A capital markets expert offers insight based on TAC ECONOMICS research.

The Market Insight

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Writer and commentator David Wigan offers his thoughts on the key trends revealed by TAC ECONOMICS quantitative models and insight.

Love Changes Everything?

The Fed changes everything

In the words of the well-known song, Love Changes Everything. However, as every economist will tell you, it's not love that changes everything. It's the Fed. Emboldened by the Fed, equity markets in the first quarter staged a rally from the first week of January until April. Bond yields, meanwhile, fell sharply until the end of April (and have retraced somewhat since). The cause of this sharp turnaround from a weak fourth quarter of 2018 was a Fed 'pivot' which saw it move from predicting two rate hikes in 2019 to a prediction that its key rate would remain in its current 2.25-2.5% range at least through this year. Rates are now seen peaking at 2.6 percent sometime in 2020, roughly a percentage point lower than the historic average. Of course, this does not take into account the impact of balance sheet easing, which TAC economists estimate was equivalent to 75 bps of hikes in the year to January, but it is still a sure sign that the U.S. economy has entered a more subdued phase.

Take-away

Fed policy change boosts markets… but for how long?

Of course, this does not come as a huge surprise. TAC scenarios for more than year have predicted a cyclical reversal in the U.S. from around mid-2019. With that in mind the Fed's change of direction is entirely justified, albeit that it comes slightly earlier than expected.

TAC's central projection for the U.S. economy is a gradual progression to a cyclical trough in 2020, with the slowdown gathering pace and spreading worldwide in the first half of next year. TAC recursive partitioning models suggest a mild U.S. recession or no growth in the first two quarters of 2020. For the full year, TAC expects 1.6% growth, compared with 2.4% in 2019.

The impact of the "Powell put" on asset prices is a welcome relief for investors that were hit hard in 2018, and for asset managers. However, whether those gains are sustainable is another question. If the cycle is turning, there can be very little fundamental reason for valuations to continue rising. In fact, the more likely scenario is a return to bouts of volatility and a sharply negative reversal once the realities of the slowdown come home to roost on the corporate bottom line. Further, any reversal is likely itself to trigger a further slowdown in the U.S. and other mature economies.

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