Northern Trust | Bond Outlook: Expect a Steadier 2019

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2018 was a volatile and challenging year for fixed-income investors. With negative total returns in the US caused partially by rate hikes by the Federal Reserve, which led to higher long-term yields. We expect a steadier path in 2019.

Last week was interesting as Fed chair Jay Powell spoke in New York and flipped the narrative with respect to the expected state of interest rates in the US. As recently as this past October, Powell spoke of interest rates being well below the neutral rate. But last week he said US rates were, in fact, very close to neutral.

So there might be fewer rate hikes in 2019 than some had believed. As many market participants were projecting five rate hikes by the end of next year. However, all along, we weren't expecting the Fed to be that aggressive. And now the broad consensus is moving decidedly in our direction.

This is good news, because a pause in rate hikes would be much more supportive of continued US economic growth. While current growth and inflation data are strong, forecasters and the Fed need to look further down the line. Thinking about how economies, especially in the US, may be performing in six to 12 months is much more critical than how they look today.

The Fed has signaled they will be data dependent, and we believe the data is going to soften. Trade issues, waning benefits from tax cuts, Brexit, and the weak global economy are just a few reasons. Further, interest rates globally are low and likely to stay there, which puts pressure on US rates to also stay low.

We expect no more than two more rate hikes through 2019. And one of those may come this month. We think longer rates have likely seen their high in this cycle. So the 10-year treasury yield at or above 3% will be an attractive entry point for investors if it's available. While 2018 was volatile and challenging, we believe 2019 will present positive returns for investors and fixed income.