

## Markets Delivering a Message

December 20, 2018

Most equity markets in the developed countries have experienced sharp selloffs this week although the focus has been primarily on the US. US equities are now 16% below the late September highs. Overall market sentiment has been obviously rather poor and, as is usually the case, there are a number of causes:

- At the FOMC meeting this week, the Fed and Chairman Powell disappointed the markets not so much for increasing rates a very well telegraphed 25 basis points, but in not giving a strong enough signal that they may be nearing the end of the tightening cycle. The yield curve, which is partially inverted between 2 and 5 year maturities, flattened to 10 basis points between the actively monitored 2 and 10 year maturities before widening to 13 basis points by the end of the day. An inverted yield curve has often led to recessions 12-18 months after the initial inversion.
- While not expected to have a meaningful impact on the economy, the threat of a government shutdown increased as Congress and the Administration remain at an impasse over funding requested for border security. There is concern that this disagreement could presage a more impactful showdown over increasing the federal debt limit in March of next year.
- After recovering somewhat yesterday, oil prices fell another 2% today to \$46/bbl. This may be good for consumer spending in the form of lower gasoline prices, but the US has become a much larger producer of oil and the sharp price drop could notably impact capital spending in the energy sector over the coming months. Lower prices also negatively impact the high yield (below investment grade) bond asset class in which 15% of the issuers are energy related companies.
- Economic statistics this week have been mixed with housing picking up a bit, but the first two regional purchasing managers surveys out of New York and Philadelphia were weak. Consumer spending has been fine at this stage of the cycle, but many market participants believe businesses need to spend at a reasonably high rate to extend the economic expansion another few years.

Interestingly, emerging equity markets were actually up approximately 75 basis points today amidst developed markets that were down over 100 basis points. This return differential, which started to occur over the last month, could be merely a closing of the large performance gap between the US and emerging markets which developed through most of the year. However, it could also be providing some insight on the outlook for China, the most important country in the EM sector. The temporary truce in the trade war with the US combined with the fiscal policy initiatives implemented by the Chinese government may allow a continuation of the controlled slowdown China has been attempting to engineer over the last few years. The Chinese renminbi has stabilized at higher levels over the last month which should take some pressure off of equity and debt markets in the region.

In assessing whether this market downturn we have seen this month is a correction that will recover over the coming months or the beginning of a bear market that will decline further, continued strength in the US and a controlled slowing in China are most important to global growth. European and Japanese economies have slowed this year with some countries such as Italy perilously close to recession. However, the overall Eurozone should avoid recession especially given the currency weakness and continued strength of the US as an important export destination.

The US economy is expected to slow from the 3.0% growth rate achieved in 2018 to a still rather high 2.5% in 2019. This will occur primarily on the back of the consumer who is benefitting from strong job growth and an increase in wages. Business confidence is an important element to achieving this growth rate as capital spending needs to be an incremental contributor to the economy next year. With ample cash in the coffers from the strong earnings growth of the last few years, lower interest rates and some resolution of the trade conflict with China could provide the impetus for companies to resume the strong spending we saw in the back end of 2017 and the first half of this year.

Markets appear to be testing the resolve of the new Fed chairman and delivering a message to the President to try hard to negotiate a solution to the trade conflict with China. While it is always difficult to predict a bottom in such a volatile environment, given our aforementioned GDP forecast and expected earnings growth of 5-7% next year with no tangible signs of a recession over the next 18 months, we do not believe we are entering a bear market and expect equity markets to begin recovering over the coming months.

Ben Pace is the Chief Investment Officer and a Partner in the New York office. He leads the firm's Investment Committee and is a member of the Executive Committee. He has more than thirty years of experience in investment management. Ben has been featured in the Wall Street Journal and Reuters, and is a frequent commentator on Bloomberg TV and radio, Fox TV and CNBC, appearing regularly on network programs such as Power Lunch, The Closing Bell, Squawk Box, and Worldwide.



**Disclosures:**

Cerity Partners LLC ("Cerity Partners") is an SEC registered investment adviser with offices in New York, Illinois, Ohio, Michigan and California. This commentary is limited to general information about Cerity Partners' financial market outlook. Cerity Partners' services may not be suitable for everyone. The information contained herein should not be construed as personalized investment advice. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this brochure will come to pass. Investing in the financial markets involves risk, including the risk of loss of the principal amount invested; and may not be appropriate for everyone. Before making any decision or taking any action that may affect your finances or investment goals, you should consult a qualified professional adviser. The information presented is subject to change without notice and should not be considered as an offer to sell or a solicitation of an offer to buy any security. All information is deemed reliable but is not guaranteed. For information pertaining to the registration status of Cerity Partners, please contact us or refer to the Investment Adviser Public Disclosure web site ([www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)). For additional information about Cerity Partners, including fees and services, send for our disclosure statement as set forth on Form ADV Part 2A using the contact information herein. Please read the disclosure statement carefully before you invest or send money.