

MAKING SENSE OF RECENT MARKET VOLATILITY

Technology stocks recently experienced a pullback due to a strong jobs report and heightened expectations for a Fed rate hike. How can investors put this in perspective?

The stock market has experienced historically strong returns over the past quarter, so the latest episode of volatility may raise questions among investors. The Nasdaq recently experienced its largest single-day fall in a year, with the index declining 4.2% on Friday, June 5. Counterintuitively, the drop followed a strong jobs report, which is good news for the broader economy, because it raises the possibility of a Federal Reserve rate hike by the end of the year.

While it's normal for the stock market to experience swings, this volatility has some clear causes that history can help us understand. Investors should remember that periods of strong returns are not a reason to forget about risk management and portfolio balance. While it's important to appreciate when the market performs well, it's during the good times that investors are best positioned to prepare their portfolios for whatever lies ahead. Understanding why markets react to interest rates, and keeping these moves in perspective, can help investors stay focused on their long-term goals.

The Market Has Experienced Renewed Volatility

Major indices, including the S&P 500, Dow Jones Industrial Average, and the Nasdaq, have accelerated in recent months. Part of this strength can be described as a "relief rally." Specifically, the conflict in the Middle East has had less of an economic impact than many originally feared, despite higher oil prices. Corporate earnings have also been strong and there is growing enthusiasm for a wave of upcoming initial public offerings. Perhaps most interesting is the fact that the bond market has faced a more challenging environment as interest rates have remained high.

Stock Market Cycles
NASDAQ Composite since 1995



The bond market is sometimes described as the "smart money," meaning that bond investors tend to more closely analyze the underlying trends in inflation, growth, and Fed policy compared to stock investors. Whether this is true, bonds have indeed been signaling that rates may stay higher than some had hoped, even as the stock market has rallied. It's not too surprising, then, that the stock market reacted to these same developments. This is particularly true for technology and AI-related stocks, which are highly sensitive to interest rates.

Technology Stocks Can Be Sensitive to Interest Rates

A clear example of this sensitivity is the Magnificent 7, a group of large technology companies. From their peak at the end of 2021 to their bottom in late 2022, when inflation was heating up and interest rates jumped, this group lost about half of its value. This decline affected the value of the Nasdaq as well as broad sectors such as Information Technology and Communication Services. However, these groups then began to recover as rates stabilized and the Fed slowed its pace of hikes, eventually going on to rally to new highs.

Why are technology stocks sensitive to interest rates? Investors buy these stocks largely because they expect high growth that extends far

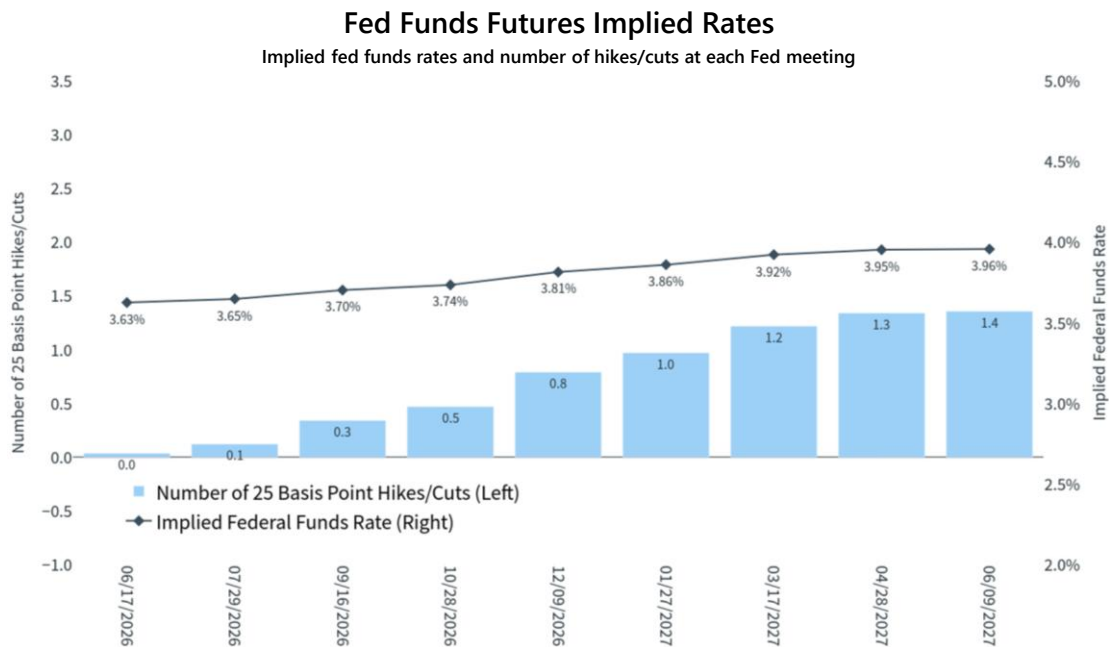
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into the future, in contrast to more established businesses with steady cash flows. Since interest rates affect how future profits are valued today, even small changes can lead to large swings. Thus, interest rates are like a long lever, where even small moves at one end can make a large difference at the other.

This dynamic is important because technology-related stocks now constitute a larger proportion of the overall stock market. The Magnificent 7, for instance, now makes up about one-third of the S&P 500, meaning that many investors hold a larger proportion of these companies than in the past. Even with the latest pullback, these sectors have performed well this year. Still, investors may experience periods of volatility they may not have in the past, which is why maintaining portfolio balance matters just as much when markets are rising as when they are falling.

Markets Have Performed Well Across Fed Rate Hike Cycles

It's important to remember that expectations for Fed policy can change quickly depending on underlying economic conditions. Earlier this year, the consensus view was that the Fed would continue cutting rates. Those expectations shifted quickly as energy prices rose and the job market strengthened, as shown in the chart below. This is a reminder that the Fed is often reacting to economic events rather than sitting in the driver's seat.



Sources: Clearnomics, Bloomberg. Latest data point is June 11, 2026.

There is also uncertainty around how Kevin Warsh, as the new Fed chair, will respond to inflation. In the past, he has been viewed as an inflation hawk, meaning he would lean toward raising rates to help stabilize prices for consumers and businesses. Like his predecessor, this would put him at odds with the White House's desire for rate cuts.

However, all of this remains speculation until the Fed actually makes its decisions based on the actual economic environment. It's also uncertain whether this would be the beginning of a rate hike cycle, or simply a short period of tighter rates.

That said, even if current market expectations prove to be correct, the Fed is not expected to raise rates until the end of the year, and only by 25 basis points, as seen in the chart. This is a modest move by historical standards, especially compared to the rate hike cycle from 2022 to 2023, when the Fed raised rates from the zero-lower-bound to 5.25% over 11 hikes.

More importantly, the market has performed well across many different rate environments, including periods when rates are rising. This is especially true when the Fed is tightening conditions because the economy is strong, since healthy growth tends to support corporate earnings. In other words, it's not unusual in rising markets for the Fed to also be raising rates.



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