Marketing Communication

Economic And Financial Outlook Highlights

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- Moderating economic growth is set to stabilize at an adequate—if not respectable—2%-2.5% in the coming year, as the decade-long expansion continues its assault on a June 2019 longevity record. Added support to consumer-centric growth is coming from an accelerated pace of late-cycle, state and local government spending, and from housing's anticipated "mini"-revival amid recent mortgage-rate declines and improved "affordability" conditions.
  - Still missing from this moderate, often stop-go economic cycle are the usual inventory imbalances, inflation and interest-rate strains capable of up-ending growth, giving a low probability to a "never-say-never" recession in 2019.

- More cautious interest-rate "normalization" by the Fed, if sustained, will lessen the most visible threat to this growth cycle, from de-leveraging and an associated asset-price unwind, threatening household wealth, consumer confidence, business capital costs and, most importantly, the smooth flow of "liquidity" needed to lubricate economic activity.

- Oil price's downside bias, increasing with U.S. supply next year, will combine with slowing growth abroad and with business "pricing power's" sluggish recovery to support the consensus inflation forecast of 2%-2.25% in 2019-20. Subdued inflation complicates the Fed's interest-rate "normalization" strategy plus the recovery of corporate "pricing power" and earnings prospects, not to mention the outlook for inflation and market-driven interest rates.
  - Stoking secular "disinflation" are "globalization," weakened labor unions, cumulative de-regulation, disruptive innovations, and demographic changes. Tariffs, oil-price increases, and other "exogenous" (or outside) inflation "shocks" ultimately risk adding to disinflation through their debilitating effect on economic growth.

- A typical, but more erratic late-cycle "flattening" of the Treasury yield curve (in which rising short-term rates converge with a more gradual rise in longer-dated bond yields) is set to resume next year. The move toward an "inverted" yield curve, in which bill rates move above those on government bonds, could be delayed by the Fed's more cautious short-term rate increases and by unwinding "safe-haven" demand lifting yields on longer-dated securities.
  - The inverted curve's historically reliable record as a recession indicator could fall victim to this cycle's unique features, including inflation-suppressed bond yields and asset-price distortions created by aggressive monetary stimulus.

- The dollar will face head winds in the coming year from less divergent central-bank policies, fostered by a more cautious Federal Reserve and by a wind down of "quantitative easing" (QE) from the European Central Bank. That will ease pressure on commodity prices, emerging-market assets and, more generally, global "liquidity."

- Recent stock-market turbulence has been the inevitable by-product of a monetary-policy sea change from aggressive stimulus and associated asset-price distortions during a decade-long adjustment to the financial "meltdown," aggravated by automated trades from increasingly important quant-based strategies and indexed-driven investing. Supportive "fundamentals," based on economic and earnings growth, subdued inflation and historically low interest rates are the market's strong suit, capable of levering attractive valuations as policy and other distractions dissipate.

- A "fundamentals"-based rally in stocks likely would be accompanied by rotation from longer-dated Treasury securities back to credit-driven strategies benefiting from narrowing "quality" differences between Treasury and non-Treasury yields. Compositional and "duration"-based changes to the U.S. Aggregate and certain other benchmarks over the years could produce unexpected twists to strategy shifts achieved through indexed-based investing.