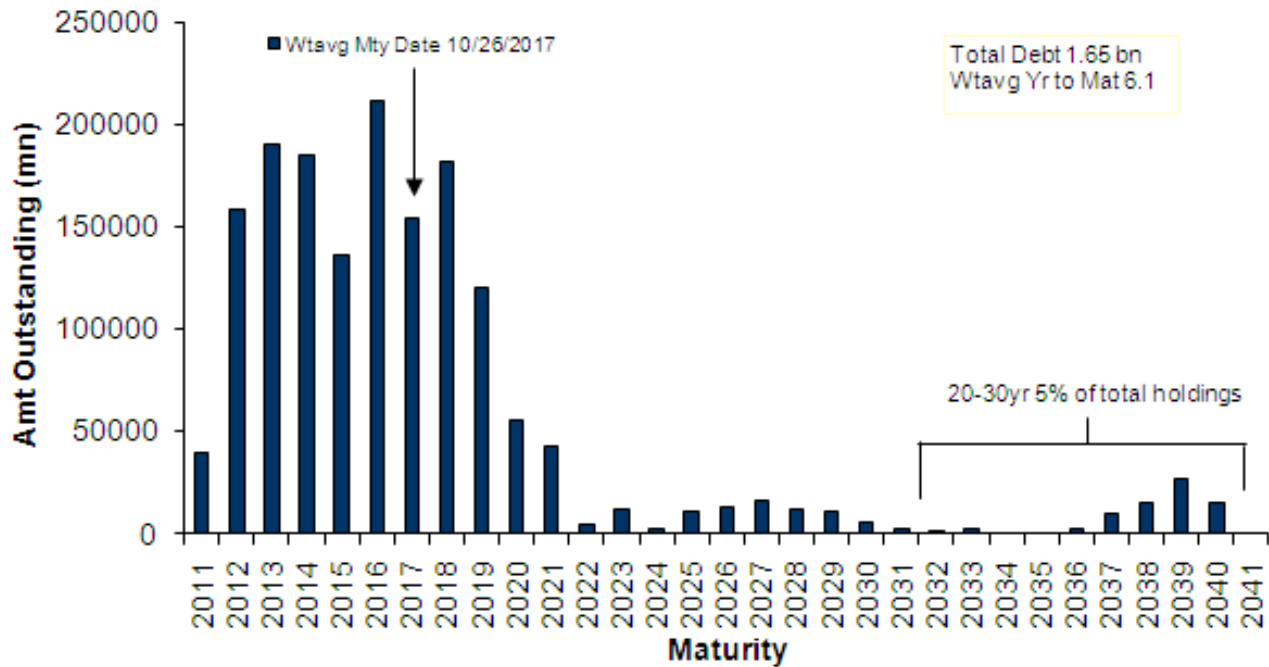
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### Total US debt



Source: Standard Chartered, Bloomberg

### Fed Holdings of US debt



Source: Standard Chartered, Bloomberg

## Disclosure Appendix

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