Infomail
September 22, 2014

The New Goldilocks (Redux)

The Fed Cometh

"Economists are pessimists: they've predicted 8 of the last 3 depressions"

Anonymous

Recent comments out of the US Federal Reserve indicated the Fed, led by Chair Janet Yellen, is in no rush to raise interest rates. In their latest communique, they did not change the language, which many market watchers were expecting, so the new result was a sigh of relief, though not before markets tumbled a bit.

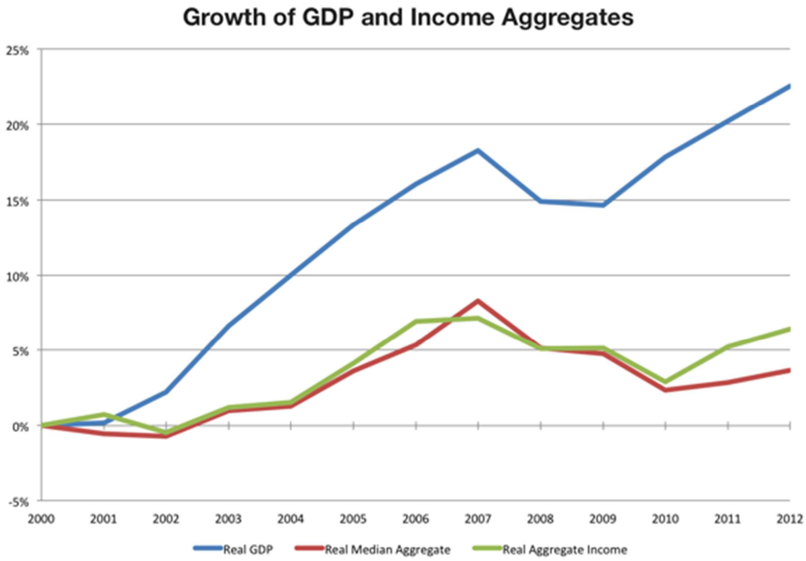
The Fed and stock market watchers might think this is the perfect "Goldilocks" period of tepid growth, low inflation, and higher asset prices. However, the Fed is not going to raise rates just yet because the numbers we have right now, including the employment picture, would be admitting it is an ineffective organization.

As things stand now, it would seem that all the monetary stimulation introduced by the Fed since 2009, has not made much of a dent. The other side would argue that without the massive Fed stimulation, things would have been worse. The last hope is for people to stop saving and to start spending (which might be happening anyway), even if this uneven recovery leaves a lot to be desired.

It seems that US equity markets are no longer a direct reflection of America anymore, especially as the nation looks more and more like the new story of "Goldilocks":

- Bigger and better for some
- Just right/OK for others
- Too little for many more

Despite the fact the national GDP continues to climb higher, the median household income has been declining since the mid 1990's.



(Source: Department of Numbers, US Data Analysis)

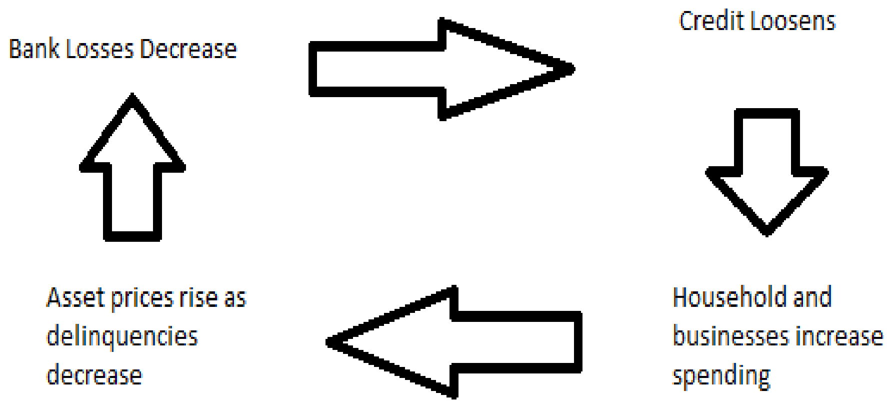
In fact, since 2000, there has been an explosion of Americans living in poverty, from 30 million to over 45 million. The latest Federal Reserve Beige Book (Sept 2014), paints a picture of improvement which might be gaining steam. Low inflation and pockets of strength in retail, construction and manufacturing, is nudging optimism in the right direction.

Make no mistake, there are incremental signs that things are getting better, but with all the malaise in place, how long before people feel better is the real question? At the end of the day, it will revolve around jobs (at first) and then "good paying" jobs.

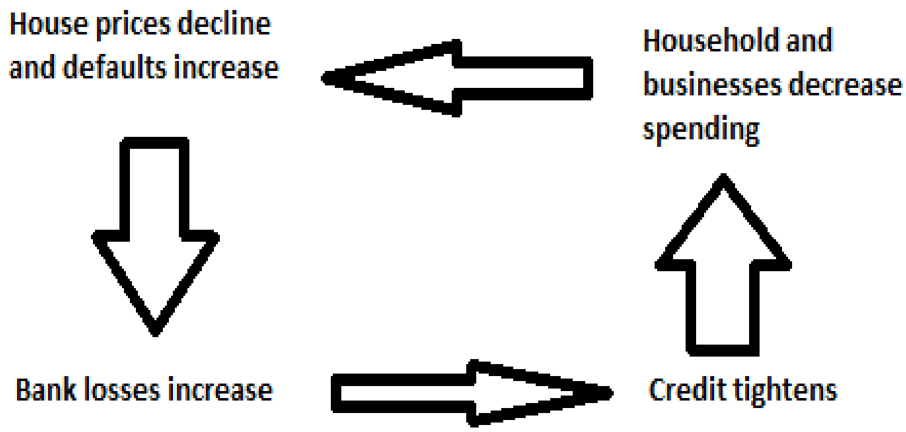
The Federal Reserve is going to be watching jobs, wages, and the participation rate, but the most important thing for Fed Chair Janet Yellen might be if and when people feel confident again, and if people begin to feel like there are better-paying jobs available.

It all points back to the "Virtuous Cycle" which never truly materialized under Ben Bernanke, and more than likely will not materialize under Yellen because all the money printing in the world cannot counter a regime designed to loot corporate America, redistribute wealth, and punish individual success.

The virtuous cycle would look like:



Versus the "Vicious Cycle" which Europe is experiencing (or what the 2008-2010 cycle was like in North America):



Still, businesses want to grow, it may not be what is normal at this point out of a recession, but it's growth nevertheless and should get people feeling better out of the current economic and spiritual malaise. The virtuous cycle has only recently begun to show signs of life, but it's (slowly) heading in the right direction.

Global growth is disappointing, and continues to plod along despite the Fed's purchases of assets in the trillions of dollars. The theory was that with all that monetary policy injection, global growth would go back to "normal." But the global economic engine never revved back up, and the central bankers answer has been to do more. So we got QE2, QE3, QE4, Abenomics in Japan, and as of last week, Draghinomics in Europe.

The Fed will raise rates next year sometime (2015) and the market seems to know this. The rally will now have to be based more than ever on greater evidence the economy is ready to stand on its own without the training wheels.

Stay tuned,

Vito Finucci
Vice President and Director
Investment Advisor