2019…A New Direction for the Fed?

During the course of 2018 Jerome Powell, the Fed Chairman, signalled to the market that the Federal Open Market Committee (FOMC) were on a clear rate hiking programme, undertaking four rate hikes during 2018. However, Mr Powell and the FOMC Board's rhetoric have taken an about turn since the start of 2019, with a far more dovish stance following a volatile December for risk-assets – putting this in to perspective, the December slump was among the worst in history as the US market observed one of the biggest December falls since the 1930's!

Markets took a somewhat well-deserved breather following Mr Powell's remarks at the beginning of January with both developed and emerging market equities gaining over 7% in total return terms. Mr Powell not only claimed that the FOMC is ready to pause its rate hiking cycle, but more importantly commented that the Committee will not shy away from making changes [to the current normalisation of the balance sheet] in light of economic and financial developments and will be keeping a very close eye on the data points, as they become available. This was the first time that Mr Powell openly communicated about the possibility of a pause in the run-off of the central bank's balance sheet – should the economic environment call for it. There has been a lot written and discussed about the effect of the Fed's normalisation policies being one of, if not, the most important structural drivers of global capital markets and asset prices. The market's rally so far this year in response to the Fed Chair's latest remarks demonstrates this significance.

So, where to next? Are the 'permabears' gone and is the Goldilocks environment back in play? Probably, yes, as the Fed has become 'patient' in an environment where inflation remains muted, the headlines from the US-Sino trade discussions sound increasingly more constructive and Chinese authorities have been delivering stimulatory measures to boost the world's second largest economy's domestic drivers. As a result, should the Fed's attitude remain dovish this could be an interesting time to look once more at emerging markets, as they could have the chance of performing well in the near to medium term as the market discounts a further reduction in these risks.

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Moreover, with recent data showing the housing market slowing, employment statistics cooling and inflationary pressures showing no signs of rising above the Fed's 2% target - there are plenty of reasons hinting for a pause in March. Even so, political uncertainty remains a key headwind over the coming months.

Notwithstanding the above comments, our in-house view is that rates over the longer term will continue to normalise and we are therefore positioned accordingly within our fixed income allocation across our various investment solutions.

Simon Sharrott

Joint Managing Director (Guernsey) & Portfolio Manager

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