Bell Bank Wealth Management

EQUITY & FIXED INCOME OUTLOOK OCTOBER 2019

Federal Reserve Monetary Policy

The Federal Reserve reduced the high end of the Fed funds rate by 25 basis points, dropping from 2.25% to 2.0%, at its September 18 meeting. Current consensus is that the Fed will leave the rate unchanged at its October 30 meeting. There is about a 75% probability of another rate cut at the December 12 meeting.

Inflation

The most recent year-over-year inflation rate was 1.7%, with the next release scheduled for October 10. We look for the rate to be 1.8% at that announcement. Inflation continues to be stable, while nearly all other sources of data are experiencing elevated volatility.

Economic Activity

If someone asked us for a list of economic attributes that look good in the current economy, we would cite unemployment at 50-year lows, employment at a record high, wages up, home values up, consumer confidence strong, 401(k) balances up and gross domestic product (GDP) growth remaining in the 2 to 2.5% range.

If someone asked us for a list of attributes we would like to see improve in the current economy, we would suggest a resolution to the trade war, lifting of tariffs, acceleration in manufacturing, better economic growth in Japan and Europe, more business investment and stronger "soft data."

Soft data are responses to survey questions from consumers, manufacturers, small business owners and corporate CEOs and CFOs. The surveys ask about how respondents feel about prospects for hiring, sales growth, new business investment, economic growth and other expectations for general business conditions over the coming year. Even though the "hard data" looks good, there is so much psychology around the extended length of the current economic cycle, slowing economic growth in developed foreign countries, trade, tariffs and negative interest rates that it is starting to erode confidence. These conditions can then become a self-fulfilling prophecy.

Fixed Income

Interest rates remain suppressed, but are higher than they were at their lows. After the 10-year Treasury reached a recent low of 1.45%, it has been all the way up to 1.90% and back down to its current level of 1.67%. Rising interest rates erode the value of fixed income holdings. Negative-yielding foreign bonds also declined from a high of $17 trillion to their current level of $14.89 trillion.

Near-term U.S. Treasury bond rates are still above the 10-year Treasury bond rate, but the critical 2-year to 10-year Treasury bond yield curve remains normally sloped – albeit only moderately.

Stock Market

There has been a noticeable shift in interest toward value investing over the last 3 months. To see this shift away from growth stocks suggests that some of the "soft data" thinking is finding its way into investing activity, with investors looking for a slightly more defensive position in equities.

Price-to-earnings (P/E) ratios have climbed back up from lows of the past year-end after the selloff, but are not back up to the highs at the end of the third quarter last year.

We expect third-quarter earnings to have a lot to do with market performance in the final quarter of this year. Solid earnings news and expectations for continued growth will push the S&P to new records – and the opposite effect likely will manifest itself in market weakness. We will be watching the developments as they are announced.

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