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The Weekly Note

A Weekly **Market Commentary**

Monday, February 11th, 2019

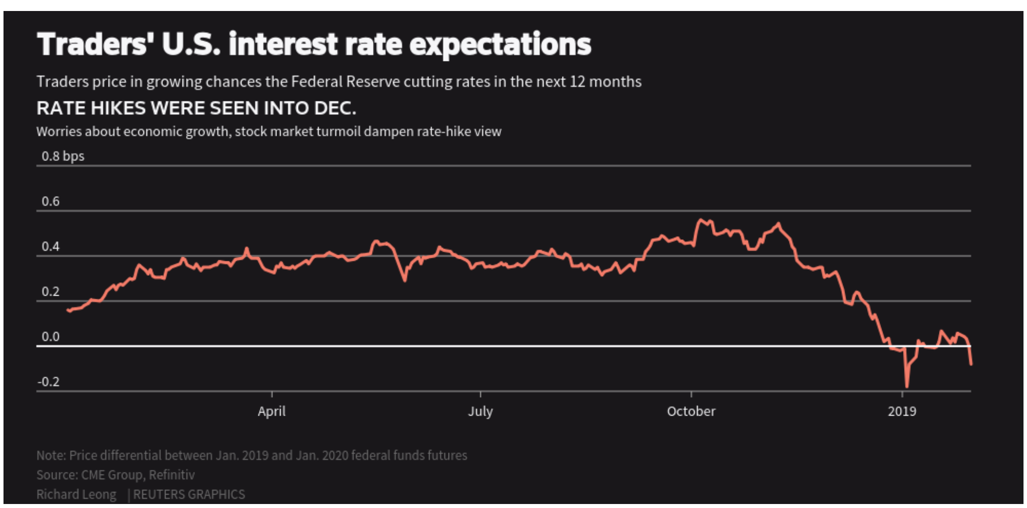
"Fed turns increasingly cautious after recent data"

It was only four months ago when Fed Chair James Powell stated that the current policy rate (at the time just a quarter point lower) was a "long way" from neutral, and that it was possible the Fed could run past neutral on its current quantitative tightening path. Now the probability of the next policy move being a cut vs. a hike is about even odds according to the Fed futures market.

At the January FOMC policy meeting press conference, Powell noted three reasons why the Fed will now be patient with future quantitative tightening polices: 1) slowing global growth, 2) muted inflation and 3) tighter financial conditions. After sticking to their projections for a December rate hike, to the dismay of investor sentiment, the Fed has now done a complete reversal on its policy path for 2019 over the past few months.

Even past-chair Janet Yellen says the Fed could wind up cutting interest rates before the next increase. Yellen told CNBC last Wednesday, "If global growth really weakens and that spills over to the United States, where financial conditions tighten more and we do see a weakening in the US economy, it's certainly possible that the next move is a cut."

As of right now, traders are pricing in about the same probability of a rate hike vs. a rate cut in 2019.



Despite global industrial data continuing to deteriorate in recent weeks, stocks posted their 7th straight weekly advance last week. Since the Christmas bottom, the S&P 500 has now advanced over 15%, sitting within 8% of its all-time high set last year. It seems that investors are embracing the more dovish Fed policy and also pricing in the first quarter earnings declines as transitory vs. systemic in nature. We will have to wait to see if the trend in earnings estimates reverses. This 7-week rally in stocks has come at the same time that estimates for 2019 have been cut nearly in half, with projections for a year-over-year decline in Q1.

The bond market is also painting a different picture vs. the recent stock market rally. Treasury yields continue to drop as economic data from around the world weakens in recent months. The 10-year treasury hit a 13-month low last week of 2.63%, down over 60bps from the 3.26% peak hit in early October. Despite the U.S. data being best-in-class, the fear is that sputtering global growth will eventually work its way into U.S. companies who capture ~40% of sales abroad.

Whether the recent rally in stocks is more of a relief rally or the beginning of a new fundamental uptrend will be data dependent, just like the Fed. To that end, it will be interesting to see if the bond market is in fact getting ahead of worse economic data to come, or if bond yields will soon have to rise as this pocket of softness passes. Either result should tell investors a lot about the market's appetite for risk assets for the duration of 2019. Right now, the shifting trends in fundamentals have created a lot of confusion for markets and Fed officials trying to steer the ship.

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