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Worst Of Both Worlds From The Federal Reserve Stokes Continued Selling

On Wednesday, the Federal Reserve delivered the worst of both worlds, as far as Wall Street is concerned, and the 25 basis point increase in benchmark interest rates does not even count – since that was what the market was expecting.

First, the Fed drew attention to the probability of at least a growth slow-down in 2019 and heightened fears of a recession in 2019 or 2020. The Fed's dot plot summary of projections from Fed officials showed a median expectation of 3% real (that is after accounting for inflation) in 2018 and just 2.3% in 2019. That is down from the 3.1% growth rate for 2018 and the 2.5% growth rate for 2019 that the Fed's dot plot showed at the central bank's September meeting. The market is even more pessimistic about growth in 2019 than the Fed is, but the downward shift in the Fed's projections just confirms the market's belief in slower slow growth in 2019.

Second, the market was disappointed that the Fed did not respond more forcefully to signs of a slow-down. The market had already priced in a shift to two interest rate increases in 2019, rather than three, and was looking for the Fed to move to just one interest rate increase in 2019. The market did not get that – the Fed did signal two instead of three interest rate increases in 2019 but shied away from moving more forcefully.

Third, the Fed did not address at all a growing fear among market participants that the Fed's decision to reduce the size of its asset portfolio is a significant tightening of the money supply – even more significant than shifts in the Fed's benchmark interest rate.

In Wednesday's post-announcement press conference, Fed chair Jerome Powell said he was not looking to slow the pace at which the Fed is reducing the size of its balance sheet. (The Fed reduces its balance sheet by selling Treasuries and other assets on the market, or not buying assets to replace those that mature. That has the effect of pulling liquidity, cash, out of the economy and putting it instead on the Fed's books.)

The Fed is currently reducing the size of its balance sheet by $50 billion a month and Powell's statement indicated that the Fed is not interested at this moment in reducing the size of that tightening.

There has been increasing worry recently that a lack of liquidity on down-days for stocks is making down-ward moves larger since potential buyers lack the liquidity to step up and purchase.

If there is a structural reason to fear that the growling bear market is going to get really fierce, it centers on this lack of liquidity. And on Wednesday the Fed struck the market as completely oblivious to the danger.

The recent drop in the S&P 500 has taken the index well below the February 8 and April 2 closing lows at 2581. A close below the lows for 2018 for a second day would exacerbate fears that this bear is not anywhere near done. That would likely lead to more selling by those analysts who said, before the Fed meeting, that they saw signs that the market had put in a bottom.

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BW: See "About the Author" on the next page.

About the Author

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Web sites: www.jubakpicks.com; http://jubakfund.com/; http://jubakam.com/

BW: here is an excerpt from Jim's WELCOME message on his website

After twelve years with MSN Money, I am excited at being on my own. The move gives me a chance to bring you, my readers, more and better ideas for profitable investing. Each week the folks at the MoneyShow.com and MSN Money will publish seven of my posts from this blog on their sites. That is already an increase in your weekly dose of Jubak from the days when I wrote Jubak's Journal twice a week. But you will also find another 18 or so posts a week on my JubakPicks.com blog that do not appear on either of those two sites. (Although they have appeared as much as three days ago and as little as a few minutes ago, if they are really important) on my new subscription site at http://jubakam.com/)

Here I am aiming for five posts a day five days a week. I won't always get to those numbers. Some posts just take longer to research and write and sometimes, like everyone else, I run out of gas and need to take a break. But my goal isn't some arbitrary number of posts, anyway. The goal is to bring you the best market intelligence that I can on a schedule that keeps you at least one step ahead of the market.

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