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Goldilocks and the Bears

In This Letter

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Once upon a time there was a little girl named Goldilocks. She went for a walk in the forest. You know the story. Pretty soon, Goldilocks came upon a house. She knocked, found no one home, and entered. At the kitchen table, she saw three bowls of porridge. She tasted one bowl and found it too hot. She tasted another and found it too cold. Goldilocks ate the third bowl and found it "just right".

"Our Goldilocks economy, engineered by Fed Chair, Janet Yellen, has seemed to capture the sweet spot for investors."

In years past, we have used the term *Goldilocks economy* to signify an economy that seemed "just right"… not growing too fast to burden consumers with inflation, yet not growing too slow. Our Goldilocks economy, engineered by Fed Chair, Janet Yellen, has seemed to capture the sweet spot for investors.

The Economy is Just Right

GDP increased at an annual rate of 2.6% in the second quarter. This was a marketed improvement from the paltry 1.2% during the first quarter of 2017.

The US Bureau of Labor Statistics just reported the unemployment rate of 4.3% was holding steady. Payrolls are expanding for the seventh year in a row. We are in the midst of the longest streak on record. Happy Labor Day!

The CPI inflation index rose 1.7% in the 12 months through July, and seems to be staying low for now.

The economic numbers seem fine. The volatility index seems fine. Consumer sentiment seems fine. Like Goldilocks, should we all take a nap? Let's explore for a minute what might happen if one of the three bears arrives back at the house.

Goldilocks and Three Potential Bears

1. The Federal Reserve, Chairwomen, Janet Yellen could get it wrong. After a decade of easy monetary policy, and low interest rates, we could see interest rates increase which could choke off the economy. Our sense is interest rates should stay muted for some time, but it is something that we monitor.

   The low interest rates of the past several years can bring imbalances into the system. Over-leveraged individuals can benefit off the easy money policy. History tells us that too much leverage and margin debt can be a potential problem.

2. Papa Bear Trump has to try to minimize the worry factor. The stock markets have increased in part due to promised infrastructure spending, lower taxes, less regulation, and more affordable healthcare. If our Legislative body remains paralyzed, and doesn't get its act together and adopt some of the President's policy promises, the shot in the arm most people want, will vanish.

3. The last bear that could be problematic are a myriad of variables, such as North Korea, ISIS, tapped out consumers, home prices cooling off, or natural disasters. The headlines discuss North Korea the most. The Trump Administration is struggling with how to diffuse the potential hazard, Kim Jong Un. If missiles start flying, it could send quite a shock into the markets.

Secretary of State, Rex Tillerson, insists that we should not worry and go ahead and take that nap. We all hope that is true. All in all, it is still a little unsettling.

Of course these are just fairy tales. Nothing bad could really happen, right? The market is certainly due for a drop. We are up 265% since bottoming on March 9, 2009. Valuations are not cheap. We haven't had a single 3% drop this year. We are kidding ourselves if we think this lack of volatility will continue. A 10% correction would actually be a healthy phase, providing good buying opportunities.

It is our job to look at the economy and potential hazards. We still feel like the Goldilocks economy will continue. We'll get a pull back at some point, but don't be surprised if the three bears stay away for a while.

Summer is ending this month. It is ending with some severe heat in the Bay Area. It is definitely too hot. Other times it's been too cold. Seldom do things stay, "just right".