12/21/2018

# Fed Tightens the Screws, Government Shutdown Looms

- Equities have sold off as the Federal Reserve hiked rates for the fourth time this year.
- Possible government shutdown looms, but government dysfunction is nothing new.
- We remain cautiously optimistic. Economic and company fundamentals remain strong.

In 2018, U.S. GDP growth could top 3% for the first time in a decade, tax reform legislation was implemented, corporate earnings grew to nearly 20% and the unemployment rate is near a 50-year low, with more job openings than people looking for jobs. With that backdrop, broad stock market indices are on pace to finish the year in negative territory and well off their intra year peaks. With just a few trading days remaining in the year, this month marks the worst December for the Dow Jones Industrial Average since 1931, when the United States was in a great depression. This is leaving many investors scratching their heads in disbelief.

The main culprit for the declines this week is the Federal Reserve. Equity markets have been declining since the Fed decided to raise the Fed Funds rate a fourth time in 2018 and the seventh time in two years. The Fed tried to be dovish in making their last move upward, by signaling fewer hikes in 2019. However, investors had expected a much more dovish tone, and risk assets sold off because the chances of a policy mistake increased. Current inflation is below the Fed’s target and has been trending downward in the fourth quarter, and unemployment is extremely low. While the economy is humming along, the Fed even agreed there does not seem to be any asset bubbles. This leaves many questioning why the Fed continues to push rates higher when the economy is widely expected to slow in 2019 and 2020. Looking to Fed Funds futures, the market is pricing in over a 50% probability that the Fed will not hike rates at all in 2019, but the probability that there will be more is driving equities lower.

In addition to the Fed raising short-term rates, a government shutdown looks increasingly likely. President Trump is threatening to veto any spending bill that does not include border security. However, government shutdowns are nothing new. This would mark the 21 time since 1976 that there has been a government shutdown. Shutdowns have ranged from 1- 21 days, so they tend to be relatively shor -term in nature. Also, the potential shutdown is limited in scope this time around, as it impacts about 25% of government agencies, and is limited to non-essential federal workers. These workers are likely to eventually be paid in full. Markets tend to trade down on news of a shutdown, but recover quickly, frequently recovering more than twice as much as they lost.

Other concerns that have been hanging on investors’ minds have been slower economic growth, weaker earnings growth, and tariffs. We covered these topics in more detail in our 2019 outlook. In summary, earnings growth is expected to slow with the U.S. economy, but both are still expected to be healthy. The economy and corporate earnings were propelled by tax cuts and growth is declining to sustainable levels. Tariffs are a risk but have yet to impact prices of goods on a broad scale. The impact has been limited to certain industries and products.

We do not mean to dismiss these investor concerns, but merely put them in perspective. The Fed continuing to raise rates is our biggest concern right now, but we think the Fed will be more cautious in 2019. We believe there is a chance for a pause to reassess actions, and there could be one rate hike in 2019 rather than two as the Fed is currently anticipating. If there is a government shutdown, we think it will be short-lived, and with limited impact. We will continue following developments out of Washington and watching for any signs the shutdown will be prolonged. Tariffs are hard to predict, but this could be a longer-term issue. Both the United States and China will want to come to a trade agreement, but neither will want to concede much.

Overall, we are cautiously optimistic. Valuations in equities were near 15-year highs in some indexes and have come down over the past quarter. Valuations are closer to their 15-year averages now and small capitalization stocks and value stocks are a lot cheaper than their long-term averages. There are many uncertainties in the market, but economic and company fundamentals remain strong.

---

*This report is created by Cetera Investment Management LLC*

**About Cetera® Investment Management**

Cetera Investment Management LLC is an SEC registered investment adviser owned by Cetera Financial Group®. Cetera Investment Management provides market perspectives, portfolio guidance and other investment advice to its affiliated broker-dealers, dually registered broker-dealers and registered investment advisers.

**About Cetera Financial Group®**

Cetera Financial Group ("Cetera") is a leading network of independent firms empowering the delivery of professional financial advice to individuals, families and company retirement plans across the country through trusted financial advisors and financial institutions. Cetera is the second-largest independent financial advisor network in the nation by number of advisors, as well as a leading provider of retail services to the investment programs of banks and credit unions.

Through its multiple distinct firms, Cetera offers independent and institutions-based advisors the benefits of a large, established broker-dealer and registered investment adviser, while serving advisors and institutions in a way that is customized to their needs and aspirations. Advisor support resources offered through Cetera include award-winning wealth management and advisory platforms, comprehensive broker-dealer and registered investment adviser services, practice management support and innovative technology. For more information, visit cetera.com.

"Cetera Financial Group" refers to the network of independent retail firms encompassing, among others, Cetera Advisors, Cetera Advisor Networks, Cetera Investment Services (marketed as Cetera Financial Institutions), Cetera Financial Specialists, First Allied Securities, and Summit Brokerage Services. All firms are members FINRA/SIPC.

**Disclosures**

*The material contained in this document was authored by and is the property of Cetera Investment Management LLC. Cetera Investment Management provides investment management and advisory services to a number of programs sponsored by affiliated and non-affiliated registered investment advisers. Your registered representative or investment adviser representative is not registered with Cetera Investment Management and did not take part in the creation of this material. He or she may not be able to offer Cetera Investment Management portfolio management services.*

*Nothing in this presentation should be construed as offering or disseminating specific investment, tax, or legal advice to any individual without the benefit of direct and specific consultation with an investment adviser representative authorized to offer Cetera Investment Management services. Information contained herein shall not constitute an offer or a solicitation of any services. Past performance is not a guarantee of future results.*

*For more information about Cetera Investment Management, please reference the Cetera Investment Management LLC Form ADV disclosure brochure and the disclosure brochure for the registered investment adviser your adviser is registered with. Please consult with your adviser for his or her specific firm registrations and programs available.*

*No independent analysis has been performed and the material should not be construed as investment advice. Investment decisions should not be based on this material since the information contained here is a singular update, and prudent investment decisions require the analysis of a much broader collection of facts and context. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The opinions expressed are as of the date published and may change without notice. Any forward-looking statements are based on assumptions, may not materialize, and are subject to revision.*

*All economic and performance information is historical and not indicative of future results. The market indices discussed are not actively managed. Investors cannot directly invest in unmanaged indices. Please consult your financial advisor for more information.*

*Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.*

***Glossary***

*The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.*