Wealth Management Division

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Goldilocks Minus the Bears

Not too cold, not too hot, not too hard, not too soft but just right! The favorite classic children's tale of Goldilocks and the Three Bears is often used as an analogy of the best of times for the stock market. The only catch is that, just like in the story, it is hard to find and sometimes it is only by chance that "best of times" occurs. Well, welcome to the "best of times!" Or at least something close to it. The stock market is soaring, the bond market is doing just fine thank you, and much of the other economic data is performing nicely as well. The problem with the Goldilocks story is that it doesn't end perfectly as Goldilocks runs away at the end never to return to the Three Bears home. While markets do periodically enter the Goldilocks zone the occasions are sufficiently rare that they should be celebrated but one should also prepare for their end. So, to that point, what does the data indicate right now and where might we be headed?

Goldilocks found the perfect porridge and bedding in March and April as the economic data was supportive of a growing economy (GDP up 3.2% in the first quarter according to the initial data) and that allowed the markets to maintain their momentum to the upside. Through April, the DJIA is up 14.79% this year while the S&P 500 has set a new all-time high and has soared 18.25% in 2019. The NASDAQ has performed even better while the S&P 400 and 600 trail slightly. Even the much maligned EAFE (international stocks) is up a very nice 11.72%. With stocks soaring one would expect that valuations would have as well. To a degree that is true but because earnings have continued to grow, we aren't yet in a position of being significantly overvalued. Job creation rebounded from a dismal February (since revised slightly higher) to post better numbers in March (196,000 new jobs) and April (expected 186,000 new jobs for the month but initial figures put the number at an even greater 263,000 while also upping both February and March numbers slightly) and unemployment has remained at 3.8% (through March while actually falling to 3.6% at the end of April). Wages have ticked up slightly while inflation has remained consistent at just under 2%. Interest rates on mortgages have fallen lately which is good news for borrowers and has helped the housing market remain strong. The Barclays U.S. Bond Aggregate index is up 2.97% on the year representing a decent total return for fixed income investors. Please see the end of this commentary for information as to how various indexes have performed in 2019.

Goldilocks is pleasantly enjoying life right now but is the Bear family about to come home causing Goldilocks to flee? Remember, when Goldilocks worked her way through the Bears house, she created some damage along the way that could understandably make the Bear family angry (she broke Baby Bear's chair and ate all of Baby Bear's porridge after trying the other two bowls). Perhaps it was right, then, that she fled when they found her in Baby Bear's bed. Will Goldilocks be fleeing us (the markets, economy) anytime soon? Not necessarily but if investors aren't careful, they could get burned once she does leave (remember she "fled" she

didn't just stroll out the cottage). The Dow's gain this year is the best start to a year since 1999 and the S&P 500's 18% plus gain is the best start to a year since 1987. Well, 2000 was not a good year as the tech bubble burst sending stocks crashing and October 19, 1987 will forever be known as Black Monday for the almost 25% drop in stock prices that day alone. While we don't anticipate either or those severe drops to occur anytime soon, the punishment the markets took in the fourth quarter of 2018 should make one sit up and pay attention. The Fed has indicated that they do not plan on raising rates this year and only perhaps once in 2020 as fears of inflation and a too-hot economy have cooled. Importantly, they haven't indicated a strong desire yet to cut rates either as the economy continues to show strength. Most economists expect the jobs picture to remain robust, but they do fear that we will run out of workers at some point causing wages to skyrocket. While that may be true that refrain has been sung for the past couple of years and there doesn't seem to be an endpoint in the near- or mid-term at least. And that is in the face of wages growing steadily (yes there have been a blip or two along the way) but not to the point of causing significant pressure on the inflation. Trade issues could always upset things but by and large the damage caused by tariffs have been felt more elsewhere than in the U.S. and the trade picture seems to be brightening not darkening. Brexit is certainly an issue but again it may depend upon your point of view as by some measures Britain is doing better than Europe even in the face of it. So, is the fear driven by those in Europe or sympathetic to Europe vs. what is happening in reality? Only time will tell, I guess. Certainly, if the economy does appear to slow, inflation rears up, or something unexpected happens (war in Venezuela, etc.) then Goldilocks may head out the door faster than we would like but for now let's let her enjoy her peaceful slumber!

The markets performance this year has been defined as a *relief rally* after the fourth quarter last year and in some ways is a *prove-it* market where investors are letting the markets prove their strength and resiliency before jumping in. Those descriptions are pretty much to the point while a more troublesome picture would emerge if investors moved from the prove-it position to one of *FOMO* (fear of missing out) which could lead to the more ominous condition of a market *melt-up* where everyone just jumps in because they can't stand staying on the sideline any longer. Typically, when you see that happens you should be prepared to get out quickly as the tide tends to turn without notice causing a dreaded melt-down.

Right now, the evidence appears to point to investors prudently letting the market prove it's worth to them vs. experiencing the fear of missing out. In late February and early March, it did appear that we needed to be vigilant as cash flows into equity funds was increasing but by the end of March cash flows had turned slightly negative again. In April, fund flows picked up into fixed income funds and international equity funds while domestic funds saw outflows again. This does not look like a picture of a market melt-up where investors feel they might miss out if they don't jump in now. In fact, investors may be doing the right thing as international equities are undervalued compared to domestic equities and in theory at least that is where you should consider investing. The adage "sell in May and walk away" might hold true this year but I

suspect that things will just plod along through summer without a major disruption to the upside or downside. We have taken some steps to protect the downside to prepare ourselves for the day that things cool off but not to the extent that we are giving up much, if anything, on the upside. We will be watching how things unfold as we move into summer and fall but, for now, we are fully invested on the equity side and broadly diversified on the fixed income side and see no reason to alter this strategy.

Hard to believe we are already a third of the way through the year (of course the lousy weather isn't helping). If you haven't already, please call our Wealth Management department at (608) 826-3570 to schedule a portfolio update where your goals, objectives, and risk tolerance can be reviewed and to make sure your asset allocation is set accordingly. Please feel free to call or email us with questions.

As of April 30th, 2019….

Dow Jones Industrial Average up 14.79% YTD
S&P 500 up 18.25% YTD
S&P 400 up 19.09% YTD
S&P 600 up 15.93% YTD
NASDAQ up 22.38%

Barclays U.S. Agg. Bond Index up 2.97% YTD
EAFE up 11.72% YTD
Inflation (CPI) 1.9% (as of March 31st)
Unemployment 3.6% (as of April 30th)

Thank you for your business – we look forward to speaking with you soon. *(Note – this commentary used various articles from Morningstar, the Wall Street Journal, Investor's Business Daily, Northern Trust, CNNMoney.com, msn.com, Kiplingers.com, nytimes.com, Fidelity Investments, American Funds, LPL Financial and other tools as sources of information)*