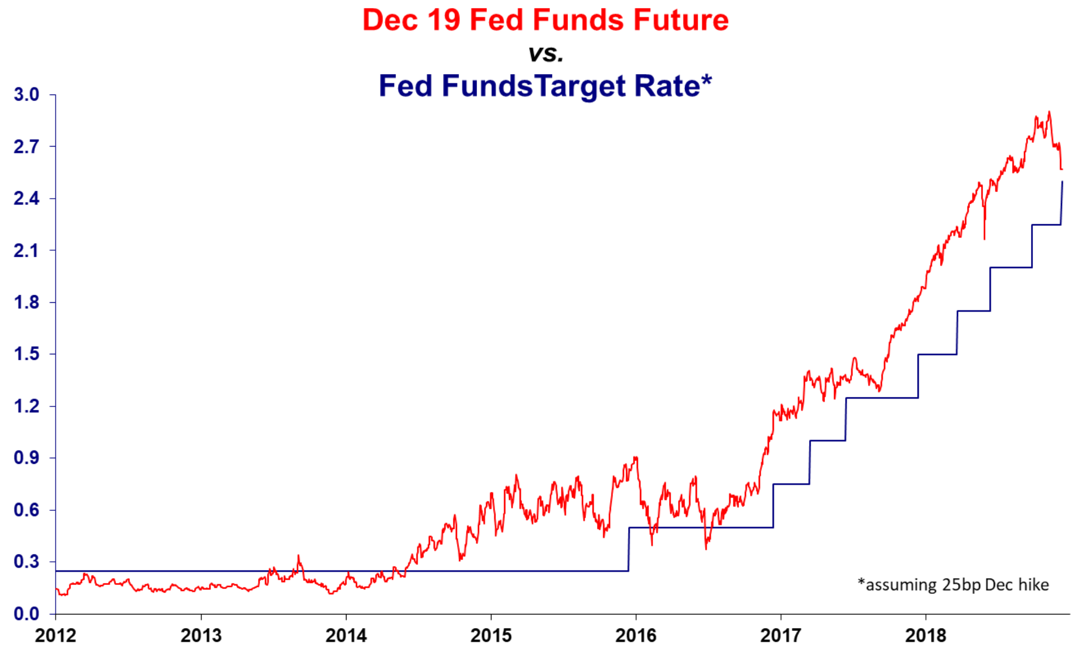
Stephanie Pomboy
212.989.3311



Here Comes Santa 'Pause'…

For a moment there last Friday investors were like kids on Christmas Eve. Disappointing Payrolls had them practically peeing their pants with excitement that Chairman Powell might deliver them a bright, shiny gift. After hiking rates at the final meeting of the FOMC for 2018, he and his elves might hit the 'pause' button and reflect.

With visions of sugarplums dancing in their heads, investors gleefully slashed their expectations for Fed rate hikes next year. **From 80% odds of two hikes, they've taken expectations all the way down to a 15% chance of just ONE (!).** The Dec 19 Fed Funds future travelling the distance from 2.9% to 2.54% in one month's time.

But as they stood back and admired their work, a sinister thought snuck in. What if, *oh heavens*, the weaker growth that is rationale for this shift is not, in fact, bullish???????

Wait.

What??

Their arrival at this radical conclusion has been a long time coming. But now that it's here, it substantially changes the picture for Mr. Powell … or whoever ends up replacing him. ☺

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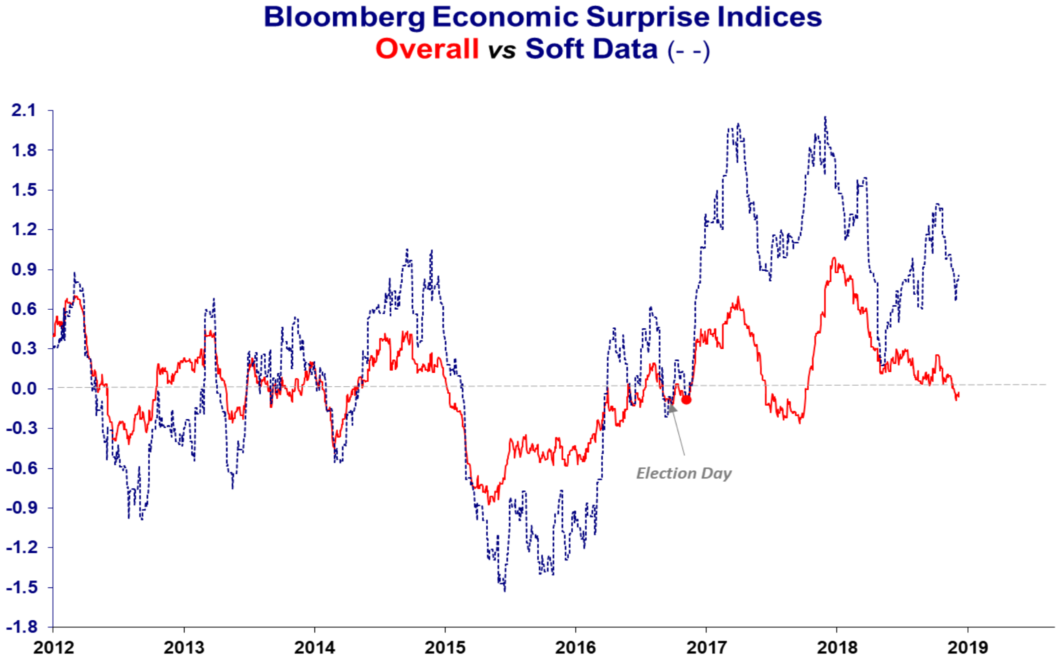

For, **the flip to 'bad news is bad news' suggests the Fed is going to have a much harder time placating the markets. They're already acting like spoiled brats and the bad news has barely begun.** For reasons outlined in exhaustive detail in "Flannel Pajamas" last week, **the seasonal tendency for the 1st quarter to disappoint is going to be greatly amplified in 1q: 2019.**

I'll spare you a detailed rehash of each, but the list includes: the swing from inventory accumulation to liquidation, challenging y/y comps from the anniversary of the tax cut, the end of post-hurricane rebuilding and the reduction in global central bank balance sheets.

Right now, all of these factors are providing silent support, although you'd be forgiven for not knowing it. **The deterioration in the tone of the data (shown above) despite all of these tailwinds is remarkable. Doubly so at a time when the seasonal factors are also hugely supportive.** Again, I'll spare you a repeat. *Lawd knows*, you've heard me go off on this topic plenty of times before. But you can see for yourself (below) just how low the bar has been set for the data driving the disappointments in the chart above these last 2 months. **The obvious point being, if this is the picture *now…***

Seasonal Assumptions			
	Retail Sales mm%	Auto Sales mm%	Existing Home Sales mm%
Oct	3.12	-0.61	-1.03
Nov	1.25	-2.18	-10.31
Dec	14.08	18.53	7.07

5 year average (2012-2016)

Stephanie Pomboy
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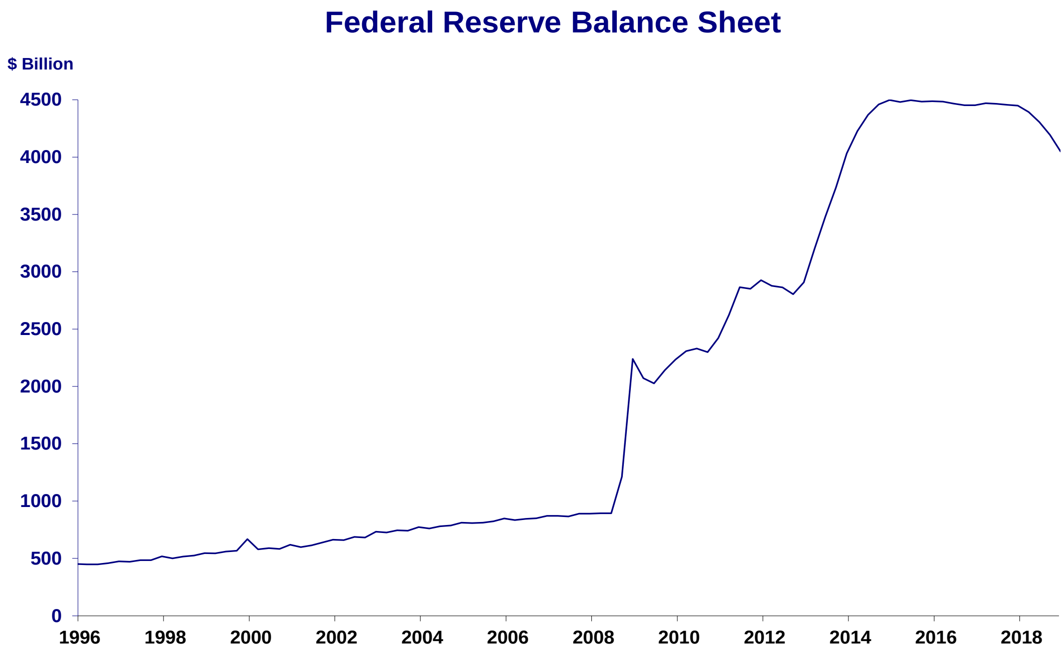
MacroMavens



As surprisingly soft 1Q data feed nascent concerns about a slowdown-- and the 'R' word grows in reference-- might the markets even begin to price in rate CUTS??????

Snore. **That's not even a question in my view.** No. In my view **the big surprise for 2019 isn't the potential discussion around whether and when the Fed pauses rate hikes, *but whether and when it pauses QT*.** For, as lamented here since the wind-down began a little more than a year ago, the reduction in the Fed's balance sheet is a huge deal—far bigger than it is credited to be. **Because it has been unfolding behind the scenes and in mechanical fashion, it has mistakenly been viewed as innocuous.**

Meanwhile, the retreat in the credit upon which the economy so urgently depends is well underway. Within the banking system, where Fed rate hikes were imagined to see an acceleration in lending at higher rates (?!) total credit growth has been cut in half over the last 2 years and has accelerated its slowdown in the last 5 months. And outside the banking system, things are cooling even faster. Investment Grade issuance is down -11% ytd, its weakest pace since 2014. While High yield issuance is down a stunning -41%. That puts it on pace for the weakest year since the financial crisis in 2009 (see addenda). Even the red-hot leveraged loan market has been brought to heel by recent market jitters.

Again, wait 'til the 1q data roll in…

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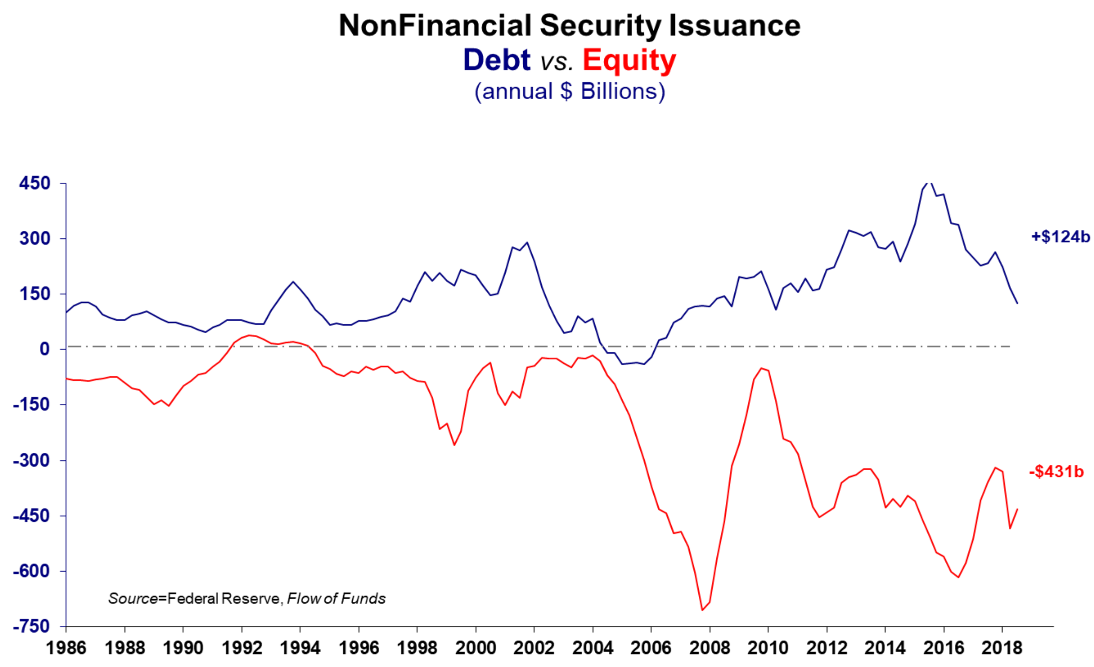

That's when the stock market's reliance on surfeit credit issuance will come into sharp and urgent focus. As the corporate sector that has been the largest buyer of equities is **deprived of the funding with which to do so, stocks will come under further pressure.** (Expect those desperately clinging to the tail of the bull to offer assurances that companies will simply shift to funding their buybacks with cash. But with profits expected to grow at less than half their current pace in the best case scenario, that prospect seems lower than low).

As the *bad news is bad news* dynamic feeds on itself, **the flight from risk will send corporate borrowing costs higher and stocks lower. And the Fed will discover that simply pausing further rate hikes isn't enough to arrest, much less reverse, the trend.**

As for cutting rates, doing so while continuing to shrink the balance sheet wouldn't seem to make any sense.

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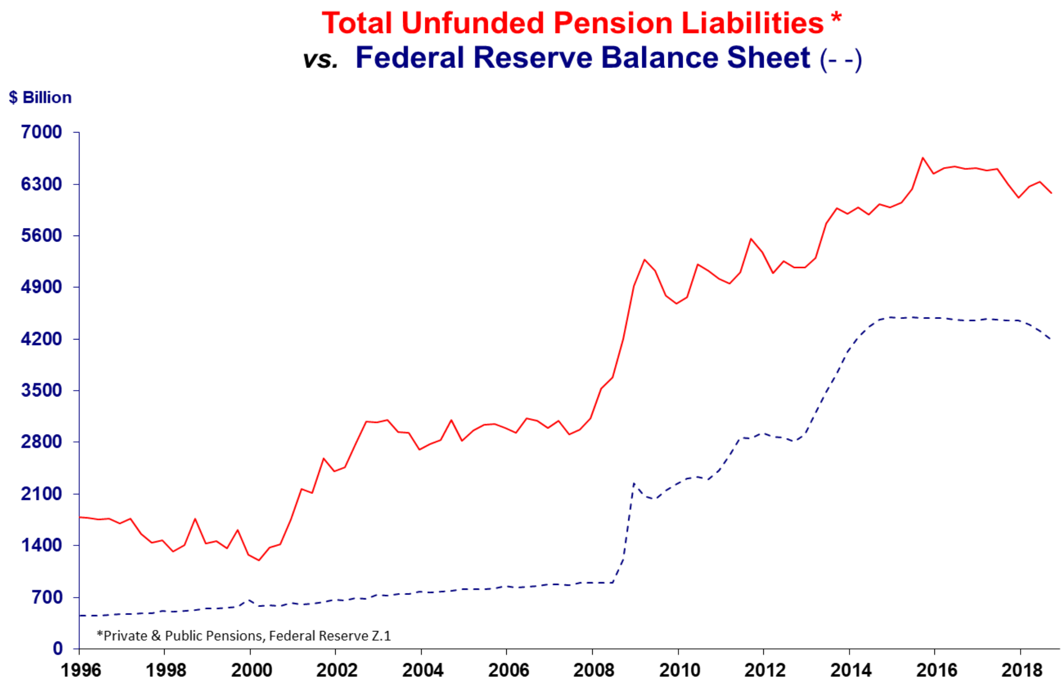
212.989.3311



Not that THAT would necessarily be a deal-breaker for the Fed. (!!) Particularly given their professed desire to maintain whatever's left of their credibility. But **as high as the bar may be for the Fed to pause QT, already 15 months in progress, the consequences of not doing so will soon be seen as too great.**

But then, I'm just talking my book. **As regular readers know, a pause in QT would simply be the first, necessary step on the road to the massive re-implementation of QE that I have long forecast.** The unwinding of risk now upon us is going to bring the pension issue –the same one that has caused many an eyeball staring at these pages to glaze over this past year -- into sharp focus. It will be clear that, **where the financial sector required a massive and urgent bailout the last time the Fed inadvertently burst a bubble of its own creation—this time it is the pension sector that will be left teetering on the brink.**

The revelation that the economic recovery and the longest running bull market in history not only failed to repair pension finances, but saw the cumulative deficit swell to $6t (!) will lead more to my grim conclusion: the only way out from under these untenable obligations is to *print, print, print.*

All of which may have sounded like a distant, or even absurd, concern just 48 hours ago. **But with investors already requesting, expecting …*and rejecting*… the gift of a rate pause under the tree, it's clearly just a matter of time before Powell and his elves are forced to re-gift Bernanke's QE.**

Stephanie Pomboy
212.989.3311

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Table: US High Yield Corporate Bonds | Exclude Self-led | Party: JP Morgan

Period: Custom | 01/01/18 - 12/08/18 | Role: Manager

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Table History | Manager History

Historical Periods | Year Over Year | Rolling Periods

Market					Top Party				JP Morgan			
Period	Vol (MM USD)	Issu...	Fees	#Parti...	Name	Issu...	Fees	Shr ...	Ra...	Issu...	Fees	Shr (...
1/1/1...	188,642.56	426	1.303	93	JP Morgan	149	1.265	9.35	1	149	1.265	9.35
1/1/1...	323,714.82	674	1.274	102	JP Morgan	286	1.098	10.61	1	286	1.098	10.61
1/1/1...	238,914.72	468	1.319	78	Bank of America Merrill Lynch	190	1.836	9.87	3	197	1.095	9.35
1/1/1...	285,580.27	617	1.143	82	Bank of America Merrill Lynch	214	1.508	10.41	3	202	0.970	9.63
1/1/1...	366,508.34	749	1.470	86	Bank of America Merrill Lynch	249	1.512	10.24	2	270	1.475	9.90
1/1/1...	360,601.16	798	1.420	93	JP Morgan	298	1.264	11.30	1	298	1.264	11.30
1/1/1	337,585.06	752	1.440	76	JP Morgan	318	1.483	11.81	1	318	1.483	11.81

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