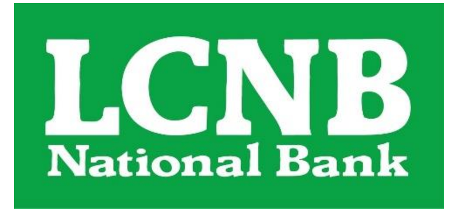
Market Commentary



Has the Fed painted themselves into a corner?

As we noted in our 3rd quarter bulletin, perhaps it is time for the Fed to consider a pause in hiking interest rates. With the Fed funds rate approaching the core inflation level and the yield curve continuing to flatten, we argued that the Fed had already achieved its goal of a neutral interest rate for the time being.

We were certainly not alone in this view as other market participants and President Trump (albeit more vociferously) have also called for a pause. Maybe President Trump should have considered this before replacing the dovish Fed Chair Yellen.

Despite these concerns, the Fed remained hawkish throughout October and November, continuing to forecast a rate hike in December and as many as three additional hikes in 2019. The hawkish tone along with trade uncertainty and geopolitical concerns on numerous fronts has roiled markets over the past several weeks.

Ever independent, the Fed does not want to appear to be beholden to the whims of markets or Presidents. While their tone has softened in recent weeks, we expect another quarter point rate hike when the December meeting concludes tomorrow afternoon. We do expect the Fed's Dot plot (FOMC member projections) to show a significant reduction in expected interest rate levels for 2019 and beyond. A softer tone on future increases may help set a floor for the current correction.

Currently the S&P 500 Index is testing intraday lows from February and March of this year around 2535. This is roughly a 13% correction from the closing high of 2930 back in September. Should the index meaningfully breach this level, we could be set for a more significant correction. The next support level may be closer to 2350, which would represent a 20% correction. It is important for equity investors to remember that 20% corrections are normal every few years and we have not had such a selloff since 2011.

As we move into 2019, we expect solid earnings for the most recent quarter which should also help stabilize markets. Despite increasing recession concerns, we feel the more likely outcome is a slowing growth rate. The 3.5% growth rate for much of this year is likely giving way to the slower longer-term trend of approximately 2% growth that we have seen for the past two decades. Equity investors should expect volatility and stay the course.

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We hope that we are exceeding your expectations. The best compliment we could receive would be a referral of your friends and family. Please contact Mike Miller @ 513.932.1414, ext. 59101 or mmiller@LCNB.com for more information.