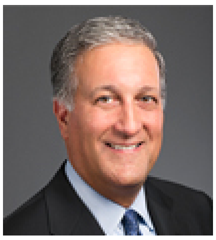
U.S. markets: 3 things to watch in 2019

12-20-2018

- **Market technicals in a free fall** Stocks hit an air pocket over the past four months, suffering one of the ugliest end-of-year corrections in history. In a massive flight-to-safety rally, benchmark 10-year Treasury yields have tumbled since early November's 7-year high of 3.25%, volatility has spiked and stocks have been slicing through technical support levels like the proverbial hot knife through butter, forming death crosses as the S&P 500 has plummeted by more than 15% from mid-September and the small-cap Russell 2000 has plunged 23% since late August, both to oversold levels. Investor sentiment is toxic, and relatively constructive fundamentals no longer seem to matter. So where's the bottom on this waterfall decline? In a worst-case scenario, the long-term uptrend line from the bottom of the Great Recession in March 2009 measures to 2,300, so there could be another 5% or so of first-quarter 2019 downside, before the market fully capitulates and favorable catalysts begin to emerge.
- **Fed's dovish hike comes up short** Correcting an early October monetary-policy blunder, Fed Chair Jay Powell delivered a well-received speech in New York last month, in which he stated the Fed was data dependent, cognizant of slowing economies here and abroad, not on a pre-set glide path to hike rates and possibly just a few more hikes away from neutral. That positive market karma dissipated instantly yesterday, as Powell delivered a lump of coal at the end of the 2-day policy-setting meeting, fueling investor concerns that a monetary policy error may invert the yield curve and push the U.S. into recession. While we expected the quarter-point rate hike, we also thought the Fed would pull in its dot plots and future rate-hike plans more aggressively. We still believe the Fed will skip a March 2019 rate hike due to the China trade skirmish and Brexit, but this Missouri market refuses to take a leap of faith on its data-dependent plans for the balance of 2019. The Fed ultimately should get this right, with a one-and-done next year.
- **Where's the end on QT?** The Fed began to shrink its $4.5 trillion balance sheet in October 2017 by rolling off $10 billion in maturing Treasury and mortgage-backed security obligations each month, a level it has increased by $10 billion each quarter over the past year to a current $50 billion monthly. At this pace, this so-called quantitative tapering (QT) will have pared the Fed's balance sheet to $3.45 trillion by year-end 2019 and $2.85 trillion by year-end 2020. Part of the market's consternation is this restrictive tightening is just as potentially damaging to the economy as hiking rates, and Powell gave no hint yesterday he plans to go off autopilot any time soon. We've been thinking the Fed wants to reduce the balance sheet to around $3 trillion to leave it with some dry powder to combat the next recession, but achieving that objective over the next two years could prove counterproductive for the economy and financial markets

Connect with Phil on LinkedIn



Philip Orlando, CFA
Chief Equity Market Strategist, Head of Client Portfolio Management

Also by Philip Orlando

Orlando's Outlook: Will stock market Grinch steal holiday spending?

Orlando's Outlook: Cooler jobs report restrains Fed

Orlando's Outlook: Will soft patch derail Santa Claus rally? No, no, no!

Recent Equity

Global markets: 3 things to watch in 2019
Linda Duessel

Weekly Update: May you have very happy holidays
Linda Duessel

Volatile year ahead likely to end well
Stephen Auth

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Russell 2000® Index: Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. Investments cannot be made directly in an index.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

Federated Advisory Services Company

442388

Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3779
Telephone: 412-288-1900