Investment Watch

4^{th} Quarter, 2017

"JUST RIGHT"

Goldilocks, and her *"not too hot, not too cold"* economy, is stealing the reins from Santa to take all the credit for the stock market rally, but Santa will not give up easily as this year's holiday spending spree may stoke another Santa Claus Rally. Goldi has been doing all the heavy lifting here at home guiding our economy upward from the depths of the Great Recession and mounting a bull market run that has lasted nearly nine years.

Defying professional predictions, the US stock markets soared in 2017 with nary a stumble, surprising most skeptics . This year marks the longest steak for the S&P 500 index without a 3% drop. This unprecedented market calm bolstered the continuous upward market trajectory from the nadir on March 9, 2009 without ever experiencing a bear market, marked by a 20% decline. Market volatility swooned to historic lows confirmed by the CBOE Volatility Index recording the lowest readings in decades.

A Goldilocks economy is one that's "*not too hot"* to stoke inflation and "*not so cold"* to cause a recession. Up until now this economic recovery has been below par, even anemic compared to past recoveries, with the US Gross Domestic Product (GDP) averaging a measly 2.1% rise per year according to the Bureau of Economic Analysis. However, many believe this *"not too hot, not too cold"* economy could foster longer lasting sustained growth. The US economy's porridge may be "*just right".*

Goldi may have knocked Santa off the sleigh as she pulled on the reins to drive Santa's reindeers upward as our economy has surpassed almost all expectations, recording two consecutive quarters of 3%+ GDP growth with many forecasts for the 4^{th} quarter also topping 3%. The Citi US Economic Surprise Index has skyrocketed as the economy has outpaced almost all economic expectations. The index was negative just a few short months ago, but now, as a confluence of robust economic data have poured in, the index has soared.

Economists are also brightening their predictions for the New Year due to the $1.5 trillion tax cut. The Joint Committee on Taxation estimates that tax reform will likely add 0.8% to 2018 GDP. Most other forecasters are less impressed and estimate the lower taxes will add around only 0.5% to US growth. Many pessimistic pundits, envisioning Scrooge's view of the future, predict a drag on growth after 2019 from larger deficits which could trigger inflation and higher interest rates. However the majority agree, the sweeping personal tax and corporate cuts should boost consumer spending and spur business investment for the next two years.

The recent economic spurt here at home has been joined by worldwide good fortune. The Organization for Economic Cooperation reported all 45 countries they track are expanding, 33 of which are reporting accelerating growth. Despite government rhetoric on protectionism, tariffs and trade deals, global trade is accelerating, manufacturing is expanding, and the whole world is collectively growing in concert. This rare occurrence of synchronized global expansion has not been seen in years.

2017 was also a banner year for American economic confidence. The Conference Board reported that the November reading of consumer confidence hit its highest level in 17 years. Consumers opened their wallets driving holiday season sales up 4.9%, the fastest pace since 2011. Americans may be spending more, but are saving less. With little movement on wages, household spending has outpaced income gains. The November savings rate at 2.9% was a 10-year low.

Although the hype is centered around our stock markets, international stocks actually outpaced their US counterparts due in part to a windfall from the US Dollar's decline, dropping 7.5% during 2017 after five years of gains. Good bond returns also defied the experts who thought the Federal Reserve's rate hikes would push bond yields up and therefore depress prices. However, mid and long term yields have remained low resulting in a surprising good year for bond investors.

Forecasters are again calling for muted stock returns and a poor year for bond investors. Will Goldi's porridge stay *just right* in 2018 or will it be *too hot* or *too cold*?

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