Market Summary – June 18, 2018

For the week ending June 15

This summary is provided by BMT Wealth Management.

Is the Fed Getting Too Hawkish?

The Federal Open Market Committee (FOMC) met last week for the fourth time this year. As widely anticipated, members of the Fed, who are voting participants of the FOMC, decided to raise the target range for the federal funds rate to 1.75% to 2.0%, up from a range of 1.5% to 1.75%. This is the second rate hike by the FOMC in 2018, and the seventh since the end of the Great Recession of 2008-09.

The FOMC's decision to raise rates was not surprising, given the strength of the labor market, accelerating economic activity, elevated consumer and business confidence, and rising inflation data. Economic reports from this past week, such as the Retail Sales Report, the University of Michigan Consumer Sentiment Index, and the Consumer Price Index and Producer Price Index (both measurements of inflation), all surprised to the upside.

What was not expected was the FOMC's signaling of two more potential rate hikes in 2018. This news prompted a modest selloff in equity markets during Wednesday's (June 13) trading session.

Given how low interest rates are relative to historical levels, the mention of one additional rate hike does not seem overly worrisome on the surface. However, we have some concern that the Fed may attempt to normalize rates at a more rapid pace than the market has been anticipating, especially with the current lack of robust wage growth, news surrounding tariffs, and trade-war rhetoric. This could offset some of the positive economic developments that have been brought about by recent tax cuts, deregulation in the financial sector, and announcements of additional fiscal spending.

A more hawkish Fed often causes recessions, and while we do not think a recession is in the immediate offing, we would start to get less sanguine about future economic conditions if the Fed raises rates more aggressively than what is being priced into the market.

As the chart below illustrates, wage growth has yet to reach levels that would warrant a more aggressive Fed rate-hiking campaign.

Bureau of Labor Statistics
Average Hourly Earnings:
30 Years Ending 5/31/2018

Source: FactSet, Inc.

Financial Market Overview

Despite all the potential market-moving events of last week, including the FOMC's surprising statement that it might make two additional rate hikes in 2018, tariff announcements, and deteriorating trade relations between the United States and China, the S&P 500 Index ended the week virtually unchanged, up 0.07%.

Small caps, as measured by the Russell 2000 Index, rose 0.72% and finished in the black for the third consecutive week. Small cap stocks, which are arguably less affected by tariffs and the recent strengthening of the U.S. dollar, and more favorably impacted by tax cuts, have been market leaders of late.

International developed markets, as measured by the MSCI EAFE Index, finished last week with modest gains (+0.62%). Meanwhile, emerging market equities had a much more negative reaction to Wednesday's FOMC announcement regarding the potential of two additional rate hikes in 2018. The MSCI Emerging Markets Index fell -1.08% over the course of the week.

On the fixed income side, the ten-year U.S. Treasury yield drifted higher during the first half of last week, but fell in yield after Wednesday's FOMC announcement, finishing the week at 2.92%. On the short-end of the yield curve, the two-year Treasury yield rose 7 basis points (+0.07%) to 2.55%.

Last week's interest-rate movements resulted in a further flattening of the yield curve (the difference between short-term and long-term yields). The 37-basis-point (0.37%) spread between the two-year and ten-year Treasuries is now the lowest we have seen since the current business cycle began in June 2009.

Looking Ahead

Economic reports related to housing and The Conference Board Leading Economic Index are scheduled to be released this week. Hopefully, they will confirm the strength of the housing market and key leading indicators of economic activity.

While last week's FOMC meeting raises some concerns about whether the Fed will become too aggressive with its monetary tightening campaign, we do not think a lone comment from the Fed warrants a move to a more defensive posture in the portfolios we oversee, especially since economic and individual company fundamentals are still on solid footing.

BMT Podcasts

Bryn Mawr Trust is pleased to announce the launch of a podcast series, providing another way to share our expertise and offer commentary on what is moving the financial markets, financial planning, and other timely business and monetary topics.

In the inaugural podcast recorded on June 12, 2018, Jennifer Fox, President of BMT Wealth Management, and Ernie Cecilia, BMT Wealth Management's Chief Investment Officer, discuss how the financial markets are reacting to news from the recent G7 meeting in Canada and the historic meeting between U.S. President Donald Trump and North Korean leader Kim Jong-un in Singapore. They also talk about investment portfolio structuring, quantitative easing, and market fundamentals.

In Episode 2 of the BMT Wealth Management podcast of June 12, Jennifer Fox and Ernie Cecilia discuss what is driving the financial markets, the Tax Cuts and Jobs Act, regulatory trends, interest rate hikes, and government bonds around the world.

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