The Meridian Memo

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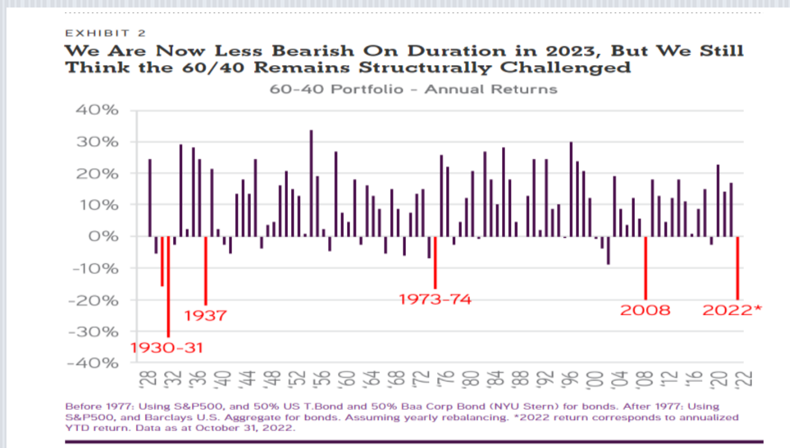
A Spring Letter to Clients: Markets & Secure Act 2.0

Let me start by saying there are good and not so good things to report. **On the whole, the risk/return relationship for investors is much better right now than it was in Jan 2022.**

I have said before, the 60/40 stock/bond portfolio (also known as the "balanced portfolio") is a good representation of a reasonable diversified portfolio.

A lot of commentators have said the 60/40 is no longer a good setup or even that it is dead due to the historically bad performance in 2022. My response would be yes and no. Yes, because we can do better than a 60/40.[1] But no, because it is silly to extrapolate from an anomaly and therefore reorient your whole investment philosophy.

To paraphrase Mark Twain, "**the reports of the death of the 60/40 Stock/Bond 'balanced portfolio' are greatly exaggerated.**"



ABOUT US:

We will have more news to provide about ongoing initiatives we have at the firm in the future. As an independent Registered Investment Advisor, Meridian is able to stay nimble in order to respond to where the industry is going in order to best serve its clients. That is key in everything we undertake as we are always reevaluating what we do to improve and be on the leading edge of planning and investment management.

Generally, this combination of asset classes performs well in the years after it does poorly (see nearby chart) and last year was the 3rd worst year for this combination of asset classes on record. The fact that is does well after bad years should be encouraging to investors.

The 60/40, as good as it is (and it is much better than nothing), does have risk in it that does not have to be accepted. One thing market participants noticed last year was that bonds were not as safe as most

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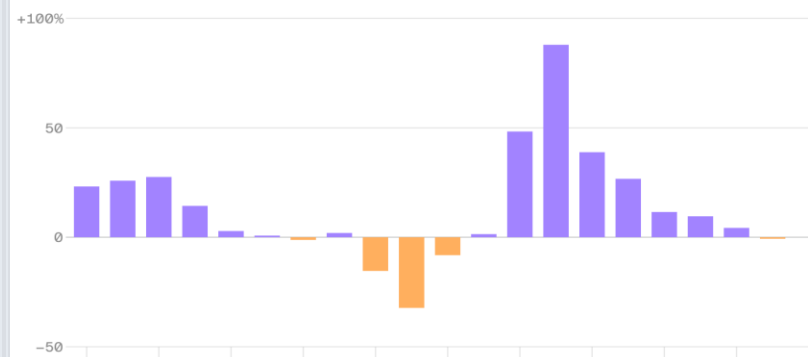
[1] Even so, most portfolios will have considerable allocations to those 2 buckets, both the "60" and the "40."

investors had previously thought. (The Bloomberg Aggregate Bond Index was down by more than 13% in 2022.) When interest rates are low, there is a greater chance that they move up meaningfully than there is that they move down meaningfully. That means the prices of bonds become more exposed to downside risk.[2] Having said that, at these elevated levels of interest rates, **bonds seem to be priced at a good value and are a good purchase**. At the same time, because of these risks, Meridian does employ some bond alternatives. These investments provide a level of safety like bonds and have less interest rate risk than bonds. They add real diversification, more potential growth than bonds, but less risk than stocks. *That is where alternative strategies for a portion of the overall portfolio make sense.*



Let's talk briefly about market expectations for 2023. Originally most economists were thinking the economy would enter recession in 2023 in the first half of the year. Now many economists are thinking, if there will be any recession at all, it will be in the second half. The second half (H2) looks more challenged from an economic standpoint than H1. There are 2 primary reasons that indicate a recession as a possibility, if not likelihood.

(1) There are 3 types of economic indicators. There are **leading indicators**, there are **coincident indicators**, and there are **lagging indicators**. Certain coincident indicators (like payrolls and strength of the consumer) look great. But when looking at the future and making forecasts, we have to look at indicators that are forward looking such as the leading indicators. The labor market and payrolls are almost always strong before a recession. They don't tell us where the economy is heading.[3]

Leading indicators like interest rate spreads, money supply, credit usage foreshadow a slowing economy. The leading indicators are the ones that are most likely to tell us about the future of the economy. Right now in early March 2023, the coincident and lagging indicators are positive, but the leading indicators are negative. One way to think about it is the coincident indicators are looking out the side window, the lagging indicators are looking in the rear view mirror and the leading indicators are looking through the windshield. Unfortunately, the leading indicators are negative and have been negative for a while.

Another key. Slower growth as a consequence of increased interest rates has yet to be felt, at least meaningfully. We mentioned this before but the economic impacts from increased interest rates by the Federal

[2] Bond prices and interest rates (yields) move inversely. So when interest rates rise, the price of bonds go down. This is known as interest rate risk.

[3] The one exception is initial jobless claims which are now strong.

Reserve don't hit the economy until 9 to 12+ months after they have been increased. Economists refer to this as the long and variable effects of monetary policy.

Whether we enter a recession or not does matter, because as I have written before, the market does not bottom before a recession begins (at least it has not historically). It may bottom before the end of the recession, but it does not bottom before the recession even begins.

(2) Lastly and very briefly let's turn our attention to current and future corporate earnings. The value of stocks is determined by a number of things but foremost among them is the amount of earnings per share and the growth in earnings per share. The nearby chart shows that corporate earnings per share year over year have turned negative. This is even with a positive GDP (i.e. growing economy). If later this year GDP slows or even goes negative, earnings should get worse on a comparative basis. That is not positive for stocks.

Let us end on this positive note. Even with all of this known negative information and the very real possibility that stocks could be challenged during the remainder of this year, future downside risk is limited because stocks lost much value in 2022. Successful investors will not sell at this point and if anything will take advantage of this pullback in stocks to add new capital to the markets.

How the Change in Retirement Laws Will Affect You

Let's jump right into this letter's other main topic. The Setting Every Community Up for Retirement Enhancement Act of 2019, popularly known as the SECURE Act, was signed into law in late 2019.

Now called SECURE Act 1.0, it included provisions that raised the requirement for mandatory distributions from retirement accounts and increased access to retirement accounts.

But it didn't take long for Congress to enhance the landmark bill that was enacted barely three years ago.

Tucked inside a just-passed 4,155-page, $1.7 trillion spending bill are plenty of goodies, including another overhaul of the nation's retirement laws.

The bill enjoys widespread bipartisan support and builds on SECURE Act 1.0 by strengthening the financial safety net by encouraging Americans to save for retirement.

9 key takeaways on SECURE Act 2.0

1**. Changing the age of the required minimum distributions**. Three years ago, 1.0 increased the age for taking the required minimum distribution, or RMD, to 72 years from 70½. If you turn 72 this year, the age required for taking your RMD rises to 73 with 2.0.

If you turned 72 in 2022, you'll remain on the prior schedule.

If you turn 72 in 2023, you may delay your RMD until 2024, when you turn 73. Or you may push back your first RMD to April 1, 2025. Just be aware that you will be required to take two RMDs in 2025, one no later than April 1 and the second no later than December 31.

Starting in 2033, the age for the RMD will rise to 75.

Employees enrolled in a Roth 401(k) won't be required to take RMDs from their Roth 401(k). That begins in 2024.

2. **RMD penalty relief**. Beginning this year, the penalty for missing an RMD is reduced to 25% from 50%. And 2.0 goes one step further. If the RMD that was

missed is taken in a timely manner and the IRA account holder files an updated tax return, the penalty is reduced to 10%.

But let's be clear, while the penalty has been reduced, you'll still pay a penalty for missing your RMD.

3. **A shot in the arm for employer-sponsored plans**. Too many Americans do not have access to employer plans or simply don't participate.

Starting in 2025, companies that set up new 401(k) or 403(b) plans will be required to automatically enroll employees at a rate between 3% and 10% of their salary.

The new legislation also allows for automatic portability, which will encourage folks in low-balance plans to transfer their retirement account to a new employer-sponsored account rather than cash out.

In order to encourage employees to sign up, employers may offer gift cards or small cash payments. Think of it as a signing bonus.

Employees may opt out of the employer-sponsored plan.

4. **Increased catchup provisions**. In 2025, 2.0 increases the catch-up provision for those between 60 and 63 from $6,500 in 2022 ($7,500 in 2023 if 50 or older) to $10,000, (the greater of $10,000 or 50% more than the regular catch-up amount). The amount is indexed to inflation.

Catch-up dollars are required to be made into a Roth IRA unless your wages are under $145,000.

5. **Charitable contributions**. Starting in 2023, 2.0 allows a one-time, $50,000 distribution to charities through charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts. One must be 70½ or older to take advantage of this provision.

The $50,000 limit counts toward the year's RMD.

It also indexes an annual IRA charitable distribution limit of $100,000, known as a qualified charitable distribution, or QCD, beginning in 2023.

6. **Back-door student loan relief**. Starting next year, employers are allowed to match student loan payments made by their employees. The employer's match must be directed into a retirement account, but it is an added incentive to sock away funds for retirement.

Additional provisions

7. **Disaster relief**. You may withdraw up to $22,000 penalty-free from an IRA or an employer-sponsored plan for federally declared disasters. Withdrawals can be repaid to the retirement account.

8. **Help for survivors**. Victims of abuse may need funds for various reasons, including cash to extricate themselves from a difficult situation. 2.0 allows a victim of domestic violence to withdraw the lesser of 50% of an account or $10,000 penalty-free.

9. **Rollover of 529 plans.** Starting in 2024 and subject to annual Roth contribution limits, assets in a 529 plan can be rolled into a Roth IRA, with a maximum lifetime limit of $35,000. The rollover must be in the name of the plan's beneficiary. The 529 plan must be at least 15 years old.

In the past, families may have hesitated in fully funding 529s amid fears the plan could wind up being overfunded and withdrawals would be subject to a penalty. Though there is a $35,000 cap, the provision helps alleviate some of these concerns.