

Jerome Powell may have just given stock investors a new reason to be worried

Story by Mark Hulbert 10-16-2025

The economy and the stock market may eventually respond favorably to the change of policy, but if history is any guide, things will get worse before they get better.

U.S. Federal Reserve Chair Jerome Powell has announced that the Fed will soon end its balance sheet reduction program, known as quantitative tightening, or QT. But this policy shift isn't the bullish stock-market driver most investors believe it is.

Of course, the Fed's decision is meaningful; the central bank has been draining a large amount of liquidity from the financial system. Since some of that liquidity otherwise would have found its way into equities, QT presumably has been a significant headwind for the stock market. Since June 2022 the Fed has shrunk its balance sheet by \$2.2 trillion. It seems plausible that ending it should provide a big boost for the stock market.

Yet history suggests just the opposite. Over the past two decades, the stock market has done better during QT periods than when the Fed was injecting liquidity into the markets — quantitative easing (QE).

Just take the most recent QT phase since June 2022. During this period in which the Fed drained \$2.2 trillion from the financial market, the S&P 500's total return index has risen at the annualized rate of 20.9%, about twice its historical average.

This recent experience is the rule rather than the exception. Since 2003, the S&P 500's average gain has been 16.9% during 12-month periods in which the Fed's balance sheet was shrinking. That compares to an average gain of 10.3% during 12-month periods in which the Fed's balance sheet was expanding.

What is the source of this inverse correlation between Fed balance sheet growth and the stock market? It has to do with what's going on in the U.S. economy when the Fed decides to expand or shrink its balance sheet. When the economy is slumping, the Fed will flood the markets with liquidity in hopes of turning the ship around. Since that takes time, the economy typically will weaken while the Fed is expanding its balance sheet.

Notice from the chart above that the Fed hugely boosted its balance sheet during the 2008 Global Financial Crisis and during the recession that accompanied the Covid-19 pandemic lockdown. The stock market suffered severe bear markets during those times of QE.

Note

The same story in reverse applies to the past couple of years. It was precisely because the economy was so strong that the Fed felt comfortable draining liquidity from it.

This puts a surprisingly bearish spin on Powell's announcement this week that the central bank was ending the three-plus year period of QT. This suggests we're entering a period of economic

weakness. The economy and the stock market may eventually respond favorably to the change of policy, but if history is any guide, things will get worse before they get better.

Mark Hulbert is a regular contributor to MarketWatch. His Hulbert Ratings tracks investment newsletters that pay a flat fee to be audited. He can be reached at mark@hulbertratings.com