Federated

Shaken, not stirred

11-21-2018

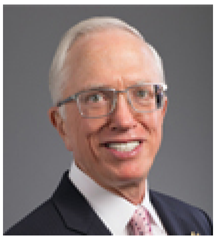
We understandably have been getting a lot of queries about what is going on with the market and whether our bullish long-term view has changed. Let me answer the second part of that question first: No. When we pushed our year-end S&P 500 target of 3,100 to mid-2019 a few weeks ago, we did so because we weren't confident stocks could make up all the ground they'd lost in October. Events of the past week have only strengthened our view on this outcome. Selling often begets more selling in the short term, and the market feels heavy. Indeed, a retest of the October low at 2,600 on the S&P seems likely, and even a brief move through might be needed to wash out the remaining bulls. Still, our longer term outlook into next year remains very positive, and as investors begin to set up for 2019, it would not surprise us to see the market rally we anticipate in the first half of next year to get underway in time for a green Christmas, at least relative to present oversold levels.

Whether we take one last dive lower, or bounce higher before year end—or more probably, both—may hang on two upcoming binary events that we've flagged in previous pieces: the Fed and China. On a 6-month view, we expect both these impediments to the secular bull to resolve themselves favorably. The Fed is fighting an inflation bugaboo while its policy risk is asymmetric to the downside, and sooner or later policymakers will begin to hint that they realize this and are poised to pause their rate-hiking cycle. As to China and the trade war, neither Presidents Xi nor Trump can be terribly pleased with how their current belligerence is working out for their own countries. Economic and political self-interest on both sides should eventually prevail. So the intermediate-term view is bright on both counts. If positive progress is hinted on either between here and year end—Xi meets with Trump on Dec. 1, Fed Chair Powell speaks next week at the New York Economic Club and the Fed meets on December 18-19—the market should bounce. Alternatively, we may have to wait into next quarter for progress on one or both of these fronts, and if so, we could plumb new lows before stabilizing.

The key risk to our positive 2019 outlook is if somehow this volatility/trade war bleeds into the economy more directly than what we have experienced so far, causing a soft patch as everyone taps on the brakes at the same time. This may already be underway, but the longer uncertainty reigns, the greater the risks that a soft patch becomes something worse. We will continue to monitor this, as we expect Powell, Xi and Trump are. The good news is that the current stock market action has already discounted a soft patch and, in some cases, worse. This means the balance of risk and reward is solidly with the bulls, at least the few still standing.

In the meantime, at Federated I am urging our investment teams to exploit the current volatility to upgrade the quality of our portfolios, selling names in which we have less forward confidence and buying ones in which we have more confidence, especially in cases in which the current indiscriminate selling has pounded both stocks in the pair. Beyond this, to quote James Joyce, "They also serve who only stand and wait.''

Happy Thanksgiving everyone. And remember, humility at the highs, confidence at the lows, integrity always.



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