UOB Asset Management

Insights

Fed: Subtract and divide

The US Federal Reserve (Fed) has lowered the benchmark federal funds rate by 25 basis points. The decision marks an opinion division between members of the Federal Open Market Committee (FOMC) on whether to hold rates or enact one more reduction in 2019.

Our opinion is that the Fed will undertake one more cut at the December FOMC meeting as officials communicated a pledge to utilise policy to sustain the economic expansion.

Here are the key messages from the meeting:

- Benchmark federal funds rate are now in a range between 1.75-2.00%
- Tariffs and weak global manufacturing data were cited as reasons for increased caution

The Fed follows the decision from the European Central Bank (ECB) last week to ease policy rates. The ECB unveiled several measures to combat flagging manufacturing activity amid slowing global growth and headwinds from trade uncertainties which have raised concerns of a recession.

While business fixed investment and exports have taken a hit, the US economy has been supported by household spending rising at a strong pace. Further, the Fed upgraded their median GDP growth projections in both 2019 and 2021. It is our view that the tension between weak global business confidence and healthy global consumer confidence is going to determine whether the cycle can be extended.

House view and positioning

Since slower growth does not automatically mean that a recession is imminent, we still need to take advantage of the market, however avoiding risks while staying cautious.

Hence we underweight equities and overweight fixed income. Within equities we are focused on high quality, dividend focused stocks. For fixed income, we focus on good quality investment grade names over high yield. In addition, investing in higher yielding emerging market bonds might become the new normal in an era where yield hunting flows are getting more aggressive. Long duration had paid off nicely for us in the last few quarters, but concurrently bond yields have been volatile. As benchmark yields such as the 10-year US Treasury falls below 1.7% we would recommend short duration bills but as yields climb back above 1.7% then we would prefer longer duration credits.

We are raising cash levels and will look for greater economic clarity before any repositioning.

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