"Three steps and no stumble"

By Tommy Williams, CFP®

Technical analyst Edson Gould developed a market rule of thumb known as 'three steps and a stumble.' It states stock prices may fall after the Federal Reserve (Fed) raises the Fed funds rate three times in a row without a decline, according to Market Technicians Association.


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The idea is three increases show the Fed is serious about keeping rates at a relatively high level for a significant length of time. Higher interest rates could potentially mean higher costs and lower profits for businesses. As a result, stock investors may sell shares and share prices may fall.

In mid-March, with employment and inflation data approaching Fed targets, the Federal Open Market Committee raised rates for the third time, pushing the Fed funds target rate into the 0.75 percent to 1 percent range, reported Financial Times:

"Fed policymakers' forecasts for growth and inflation remained little changed, with growth tipped to be 2.1 percent this year and next year, slipping to 1.9 percent in 2019. The possibility of looser fiscal policy emerging from Congress has triggered speculation that the central bank will have to further accelerate its rate-rising campaign, but a number of policymakers are insistent that they want to see firmer plans emerging from Congress before making a call on the impact of possible tax cuts on the economy."

Based on the 'three steps and a stumble' theory, investors may be concerned about stocks. However, Barron's recommends we not worry ourselves too quickly:

"We caution equity investors against becoming too pessimistic about [recent] Fed action. The mindset of the marketplace is currently very different compared to recent decades when the Fed raised interest rates and when the "Three Steps and Stumble" rule was popularized. Indeed, because the correlation between the stock market and bond yields is unusually positive today, even though the Fed is finally starting to increase interest rates, rather than stumble soon, the stock market may just continue to rumble."

According to a recent article published by NASDAQ,

"Yale economics professor Robert Shiller…noted the similarities in sentiment between the current market and that of the late tech bubble in a recent Bloomberg article." They're both

revolutionary eras, in the tech boom it was a new era of prosperity brought on by the internet.' But no matter how you cut it, Shiller said, *"The market is way overpriced. It is not as intellectual as…economics would have you believe.'* Take a look at magazine covers and article headlines and it is easy to see the market is entering a new level of optimism and complacency.

The article concluded with a very thought provoking quote:

"As we progress further into…[complacency], it pays to remember the following from Mark Buchanan's book, 'Ubiquity: Why Catastrophes Happen': "In this simplified setting of the sandpile, the power law also points to something else: the surprising conclusion that even the greatest of events have no special or exceptional causes. After all, every avalanche large or small starts out the same way, when a single grain falls and makes the pile just slightly too steep at one point. What makes one avalanche much larger than another has nothing to do with its original cause. Rather, it has to do with the perpetually unstable organization of the critical state, which makes it always possible for the next grain to trigger an avalanche of any size."

Once again it appears "experts" feel very strongly both ways. The truth is, all markets will always experience fluctuation. Define clear objectives for yourself, stick to your plan and seek competent trusted advice. However problematic it may be, you can always find an expert to affirm your opinion.

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