Common Concerns vs. Our Concerns

What are you worried about? This is a question we get A LOT from current clients and prospects. It takes many forms: What are you worried about, aren't you worried about X, what have you heard about Y, have you thought about Z. Regardless of the form, the heart of the question is what concerns does Legacy have that could impact the financial future of our clients and negatively affect their plans (for some reason there is not a lot of concern about things that would affect financial plans to the upside). With that in mind, this commentary will address three of the common questions we get and why we are not worried about them. Then, it will dive into a more nuanced, technical, and longer-term issue about which we are slightly concerned.

Aren't you worried about the market declining?

This one is less common now that the S&P 500 has rallied back to its all-time high, but inevitably, the question will resurface the next time the market falls approximately 10%. As Appendix 1 illustrates, market declines are a standard part of market performance. The average intra-year market decline is 13% and the median decline is 10%. We try not to worry about market declines and instead use them to our advantage by rebalancing out of bonds and into stocks when these inevitable declines occur.

Aren't you worried about the election?

This worry presents itself every four years. Regardless of where on the political spectrum our clients may lean, many worry that their financial plan is at risk if the votes do not go their way. As Appendix 2, 3, and 4 illustrate, stock market returns do not particularly mind who the president is. This makes intuitive sense - stock markets are driven by earnings and earnings are driven by consumption. My personal spending habits (and I'm willing to bet yours as well) will not change in 2025 regardless of who is elected. Instead, they will be driven by whether it is time for a new car or home, where my family wants to go on vacation, in what activities my kids choose to participate, and what food I happen to be craving on any given Friday evening. These trends hold true regardless of the orientation of the three branches of government as well. For a chart on that, see the 12/31/2023 commentary.

Aren't you worried about what the people on the news are saying?

Generally, no. The expanding news business has been challenging for investors. Between Bloomberg TV, CNBC, Fox Business and a multitude of other investment related television channels, commentators are now forced to opine their thoughts on the market 24 hours a day, 7 days a week, 365.25 days a year. There is generally only so much you can say and know about the market. Most of these commentators try to fit past data into the current environment regardless of what was or should have been known in the past. It's often much easier to explain things in retrospect than predict an outcome ahead of time. You also likely will hear conflicting advice on these shows as some people argue buy while others argue sell. It is nearly guaranteed that the boiler plate advice, be it buy or sell, isn't perfectly suitable to your specific financial situation. What we know about news is that it passes and markets have trended higher for over 100 years and short-term news stories are unlikely to change that trajectory.

So, what could change that trajectory? The main thing we are worried about.

Population Demographics

The globalized world is driven by consumption. People consume millions of things. This consumption drives earnings for corporations. These earnings drive the stock market higher. Historically, it's been easy to consume more globally. People, on average, had children above the replacement rate of 2.1 children per woman. Additionally, life expectancy has been increasing. These two things led to an increase in global population from 4.4 billion people in 1980 to 6.1 billion in 2000 to 7.8 billion in 2020 and finally over 8 billion in 2023. It's not hard to imagine how 8 billion people can easily consume more goods and services than 4.4 billion people. Even if per person consumption remained constant, global growth in consumption would increase by 82%. There is reason to think that this growth may not continue indefinitely, and the impacts will vary by time and region.

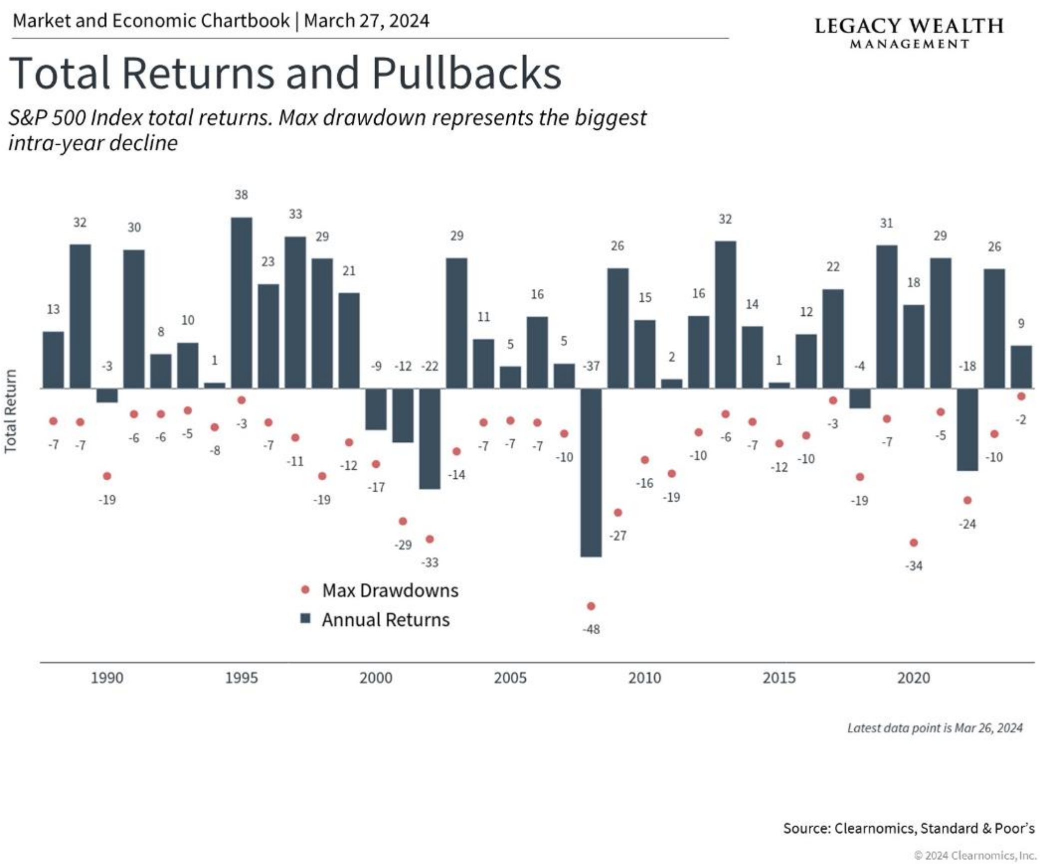
Japan's population in 1980 was 117.6 million, in 2000 it was 126.8 million and in 2020 it was 125.2 million. As you can see, this doesn't follow the global population trend as Japan has decreased population over the last 20 years. The Nikkei 225, Japan's stock market index set an all-time high in 1989 and did not set a new record until early 2024 (35 years between new market highs). While Japan was early to this problem, evidence suggests the rest of the world may join them at various times and in varying degrees in the future.

The most troubling trend here comes out of China. China had a one-child policy from 1980-2015; from 2016 -2021 they had a two-child policy; since 2021 there has been no formal policy. The problem with population issues is that any solution takes 30-40 years to effectively work its way into the economy. That means, this policy of requiring families to reproduce below replacement rate that started in 1980 will not start to show signs of economic problems until the current era. Currently China has approximately 122 million people aged 50-54. As they get ready to retire in 10 years, the generation that needs to backfill their consumption and workload, those aged 15-19 has only 82 million people. While technology MAY help replace the workload, it's going to be challenging for 82 million people to consume more goods and services than 122 million people.

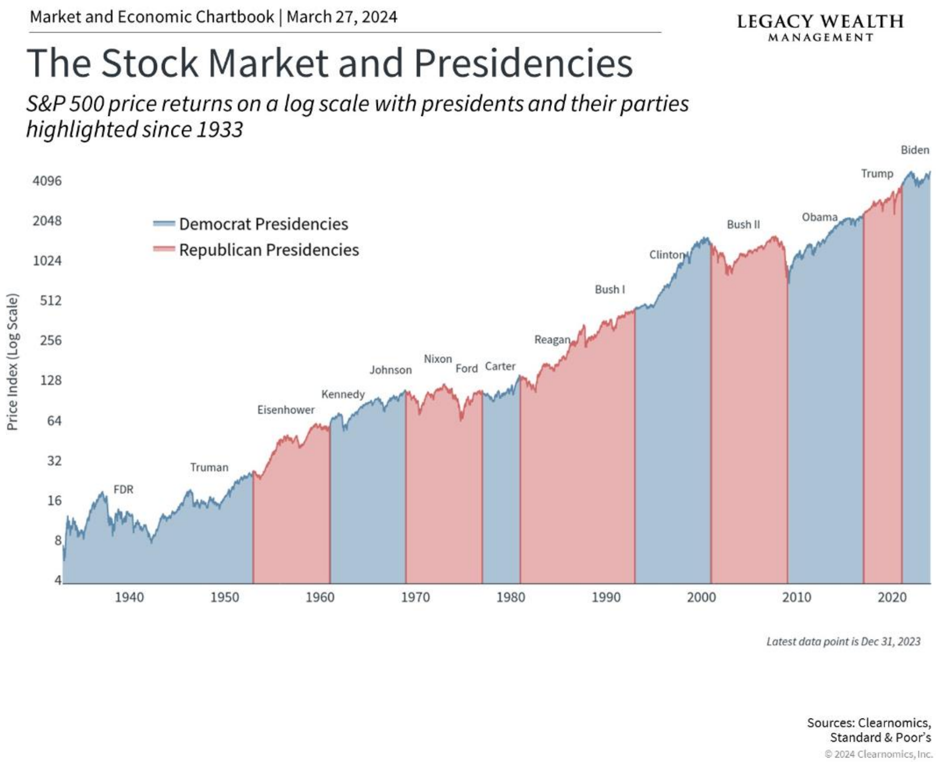
The good news is that the United States has a better population demographic profile. For comparison, the United States has approximately 21 million people aged 50-54 and also has approximately 21 million people aged 15-19. The drop-off for the United States is currently projected in the 0-4 age group (18 million people). The vast majority of the developed world comes in somewhere between these extremes.

We incorporate our concerns into the portfolio in various ways. First, relative to the global MSCI All Country World stock index, we are overweight to the United States. Next, we believe in a rules-based rebalancing approach. As markets decline, we sell bonds and buy into stocks for a potential recovery. As markets increase, we sell stocks and buy into safer bond securities. While it may have taken 35 years for a full recovery in the Nikkei, a rebalancing approach would have added value through various ups and downs in the interim. Finally, we make tactical choices in the portfolio when we see opportunities. These include manager-level changes and strategic changes such as adding risk to the bond portfolio with high-yield bonds or buying very safe short-duration bonds depending on current market risks. These investment decisions paired with prudent and ongoing financial planning are the best way we know to help you create a secure financial future.

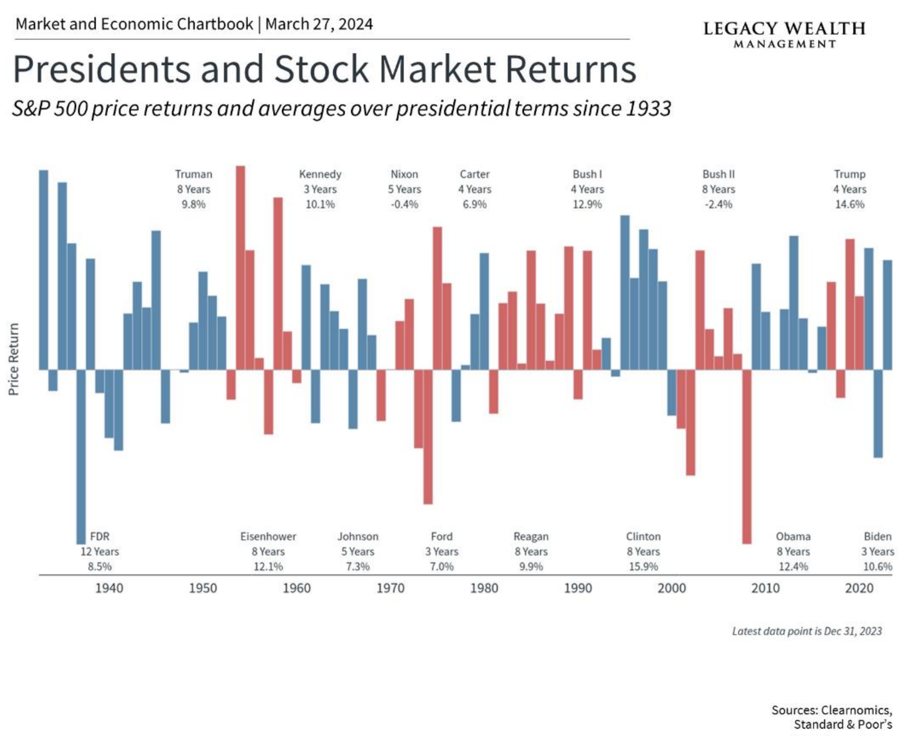
Appendix 1



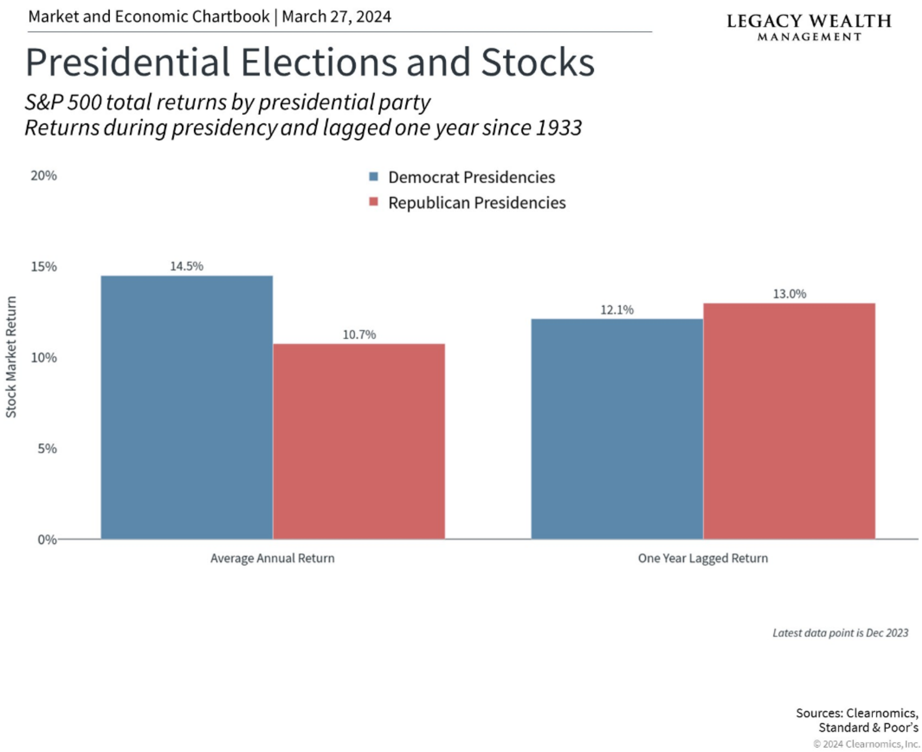
Appendix 2



Appendix 3



Appendix 4



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