KELLEHER FINANCIAL ADVISORS

Newsletter

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In This Edition:

"Times and conditions change so rapidly that we must keep our aim constantly focused on the future." – Walt Disney

LOOKING BACK AT 2022

*Analysis and Review co-written by **Neil Cataldi**, Managing Director at Starboard Advisors and **Thomas Burnett, CFA**, Vice Chairman & Director of Research at Kelleher Financial Advisors*

Greetings and Happy New Year from your team at KFA. As we reflect on 2022 and look ahead to 2023, most investors are relieved to turn the page on what was one of the most challenging investing environments in recent memory.

Interest Rates Matter

The era of "cheap money" came to an end in 2022 as central banks across the world raised rates to slow economic growth and bring down inflation. Equity markets in the U.S. received the message, *"interest rates matter."* This sea change in monetary policy by the Federal Reserve created a significant head wind for valuations, and in an environment where the cost of capital has been reset significantly higher, we enter the new year with an unclear path ahead, albeit one where interest rates are materially higher today than they have been in the past decade.

Globally, all the major stock indices declined during 2022. The U.S. markets were no exception. The Dow Jones Average outperformed the S&P 500 Index as well as the NASDAQ Composite. A shift from growth to value helped the Dow where many of its companies offer lower earnings multiples and higher dividend payments than the companies in the other two indexes. Several high-profile technology companies suffered severe stock price losses in 2022. The popular FAANG trade lost over $3 trillion in market value with Facebook/META (-64%), Apple (-27%), Amazon (-49%), Netflix (-51%), and Alphabet (-39%) all significantly underperforming market indices. These high growth technology companies trade at above-market earnings multiples and offer low or zero dividends in contrast to the profile of most companies in the Dow Jones Index. The S&P Energy Sector ("XLE"), gaining 59%, was the only S&P 500 Index Sector with a positive performance driven in part by higher oil prices following the Russian invasion of Ukraine. The Communications Select Sector ("XLC") was the worst performer, down -40% for the year.

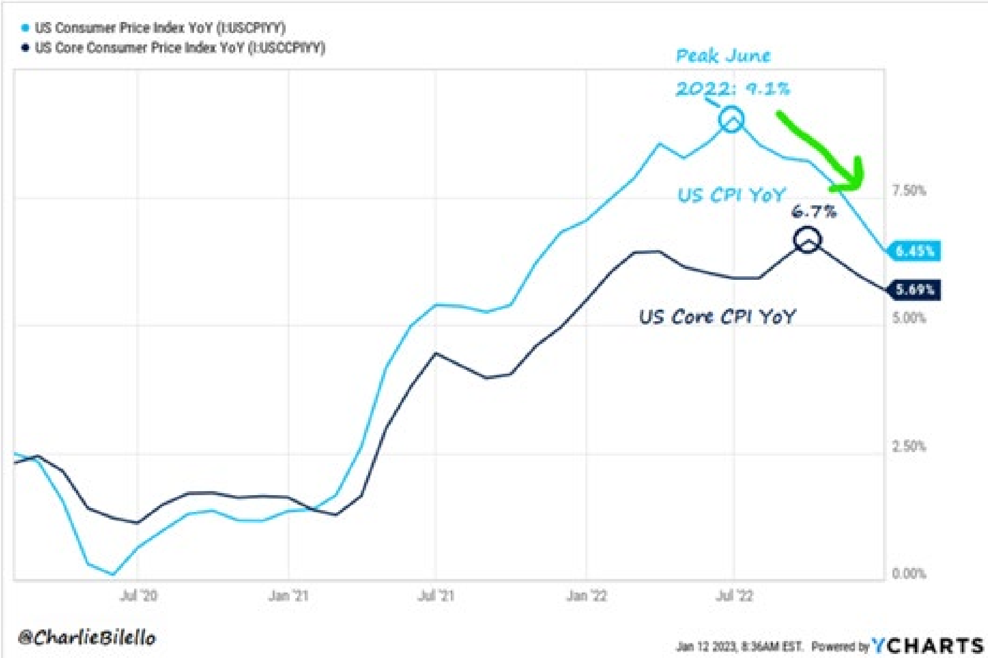
INDEX	% Change YTD as of 12/31/2022
Dow Jones Industrial AVG. (TR)	-6.8%
S/P 500 Index (TR)	-17.2%
Nasdaq Composite	-33.1%
Nikkei Tokyo	-9.4%
China (Shanghai)	-15.1%
GOLD	flat
Crude Oil per bbl	6.7%
RATE on Ten-Year T Bond	3.88%
VIX Volatility Index Change	25.8%

Source: WSJ.com January 3, 2023

Bond investors did not fare much better in 2022. The yield on the Ten-Year Treasury Bond rose from 1.51% at the end of 2021 to 3.88% one year later. The JP Morgan Global Government Bond Index fell by -13.01 % in 2022. The Bloomberg Index of Long-Term (20+years) U. S. Government securities was down -23.7% for the year. The Bond Buyer Municipal Index dropped by -18.1% and the Fannie Mae Mortgage Index fell by -12.1% in the year.

WHAT COMES NEXT IN 2023?

The good news, in our opinion, is that inflationary pressures are in decline today. The Consumer Price Index topped out at +9% in 2022 with current readings closer to +7%. Gas prices in the United States are now lower than they were a year ago and down greater than -35% from their peak last June. Similarly, lumber prices are at their lowest levels since June 2020, down greater than -75% from their peak in May of 2021.



The list goes on and while some categories are still inflated, there is strong evidence to support that inflation has peaked in the current cycle.

Source: Carson Investment Research YCharts 1/12/2023

Soft or Hard Landing

With greater confidence in the inflationary problem now being under control, the focus is beginning to shift back to the economy and to what magnitude a slowdown may occur in the near term. This is where the Federal Reserve will attempt a delicate balancing act. The terms “soft landing” and “hard landing” are often used. A soft landing is when the economy can show resilience in withstanding the changing conditions. A slowdown occurs but not so much to create a significant recession. The opposite is a “hard landing” which takes place when the restrictive policy measures overshoot leading to economic declines, job loss, material growth deceleration, and a recession. The jury is still out on how we will categorize the “landing” of this cycle and that question is the greatest one that markets are trying to figure out as we enter the new year.

We feel strongly that the Fed framework and narrative is going to change dramatically early in 2023. Many investors expect the Fed to pause or slow the interest rate hike cycle during the first quarter and in doing so should stabilize the markets from a liquidity perspective. This is an important step forward to improving the conditions of the equity markets.

The economy itself has been extremely resilient to date and while the consensus view is one of caution, it will be particularly important to watch earnings from the largest companies here in the United States to gauge whether a slowdown is emerging or not.

If growth continues and equities have a productive year,

that would be a “soft landing.”

A more cautious perspective on the macro environment exists around a “hard landing” scenario. If the economy starts to slow more rapidly and earnings estimates for 2023 prove to be high, the market will need to reset lower and digest the likelihood of a more challenging economic environment. Many economic analysts are starting to forecast such declines in 2023. Time will tell.

As we move through this uncertain timeframe during the early part of 2023, markets are likely to remain volatile. Investors are best served during this period to focus on positions in high quality, financially strong companies whose balance sheets will allow them to weather the storms of higher interest rates and decelerating economic growth.

Treasury bonds also offer an attractive yield,

one which has not been available in over a decade.

Short duration government securities offering 4.5%+ returns is an attractive “port in the storm” for assets until the clouds of this higher interest rate environment begin to pass and clear visibility for the economy returns.

-Tom & Neil

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SECURE 2.0 ACT (SETTING UP EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT)

For the second time in three years, Congress passed broad legislation that impacts retirement savings programs. The initial phase, Secure 1.0, was passed in 2019 to address new enhancements to the retirement system in the United States. Secure 2.0 builds off the previous legislation providing a slate of new changes designed to further strengthen Americans' readiness for retirement. Many of the changes do not take place until 2024 or 2025 but several will impact plans in 2023 as highlighted below.

More detailed information can be found at: **Secure Act 2.0**

Our key takeaways include:

1. **Required minimum distributions** (RMD) from retirement accounts increase from the age of 72 to the age of 73 in 2023 and to the age of 75 in 2033.
2. **Increased catch-up contributions** in 401k's: up to $10,000 annually (vs $6,500 previously) for individuals between the ages of 60 and 63; $7,500 for people age 50 and older.
3. Expanded **Roth opportunities** now allow Retirement Plan Sponsors the option to allow for Roth matching contributions in 2023.
4. **Employers are required** to automatically enroll employees in 401k plans at a rate of at least 3%.
5. People aged 70 ½ and older may elect as part of their **QCD** (qualified charitable distributions) limit a one-time gift up to $50,000 to a charitable remainder unitrust, a charitable remainder annuity trust, or a charitable gift annuity.
6. After 15 years, **529 plan assets** can be rolled over to a Roth IRA for the beneficiary, subject to annual Roth contribution limits and an aggregate lifetime limit of $35,000.

ABOUT US

Since 1995, our firm and its affiliates have provided clients with thoughtful and personalized solutions in many areas of financial planning. At KFA, we place our clients at the center of everything we do. And while situations and experiences differ, our belief is that every client deserves the very best of what we have to offer.

Our firm acts as both an advisor, formulating long-term strategies, and as a manager, making specific recommendations and implementing decisions in areas such as portfolio construction, estate planning and investment management.

KFA educates our clients, communicating with them and sharing our rationale and analysis about issues that should be considered on an ongoing basis and ensuring that appropriate actions are taken. We do not sell proprietary financial products and are paid solely by our clients. In this way, KFA is able to recommend and incorporate independent investment vehicles and managers into a portfolio as needed.

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