First Trust
Monday Morning OUTLOOK
630-517-7756 • www.ftportfolios.com
October 15, 2018

Heartburn, Not a Heart Attack

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*

Not long ago, many investors were kicking themselves for not investing more when the stock market was cheaper. But when stocks fall, like they did last week, many investors have a hard time buying for fear stocks may go lower still.

Who knows, maybe they're right. We have no idea where stocks will close today, nor at the end of the week. Corrections (both small and large) happen from time to time. In hindsight, many claim they knew it was coming, but we don't know anyone who has successfully traded corrections on a consistent basis – we certainly won't try.

We're also skeptical when analysts try to attribute corrections to a particular cause. It's a basic logical flaw: *post hoc ergo propter hoc*. Because the correction happened after a certain event, that event must have been the cause. But important news and economic events happen all the time. Sometimes the market goes up afterward, sometimes down, and similar events at different times have no discernible impact.

Now some are blaming the Federal Reserve, and specifically statements from Chairman Powell, for the downdraft in equities. But, according to futures markets, the outlook for monetary policy has barely changed. The markets are still pricing in a path of gradual rate hikes and continued reduction in the size of the Fed's balance sheet.

Let's face it, fretting over the Fed is as old as the Fed itself. In recent years alone, we faced the "Taper Tantrum" and calls for a fourth round of quantitative easing. And remember when the Fed first raised rates and then announced it would reduce its balance sheet? Each time, analysts predicted the apocalypse was upon us – that a recession and bear market were right around the corner. How did those calls pan out?

Exactly, they were wrong, and this time looks no different. QE never lifted stocks, taking it away won't hurt; and interest rates are still well below neutral. The biggest pain has been felt by those who followed the false prophets of doom.

The odds of a recession happening anytime soon remain remote, we put them at 10%, or less. And a recession is what it would take for us to expect a full-blown bear market. In other words, the current drop is just heartburn, not a heart attack.

We'll publish a piece next week about our exact forecast for economic growth in Q3, but it looks like real GDP rose at about a 4.0% annual rate. Profits are hitting record highs and businesses are still adapting to the improved incentives of lower tax rates and full tax expensing for business equipment. Home building is still well below the pace required to meet population growth and scrappage (roughly 1.5 million units per year). Household debts are low relative to assets and debt service payments are low relative to income. These are not the ingredients for a recession.

That's why we love Jerome Powell's response to the recent gyrations in the market. Many pundits were calling for him to back off his tightening and his "hawkish" language, but he didn't take the bait. He's focused on monetary policy, and the economy and won't be pushed around by hysterics or market gyrations. The S&P 500 fell about 6% from its intraday all-time high to Friday's close. This isn't earth-shattering, and the Fed shouldn't respond. Investors need to stop obsessing about the Fed. Instead, they should focus on entrepreneurship and profits. The fundamentals are what matter.

Meanwhile, some investors are concerned about President Trump tweeting or speaking out on the Fed and monetary policy. If this were any other president, we'd be concerned, as well. But we all know Trump isn't the kind of president to hold his opinions close to the vest on <u>any</u> topic. If he thinks it, he says it. Please take his comments on the Fed in that context. That certainly seems to be what Jerome Powell is doing.

The bull market in equities that started in March 2009 isn't going to last forever. But we don't see anything that's going to bring it to a screeching halt anytime soon.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-15 / 7:30 am	Retail Sales – Sep	+0.6%	**+0.6%**	+0.1%	+0.1%
7:30 am	Retail Sales Ex-Auto – Sep	+0.4%	**+0.3%**	-0.1%	+0.2%
7:30 am	Empire State Mfg Survey – Oct	20.0	**21.4**	21.1	19.0
9:00 am	Business Inventories – Aug	+0.5%	**+0.5%**	+0.5%	+0.7%
10-16 / 8:15 am	Industrial Production – Sep	+0.2%	**+0.1%**		+0.4%
8:15 am	Capacity Utilization – Sep	78.2%	**78.1%**		78.1%
10-17 / 7:30 am	Housing Starts – Sep	1.210 Mil	**1.251 Mil**		1.282 Mill
10-18 / 7:30 am	Initial Claims – Oct 13	210K	**215K**		214K
7:30 am	Philly Fed Survey – Oct	20.0	**16.2**		22.9
10-19 / 9:00 am	Existing Home Sales – Sep	5.290 Mil	**5.270 Mil**		5.340 Mil

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.