Market Bulletin

13 December 2017

Fed reactions following the December FOMC meeting

In a widely anticipated move, the Federal Reserve announced today it would raise the federal funds rate by 25bps to a range of 1.25% - 1.50%. The committee cited continued strength in the labor market and rising economic growth as the deciding factors in today's announcement.

The committee expects that inflation will remain below its 2% target in the near term, but stabilize at 2% over the medium term. While acknowledging hurricane-related disruptions and rebuilding may have impacted short-term economic activity, participants believe the economy will continue to expand at a moderate pace and labor markets will remain strong over the medium term.

With regards to interest rates, revised projections for year-end federal funds rates suggests three rate hikes in 2018. Participants continue to remain data dependent, monitoring inflation, economic activity, labor market strength, readings on financial conditions and international developments.

In addition, the Fed will continue to reduce its balance sheet at a monthly pace of $6 billion in treasuries and $4 billion in mortgage-backed securities through December. Effective January, the pace will increase to a cap of $20 billion per month, in line with expectations.

The committee seems to be positive on the economy and believes that the impact of fiscal stimulus will feed through to investment spending and consumption; growth was revised upwards in 2018 to 2.5% from 2.1%. The unemployment rate was revised lower from 4.1% to 3.9%, in line with recent labor market expectations. Surprisingly, inflation expectations remained unchanged despite the more bullish outlook on economic growth, likely due to recent weakness in inflation.

Overall, interest rate projections remained stable for next year and growth was revised upward. This was a largely expected, but may be interpreted as a slightly hawkish outcome. In addition, it is important to note that there will be a lot of change at the Federal Reserve in 2018, with a new Federal Reserve chair taking over in February and a number of committee members rotating out of their voting positions. We believe the Fed in 2018 will be slightly more hawkish than it is now, but the changing of the guard is something investors may want to watch next year.

Dr. David Kelly, CFA
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FOMC December 2017 Forecasts *

Percent

	2017	2018	2019	2020	Long Run
Change in real GDP, Q4 to Q4	2.5	2.5	2.1	2.0	1.8
September Forecast	2.4	2.1	2.0	1.8	1.8
Unemployment Rate, Q4	4.1	3.9	3.9	4.0	4.6
September Forecast	4.3	4.1	4.1	4.2	4.6
PCE Inflation, Q4 to Q4	1.7	1.9	2.0	2.0	2.0
September Forecast	1.6	1.9	2.0	2.0	2.0
Federal Funds Rate, end of year	1.4	2.1	2.7	3.1	2.8
September Forecast	1.4	2.1	2.7	2.9	2.8

Source: Federal Reserve, J.P. Morgan Asset Management. Data as of December 13, 2017.

*Forecasts of 16 FOMC participants, median estimate

** Green denotes an adjustment higher, red denotes an adjustment lower

Both short- and long-term bond yields fell slightly in reaction to the FOMC statement and Janet Yellen's press conference. The S&P 500 finished slightly lower, with telecom outperforming and financials lagging, although movement may be attributed to tax reform anticipation. While today's meeting went largely as expected, the path laid out for interest rates and the balance sheet, combined with a weaker dollar, the probable outcome of fiscal policy and tighter central banks overseas, should apply more upward pressure on long-term bond yields than what seems priced into the market today. The continuation of strong economic and earnings growth should continue supporting the equity market, but investors should look beneath the surface and distinguish between sectors that are helped by rising yields (such as financials) versus those that may react negatively to them (such as utilities).

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