

### Market Volatility Returns

Preliminary comments:

A favorite quote of ours at Legacy (and we love quotes) is “short-term volatility is the cost to participate in the stock market’s long-term gains.” It’s our way of acknowledging that selloffs, corrections and even bear markets are not just normal – they’re a part of the process of being a long-term investor. If there were no volatility or risk, there would be no reason for stocks to perform so well over the long run. These inevitable moments in time will ultimately prove to be a blip on the radar for long-term investors.

While we can’t control how the markets move day-to-day, what we can control is our emotions. Reacting emotionally to market volatility is likely to be more detrimental to portfolio performance than a drawdown itself; thus, the importance of maintaining perspective and identifying the drivers of the current equity market pullback. Last, but not least, it is always important to maintain perspective when listening to financial media outlets; they often focus on broad indexes such as the S&P 500 Index. Legacy’s portfolios are diversified within and across asset classes that don’t all move in the same direction nor magnitude.

With volatility comes opportunity. Legacy’s Investment Committee will be keeping a keen eye on potential opportunities to purchase high quality assets at a discount.

### Drivers of Recent Market Volatility

Key Points:

- After an extremely calm year, the past week or so has finally seen some volatility in the stock market with the S&P 500 down approximately 8%, on the cusp of entering correction territory (a decline of 10% from peak levels), as of this writing.
- **Primary drivers behind current market volatility: Hints of economic weakness**, such as the US unemployment rate rising to 4.3% from 4.1%, **paired with a short-term technical market factor** which arose from institutional investors borrowing money in Japan (which has lower interest rates) and investing in domestic markets (referred to as the Yen carry trade) that has led to more selling.
- **The Federal Reserve is set to cut interest rates by September, if not sooner**, thus stimulating areas of the economy that have been unduly impacted by the elevated rates over the past 2 years (e.g. housing and manufacturing) and setting the stage for what has historically been a strong period of market returns.
  - **Rate cuts by the Federal Reserve have historically been followed by periods of strong returns across equity markets; with an average return of 13% for the S&P 500 in the 12 months following the initial rate cut (see charts below).** As the adage goes, don’t fight the Fed.
- **Legacy’s portfolios are well positioned to navigate the current bout of volatility.** Throughout June into early July, Legacy was actively rotating U.S. large cap equity exposure by taking profits in U.S. growth stocks to fund increases to value stocks and fixed income exposure. Following the strong level of outperformance across growth stocks, exposure had

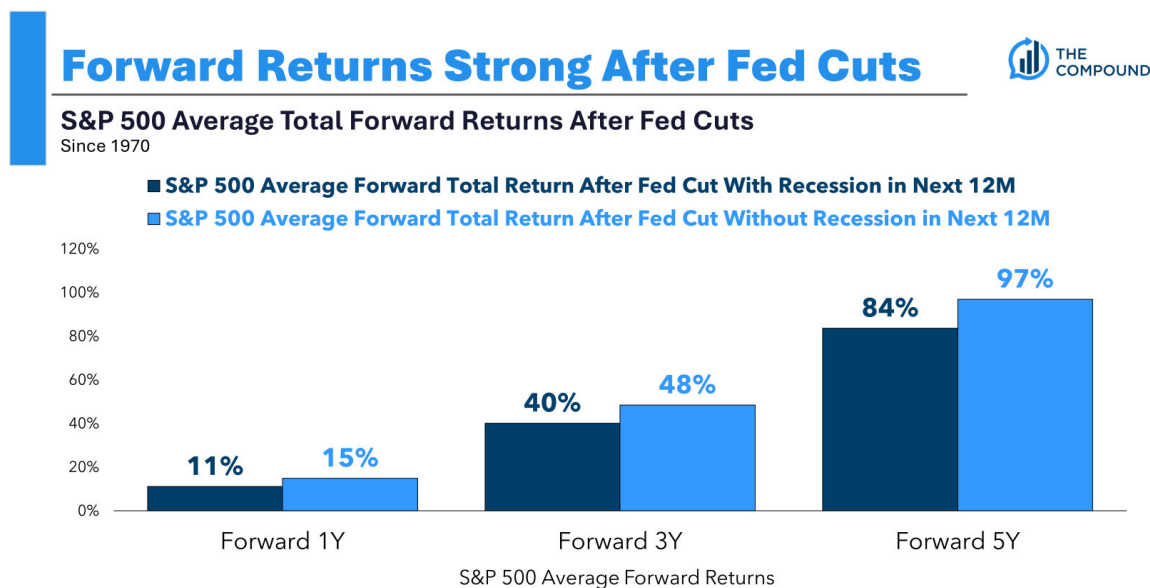
grown to an overweight relative to targets. As such, the Investment Team eliminated this overweight, locked in profits, and redeployed the proceeds into more attractively priced value stocks as well as fixed income; both areas of the market that have held up significantly better.

- **One of our key investment themes** coming into the year read as follows, **“Role of Bonds Reestablished as an income generator, portfolio diversifier and volatility dampener.** If there is a positive takeaway from Fed’s policy actions, it is that bond yields have become attractive again and high-quality fixed income is providing the highest yield to investors in over a decade. Going forward, bonds ought to provide the intended defensive buffer should the economy struggle.”
- **Indeed, the role of bonds within a diversified portfolio has shined in the past week generating a positive return of +2% to help offset weakness experienced across other areas of the portfolio.** Should opportunities arise as a result of continued equity market weakness, the allocation to bonds will provide a funding source to take advantage of such opportunities (the essence of selling high and buying low).

As always, Legacy remains vigilant in monitoring economic and market conditions as they unfold.

### Fed Rate Cuts & Stock Market Returns

A look at average returns following interest rate cuts by the Federal Reserve during recession and non-recessionary scenarios. While average returns have been better when no recession occurs, the disparity isn’t as large as you would assume. Our base case remains that the Federal Reserve would be cutting rates because both the economy and inflation are cooling off – not because of a recession – which bodes well for forward returns.



Source: Ritholtz Wealth Management. Data via YCharts