

Top-10 investment strategies for 2019: #1 Bet on more rate hikes by the Fed

Group Research

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Rates



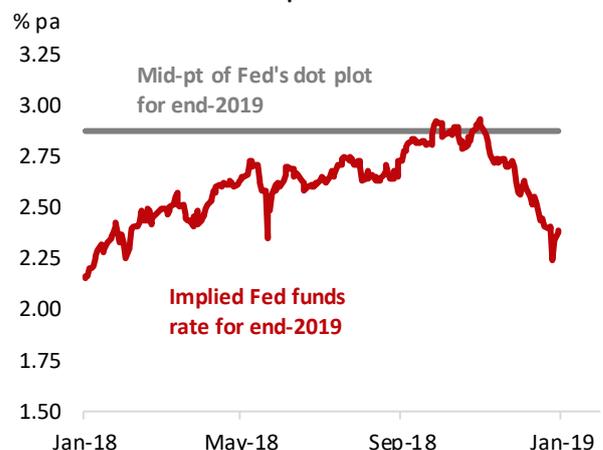
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- We begin a 10-part series on our favourite trades for 2019 across key asset classes
- The market has gotten ahead of itself, pricing in recession risks and removing Fed rate hikes for 2019
- This is too dovish. Fade the excessive pessimism by betting on 1-2 hikes this year

In the fixed income space, we think that fading the extreme negativity in the markets by selling the Dec-2019 Fed funds futures (selling Eurodollar futures or paying 1Y USD IRS are also possible) is a good risk-to-reward play. Towards the last few months of 2018, sentiment took a turn for the worse as the S&P 500 plunged by close to 20%, dragging UST yields down accordingly. Meanwhile, the VIX also peaked above 35 in late December as trade war concerns, US government shutdown and Fed worries weigh on risky assets.

We think that short-term USD rates are too low. **While a slowdown in 2019 appears inevitable, a recession does not seem probable** (we think 2020 will be a much closer call). To put things into perspective, the market was pricing in an implied Fed funds rate of 2.93% in early November, but this figure has since dropped to 2.39%, pointing to zero Fed hikes over the coming year. We think that there is a disconnect between still-strong US economic fundamentals and the market. Once risk aversion wanes somewhat, the market should price in 1-2 rate hikes again. The key risk to our outlook is a marked deterioration in the US economy, prompting the Fed to reverse course in 2019. If the Fed holds rates, this trade would about breakeven.

The market has turned too pessimistic



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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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