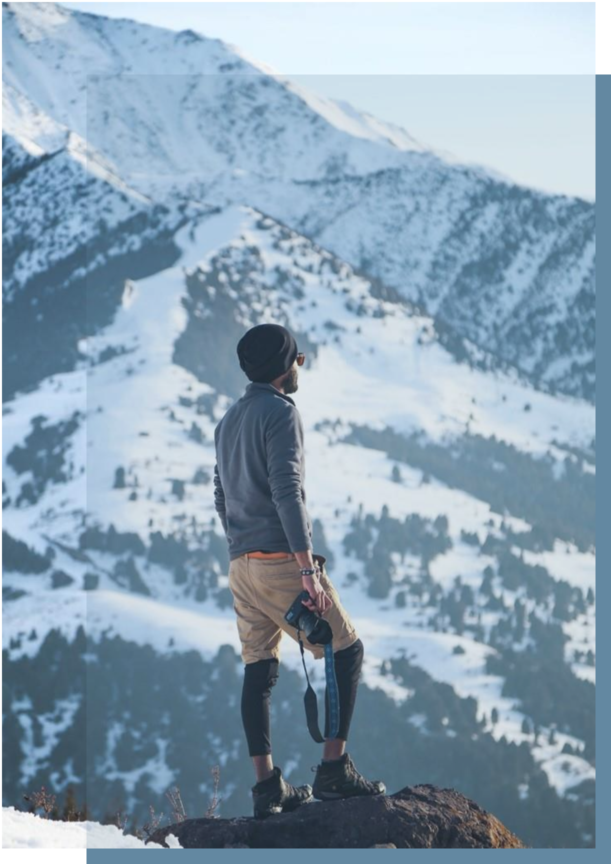
PERSPECTIVES

Benefit Financial Services Group's Newsletter

Quarter Ending September 30, 2022



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Market Recap

Michael Allbee, CFP® (Partner/Senior Portfolio Manager)

Paul Horn, CFP®, CPWA® (Senior Financial Planner/Wealth Manager)

A robust response to inflation by central banks globally and Russia's aggression in Ukraine are sending shockwaves through global stock and bond markets. While inflation showed some signs of cooling in July, the August Consumer Price Index (CPI) print showed that broad-based pressures are still prevalent as inflation continues to hover at the highest levels seen since 1981.[1] The Federal Reserve's economic forecasts now show more of a rise in unemployment to bring inflation down.[2]

All major U.S. equity indices are in bear market territory with year-to-date losses for the S&P 500[3], DJIA[4] and NASDAQ[5] at (24.8%), (20.9%) and (32.4%), respectively, as of September 30, 2022. The U.S. 10-year Treasury yield surpassed 3.8%, marking the quickest re-rating in daily yields since 2009. A 60/40 balanced portfolio of U.S. stocks and U.S. bonds is now down (-20.2%) year-to-date through September 30th, the worst return in nearly 35 years.[6]

Globally, we (consumers, governments, and markets) were addicted to the low-interest rates post the "Great Financial Crisis" (2007-2008). We now are, collectively, suffering an economic illness due to this addiction. Like an addict going "cold turkey", we're taking our medicine of rapidly rising interest rates to normalize inflation and boy, does it taste awful. However, recessions act like a cleansing mechanism, exposing/eliminating waste and inefficiency, ultimately creating a healthier economy when we come out the other end. This, of course, is why bear markets end and stocks return to (and always, in the past, have surpassed) their original highs. Anybody that has taken medicine to cure the symptoms, knows that the former unpleasantness doesn't last forever, and therefore neither does the latter.

Like any sickness, we know it will take time for the markets and economy to heal from this. While we do not know the exact length of time it will take, we can look at history to get a sense of what to expect going forward (as Mark Twain said, "History never repeats itself, but it does often rhyme.").

Below are some pertinent historical facts:

- The stock market tends to peak 12 – 18 months before a recession occurs. The peak in the U.S. stock market was January 2022. The major U.S. stock and bond indices are reflecting that the U.S. economy is either in or may soon face a recession.

- The seven recessions over the past 50 years each lasted on average around 11 months, while each expansion lasted on average about 72 months.[7] The U.S. economy has historically experienced growth far more often than decline.

- On average, stock market returns are correlated with future economic growth.[8] However, the economy is not the market, and the market is not the economy. In other words, the economy and markets are interrelated but do not move in lockstep.The stock market is a "forward-looking mechanism" - current market prices reflect all currently known information.

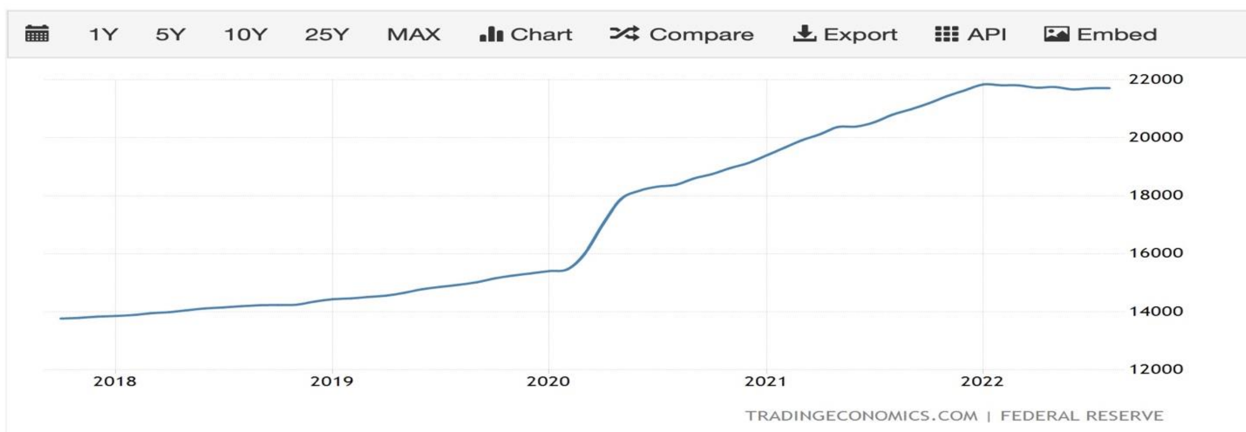
In summary, over the long term, the U.S. economy has overcome many recessions, and despite these short-term bumps along the way, has time and again recovered and experienced tremendous growth in Gross Domestic Product (GDP). We think the past record of the stock market ultimately recovering during recessions and going on to higher highs will, more likely than not, continue.

We understand this has been a tough year and are grateful for our clients' continued trust and confidence and appreciate that together we are getting through this very difficult period.

Forecast

Steven Yamshon, Ph.D. (Managing Principal)

Economists often take a simple concept and make it more complicated than it should be. For example, take the relationship between money and inflation. There is nothing mysterious about it, because inflation is a monetary phenomenon. When the supply for money exceeds the demand for it, inflation ensues. In the chart below, we can see the vast expansion of money (M2 money supply)[9] beginning in 2020 and then it starts to level off in 2022. This extremely high expansion of the M2 money supply is the primary reason why we are having an inflation problem right now. Simply put - too much money, chasing too few goods, raises prices. Note that inflationary impacts take effect anywhere from 9 months to 18 months after the expansion of M2.



In a situation where the supply chain in manufactured goods is in short supply, and the demand for them is strong, combined with easy money, it is no wonder we have inflation. Famously, the quip "the cure for high prices is higher prices", turns out to be true. High interest rates are beginning to soften demand and inflation should fall from its present rate of 8.3% to approximately 4% by next year. However, to get to the magic number of 2%, I believe it will require a hard landing of the economy with the Federal Funds rate having to go above the Federal Reserve's currrent median forecast of 4.6%.[2] I'm not so sure the Federal Reserve has the political willpower to do that. Therefore, inflation may be with us for awhile.

Portfolio Management

Michael Allbee, CFP® (Partner/Senior Portfolio Manager)

Paul Horn, CFP®, CPWA® (Senior Financial Planner/Wealth Manager)

Wouldn't it be great if we could get out of the market at the start of a recession, before stocks typically experience a downturn and then get back in as prices go back up? The issue is that we can't say, with certainty, when economic peaks and troughs will start and end until after the fact — and trying to time these events can have detrimental effects on investors if they get it wrong. The risk of fleeing the market today is that investors may leave when the bad news is priced in and miss out on the historically positive returns typically seen in the second half of recessions.[10]

The proper goal is to do the best possible job of investing in the absence of knowing what the future may hold and position portfolios for possible implications of the future. To quote Mark Twain again, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." The best way we know how to handle this, is to stay true and disciplined to our time-tested process. For the most part, this means staying the course with our portfolios.

However, staying the course doesn't have to mean standing still. For many clients, we have been busy rebalancing (selling high, buying low), tax-loss harvesting (reducing the total amount of capital gains taxes), making portfolios more tax-efficient (i.e., adding to municipal bonds for certain clients), increasing portfolio yield as bonds have become more attractive, making tactical shifts like reducing exposure to areas like U.S. large-cap growth stocks, and taking advantage of opportunities to swap underperforming higher-cost mutual funds with lower-cost replacements with similar return potential.

For our clients, the best advice we can provide, is to focus on what you can control like reducing spending and avoid making financial decisions based on emotions. If you have not done a financial plan in a while (or ever), now is a good time to do so as it will help you maintain a long-term perspective and alleviate the concerns you have when you realize you are still on track. We view our relationship as a partnership and keeping open lines of communication is key. Let us spend the time reviewing what you own and why, so we can proceed with caution, care, and remain focused on your long-term objectives, not just the short-term issues at hand.

Talk With Us!

Arash Navi, CFP®, CPA (Controller/Wealth Manager)

One silver lining in the current bear market is that this could be a good time to convert assets from a traditional IRA to a Roth IRA. Converted assets are subject to federal income tax in the year of conversion, which might be a substantial tax bill. However, if assets in your traditional IRA have lost value, you will pay taxes on a lower asset base when you convert. If all conditions are met, the Roth account will incur no further income tax liability for you or your designated beneficiaries, no matter how much growth the account experiences.

Tax Trade-Off

The logic behind deferring taxes on retirement savings is that you may be in a lower tax bracket when you retire, so a current tax deduction might be more appealing than tax-free income in retirement. However, lower rates set by the Tax Cuts and Jobs Act (set to expire after 2025) may have changed that calculation for you. A cost-benefit analysis could help determine whether it would be beneficial to pay taxes on some of your IRA assets now rather than later. One strategy is to "fill your tax bracket," meaning you would convert an asset value that would keep you in the same tax bracket. This requires projecting your income for 2022.

Lower Values, More Shares

As long as your traditional and Roth IRAs are with the same custodian, you can typically transfer shares from one account to the other. Thus, when share prices are lower, you could theoretically convert more shares for each taxable dollar and would have more shares in your Roth account to pursue tax-free growth. Of course, there is also a risk that the converted assets will go down in value. You may have the option to take taxes directly out of your converted assets, but this is generally not wise.

Two Time Tests

Roth accounts are subject to two different five-year holding requirements: one related to withdrawals of earnings and the other related to conversions. For a tax-free and penalty-free withdrawal of earnings, including earnings on converted amounts, a Roth account must meet a five-year holding period beginning January 1 of the year your first Roth account was opened, and the withdrawal must take place after age 59½ or meet an IRS exception. If you have had a Roth IRA for some time, this may not be an issue, but it could come into play if you open your first Roth IRA for the conversion.

Assets converted to a Roth IRA can be withdrawn free of ordinary income tax at any time, because you paid taxes at the time of the conversion. However, a 10% penalty may apply if you withdraw the assets before the end of a different five-year period, which begins January 1 of the year of each conversion, unless you are age 59½ or another exception applies.

More Favorable RMD Rules

Unlike a traditional IRA, Roth IRAs are not subject to required minimum distribution (RMD) rules during the lifetime of the original owner. Spouse beneficiaries who treat a Roth IRA as their own are also not subject to RMDs during their lifetimes. Other beneficiaries inheriting a Roth IRA are subject to the RMD rules. In any case, Roth distributions would be tax-free. The longer your investments can pursue growth, the more advantageous it may be for you and your beneficiaries to have tax-free income.

If you are interested in completing a Roth conversion, please Talk With Us! We will complete a cost-benefit analysis to help you understand the implications of completing a conversion.

In the News

July 20, 2022 – BFSG Nationally Ranked in Financial Advisor's (FA) Magazine

The Score Board

	09/30/2022	YTD Change
Dow Jones Industrial Average	28,725.51	-19.72%
S&P 500*	3,585.62	-24.77%
NASDAQ Composite*	10,575.62	-32.40%
MSCI EAFE (USD)*	1,660.32	-28.88%
Bloomberg Commodity Index	111.49	12.42%
U.S. Aggregate Bond Index	2,011.06	-14.61%
10 Yr U.S. Treasury Bond Yield	3.82%	+231bps
30 Yr Fixed Mortgage Rate	7.06%	+379bps
Prime Rate	6.25%	+300bps
Crude Oil ($ / Barrel)	$88.03	4.48%
Gold ($ / Oz.)	$1,660.61	-9.21%
U.S. $ / Euro €	$1.02	16.00%
Core Inflation (excluding food / energy)		6.30%
Inflation (including food / energy)		8.30%

**Without Dividends; **Unadjusted 12-Months ended August 2022; bps (1 Basis Point = 1/100%); UNCH (Unchanged)*
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

Sources:

1. Source: U.S. Bureau of Labor Statistics (BLS). Consumer Price Index Summary. As of August, 2022.
2. Source: Federal Reserve. Summary of Economic Projections. As of September 21, 2022.
3. The S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market. Price return quoted.
4. The Dow Jones Industrial Average (DJIA), or simply the Dow, is a stock market index of 30 prominent companies listed on stocks exchanges in the U.S. Price return quoted.
5. The Nasdaq Composite is a stock market index that includes almost all stocks listed on the Nasdaq stock market and is heavily weighted towards companies in the information technology sector. Price return quoted.
6. The U.S. balanced portfolio reflects 60% S&P 500 index (a proxy for the U.S. stock market) and 40% U.S. Aggregate Bond index (a proxy for the U.S. bond market). The earliest we have total returns for both the S&P 500 and U.S. Aggregate Bond indices is 1988.
7. Source: Avantis. The market is represented by the CRSP U.S. Total Market Index. The average number of months over the period from peak to trough is 10.7 and from trough to peak is 71.9. Data from 1973 – 2021.
8. Source: St. Louis Federal Reserve. Guo, H. (2002). "Why are stock market returns correlated with future economic activities?"
9. M2 is a measure of the U.S. money stock that includes M1 (currency and coins held by the non-bank public, checkable deposits, and travelers' checks) plus savings deposits (including money market deposit accounts), small time deposits under $100,000, and shares in retail money market mutual funds.
10. Source: BLS, Ibbotson, J.P. Morgan Asset Management. Guide to the Markets. Data from 1960 – 2021.
11. Talk With Us! section prepared by Broadridge Advisor Solutions (copyright 2022). Edited by BFSG.

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