Partner Talk®

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Goldilocks Economy?

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The story of *Goldilocks and the Three Bears* is one of the most popular fairy tales in the English language. As you likely recall, Goldilocks discovers a house in the woods in which she finds and tries three bowls of porridge, three chairs and three beds successively, with the first two being "not right" for opposite reasons and each time finding the third "just right".

The finance industry has coined a term, the "Goldilocks Economy" (often attributed to economist David Shulman), to describe an economy that is not too hot or too cold but "just right". Economic growth, employment, and inflation are balanced such that they are warm enough to prevent a recession but not so hot as to cause a rabid inflationary environment forcing the Federal Reserve to hike interest rates in an effort to slow inflation before it gets out of control.

Whether we are currently in a "Goldilocks Economy" has been debated widely in the press for the past several years. As we have stated often in *Partner Talk* letters, we know that no one can predict the future, but it does not mean that we should stick our heads in the sand and ignore what is occurring in the economic, financial and political environments.

We follow all of these issues closely and consider them as part of our evaluation of asset allocation decisions and risk control. We also discuss many of these issues at our quarterly investment committee meetings. To help our clients better understand our thoughts, our process and our strategies, I am providing an overview summary of our most recent Investment Committee meeting which took place on October 16, 2019.

The PMA Investment Committee is responsible for setting the asset allocation policy, monitoring the level of risk in our portfolios, rebalancing them when necessary and for qualifying and monitoring the mutual fund managers we hire to implement our asset allocation strategies.

The Investment Committee generally meets once a quarter or more often in especially volatile periods like we experienced in late 2008 and early 2009. During this meeting, we typically consider a number of matters including a review of what the markets and the economy have done for the past 3-6 months as well as any potential changes to your portfolios which we think are prudent. Our primary consideration always is to manage the risk in your portfolios.

The Economy

It does appear that we have enjoyed, for the most part, a “Goldilocks Economy” of moderate growth, low unemployment and stable inflation for the past several years. While the economy appears to be slowing relative to 2018, it does continue to expand with employers hiring, consumers spending and growth stabilizing. In October, employment grew by 128,000 jobs, the unemployment rate ticked-up slightly from a 50-year low of 3.5% to 3.6% even as hundreds of thousands of Americans joined the labor force while wage growth remained relatively steady having increased 3% from a year earlier. While positive GDP growth is expected and corporate profits have been better than expected, many forecasters still assign a significant probability of a recession by the end of 2020 with the biggest risks being trade war uncertainty and a global slowdown.

The Markets

2019 has been a very strong year so far! Consider the performance of the S&P 500 on a month-by-month basis and on a year-to-date basis:

Month	Return	YTD Return
January	8.01%	8.01%
February	3.21%	11.48%
March	1.94%	13.65%
April	4.05%	18.25%
May	-6.35%	10.74%
June	7.05%	18.54%
July	1.44%	20.24%
August	-1.58%	18.34%
September	1.87%	20.55%
October	2.17%	23.16%

While May was not a pleasant month at down 6.35%, as of October 31st the S&P 500 is up 23.16% for the year, dramatically ahead of the average 10% annual return for the S&P 500 from 1926-2018. However, none of this guarantees that 2019 will close with the markets having had an up year nor does this tell us anything about what may lie ahead.

Asset Allocation

Having analyzed the markets, the economy, additional reductions in interest rates, and signs of slowing economic growth, the Investment Committee decided to maintain our current allocation of equities relative to bonds. Within the bond portfolio, we decided to reduce our current high yield bond allocation from 20 percent to 10 percent and to allocate these funds to intermediate-term corporate bonds. With this change, the allocation of our fixed income portfolio will be 50 percent in short-term, 40 percent in intermediate-term, and 10 percent in Hi-Yield. As we go forward, given previously noted concerns of an economic slowdown, the high yield allocation will continue to be carefully monitored.

Conclusion

Since PMA was founded thirty-seven years ago, we have sought to protect our clients' assets in bad markets and to deliver very respectable performance in good markets. This was not by accident, but by design. From the beginning, we have known that no one can predict the future and trying to do so is a fool's exercise. However, what we do believe in is measuring and controlling risk and building properly diversified portfolios. We work hard to evaluate mutual fund managers so that we are able to build-out those portfolios properly and in order to have a very good chance of generating a successful investment experience. Yes, we know how to do this at PMA, and we have done this work for thirty-seven years. Given the current concerns about trade and the U.S. and global economies, having a fully diversified, risk-controlled portfolio is more important than ever. We believe that doing so is the best protection available to prepare for the inevitable day when the "Goldilocks" economy ends.