The Fed's legacy will live on

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The legacy of the December Federal Open Market Committee (FOMC) meeting promises to have lasting effects well into the new year. Once again, there were no surprises on the outcome for the US Federal Reserve (Fed) funds target following this convocation. As widely expected, the policymakers implemented their 4th rate hike of 2018, pushing the upper band of the fed funds range up a quarter-point to 2.50%. This part of the Fed outlook was the "easy" part of the equation, now comes the more challenging aspect; what will the FOMC do in 2019?

The financial markets' initial response to the outcome of this Fed meeting was an interesting one. Commentary waffled back and forth between a "hawkish" and "dovish" take. However, more importantly, in the US the 'risk' markets take was decidedly a negative one, as both the equity and high yield arenas came under visible selling pressure. As a result, the US Treasury (UST) 10-year note yield fell, flattening the yield curve, accordingly.

Experience has taught me that the markets are much smarter than I am, but one has to wonder; did the Fed really do anything surprising to warrant such reactions? In my opinion, the US policymakers delivered 'as advertised'. The problem seems to be that there was a school of thought whereby there was hope for 'no rate cut' combined with a dovish policy statement and scaled-back rate-hike projections for 2019. As a result, heading into the meeting, fed funds futures did still tilt towards a December rate increase, but the outlook for this year was essentially scaled back to virtually no moves and a rate cut for 2020.

So, what were the key aspects of this FOMC meeting, and attendant Chairman Jerome Powell's press conference, that will live on? Obviously, the rate hike comes in as number 1 on the list. The accompanying policy statement was the Fed's attempt at "threading the needle", i.e. acknowledging both a "strong" economy and giving a nod to monitoring "global economic and financial developments" for their possible "implications for the economic outlook." In addition, they added the word "some" before their "further gradual increases" language regarding the target range for fed funds. Powell did mention at the press conference that "for now, financial conditions have tightened a little bit." The Fed also dialled down their growth projections a tad, but their real Gross Domestic Product (GDP) forecasts did not envision any meaningful slowdown in economic activity. Finally, their Fed funds projections for 2019 were reduced to two rate increases from three, but they still showed one hike for 2020.

Conclusion

For 2019 we can expect a data dependent Fed, back to how the Fed normally operates. Telegraphing each and every move that will occur every three months is not the norm. Add in a new wrinkle as well: there will be

press briefings following each FOMC meeting beginning in January. In other words, the markets will have to get used to the notion that each Fed meeting will now be 'live', i.e. policy moves could potentially occur at any given convocation. The primary focus on future decision-making will be on both economic/inflation and financial conditions, but it appears as if the tug-of-war between the Fed and the money and bond markets has only just begun.

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