Donaldson
CAPITAL MANAGEMENT

This Week in the Market
3-18-19

## Where's The Inflation?

Markets were whipsawed in a week where the Fed made clear their intention to stand pat on rates for the balance of the year. What was initially cheered as an accommodative move from the FOMC, was ultimately questioned with the shocking degradation revealed in the European economy. After a 44.7 reading on the German Manufacturing PMI indicated a 3rd straight month of contraction, markets began to question whether soft economic conditions around the world would begin to infect the US. German 10 Year bund yields went negative and the 3 Month/ 10 Yr. US treasury yield curve inverted. This move sent the quants in motion and ended the week with our worst single day session since January. From a technical standpoint, we have broken back down through our previous levels of resistance around 2800 and sector performance has gone decidedly risk-off. An early week surge in technology shares was mostly reversed by the end of the week. With growth concerns returning, the battle for 2800 rages on.

The Fed emphasized their concern with the lack of inflation in this week's meeting. As such, rate hikes are on hold and the probability of a cut is building. Powell believes that slack in the form of a low labor force participation rate may be holding down inflation more than unemployment alone would indicate. The FOMC looks to be taking it open themselves to kick-start inflation by completely backing off their previously aggressive path. While this heightens growth concerns at first glance, Strategas notes that ultimately this will ease monetary conditions once again. We've already seen mortgage rates fall significantly as evidence. The curve has a chance to re-steepen over the interim if the Fed's more dovish stance is successful in stoking inflation. We'll have to pay attention to the data in coming months.

On the trade front, it appears that a deal is near with China. However, investors are not pricing in existing tariffs rolling off. Should that be the case, the market could surprise to the upside. To that end, the early week action in tech and in particular semiconductors was indicative of that notion. We've said before that settling trade would be the equivalent of additional fiscal stimulus. This is especially true if business confidence improves after a deal. A subsequent CapEx splurge would have the potential to provide a lift to US growth and help insulate us from the global softness. The risk is obviously that a deal fails to materialize. We'll be watching.

For us, our portfolios held up as they should in this week's volatility. The action in utilities and the more blue chip names buffered the portfolio nicely.