State of the Economy December 2018

It was generally a good year for the economy. However, you may not know that was the case if you recently glanced at the stock market indexes. The news from Washington played a major role in pushing both the S&P 500* and the Dow Jones* towards their worst performances since 2008. Both indexes have touched bear market territory by suffering a 20% drop from their all-time highs. Investors worry the economy is on the brink of a possible recession as the stock market continues to spiral downwards.

The uncertainty surrounding Washington and fear of a cooling economy are driving down investor sentiment. Throughout the fourth quarter of 2018, the negative headlines coming from Washington overwhelmed the market. The tariff discussions between China and the U.S. have not made much headway after conflicting reports on the specifics and existence of an agreement. The lack of resolution is weighing on U.S. companies and hampers their ability to effectively plan for the future. It does not help that the U.S. government is currently in a partial shutdown. Also, the Robert Mueller investigation continues to dominate the news. In addition to the political misery, there are signs pointing to a slowdown in growth, particularly within the housing and auto sectors. For the first time since the dot-com era, investors are cautious about buying back shares after selloffs.

This past week, the Federal Reserve had the opportunity to throw the market a lifeline but ended up leaving investors in the cold. Fed Chairman Jerome Powell announced that the central bank would raise interest rates a quarter point. Despite President Trump pleading to hold steady, the Fed decided to increase the federal funds rate to a range between 2.25% and 2.5%. However, Powell did imply that the Fed will have a less aggressive rate path going forward as they now project to raise rates only twice in 2019. Nevertheless, Powell's statement did not do enough to comfort the turbulent markets. Consequently, the lack of support from the Fed added to the worst performing week in the U.S. stock market since 2008.

New evidence that the economies in Europe and China are slowing continue to add worries for further U.S. expansion. China announced earlier this month that tariffs hurt growth after their economic numbers reflected a deepened slowdown. In Europe, Italy is close to falling into a recession, Germany is struggling to rebound from a third quarter contraction, and France witnessed significant political and economic protests this past month. Lastly, in England, the Brexit situation is murkier than ever as British Prime Minister Theresa May had to repel a leadership challenge within her party. Similar to the Fed's actions here in the U.S., the European Central Bank was not deterred by recent weak data reports. Earlier this month, the central bank moved forward with ending their quantitative easing program. The central bank chief said the recent slowdown was normal and reflected temporary headwinds.

As fear of an upcoming global recession continues to build, it is important to be cognizant of the strong economic indicators in the U.S. The second and third quarter GDP remained robust after each exceeded 3.5%. The numbers demonstrate strong job growth, accelerating pay increases and low inflation. Additionally, a recent report from the Commerce Department showed an increase in consumer spending. During the Fed's report last week, Chairman Powell referenced modest revisions to their economic projections showing only slightly slower growth than previously anticipated. He did not express or even hint toward a possible recession on the horizon.

The stock market and the economy do not always move in lockstep. The market does not rely solely on economic indicators and the current performance of companies. The market also focuses on future expectations of economic performance as investors attempt to be ahead of the curve. We are in the middle of a nine-year bull run, but it appears investors are ready for the other shoe to drop. This also includes electronic investors made up of machines, models, or passive investing formulas. They account for about 85% of all trading volume based and are based on models employed by algorithms that automatically buy and sell positioned by pre-set inputs. In other words, the speed and magnitude of recent moves in the market may not all be driven by humans.

Will the market continue to drop into next year? Will outside noise linger, essentially drowning out economic performance? Will the Federal Reserve step in if the market continues to tumble? I expect to see an early rebound in 2019 as some of the temporary obstacles may be resolved, but the long-term consequences remain to be seen.

Have a safe and happy new year!

Sincerely,

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The Dow Jones Industrial Average is a popular indicator of the stock market based on the average closing prices of 30 active U.S. stocks representative of the overall economy.

S&P 500 Index is an unmanaged group of securities considered to be representative of the stock market in general. You cannot directly invest in the index.