When Fed announcements don’t go as expected, momentum traders gain

Investors in US stocks can earn significant short-term gains by exploiting stock-return movements around the Federal Reserve’s monetary-policy announcements, according to research by University of Notre Dame’s Andreas Neuhierl and Chicago Booth’s Michael Weber.

Around 25 days before a policy announcement accompanying a Federal Open Market Committee meeting, cumulative market returns drifted upward when the Fed went on to announce a lower-than-expected funds rate and downward when it went on to reveal a higher-than-expected rate, the researchers find. Returns continued to drift in the same direction for another 15 days after the announcement.

Using this momentum, a trading strategy that invests when the rate turns out lower than expected and shorts the market when the rate is higher than expected will yield a better return than a passive buy-and-hold strategy, the research suggests.

Cumulative US stock returns
CRSP value-weighted index (’94–’09)

- On days before/after the Fed makes surprisingly positive policy announcements
- Surprisingly negative policy announcements