Reliant Review

Vol. 7: January 2022

Beginning of Year Update

Summary

Welcome to our 7th Beginning-of-the-Year Reliant Review. For those of you who have been reading these for years, you will notice the articles are a bit longer than normal in this year's edition. We felt we should explain in some depth what we see as potential issues and opportunities coming in this year, trying to answer the questions we imagine many of you will have before you ask them. To help digest all that information in a light-hearted, bite-sized serving, we have added that cultural phenomena of modern communication, the meme! So, without further ado, let's dig in.

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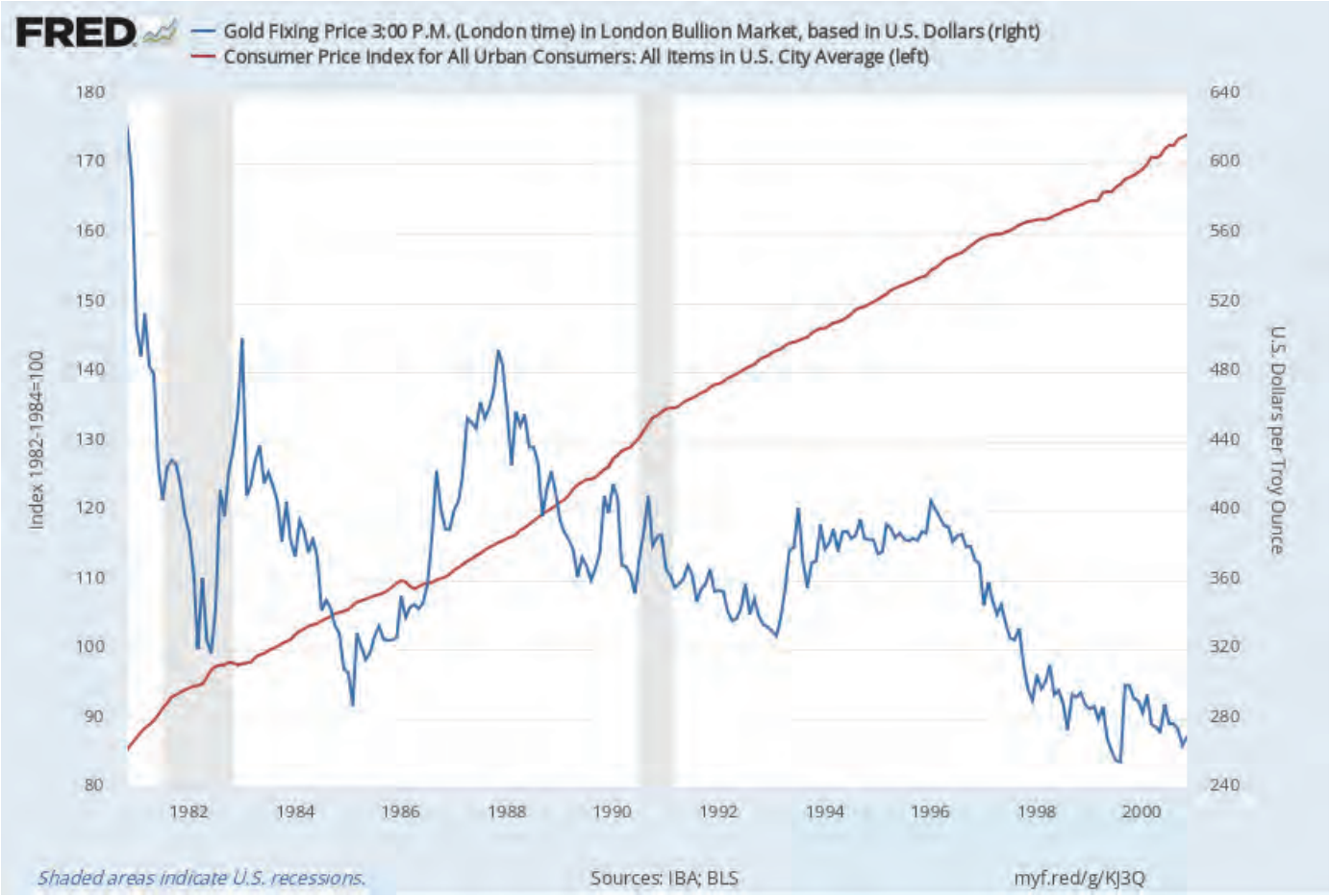
Build Back Better…Not Now, but Maybe Later

Everyone first got a look at the details of the bill named Build Back Better and dubbed "social infrastructure" in the spring of '21. As more details came out, it became obvious the bill would have large impacts across different areas of financial planning. It would have greatly lowered the amount that you could leave estate tax free after you pass. It would have effectively ended most step-up of cost basis at a person's passing (which would have impacted MANY more people than the estate tax changes). It would have raised taxes on many of you. It would have stopped Roth conversions of all kinds (including Backdoor Roths, see a separate article about this later). And the list goes on. When it was obvious that enough votes could not be found for the bill, it was stripped down and passed by the House of Representatives. It then stalled in the Senate, where even the stripped-down version could not get enough votes. The bill sponsors vow to vote on it in early 2022, perhaps passing multiple bills that deal with the issues individually, instead of all at once.

We generally don't offer personal opinions on whether such things should be passed. First, we have clients across the political spectrum. It wouldn't matter what we said, it would be hard to be in agreement with even a majority of you. Second, although we at Reliant get along wonderfully and respect one another, even we don't all share the same opinions on such things. Third, and most importantly, we don't think you work with and have trust in us to hear our opinions on what should happen. You would much prefer us to focus on advising you as to what you need to do no matter what happens. And that is exactly what we try to do- provide you with the best advice we can, given the laws and regulations at the time and in agreement with your personal situation, priorities, and beliefs.

Inflation has become a top-of-mind issue for many people, and rightly so. We have seen inflation rates the likes of which haven't been seen in the US for 40 years. That has led many of you to ask what can be done in portfolios to help counter persistent inflation. In our opinion, the bottom line is that equities and real estate (owned in either mutual funds or ETFs) are the best inflation fighters we can have in portfolios. You must grow your way out of inflation. The good news is that both of those components are already in the portfolios. To add MORE inflation protection means to add to equities and/or real estate, which will also increase the risk in a portfolio during a recession. For some of you, that might be a fair trade-off.

"But what about GOLD!?!?" I can hear many of you ask. To put it bluntly, we strongly believe that gold as an inflation hedge is a near-myth, often repeated, but a myth nonetheless. Why do we believe that? Look at the chart below that shows inflation versus the price of gold over a 20 year period:



ICE Benchmark Administration Limited (IBA), Gold Fixing Price 3:00 P.M. (London time) in London Bullion Market, based in U.S. Dollars [GOLDPMGBD228NLBM], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GOLDPMGBD228NLBM, January 10, 2022. U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items in U.S. City Average [CPIAUCSL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CPIAUCSL, January 10, 2022.

If gold is a dependable inflation hedge, how can there be steady inflation for 20 years while the price of gold plummets? How can inflation have its highest measure for 40 years in

2021, yet gold return -3.6%? The answer is that gold is better thought of as a fear hedge, rather than an inflation hedge. When fear runs strong, gold can do quite well. Once the fear subsides, gold can stagnate or lose value. So, where did this near-myth start? It's a tad complicated, but up until the 70's, the price of gold was held artificially low. When it was finally allowed to have a market-determined price, it began to rise, pushed by decades of demand that was not allowed to be realized. Coincidentally, in the late 70's and early 80's, inflation hit the world in a powerful way. Thus, gold prices were unleashed at almost the exact same time as we entered a huge inflationary period. The values rose together, and in the collective imagination the two were forever linked. Please note, the gold versus inflation chart above is from the 80's through the 90's. Thus, it didn't take long at all for gold to prove itself NOT to be a dependable inflation hedge, but sometimes we are slow to learn.

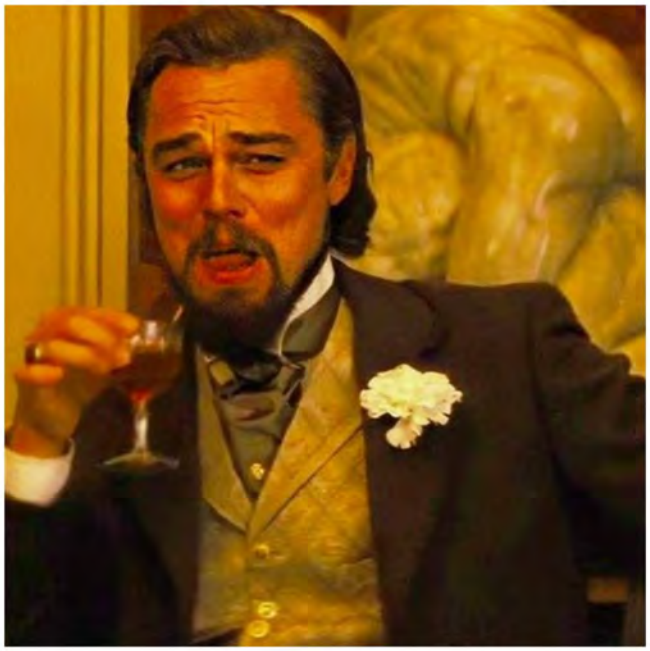
Lately, some have been calling for cryptocurrency (e.g., Bitcoin, Ethereum) to "take over" as the predominate inflation hedge asset. This would be humorous if some weren't so serious about it. We are not anti-cryptocurrency, but we also are not crypto fanatics. The true believers of crypto have gone through three major cycles of what they tout as the great benefit of the asset: 1st crypto was going to revolutionize the monetary system and replace state-sponsored fiat currencies (hasn't happened), 2nd then, it was going to be the great diversifier in the portfolio (for the last several years, the moves in crypto have been correlated to the stock market), and 3rd it is supposed to be THE inflation hedge of the future. This last one may prove to be true, but there is no evidence yet that it will be. It takes a few inflationary cycles to put the "inflation-beater" crown on the head of an asset class, and crypto has yet to make it through even one.

Making Sure the Defensive Side of the Portfolio Stays Defensive

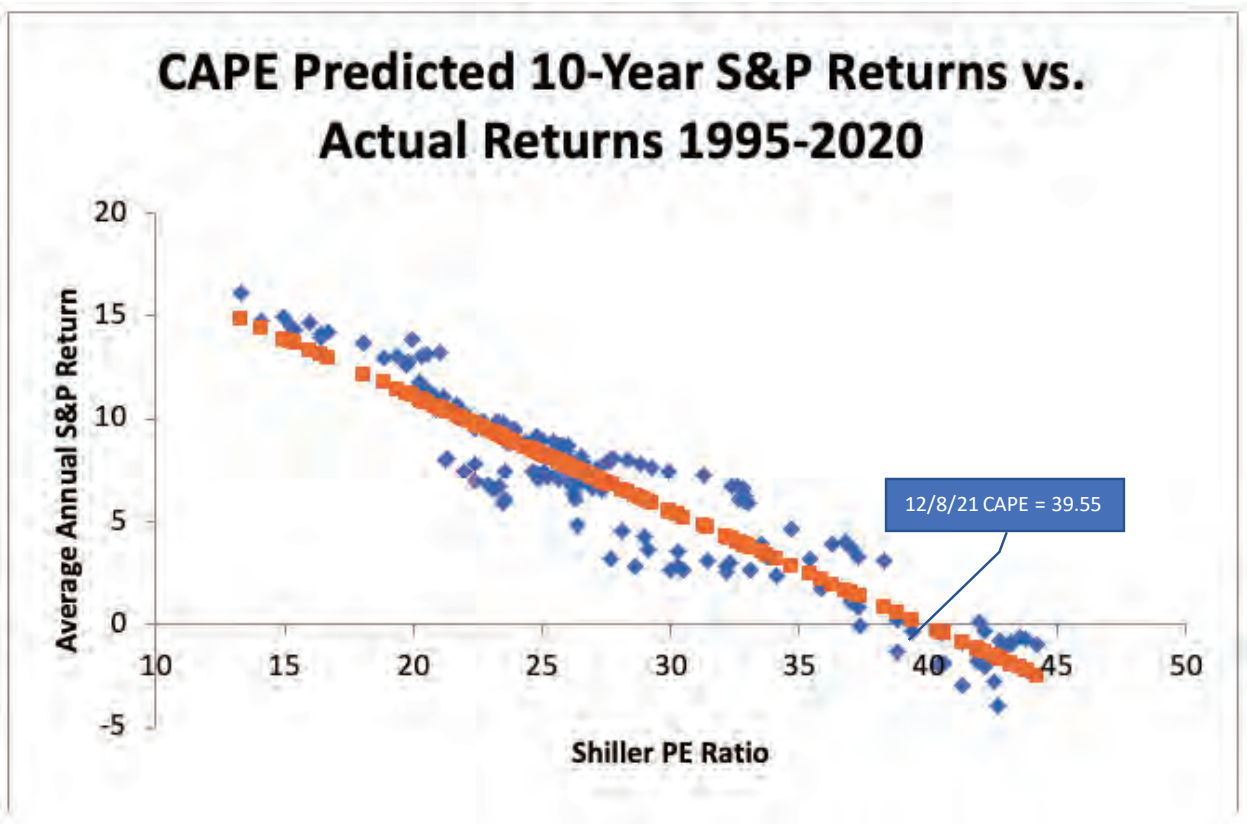
We have already mentioned inflation. One of the almost certain outcomes of inflation is rising interest rates. Rising interest rates can cause fixed income (such as bonds) returns to become muted. This is well-documented and is now an often-discussed issue among portfolio managers. The issue is that fixed income makes up the lion's share of the defensive side of investment portfolios, with the other side being growth. This leads to the question: if we are confident interest rates are going to rise, should any changes be made to the defensive side of the portfolio?

The most common answer we read about from other managers/advisors is to sell bonds and use the proceeds to buy dividend paying stocks. The assumption buried in this solution is that the bonds are there only to create cashflow in the form of interest payments. Thus, they want to find something to the replace the cashflow (dividend-paying stocks) that might not be as affected by rising interest rates. To us, this is an almost heretical solution. It totally confuses the purpose of the defensive holdings. The defensive side of the portfolio does NOT exist to create cashflow; rather it creates buoyancy (or protection) during a recession, when the growth side of the portfolio will go negative. To replace bonds with dividend-paying stocks is just moving assets from the defensive side of the portfolio to the growth side, because that is exactly what stocks (even ones that pay a dividend) are, growth assets. If you question this, pick out your favorite ten large cap dividend-paying stocks and look up their returns in the Great Recession of 2008. I feel confident they didn't provide much in the way of protection.

But that doesn't mean there is nothing that can be done. We have been focusing quite a bit of attention on the defensive side of the portfolio, looking for additions to add to the bonds that will both be less sensitive to rising rates while still retaining the defensive nature needed. Some of these additions we can add using our discretionary management of the portfolio, and others we may need to discuss with you first. Know we are doing our best to find a prudent balance between overall returns, defense in a recession, and ability to deal with rising rates.



Trying to determine what the market is going to do in the future is a tough game to win. One of the best phrases about this is, "In the short term, the market is unknowable. In the long term, it is inevitable" (spoiler alert: that means it goes up). Some measures, however, have been proven to be better than others forecasting the market's future. One of the most successful is the market's valuation. Valuation is a measure that takes into account not just how high the market is, but also how much in earnings the market is producing. Thus, valuation is answering the question, "How much do I have to pay for a dollar of earnings in the average stock?" A common way to measure earnings is the CAPE (Cyclically Adjusted Price/Earnings) ratio, developed by Nobel Prize-winning economist Robert Shiller. As of 12/23/2021, the CAPE was 39.65. Please take a look at the chart below, which measures over the last almost 30 years what the following ten years of US stock market returns were once the CAPE reached any particular level:



Finke, M. (2020, July 20). The remarkable accuracy of Cape as a predictor of returns … Advisor Perspectives. Retrieved December 8, 2021, from https://www.advisorperspectives.com/articles/2020/07/20/the-remarkable-accuracy-of-cape-as-a-predictor-of-returns-1. "Shiller PE Ratio by Month." Www.multpl.com, www.multpl.com/shiller-pe/table/by-month.

The orange line is the best fit line (think of it as the average). The first thing to notice is how consistent the actual individual data points are. History does repeat itself rather closely in this case. The orange line shows this. Notice in history what the market averaged over the following ten years when the CAPE reached the levels we are at now. It is a positive number (sometimes) but always well below long-term market averages. In contrast, international

markets (both European and Asian) appear to be much less “expensive” compared to their historical norms. It is in an US environment like we are in that just “buying the market and forgetting it” hasn’t paid off all that handsomely. What should we do?

The first thing to note is what we aren’t going to do. No, we are not going to sell the stocks in your account. Selling out of the market at the wrong time would have fared even WORSE during these periods than just staying in. But there are things we are going to do. It is important to understand that if the market averaged, say, 4% for ten years that does not mean it returned 4% each year for ten years straight. How this usually unfolds is there are 1 - 3 well-below average years, with the rest of the years being fine or well-above average. Thus, if we can mitigate those 1 to 3 bad years, the decade would begin to look much better. This is exactly what TAPA (Tactical Allocation of Passive Assets) is attempting to do: mute the worst of a large downside while capturing much of the up years. Many of you have this investment strategy already in your portfolios. Owning assets that are not at such high valuation rates, such as international stocks, should help as well. We can also try to ensure the amount of risk in the account makes sense, given your feelings about risk (risk appetite) and your situation (risk capacity).

Pushing Pause on the Backdoor Roth

We use a strategy called the Backdoor Roth for many of you who are still working which allows Roth contributions, even when your income would normally not allow it. A Backdoor Roth is not a special account, but rather a series of actions. As part of the proposed Build Back Better bill that was under consideration in Dec. '21, one of the actions necessary to complete a Backdoor Roth would have been disallowed, thus ending the entire strategy. Due to a lack of necessary votes, Build Back Better was not passed in 2021. However, it is wholly possible that a leaner version could be passed in 2022, with the same Backdoor Roth-ending provision. Thus, we will wait to execute any Backdoor Roths until it is clearer if they will still be allowed in 2022.

Federal Estate Law

As mentioned in the "Build Back Better…Not Now, but Maybe Later" article, this was shaping up to be a year where federal estate law was going to noticeably change. And as already mentioned, none of it passed, but that doesn't mean it won't. A huge point to remember as well is that even if Congress doesn't pass any additional laws pertaining to estates, the laws revert in 2026 to where they were in 2016, due to a ten-year sunset provision in the LAST estate law update.

In 2022, the amount excluded from federal estate taxes for those that pass during the year is $12,060,000. That is also the amount allowed for lifetime gifts over the annual gift tax exclusion.

IMPORTANT CHANGE: The annual gifting amount excluded from gift taxes has increased in 2022 to $16,000. Many of you actively gift to family, so this is good news.

Federal Tax Tidbits

(CHANGE) Standard Deduction:
Single $12,950
Filing Jointly $25,900

Personal Exemption:
Still eliminated

(CHANGE) Gift Tax Exclusion:
Each person may gift to as many people as they wish $16,000 annually.

SALT tax deduction cap:
Cap on claiming property taxes, state and local income taxes, and state/local sales tax as federal income tax deductions is $10,000 annually for both joint and single filers.

Additional Medicare Tax:
Some high-income taxpayers owe an additional 0.9% tax on earned and self-employed income over $200,000 for single filers and $250,000 for joint filers.

Medical Deductions:
Medical expenses that exceeded 7.5% of your Adjusted Gross Income (AGI) can be deducted from your taxable income.

2022 Tax Brackets

Tax Rate	Single	Married, Filing Jointly
10%	$0 to $10,275	$0 to $20,550
12%	$10,276 to $41,775	$20,551 to $83,550
22%	$41,776 to $89,075	$83,551 to $178,150
24%	$89,076 to $170,050	$178,151 to $340,100
32%	$170,051 to $215,950	$340,101 to $431,900
35%	$215,951 to $539,900	$431,901 to $647,850
37%	$539,901 and up	$647,851 and up

2022 Cap Gains Tax Rates

Tax Rate	Single	Married, Filing Jointly
0%	$0 to $41,674	$0 to $83,349
15%	$41,675 to $459,749	$83,350 to $517,199
20%	$459,750 and up	$517,200 and up
+3.8% Medicare Net Investment Income Tax (NIIT)	$200,000	$250,000

Social Security

SS tax paid on earned income up to $147,000	% withheld	Maximum tax payable
Employee Pays	6.2%	$9,114.00
Employer Pays	6.2%	$9,114.00
Self-employed pays	12.4%	$18,228.00
Earnings Allowed before Full Retirement Age (FRA)		
Retirement earnings exempt amounts	$19,560 if age under FRA $51,960 during year will reach FRA No Limit after reaching FRA	

Medicare

Medicare Part B monthly premium for new beneficiary in 2022 = $170.10 (a 15% increase from the year prior, one of the largest in history).
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 2020 MAGI	Joint 2020 MAGI	2022 Part B Premium + IRMAA	2022 Part D adjustment
$0-$91,000	$0-$182,000	$170.10	$0.00
$91,001-$114,000	$182,001-$228,000	$238.10	$12.40
$114,001-$142,000	$228,001-$284,000	$340.20	$32.10
$142,001-$170,000	$284,001-$340,000	$442.30	$51.70
$170,001-$499,999	$340,001-$749,999	$544.30	$71.30
$500,000 or above	$750,000 or above	$578.30	$77.90

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 2022, Social Security benefits will receive a whopping 5.9% COLA, the largest raise in 40 years (can you say "inflation?").

2022 Retirement Plan Contribution Limits

Annual compensation used to determine contribution for most plans	$305,000
Defined-contribution plans, basic limit	$61,000
401(k), 403(b), 457 plans elective deferral limit	$20,500
Catch-up for age 50 and over, 401(k), 403(b), 457	$6,500
SIMPLE plans, elective deferral limit	$14,000
SIMPLE Plans, catch-up for age 50 and older	$3,000

2022 Retirement Accounts

IRA Type	Contribution Limit	Catch-Up at 50+	Income Limit / Notes
Traditional nondeductible	$6,000	$1,000	None
Traditional deductible	$6,000	$1,000	If covered by employer plan: $109K - $129K Joint $68K - $78K Single, HOH If spouse is covered by plan: $204K - $214K
Roth	$6,000	$1,000	$204K - $214K Joint $129K - $144K 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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