LEWIS
WEALTH MANAGEMENT

Newsletter

January 16, 2023

Executive Summary

Last year was extremely difficult for investors. Both the stock and bond markets were down. It was the fourth-worst year for the S&P 500 since the end of WWII, and the worst bond market in over 100 years.

The Federal Reserve has aggressively raised interest rates to combat inflation, and this has crushed the markets. However, inflation looks to be finally cooling off and the Fed may be able to back off soon.

Markets are starting to recover, but it is too soon to tell if the recovery is durable and sustainable.

History shows that when the stock market has a down year (as it does in 27% of years), 81% of the time the market goes up in the following year and the average gain is 14.2%.

Some highlights from the new SECURE 2.0 Act are discussed.

Lewis Wealth Management
(855) 353-3800
www.LewisWM.com

Market Data as of December 31, 2022

		YTD 2022
US Equities	S&P 500 ETF	-18.14%
International Equities	MSCI EAFE ETF	-14.27%
Emerging Markets Equities	MSCI Emerging Mkts ETF	-20.55%
US Bond Market	iShares US Core Bond ETF	-13.06%
Commodities	S&P GSCI Comm ETF	24.09%
Real Estate	iShares US Real Estate ETF	-25.46%

An Extremely Difficult Year

In fact, ***it was the fourth-worst year for the S&P 500*** (down 19.4%) since World War II. Only three years were worse:

1) The Great Recession in 2008 (down 38.5%);
2) The Arab oil embargo in 1974 (down 29.7%); and
3) the Tech Bubble in 2002 (down 23.4%).

As for the bond market, it had its worst year in over 100 years (down 13.02%)!

Fighting Inflation

As last year began, the economy struggled with supply chain disruptions left over from the pandemic. During the pandemic, the last two administrations passed several massive fiscal stimulus packages. The Federal Reserve maintained a very accommodative monetary policy.

As these programs lingered beyond the pandemic and more government spending occurred, a significant inflationary cycle was triggered. Then the war in Ukraine exploded – the largest war in Europe since World War II – which increased energy prices.

To combat inflation, the Federal Reserve aggressively raised interest rates and shrank its balance sheet. This crushed the bond market, contracted the economy, and had a negative effect on corporate profits and borrowing.

As we begin this year, ***there is strong evidence that inflation is finally cooling off***. The Fed has indicated that it will slow interest rate increases and perhaps halt them by midyear. The labor market is showing mixed signs – some point to more layoffs and others to a tight market. The war in Ukraine grinds on.

A Hard or Soft Landing?

The key issue this year is whether the economy will have a hard or soft landing given the aggressive interest rate increases by the Fed. A recession certainly seems likely, and we should prepare for that. The Fed would like to engineer a soft landing. Most economists are skeptical they can do it.

Certainly, there has been a turnover in economic activity. The yield curve has been inverted for some time (a very good recession predictor). And corporate profits and borrowing are down.

The labor market is showing mixed signals. There have been layoffs in the technology and financial sectors, but the unemployment rate remains very low. The Fed is watching the labor market closely to make sure that wages are not going up and thereby feeding the inflation cycle.

Bottom line – it's too soon to tell if we will have a hard or soft economic landing this year. Stay tuned.

Swimming Naked

When markets plunge, we often see a few things break. As Warren Buffett says, ***"It's only when the tide goes out that you learn who has been swimming naked."*** In this cycle, the most prominent naked swimmer is Sam Bankman-Fried of FTX and the cryptocurrency trade in general. Cryptocurrencies lost 75% last year, and Mr. Bankman-Fried is enjoying house arrest in California.

From time to time, these spectacular crashes remind us not to chase hot speculative investments. They usually meet their fate over time. Even so, ***speculative investors have very short memories***. They will be off and running toward the next shiny object before long – you can count on it.

I know slow and steady is not very exciting at times, but it wins the wealth race over time.

A Recovery Has Begun – Is It Sustainable?

Markets were up strongly in the fourth quarter (the S&P 500 was up 7.06% for the quarter), and they are up so far in the new year (the S&P 500 is up 3.8% YTD through 1/12). This is a good sign. Time will tell if this recovery is durable and sustainable.

While we wait and see what the economy will do this year, ***remember that markets are forward-looking, and recoveries often take place during recessions***. Waiting for a recession to be over (which can take a very long time for the National Bureau of Economic Research to figure out) will likely mean that you will miss the recovery.

And markets do recover. While predictions and forecasts are always unreliable, ***history shows that when the stock market has a down year (as it does in 27% of years), 81% of the time the market goes up in the following year, and the average gain is 14.2%.***

For example, consider the three bear markets referenced earlier. How did they fare the following year?

1) After the Great Recession in 2008, the market went up 26.5% in 2009.
2) Following the Arab oil embargo in 1974, the market went up 37.2% in 1975.

3) After the Tech Bubble in 2002, the market went up 28.7% in 2003.

Multiple down years are rare, but they have happened before (e.g., 1973-1974 and 2000-2002). We will see, but ***I like the historical odds here***.

This Time It's Different

At times, when historical returns and bear markets are discussed, frustrated and impatient investors will say these infamous words: "Okay, but this time it's different."

One of our greatest investors, Sir John Templeton, once famously said, ***"The four most expensive words in the English language are 'This time it's different.'"*** So, what did he mean by this? Specifically, ***at stock market tops and bottoms, investors invariably use this rationale to justify their emotion-driven decisions.***

Here are two examples – one at a market bottom and another at a market top.

In 1979, *BusinessWeek* ran the following now-infamous headline on its cover: "The Death of Equities: How Inflation Is Destroying the Stock Market." The article argued:

> Only the elderly who have not understood the changes in the nation's financial markets, or who are unable to adjust to them, are sticking with stocks. . . . For better or worse, then, the U.S. economy probably has to regard the death of equities as near-permanent condition. . . . We have entered a new financial age. The old rules no longer apply."

The market did decline further, but since 1982 the S&P 500's total return, with dividends reinvested, is nearly 7,000%. Equities did not die; it was just a painful market bottom. That time was not different.

From 1999 to 2001, stock analysts believed that dot-com startups had permanently changed the stock market game. A company no longer had to show a profit to be a sensible investment. Many investors became eager to invest in any dot-com company at any valuation, however optimistic. Investors quit their jobs to become day traders. The market had changed. Things were different, they argued.

Then the whole bubble collapsed, and many dot-com stock investors suffered losses of 90%. Turns out that profitability and fundamental valuation were still important. Dot-com stocks were simply a bubble – no different from the tulip bulb mania of 1637. That time was not different, either.

These examples should remind us that while current market conditions are always unique, the underlying challenges are not. ***Business and valuation cycles grind on despite our impatience, emotional passions, and irrational thinking. Yes, we have just experienced a painful bear market, but this time is not different.***

SECURE 2.0 Act – Some Welcome News from Washington (for a change)

A few weeks ago, Congress passed the SECURE 2.0 Act, and it contains numerous interesting benefits for investors, retirement savers, and retirees. Here are a few takeaways. For a more thorough discussion, see the attached article from *Kitces*.

Required Minimum Distributions

For those who are just starting required minimum distributions (RMDs), the starting age is pushed back to 73 in 2023 (for those born between 1951 and 1959). The age is pushed back to 75 for those born in 1960 or later. Sorry, this only impacts people who are just commencing distributions, not anyone already taking distributions under the old 70.5 or 72 RMD rules.

RMDs from Roth 401(k)s are eliminated.

The missed RMD penalty is reduced from 50% to 25%, and if timely corrective action is taken, the penalty goes down to 10%.

New Roth Opportunities

SEP and SIMPLE plans can now include a Roth option, which is exciting news for those who want to enjoy the benefits of a Roth account but are disqualified because of their income.

Employers may now make contributions to the Roth side of their 401(k) plans.

For those with excess education savings in 529 accounts, you may now roll those balances into a Roth IRA in the beneficiary's name. There are many restrictions here, but it is an interesting option.

Changed Penalties

For those contemplating early distributions from retirement accounts, there are new exceptions to the 10% penalty rule, including the ability to withdraw $1,000 per year for emergencies (restrictions apply). Also, employers may offer emergency savings accounts in 401(k) plans (with additional restrictions, of course).

Catch-up Contributions and Retirement Plan Enrollment

Catch-up contributions are bumped up by another $1,000 if you are age 50 or older.

Enrollment in 401(k) plans is mandatory for new employees (unless they opt out).

If you have questions about your portfolio or your long-term financial plan, give us a call.

Thank you.

D. Austin Lewis

This is an educational newsletter expressing opinions only. This newsletter should not be relied upon until your individual situation is taken into consideration by an experienced advisor. This newsletter is not designed or intended to give you individual investment, tax, or legal advice. We strongly recommend that you consult with your own financial/tax advisor and/or legal counsel for information and advice concerning your particular situation. If you are a client, please give us a call. Past performance does not indicate or guarantee future results. Investing involves substantial risks, including loss of principal.