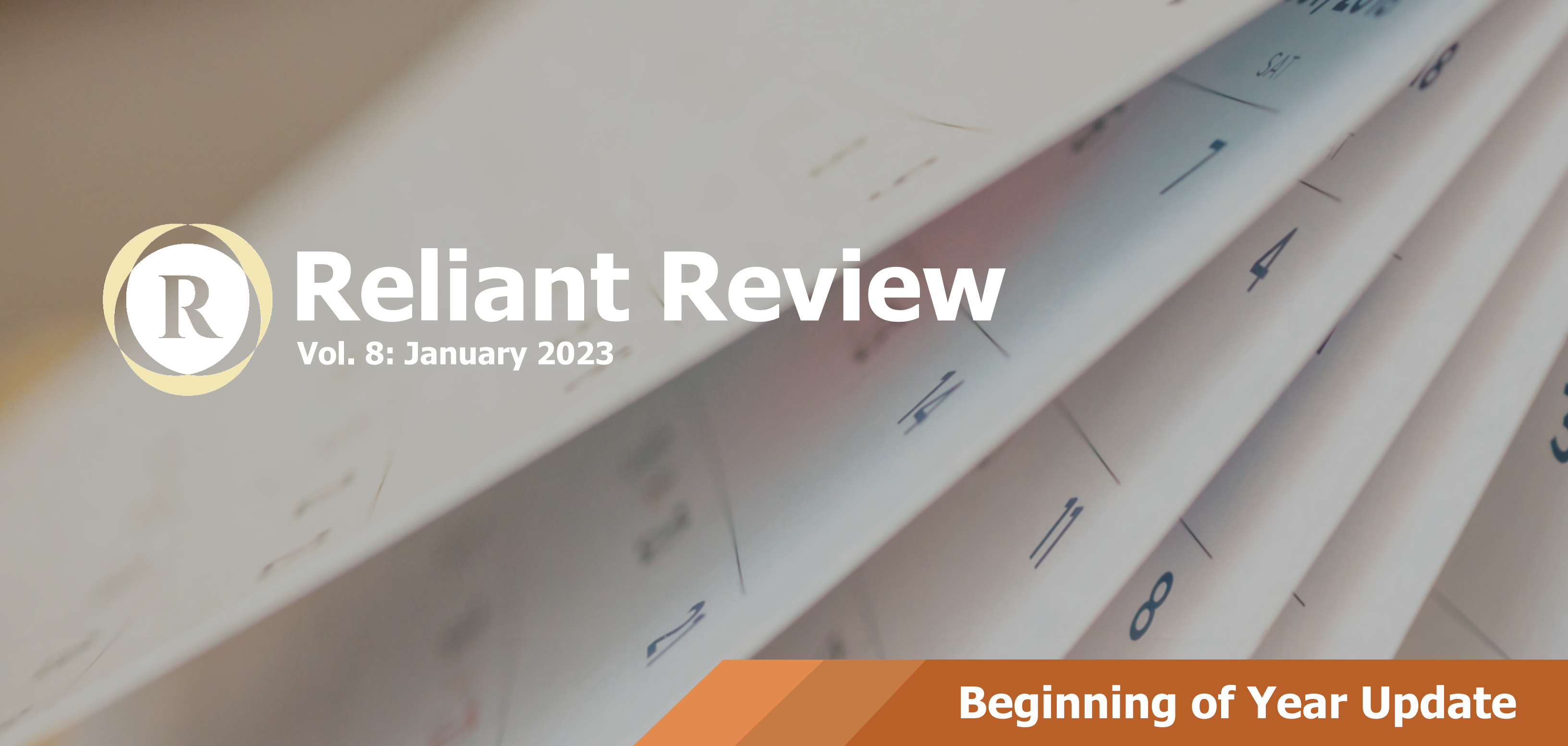

Reliant Review

Vol. 8: January 2023

Beginning of Year Update

Summary

Welcome to our 8th Beginning-of-the-Year letter. 2022 was certainly one for the books. US stock, international stock, and bonds were ALL down double digits. Even things that FEEL like they went way up didn't: oil was up only about 2% Jan 3 to Dec 29th. In the articles that follow, we both rate how well we foresaw what was coming and what we see for 2023.

The crystal ball is a lot murkier for 2023 than it was for 2022. For those of you that don't want to read the details, the boiled down version is "the beginning will be bad, the end will be good."

Contents:

Report Card for 2022

Last year's 2022 Beginning of the Year letter was packed full of thoughts, predictions, and contemplated actions. How did we do with those? Feel welcome to review it on our website to keep us honest. Below is a quick report card, showing the Marvelous, the Mediocre, and the Misses.

The Marvelous: We hit dead bullseye when laying out the general direction of several issues:

Score:

Valuations were near all-time historical highs and would come down through share prices dropping. (We moved some growth assets to areas that had lower valuations.)

Defensive assets, such as bonds, would really struggle and cause more relative issues than would the growth side of the portfolio. (We completely restructured the defensive side of Core portfolios to try to deal with the issue.)

The strengthening dollar would negatively impact international investments due to the currency conversion. (We moved almost half of our international holdings to investments that were currency hedged, thus having a mechanism to potentially deal with the strong dollar.)

Assets like gold that are traditionally viewed as inflation hedges can't always be counted on. In a year when inflation rates hit near 10% annually, gold returned somewhere between +0.4% to -0.23%. Not exactly an effective hedge.

Cryptocurrencies, which had been presented as the new and improved inflation hedge of the future, had no right to claim that title. Bitcoin had an annual return of approximately -65%.

The Mediocre:

Score:

TAPA started the year partially out of the market and got down to having only an approximate market exposure of 45%, which was great.

Unfortunately, a false positive signal to re-enter the market occurred. Although that was quickly reversed, it made TAPA's annual return look much like the stock market. The book isn't closed on TAPA in this bear market, however, as TAPA enters 2023 with a low stock market exposure of around 30%. It may redeem itself yet in this cycle that started in Jan 2022.

Misses: Although we were pretty much right-on in our directional thoughts for 2022, some of the ways we translated those into actions distracted from some of the good we were trying to do.	**Score:**
Timing is everything and getting the timing just right is really difficult, if not impossible. Even though some of the adjustments we made were definitely positive, the timing of some of the moves could have been better.	⊗
Both a defensive asset we bought (Guggenheim Total Return) and US stock holding (Hartford Core) underperformed our expectations in the rising interest rate environment.	⊗
American Funds New Perspectives is an investment we have held for years. Due to its growth tilt, it has been the best annual performer in the portfolio in the past. That growth tilt was a definite drag this year, making it one of the worst performers in the portfolio for 2022.	⊗

What's Coming in 2023

2023 looks to be a toss-up as to how it will unfold, much more than 2022 was. Trying to predict what the market is going to do in the short-term is a great way to be very wrong and look stupid. However, many of you keep asking us to take a guess of what it may look like, so here it is. Caution, this is for entertainment purposes ONLY!!

1st Quarter

Earnings will probably look bad as companies use everyone's almost universally bad expectations to employ a "kitchen sink" approach to reporting, throwing every bad thing they can think of into their earnings releases to get it out of the way. This will cause the market problems.

2nd Quarter

This could be a stabilizing quarter, with some wild swings but not really going anywhere. This is termed "trendless volatility."

3rd/4th Quarter

This is when some serious rebuilding could occur. The bad news of earnings should be out of the way, and inflation could be very close to target, with the Fed completely ceasing any interest rate increases. All of this may be the catalyst for the beginning of the next official bull market.

Planned Portfolio Moves

Given both the current environment we are in and how it appears to be unfolding, we have made some decisions for adjustments in the 2023 portfolio.

Core: Growth

- We are keeping the less expensive and higher dividend paying investments we made in 2022.
- As explained above, we purchased an international investment that is hedged against currency exchange risk (works when the dollar is strong). It was successful, and we believe that we have milked the strategy for all it is worth. We will move those funds into an investment that does well when the dollar is flat to falling.

Core: Defensive

- After the massive changes we made in the beginning of 2022, we aren't planning any major changes to the defensive side, as we feel satisfied it is well-positioned.

Tactical Allocation of Passive Assets (TAPA)

- TAPA enters the New Year with approximately 70% of its holdings in money markets with attractive yields.
- The exciting or scary part (depending on your general outlook) is that for TAPA to work well, the idea is to sell high and buy low. The selling has occurred. Thus, we have targets for when to buy back into the markets. Spoiler alert: several are noticeably lower than the market levels now. That means we will begin moving the assets back into the market when things look WORSE than they currently do. For some of you, that will make perfect sense. For others, it will seem counterintuitive. That is why we are giving you a peek at how the sausage is made in TAPA, so when it happens, it won't be a surprise.

How Tactical Allocation of Passive Assets (TAPA) Works

Many of our clients have some level of assets in our TAPA strategy. We often get questions about what it is and what it is doing. Below is a quick summary for the curious:

TAPA is a proprietary strategy designed by us. Strategies like TAPA are often referred to as "tactical." Its main thrust is not necessarily using clever investments, as it is invested in simple index products. The key is that it actively adjusts how much exposure it has to growth assets and how much it has in defensive assets. It can be anywhere from 0% to 100% on either side of those two. If successful, that means it can sidestep the worst of the downsides and still participate in the upside. Of course, there is no guarantee it will be successful.

We watch mathematical measures in the market to give us signals as to how likely a recession or large, prolonged market downturn may be. Some of those signals are the rate of change in market values, yield curve inversions, and the trending direction of the markets.

Although we are watching mathematical signals, TAPA does NOT automatically trade when those signals hit certain levels. We are alerted that those levels have been reached, but it is still a human that must decide whether to trade at all and when to start the manual process to place the necessary trades.

Over time, we refine, and hopefully improve, the trading signals and our planned reactions to them. It is an ever-evolving process, as the markets themselves change over time.

Secure 2.0

The first Secure Act passed in December 2019. As a final gift in 2022, Congress has passed what is being termed Secure 2.0, expanding on what the first act put into place.

RMDs:

The age at which a person must start taking Required Minimum Distributions (RMDs) from retirement accounts has been raised again, from the current age 72:

2023-2032: RMDs begin at age 73
2033 and beyond: RMDs begin at age 75

Penalties: Up until now, the penalties for NOT taking an RMD were steep: 50% penalty for the amounts not taken. Starting in 2023, that penalty is reduced to 25%, and in some cases 10% if corrected quickly enough.

Roth 401(k)s: One of the advantages of a Roth IRA is it has no RMDs, thus no money is forced out during the saver's life. Strangely, this was not true in Roth 401(k)s, which still had an RMD. Beginning in 2024, neither Roth IRAs nor Roth 401(k)s have an RMD.

Qualified Charitable Distribution (QCD) limits:

The great deal of being able to directly donate to a charity from a retirement account at age 70 ½ continues and gets even better. Beginning in 2024, the $100,000 annual limit begins to be adjusted upward for inflation.

Rolling Section 529 funds to a Roth IRA:

A new option for unused 529 funds beginning in 2024 will allow tax- and penalty-free rollovers of such funds to a Roth IRA. The 529 must be at least 15 years old and there are limits, lots of them. A few big ones: 1) must go into a Roth in the name of the beneficiary of the 529 2) no contributions made in the last 5 years can be moved 3) counts against the amount of normal contributions that can be made and 4) a lifetime limit of $35,000.

For those of you out there already thinking about how to game the system, it is unclear if a parent/grandparent could change the beneficiary to themselves and then do the rollover. That remains to be seen in further guidance.

Catch-up Contributions in Retirement Accounts:

For employer-sponsored retirement plans like 401(k)s, the "catch-up" amounts for older workers have increased:

2023-2024: Age 50 or older= $7,500
2025 and beyond: Age 50 to 59= $7,500
Age 60 to 63= $10,000 or 150% of regular catch-up amount
For SIMPLE Plans, catch-up becomes $5,000 or 150% of regular SIMPLE catch-up limit.

Beginning in 2024, all catch-up contributions will be treated as Roth (no tax deduction going in but grown and withdrawn tax-free) if the plan allows Roth contributions, except for workers who earn $145,000 or less.

Lastly, beginning in 2024, all catch-up contributions, including for IRAs, will be indexed to inflation in increments of $100.

Creation of Roth SIMPLEs and Roth SEPs:

Up through 2022, only pre-tax contributions could be made into SIMPLE or SEP retirement plans. It will now be possible to create Roth versions of these small business retirement plans.

Forced Enrollment in 401(k)s:

For those still working, be aware that businesses with more than 10 workers and in business for more than 3 years are now required to enroll employees in their 401(k) plan, setting the withholding rate at a minimum of 3% but no more than 10%. This auto-enrollment can be adjusted by the employee later, but behavioral finance shows most won't bother.

Emergency Funds:

Beginning in 2024, account holders are allowed to withdraw certain amounts for emergency expenses from employer-sponsored retirement accounts without the normal 10% penalty. There are various emergencies, each with somewhat differing amounts you can withdraw and how fast it must be repaid, if at all. Some examples are 1) natural disasters 2) diagnosis of a terminal illness likely to cause death within 7 years 3) victims of domestic abuse and 4) an all-inclusive "unforeseeable or immediate financial need" which has the smallest limit of $1,000. This would need to be repaid within 3 years before being allowed to do it again.

Companies will also be allowed to let workers create an emergency savings account through after-tax automatic payroll deductions, with a $2,500 cap.

Tax Tidbits

(CHANGE) Kentucky State Tax:

KY state income tax is DROPPING from 5% to 4.5%. Sorry non-KY folks.

(CHANGE) Standard Deduction:

Single $13,850 (was $12,950)
Filing Jointly $27,700 (was $25,900)

(CHANGE) Gift Tax Exclusion:

Each person may gift to as many people as they wish $17,000 annually, up from $16,000 in 2022.

(CHANGE) Retirement Contributions:

401(k)/403(b) annual contrib $22,500 (was $20,500) Catch-up for age 50+ $7,500 (was $6,500).

Roth/IRA annual contrib $6,500 (was $6,000)

(CHANGE) Estate Tax Exemption:

$12,920,000 each person (was $12,060,00). This still sunsets to a much lower level in 2026. However, the IRS issued final regulations stating there will be NO clawbacks at sunset. Thus, if you take an action now covered by the exemption amount, such an action should not be retroactively taxed if the limits fall in the future.

2023 Tax Brackets

Tax Rate	Single	Married, Filing Jointly
10%	$0 to $11,000	$0 to $22,000
12%	$11,001 to $44,725	$22,001 to $89,450
22%	$44,726 to $95,375	$89,451 to $190,750
24%	$95,376 to $182,100	$190,751 to $364,200
32%	$182,101 to $231,250	$364,201 to $462,500
35%	$231,251 to $578,125	$462,501 to $693,750
37%	$578,126 and up	$693,751 and up

2023 Cap Gains Tax Rates

Tax Rate	Single	Married, Filing Jointly
0%	$0 to $44,625	$0 to $89,250
15%	$44,626 to $492,300	$89,251 to $553,850
20%	$492,301 and up	$553,851 and up
+3.8% Medicare Net Investment Income Tax (NIIT)	$200,000	$250,000

Social Security

SS tax paid on earned income up to $160,200	% withheld	Maximum tax payable
Employee Pays	6.2%	$9,932.40
Employer Pays	6.2%	$9,932.40
Self-employed pays	12.4%	$19,864.80
Earnings Allowed before Full Retirement Age (FRA)		
Retirement earnings exempt amounts	$21,240 if age under FRA $56,520 during year will reach FRA No Limit after reaching FRA	

Medicare

Medicare Part B monthly premium for new beneficiary in 2023 = $164.90 (a DECREASE from 2022, when it was $170.10).
Medicare looks back two years at income to determine if there will be a surcharge based on higher income levels (Income-Related Monthly Adjustment Amount – IRMAA).

Single 2021 MAGI	Joint 2021 MAGI	2023 Part B Premium + IRMAA	2023 Part D adjustment
$0-$97,000	$0-$194,000	$164.90	$0.00
$97,001-$123,000	$194,001-$246,000	$230.80	$12.20
$123,001-$153,000	$246,001-$306,000	$329.70	$31.50
$153,001-$183,000	$306,001-$366,000	$428.60	$50.70
$183,001-$500,000	$366,000-$750,000	$527.50	$70.00
Above $500,000	Above $750,000	$560.50	$76.40

Social Security COLA

Each October, Social Security determines what the change has been in the Consumer's Price Index (CPI) over the last 12 months and makes Cost of Living Adjustments (COLA) to Social Security payments for the coming year. For 2023, Social Security benefits will receive a whopping 8.7% COLA, the largest raise in 40 years (can you say "inflation?").

2023 Retirement Plan Contribution Limits

Annual compensation used to determine contribution for most plans	$330,000
Defined-contribution plans, basic limit	$66,000
401(k), 403(b), 457 plans elective deferral limit	$22,500
Catch-up for age 50 and over, 401(k), 403(b), 457	$7,500
SIMPLE plans, elective deferral limit	$15,500
SIMPLE Plans, catch-up for age 50 and older	$3,500

2023 Retirement Accounts

IRA Type	Contribution Limit	Catch-Up at 50+	Income Limit / Notes
Traditional nondeductible	$6,500	$1,000	None
Traditional deductible	$6,500	$1,000	If covered by employer plan: $116K - $136K Joint $73K - $83K Single, HOH If spouse is covered by plan: $218K - $228K
Roth	$6,500	$1,000	$218K - $228K Joint $138K - $153K Single, HOH
Roth Conversion	Up to total value of tax deferred retirement accounts	N/A	No income limit / Ability to recharacterize (undo) a Roth conversion was eliminated in 2018

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