Prudence is restraining growth?

> "Perhaps years of inadequate fixed-income returns finally have frightened people into (saving)."

Second-quarter domestic economic growth has not bounced as much as expected. That's curious because the weather has improved and the collapse in the price of oil put money in folks' pockets. I've read in a few different places that we are saving the money that we would have spent on fuel. Saving? Like, not spending? Frankly, I'd dismissed the whole notion as absurd. Americans spend. However, that was until I saw a brief note describing Larry Fink's theory on the matter. He's the maestro of BlackRock and I pay attention when he speaks (he manages a few trillion dollars more than me). Mr. Fink believes very low interest rates are forcing people to save more for retirement. That's entirely logical but hard to embrace since we (a large swath of the adult population) have ignored the economic realities of retirement for as long as I can remember.

Perhaps years of inadequate fixed-income returns finally have frightened people into action. If that's the case, there's an unfortunate self-fulfilling aspect to this. More saving and less consumption depresses growth and interest rates. And there is precedent. My favorite China analyst, Michael Pettis, often described a similar effect: China kept bank-deposit rates unnaturally low to spur investment spending but this robbed consumers of adequate savings growth that – in turn – caused them to save even more, depressing consumption. This is a devil of a problem to solve because higher rates will simply choke off growth, or worse if you've borrowed foolishly.

The U.S. and Chinese economies are radically different, of course, but the point is that if you depress returns, you will eventually force more saving as the population is left with no alternative but to adjust. If this is, in fact, what is restraining our economy then it's a permanent headache for just about everyone and a serious migraine for those facing retirement. And assuming equity returns will also be restrained – something I've argued for a while – the effect isn't likely to abate. I'm hard-pressed to find a bright side to this. Ah, but there is one … if you're Mr. Fink. Who's going to manage all those savings? His firm doesn't manage all the money but it's not for lack of trying.

This argument will gain wide attention if economic growth remains subdued and savings elevated. Let's hope Mr. Fink is only half right (an insult to his batting average) and other forces (e.g., housing formation) overcome the drag.

Thank you for taking the time to read this month's Market Perspective. I hope you found it helpful.

Strategic Return Portfolio	
Equities	68%
Bonds	12%
Gold	2%
Cash & similar	18%
Total	**100%**

as of June 24, 2015

Richard, an investment professional with more than two decades of experience, manages Eagle's Strategic Return Portfolio. His views are his own and may not reflect those of other Eagle portfolio managers.

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