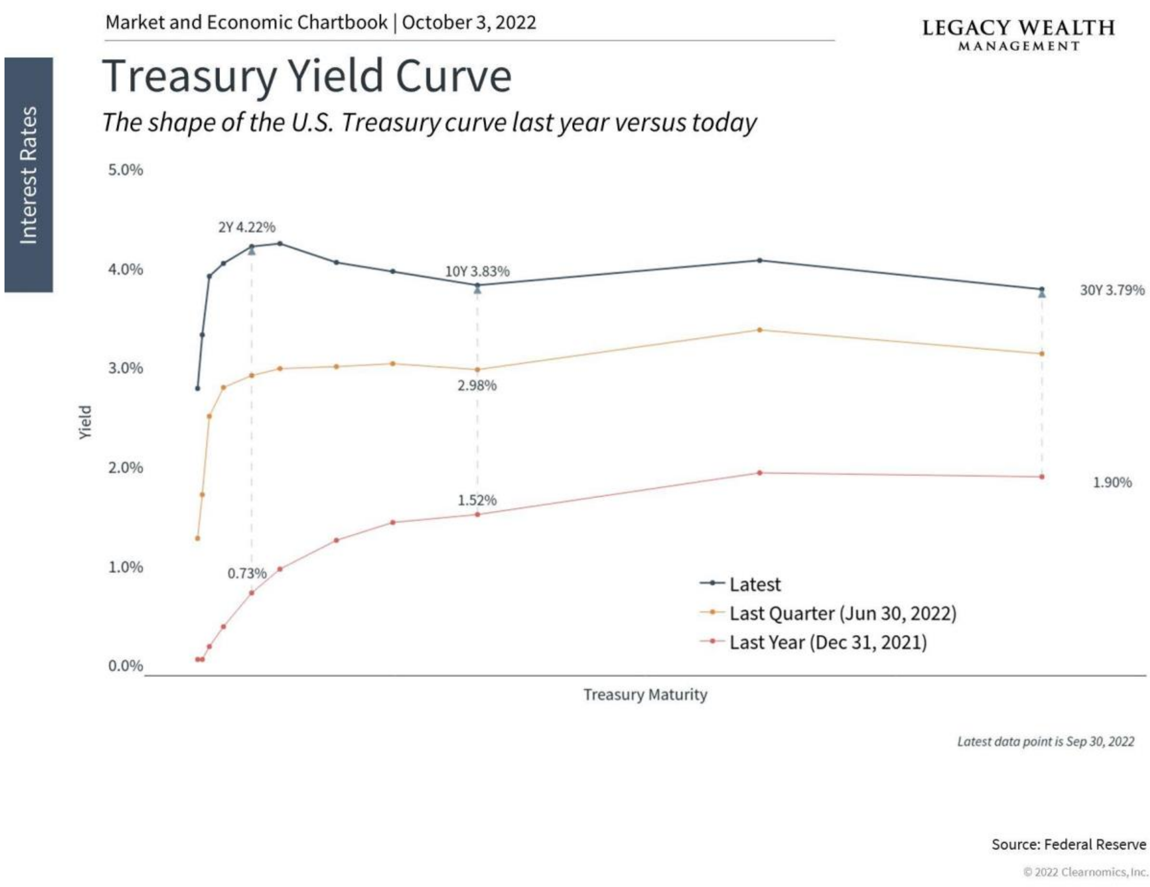
Q3 2022 Investment Insight

Since our last Investment Insight in July, not a lot has changed. Inflation is still elevated, interest rates continue to rise, markets remain volatile, and recession indicators remain high. Whether we are in a recession or not is good fodder for conversation. What does it mean for you as investors and what can you do now to improve the probability of success in your financial plan? This quarter's Investment Insight will discuss what we have done as an Investment Committee in anticipation of a recession and provide a few opportunities to consider during our current market environment.

As the threat of a recession became more apparent and as interest rates continued their ascent, the Investment Committee (IC) determined that our bond allocation needed some adjustments. Over the course of this year, we have significantly reduced your exposure to bonds that are more likely to be negatively impacted by a recession and increased our exposure to higher quality investment grade bonds with shorter maturities. Unexpectedly, shorter term bonds are paying more than some longer dated bonds. This phenomenon is rare and is known as an inverted yield curve. When this happens recessions typically follow, but timing on those recessions can run from a few quarters to a couple of years post inversion. By selling bonds that could be hurt by a pending recession, we are better prepared to protect capital in the event of a recession and take advantage of opportunities that may present themselves in the markets.



On the equity front the IC has also made a few decisions for clients, as appropriate. We have reduced our exposure to growth assets by selling a Large Cap Growth index fund in favor of a Core index fund that tracks the broader stock market. As interest rates rise, growth companies that depend more on financing become less valuable as their borrowing costs increase. Growth stocks also look less attractive to prospective investors when interest rates rise, giving investors other alternatives in which to invest. In addition to the sale of Large Cap Growth, we have increased our overweight to US equities versus international equities. US stocks tend to hold up better during recessions and tend to lead markets exiting recessions.

In our next section we will discuss a few opportunities that might be more specific to your unique situation. Some of these ideas will make sense for some but not for others. So, in the spirit of turning a frown upside down, here are some opportunities to take advantage of during our current market environment:

1) **Cash Management for emergency funds and savings accounts** - Investors can now earn interest on their cash for the first time in years. We are seeing money market rates north of 2% and these should go higher as the Federal Reserve (the Fed) continues to raise rates. Emergency funds and savings accounts should be earning at least 2%. We expect money market fund rates to approach 3% over the next 4-6 weeks. If you need help finding a good rate, call your relationship manager. We have good options available at Schwab and Fidelity. If you have excess cash that you want invested for the long run, consider putting money into your managed portfolio as markets are certainly on sale.

2) **I bonds** - I bonds are unique bonds issued by the Treasury department that are paying one of the best rates in the bond markets. The rates are reset semiannually based on what happens with inflation. Individuals can only purchase up to $10,000 annually, but with rates currently at 9.6%, they might be worth a look. You must hold them for at least a year but can sell them with a small penalty between 1 and 5 years. That rate is expected to go down in November as inflation slowly falls but should remain a good alternative to cash for the foreseeable future. These are certainly not for everyone but can be a good fit in the right situation. To learn more, check out the link below or reach out to your relationship manager with questions. Note that Legacy cannot buy these for you. You must buy them from the Treasury directly.
https://www.treasurydirect.gov/indiv/research/indepth/ibonds/res_ibonds_ibuy.htm

3) **Tax loss harvesting** - If you have invested any cash in the stock market over the last 12-18 months there is a good chance you have losses in those positions. If those purchases were done at Legacy, we have more than likely proactively realized losses on your behalf this year. Those losses can be used to offset current or future capital gains. The losses don’t expire and may help ease the sting of a higher-than-normal tax bill when markets recover. If you have sold a business, investment property, or maybe a second home for a gain in 2022, please reach out to your relationship manager to determine if there are additional losses that may be advantageous for you to take this year with the idea of offsetting those gains.

4) **Roth Conversions** - If you have ever considered the idea of a Roth conversion, now might be a good time. Stock prices are down and converting funds from a Traditional IRA to a Roth during depressed markets

allows for you to convert more shares per dollar of conversion. When the economy ramps back up, the future growth of those shares occurs in the tax-free Roth IRA. Good candidates for Roth Conversion are recent retirees who may temporarily be in a low tax bracket before the start of annual required minimum distributions, young workers who are in lower tax brackets now than they will be in the future, and individuals with taxable estates who have a strong desire to leave tax-free money to their non-spouse beneficiaries.

It's important to note that all 4 of these opportunities are specific to each client's goals and objectives. Before making any decisions, we recommend talking with your relationship manager.

Finally, there is an adage among economists that mentions that they have predicted 9 out the last 5 recessions. One is seemingly always on the horizon. Regardless of whether we are in a recession, will be in a recession, or will have a soft landing, Legacy will continue to adjust the portfolio as necessary to make the best of our current market environment. A patient investor makes small course corrections when opportunities present themselves and avoids making the potentially large mistakes of getting out of the market altogether or changing risk tolerance at an inopportune time. Focus on things you can control. Several of the opportunities presented above can help improve your after-tax rate of return. Try to ignore things you cannot control, like the markets. Over the long run, markets will be higher. The average recovery from a bear market pullback is 2 years. While 2 years may seem like a lifetime during a bear market, in reality, 2024 will be here before you realize it. Hang in there and remember that our personal investment portfolios are invested just like your investment portfolios. We are all in this together. Thank you for your continued trust in Legacy.

We hope to see you at our 40-year anniversary party at the FedEx Event Center at Shelby Farms Park on Thursday October 27th from 4-7pm! To RSVP please email 40@Legacywealth.com or call 901-473-8233.