METIS WEALTH
MANAGEMENT & PLANNING

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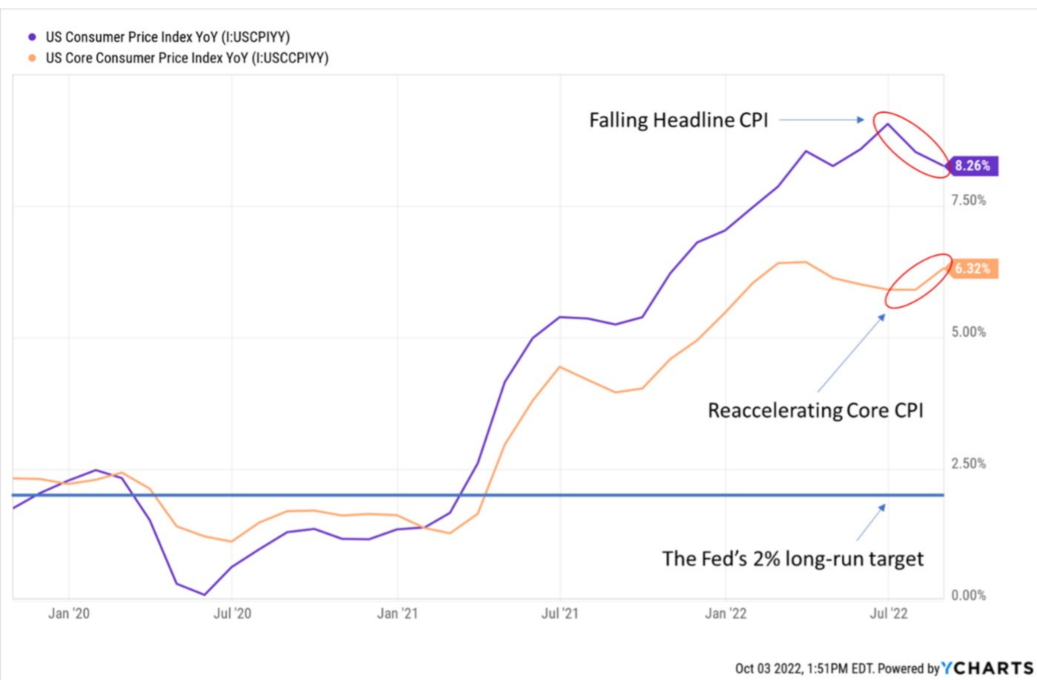
Playing Defense

by Robert Sokolowski

The third quarter was a textbook "tale of two halves." The first half saw optimism that inflation had started to roll over, flat (though volatile) interest rates, and a rising stock market. The S&P 500 returned nearly 13% from July 1st to its peak for the quarter on August 16th. The second half of the quarter saw rising fears that inflation was reaccelerating (or at least failing to roll over), rapidly rising interest rates, and falling stocks. The S&P 500 lost over 16% during the final six weeks of the quarter to end down 5.9%.

The bulk of the focus, justifiably so, remained on inflation and interest rates. The Federal Reserve raised the Fed funds rate twice during the quarter by 0.75% each time. The pace at which rates are rising is extremely fast by historical standards. But looking at the most recent inflation data, it is easy to see the Fed's rationale. Inflation is at a 40-year high and while we have observed a falling (though still very elevated) headline Consumer Price Index (CPI) number, it appears that Core CPI may be reaccelerating. Core CPI excludes the volatile food and energy categories. Fed officials are worried reaccelerating Core CPI may point to a reacceleration in overall prices down the road.



What's going on with labor?

At a very high level, inflation occurs when the demand for goods and services outpaces an economy's capacity to supply those goods and services. One of the largest inputs for supply is labor. Coming out of the pandemic, businesses have been unable to find enough workers. The unemployment rate fell to 3.5% in July, equaling the pre-pandemic low. There are currently openings for over 11 million jobs with only 6 million people unemployed. This equates to 1.9 open jobs for every unemployed person. Initial unemployment claims (the number of people who have opened new claims in the past week) have trended down since June.

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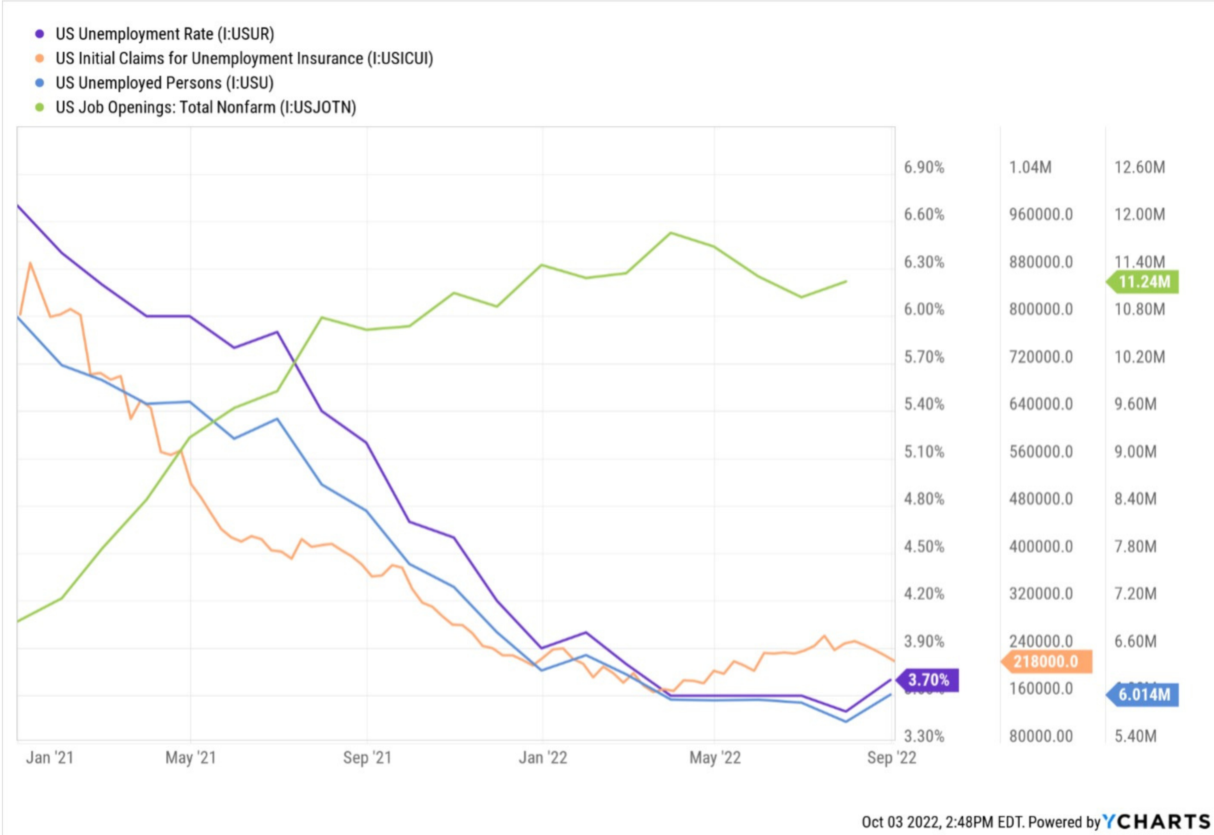
SPECIAL POINTS OF INTEREST

- **Our new office in Bluffton is still not complete. We do not have a move in date yet, but we are hoping by the end of the month. We will keep you updated.**
- We will be on vacation from 10/19-10/21 - we will be checking e-mails and messages while we are away!
- The RMD deadline is approaching. We will contact you in November if you have not already taken your 2022 RMD.



The total number of employed people in the U.S. has already returned to pre-COVID levels, yet the total number of job openings posted by businesses are over 40% higher than January 2020 indicating we are still far short of the number of workers we need. What accounts for this shortfall? There are several factors at play here:

- Legal immigration into the U.S. began to fall sharply starting in 2017. COVID exacerbated the decline due to closed borders and closed consulates abroad. Barron's reported this had caused a shortfall of roughly 2 million working age immigrants up to the start of 2022. A separate more up to date report from economists at JP Morgan estimates this number to be even higher at 3.2 million potential workers.

- Some 260,000 working age Americans died from COVID.

- The Brookings Institute estimates about 1.6 million people are out of the workforce due to long COVID.

- The 7 Day average for positive COVID tests is about 47,000 cases per day. Former FDA commissioner Scott Gottlieb has estimated that we are counting as few as 1 in 10 positive tests due to the rise in at-home testing. This potentially means 3.3 million new COVID cases a week- putting a drag on the availability of workers.

- The Kansas City Fed estimates there were 2.1 million "extra" retirements (above the pre-COVID trend) in the past two years.

- Finally, the labor force participation rate (which has fallen steadily since 2000) is running about 1 percentage point below early 2020 levels.

It is not a stretch to say that if the supply of labor had been greater coming out COVID, the outcomes- particularly on inflation- could have been markedly different. We feel that labor supply will be a major issue for the US economy for years to come and we will be monitoring this closely going forward.

Regardless of the causes, the continued tightness we're observing in the labor market is having two effects on Fed psychology: 1) It is causing more <u>concern</u> at the Fed that inflation will be difficult to control and 2) It is <u>emboldening</u> the Fed to act aggressively with interest rate hikes. After all, if they are fulfilling the maximum employment part of their dual mandate, why would they focus on anything but inflation?

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Where do we go from here?

It's fair to say we have become more bearish over the past two months. There are several factors behind this. Though there are many indications of improvements in supply chains, we are still seeing issues. Ford recently reported they can't ship vehicles because they aren't receiving Ford emblems from their suppliers, for example. China continues to enforce draconian COVID lockdowns of entire cities which is crimping supply. Furthermore, the market's interpretation of the September data releases on inflation and employment was very negative, indicating fears of persistent inflation and higher interest rates to come.

We continue to be concerned about potential geopolitical risks. Ukraine has made significant progress pushing back the Russians and retaking Russian occupied areas. While on its face this is good news for Ukraine, it has created a situation where Putin feels backed into a corner and it potentially raises the odds for escalation. Likewise, China's posture toward Taiwan has not changed and there is still a chance for conflict there.

The dollar index, which measures the dollar against six developed market currencies, has risen over 17% year-to-date- a huge move. This is a boon to American consumers because the strong dollar allows us to buy imported goods at more favorable rates. It is therefore applying downward pressure to inflation in the US. However, a dollar this strong can cause issues abroad. For starters, about 40% of international trade is transacted in dollars, whether an American company is involved or not. This can make imports more expensive for foreign countries when the dollar gains strength which can be very painful. Furthermore, a lot of emerging markets debt is priced in dollars. When the dollar rises relative to local currency, it becomes more expensive to repay that debt. This has the potential to cause debt crises. For this reason and others, we sold the small emerging markets debt position we had in July.

In light of the risks we see, we are maintaining a defensive posture. We raised cash levels at the beginning of the year, which reduces portfolio volatility. We also entered the year with the assumption that interest rates would likely rise and therefore held bonds of significantly shorter duration than the market average. Again, this reduces volatility. Our custom portfolios have been overweight on the healthcare and utilities sectors, both of which have outperformed this year. As importantly, we spent most of 2021 and January 2022 taking gains in stocks that had done very well. This allowed us to avoid some losses as many of these stocks have fared poorly in 2022.

Recently, as interest rates have become more attractive, we have moved to an overweight position in bonds as appropriate. For example, many of our clients with a 60/40 asset allocation will see 41 – 44% of their portfolio in bonds now. The vast majority of the bonds we purchased recently had yields to maturity of 4.3% - 5.1% and were high quality and fairly short duration. This has allowed us to: earn a much higher yield than the yield on cash, "lock-in" those yields to maturity, and it gives us the option to use the proceeds from maturing bonds to buy stocks if and when the market conditions improve.

We take no joy in sending clients reports showing that portfolio values declined. However, in most cases, we have been able to significantly limit downside volatility in the face of a very tough market. It's important to remember that we have been through periods of high inflation and interest rate hikes before and while it isn't much fun to experience, we have always gotten through it. We remain optimistic that we have better days ahead.

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Updates for Retirees

By Jenn Sokolowski

Reduced Required Minimum Distributions

Required Minimum Distributions (RMDs) are the amount that must be withdrawn from an IRA (or other tax deferred retirement account) each year beginning at age 72. The amount that you are required to withdraw from tax deferred retirement accounts is going down in 2022. The IRS, for the first time in two decades, has updated the actuarial tables used to determine RMD amounts. The new tables project longer life spans which reduces the amount of each RMD because retirement accounts would need to last for more years based on these new longer life spans.

For example, if you had an IRA valued at $1,000,000 at the end of the year and you are currently 74, under the old life expectancy tables your RMD would have been $42,016. With the updated table, your RMD would now be $39,215.

This is good news for retirees because they can keep more of their tax deferred money in their IRA (or other retirement accounts) growing without the impact of taxes for longer. The new tables have been used to calculate your RMDs for 2022.

2022 RMDs must be taken by 12/31/22. If you haven't already taken yours, we will contact you in November to make sure the distribution is made before the end of the year. If you have any questions about your RMD or if you would like to take it now, let us know.

2023 Medicare Premiums

Medicare part B premiums will be going down in 2023. It feels like we haven't heard about the price of anything going down in the last two years, so this is a welcome surprise for Medicare recipients. The standard premium for Part B in 2022 is $170.10 and will be reduced to $164.90 in 2023. Keep in mind the price you pay for Medicare Part B premiums is tied to your income, so you may pay more. Part B deductibles are also going down in 2023 to $226 from $233 in 2022.

Market Index	Q3 Total Return	YTD Total Return	1 Year Total Return
S&P 500	-5.9%	-23.9%	-16.4%
DJIA	-7.1%	-19.7%	-14.6%
Nasdaq Comp	-4.8%	-32%	-26.9%
MSCI EAFE	-8.6%	-26.8%	-24.2%
Russell 2000	-3.3%	-25.1%	-24.8%
US Aggregate Bond	-5.3%	-14.6%	-14.8%