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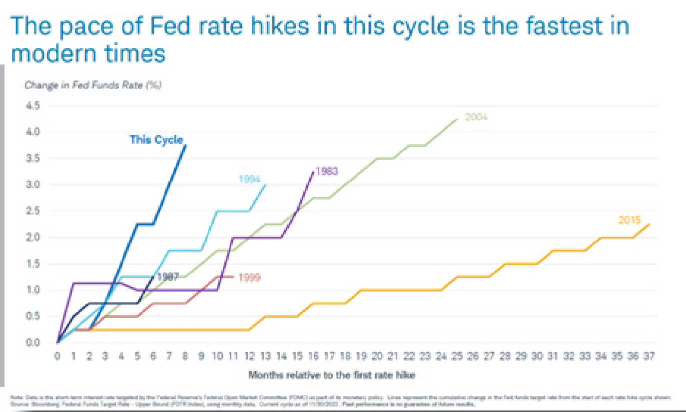
Quarterly

2022 Year-End Investment Market Report

Investors are undoubtedly glad to have 2022 behind them as it turned out to be the worst year for markets since the 2008 Financial Crisis - the biggest factor, inflation, reared its head for the first time in the last 40 years! Unlike most years of market turmoil, there was no place to hide in 2022 – whether in equities or fixed income, all major market indexes saw double digit percentage declines, which is a first.

THE FED VS. INFLATION

It seems such a distant memory now, it is hard to believe that 2022 started out with the Fed calling the high inflation statistics "transitory." As inflation persisted, it became clear that the Fed had fallen behind and risked letting inflation get out of control and dangerously imbedded in the economy. The Fed raised interest rates at the fastest rate in modern times climbing from a 0-0.25% range to a 4.25-4.5% range as the Fed found itself in a desperate fight to restore its credibility.



Source: Schwab Center for Financial Research

This more restrictive monetary policy is something we have not seen in a long time. Since the 2008 Financial Crisis, real interest rates have been zero or even negative in the US and much of the world. This "free" money led to numerous bubbles and excesses – stocks trading at sky-high multiples, bonds overpriced due to unnaturally low rates, real estate markets where bidding wars became the norm, and speculation in cryptocurrencies. Virtually free financing encourages poor allocation of capital, and now we are seeing those excesses unwind.

THE IMPACT OF HIGHER RATES ON STOCKS

Interest rate increases intended to curb inflation by purposely slowing the economy don't typically bode well for corporate profits, so investors quickly began to fear the possibility of a recession. With mortgage rates doubling, the housing sector ground to a halt. High-flying tech and biotech stocks that were trading at lofty valuations in hopes of giant, but perhaps distant, future profits came crashing back to earth because in a higher interest rate environment, distant earnings are worth far less. With more competitive returns coming from interest rates, stocks in general need to provide higher expected returns, requiring lower purchase prices and valuations. Given stocks are valued based on a multiple of earnings coupled with those earnings slowing, purchase prices had to go decline even further.

INDEX	2022
S&P 500	-18.1%
Dow Jones Industrial Average	-6.9%
Nasdaq Composite	-32.5%

Source: Morningstar Direct; See disclosures for important benchmark information

Overseas markets held up relatively well when measured in their local currencies, but the interest rate-driven appreciation of the US dollar magnified the losses for US investors.

INDEX	2022
MSCI EAFE (Developed Markets)	-14.5%
MSCI Emerging Markets	-20.1%

Source: Morningstar Direct; See disclosures for important benchmark information

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Global equities markets also had to deal with the Ukraine/Russia conflict and its potential impact on other regions, not to mention on sky-rocketing energy prices. Supply chain interruptions disrupted global production and caused widespread inventory shortages. China virtually shut down their economy due to their zero-Covid policies. All these factors combined to create the most challenging global equities market environment since 2008.

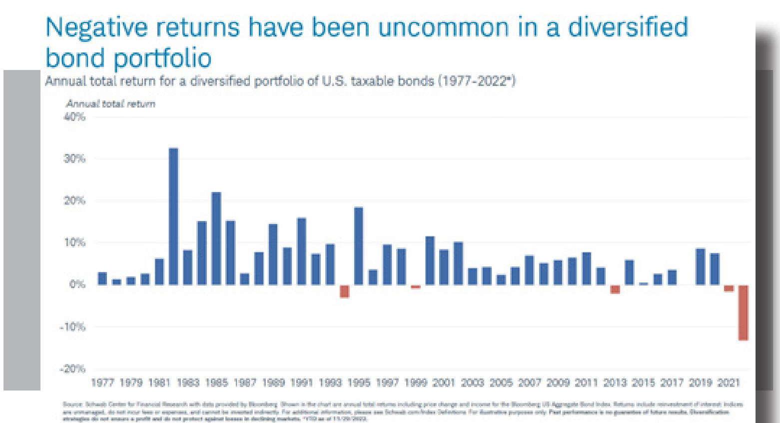
IMPACT ON FIXED INCOME

Since rising interest rates cause bond prices to fall, many investors were not surprised to see bonds decline, but many investors were shocked to see the degree to which they fell.

INDEX	2022
Bloomberg Global Aggregate Bond Index	-16.3%
Bloomberg US Aggregate Bond Index	-13.0%

Source: Morningstar Direct; See disclosures for important benchmark information

We not only had a historically rapid increase in interest rates, but our starting point for rates was historically low; regardless of maturity, bonds had very little interest income to buffer the blow from higher rates. The chart below illustrates the rarity for bond portfolios to realize negative returns. To put the effect of low interest income into context, 1994 saw a similar rise in interest rates from the Fed, but the damage was much smaller than 2022 because interest rates started at higher levels and the interest income buffered the price declines.



Source: Schwab Center for Financial Research

OUTLOOK FOR 2023

While it is likely that market volatility continues in the coming year as most of the uncertainties that plagued investors in 2022 have followed into 2023, it is worth noting that in many ways, investors are in a much better position than they were a year ago.

• Many excesses arising from the near zero interest rates of the past decade are being wrung out of the financial system, the Fed has made substantial progress in bringing rates in line with levels needed to control inflation, and the foundation is being set for the U.S. to resume robust and sustainable economic growth

• U.S. equities have pulled back from peak market valuations, and even with more volatility in 2023 and a possible recession, working through these normal cycles for markets and economies removes excesses and positions the market for new leadership and growth, which we expect to present investors with new opportunities in 2023

• Valuations in international equities markets have come down substantially, and with likely unwinding of the historically strong 2022 moves of the US dollar, we think they could prove much more beneficial to client returns in 2023 and beyond

• Because bond yields are so much higher than a year ago, we expect bonds to resume their role as a diversifier for client portfolios, even if rates move somewhat higher as the Fed finishes their rate increases

2022 was a turning point for the markets in many ways, and we think 2023 will present exciting opportunities to reposi-tion existing allocations and introduce some new allocations to client portfolios to take advantage of opportunities arising from this evolving market environment. While we are seeing exciting opportunities, we also recognize that more turmoil may lie ahead. As we ride out further volatility and position for the next bull market, we currently favor diversified exposures relative to individual names. As always, we are excited to share our research, diligence, and ideas with you as we navigate the market environment in 2023.

Outlook: *While it is likely that market volatility continues in the coming year as most of the uncertainties that plagued investors in 2022 have followed into 2023, in many ways, investors are in a much better position than they were a year ago.*

Financial Planning News

Just before year-end, the Secure 2.0 Act of 2022 became law. Considering that more than 100 provisions in the Secure 2.0 Act impact retirement savings, we'll highlight only the most relevant and applicable.

RMD Changes: The age for first required minimum distributions ("RMDs") from retirement plans will move from 72 to 73 starting this year. Anyone who reaches age 74 after December 31, 2032 will have to start taking RMDs by age 75. To those already taking RMDs annually, the Secure 2.0 changes do not apply.

Steep penalties still exist for failing to take an RMD. The previous 50% tax was one of the heaviest penalties in the entire tax code. The Secure 2.0 Act reduces the penalty to 25% in all cases. In addition, the penalty drops down to 10% if you take the necessary RMD by the end of the second year following the year it was due. These penalty-reduction provisions apply beginning in 2023.

Larger Catch-up Contributions: It's complicated and there are a number of pieces, but the bottom line of the legislation is that most catch-up provisions will increase now or begin to increase in the coming years, offering more opportunity to sock away funds for retirement.

People over 50 have been able to make an additional $1,000 contribution to their IRA, what has been called a "catch-up provision." However, that amount has never been indexed to inflation. Now, starting in 2024, the catch-up contribution limit will be raised with the inflation rate, in increments of $100. Meanwhile, starting in 2025, participants aged 60 to 63 will be permitted to make catch-up provisions of $10,000 (up from the current $7,500) in their 401(k) plan, or $5,000 if they are participants in a SIMPLE plan.

Starting in 2024, the Secure 2.0 Act also requires all catch-up contributions for workers with wages over $145,000 during the previous year to be deposited into a Roth account. The wage threshold will be adjusted annually for inflation beginning in 2025 (rounded down to the lowest multiple of $5,000).

529 Plan Funds to ROTH: Beginning in 2024, people who have set aside money in a 529 plan to pay for college expenses, and no longer have a need for the funds, are now able to move those excess dollars directly into a Roth IRA, up to a lifetime maximum of $35,000. The bill requires that the Roth IRA receiving the funds be in the name of the beneficiary of the 529 plan, and the 529 account must have been in existence for 15 years or longer. To note, any contributions made in the most recent five years, and earnings on those contributions, are not eligible for this transfer.

MONTIS COMPANY NEWS:

We are thrilled to announce that Dennis Follmer joined Montis Financial as our Chief Investment Officer. Dennis earned his MBA from Sloan School of Management at MIT and brings over three decades of experience as a portfolio manager. He previously managed portfolios for the largest institutions in the country at Tudor Investment Corp, co-founded Oceanwood Capital Management, and built a tax optimized portfolio management platform at 55ip. For more information, please see Dennis' full bio on our website. Welcome to the Montis Family, Dennis!

Important Disclosure Information

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S&P 500, Russell 2000, Wilshire U.S. REIT, and Barclays U.S. Aggregate Bond indexes are reported using Total Return. Total Return assumes the reinvestment of dividends/interest. MSCI EAFE and MSCI EM benchmark performance is reported using Net Total Return. Net total return indexes reinvest dividends after the deduction of withholding taxes, using (for international indexes) a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties. Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational/comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Montis account holdings correspond directly to any comparative indices or categories. Please Also Note: (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your Montis accounts; and, (3) a description of each comparative benchmark/index is available upon request.

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