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MARKET PERSPECTIVE

INSIGHTS & REVIEW FROM PERFORMA'S INVESTMENT TEAM

AN UPDATE ON THE FED

We are in the typical blackout period leading up to the October 29th & 30th Federal Open Market Committee (FOMC) meeting. The FOMC is a branch of the Federal Reserve Board that meets eight times a year and is responsible for setting U.S. monetary policy. Chaired by Jerome Powell, the Federal Reserve is the most powerful monetary authority in the world. Interestingly enough, even the most powerful authorities sometimes struggle to achieve desired outcomes.

Next week's FOMC meeting will be the second-to-last of 2019, leaving December as the final meeting in what has been an eventful year for monetary policy. With little historical precedent, we've watched policy transition from tightening, to patience, to easing in short order. This dramatic shift in monetary policy has been characterized by Chair Powell as a mid-cycle adjustment akin to the easing seen in the 1990s. When Mr. Powell first made this comparison during his customary post-meeting press conference in July, equity markets were disappointed. At the time, markets wanted confirmation that the FOMC was embarking on a full-blown easing cycle; to their dismay, Chair Powell was unwilling to supply that transparency (rightly so) and the market sold-off.

Today, the market fully anticipates the FOMC to deliver another interest rate cut next week and we share that expectation. Intra-meeting economic data flow has been muddling, inflation is still below target, and downside risks remain present. Moreover, recent comments from Fed officials have done little to push back on current market pricing, which indicates a 90% probability of another interest rate cut next week. If they fail to deliver next week, the market will surely be caught offsides. As such, the most likely course of action is a decision to reduce the target rate from 1.75%-2.00% to 1.50% - 1.75%, the third ease of 2019. The question for next week's meeting becomes this: what will members attempt to communicate in their policy statement?

As former Chair Yellen loved to say (we paraphrase), "if you're wondering about Fed policy, read the statement because that's where it's set."

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Yellen is referring to incidences where market participants assign too much weight to a drifting median dot, or an overreaction to a hollow slip of the tongue. She would say this to politely remind the public that the post-FOMC meeting statement is where monetary policy is set - read it. This all makes for an interesting drama heading into next week's meeting. There will be neither dots nor an updated survey of economic projections, rather, just an old-school policy statement paired with a new-school press conference.

> ***"Unfortunately, for the Fed, even the most powerful authorities in the world sometimes struggle to achieve desired outcomes."***

We see two likely avenues for the policy statement. First, the FOMC could cut 25 basis points, make the customary changes to the first paragraph of the statement and leave most everything else unchanged (e.g. *the status quo*). Second, they could cut 25 basis points, make the customary changes to the first paragraph and then change the end of the second paragraph and/or add a new third paragraph prior to the commonly used closing paragraph. Whatever form it might take, the purpose of any new verbiage would be to signal to the markets that they feel they have done enough to address global uncertainties. They are confident that with the support of three interest rate cuts (oh, not to mention hundreds of billions in short-term funding), the U.S. economy is in a strong enough position that they are going to employ a *wait-and-see* approach, again.

Whether the outcome of the FOMC's policy update lies behind door number 1, 2, or a 3rd alternative, a few things are clear: job creation and economic growth have slowed; fiscal policy that was supportive last year is now fading and we're left with a ballooning U.S. deficit; and while consumers remain somewhat optimistic, business confidence has waned due to persistent trade uncertainty and late cycle dynamics.

The Fed has been clear that they have no interest in implementing negative interest rates during the next recession. As such, the preemptive easing over the last few months was an effort to avoid the effective lower bound and bring inflation back to their 2% target. Unfortunately for the Fed, even the most powerful authorities in the world sometimes struggle to achieve desired outcomes. Which is to say, the Fed alone can't solve the problems that currently face the U.S. economy. Despite the known limitations to monetary policy, the Fed will do their best to support this expansion and that might mean changing their policy framework down the road or, possibly, another shopping spree (data-dependent, of course).

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ABOUT PERFORMA

Combining our extensive knowledge of the insurance industry with the institutional expertise of our investment team, Performa has been managing assets on behalf of captive and other insurance clients for more than 25 years. Our capabilities include asset allocation, active fixed income and equity management through diversified mutual funds and separate account portfolios. With offices in the world's largest captive domiciles, including Bermuda, Vermont and South Carolina, we are focused on delivering customized solutions to meet the unique investment objectives and liquidity requirements of our clients. We are 100% employee-owned and have $4.58 billion in captive assets under management and advisement as of August 31, 2019. Our investment philosophy is value driven and long-term in nature. Whether approaching asset allocation, fixed income or equities, our ability to be nimble, contrarian and decisive sets us apart from our peers and promotes capital preservation.

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