Weekly Market Flash

Fall Event Risk Outlook

August 31, 2018

Is anyone else not quite ready for back to school season? Every year it seems that the calendar races by that much faster – which of course just means that we're getting older and grayer. Anyway! Labor Day weekend is here and thus begins the critically important fall season for asset markets. Much of the time the going is great these last four months of the year, particularly if things look promising for retailers heading into Black Friday and the holiday season. But in October, the stock market reminds us of that old nursery rhyme about the little girl who had a little curl – "when she was good she was very, very good, but when she was bad she was horrid!"

Indeed. 1929, 1987, 2008 – investors need no reminding of just how horrid some of these fall seasons have been. From where we sit today, things don't look particularly ominous. Which is not to say that we may not have some twists and turns ahead, but no one particular X-factor looms large. Here is a brief run-down of some of the events ahead that we'll be keeping an eye on to make sure our prognosis stays intact.

The Never-ending Back Story

US stocks this year had a somewhat wilder ride than they did in 2017, but the back story really has not changed all that much. The two key propellers behind this slow and steady boat are (a) continued GDP growth with relatively modest inflation, and (b) strong corporate earnings and sales. Businesses are confident, consumers are spending at a decent pace, and all that trade war rhetoric seems to be on a back burner for now – at least the trade negotiators are fumbling along incoherently without actually choosing the worst possible outcomes. Now, at some point the music will stop – no expansion lasts forever. And the next downturn will have its own special set of problems, not least of which will be how much ammunition the Fed has on hand to fight back. But that is likely a problem for another day.

September and December…

"Wake me up when September ends" goes the Green Day song. By the time September ends we will know if the Fed funds rate is higher than it was at the beginning of the month. The likelihood is that it will be – a third 2018 rate hike is pretty well baked into current market yields for short term Treasuries. That leaves December, the final FOMC meeting that will include the whole carnival of press conference and dot-plots. Recent FOMC press releases have conveyed a generally more upbeat assessment of market conditions (see "never-ending back story" above). We sense the Powell Fed wants us to understand that a fourth rate hike is very much a possibility (and not subject to undue pressure from certain Executive Branch politicians with incurable Twitter habits).

But December is still a long way off. If little has changed in the economic story and holiday shoppers appear to be rocking their Santa hats all over the malls and cyberstores, then we should expect a rate hike (and also expect that it would not much faze markets). But, anything can happen between now and then.

…And Don't Forget November

Oh, yes, and one of those "anythings," of course, happens to be a midterm election likely to draw much more interest than these midterm decision days usually do. How much event risk might there be in the midterms – either because Democrats win big and the specter of impeachment rises front and center, or because the Republicans hang on to Congress and Trump announces the evisceration of the Mueller probe and the Justice Department on November 6 evening amid all the victory and concession speeches? Not much, in our opinion. Markets have been almost unrelentingly placid in the face of all the political squalls and brushfires of the past 19 months. There seems little reason to think this one will be any different.

Don't Cry for Argentina – Or Ankara

We've had our eye on the various emerging markets woes that have been a drag on this asset class this year, including the meltdown of the Turkish lira a few weeks ago. This week it's Argentina's turn to fail at winning the battle against a freefalling currency. The monetary authorities there have pushed interest rates up to 60 percent to fight the peso's plunge (remember those hundred year Argentine bonds that were in vogue a couple years ago? Ouch) and the reformist government of Mauricio Macri is fighting to retain credibility. Meanwhile, Argentina's neighbor to the north, Brazil, has presidential elections this fall where the leading candidate is in jail and the second-place contender in the polls is a far-right populist with a flair for controversy. The good citizens of Brazil, like Queen Victoria, are not amused.

These random disruptions in developing markets could continue to stay mostly in isolation – witness that the S&P 500's total return for the year to date is over 9 percent while the MSCI emerging markets index has moved in and out of bear market territory. Again – we don't see event risk clouds of a dark enough hue to suggest a more systemic pullback across a broader swath of asset classes. But it's the fall, and tricks & treats come with the territory.

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