Good Riddance to 2022

January 2023

We opened last quarter's commentary characterizing the first nine-months of the year ranking as the 6th-worst year for stocks ever. Despite reaching a bottom in the first few days of October and rising 7.5% through the end of the year, the S&P 500 still clocked in with the 7th-worst year on record. But, to be honest, just looking at the returns of large US stocks undersells the pain many investors, particularly retirees, felt in 2022.

Often when stocks have fallen, bonds have acted as a ballast for an investment portfolio. As investors flee from riskier assets in declines, bonds tend to be bid up and provide an inversely correlated return stream for diversified investors. That didn't happen in 2022. While it was the seventh-worst year for stocks, it was *the* worst year for bonds. The Federal Reserve's rate-hiking campaign laid waste to fixed income returns throughout the year. As interest rates rise, bond prices fall (the reverse is also true). To explain this phenomenon simply, as new bonds are issued at higher interest rates, the value of existing bonds carrying lower interest rates falls. Unfortunately, this all led to a diversifier's worst nightmare as there was nowhere really to find reprieve from negative returns.

Asset Class	Asset Type	2022 Performance
Cash	Cash	+1.6%
Gold	Alternative	-0.8%
Short-Term Treasuries	Bonds	-4.7%
Inflation-Protected Treasuries	Bonds	-12.0%
Total US Bond Market	Bonds	-13.3%
Developed International	Foreign Stock	-14.0%
US Large Companies	US Stock	-18.1%
Emerging Markets	Foreign Stock	-19.7%
US Small Companies	US Stock	-20.4%
Real Estate (REIT)	Alternative	-24.4%
Long-Term Treasuries	Bonds	-29.6%
Bitcoin	Alternative	-64.2%

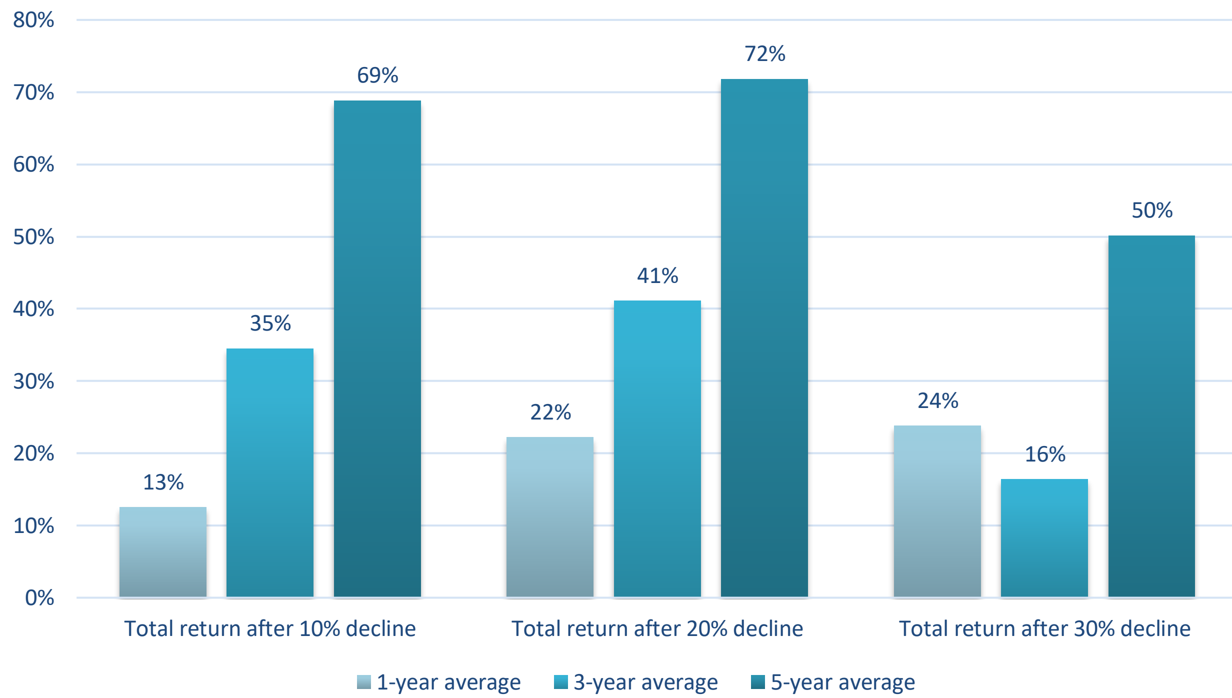
**Sources: Morningstar, Coindesk. Data as of December 31, 2022. See footnote for details asset class/index details[1]*

What I'm hoping was a generationally bad year for investments, will hopefully give way to comparatively strong returns moving forward. If you're someone who can see the silver-lining in things - the losses from 2022 have added yield to investment portfolios. The dividend yield on the S&P 500 is now over 2%. The yield on the US Aggregate Bond Index is in the 4-5% range. We haven't been able to earn interest on investment grade bonds at this level in over 15 years.

When stocks have declined in the past, the subsequent returns have often been above average in the short-to-intermediate periods that follow.

Average Returns after Downturns

Fama/French Total US Market Research Index Returns (July 1, 1926 – December 21, 2021)



**Source: Dimensional Fund Advisors. See footnote for additional calculation information and disclosures*[2]

Does this mean that clear skies are ahead? We don't know. There is still plenty of uncertainty that will linger over financial markets as we begin 2023. It remains to be seen how far the Federal Reserve will go in its campaign to curb inflation, how higher interest rates will affect consumer spending and company earnings, how the war in Ukraine will play out, or what will result from China's shift away from its zero-COVID policy. Then of course, there are all the things we don't know that we don't know. Remember COVID? No one had that on their January 2020 bingo card. The only constant is that markets are always clouded with uncertainty. This is why, over the long-term, investors have been compensated for investing in financial markets, for accepting this uncertainty.

If we consider previous periods when economic unease was high, we've seen that the market has historically rallied well before those worries subsided - once light appeared at the end of the tunnel and signs of improving conditions were apparent. Waiting for an 'all-clear' (if such a thing even exists) spells a good chance of missing out on a significant share of potential gains.

The lesson is that markets react quickly when good news appears and staying in the market is the only way to benefit when it does. Here's to hoping we see lots of good news in 2023.

New Retirement Legislation

The waning hours of 2022 saw the passage of *Secure Act 2.0* which brings modest revisions to numerous rules governing employer-sponsored retirement plans and IRAs. Many of the changes deal with eligibility and contribution requirements for solo and small business plans, but a few of the new provisions have broader application to many of our clients. Here are the highlights:

- **Required minimum distribution age rises** – Effective for 2023, the new age to begin taking required distributions rises to 73. However, this doesn't provide any reprieve to those who have already begun RMDs. Additionally, the RMD age will rise again in 2033 to age 75.
- **Enhanced catch-up contributions** – Beginning in 2025, savers between ages 60 and 63 are eligible to contribute 150% of the catch-up limit each year. In today's dollars, this would translate to an extra $4,250/year eligible to be contributed to a 401(k).
- **Catch-up contributions lose tax-deductibility for high earners** – When making catch-up contributions to a 401(k) or IRA, if you earn more than $145,000/year, those contributions must be made on an after-tax or Roth basis – meaning, these catch-up contributions will not be deductible. This will apply to *all* catch-up contributions – both the new enhanced catch-up contributions for ages 60-63 discussed above as well as 'regular' catch-up contributions eligible to anyone 50 and older.
- **529 Plans are eligible to be rolled into a Roth IRA** – If a 529 Plan was opened 15 or more years ago, a new provision would allow up to $35,000 of the account's balance to be rolled into a Roth IRA in the name of the beneficiary of the 529 Plan. This should help defray some of the risk of 'overfunding' 529 Plans.

We are already incorporating these changes into our financial and tax planning analyses for clients. One of our initiatives for 2023 is to enhance our focus on tax planning as we approach the sunset of the current personal income tax rates in 2026. Congress may still pass legislation to avert the increase in tax rates, but until we're given indication that this is a realistic possibility, we need to operate on how the current laws are written. This means that for some clients, performing significant Roth conversions over the next several years may make financial sense.

While returns in 2022 were disappointing, we've been encouraged by the enduring strength of our clients' financial plans despite these declines. As we have our conversations over the coming months, let us know how we can better add context to your financial lives or if there are others you think could benefit from our help.

[1] The asset classes are represented by indexes as follows: Cash – S&P US Treasury Bill 0-3 Month Index; Gold – SPDR Gold Shares (GLD); Short-Term Treasuries – Bloomberg US 1-5 Year Treasury Index; Inflation Protected Treasuries – Bloomberg US Treasury Inflation Protected Index; Total US Bond Market – Bloomberg/Barclays US Aggregate Bond Index; Developed International – FTSE Developed All Cap ex USA Index; US Large Companies – S&P 500 Index; Emerging Markets – MSCI Emerging Markets Index; US Small Companies – Russell 2000 Index; Real Estate (REIT) – MSCI US REIT Index; Long-Term Treasuries – ICE US Treasury 20+ Year Index; Bitcoin – Bitcoin Price Return (Coindesk).

[2] In USD. Total returns are calculated for the 1-, 3-, and 5-year periods beginning the day after a downturn of 10%, 20%, or 30% from a new all-time high for the market. The bar chart shows the average total returns for the 1-, 3-, and 5-year periods following the 10%, 20% and 30% thresholds. For the 10% threshold, there are 29, 28, and 27 observations for the 1-, 3-, and 5-year periods, respectively. For the 20% threshold, there are 15, 14, and 13 observations for the 1-, 3-, and 5-year periods, respectively. For the 30% threshold, there are 7, 6, and 6 observations for 1-, 3-, and 5-year periods, respectively. Data provided by Fama/French and available at mba.tuck.dartmouth.edu/pages/ken.french/data_library.html.

Past performance is no guarantee of future results.