The Influence of Monetary Policy Shock on Large-cap and Small-cap Indexes and Index Funds: An Incorporation of the Taylor Rule

Ihechiluru Charles Osueke*
Faculty: Jen-Chi Cheng
Department of Economics, W. Frank Barton School of Business

Empirical theory suggests that interest rates often have a negative correlation with investments, and in some cases the price variability of securities. This study incorporates an adjusted Taylor rule interest rate as the monetary policy shock proxy to determine if, and to what degree, it influences large-cap, and small-cap indexes and index funds. Using the Ordinary Least Squares method of estimation, and an Autoregressive Integrated Moving Average model in the multiple regression analysis, the results suggest that for the sample period (January, 1980 to January, 2016), the large-cap index, and index fund both show positive correlation with the market, and negative correlation with monetary policy shock. However, the results of the small-cap index and index fund were inconsistent. This may be because the small-cap is not significantly influenced by a monetary policy shock.