Macroeconomic Outlook

It's All Downhill from Here

Brian Smedley
Head of Macroeconomic and Investment Research

Maria Giraldo, CFA
Managing Director

Matt Bush, CFA, CBE
Director

Global growth has peaked, but a tight U.S. labor market will ultimately prompt the Fed to tighten again.

U.S. economic growth was solid at an estimated 2.6 percent in the fourth quarter of 2018, but we expect first quarter growth to slow to about 1.0 percent. This stems in part from tighter financial conditions, but reported growth is also likely to be weighed down by seasonal adjustment issues along with the temporary impact of the government shutdown.

The good news is that sequential growth is likely to rebound in the second quarter as statistical and shutdown distortions are reversed. Nevertheless, growth is now on a downward trajectory in year-over-year terms. The combination of tighter Fed policy and fading fiscal stimulus will ensure that growth in 2019 is weaker than it was in 2018. Leading indicators confirm that the peak in growth is behind us (see chart, top right), and our recession forecasting tools continue to point to a downturn starting by mid-2020. However, there is a chance that a Fed pause could delay a downturn until late 2020 or even early 2021.

Meanwhile, the steady softening in global manufacturing purchasing managers' indexes illustrates how global growth momentum has faded (see chart, bottom right). Growth in Europe is sputtering, and the ongoing Brexit saga is still unresolved. The steady slide in Chinese growth has prompted authorities to announce a series of stimulus measures with more forthcoming, but policy lags will delay any positive impact.

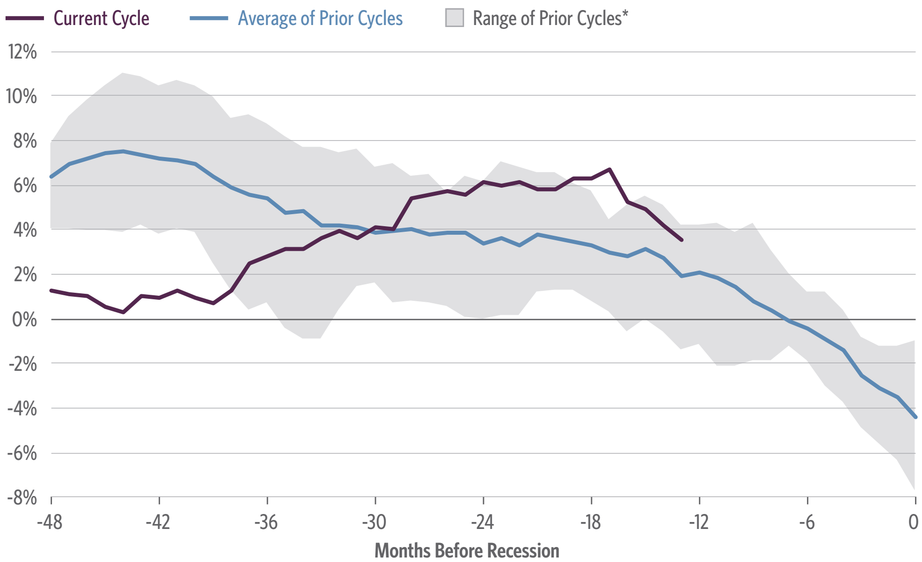
Against this backdrop, the Fed has moved to the sidelines. A pause in the hiking cycle is likely for the first half of the year, but we do not believe the Fed is done tightening just yet. The labor market continues to strengthen, and we see further wage gains ahead. And while core inflation should remain soft in coming months, we expect it to rebound in the second half. Our baseline forecast now envisions one more hike later in the year. Further rate hikes may be required in 2020 should inflation expectations begin to rise meaningfully. Balance sheet runoff should conclude in the third quarter, with details likely to be announced at the March meeting. This will allay market concerns about balance sheet reduction being on "autopilot."

A more patient Fed and multi-pronged stimulus in China should foster a recovery in risk assets in the near term. Additionally, the ECB may add liquidity through long-term refinancing operations (LTRO) or targeted LTROs. This would support our call for an Indian Summer for risk assets , which is characterized by the warm spell that follows a cold snap. We see this as a window of opportunity to further de-risk portfolios in preparation for a 2020 recession.

This article is distributed for informational purposes only and should not be considered as investing advice or a recommendation of any particular security, strategy or investment product. It contains opinions of the authors but not necessarily those of Guggenheim Partners or its subsidiaries. The authors' opinions are subject to change without notice. Information contained herein has been obtained from sources believed to be reliable, but are not assured as to accuracy. Past performance is no guarantee of future results.

Leading Indicators Confirm that the Peak in Growth Is Behind Us

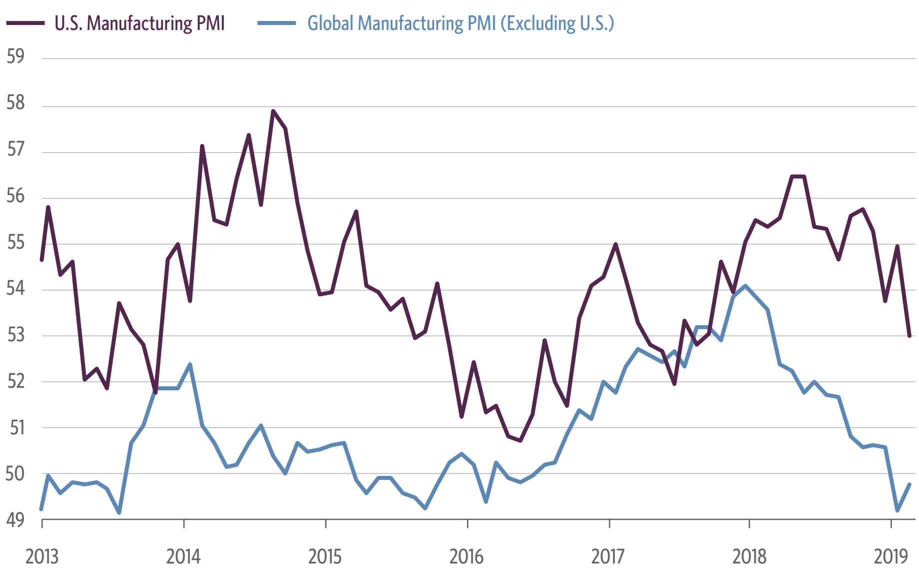
Leading Economic Index, YoY% Change



Source: Guggenheim Investments, Bloomberg. Data as of 1.31.2018. *Note: includes cycles ending in 1970, 1980, 1990, 2001, and 2007. Shows the evolution of the LEI starting 48 months before the recession. Current cycle is assumed to end in February 2020.

Leading indicators confirm that the peak in growth is behind us, and our recession forecasting tools continue to point to a downturn beginning by mid-2020.

U.S. Is Still Outperforming as Global Growth Downshifts



Source: Guggenheim Investments, Haver Analytics, Markit, JPMorgan. Actual data as of 2.28.2019. PMIs are GDP-weighted. Values above 50 denote expansion in manufacturing activity.

The steady softening in global manufacturing purchasing managers' indexes illustrates how global growth momentum has faded.

Investing involves risk. In general, the value of fixed-income securities fall when interest rates rise. High-yield securities present more liquidity and credit risk than investment grade bonds and may be subject to greater volatility. Asset-backed securities, including mortgage-backed securities, may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity risk. Investments in floating rate senior secured syndicated bank loans and other floating rate securities involve special types of risks, including credit risk, interest rate risk, liquidity risk and prepayment risk. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Real Estate, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2018, Guggenheim Partners, LLC. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Guggenheim Partners, LLC.