INVESTMENT INSIGHT

2018
SECOND QUARTER

LEGACY WEALTH MANAGEMENT®

When you purchase a new car, you may find yourself a bit more cautious on how you drive, the speed at which you drive, how you start and stop, and maybe even where you park. There seems to be an adjustment period.

In comparison, the stock market this year seems to be making an adjustment to the new level of interest rates as the Federal Reserve continues to raise its benchmark federal funds rate.

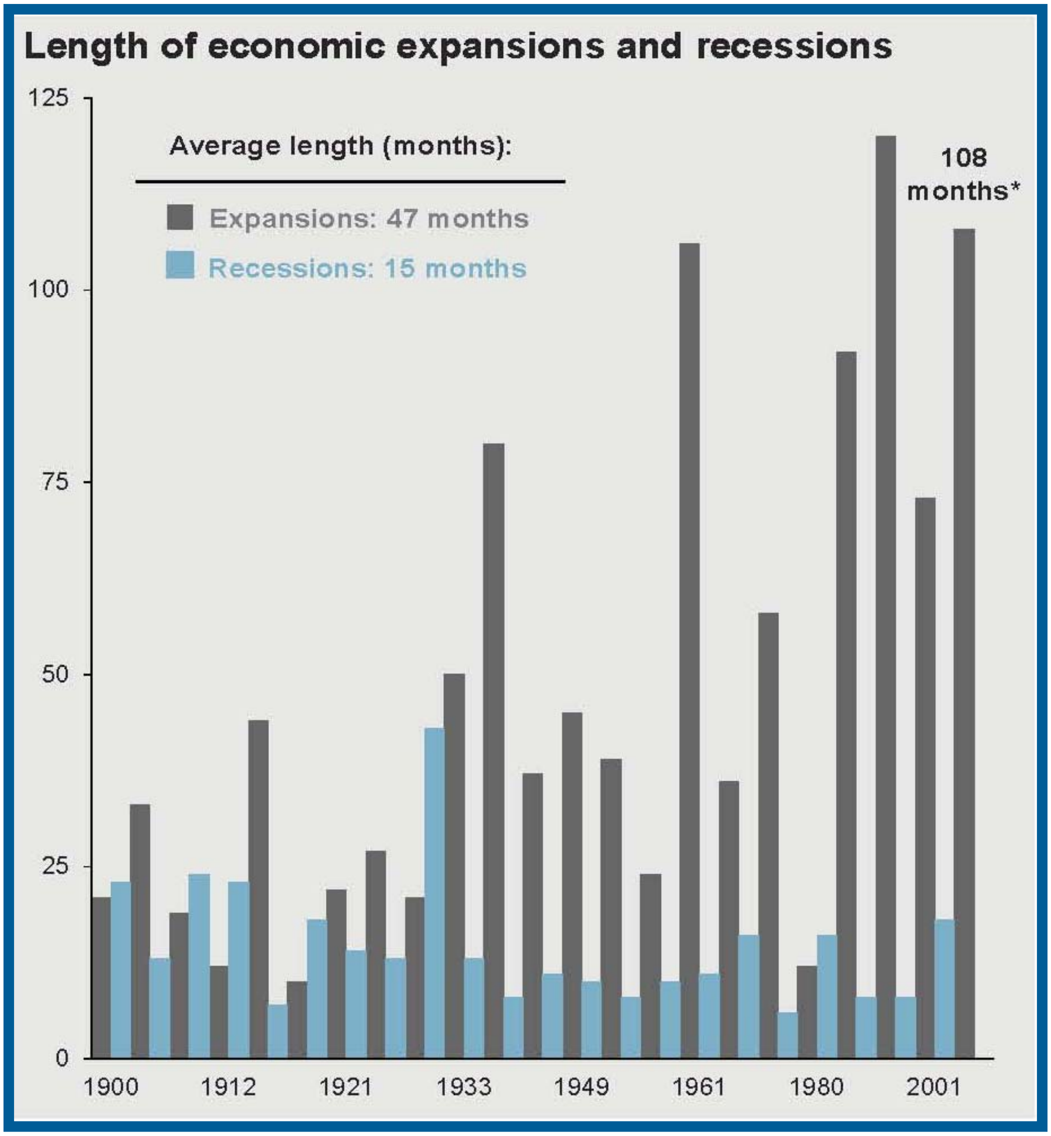
The Fed has now raised the fed funds rate seven times to a current level of 2.0%. Throughout this move to new higher interest rates, the stock market has been cautious on how fast to move forward, how it starts and stops, and pausing/parking some along the way as it maneuvers through this new period of rising rates.

At the same time, the US economy continues to remain healthy. Decreasing unemployment, a strong consumer, and business-to-business activity are all helping to strengthen the economy. The 3.8% US unemployment rate is matching its lowest level since 1969. Consumer spending and retail sales are running at a brisk pace, while consumer confidence remains near a 17-year high. US Gross Domestic Product (GDP) could very well hit 4.0%+ for the second quarter 2018, a level we have not seen in four years. Furthermore, inflation remains modest with the likelihood of it increasing slowly.

The adjustment to higher interest rates has created some volatility for the stock market in first half of 2018 – alongside of geopolitical event headlines and trade tensions with our foreign trading partners. It's very normal for this type of uncertainty to be tugging at the markets. So far this year, the markets have been absorbing the news flow relatively well. Meanwhile, the move higher in interest rates is happening as the US economic expansion has now reached 108 months through June 2018, making it the second longest expansion in American history surpassing the 1961-1969 recovery which ran 106 months *(see chart below)*. The longest expansion on record is exactly 10 years (1991-2001), and given the current health of our US economy, it is expected that this current expansion will become #1 assuming it lasts until July 2019.

A positive aspect of these rising interest rates is that it has created an opportunity for short-term bonds to be a viable holding for investors. For a significant period, the return on short-term bonds was basically non-existent. During the second quarter, Legacy added a short-term bond manager and replaced two other bond positions for client portfolios having those holdings. This shift will play a dual role of being protective of principal and balancing out client positions in core bond holdings that have longer maturities. Bonds with longer maturities are subject to some negative price movements in a rising rate environment.

Despite the possibility for negative price movements, bonds still play an important role as "sleep insurance" or protection of the volatility and downside risk in the stock market. But with the US economic expansion intact and corporate earnings continuing at double-digit growth levels, stocks should continue to be the best place for higher returns over the long run.



Source: BEA, NBER, J.P. Morgan Asset Management.
**Chart assumes current expansion started in July 2009 and continued through June 2018, lasting 108 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at* www.nber.org/cycles/ *and reflect information through June 2018. Past performance is not a reliable indicator of current and future results.*
Guide to the Markets – U.S. Data are as of June 30, 2018.

With that in mind, the US economy should prove to be resilient this next year as interest rates gradually rise. And just as a person goes back to driving normal after that new car adjustment period, so too will the stock market continue on its path forward and make its adjustment to the new level of interest rates.

This Second Quarter
Investment Insight
has been written by Legacy's
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