Weekly Capital Market Comments

Friday, December 21, 2018

NORTHEAST
PRIVATE CLIENT GROUP

The Federal Reserve continued to play Marco-Polo with the US equity markets this week, after the much-anticipated Powell Put disappointed most market participants. For the week (Thursday through Thursday), the broader US market (as measured by the S&P Total Return Index) was down 6.4%, while the 10-year US Treasury was for bid, as the yield dropped as low as 2.75% in early trading on Thursday. There was no dearth of worrisome news early in the week, which only increased expectations and anxiety for a more dovish stance from the Fed come mid-week. Technology shares remained under pressure, as shares of Micron fell commensurate with a gloomy outlook, while Facebook plunged following negative reports spanning from data sharing allegations to a breach of user's private messaging. Crude's tumble paused on Wednesday at $47, but only resumed through the end of the week. Weaker economic data hit the tape on Friday including estimated 3Q18 GDP, which was revised lower by 10bps to 3.4%, and weaker than expected durable goods. This was modestly offset by better than expected corporate profits. However, the negative news cycle continued out of Washington, as the POTUS raised his rhetoric on shutting down the government, if boarder wall funding falls short. In addition, another high-profile resignation hit the Oval Office with the departure of Defense Secretary Mattis. Global markets also remain under pressure, as additional stress caused from a dysfunctional UK parliament heightens concerns out of France, where a political quagmire born from President's Macron's energy policies erupted to the point that may now usher in a potential FREXIT. Add to this, Emerging markets remain challenged as China's Xi reinforced the notion/vision of state-run economy. And while acknowledging the continued strain the current trade war is placing on the Chinese economy, President Xi still remained resolved, and stated, "No one is in the position to dictate to the Chinese people what should and should not be done."

We were also anticipating a more dovish Fed and believe while Wednesday's FOMC statement and SEP (Summary of Economic Projections) represents a pull-back in growth (and rate) expectations, the press releases and ensuing press conference were still modestly hawkish. But it is our opinion, that this was intentional, and served as: 1) an attempt by Chairman Powell to prove his independence, and 2) a trial balloon to better gauge the market's response and expectations. Still, while we believe Chairman Powell to be a pragmatist and will ultimately pause any significant hikes as softening economic conditions warrant, we also believe he has miscalculated in his messaging over the last 4 weeks. We believe an additional two (2) more hikes in 2019 will be a stretch, and feel only one (not until the April or June meeting) is probable. As a result, we remain cautious regarding equities in the near-term, despite the S&P 500 trading below 15x on consensus '19 earnings expectations. Equity markets (here and across the globe) remain fragile and volatile, and while the US job market remains on solid footing, we do not see too many postings for knife catchers on ZipRecruiter. Much of the economic data we follow suggest a slowing trend, but not full out stall. Equity markets outside the US seem to be further along this deceleration curve, may very well be a place to dollar-cost-average into exploiting a strong US dollar. Finally, credit spreads continue to widen across both investment grade (IG) and below investment-grade (aka Junk). While at the same time, the 10-2 spread is now around 12bps, which typically suggests additional economic weakness. We believe equity investors should continue to favor value over growth and bond investors opt for duration over credit in the context of a diversified equity and fixed income portfolio. (Chris Pike, CFA 12/21/18)