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Crosscurrents fading

If they do, stocks could float to our 3,100 year-end target.

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BOTTOM LINE

The month of March has roared in like a bull, with the S&P 500 up nearly 20% since Christmas Eve. The charge has reversed much of the damage from the fourth quarter's 20% waterfall decline that was driven in large part by recession fears, uncertain Federal Reserve policy and the onset of the federal government shutdown. The plunge dragged business and consumer confidence with it. Combined with a negative wealth effect, this resulted in the worst Christmas retail sales season in a decade, despite a healthy labor market and declining gas prices.

Brutal winter weather across the country in January and "frugal February" likely kept consumers out of the malls, but they may return for Easter, which is late this year (April 21), aided by a savings rate that soared to a 3-year high of 7.6% in December from 6.4% in the third quarter. Consumers are amassing dry powder, possibly portending a second-quarter rebound in spending.

The Fed's policy-setting meeting on March 20 looms large. We expect it to pull another rate hike or two off the table through 2020 and announce balance sheet runoff will conclude this year, leaving reserves at about $3.5 trillion. The labor market remains robust despite ongoing weakness in autos and housing. We believe the current manufacturing soft patch will bottom as the trade and tariff skirmish with China is successfully resolved, and we think investors will *look through these crosscurrents. If they do conclude a recession is off the table, stocks might head back to record highs and to our 3,100 target at year-end.*

Adjusting our GDP forecast The equity and fixed-income investment professionals who comprise Federated's macroeconomic policy committee met last week to discuss a host of issues:

- The flash fourth quarter GDP growth rate released last Thursday was a better-than-expected 2.6% compared with gains of 3.4% in the third quarter and 4.2% in the second. Because of the 20% collapse in stock prices, miserable December retail sales and the start of the government shutdown on Dec. 22, we were expecting only 2%. The Bloomberg consensus estimate was at 2.2% and the Atlanta Fed's GDPNow model was 1.8%.
- That brought full-year 2018 GDP growth to 2.9%, exactly in line with our estimate and that of the Blue Chip consensus.
- The government shutdown ended on Jan. 25 and the Commerce Department estimates GDP growth was at least a tenth of a percentage point slower for each of those weeks, with some additional weakness stemming from a negative multiplier effect. In conjunction with brutal winter weather across the country and ongoing concerns about manufacturing, trade and inventories, we kept our first-quarter 2019 estimate at 1.7%. The Blue Chip consensus lowered its from 2.2% to 2% (within a range of 1.5% to 2.6%).
- In response to the government reopening, winter soon behind us, the Fed on hold, the China trade deal likely resolved and the potential for consumers to spend their savings-rate nest-egg during Easter, we sharply increased our second quarter estimate from 2.1% to 2.6%. The Blue Chip consensus raised its up a tick from 2.5% to 2.6% (within a range of 2.1% to 3.3%).
- These positive trends should continue to unfold into the second half of 2019, so we ticked up our third-quarter estimate from 2.5% to 2.6%, while the Blue Chip consensus is standing pat at 2.2% (within a range of 1.7% to 2.7%).
- We are expecting a better Christmas this year, so we are raising our fourth-quarter estimate from 2.6% to 2.8%, while the Blue Chip consensus remains unchanged at 2.0% (within a range of 1.4% to 2.5%).

- That moves our full-year 2019 GDP growth estimate up from 2.5% to 2.6%, while the Blue Chip consensus remains at 2.6% (within a range of 2.2% to 2.8%).

TAGS

EQUITY | MARKETS/ECONOMY | CONSUMER SPENDING

DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

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