Fixed income: 3 things to watch in 2019

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- **The Federal Reserve** The Fed's federal funds target range will finish 2018 at 2.25%-2.50%, policymakers project two more hikes in 2019 and the Fed's $4 trillion balance sheet is contracting by $50 billion each month. So when is enough, enough? The financial markets seem to fear that further monetary tightening amid decelerating global growth and smoldering trade frictions raises near-term recession risk. The Fed must consider how deteriorating financial conditions affect its maximum employment and stable inflation objectives. Currently, the Fed is achieving its objectives—with the unemployment rate at 50-year lows and inflation near 2%—and Fed policymakers retain a more optimistic economic outlook than currently evident in the markets.
- **U.S. & global growth** China, Europe and Japan each seem to have lost economic momentum. Can the U.S. economy expand while much of the world slows? We believe the answer is yes, fueled by a strong consumer, favorable job creation and fiscal expansion, while higher rates, tighter financial conditions and trade policy constrain—but do not overwhelm—domestic economic momentum. The recent financial market tumult presents risk to our outlook. We may have seen a near-term top for the U.S. 10-year Treasury yield, but should our economic optimism prove correct, expect this bellwether to rise back above 3% as 2019 unfolds.
- **Inflation** Even if U.S. growth persists, the magnitude of Fed moves and the degree to which the 10-year rises above 3% rests on inflation. Tight labor markets should boost wage growth and inflation, but some portion may be absorbed by narrowing corporate profits. Tariffs should boost inflation, but trade conflict also restrains global growth and erodes market sentiment. Recent sharp oil price declines have weakened near-term inflation indicators. The net impact of these crosscurrents leaves high uncertainty for the inflation outlook for 2019.

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

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