Market Commentary

LCNB National Bank

<u>Perspectives on Recent Volatility:</u>

With equity markets in decline, it is important for long-term investors to keep some perspective. It may seem counterintuitive, but much of the recent sell-off is actually a result of stronger economic data. The most recent unemployment and wage data released last Friday reinforced the notion that the economy may be shifting into a higher gear and inflation may finally be on the horizon. This sent bond prices lower and interest rates higher.

All else being equal, higher inflation and higher interest rates lead to lower price multiples for stocks. Stocks and bonds compete for investor dollars, so as bond interest rates increase, stock investors demand a higher return on their investments as well. This is a function of the equity risk premium, which has averaged about 4% over time. Simply put, higher risk = higher return, and stock investors have required about a 4% excess return over treasuries in exchange for higher levels of risk.

A pullback in stocks was also long overdue. Stocks are not supposed to go straight up for several years at a time. Volatility, or risk, is a normal function of the stock market and necessary for investors expecting to earn a risk premium over bonds. So as painful as the short-term volatility may be, long-term investors should actually welcome a little risk.

So where is the bottom? This is always the most difficult question. As I write this, the S&P 500 is about 8% below the recent all-time high 2872. The 200-day moving average is often a point of support or resistance for financial assets. The current 200-day moving average is at about 2535 for the S&P and would represent another 4% down from current levels. That would be a 12% correction and seems like a reasonable guess for where we might get some support.

To sum up:

- The fundamental backdrop for the economy and earnings remains strong.
- An increase in interest rates has led to a repricing of equity/risk securities.
- A pullback in stocks was long overdue.
- Volatility is normal and necessary to justify an equity risk premium.
- Long-term investors should stay the course.

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We hope that we are exceeding your expectations. The best compliment we could receive would be a referral of your friends and family. Please contact Mike Miller @ 513.932.1414, ext. 59101 or mmiller@LCNB.com for more information.