thoughts

FROM HANSON+DOREMUS

HANSON+DOREMUS
INVESTMENTS AND PLANNING

JANUARY 2023

A new year, a new face...

It's not too often we get to introduce a new team member, but this is one of those rare times, and we're excited. H+D is delighted to welcome Mark Andrews, who joins us as an Associate Portfolio Manager. Mark will be working closely with clients on investments and planning as well as helping with research and investment decision-making.

Mark comes to us from the Federal Reserve Bank of New York, where he worked on the open market desk and was responsible for the analysis and purchase of mortgage-backed securities. His strong macro background and Fed knowledge will be enormously valuable to us. Mark also covered ESG (Environmental, Social, and Governance) issues and sustainable finance for the Federal Reserve system, and he will be helping us in this area as well.

Mark is originally from Portland, Maine, but he's lived around the world – in Ukraine, Bolivia, Italy, Argentina, and for three years in Equatorial Guinea. His undergraduate degree is from Bates College in Spanish literature and Russian. He also has an MBA from the Tuck School of Business at Dartmouth and a Master's in international economics and finance from the Johns Hopkins School of Advanced International Studies (SAIS).

One of Mark's long-time ambitions has been to settle in Vermont, where his wife grew up, and we're glad he's finally here. He now lives in Randolph with his wife and two daughters, and you'll all have the chance to see him in the office.

We welcome Mark Andrews

And the rest of us?

We're still all here and proud of our continuity. Here's a quick overview on the rest of us:

The first stop for questions or requests still is **Jordan Lafayette**, **Alma Pilausic**, or **Sarah Cocina.** Jordan has taken a big step up to become Head of Operations, a job that oversees everything from portfolio administration to trading and reporting. Meanwhile, Sarah and Alma remain our experts not only in client service, but also in several other areas. Alma has long been our equity trader and now is moving into bond trading as well. Sarah has been stepping up her interactions with clients seeking advice and planning.

Kristen Rich, who has been with the firm for 26 years, continues to keep things running as HR and Office Manager – and she remains our repository of knowledge on firm history. **Henry Preston** still is helping us with financial plans and back office functions while energetically pursuing his MBA at the University of Michigan's Ross School of Business.

On the investment side, in addition to Mark, the firm has five portfolio managers who work closely with clients: **Alex Watson**, **Art Wright**, **Liz Ford**, **Sven Eklof**, and **Julie Won**. All five work together to share best practices and deliver consistent recommendations. Many of us wear other hats as well. For example, Alex manages the firm's technology resources and sits on our Investment Committee. Liz, who earned the CFA charter last year, oversees bond trading and compliance.

Finally, **Eric Hanson** and **Anne Doremus** still are very much with the firm, with Eric doing more writing, and Anne diving deep into individual stock research. Both are focused on thinking and idea generation, and you'll continue to see their thoughts in these pages.

- Julie Won

Hanson+Doremus Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients.
The firm also consults with individuals on financial planning, and works with self-directed retirement plans on investment options.

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THE YEAR AHEAD

By Eric Hanson

People don't forecast because they know, they forecast because they are asked...

No one has actually asked us for our 2023 forecast, but it is customary this time of year to say something about the upcoming twelve months, so into the abyss we go. The problem is, as Hugh Hendry a British hedge fund manager has said, none of us have been to the future so we really have no idea of what we are talking about. We agree, so we won't be making a forecast here. Instead, we will write about what we think the consensus of Wall Street forecasters is today, both for the economy and the market.

First, with regards the economy, roughly 90% of investors expect global inflation to be lower within the next 12 months, according to a *Wall Street Journal* story at the end of last year. The thinking is, as the global economy cools, and this includes the U.S., wage inflation will also cool (*see chart to the right*), which means inflation will peak and start to come down. The Fed can then stop pushing up short term rates and overall interest rates will decline.

But a cooling economy often means recession. *The Economist* notes that over the last half century whenever the inflation rate in the U.S. has reached an annual rate of 5% (spoiler alert, we are there now,) a recession has occurred. Are we in for a recession this time and if so, how severe? Howard Marks at Oaktree Capital, who does not believe in forecasters or forecasts, likes to say that "whenever we are not in recession, we are headed towards one."

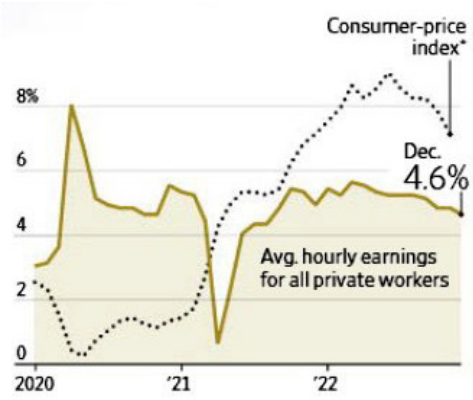
So, let's say we get a recession in 2023 in the U.S. Severe or not so severe? According to *The Economist* again, a recession in the U.S. will not be severe. Why? First, there are still a lot of jobs available in the economy and not so many workers. Companies are going to be hesitant about laying off too many employees today, for fear of not getting them back on the other side. Second, the federal stimulus payments since March 2020 have been enormous. State governments are still sitting on $250 billion of stimulus cash they can use to paper over tax shortfalls and individuals are estimated to have $1.5 trillion in excess savings they can use in the event of layoffs.

On the stock market front, an amazing forecast is out there if you believe Bloomberg (*see chart in lower left*). As we all know stocks go up and they also go down, but that message hasn't always gotten through to Wall Street forecasters. Not once over the past 24 years have forecasters in January said that the overall market would go down the next 12 months. Not after the tech crash in 2000, not after the housing debacle in 2008. Not once. And yet the market actually went down one third of those years. So now, the prediction is a decline in 2023. Is this overreaction or a sign of the apocalypse?

Where do we stand on all this? Lower interest rates and stock prices, or higher? We go back to Howard Marks, the forecast non-believer who notes that since 1920, we have had 17 recessions, a Great Depression, two World Wars, a pandemic, and a zillion other crises. And yet stocks have still returned more than 10% per year over 10 decades. Our recommendation is, block out the forecasts and stay focused on the long term.

WAGES VS. CPI

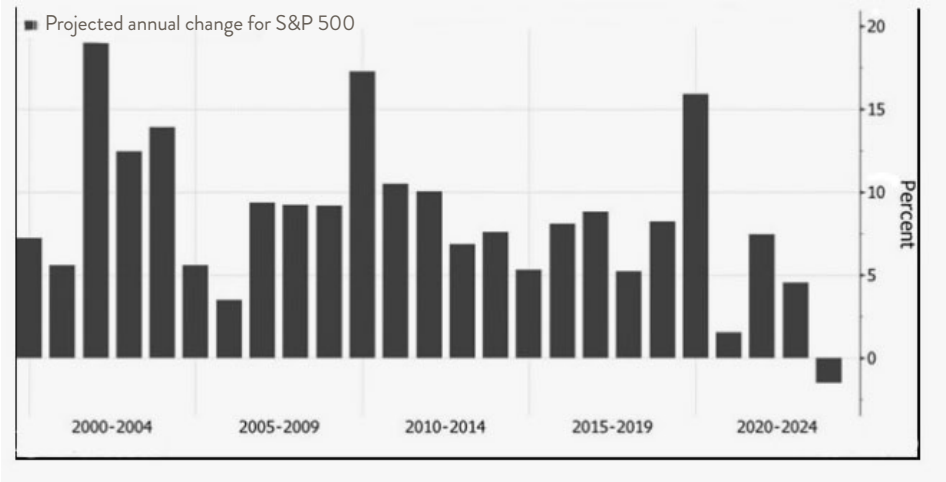
Changes from a year earlier



Source: *The Wall Street Journal*

BUCKING THE TREND

For the first time in decades, Wall Street strategists see down year for stocks



Source: *Bloomberg*

FUN AND GAMES

By Julie Won

What we learned from our World Cup office pool...

Like the rest of the world, we at H+D were glued to the 2022 FIFA World Cup, which began November 20 and concluded December 18 with Argentina winning over France in an absolute nailbiter. Like any good organization, we also held an office pool where we vied to predict the outcomes of each World Cup match correctly. Though the stakes in our betting pool were laughably low, the competition was fierce – dare I say almost as fierce as the Cup itself?

Well, perhaps that is an exaggeration. But what I can say is that our office pool gave us all a chance to eat humble pie – something all investors grow accustomed to, along with reflecting on bruising lessons and misjudgments.

The lessons for us were simple: First, we are pretty bad at predicting soccer match outcomes – sometimes terribly so. Second, very often, things do not turn out the way you think they should. Third, it can be very costly to think you know more than you do. Case in point: our office pool winners were all people who said they knew nothing about soccer. They absolutely wiped the floor with those of us who had been watching the international games leading up to the Cup and thought we had a handle on it all.

But let us be kind and cut ourselves some slack by saying that low scores and frequent ties make soccer games notoriously difficult to predict. *The New York Times* wrote in 2014 that it's easier for underdogs to triumph in soccer than in other sports because of a higher element of chance. There are "hundreds of skillful moves and stratagems, yet each team averages only a dozen shots, and the outcome is decided by several quick and often random events. In most games, no more than three goals are scored, and the typical margin of victory is a single goal."

A book called *The Numbers Game* by Chris Anderson and David Sally (professors at Cornell and Dartmouth) found that favored teams beat underdogs in soccer just half the time – far less than in baseball, football, or basketball. And in December, *The Economist* wrote that soccer "is one of the few sports where dominance need not translate to victory." In other words, winning soccer matches requires not just great skill, but also great luck.

Whenever skill and luck get intertwined, predicting outcomes gets very difficult. The classic book on this is Michael Mauboussin's *The Success Equation: Untangling Skill and Luck in Business, Sports, and Investing.* In it, we learn that some activities, like chess, are mostly determined by skill, while others, like playing slot machines, are determined completely by chance. But many activities, including sports and investing, lie in between, and the more luck that's involved, the less significance we should assign to single or short-term outcomes. The paradox is that the more skillful the participants and the stiffer the competition, the greater a role luck plays.

The Economist claimed there were more upsets in 2022 than any World Cup since 2002, which suggests that a successful entrant into our office pool needed to include a decent number of upsets. The problem is that correctly predicting which games end in upset is ridiculously hard. Many of us fell to the bottom of the pack trying. We would have been better off picking the favored team across the board – a simple strategy that would have put us in the top quartile of entrants, but not in first place.

Alas, not everyone can win a World Cup or an office pool -- and thankfully, none of us took our pool very seriously. No one tried applying data science while completing his or her entry, and it likely would not have helped anyway.

Top soccer players too often ignore the data while on the pitch. Why are most corner kicks served long into the box when the stats say that playing short is more likely to end in a goal? And why, as Eric Hanson wrote in his classic 2008 and 2017 articles, do goalies facing a penalty kicker irrationally dive to the right or left 90% of the time when the stats say they'd do better if they stood in the center and did nothing? That is soccer. Delightfully unscientific and often, beautiful to watch.

FRENCH GOALKEEPER HUGO LLORIS DIVES

France's goalkeeper Hugo Lloris dives while Argentina's Paulo Dybala hits the center of the net during the penalty shootout of the 2022 World Cup Final. (Photo by FRANCK FIFE/AFP)

Source: *Qatar Tribune*

RETIREMENT SAVINGS

By Anne Doremus

Will the recently signed Secure Act 2.0 make us more secure?...

Americans have long struggled to save enough for retirement, and unfortunately, the recent bout of inflation has not made that job any easier. In a recent survey, online financial publication *Bankrate* found that 55% of respondents reported feeling behind in their retirement savings, up from 52% last year (*see chart below*). To help bolster Americans' retirement security, Congress passed the Secure Act back in 2019. While this was a good first step, the House and Senate have been working since then on further enhancements. The culmination of these efforts, the SECURE Act 2.0 (SA2), was passed as part of the Omnibus Budget Act in the waning hours of 2022. Like a lot of legislation, there is a little bit of something for everyone in this bill. Here is a summary of how some groups benefit from this recent effort.

Part Timers: Temporary workers are often excluded from participating in company sponsored retirement plans. SA2 helps correct this by reducing the number of work hours required for employees to join a plan.

Lower Income Earners: SA2 changes the current, federal "Saver's Tax Credit" (available to lower income filers) from a cash tax refund to a matching contribution that is deposited directly into a taxpayer's retirement account.

Job Switchers: The average U.S. worker will have twelve jobs in their lifetime. Keeping track of the accounts resulting from multiple jobs can be challenging. To ease this burden, SA2 allows employees to transfer "default" IRAs into a new employer's plan and further encourages rollovers. The Act also calls for the creation of a national database for "lost and found" 401(k) accounts.

Student Debt Holders: Beginning in 2024, employers will be able to make retirement contributions equal to the amount of an employee's student loan payment regardless of whether the employee elects a deferral or not.

College Savers: Individuals with unused funds in an old (15 years at least) 529 plan will be able to roll-over up to $35,000 into a Roth IRA.

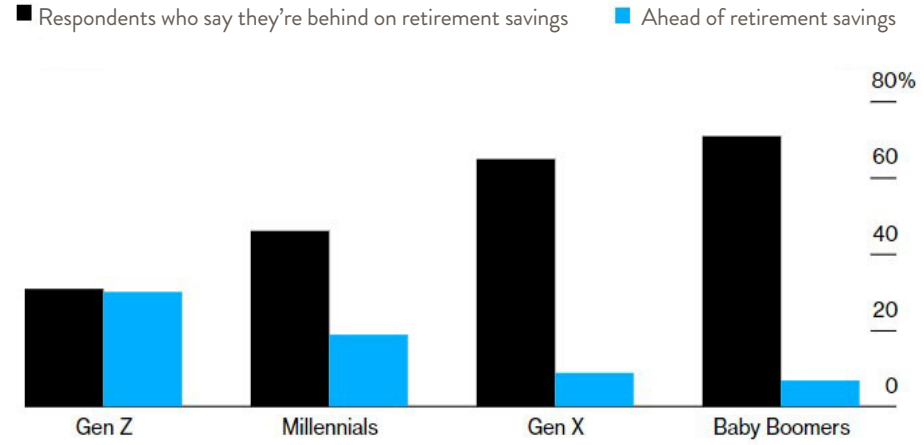
Older Workers: SA2 expands the "catch-up" contribution limits for older workers. Beginning in 2023, workers who are over 50 can add an additional $7,500 to their plan and beginning in 2025, 60-63 year-olds can expand their contributions by the greater amount of $10,000 or 50% more than the regular allowed 2024 amount. For higher earners, these "catch-ups," will be treated as after-tax additions.

Retirees: SA2 extends the age at which you must take distributions (RMDs.) Beginning in 2023, the RMD age shifts from 72 to 73 and then in 2033, it shifts to 75. For those who miss these RMD deadlines, the good news is that the previously onerous penalties (50% of undistributed amounts) are reduced.

Employers: Today, approximately 40% of workers do not have access to a company sponsored defined contribution plan. To address this, SA2 expands the tax credits available to smaller firms setting up new plans. To get more employees to sign up, the Act will require, beginning in 2025, most companies to automatically enroll workers. Importantly, employers will also be able to offer emergency savings accounts to participating employees. Employees can contribute up to $2,500 to these accounts and the funds can be withdrawn penalty-free. SA2 also allows employees to withdraw another $1,000 per year from their retirement plan to cover emergency expenses. While these distributions may be taxable, they can be repaid and will not be subject to the typical 10% early withdrawal penalty tax.

Provisions of the Act are complicated so employees and plan sponsors alike should be sure to review them with their accountants and financial advisors to assess potential benefits. But make no mistake, despite all its complexities SA2 is an important step in the right direction and should, over time, improve Americans' retirement security.

FALLING BEHIND



Source: *Bankrate.com; Bloomberg*