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## The Fed gives stocks free rein to run. Can the rally continue?

Weekly Market Compass: Powell's assurances boosted the market's confidence that rates will stay low until inflation flares significantly

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**Nov 4, 2019 | Kristina Hooper, Chief Global Market Strategist**

Last week's Federal Reserve (Fed) meeting proceeded largely as expected, but a very important development for stocks occurred during the follow-up press conference.

As expected, the Fed decided to cut rates by 25 basis points. Additionally, in its announcement, the Fed removed the language that stated it would "act as appropriate to sustain the expansion." This was a change that many expected and some feared, as it suggests a higher hurdle to cut rates going forward. I worried that the removal of this language in the Fed announcement could have been negative for stocks. After all, expectations were relatively high that the Fed would cut rates again.

However, Fed Chair Jay Powell did something very significant at the press conference: He assured markets that the Fed will not raise rates until inflation increases significantly - which seems very unlikely any time soon given the data we have been seeing. Essentially, this gives stocks free rein to perform as they will without the concern that the Fed will unexpectedly tighten its grip. The result was a rally for stocks. From the time that the press conference started on the afternoon of Oct. 30 through end of day Nov. 1, the S&P 500 Index rose 1.06%.<sup>1</sup>

### Is the stock market rally sustainable?

As I have said before, monetary policy can have a more positive impact on asset prices than on the general economy, and I believe that will continue to be the case going forward. The rally we experienced last week after Powell's press conference could very well continue. At the very least, I expect a strong positive bias for stocks in the coming weeks.

Of course, that begs the question of what could possibly derail a Fed-induced rally. The following are several possible factors:

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#### The US-China trade situation

US Treasury Secretary Steven Mnuchin confirmed last week that the United States and China remained on track to sign a "Phase 1" trade agreement in November. However, I don't believe this is a fait accompli as there continue to be some conflicting statements from both parties on the progress of trade talks. And even if Phase 1 were completed, there's a far smaller likelihood that any other phases of the trade deal would come to fruition. If we get negative news flow around trade - or, even worse, if trade talks are derailed - this would likely exert downward pressure on stocks. However, I expect any such stock sell-off would be short-lived, as it seems the Fed left the door open to cutting rates again if the trade situation deteriorated.

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#### Very weak economic data

US economic data has been generally positive, but there have been some signs of weakness. While overshadowed by a strong jobs report, the Chicago Business Barometer (also known as the Chicago Purchasing Managers Index) for October caused apprehension when it was released. It clocked in at 43.2, which is not only below expectations but represents a four-year low.<sup>2</sup> And, of course, we continue to see weakness in manufacturing: The national ISM Manufacturing Purchasing Managers Index clocked in at 48.3, which was below consensus - and the third straight month of contraction.<sup>3</sup> If economic data were to weaken further, that could derail a stock market rally. Although, similar to the US-China trade war scenario, the Fed would likely step in and cut rates if data were to deteriorate.

Powell's words reassured markets during his press conference last week, but they are just words. And so speeches in the coming weeks by Powell or Fed Vice Chair Richard Clarida have the potential to upend positive sentiment if they contradict what Powell said last week. In my view, this would be the most dangerous threat to a Fed-induced stock market rally. In the previous two scenarios, the Fed could be the remedy for the problem - in this case, it could be the problem.

Despite the potential rally-stoppers described above, what happened last week at Powell's press conference was nothing to sneeze at. Make no mistake - the Fed has loosened its grip and given US stocks free rein to run as we head into the end of the year.

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**Source**

<sup>1</sup>Source: Bloomberg, L.P.

<sup>2</sup>Source: Institute for Supply Management - Chicago, as of Oct. 31, 2019

<sup>3</sup>Source: Institute for Supply Management, as of Nov. 1, 2019

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Blog header image:

All investing involves risk, including the risk of loss.

A basis point is one hundredth of a percentage point.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

The Chicago Business Barometer™ is a weighted composite indicator made up of five sub-indicators, namely New Orders, Production, Employment, Order Backlogs and Supplier Deliveries. It is designed to predict future changes in gross domestic product (GDP). Survey data is collected online each month from manufacturing and non-manufacturing firms in the Chicago area.

The Purchasing Managers Index (PMI), a commonly cited indicator of the manufacturing sectors' economic health, is calculated by the Institute of Supply Management in the US.

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