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News Release

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Is the U.S. Economy Entering a "Goldilocks" Zone?

Multiple Factors Driving Optimism for Sustained Economic Growth

(New York, NY, December 20, 2016) – In a video presentation discussing the post-presidential election outlook for the U.S. economy, four senior Legg Mason investment leaders focused on prospects that we may be reaching a "Goldilocks zone:" not too hot, not too cold, but just right.

"This is not the start of a new bull market," declared Scott Glasser, Co-Chief Investment Officer of ClearBridge Investment. "This is potentially the extension of an existing and mature bull market. How long do we extend that growth? There's going to be some very strong offsetting negatives that retard that growth, whether it be the dollar or higher rates. Internationally all the factors that had been in place are not going away. The market has rallied in anticipation."

"I do think you're going to get this growth, but I think it needs to be put in the context of a mature bull market. That has the opportunity to be extended for a year, two years. We'll see."

The full video, "What Could Go Right in 2017," can be accessed via this link:
https://youtu.be/d0l5IHoeSas

James H. Norman, President of QS Investors, replied, "Do you see the potential for there to be, because of those countervailing forces, a Goldilocks [zone] – or if not too hot, not too cold? Employment growth continues at a reasonable level so it does not get overdone?"

Mr. Glasser agreed, and thought corporate profits will increase, slowly but surely.

But, "I don't like the word 'Goldilocks,'" Mr. Glasser said. "You [should] get huge repatriation. I think that's a big positive. The last time we did this, in 2005 I believe, there were $600 billion overseas, and approximately $300 billion came back to us. Right now there's approximately $2.4 trillion overseas. There's a potential for over $1 trillion cash to come back through repatriation."

"That money will get put to work," he continued. "It may not be put into capital expenditures (CAPEX). It may be used to support share buybacks, or it may be used to offset some of the significant debt that's been put on balance sheets. You get to extend share programs for the next three, four, five years. Those are all positives.

"That is the ideal scenario: 'Goldilocks' in the sense that you get a little bit of growth, you don't get inflation, rates stay within a moderate range. It's not about the market as a whole, it's much more dependent on which sectors benefit, and why. You've seen financials react because of the prospect of less regulation and higher margins. That's good for stock pickers."

Messrs. Glasser and Norman were joined by Jack P. McIntyre, a fixed income portfolio manager with Brandywine Global, based in Philadelphia. He agreed that financials may benefit.

"I'd like to add in tax cuts, but regulation too," Mr. McIntyre said, "because for eight years it seems as though the administration sort of had its hand on the throat of the banking industry. It hasn't been necessarily a pro-business type of environment. The U.S. consumer is in pretty good shape, their balance sheet is in good shape. We're seeing wages improve. At this point debt service costs are still low, but it's the corporate sector that's been missing in action. If they can ramp up the CAPEX, these capital-intensive projects, it's going to certainly help productivity."

"We have to unleash these animal spirits," Mr. McIntyre continued. "We get entrepreneurs, we get wealth-creating activities. That's part of a good environment for 2017, but 2018 and 2019 too. That certainly can keep growth moving forward and extending the business cycle."

Another Legg Mason fixed income portfolio manager, Carl L. Eichstaedt of Western Asset Management, saw optimistic possibilities for U.S. bond markets.

"The Goldilocks scenario would be Trump's policies at 50/75 basis points of GDP," he said. "So instead of mid-high-ones or low-mid-twos, inflation stays contained: 2 percent, plus or minus. Corporate profits remain strong. Debt coverage remains good. Corporate bonds in that environment do very well, also securitized mortgage products, both residential and commercial." Mr. Glasser added, "Profit growth is probably high-single-digits in that scenario, versus a baseline of probably 3 or 4 percent right now."

That led Mr. Norman to concur, "It's important to keep the consumer going as well. So much of GDP growth can come from the consumer. We're starting to see that a little bit, people feel a little more comfortable. Some of the consumer sentiment numbers as well as consumer spending has started to firm up and be a little more attractive. If we can keep that going … I think that could be quite attractive in terms of corporate profit growth."

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