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Volume XXV | **Issue IV** | **December 2022**

Market Overview

All major stock indices declined in 2022, despite a rally into year end, which was driven by increased hawkish rhetoric from the Federal Reserve while increasing interest rates. This occurred even though the annual rate of change in the Consumer Price Index (CPI) was falling, which led to a bottom for the stock market on October 13th of last year. Since that date, there was a rally into the beginning of December and a slight sell off into the end of the year. The Dow Jones Industrial Average (DJIA) led the 4th quarter finishing up 16%, the S&P 500 Index was up 7.6%, and the Nasdaq finished down (0.8%).

In the fourth quarter of 2022, energy was the top performing sector followed by industrials and materials. Energy finished the year up 64.6%, while industrials were down (5.5%), and materials closed out the year down (12.3%).

The Federal Reserve ("the Fed") continued to hike interest rates in the fourth quarter with increases in November by 75bps and by 50bps in December which led to a Federal funds rate range of 4.25% to 4.50%. It is expected that the Fed will continue to lift interest rates by another 50-75bps throughout 2023, which would bring a forecasted Federal funds rate of 5.0% - 5.25%. However, we are closer to the end of rate hikes than the beginning. With a slowing economy and increasing unemployment/layoffs especially in the technology sector, Fed policy is working. Eventually they will have to shift their policy to a less hawkish stance as the economy slows and inflation continues to recede. Finally, commodity prices were mainly flat during the last half of the year after posting 40% gains through the first two quarters of 2022.

Ten-year Treasury bond yields climbed higher during the fourth quarter from 3.6% to a peak of 4.3% and closed out the quarter at 3.9%. With the 10-year bond yield decreasing during the quarter, the equity markets turned to the upside, but volatility continued to exert a cautious tone among investors.

International and emerging markets were positive for the final quarter of the year as the US dollar closed down (6.9%) for Q4 2022 but was still positive 9.5% year to date.

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U.S. Equity Returns Table
Source: Tamarac

Index	Q4 2022 Returns	2022 Returns
Dow Jones	16.01%	-6.86%
S&P 500	7.56%	-18.11%
NASDAQ	-0.79%	-32.54%
Russell 2000	6.23%	-20.43%
MSCI World	14.37%	-15.57%

U.S. Treasury Yield Table
Source: Treasury

	12/2022	12/2021	12/2020
3 month	4.30%	0.06%	0.09%
2 year	4.41%	0.73%	0.13%
5 year	3.99%	1.26%	0.36%
10 year	3.88%	1.52%	0.93%
30 year	3.97%	1.90%	1.65%

Other Indices Table
Source: Morningstar

	Q4 2022 Returns	2022 Returns
Gold (GLD)	9.68%	-0.77%
Brent Oil (BNO)	3.51%	35.25%
U.S. Dollar Index (UUP)	-6.95%	9.46%
Int'l Equity Markets (EFA)	17.66%	-14.35%
Emerging Equity Markets (EEM)	10.30%	-20.56%

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The Financial Markets and the Economy: Retrospect and Prospects

Last year was a payback period, ridding the financial markets of the speculative excesses built up from years of lax monetary policy. Near-zero interest rates and the steady increases in liquidity by the Fed fueled financial and real asset prices That came to a halt when a tsunami of fiscal stimulus combined with the war in Ukraine produced a surge in inflation not seen in 40 years. Interest rates soared at a record pace, leading to the worst performing year for stocks and bonds since 2008.

We saw a steady decline in the stock prices of the largest technology stocks that still dominate the weightings in the S&P 500 and Nasdaq Composite indexes and a collapse in the most speculative segments of the market including meme stocks, SPACs, and cryptocurrencies, which ended in the demise of the FTX exchange. And Cathie Wood's ARK Innovation Fund, which is the poster child for expensive growth stocks, lost 70% of its value

Despite all this, the economy itself has fared rather well, thank you. Despite slight declines in real GDP in the first two quarters of last year, due mostly to inventory liquidation and declines in foreign trade, the economy bounced back to 3.2% in the third quarter and the Atlanta Federal Reserve[1] estimates the fourth quarter growth rate to be 3.7%. If so, last year would have posted a surprising 1.05% *increase* in real growth. And the data firm FactSet[2], estimates that corporate revenues increased 10.4% last year, while profits rose 5.1%. Given the circumstances, this is quite impressive.

Despite this economic and corporate performance, higher interest rates and the increase in inflation last year weighed heavily on stock valuations. The majority of stocks have fallen sharply and are now in line with historical average P/E multiples. Inflationary pressures have receded, and now recession fears are mounting.

The reason is that inflation is still expected to remain elevated in 2023, with the Federal Reserve determined to raise the Federal funds rate even further. This is likely to increase unemployment and diminish wage growth and consumer spending, resulting in another bout of negative GDP quarters somewhat worse in magnitude to what was experienced in last year's first two quarters. Corporate earnings would most likely follow suit with mid to high double-digit losses.

All this is currently hard wired into consensus thinking. But the important question is: Have financial markets amply discounted such a recession scenario? We think they have. A recession this year would be the most widely anticipated downturn in business cycle history. Is it reasonable to assume that has gone unrecognized by stocks and bonds? Consider that large cap value stocks, which fare much better than their growth counterparts in a recessionary environment, have returned 20 percentage points better than large cap growth stocks over the past 12 months, according to Morningstar[3]. Pretty strong evidence that investors have been discounting the risk of a recession in 2023.

What about bond yields? The evidence here is just as strong. The yield on the benchmark 10-year Treasury bond has been below that of the two-year yield since June of last year, indicating that bond investors expect the Federal Reserve to raise interest rates too high, given their harsh rhetoric about fighting inflation, and pushing the economy into recession just as inflation itself has peaked and is turning down. The subsequent relenting of the Fed, by pausing or reversing their tight monetary policy, would force fearful bond investors to sell their now declining yield short-term maturity bonds to purchase more attractive longer term maturities. And smart money investors will be there to accommodate them.

It has been remarkable that in the face of Federal Reserve foot-stomping over their mission to slay the inflation dragon that the bond market in true vigilante fashion continues to bait the Fed (by keeping long-term bond yields stubbornly low) to do what they have historically done, raising rates too high and staying too long.

As markets are forward looking, all this suggests that the worst of the stock market decline and interest increases are likely behind us.

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$1.7 Trillion Omnibus Spending Bill includes updates to SECURE Act of 2019

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.

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

Benefits to Individuals

- 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, butbeginning 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 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.
- The excise tax on failing to take an RMD (or distribute too little) is reduced to 25% or it can be 10% if the mistake is corrected in a timely manner.
- 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 2024, allows a surviving spouse to elect to be treated as the deceased spouse for RMD rules.

Benefits to Employees

- 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.

Disclosures

- 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.

- 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.

- New exemptions to the 10% early withdrawal penalty before age 59.5: Emergency withdrawal exemption up to $1,000 per year (tax refund if the taxpayer repays the withdrawal within three years). Also applies to traditional IRAs. Effective 2024.

  ◊ Disaster relief (up to $22k distribution and may be paid back into the plan). Also applies to traditional IRAs.
  ◊ Pay for specified long-term care insurance premiums up to $2,500 per year. Effective 12/23/25.
  ◊ Victims of domestic abuse (the lesser of $10,000 as indexed for inflation or 50% of the participant's account). Effective 2024.
  ◊ Individuals that are "terminally ill".
  ◊ Private sector firefighters.
  ◊ State and local government correction officers.
  ◊ Public safety officers with at least 25 years of service.

Sources:

1. https://www.atlantafed.org/cqer/research/gdpnow
2. https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_121522C.pdf
3. https://www.morningstar.com/etfs/arcx/iwf/performance, https://www.morningstar.com/etfs/arcx/iwd/quote

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