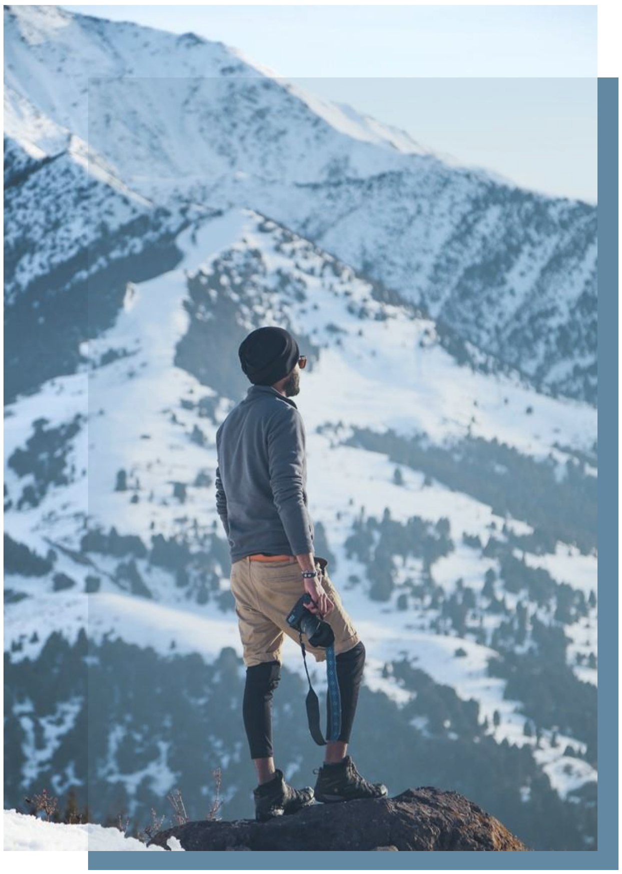
PERSPECTIVES

Benefit Financial Services Group's Newsletter

Quarter Ending December 31, 2022



What's New

Market Recap

Patrick Powers, CFA, CPA/PFP, CFP® (Managing Principal)

Well, it certainly wasn't the kind of year we wanted, but it was probably the kind of year we needed. This allowed for cleansing of the excesses of monetary stimulation and government manipulation in our economy and financial markets, which resulted from our efforts to recover from the 2008 financial crisis and the effects of the COVID pandemic on our economy. To be fair, inflation skyrocketed at the beginning of the year as supply chains collapsed because of COVID-related problems that severely restricted the movement and availability of goods. In addition, the Russian invasion of Ukraine in February did not help matters, as the world wondered if a third World War was about to unfold – and a nuclear one at that.

The Federal Reserve Open Market Committee (FOMC) jumped into the fray in March in a dramatic attempt to change the direction of rising inflation. After holding interest rates at historically low levels for what some would say was far too long, they quickly and determinedly raised interest rates at the fastest rate in our history (by 4.25% in 7 consecutive hikes). And, yes, inflation is now falling, but does it have more to do with supply chain improvement (nearly back to normal in most cases) or due to the FOMC's moves? That is the question, and time will tell if the Federal Reserve (Fed) overshoots and unnecessarily slows our economy. All eyes are on the Fed and investors are mindful of the proven admonition of "Don't fight the Fed!"

The bear market[1] in stocks was simply a result of investors who were willing to pay 21.4x corporate earnings when interest rates (i.e., the cost of borrowing) were at all-time lows, being unwilling to pay more than 16.7x earnings as the cost of borrowing rose.[2] In actuality, 2022 corporate earnings came in almost exactly as expected by most! Also, investors were very much surprised at how fast and by how much the Fed raised interest rates. The stock market doesn't like surprises![3]

In 2022, investors were hit with a historical double whammy as bonds also cratered. Bonds usually perform well when stocks are falling, as investors seek their relative safety. However, in 2022, higher interest rates resulted in discounted bond prices. Bonds, as measured by the Bloomberg U.S. Aggregate Bond Index[4], were down 13% in 2022, the most in the indices history! A very painful adjustment for sure, but because of this not-so-great rate reset, fixed income portfolios are now positioned to deliver income, something that has been lacking over the last several years.

We want to emphasize that these 2022 market adjustments were necessary: interest rates had to rise, and inflation has to fall (which it is). The adjustment in bond and stock prices in 2022 had to happen. Fortunately, this 2022 weakness follows some very good years of outsized returns. So yes, it has been two or more steps forward and one step back recently, but let's not forget those two steps forward! What really matters is the performance of your holdings over the next five or ten years (or more) and how the value at the end of the period compares to the amount you invested and to your financial position, needs, aspirations, and ability to live with fluctuations and whether periods when things go less well than you expected.

Forecast

Steven Yamshon, Ph.D. (Managing Principal)

If only economists could be as famous as the Kardashian's. The truth is that economic forecasting is a social science with so many quantitative and qualitative inputs. It will never be a precise science, such as physics, or achieve rock star status. Educated hunches that lead to concrete actions are more useful and better suited to the investor than either reading tea leaves or tarot cards. These are my hunches.

The Fed is walking a tightrope between driving inflation to 2% and steering the economy off a cliff. Higher interest rates are already slowing the economy down, with many of the leading indicators pointing in this direction. It appears that a recession will occur in the second half of 2023 or early 2024, but we believe it should be mild. Unlike 2008, there appears to be no systemic risks in either the banking system or in real estate. In any event, the Fed would likely cut interest rates if a recession did occur.

Inflation is coming down slowly but not fast enough. It is sticky, due to wage increases and housing costs. Although inflation should decline to the 3% to 5% range by the end of 2023 or by early 2024, it most likely will not come down to the preferred 2% level unless the central bank wants to put the economy in a deep recession and the U.S. Government is willing to get its budget deficit under control. Two actions that we believe are highly unlikely. We suspect inflation will run hotter for the rest of the decade than in the past decade due to accommodative monetary policies, expanded fiscal spending, deglobalization, higher defense spending, and higher prices for food, commodities, and oil. We will be planning for that scenario.

Recession or not, bonds could have a banner year in 2023 or 2024, and the historical relationship between stocks and bonds will prove to be unbroken. There is some sunshine for stocks too because companies will likely begin to raise prices to combat inflation and use technologies such as artificial intelligence, robotics, and machine learning to improve labor productivity.

As China recovers from their COVID lockdown policies, growth in Europe and Asia should resume as they are heavy exporters to the Middle Kingdom. This will lead to opportunities in Europe and emerging markets. As the U.S. dollar declines, gold should begin to shine once again.

Portfolio Management

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

Walter Bagehot, an English journalist, once observed: "Every great crisis reveals the excessive speculations of many houses which no one before suspected." Unprofitable companies, the SPAC boom, cryptocurrencies, fintech and metaverse stocks all were repriced in dramatic fashion over the past 12-months, and which then spread broadly to the entire equity market. We began writing about the speculation in the markets in early 2021 when valuations started to soar (read about SPACs, GameStop, speculative growth stocks, and retail trading). Many of these speculative investments have failed (read here and here), many more will fail, and some will go on to be the next great stocks to own, similar to the stocks that rose out of the ashes of the dot-com era (i.e., Netflix 2002, Google 2004, etc.). As 2023 begins, some public valuations are back to pre-COVID levels, while many private equity and private credit markets have yet to reprice. We suspect that markets will remain rocky as the growth slowdown gets closer and valuations potentially overshoot to the downside, but eventually people and companies will respond and mobilize to get things back on track.

The dot.-com crash, just like the Great Recession, and the COVID pandemic, were very real and painful downturns that caused a lot of sleepless nights for some people, but recoveries followed all of them and the markets eventually climbed to new all-time highs. “Some people say they want to wait for a clearer view of the future. But when the future is again clear,the present bargains will have vanished. In fact, does anyone think that today’s prices will prevail once full confidence has been restored?” That comment was made 91 years ago by Dean Witter in May of 1932 – only a few weeks before the end of the worst bear market in history.[5]

This still holds true today and the season of failure is the best time for sowing seeds of success. The bludgeon of market declines may bruise you but staying invested and participating in the long-term performance of the market averages is the surest way we know to compound satisfactory rates of return. The active efforts we implement in portfolios during times of market duress, such as rebalancing, tax-loss harvesting, and high-grading the portfolio, is our way of doing the little things in an extraordinary way in attempt to yield additional wealth creation.

Talk With Us!

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

Henry VanBuskirk, CFP® (Wealth Manager)

The $1.7 trillion spending package signed into law on December 29, 2022, includes updates and clarifications to the 2019 Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019. With changes to Required Minimum Distribution (RMD) beginning dates, catch-up contribution limit changes, and additional retirement plan provisions, SECURE 2.0 is chock full of changes that may impact your retirement and estate planning strategies and may require adjustments to your financial plan. We highlighted below what we believe to be the most generally applicable changes for our client base but is not intended to be an exhaustive list. For a more comprehensive list of updates, please see our recent Legislative Update.

*Unless otherwise noted, all provisions take effect on or after January 1, 2023.

- Increases the RMD age from 72 to 73 beginning on January 1, 2023, and to age 75 beginning on January 1, 2033. Meaning, if you turn 72 after 12/31/22, your RMD age will now begin at age 73 if you were born between 1951-1959.

- The Qualified Charitable Distribution (QCD) age remains the same at age 70.5, but beginning in 2023, taxpayers may take advantage of a one-time gift up to $50,000 (adjusted annually for inflation) to fund a Charitable Remainder Unitrust, Charitable Remainder Annuity Trust, or a Charitable Gift Annuity. This is an expansion of the type of charity, or charities, that can receive a QCD. This amount counts toward the annual RMD, if applicable. Beginning 2024, the QCD limit ($100,000) will change as it will be linked to inflation.

- Allows for tax-free and penalty-free rollovers from 529 plan accounts to a Roth IRA in the beneficiary's name, up to $35,000 during the beneficiaries’ lifetime. Rollovers in any one year are subjected to the Roth IRA contribution limits and the 529 plan must have been opened for at least 15 years. This is a wealth transfer opportunity for parents/grandparents concerned about overfunding their beneficiaries' 529 plan accounts.

- Qualified Longevity Annuity Contract (QLAC) total lifetime contribution limit has increased to $200,000, regardless of the IRA’s account balance.

- Effective 2024, the IRA catch-up contribution limit will now be indexed to inflation.

- Effective 2025, retirement plan participants aged 60-63 years old will be able to make catch-up contributions up to $10,000 annually to a qualified retirement plan, and that amount will be indexed to inflation (the catch-up amount for people aged 50 and older in 2023 is currently $7,500). One caveat: Effective 2024, if you earn more than $145,000 (adjusted for inflation) in the prior calendar year, all catch-up contributions at age 50 or older will need to be made to an employer-sponsored Roth account in after-tax dollars.

- Employers will be able to provide employees the option of receiving vested matching contributions to Roth accounts (although it may take time for plan providers to offer this and for payroll systems to be updated). Previously, matching in employer-sponsored plans were made on a pre-tax basis.

- Effective 2024, pre-death RMDs are not required for employer-sponsored Roth plans (i.e., Roth 401k, Roth 403b, and governmental Roth 457b plans).

- Effective 2024, allows employees to receive matching contributions from employers for repayment of student loans. Governmental employers are also allowed to make matching contributions to 457(b) plans with respect to such repayments.

- Effective 2024, employers may automatically opt in non-highly compensated employees into an emergency savings account at a rate of 3% salary with a cap of $2,500 annually (or lower, as set by the employer). Contributions are treated as Roth elective deferrals and may be matched up to the cap. The first four withdrawals in a year would be tax- and penalty-free.

In the News

As you are part of our BFSG family, we have some exciting news to share. Kyle Nixon, our Operations & Systems Manager, and his wife, Vanessa, are proud new parents to a baby boy – Anderson. We are thrilled for them!

The Score Board

	12/31/2022	YTD Change
Dow Jones Industrial Average	33,147.25	-8.78%
S&P 500*	3,839.50	-19.44%
NASDAQ Composite*	10,466.48	-33.10%
MSCI EAFE (USD)*	1,943.93	-16.78%
Bloomberg Commodity Index	112.80	13.75%
U.S. Aggregate Bond Index	2,048.73	-13.01%
10 Yr U.S. Treasury Bond Yield	3.87%	236 bps
30 Yr Fixed Mortgage Rate	6.66%	339 bps
Prime Rate	7.50%	425bps
Crude Oil ($ / Barrel)	$80.26	5.49%
Gold ($ / Oz.)	$1,812.35	-0.43%
U.S. $ / Euro €	$0.93	6.20%
Core Inflation (excluding food / energy)		6.00%
Inflation (including food / energy)		7.10%

**Without Dividends; **Unadjusted 12-Months ended November 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. A condition in which securities prices fall 20% or more from recent highs amid widespread pessimism and negative investor sentiment.
2. Source: FactSet, Refinitiv Datastream, J.P. Morgan Asset Management. Forward price-to-earnings ratio is a bottom-up calculation based on IBES estimates and FactSet estimates since January 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 Bloomberg U.S. Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market. The index was created on July 7, 1973.
5. Dean Witter & Co. was founded by Dean Witter as a retail brokerage firm in 1924 and would be among the largest brokerages on the West Coast. Morgan Stanley merged with Dean Witter in 1997.

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