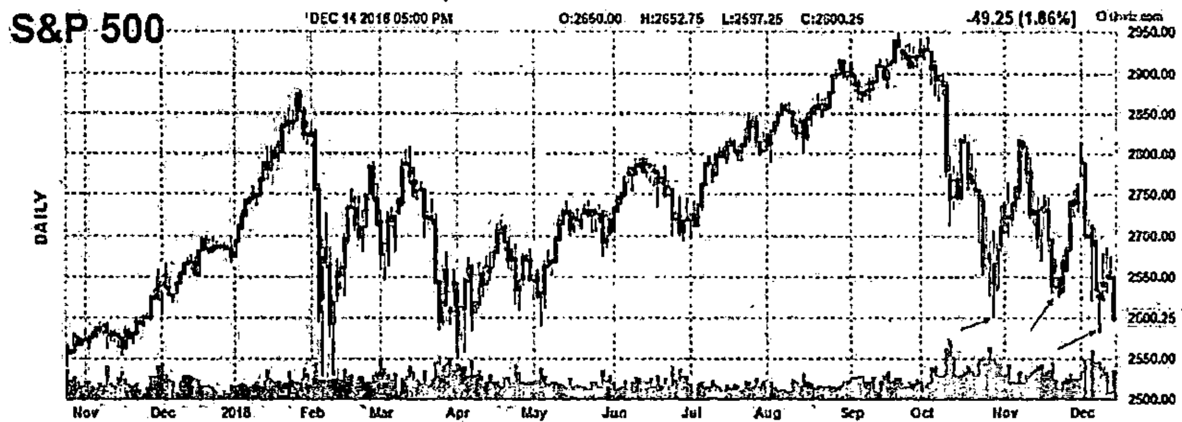
Nobody can consistently forecast short-term market moves accurately. Sometimes, like this year (and we've seen it before), fundamentals are strong but markets fall anyway. But over a longer period of time, fundamentals prevail. We fully expect the economy and earnings to grow at a slower rate next year, but we see no indications of a recession. The big positive, which we've communicated on November 29, is that Federal Reserve Board Chairman Powell clearly indicated on November 28 that the Federal Reserve is close to ending its interest rate hikes. We can't emphasize enough how positive we believe this is for stocks.

Stephen Auth is Federated Investors' Chief Investment Officer, and one of the investment strategists we closely follow. His long-term outlook has been correct, but not necessarily his short-term forecast. That's understandable, as markets move on emotion in the short-term, but fundamentals prevail over the long-term. We are attaching an article Steve recently published, which we think you'll find interesting. Steve summarizes 2018 well. His, and our, rosy predictions for the economy and earnings in 2018 came true, yet stock markets in the U.S. and most of the world are down for the year. He remains bullish about 2019, but thinks the stock market may remain frustrating in the first-half of the year. Remember, though, short-term predictions, like Steve's for the next 6 months, are usually unreliable.

Please know that we share your frustration with the market this year. As you can see on the chart below, the S&P 500 has bounced off the 2,600 area a half dozen times this year, and closed today at the lows we saw last winter. While stocks aren't collapsing, it is just so frustrating that we can't escape this downward pull to the 2,600 level. We believe that we eventually will, but as to when, that would be nothing more than a guess. We're confident patience and fundamentals will prevail.

In the meantime, if you have any questions or concerns, please don't hesitate to contact us.



Source: Finviz

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Volatile year ahead likely to end well

12-13-2018
As 2018 bounces up and down to a disappointing outcome relative to our expectations, it seems a particularly good time to consider what went right and wrong and where we might be heading in 2019.

Looking back

What is most disappointing to us about 2018 is that most fundamentals improved even while the market was roughly a wash. Tax reform passed late in 2017, offering the promise of a supply-side investment pickup that has been delayed but likely awaits more stable times. Earnings should end the year above $160, up 19% from 2017. Economic growth, fueled in the short term by the demand stimulus in the tax reform bill, was better than expected, close to 4%. Bond yields, after attempting to break higher in January, look now to end the year only modestly higher than their year-ago levels.

Why, then is the market flat and down almost 10% from intra-year highs and more importantly, why are the more economically sensitive areas of the market down 20% or more? Frankly, as we've expressed in several of our recent pieces, there is no perfect explanation despite all the narratives out there seeking one. As an old industry veteran once told me many years ago, "Steve, sometimes there are simply more sellers than buyers." Indeed, with the increasingly high share of market activity dominated by players with relatively short horizons (think ETF investors, hedge funds, risk parity funds, etc.), combined with concerns that we are "late cycle" (whatever that means), short-term news flow has driven markets more than ever.

Of late, headlines on the Fed, trade and oil have been key. And though all three seem to be moving in a market-positive direction (see "The bulls hit the trifecta"), the market continues to fret with every early morning tweet on Xi, Huawei, Jay Powell and Saudi Arabia. Piling on top are economists insisting that the cycle must end soon simply because it is old in age, despite it's being young in cumulative growth with few signs of typical late-cycle optimism and over investment/consumption. Behind the scenes, the Ouija board operators whom confused investors turn to when all else fails—the so-called technicians—are all issuing foreboding warnings about market death crosses, double tops and other scary "explanations."

Looking ahead

Given all the worries out there, and investors' insistence on "proof" that the good news that some (including us) foresee is real, 2019's first half looks to be what I call a "Missouri Market"—unlikely to advance until all the facts are in. Compiling the difficulties we're likely to experience in next year's first half: all the fourth-quarter 2018 worries that suggest corporate decision-makers across the economy may be simultaneously tapping the breaks awaiting longer-term developments. To us, this translates as an economic soft patch ahead, with growth "slowing" to maybe 2.5% in Q1 2019 before reaccelerating later in the year as the Fed actually pauses, Trump and Xi actually sign a trade deal and OPEC+ actually cut production and stabilize oil prices. Although soft patches can and sometimes do extend to something worse—even a full-blown recession—we see this as unlikely given the solidity of the banking system, reasonably tight corporate inventories and a healthy U.S. consumer.

Although the markets could start the year where they've left off, and perhaps even temporarily plumb new depths before stabilizing, we see several good reasons we should eventually head higher, perhaps not until the second half of the year. First and foremost, by then the uncertainty around the Fed, trade, and oil should be resolved, freeing up economic players everywhere to move forward more confidently with their investment and spending plans. With this, earnings growth is likely to reaccelerate toward our 2019 target of $170 to $175. As the much touted "second derivative" turns up, investor concerns about being late cycle should ebb. As confidence rises, the gradual expansion of the market multiple, which began in the depths of 2010 but stalled out this year, should resume, re-achieving a relatively undemanding 18 P/E on trailing earnings, compared to today's Christmas bargain of 16. This should eventually get us to our longstanding 3,100 target on the S&P 500, if not by midyear as we've been expecting, then by year-end at least. This gives the market upside on a 12-month view of roughly 15%.

Stephen Auth, CFA
Chief Investment Officer, Equities, overseeing all of Federated's equity and asset allocation products globally

Also by Stephen Auth

The bulls hit the trifecta

Shaken, not stirred

Midterm redux: Partial 'Goldilocks' outcome, though Fed and China still loom

Recent Equity

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Philip Orlando

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