

the BENCHMARK

BCS Wealth Management's Quarterly Newsletter



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By Philip Bachman

Sequence of Returns

Imagine you have an investment account that enjoyed a 12% gain two years ago, a 4% gain last year, and a 10% loss this year (if the year were already over). Now imagine that you have another investment account that suffered a 10% loss two years ago then enjoyed a 4% gain last year and a 12% gain this year. Assuming no deposits or withdrawals were made, which account performed better?

That's right: it's a trick question. The two accounts ended the same! In fact, we could have arranged those hypothetical returns in any order, and the result would be the same as long as there were no inflows or outflows during those years.

This concept called Sequence of Returns was non-intuitive to me before I was in this profession. I would have expected

that the later years' returns matter more because they're more recent. Other folks might have thought that the early years' returns matter more because they impact the account sooner.

However, both of these assumptions are wrong if we're talking about buy-and-hold investing and stripping out cash flows. The reason is mathematical. The sequence of returns doesn't matter because $A \times B$ is the same as $B \times A$.

An important note: in cases where deposits and withdrawals are being made – which is many clients' accounts in the real world – the sequence of returns *does* matter! Even if two investors experience the same average annual return, the timing of the good and bad years matters to their unique

outcomes. After all, it is preferable to “buy low and sell high” when inflows and outflows are occurring. The compounding effects play into both the accumulation phase and distribution phase of a financial lifecycle.

In Focus: The Accumulation Phase

When an investor is contributing into their account, it would be to their advantage to experience the worse returns in early years and the better returns in later years. This is because the account balance would be smaller when subject to losses. The positive years would compound a larger balance towards the end.

In Focus: The Distribution Phase

The distribution phase is functionally the most important to most people. We don't want to experience a bear market in the early years of retirement. All else being equal, the early years of retirement are the most crucial to a retirement portfolio. Early market losses could strain the distant years' spending goals because the account has a double-whammy of cash outflows and investment losses.

The Sequence of Returns Effect

No Cash Flows During the Timeframe	Accumulation Phase (Example: Depositing and making investments in an account)		Distribution Phase (Example: Selling investments and withdrawing from an account)	
	Better returns earlier, worse returns later	Not preferable	Better returns earlier, worse returns later	Preferable
Better returns earlier, worse returns later =	Worse returns earlier, better returns later	Preferable	Worse returns earlier, better returns later	Not preferable
Worse returns earlier, better returns later	Better returns earlier, worse returns later	Not preferable	Better returns earlier, worse returns later	Preferable

Financial advisors like us take steps to mitigate this timing risk. A common approach is to allocate a bucket of cash or conservative assets in the portfolio to accommodate a few years of spending needs. By doing so, we lower the chance that we'd need to sell longer-term investments like stocks during a market downturn. It allows that piece of the pie to be held until the market recovers.

Other solutions for soon-to-be or recent retirees to consider are to retire slowly and to adopt a flexible withdrawal strategy. Moving from full-time work to part-time work, even if it's in a different field, helps many folks make the lifestyle shift. It allows them to not only retain a sense of purpose but also smooths the financial transition. Meanwhile, flexible budgeting (as opposed to having

rigid account withdrawals) can prolong retirement success by adapting to the variability of market returns.

“Rearrange Time” to Feel Better

During a dreary year in the stock market, I believe the Sequence of Returns concept is a good reminder to long-term investors. It helps us to confront recency bias. Recency bias is a cognitive bias that causes us to put too much emphasis on recent events or data. It can lead people to make decisions that deviate from their long-term plans.

It is easy to focus on this year's disappointing stock market because we are suffering through it at this very moment. However, unless notable deposits or withdrawals are being

made in your account, we essentially could have swapped this year's puny performance with last year's excellent performance. Imagine having been disappointed last year and elated this year. What would that feel like?

It may sound strange, but this algebraic fact gives me a glimmer of confidence as a long-term investor. I hope it gives some comfort to you too.

*Philip Bachman,
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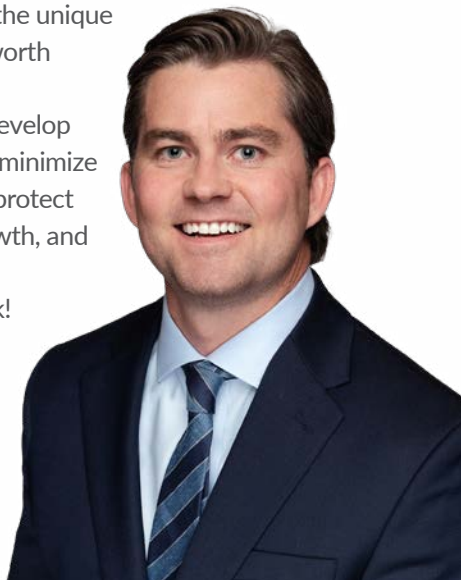


The Latest from BCSWM

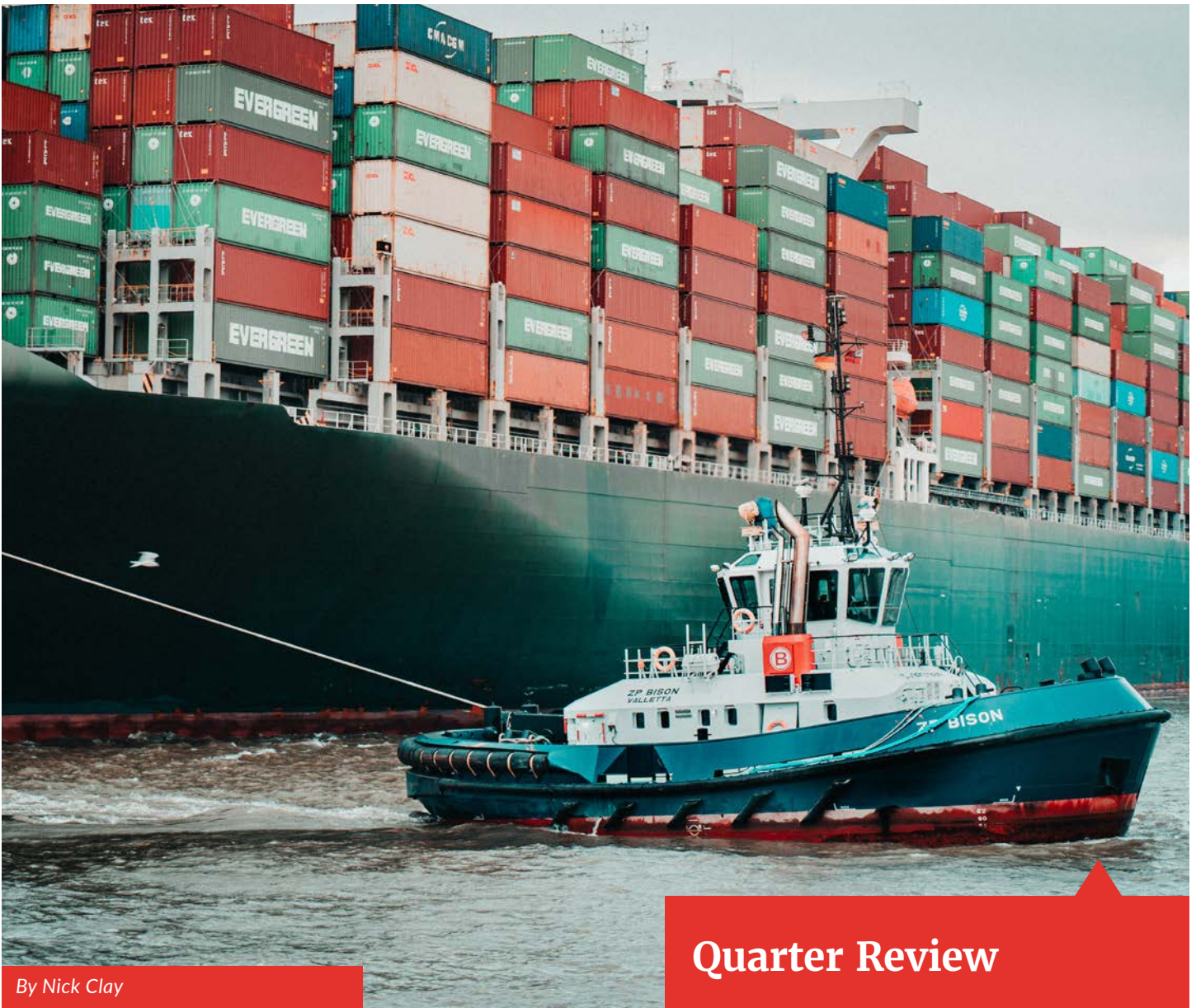
Recent achievements and appearances

Congratulations to Nick Clay for attaining the Certified Private Wealth Advisor® (CPWA®) certification. This advanced certification is for advisors and wealth managers who work with and address the specific needs of high net worth clients. CPWA-certified professionals are able to identify and analyze the unique challenges high net worth individuals face and understand how to develop specific strategies to minimize taxes, monetize and protect assets, maximize growth, and transfer wealth.

Congratulations, Nick!



Josh Smith recently interviewed Scott Linn on News Channel 11 to discuss the recent changes in the stock market and the Bear Market concerns. Scott stressed the importance of having a plan, understanding your investments, and working towards your goals with your advisor.



By Nick Clay

Quarter Review

If you follow the news headlines then it probably comes as no surprise that the chart on the next page is filled with an unfortunate amount of negative/red numbers. The S&P 500 finished the first half of the year down nearly 21%, which is the largest first-half loss we've had in more than 50 years. Ironically, the historical safe haven to stocks, bonds, are also down double-digit percent in the first half of the year, seemingly leaving investors no place to hide. This scenario of declines in stocks and intermediate-term bonds in back-to-back quarters is very rare, only happening twice prior (1969 and 1974). Depending on the

instrument, even the supposed inflation and market hedge, gold, was flat to slightly negative in the first half of the year.

Our Perception of Key Market Forces

You might be wondering what the key contributors to the rout in investment markets are. While there are many headwinds, we believe the largest drivers to negative returns continue to be inflation, Federal Reserve policy (rate hikes), the continued Russia/Ukraine war, and ongoing supply chain issues due to the Covid-19 disruptions.

Regarding Federal Reserve policy, the central bank is attempting a delicate balancing act of trying to help inflation roll over, but not so aggressively that they catapult the economy into a recession.

The optimism around effectively achieving a "soft landing" is fading.

In my opinion, it will be rather difficult to fight off a recession. One of many data points suggesting that is the Atlanta Fed's GDP projections having declined from 1.9% to -1% over the last two months. On the other hand,

some attributes that the Fed is hoping might help bypass a recession are a strong labor market with a high level of new job openings, as well as their stated stance to be nimble and data dependent.

Let's discuss the proverbial good news and bad news, starting with the latter so that we can end with some encouragement.

The Bad News

All of the usual contributors to a recession are present today, some of which are rising inflation, declining consumer sentiment, tightening Fed policy, a stronger US dollar, and a flattening of the yield curve. We are also in a confirmed bear market, which is a decline in the market index of 20% from the highs.

Historically, bear markets last about a year and take about 11 months to reach the "bottom."

If you're reading between the lines, this means we could (and are likely to) fall further.

The Good News

It's not a given that stocks will continue to decline if we end up in a recession. The S&P 500 has actually been positive in four of the last nine recessions. When declining, the average decline is just 1.5%. But what about the bear market? If we reach the average bear market decline of being down 33%, it would require a gain of 50% to get back to even. Once we are in bear market territory it takes about 25 months to break even on average. That means we could see strong double-digit returns on the way up, which is why perseverance is key.

The news headlines would lead you to believe this time is different, which the actual headlines are, but the cycle is no different than previous cycles. Since 1950, the S&P 500 has made it through 32 drops of 10% or more, 13 recessions, and many wars. On average, since 1980 the S&P 500 experiences a decline of 14% every year, and returns have been positive in 32 of those 42 years. (You might want to re-read that sentence and let it sink in.)

Behavioral Finance Bias Warning

Losing money isn't my idea of fun, and I'd imagine you would agree. This reminds me of a common behavioral finance bias. Loss aversion bias is an emotional bias that says, "The pain of losing money is psychologically twice as powerful as the pleasure of making the same amount of money." After experiencing the longest bull market in history and working with many clients, I see that this bias is alive and well. How can we combat rash decisions that it might cause us to make?

It's important to remain disciplined in your investment strategy and financial plan. If six months is going to make or break your plan, then I would argue that it wasn't an appropriate plan to begin with. If you've been investing for a long time, you know the market has been in a rut before and will be in one again in the future. If you're new to investing, this is a timely initiation.

Markets don't go up every year like clockwork, and you don't want to hang your hat on predicting which years they will go up.

However, for veterans and rookies alike, there's plenty to do during this period that can enhance your long-term investing success. This includes tax loss harvesting, rebalancing allocations, revisiting risk tolerance, value hunting, and dollar cost averaging with cash or payroll contributions.

The famous economist Paul Samuelson said,

"Investing should be more like watching paint dry or watching grass grow."

While that is hard to do in today's world of 24/7 news and predispositions of immediate gratification, it has worked in the past. I believe it will continue to work in the future. Having a long-term outlook can provide peace of mind and less heartburn in periods like we are experiencing today.

We are thankful for the trust you place in our team and the partnership that we have. As always, please feel free to reach out to us with any questions or concerns you may have regarding your specific situation. We are happy to help and enjoy the opportunity to do so.

Major Stock Indexes	2nd Quarter 2022	YTD
DJIA	-11.3%	-15.3%
Nasdaq Composite	-22.4%	-29.5%
S&P 500	-16.4%	-20.6%
Russell 2000	-17.5%	-23.9%
Global Dow	-14.7%	-15.3%
Japan: Nikkei 225	-5.1%	-8.3%
Stoxx Europe 600	-10.7%	-16.5%
UK: FTSE 100	-4.6%	-2.9%
Major Bond Index	2nd Quarter 2022	YTD
Bloomberg Barclays US Aggregate (Total Return)	-4.7%	-10.7%



Nick Clay, CFP®, CPWA®, AIF®, AAMS®
Managing Partner & Senior Financial Advisor



We grabbed our peanuts and Cracker Jacks, and headed out to the ETSU ball field for a fun night of cheering on the Bucs.



Our annual ice cream social was the perfect opportunity to catch up with clients and enjoy a sweet treat!



BCSWM partnered with United Way of East TN to "Stuff the Bus" with supplies for local summer camp programs.



We participated in United Way's Week of Caring and volunteered at Salvation Army in Johnson City and Second Harvest Food Bank in Kingsport.





By Myra O'Dell

Secure Act - RMD Rules

In our April 2020 issue of *The Benchmark*, we discussed several changes to IRAs as a result of the SECURE Act, which was signed into law in December 2019. As mentioned in that article, probably the most notable change resulting from the act was the elimination of the “stretch” provision for most non-spouse beneficiaries of Inherited IRAs and other retirement accounts. Prior to 2020, non-spouse designated beneficiaries could take distributions over their life expectancies. However, most non-spouse beneficiaries inheriting IRAs after 2019 are now required to empty the Inherited IRA by the end of the 10th year following the year of death.

Given the scale of changes brought by the new act, we have been anticipating guidance from the IRS to clarify the many issues left unresolved. The IRS did just that on February 23, 2022, releasing new proposed regulations on RMDs from IRAs and workplace retirement plans. These new regulations are anticipated to apply for 2022 and later.

Perhaps the biggest surprise in the regulations released in February is based on a provision of the tax code section IRC 401(a)(9)(B), which requires annual RMDs to continue once they are started. This rule existed prior to the SECURE Act, but many considered it void with the new act. It particularly affects the 10-year distribution rule, which applies to designated beneficiaries who are not Eligible Designated Beneficiaries (EDBs).

As a refresher from our April 2020 article, an EDB is a designated beneficiary who falls into one of the following categories: surviving spouse, minor child of the decedent, disabled individual, chronically ill individual, or a person not more than 10 years younger than the decedent. Non-Eligible Designated Beneficiaries (NEDB) include any designated beneficiary who is not an EDB.

Prior to the announcement in February, it was widely thought that NEDBs, who must follow the 10-year distribution rule, would be able to take distributions in any manner, as long as the account was emptied by the end of the 10th year. However, the interpretation by the IRS of the SECURE Act released in February requires annual Required Minimum Distributions (RMDs) when an account owner dies on or after their Required Beginning Date (RBD). In other words, certain beneficiaries are required to follow both the 10-year distribution rule and meet annual RMD requirements.

The most common impact of this rule is found when a NEDB inherits from a retirement account owner who passes on or after their RBD (currently April 1 of the year following turning age 72 for most individuals). The result is that

annual RMDs are required during the 10-year distribution period. The RMDs are calculated using the single life expectancy of the beneficiary. It's calculated just as if the old stretch IRA rules are still in place, except the account must now also be emptied within 10 years.

As part of the process of the proposed regulations, the IRS accepted comments from the public through May 25, 2022. Comments by the public, including those from industry groups and large financial institutions, have expressed concerns on the complexity the new rules require. Additionally, a hearing took place in Washington on June 15. After considering the comments from the public and the hearing, the IRS will issue final regulations. At this point, all we can do is wait until the final regulations are issued.

If all of these new rules seem confusing, you are not the only person feeling that way! However, your team at BCS Wealth Management is staying on top of these changes and is here to guide you through the process.

Myra O'Dell,
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Partner & Senior
Financial Advisor



BCS Wealth Management is an independent financial planning firm in Johnson City, TN. We help individuals, families, and businesses reach goals important to their financial wellbeing. We provide investments and financial planning, insurance, and group benefits.

Save These Dates!

October is a big month for income taxes, and also for retirement plans and IRAs. Here are several important October financial planning dates to remember.

October 1 - Safe Harbor 401(k) + Simple IRA

- Deadline to implement these plan types for current tax year

October 15 - 401(k) Plan + SEP IRA

- Deadline to implement and contribute towards all 401(k) plans in the employer portion or a SEP IRA (tax filing date including extensions).
- NOTE: September 15 for Partnerships and S Corporations