Quarterly Insights

2022 In Review: Investing Through Tough Times

By Daniel Campbell, CFA

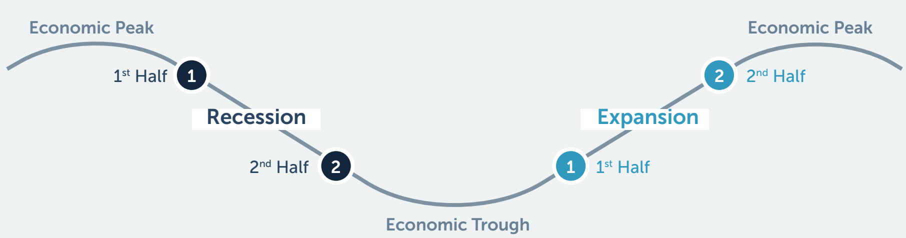
Despite a hopeful start, 2022 turned out to be a tumultuous year for financial markets. Last January, the Federal Reserve's benchmark rate was near zero, mortgages were just over 3% and the 10-year Treasury was yielding a mere 1.5%. Stock markets had returned from their 2020 lows, and although the pandemic hadn't ended, investors felt confident in the year ahead. But then came a new set of risks:

- More transmissible variants of COVID-19 emerged, leading to more shutdowns, most notably in China.
- Russia's invasion of Ukraine added pressure to global supply chains. Sanctions caused oil and energy prices to spike.
- The Fed kicked off a series of interest rate hikes to combat rising prices and cool the economy.
- Initially, rate increases did little to slow cash-rich companies and a hot labor market. The CPI peaked at 9.1% in June.
- As rate increases continued, recession concerns rose, the housing market softened and large companies announced layoffs.
- Ultimately, unexpectedly persistent inflation led to a much more aggressive Fed in 2022, which drove both stocks and bonds down for the year.

Although the U.S. stock market hit bear market territory in 2022 — a decline of 20% or more from the peak — and the U.S. economy shows signs that we are in a recession, the chart below helps demonstrate why staying invested through tough times is still likely the better path forward for investors . Markets are inherently forward-looking, meaning stocks tend to turn positive long before we officially move out of a recession — a great opportunity for long-term investors. And with the pace of interest rate hikes and inflation expected to moderate, long-term investors have plenty of reasons to be optimistic as we begin a new year.

U.S. Stocks Have Enjoyed Positive Returns in the Second Half of Recessions

As this chart shows, even knowing that we're in a recession or when a recession will end won't necessarily help you achieve better stock returns. History shows us that stock markets tend to decline in the first half of a recession, but they post some of the best returns during the second half of the recession.



	Recessions		Expansions		
	1st Half	2nd Half	1st Half	2nd Half	All Months
Average Monthly Market Return	**-2.51%**	2.25%	1.34%	1.05%	1.02%

Data from 1973 – 2021. The market is represented by the CRSP U.S. Total Market Index. Source: Avantis Investors. The average number of months over the period from Peak to ½-Trough and ½-Trough to Trough is 5.4, while the number of months over the period from Trough to ½-Peak and ½-Peak to Peak is 35.9. Past performance is no guarantee of future results.

Inflation's Silver Lining: Save More In 2023

By Jonathan Scheid, CFA, AIF®

Higher inflation not only impacts prices for goods and services, but it also influences government program benefits and the taxes we pay. Government officials use a re-calibration system when they pass many laws now, and that key calibrator is inflation. To soften the blow from higher prices, the adjustments for 2023 have been some of the largest we've seen in a long time. Here's how you may benefit:

Social Security Benefits:

What's changing: Social Security benefit checks will rise 8.7%.

Why it matters: This is the largest cost-of-living adjustment since the early 1980s, and it will go a long way in helping those receiving Social Security or Supplemental Security Income offset higher prices.

Standard Deduction for Federal Tax Return:

What's changing: For married couples filing jointly: $27,700, up $1,800 from 2022. For single taxpayers and married individuals filing separately: $13,850, up $900. For heads of households: $20,800, up $1,400.

Why it matters: Higher standard deductions may reduce your overall federal tax burden. If you itemize your deductions, the threshold between itemizing and taking the standard deduction just increased.

Federal Income Tax Brackets:

What's changing: The federal government applies taxes in a tiered fashion, using rates ranging from 10% to 37%. The rate you pay depends on your income and which bracket you fall in. While all the rates will remain the same, the breakpoints between the tiers, or income brackets, increased about 7%.

Why it matters: If your income doesn't change in 2023 versus 2022, the taxes you owe will likely go down since more money will be taxed at lower rates. For higher-income earners, some of this will be offset by the increase in wages subject to the Social Security payroll tax ($160,200, up from $147,000 in 2022).

IRA Maximum Contribution:

What's changing: The limit on annual contributions to an IRA increased to $6,500, up from $6,000. This includes both traditional and Roth IRAs. The IRA catch up contribution limit for individuals 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000.

Why it matters: The key advantage of a traditional IRA is tax-deferred growth. You'll be able to contribute more to the account now and pay taxes later down the road when you take distributions. For Roth IRAs, you can now contribute more after-tax money and let it grow tax free.

Retirement Plan Maximum Contribution:

What's changing: Employees who participate in 401(k), 403(b), most 457 plans and the federal government's Thrift Savings Plan can contribute up to $22,500 in 2023, up from $20,500 in 2022. Catch-up contribution limits for employees 50 and over also increased to $7,500 from $6,500.

Why it matters: Participants in some of the most popular retirement plan programs can save more for retirement now than ever before. In fact, participants 50 and over can contribute as much as $30,000 per year to their retirement plan.

Estate and Gifting:

What's changing: The annual exclusion for gifts: $17,000, up from $16,000 in 2022. Estates of descendants who die during 2023 have a basic exclusion amount of $12,920,000, up from $12,060,000 in 2022.

Why it matters: People can now pass more money tax-free while they are alive (as gifts) or after they depart (through their estate).

Sources: IRS Revenue Procedure 2022-38 and IRS Notice 2022-55.

The Long-Term Advantages of Planning IRA Distributions

By Matt Nelson, MBA, CFP®

Planning IRA distributions can be a challenge, especially for non-spouse beneficiaries who inherit the account from a deceased loved one. Making this dilemma even trickier to navigate – as of 2020, most non-spouse beneficiaries who inherit an IRA must distribute all funds from the account by the end of the 10th year after the original IRA owner died.

Is it better to take annual distributions or wait until the 10th year to withdraw the funds?

Although the IRS is still working to clarify its rules on taking required distributions during the 10-year window, those who inherit an IRA could avoid a big tax bill by planning early.

How could planning IRA distributions help save on taxes in the long run?

Let's consider a married couple filing jointly who has taxable income of $300,000. For 2022, this places them in the 24% tax bracket, based on tax-year 2023 IRS inflation adjustments.

They can earn an additional $40,100 of taxable income, for a total taxable income of $340,100, before worrying about being bumped into the 32% tax bracket. It would take an additional $131,900 of taxable income, for a total taxable income of $431,900, before they would find themselves in the 35% tax bracket.

Now, let's assume one of them inherited an IRA with assets worth $200,000, and each year the account, their income and the tax bracket inflation adjustments remain constant.

It would take roughly five years for the couple to deplete the account without being pushed into the next tax bracket. If they begin withdrawals immediately, they could take out $20,000 annually over the 10-year period. After that, they could be forced to take larger sums that would increase their bracket.

There are multiple ways to take the distribution over the 10 years, including distributing up to your next tax bracket until the funds are depleted, taking the distribution in equal installments over the 10 years, or taking a lump sum distribution at the end of 10 years. Not every distribution strategy yields the same results, so consider the adjacent illustration comparing the last two examples.

IRA Distribution comparison

	Scenario 1: Yearly Distributions	Scenario 2: Lump Sum Year 10	
Income	$300,000	$300,000	
Distributions	Years 1-10 $20,000	Years 1-9 $0	Year 10 $200,000
Taxable Income	$320,000	$300,000	$500,000
Tax Bracket	24%	24%	35%
Marginal Tax Rate*	20%	20%	25%
Tax Payment	$64,471	$59,671	$112,506
After Tax Income	$225,529	$240,329	$377,494
Total Tax Payment	$644,710	$695,545	
Total After Tax Income	**$2,555,290**	**$2,540,455**	

For illustrative purposes only. *The marginal tax rate is the additional amount paid on each dollar earned. Each dollar earned has the potential of a higher tax rate.

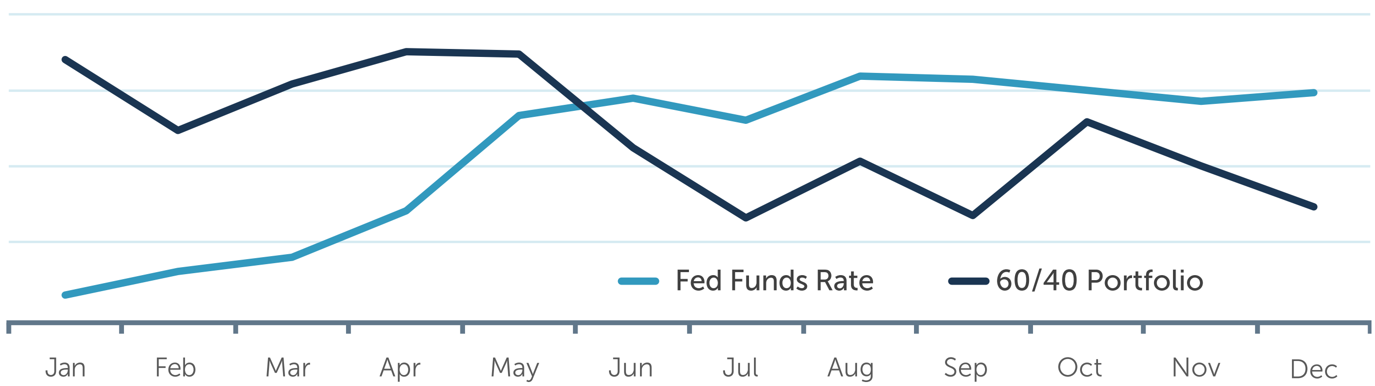
In Scenario 2, the couple pays roughly $15,000 more in total taxes because their income moved them into the 35% tax bracket in year 10.

History Often Repeats Itself in Investing

By Daniel Campbell, CFA

For the first time in over 50 years, both stocks and high-quality bonds were down in 2022. The last time this happened was 1969, and the story is eerily similar to what we just experienced. Following a decade-long expansion spurred by fiscal budget deficits and relatively low inflation, the Federal Reserve became increasingly concerned about rising prices and hiked the fed funds rate over the year to combat inflation. This is a strategy the Fed uses to control inflation: raising the cost of borrowing to curb demand for goods and services.

Portfolio Performance in 1969 As Fed Funds Rate Rose



Source: FRED, Federal Reserve Bank of St. Louis. Ken French Data Library, Dimensional. Stocks are represented by the Fama/French Total US Market Research Index Portfolio, which is an unmanaged index of stocks of all U.S. companies operating on the NYSE, AMEX, or NASDAQ. Bonds are represented by Five-Year U.S. Treasury bonds, from Dimensional. Analysis assumes the portfolio is invested at 60% U.S. Stocks and 40% bonds at the beginning of January 1969 and the portfolio is not rebalanced. Assumes that all dividends are reinvested.

In both 1969 and 2022, as the Fed's determination to fight inflation at all costs became clear, markets responded hastily. The above comparison also illustrates a pattern: Although bonds tend to offset stock market losses, both investments have declined during periods of rising inflation and aggressive Fed policy. However, consistent with other rising rate environments in history, certain types of companies performed better than others in 2022.

Growth companies are those expected to have above average earnings growth in the future. As interest rates increase, a company's future cash flows are worth less today, and that has a higher impact on growth companies. Some notable examples include big tech firms like Meta, Netflix and Peloton, which saw their stock prices decline signficantly in 2022.[1]

Value companies are those that appear to be trading at a lower price relative to their fundamentals. They tend to perform better as rates increase because they have more tangible assets, earnings and cash flow relative to their current price. Last year, value companies lost less than their growth counterparts, both in the U.S. and abroad.[2]

1 Source: Morningstar. Year-to-date through Dec. 8, 2022, Meta was down 66%, Netflix was down 49%, and Peloton was down 65%.

2 Source: Morningstar. In the U.S., the Russell 3000 Value index, a measure of value stock performance, was down 6.7% compared to the Russell 3000 Growth index, which was down 25.7%. Internationally, the MSCI World ex USA Value Index was down 5.9% compared to the MSCI World ex USA Growth index, which was down 20.8%. All return figures through Dec. 8, 2022.