Recession Fears Overdone?

The Fed Reserve Chairman Jerome Powell certainly confirmed this month that they remain independent of the White House, as the President berated the Fed for even considering raising rates at this time. Yet, that's exactly what Powell and the Federal Open Market Committee voted to do at yesterday's monetary policy meeting. The stock market immediately came under pressure, as Powell demonstrated that the Fed policy for the time being has decided to be preemptive on its dual mandate to maintain full employment and pricing stability - rather than react to declining prices of long duration assets and global headwinds.

The 10-year Treasury bond yield fell to only a 10-basis point spread against the 2-year yield, signaling that the bond vigilantes are leaving it to the equity markets to warn the Fed that a "preemptive" move to tighten monetary policy is unwarranted. At this juncture, yesterday's rate hike – without more dovish comments concerning economic data dependency or addressing the runoff of the Fed balance sheet into the new year - suggests that the possibility of two more hikes in 2019 may never materialize. The U.S. bond market so far seems to confirm this.

We still don't expect a recession in 2019, but slower economic growth is more likely as well as the possibility that even lower inflation should dissuade the Fed from hiking rates further in 2019. While the outlook for earnings growth will center the focus by investors as we enter the new year, we are sticking to a mid- single digit growth target for the S&P 500 earnings by the end of next year. This is based on our view that the economy will continue to grow into 2020, albeit at a slower pace.

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