Will the Fed pause?

SUMMARY

- **US equity markets testing key support.** The S&P 500 index fell 2.1% overnight and is now near the February 2018 low. The 10-year US bond yield fell 3bps while the USD fell marginally.
- **Reassessing growth expectations**. The list of concerns includes risks to Obamacare, a potential partial shutdown of the US government and weaker global and US economic data.
- **Fed response key.** The market is now pricing in a 35% possibility of a pause at this week's FOMC meeting, up from 26% a week ago. The tone of the press conference will be closely watched.

BACKGROUND

- **US stocks testing key technical support levels.** The S&P500 index fell below its recently established range of 2600-2800, falling below the October low of 2603, before closing just above the February intra-day low of 2533. The index has fallen 14% in the latest correction, which is within the 11-14% range experienced in the previous three corrections since 2015. Immediate support is at the February low of 2533, followed by 2375 (the 50% retracement of the 2016-2018 rise), around 7% below current levels.
- **Technology, healthcare and consumer sectors lead the equity market decline**. Insurance stocks were also in focus as a court ruling placed the future of Obamacare in question, arguing that it was unconstitutional. There is a possibility of a US government shutdown as President Trump insists on funding approval from the Congress for a wall along the US-Mexico border.
- **Global and US data point to slowing growth**. Over the past week, European business and consumer confidence data suggested the region's slowdown in Q3 extended into Q4, with Italy possibly heading into a recession. China's consumption and industrial growth slowed further, although investment started to pick up as government policy turned increasingly growth-supportive. US housing sector data pointed to further slowdown.

WHAT DOES THIS MEAN FOR INVESTORS?

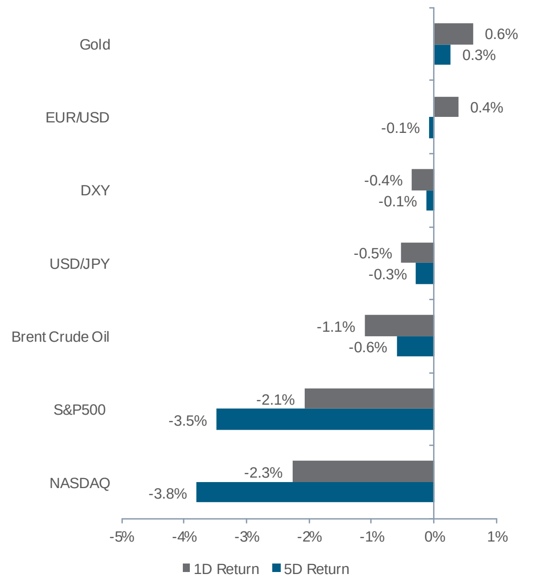
- **Staying diversified is key**. The ongoing equity market correction emphasises the importance of staying diversified. For our 2019 outlook, we have increased the allocation to cash and bonds, while dialing down risk-exposure to equities amid slowing corporate earnings growth and global growth. The recovery in bonds, as equities declined, is reassuring as it establishes the traditional role of bonds as a hedge against equity market corrections.
- **Looking for opportunities to add exposure**. We believe the latest correction presents a chance to build tactical exposure in our preferred assets classes such as US equities and Emerging Market USD government bonds.

WHAT NEXT?

- **Fed pause?** Any signal from the Fed after its 18-19 December meeting that it would pause rate hikes in 2019 (see chart) would likely be positive for risk assets. There is also growing expectation that the Fed may skip a rate hike at this week's meeting.

US equities extended their weakness yesterday

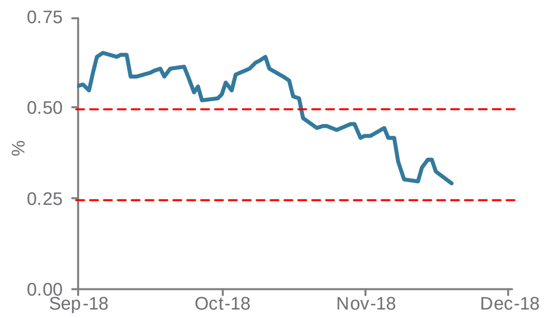
Performance of selected asset classes on 17-Dec



Source: Bloomberg, Standard Chartered

Investors are now expecting just one more 25bps rate hike in 2019 vs. two expected only a month ago

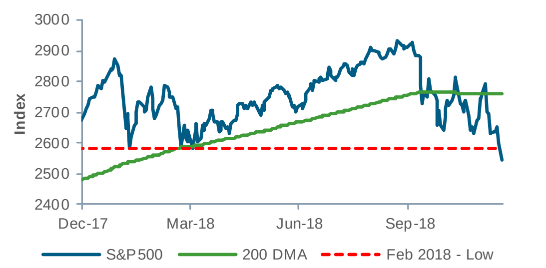
Market expectations of rate hike in 2019



Source: Bloomberg, Standard Chartered

S&P 500 fell below the 2600-2800 range, but is above the February intra-day low of 2533. This is seen as crucial short-term support

S&P 500, 200-day moving average (dma)



Source: Bloomberg, Standard Chartered

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