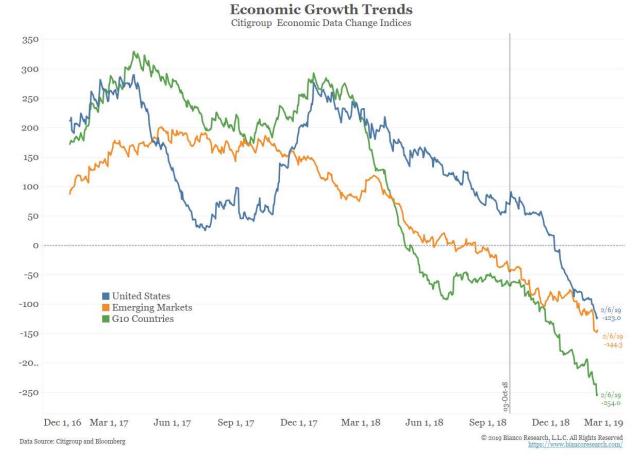


- The market interpreted the Fed's December 19 Summary of Economic Projections for two more rate hikes, along with Powell's statement on continued balance sheet reductions, to be the equivalent of 4 or 5 rate hikes. This did not sit well with risk markets. The plunge in stocks reversed when Powell offered a more dovish tone on January 4 and again on January 30.
- Clearly there is a difference of opinion regarding the effect balance sheet reductions have on the markets. The Fed thinks these reductions are a rounding error in monetary policy, equaling less than 1 rate hike. The market thinks projected reductions equate to 2, or maybe 3, rate hikes via a loss of liquidity.
- All markets are moving in tandem as the "Powell Put" exists and has been exercised.
- By inserting the word "patience" into the FOMC statement, the Fed has signal it has paused. By adding the phrase "to determine," it is more likely signaling the rate hikes are over.
- The fear is the market selloff has damaged the economy. Sentiment is poor and earnings are on the verge of a recession. Q1 2019 y-o-y forecasts are now negative.
- As Bernanke himself stated, recessions occur because the economy is murdered. So look for the murderer (i.e., the Fed) and not the victim (economic data) to determine if a recession is coming. Economists never see one coming.
- The pain trade is lower yields.
- The yield curve matters and an inversion is a sign the economy is going into recession.
- It would be surprising if we do NOT see a restest of the late December lows. Later this spring, look for 10-year yields back near 2.55%, crude under \$45 and the S&P back near 2500.

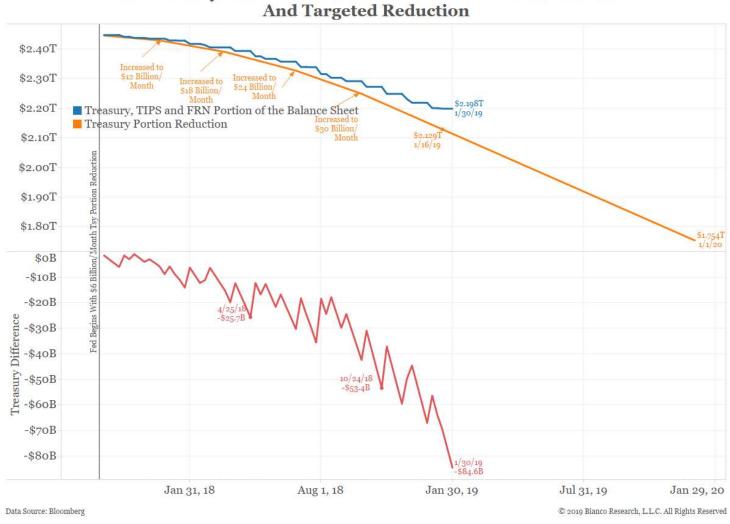
"There's really no reason to think that this cycle can't continue for quite some time, effectively indefinitely," Powell said Wednesday at an event in Washington hosted by The Atlantic magazine and the Aspen Institute. – <u>Bloomberg</u>, October 4, 2018



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So we thought carefully about this, on how to normalize policy and came to the view that we would effectively have the balance sheet runoff on automatic pilot and use monetary policy, rate policy to adjust to incoming data.

– Jay Powell, December 19, 2019

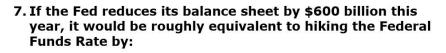


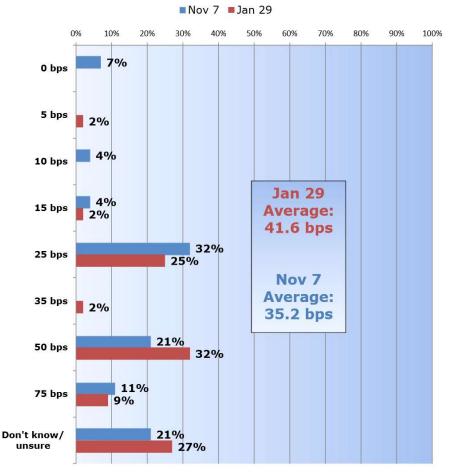
The Treasury Portion Of The Federal Reserve's Balance Sheet

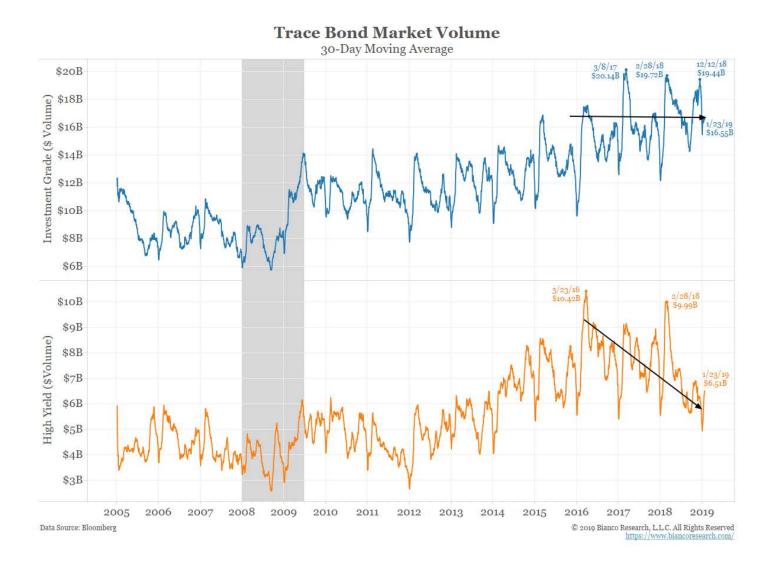
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Kansas City Federal Reserve May 10, 2017 Forecasting the Stance of Monetary Policy under Balance Sheet Adjustments

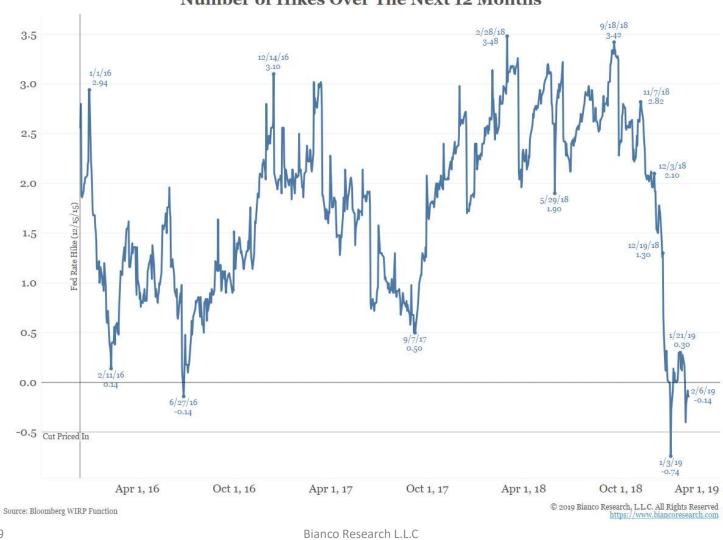
The Federal Reserve's balance sheet holdings can affect broad financial conditions, including interest rates. In this way, monetary policy accommodation provided through the balance sheet may, to a modest extent, substitute for changes in the target federal funds rate. Specifically, we find a \$675 billion reduction in the Fed's balance sheet over a two-year horizon is about equivalent to a 25 basis point hike in the funds rate.



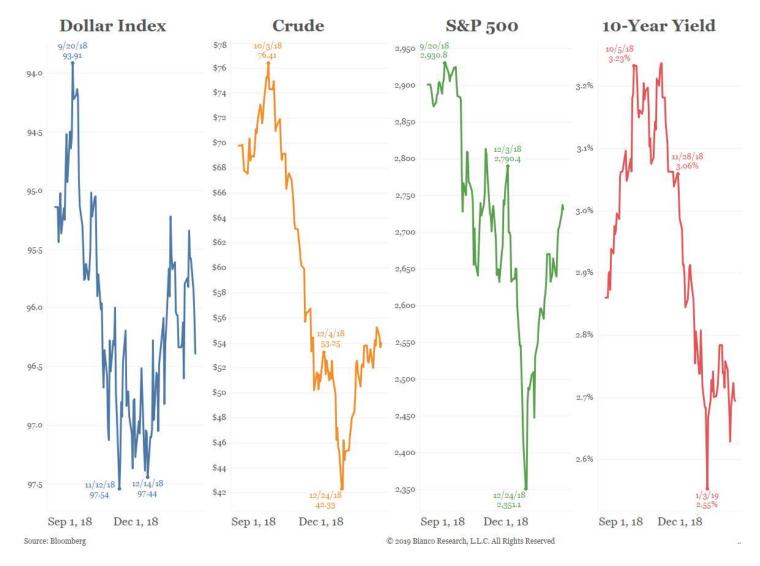




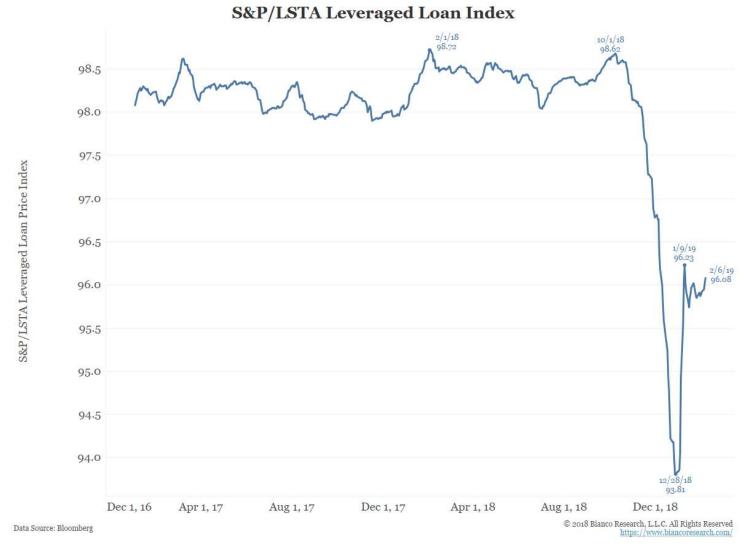
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Number of Hikes Over The Next 12 Months







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And particularly with the muted inflation readings that we've seen coming in, we will be patient as we watch to see how the economy evolves. But we're always prepared to shift the stance of policy and to shift it significantly if necessary in order to promote our statutory goals of the maximum implement and stable prices. – Jay Powell, January 4, 2019

But what I do know is that we will be prepared to adjust policy quickly and flexibly, and to use all of our tools to support the economy, should that be appropriate, to keep the expansion on track, to keep the labor markets strong and to keep — to keep inflation near 2 percent. – Jay Powell, January 4, 2019

And so we also said at the very beginning, I think in our original – certainly, the first policy normalization plans that I was involved in 2014, we said that we would be prepared to adjust our normalization plans as appropriate to achieve our goal. So if we ever came to the conclusion that any aspect of our normalization plans was – was somehow interfering with our achievement of our statutory goals, we wouldn't hesitate to change it, and that would include the balance sheet, certainly. – Jay Powell, January 4, 2019



February 8, 2019

The following passage was in January 30, 2019 FOMC statement:

In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

Historically the word "patience" in the FOMC statement means no move at the next meeting. As the chart above shows, many market participants believe the rate hike cycle is over.

The Fed will continue to reduce the balance sheet, which is a form of tightening. But the market believes the next rate move will be a cut due to economic weakness, most likely next year.

Do not celebrate a coming rate cut as a good thing. When things get bad enough for the Fed to cut rates, risk assets like stocks are usually suffering.

February 8, 2019

Bloomberg – (December 3, 2018) Fed's Clarida Says 'Powell Put' Not a Useful Concept for Policy

Federal Reserve Vice Chairman Richard Clarida said the U.S. central bank will defend both sides of its inflation target and cautioned investors against thinking the Fed would act to halt a sharp market decline. "I don't really think of it as a useful way to describe what the current Federal Reserve is doing," he said Monday when asked about the concept of a "Powell Put" in an interview with Tom Keene on Bloomberg Television. Clarida, who took his post in September, said the Fed would tolerate inflation rising slightly above its stated 2 percent target for inflation. "We have a symmetric objective around 2 percent," he said. "Two percent is not meant to be a ceiling. We've operated below 2 percent, we could operate somewhat above 2 percent, depending on the shocks.

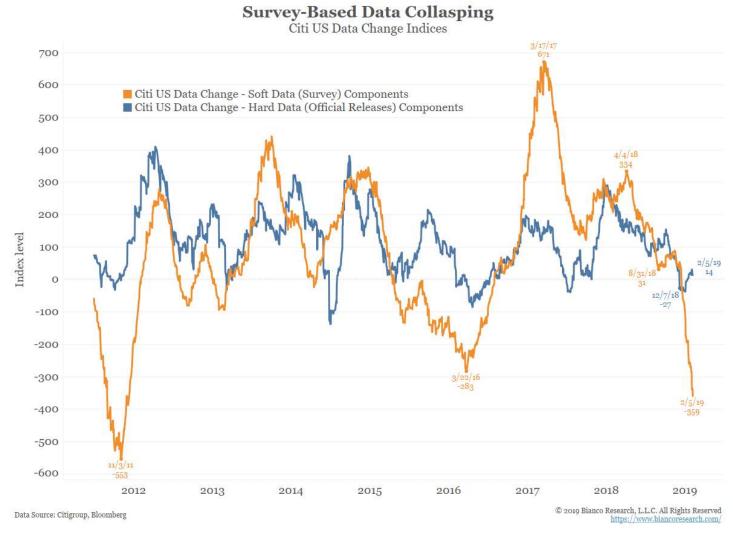
<u>Transcript of Fed Press Conference</u> - January 30, 2019

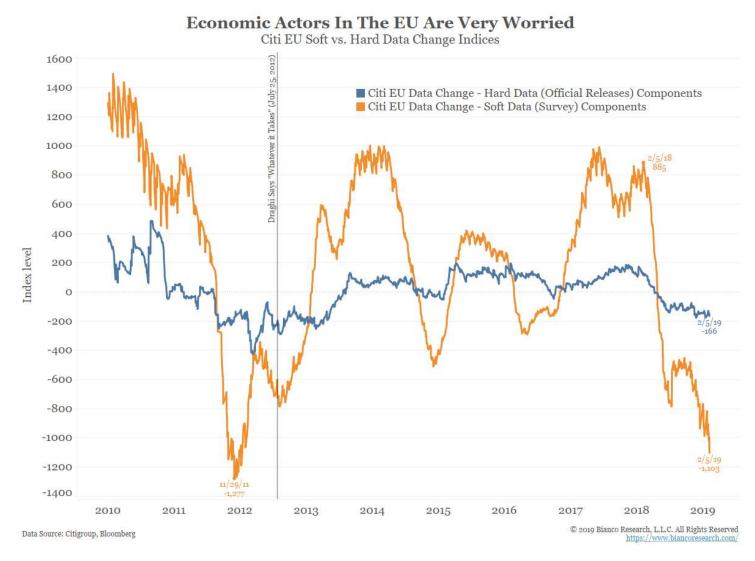
MICHAEL MCKEE. Michael McKee from Bloomberg Television and Radio. ... And I'm wondering about your reaction to the criticism you got on your December 19th news conference, your later statements -- do you feel you've put a "Powell put" into the markets?

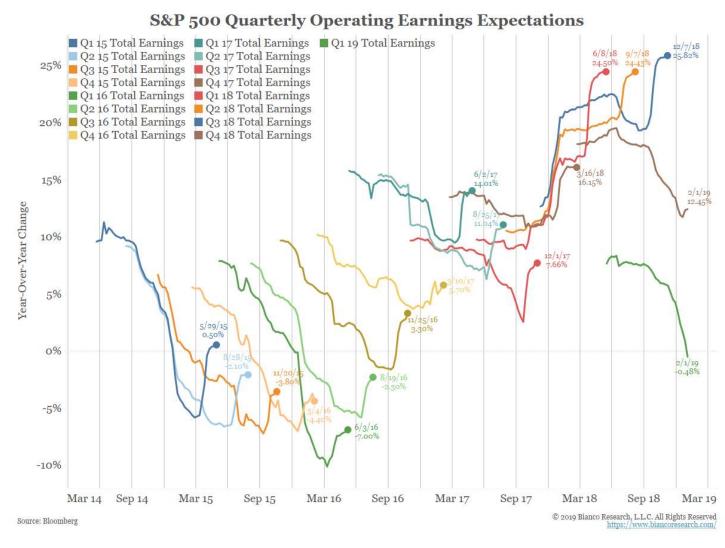
CHAIRMAN POWELL. ... So we don't react to, you know, to most things that happen in the financial markets. But when we see a sustained change in financial conditions, then that's something that has to play into our thinking. In fact, our policy works through changing financial conditions so it's sort of the essence of what we do.

GREG ROBB. Chairman Powell, Greg Robb from MarketWatch. Financial markets have reacted strongly to the decision and the press conference. The Dow Jones Industrial Average is up more than like 500 points. There's a sense in the market that there's, you know, what people call the "Powell put" on the markets. Are financial markets wrong in that assessment?

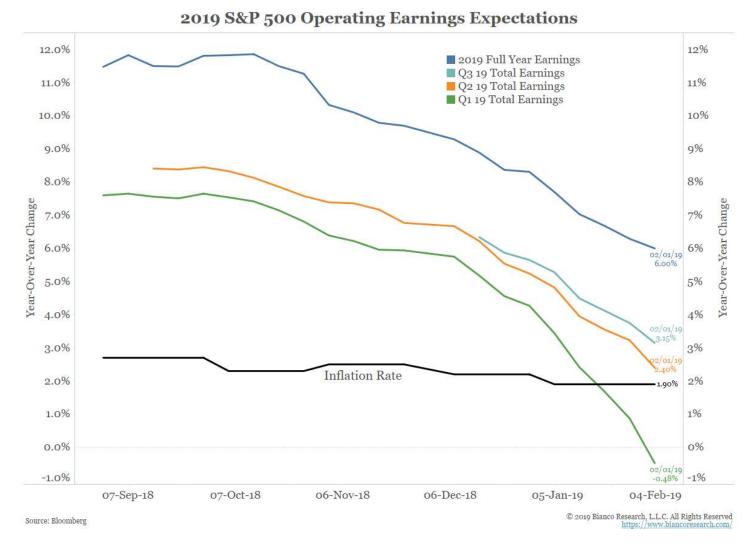
CHAIRMAN POWELL. You know, I would point to all the continuity here. You know, the thing we did on the balance sheet is something we've been working on for, frankly, years -- the thing we announced today. And so we're providing clarity there. I think that's a constructive thing to do. My honestly only motivation is to do the right thing for the economy and for the American people -- that's it. And this situation, I think, calls for patience -- I think it does. And it's just the stance of policy we think is appropriate. We see these uncertainties and we see a time when we can afford to -- we have the luxury of being able to wait and watch and that's what we're planning to do. And I think it's the right thing -- I feel strongly that it is.





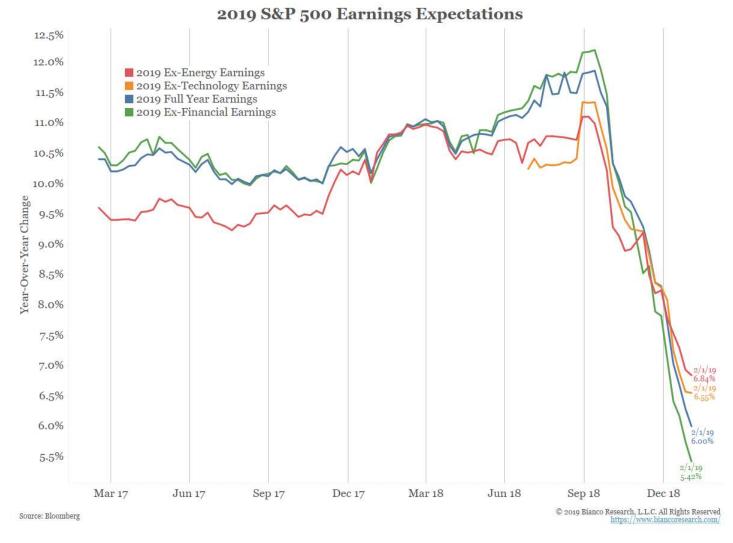








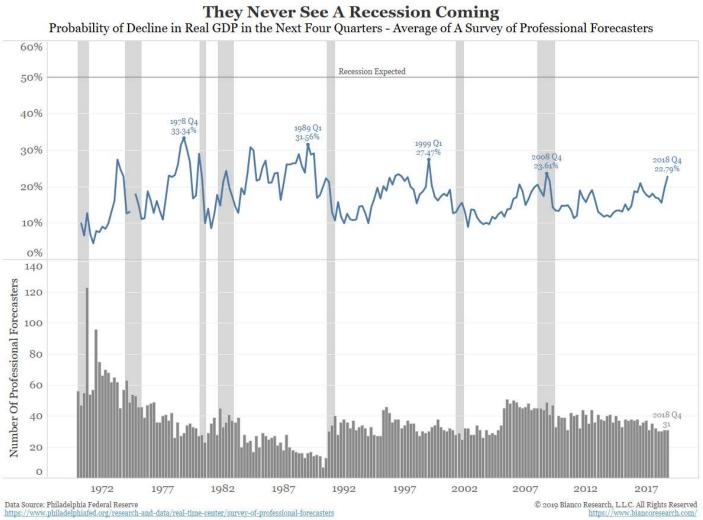
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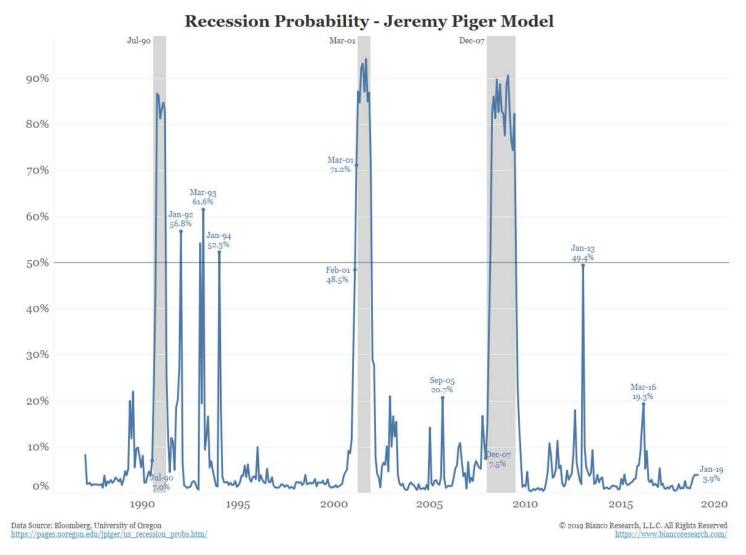


I don't think that expansions just die of old age. Two things usually end them. One is financial imbalances and the other is the Fed, and usually when the Fed ends a recession — ends an expansion, it's because inflation has gotten out of control and the Fed needs to tighten to bring it down. – **Janet Yellen, January 4, 2019**

But as Janet says, expansions don't die of old age. I'd like to say they get murdered, instead. – **Ben Bernanke, January 4, 2019**

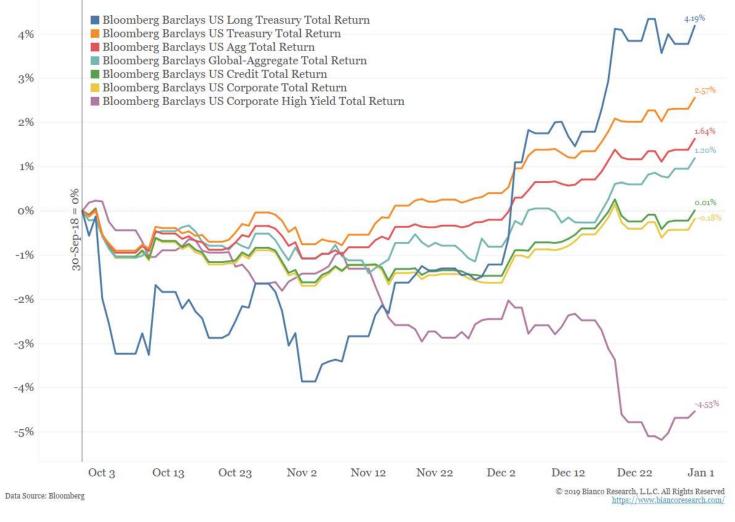
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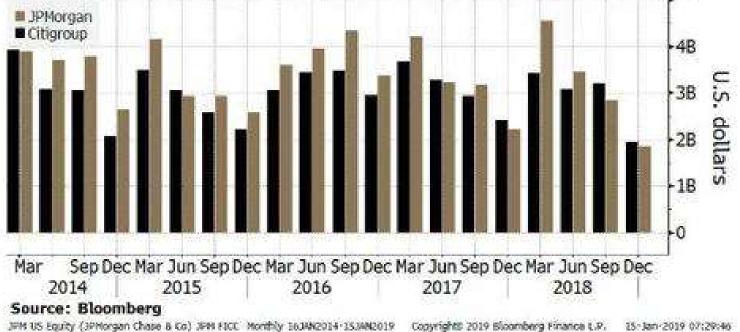
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Q4 2018 Fixed Income Total Returns





FICC JPMorgan fixed income markets revenue trailed Citigroup again

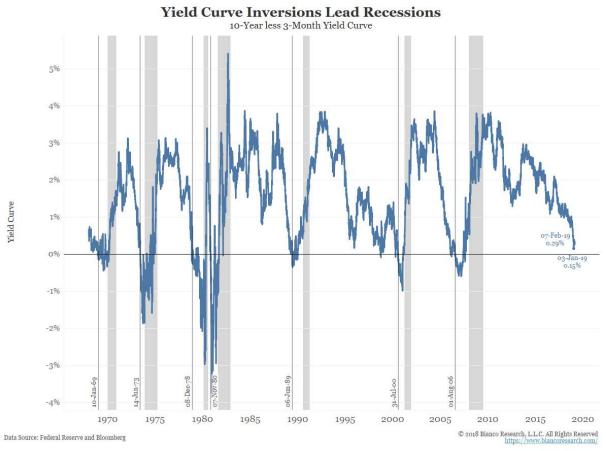


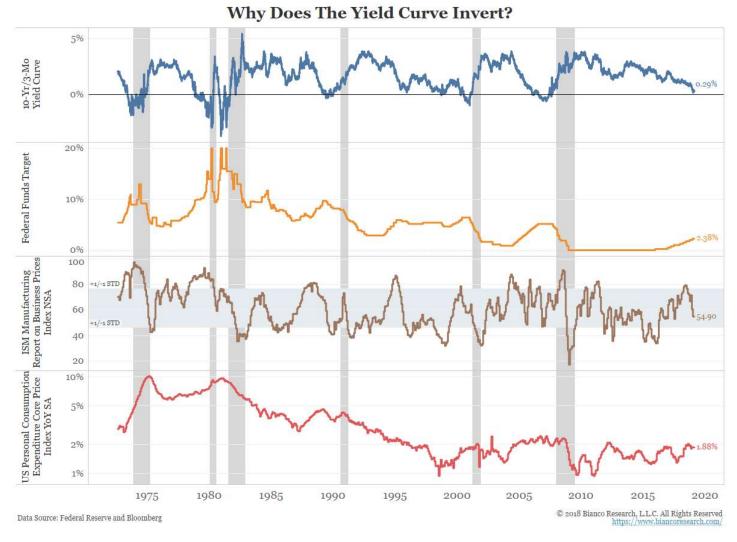


10-Year Treasury Note Forecasts

How Long Until The Recession?		
When the 3M/10Yr Curve Inverts For 10 Straight Days		
Date of	Date of	Days to
Inversion	Next Recession	Next Recession
1/10/1969	Dec-69	325
6/14/1973	Nov-73	140
12/8/1978	Jan-80	389
11/7/1980	Jul-81	236
6/6/1989	Jul-90	390
7/31/2000	Mar-01	213
8/1/2006	Dec-07	487
Average		311

Yield Curve





February 8, 2019

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