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Spring is coming

Even if Q1 earnings decline, a year-end target of 3,100 on the S&P 500 remains our forecast.

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BOTTOM LINE

The S&P 500 has rebounded more than 23% since its Christmas Eve trough, nearly erasing the sharp 20% waterfall decline in stock prices we experienced during the fourth quarter. Last December's "death cross" has since been replaced by this spring's "golden cross." The issues that drove stocks lower—the imminent fear of recession, uncertainty over Federal Reserve policy and the federal government shutdown—are now off the table.

With the brutal winter weather also behind us, several of the key economic metrics we monitor are starting to turn positive this spring, including the labor market, consumer spending, manufacturing, and business and consumer confidence. Overseas concerns linger, including slower economic growth in both Europe and Asia, ongoing Brexit uncertainty, and trade and tariff talks with China, the latter we believe will be resolved favorably by midyear.

But a likely choppy first-quarter earnings season kicks off today, which could post year-over-year profit declines of perhaps 3-5%, due to the aforementioned transitory issues fading from view. In fact, we expect company managements to speak through these temporary hurdles in their conference-call guidance, as positive earnings should get back on track in the second quarter and accelerate in the second-half of 2019. While this sloppy first quarter may spark a *healthy, modest correction in share prices, we view that as a buying opportunity. We continue to forecast a year-end target price of 3,100 for the S&P.*

Inflation and Fed policy in line Inflationary pressures appear to be relatively benign at the moment. Both core PPI and core CPI were at 2% in March, down sharply from 2.8% and 2.2%, respectively, in December. More important to Fed decision-making is that its preferred measure of inflation, core PCE, fell in January to 1.8% from 2% in December. This metric is now back below policymakers' oft-stated 2% target, which should give them more flexibility over the next two years to be patient with regard to future rate hikes.

As if on cue, at its policy-setting meeting on March 20, the Fed made no change in rates. But importantly, it removed two rate hikes from its previous 2019 plans and now estimates only one quarter-point hike in 2020. We're skeptical that this rate hike will ever be executed, as we believe the Fed may be done hiking rates this cycle. The Fed also lowered its monthly balance sheet run-off pace from $50 billion to $35 billion and promised to end the program by Sept. 30, with its balance sheet at around $3.6 trillion. At that point, the Fed said it will begin to slowly reconfigure its balance sheet over the next few years, so that it will run off all its mortgage securities and eventually maintain an all-Treasury portfolio.

Raising our GDP forecast The fixed-income and equity investment professionals who comprise Federated's macroeconomic policy committee met on Wednesday to discuss the current inflection point in economic activity:

- The Commerce Department revised down its fourth-quarter GDP from a preliminary 2.6% to a final 2.2% (compared with gains of 3.4% in the third quarter and 4.2% in the second quarter), largely due to the 1.6% decline in December's retail sales—the weakest month-over-month nominal sales in a decade.
- That brought full-year 2018 GDP to 2.9%.
- Commerce will flash first-quarter 2019 GDP on April 26. The 5-week government shutdown ended on Jan. 25, costing the economy at least 0.5%, with ongoing economic concerns relating to manufacturing, trade and inventories during the

quarter. We endured another brutal winter, the fourth in the past five years, which contributed to poor retail sales during "Frugal February." But January's retail sales recovered nicely from the dismal December results. So we're expecting a healthy bounce in March, as the personal savings rate has spiked to a 3-year high of 7.7%. As a result, we have raised our first quarter of 2019 growth estimate from 1.7% to 1.8%. The Blue Chip consensus lowered its estimate from 2% to 1.5% (within a range of 0.8% to 2%), while the Bloomberg consensus estimate is at 1.6%. Interestingly, the Atlanta Fed's GDPNow model has sharply boosted its estimate from 0.2% to 2.3% over the past month.

- Winter is over, the federal government has reopened, the labor market has recovered from its February hiccup, concerns over Fed policy have been assuaged and consumers have begun to spend some of their dry powder during the late Easter season. So we increased our second quarter 2019 growth estimate from 2.6% to 2.7%. The Blue Chip consensus remained unchanged at 2.6% (within a range of 2% to 3.4%).
- We expect strong Back-to-School retail sales, and the China trade deal should be favorably resolved by midyear. We may begin to ship more exports to China under the terms of the deal starting in the third quarter, which should boost GDP. As a result, we raised our third quarter 2019 growth estimate a tick from 2.6% to 2.7%. The Blue Chip consensus—which harbors a much more pessimistic view of the economic potential of the China negotiation—is standing pat at 2.2% (within a range of 1.7% to 2.8%)
- We are expecting a much better Christmas later this year compared with 2018, and a stronger pace of China exports, so we are raising our fourth-quarter 2019 GDP growth estimate from 2.8% to 2.9%. The Blue Chip consensus remains unchanged at 2% (within a range of 1.3% to 2.5%).
- That moves our full-year 2019 growth estimate up from 2.5% to 2.6%. In contrast, the Blue Chip consensus fell significantly from 2.6% to 2.3% (within a range of 2.1% to 2.6%).
- We are initiating our full-year 2020 GDP growth estimate at 2.4%, compared with the Blue Chip consensus at 1.9% (within a range of 1.2% to 2.4%).

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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.

Consumer Price Index (CPI): A measure of inflation at the retail level.

Personal Consumption Expenditure (PCE) Index: A measure of inflation at the consumer level.

Producer Price Index (PPI): A measure of inflation at the wholesale level.

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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