Goldilocks is back

Economic optimism drives stockmarket highs

Investors are getting convinced that the world can enjoy strong growth and low inflation

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BARELY a day goes by at the moment without Wall Street hitting a new record high. The market has kept marching upwards despite all the headlines about the North Korean nuclear threat, a potential break-up of NAFTA, and natural disasters like hurricanes.

If you want to know why the market keeps rising, just look at the latest poll of global fund managers by Bank of America Merrill Lynch. Almost half of all the managers now expect above-trend growth and below-trend inflation, what is dubbed the Goldilocks economy (she wanted porridge that was not too hot, or too cold, but just right). That is the highest proportion recorded in the history of the survey. Indeed, for the last six years, a plurality of managers have taken the view that both inflation and growth would be below trend.

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A net 41% of those managers think global growth will strengthen over the next 12 months. Putting their money behind those beliefs, a net 45% are overweight (have a higher holding than usual) in equities. A remarkable 85% of managers think bond markets are overvalued, another record. While there was talk of a "Trump bump" earlier this year, belief in fiscal stimulus is not the main reason for the optimism; just over two-thirds of the managers polled think there will be some tax reform in 2018 but that the shift will have little impact on risk assets.

The big turning point was really February 2016, when fears of a Chinese slowdown were at their worst. Since then sentiment towards emerging markets seem to have recovered; Peter Elam Håkansson of East Capital think we may be just a couple of years into a 5-6 year bull run for the asset class. As our recent briefing (https://www.economist.com/news/leaders/21730019-ultra-loose-monetary-policy-coming-end-it-best-tread-carefully-asset-prices-are) argued, asset prices are generally high, thanks largely to low interest rates. At some point, rates will rise too much, or the economy will slow, or one of the geopolitical risks will bow up (literally or metaphorically). Until one of those three bears appear, investors will trust in Goldilocks. To quote Jonathan Ruffer, a fund manager

“The pessimists sit like crows on a wet telegraph pole, waiting for the markets to break—but a crow can sit only for so long on the pole without indigestion.”

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