



## VIEWPOINTS

4<sup>TH</sup> QUARTER 2022

ADVISORY NEWSLETTER

**MARKET COMMENTARY**

**FREDRIC W. WILLIAMS**

### *The Emperor's New Clothes...*

Last year was a difficult one for many of the capital market's previous "stars" in the various "new tech" sectors, as rising interest rates reduced the value of their future (potential) earnings streams, caused a compression of their current price-earnings ratios, and thereby pushed their share prices down more sharply relative to other sectors. As pandemic-induced revenues, and theoretical earnings, receded from their previously vertical – and likely unsustainable – ascent, assumptions about their continuing rates of growth contributed to the macro concerns that questioned what "normal" might look like for their high-multiple shares.

Whether the tech sector's repricing resembled Hans Christian Andersen's 1837 folktale about a vain emperor who ended up a tad exposed when it was revealed that his new clothing was made by swindlers who sold him invisible thread that they claimed would be woven into his lavish suit, last year's run from many of the "newly popular" aggressive growth stories was quite stunning in both breadth and magnitude.

With the NASDAQ down more than 30%, crypto falling 60%-plus, and the CNBC post-SPAC index dropping 70%-ish, the trendy "easy money" themes of the recent past had a dramatic reality check in 2022. Even the fearsome "FAANG" posse had an average decline of 47% last year, while also inadvertently being rebranded as "MAANA" (Facebook changing its name to Meta; Google to Alphabet)...arguably not nearly as fearsome a moniker as in the past, given that they, at least temporarily, may have lost their incisors in the sector downdraft.

And although even the aggregate bond index got "mugged" for a 14% decline as a result of the "altercation" with the Federal Reserve and its inclination to raise interest rates to battle a spike in inflation, not all sectors of the capital markets were impacted to the same degree as last year came to a close.

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For example, the S&P 500 may have dropped just over 19% in 2022, but the S&P 500 Value index was only off 5.2%, the “stogie” Dow Jones Industrial Average had a more muted decline of just over 8.5%, while the S&P 500 Low Volatility High Dividend Index squeaked out a positive total return of 0.9%.

The common theme amongst all these relative “outperformers” includes attributes like lower P/E multiples, consistent dividend income production, and less volatile earnings streams – nothing very sexy about these metrics, other than perhaps an element of business predictability...call it revenge of the valuation nerds. In short, the concept of “pro-forma” earnings and betting on the horizon for a new technology to provide returns, gave way to a requirement for a more tangible, and current, demonstration of operating earnings as a means of attracting the attention of prudent investor’s dollars.

*“Other major observations from 2022 include the massive outperformance of value over growth and defensive over cyclical stocks. Energy stocks behaved as if there was no bear market at all. International stocks eked out outperformance over the U.S. despite China’s zero-Covid policy and the ugly Russia-Ukraine war.”*

- Robert Doll; CIO – Crossmark Global

Clouding the view for the markets going forward has been the prospect of a slowing economy given the impact of rising interest rates on continued economic growth. We know that in the Fed’s battle against inflation, tapping the brakes on the economy is their stated intention. But the act of slowing things down so that a more muted demand would allow for supply to catch up, and reduce pricing pressures, doesn’t necessarily have to lead to the dreaded “R” word (a recession).

Granted the Fed’s attempt to thread the needle toward the perfect Goldilocks moment – raising rates to slow the economy down, although not so much as to stall it into a contraction – might be akin to picking up consecutive “7-10 splits”, but it’s also not outside of the realm of possibility. One of the ways to monitor how this dynamic is working out is to check with the “canary in the mine” and assess the condition of the consumer given that they drive two-thirds of our GDP and can be a leading indicator of future economic conditions.

*“Despite 2022’s drop in stock, bond, and home prices, consumers’ net worth is \$145 trillion, up from pre-pandemic \$115 trillion. And even with the widely advertised decline in average home prices, the Case-Shiller measure of \$300,000 is still way above the \$230,000 pre-pandemic level. For all the predictions of a recession in 2023, monetary, credit, wealth and labor measures say otherwise.”*

- Evercore ISI, 4<sup>th</sup> Quarter 2022

Looking toward possible opportunities going forward, and sticking with the same mean-regression theme of value outperforming growth, international stocks beat their U.S. cousins in ’22, but continue to trade at significant valuation discounts.

*“As global markets struggle to recover from the impacts of rising inflation and the Russian invasion of Ukraine, one thing has not changed: U.S. stocks are more expensive than global stocks on numerous valuation metrics. Consider P/E ratios. The P/E ratio on the S&P 500 is 18, above the global average of 12 and well above the 6-11 average P/Es for emerging markets stocks. A review of yields tells a similar story. The current dividend yield for the S&P*

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500 is 1.7%, versus the global average of 3.8% and Asian, Australian, and Latin American yields of 5%-12%.

- Argus Research, January '23

A year ago we wrapped up our observations in this space with the following outlook:

*“As we move into the new year, rising rates could be the impetus for a mean-reversion in sector returns given the headwinds they could present to valuations in the growth sector, as well as the impact they could have on fixed-coupon, longer duration bonds. Expanding one’s exposure to equity-income sectors, as well as floaters and TIPs in the bond space, could be just the elixir for the challenges of 2022.”*

We’re comfortable with a similar approach to the coming year, with the possible addition of including a gradually increasing exposure to the lower valuations the overseas markets can add to the mix in 2023.

## CAPITAL MARKETS OVERVIEW

Index Returns			
Equities	Percentage Change for the 4 <sup>th</sup> Quarter	Percentage Change for the Year	Annualized 10-Year Returns
S&P 500	7.56%	-18.11%	12.56%
MSCI EAFE*	17.34%	-14.45%	4.67%
MSCI Emerging Markets*	9.70%	-20.09%	1.44%
Bloomberg Commodity Index	2.22%	16.09%	-1.28%
FTSE NAREIT Equity REIT Index	5.24%	-24.37%	6.53%
Fixed Income			
Bloomberg Barclays U.S. Aggregate Bond	1.87%	-13.01%	1.06%
Bloomberg Barclays U.S. Treasury Inflation-Linked Bond	2.04%	-11.85%	1.12%
<p>Source: BlackRock, Bloomberg, FTSE™, NAREIT®, YCharts            *Returns are calculated with net dividends in USD</p> <p>Index returns are for illustrative purposes only and do not represent actual performance of any investment. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.</p>			

*Domestic and Global Market Recap...*

**OPA INVESTMENT POLICY COMMITTEE**

*“I would like to underscore for the American people that we understand the hardship that high inflation is causing and that we are strongly committed to bringing inflation back down to our 2 percent goal.”*

– Jerome Powell, Chairman of the FOMC, December 14th, 2022

Despite a relatively good final quarter, 2022 was one of the worst years in history for financial markets as the Federal Reserve rapidly raised interest rates to address historic inflation. After peaking at 9.1% in June, the annual inflation rate in the US has slowed for six straight months, hitting 6.5% in December, helping markets recover some of their losses,

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with U.S. large cap stocks gaining 7.6%, and bonds 1.9%. Lower inflation went hand in hand with slowing economic activity. This puts policy makers in the delicate (but familiar) position of attempting a soft landing for the economy without triggering recession.

The fourth quarter rebound saw a big move in international markets with large cap stocks gaining 17.4%, and small cap 15.8%. The Russell 1000 Value Index significantly outperformed the Russell 1000 Growth Index, increasing 12.4% vs. 2.2%, respectively. The S&P 500 ended the quarter up 7.6%. Energy was the top-performing S&P 500 sector for 2022, returning 65.7%. The only other sector that produced positive returns for 2022 was the utility sector, ending the year up 1.6%. The communication services sector led the downside, declining 39.9%.

Both U.S. and international fixed income ended the fourth quarter with positive returns. Despite international developed market bonds being one of the best performers out of fixed income in the last quarter of 2022, they were the worst performer for the year, ending down 21.8%. Across the board, it was a tough year overall for fixed income.

Despite the late rally, the S&P 500 ended the year down 18.1%, while the Bloomberg U.S. Aggregate Bond Index lost 13%. A traditional 60% stock and 40% bond portfolio had its second-worst year since 1950. For the fourth quarter of 2022, the estimated earnings decline for the S&P 500 is -4.1%. Given concerns about recession, analysts also lowered S&P 500 earnings estimates for 2023 by 4.4%. Expectations are now for \$225 per share, 4.7% growth over 2022.

Will tighter monetary policy dampen the economy so much that it enters a recession? The answer will depend on the the decline of growth relative to inflation. Should inflation decrease more quickly than economic activity, the U.S. could experience a soft landing — which would be a positive for assets. If economic growth slows faster than inflation, then a recession ensues. Even the Fed’s staff noted in the November Federal Open Market Committee (FOMC) meeting that “the possibility that the economy would enter a recession sometime over the next year as almost as likely as the baseline”.

The interplay between monetary and fiscal policy will be another key factor in 2023, and it could significantly complicate the Fed’s efforts to further rein in inflation. The Federal Reserve is intent on getting inflation back to its 2% mandate. To accomplish this, they will continue tightening monetary policy through interest rate hikes and shrinking its balance sheet to remove liquidity from the financial system. The desired result is a weakened labor market and lower consumer demand.

“A weakened labor market” means job losses, higher unemployment, and lower wages. The middle and working class, already grappling with inflation, will face most of the hardship. In addition to being unfair, this is also a political nightmare. Some politicians will likely be compelled to add fiscal stimulus to the economy and pressure the Fed to ease interest rate hikes if employment and consumers’ financial situation erodes and a recession ensues.

The interplay between fiscal policymakers, the Federal Reserve, and market participants will largely determine the trajectory for markets in 2023. As we have seen recently in the U.K.,

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markets have become hypersensitive to increasingly heavy-handed policy decisions. With an inverted Treasury yield curve strongly suggesting a U.S. economic recession, policy decisions become even more critical to determining the magnitude and duration of the economic slowdown and how markets respond to it.

Consistent with last year, we are taking a patient stance, holding all views with an “open hand,” so to speak. Incoming economic data and the policy developments they impact are fluid and uncertain. While we wait for clarity on these topics, we can earn 4% to 5%—returns last experienced more than 15 years ago—on short-term government bonds. We are balancing elevated levels of portfolio liquidity with a diversified portfolio of assets that emphasizes quality and cash flow as much as we believe is prudent.

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**PLANNING CONCEPTS****CLIFFORD P. RYAN, CLU®, ChFC®**

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***New Year Planning Items - Legislation: SECURE 2.0 Act***

This new legislation has been signed into law with some provisions starting in 2023 and others going as far out as 2033. Although not as sweeping a piece of legislation as the earlier SECURE Act of 2019, this builds upon a few of the same themes and seeks to strengthen retirement savings. A few of the key items:

- The age to begin taking an IRA Required Minimum Distributions (RMD) increases to age 73 in 2023 and up to age 75 in 2033.
- RMDs are will not be required from Roth accounts in employer retirement plans beginning in 2024.
- Catch-up contributions will increase substantially in 2025 for employer-based plans as well as IRAs.
- The penalty for missing or mis-calculating an IRA RMD will drop from the present 50% to 25% and down to 10% if it’s corrected in a timely manner.
- IRA Qualified Charitable Distributions (QCDs) will now allow IRA owners (age 70 ½ or older) to contribute a one-time gift of up to \$50,000 (adjusted for inflation) to a charitable remainder trust, charitable remainder unitrust, or a charitable gift annuity. This is an expansion of the type of charities that can accept these gifts. These gifts can count towards an IRA owner’s RMD.
- Student Loan payments can be “matched” into employer-based retirement plans starting in 2024.
- Automatic Enrollment is required at a minimum rate of 3% for newly adopted 401(k) and 403(b) plans beginning 2025. It also permits plan providers to offer plan sponsors with automatic plan portability allowing low-balance accounts to automatically transfer as employees change jobs.

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Those are a few of the highlights. As actual rules get put in place and things develop, we'll keep you informed. There will be plenty of planning opportunities surrounding these changes.

**FIDUCIARY CORNER**

**BEN DAIGLE, JAKE KENYON CFP®**

**2023 Regulatory Limits for Retirement Plans**

<b>IRS Limits on Retirement Benefits and Compensation</b>		
<b>Year</b>	<b>2023</b>	<b>2022</b>
401(k), 403(b), 457 Elective Deferral Limit (calendar year)	<b>\$22,500</b>	\$20,500
401(k), 403(b) & 457 Catch-Up Contribution Limit (calendar, plan or limitation year)	<b>\$7,500</b>	\$6,500
Annual Compensation Limit (Plan year BEGIN)	<b>\$330,000</b>	\$305,000
Defined Contribution Limit (limitation year END)	<b>\$66,000</b>	\$61,000
Defined Benefit Limit at ages 62-65 (limitation year END)	<b>\$265,000</b>	\$245,000
Definition of Highly Compensated Employee (HCE) (plan year BEGIN)	<b>\$150,000</b>	\$135,000
<b>Key Employee Compensation Threshold (plan year END)</b>		
5% Owner Officer	<b>All \$215,000</b>	All \$205,000
IRA Contribution Limit	<b>\$6,500</b>	<b>\$6,000</b>
IRA Catch-Up Contributions	<b>\$1,000</b>	\$1,000
As published in IRS News Release IR-2022-188, Oct. 21, 2022 See <a href="http://www.irs.gov">www.irs.gov</a> for more information		

**Create A Retirement Plan Before Maine Does It For You!**

In a response to the dependency of employer sponsored retirement plans for employee retirement savings, Maine has followed suit with many other states (i.e. California, Massachusetts, Washington, etc.) and will require employers with 5 or more employees to join and offer their employees a state sponsored retirement plan unless they offer another qualified plan such as a SIMPLE IRA or 401(k).

Below we've outlined the key details and dates surrounding the implementation of this new mandate:

**Maine Retirement Savings Plan**

Program Status: State of Maine sponsored option is still in development

Program Type: Roth IRA deferrals (Option to add a Traditional IRA)

Employer Qualifications:

- Number of Employees: 5+
- Years in Business: At least 2

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- Have not sponsored a qualified plan in current year or preceding 2 years

Required Employer Adoption:

- 25+ Employees: April 2023 (Proposed Deadline)
- 15-24 Employees: October 2023 (Proposed Deadline)
- 5-14 Employees: April 2024 (Proposed Deadline)

Program Details:

- Employee Auto-Enroll: Yes
- Employee Opt-Out Option: Yes
- Contribution Amount: 5% default with flexibility for employees to increase or decrease deferrals
- Other: 1% auto-increase per year until contribution reaches 8% employee deferral

Employer Penalties:

- \$10/employee if not in compliance prior to April 1, 2024
- \$20/employee if not in compliance from April 1, 2024 to March 31, 2025
- \$50/employee if not in compliance from April 1, 2025 to September 30, 2026
- \$100/employee thereafter

While the State's plan mandate will help address the retirement readiness of Maine employees, it does not help employers from a business standpoint. All Maine businesses can implement their own qualified plan instead of using the State of Maine option and this could make sense from a business standpoint because of the following advantages:

- Greater flexibility in plan design and investment options
- Deductibility of employer contributions
- Business tax credits available
- Outsourcing of plan administration
- Higher contribution limits for business owners and their employees to save towards retirement

If you or another business owner you know would like an overview of retirement plan options and recommendations for which could be most beneficial to their business, while still satisfying the State of Maine mandate, please reach out to our Fiduciary Consulting team here at Old Port Advisors.

### ***Cyber Security: Hackers Going After Retirement Savings***

Cybersecurity experts warn that they are seeing an increase in theft scams targeting participants of employer retirement plans.

“We’re seeing a significant increase in the hackers getting access to these retirement assets,” Brian Edelman, CEO of cybersecurity protection firm FCI. Phishing scams look legitimate. The criminal will use a corporate email hack to intercept a conversation between a retirement plan saver and a plan administrator. They then try to get the participant to divert savings to a separate account run by the criminal.

What you can do – be vigilant. Check email communication and email addresses carefully. If there is any question, call your plan administrator.

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