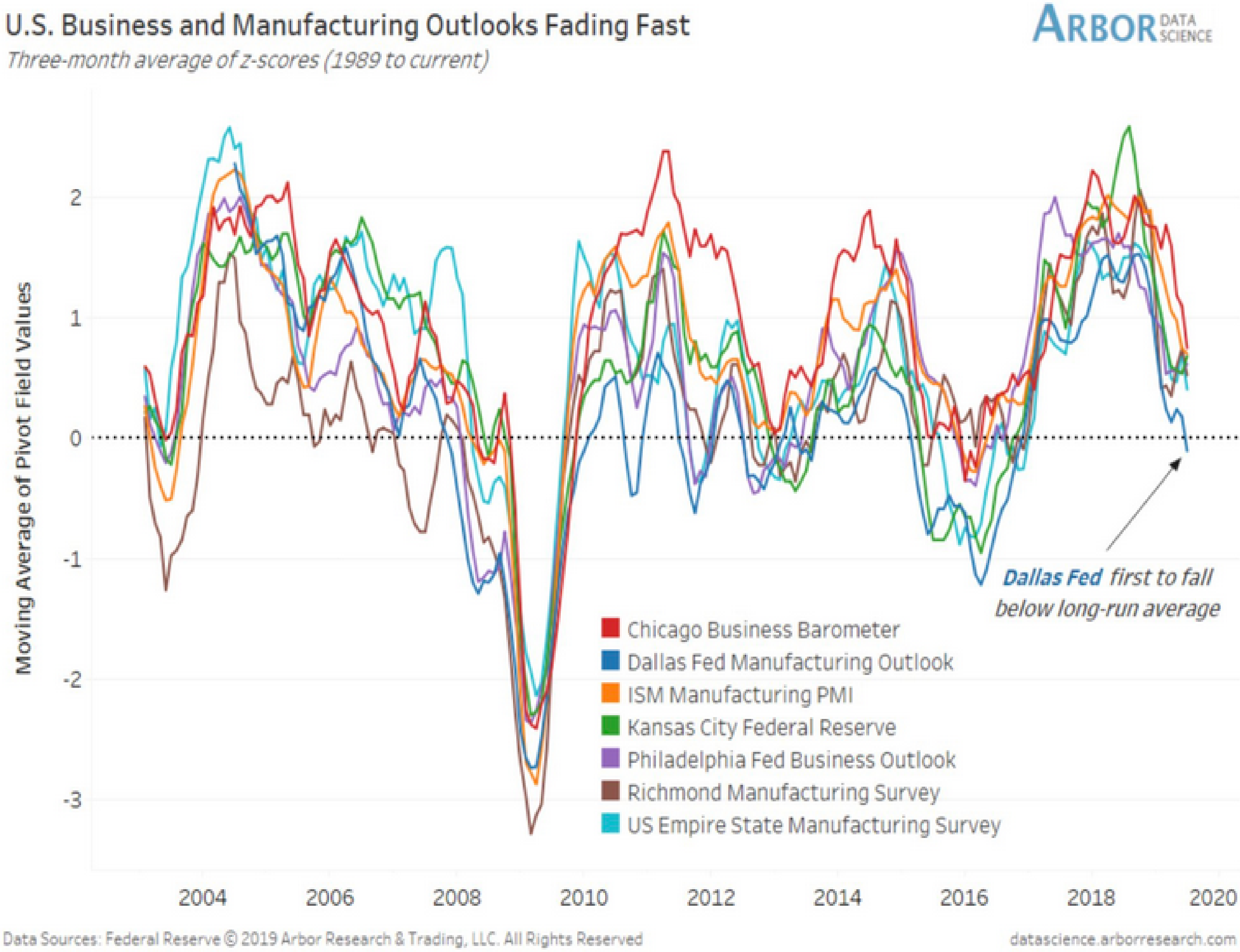
As a portfolio manager and fiduciary, it is vital that we constantly assess the risks to our market and economic forecasts. To better quantify risk we must frequently go a step further and understand where the markets may be neglecting to appreciate risk. While tricky, those that properly detect when the market is offside tend to either protect themselves and/or profit handsomely. It is with contrarian glasses on that we look beyond July 4th and towards July 31st for fireworks. Through June the stock and bond markets priced in, with near certainty, a 50 basis point rate cut at the July 31, 2019, Federal Reserve FOMC meeting. In doing so, volatility in many markets could surge if the Fed does not follow the market?s lead. Given this concern, we ask what might cause the Fed to disappoint the markets. We approach the answer from two angles, economic and political.

## Economic

On the economic front, there are a growing number of indicators that point to slowing domestic economic growth. The following graph from Arbor shows seven important leading indicators (surveys and outlooks).




While the graph is concerning, hard economic data which tends to lag the survey data graphed above has yet to weaken to the same degree. If the weakening in the indicators graphed above prove to be a false signal or transitory, the Fed might cut rates less than expected or even delay taking policy actions. A second reason the Fed might delay or not take action would be an increase in inflation expectations. The Fed has been outspoken about the need to bolster inflation expectations which have recently drifted lower. Given that unemployment is at 50 years lows and inflation close to their target, inflation expectations seems to be the rationale the Fed is using to justify action. If inflation expectations were to increase the Fed may not be able to defend reducing rates. The following events could temporarily increase inflation expectations:

- Weaker dollar due to perceived easy monetary policy.
- Iran tensions could push oil prices higher.
- Excessive weather conditions in the Midwest are affecting consumer prices for certain commodities.
- Tariffs are likely to increase prices paid by businesses and consumers.
- Fed independence compromised (as discussed in the following paragraph).

## Political

Beyond economics, politics is playing a role in the Fed?s thought process. The Fed was set up as an independent organization to insulate monetary policy from the often self-serving demands of the executive and legislative branches. Despite the Fed?s independence, many Presidents have bullied the Fed to take policy actions. Such tactics always occurred behind closed doors with the media and public having little idea that they were occurring. Currently, President Trump is taking his criticism to the public airways and has gone as far as threatening to demote or fire Chairman Powell. A Fed Chairman has never been fired or demoted, leading many to question whether Trump has the legal authority to do so. The Federal Reserve Act states that the Chairman shall serve his stated term ?*unless sooner removed for cause by the President.*? That sentence opens the door to much uncertainty under this President. The language is even less vague about demotion, which, in our opinion, is more likely. If the Fed wants to assert its independence from the executive branch, they may be inclined to cut by 25 basis points or possibly not cut at all. •Anything short of a 50 basis point rate cut would inevitably irritate the President and increase the risk that Trump fires or demotes Powell. If such an unprecedented action were to transpire the markets would likely react violently. For more on how certain asset classes might perform in this scenario, please read our article Market Implications for Removing Fed Chair Powell. Beyond the initial market responses to the news, a greater problem could arise. The peril of openly piercing the veil of independence at the Fed could impair many of the communication tools the Fed uses to influence policy and markets. In turn, the Fed will be limited in their ability to coax or pacify markets when needed. While this spat may be brushed off as Beltway politics aired for the public in the Twittersphere and media, the consequences are large, and as such we must pay attention to this political soap opera.

## Summary

We believe a 50 basis point cut is likely on July 31st and afterward the markets will renew their focus on the next few months and what that may have in store. However, unlike the vast majority, we believe that there are factors that may cause the Fed to sit on their hands. If the Fed disappoints the market, especially if not accompanied by warnings, the July fireworks this year may be coming 27 days late.