FINANCIAL DESIGN STUDIO
DESIGNED FOR LIFE
QUARTER THREE 2022

THE QUARTERLY ADVISOR

CONTENTS

QUARTERLY PERSPECTIVE

If I were to choose one word to summarize the third quarter of 2022 it would be GROWTH! Of course, this doesn't match how the market has been performing, but growth happens even in the toughest of times.

Also, growth isn't just financial. Yes, we are financial advisors who work to grow your investments. But as your financial advisor we hope to help you grow in confidence and knowledge too!

You'll notice in this issue that our team is growing in number, now seven total! It's especially exciting as we head into our seventh year as a business. We are nothing short of grateful, to you, our clients.

We hope to continually serve you better, and with a larger team we can do just that.

In this issue, we want to introduce you to the growth happening on our team!

- Michelle Smalenberger, CFP®, CEO

MEET OUR TEAM

There are some new faces around FDS! We – Michelle, Steve, Rob, and Trevore – realize that as our firm grows, our team will too. We've always shared with you that we want our firm to exist for your lifetimes. To make sure that happens we need a great team.

We have a couple of team members, Lisa and Anna, who have been around for one to two years helping behind the scenes. So they may be new to you! And we're excited to welcome Jake as our most recent addition, who just started in early September. Our newest employees are as excited to work with you as we are. So without further ado! Would you please join us in welcoming our three new team members?

JAKE TURNER

Jake is our Financial Planning Associate. Jake is a career changer coming to financial planning from a 15-year career with AbbVie where he worked in various roles. Jake's excitement for financial planning came from learning to manage his own familys' finances. Throughout the process of looking for his own financial advisor and learning his own employer benefits he developed an interest for financial planning. Jake will complete his CFP® coursework by the end of 2022 from Northwestern, he will then be eligible to sit for the CFP® exam in early 2023. When Jake isn't learning about financial planning, you can find him training for a long run, playing golf, or spending time with his wife traveling.

LISA GOTTSCHALK

Lisa is our Support Director. She mainly works behind the scenes so you may not notice all she does. She helps manage our systems so data is updated correctly and files get organized properly. She prefers to handle these tasks that people may not notice but we'll give her all the credit anyway. Lisa graduated with a degree in Social Work from Kansas State University in 2007. Lisa lives in Houston, Texas, is married and has three children. When she's not working she enjoys all things outdoors, traveling, crafting, and supporting her kids in their passions.

ANNA LEWIS

Anna is our Creative Director. She handles our marketing. When you see new designs or discover new content, she's behind that! Right now, Anna is also studying for a bachelor's degree in Organizational Leadership through Southeastern University. She hopes to lead creative teams on projects that shape the world. In any free moment, you can always find her with a book, whether it's a novel, sketchbook, or journal.

TO LEARN EVEN MORE ABOUT THESE TEAM MEMBERS AND US, CHECK OUT OUR ABOUT US PAGE ON OUR UPDATED WEBSITE AT FINANCIALDESIGNSTUDIO.COM

IS THE BEAR MARKET OVER?

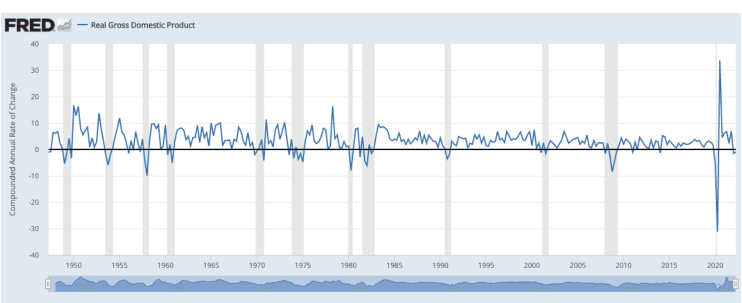
BY: ROBERT STOLL, CFP® CFA

2022 has been a challenging year for investors and economists alike. As inflation emerged from its 40 year hibernation, stocks dropped into bear market territory in the first half of the year. Fears of a recession arose. However, in the last few weeks, recession fears have eased and stocks have rebounded. Are investors out of the woods now? In this quarter's article we examine where the economy and stock markets are and how bear markets play out. Is the bear market over?

ARE WE REALLY IN A RECESSION?

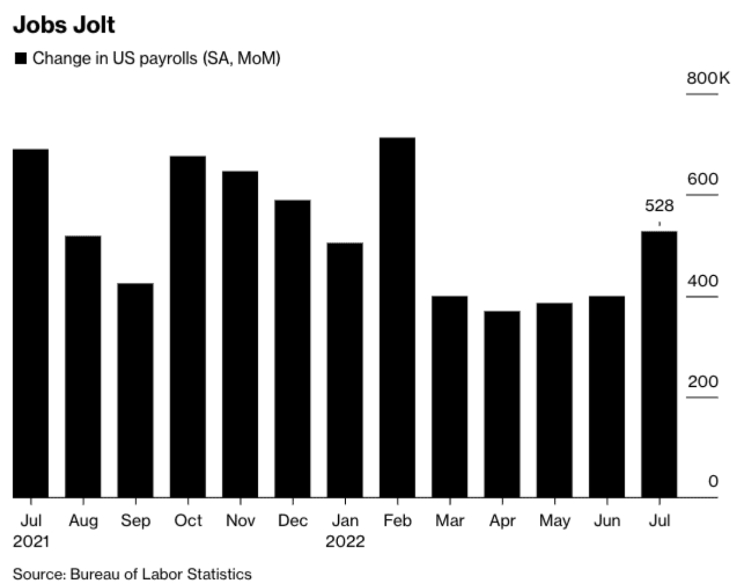
There's been a lot of debate about whether the U.S. is in a recession or not. As with most dialogue these days, they split the debate around political tribes. One side insists we're in a recession while the other side says we're not.

Here's what we know. The economy has contracted for two consecutive quarters. In the first quarter, economic output fell -1.6%. And last week, the Bureau of Economic Analysis released their early estimate of the second quarter's economic growth and estimates that it fell -0.9%.



The shaded areas in the graph above are economic recessions. Any time the line has dropped below zero and stayed there for at least two quarters, we've been in recession. But you can see the scale of the current "recession" is quite modest compared to past downturns.

Making the recession argument more difficult is the jobs report we got last week. Jobs growth came in much stronger than expected during the month of July. And if we look at jobs growth over the last 12 months it's hard to argue we're in recession. The economy doesn't GAIN jobs in a recession!



So are we in recession right now? I don't think so. Two quarters of slightly negative growth aren't positive, but people still have jobs and are spending. Let's call it a slowdown.

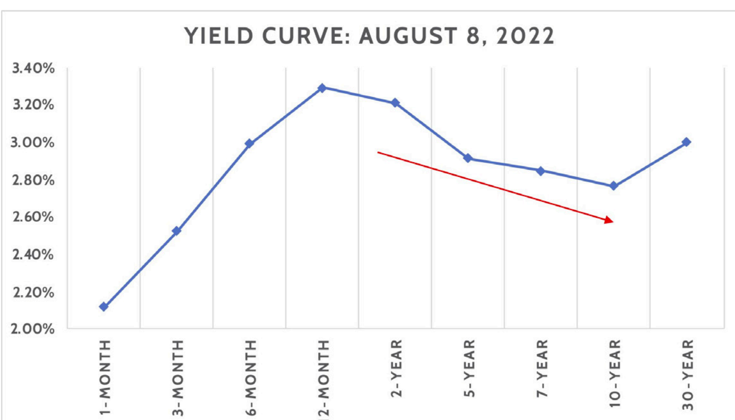
WHAT DOES THE YIELD CURVE SAY ABOUT A RECESSION?

For investors, the argument about whether we're in a recession today is irrelevant. We're more interested in what's going to happen versus what's currently happening. Almost exactly 3 years ago I wrote a blog post about how the yield curve had inverted that month. The question that was posed was, "Is a Recession Coming?"

First, what is the "yield curve" and why does it matter? The yield curve plots current U.S. government bond yields across different maturities. To fund day-to-day operations, the government is constantly issuing new debt. Sometimes they're issuing short-term debt which matures in as little as 3 months. Other times they issue debt that doesn't mature until 30 years from now. Below, you'll see the yield on government bonds ranging from 3 months to 30 years.

Gov't Bond Yields		
US3M	United States 3M Bond Yield	2.545%
US6M	United States 6M Bond Yield	3.072%
US1Y	United States 1Y Bond Yield	3.277%
US2Y	United States 2Y Bond Yield	3.224%
US5Y	United States 5Y Bond Yield	2.928%
US10Y	United States Government Bond 10Y	2.777%
US30Y	United States 30Y Bond Yield	2.996%

When we plot these yields on a graph, we get what's called a "yield curve.



I highlight two key U.S. government bond yields: those with maturity of 2-years and the other with maturity of 10-years. These are two of the most important yields to focus on and understand. Why?

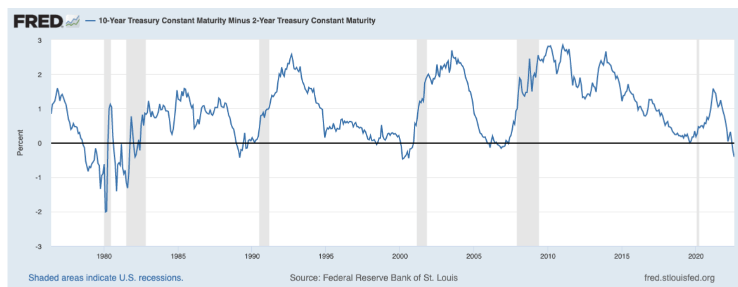
2-year yields are the best indicator of what bond investors expect the Federal Reserve to do with their interest rate policy. Two years is close enough in time to put some confidence in, but long enough to allow the Fed to change its policy. We can see that investors expect the Fed to continue hiking interest rates well into the 3% range from 2.50% today.

The 10-year yield is important because it's an indicator of what bond investors believe "normal" interest rates should be. Meaning, it's less concerned with what's happening today, but what the market expects the world to look like after the current economic cycle runs its course.

WHAT YIELD CURVE INVERSIONS SIGNAL

When we compare these two yields, we call this the "10/2 Year Yield Curve." In normal times (i.e. 99% of the time) 10-year yields are higher than 2-year yields. The reason for this is simple: there's more uncertainty about what's going to happen 10 years from now versus what will happen 2 years from now. Investors demand extra yield for that uncertainty.

Rarely, the yield curve will "invert" where 2-year yields will be higher than 10-year yields. This normally only happens at important turning points in the economy.



Over the last 40+ years, any time the yield curve inverted, a recession was around the corner. Notably, each yield curve inversion happened at the tail-end of a cycle where the Federal Reserve was increasing interest rates.

The logic for yield curve inversions is this:

- Market sees the Fed is serious about hiking rates and slowing the economy down…
- So the market builds in higher interest rates (i.e. 2-year yields go up)…
- Market believes the Fed will be successful in slowing the economy down…
- So investors factor in lower long-term growth, which leads to a decline in 10-year yields…
- Which causes the yield curve to invert.

The current yield curve inversion matters because it suggests we're not out of the woods yet. If a recession is a possibility in the next 12-18 months, then that's going to matter a lot to investors. While investors waste time debating whether or not we're in a recession today, we're keeping our eyes peeled for what's on the horizon.

WHAT KIND OF BEAR MARKET ARE WE IN?

That brings us to the stock market. The S&P 500 hit an all-time high of 4,793 on January 4 of this year. From there, it was all downhill. By June 16, the index had declined -23.5%. Any decline greater than 20% is classified as a "bear market."

Bear markets are not uncommon. There have been 12 bear markets since the end of WWII. In four instances, the economy never went into recession. So bear markets and recessions don't always go hand-in-hand.

Bear markets		
Market peak	Bear return*	Duration (months)*
Sep 1929	-86%	32
Mar 1937	-60%	61
May 1946	-30%	36
Aug 1956	-22%	14
Dec 1961	-28%	6
Feb 1966	-22%	7
Nov 1968	-36%	17
Jan 1973	-48%	20
Nov 1980	-27%	20
Aug 1987	-34%	3
Mar 2000	-49%	30
Oct 2007	-57%	17
Feb 2020	-34%	1
Jan. 2022**	-24%	5
-	**-41%**	**20**

Putting aside the 1930s Great Depression, the average bear market saw stocks decline -34% over about 15 months. Most of them saw declines from the mid-20% range to the mid-30% range. Many of those bear markets were driven by recessions or specific events, such as the COVID-19 bear market in March 2020. I'd call these "normal" bear markets.

However, there have been 3 "nasty" bear markets in the last 50 years. These three bear markets happened amid major structural issues:

- 1973-74: Inflation driven by oil embargos
- 2000-2002: Technology bubble burst; 9/11
- 2007-2009: Housing bubble burst; banking crisis

In each case, there were deep-seated economic issues and imbalances that took time to work out. Looking at the average length of those bear markets we can see they took almost two years to run their course.

What kind of bear market are we in? I think odds are higher than normal that we may be in a structural bear market. We're dealing with a lot of issues right now:

- Inflation of 9%
- Federal Reserve increasing rates aggressively
- High levels of government and corporate debt
- Speculative frenzy in large cap growth stocks and "meme" stocks during 2020-2021

This isn't a prediction that the market is doomed to drop significantly from here. Each of the nasty bear markets cited above had distinct events that turned an economic cycle into a crisis. What it may mean, however, is that investment returns are subdued for several years as we work these issues out.

NAVIGATING BEAR MARKETS

It's important at this point to remind everyone that bear markets are normal. When we build financial plans for people, we make long-term investment returns. Those assumptions come from 100 years of historical stock returns. From booming bull markets to nasty bear markets and every market in between.

"Recency bias" is a well-known behavioral finance issue. That means that investors anchor their expectations based on what's happening now, losing sight of the big picture.

We're in a bear market in 2022. But did you know that over the last 3 years the S&P 500 is up 47%? That averages out to +13.7% returns per year over the last 3 years. And that includes the March 2020 bear market AND the current bear market.

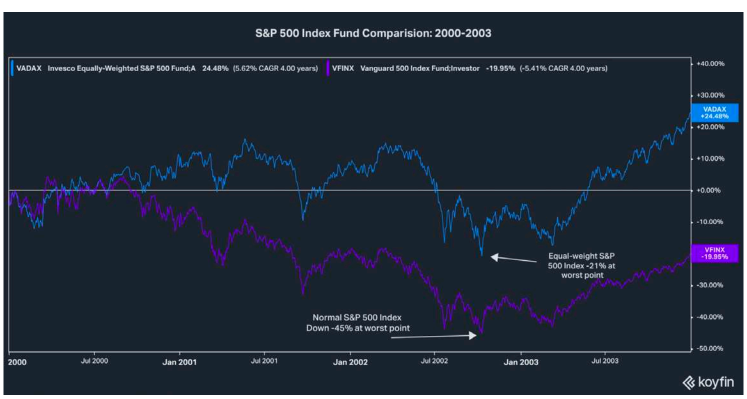
Annualized S&P 500 Returns		
1 year	-5.7%	Includes current bear market
3 years	13.7%	COVID crisis (2020) + current bear market
5 years	12.6%	COVID crisis + current bear market
10 years	13.5%	COVID crisis + current bear market
20 years	9.9%	COVID crisis + current bear market + sovereign debt crisis (2011) + Housing crisis (2008)
25 years	8.0%	COVID crisis + current bear market + sovereign debt crisis + housing crisis + burst tech bubble & 9/11 (2001)

Over any longer time period you can see that the returns on the S&P 500 have been solid and very much in-line with what we build into financial plans. And they include an array of bull and bear markets.

So that's it? We just accept that bear markets happen and do nothing? "Invest for the long-term," they say. Frankly, I see a lot of financial advisors talk like this and it really bothers me because it's intellectually lazy.

We can't and won't try to time markets. But we can position client portfolios for the environment we believe we're heading into. A very simple example that I've highlighted before is switching to an S&P 500 index fund that weights each company equally versus a conventional index fund that weighs each stock in the index based on its market value.

No two periods are the same, but if our thesis is right about inflation becoming sticky, then the expensive growth stocks that dominate the conventional S&P 500 index will get hurt. It's very similar to 2000-2003, when the tech bubble burst.



The blue line is an equal-weight S&P 500 index fund while the purple line is the conventional S&P 500 index fund. An investor who wisely switched to the equal-weight fund at the end of 1999 **DID NOT** avoid the coming bear market. But their max draw-down was -21% versus -45% for the conventional S&P fund. And after 3 years, the equal-weight investor was back in positive territory while the conventional investor was still down 20%.

We made this switch for clients just over a year ago. And earlier this year we de-risked client bond portfolios as inflation went way higher than even we thought it would.

Currently, we're in a bear market rally that has taken the S&P 500 +14% off its June lows. There's a good possibility that we reposition client portfolios further to protect them against the risk of a structural bear market. That may include further de-risking of bond portfolios, adding commodity exposure, or even raising cash levels. Fortunately, the cost of holding cash is going down as the Fed raises interest rates!

IS THE 2022 BEAR MARKET OVER?

With the current bear market rally underway, we're already seeing people call the end of the bear market. "A new bull market is getting underway!" I'm skeptical that's happening – yet.

Inflation remains very high by anything we've seen in 40 years. And that's forcing the Fed to raise rates aggressively. They have conditioned investors to expect the Fed to turn tail and cut rates at the first sign of trouble but my view is that the bar for easing rates is way, way higher than anything we've seen since the early 80s. Inflation is a political problem above all, and the pressure on the Fed to get inflation down is enormous.

Bear markets are notoriously difficult to navigate because emotions are high. They have many bear market rallies that convince people that the worst is over. And then they're hit with another leg lower.

We will continue to fine-tune portfolios and make changes as opportunities present themselves. It's been tough to do that so far this year because both stocks and bonds have declined. But we're now seeing some differentiation in performance between asset classes that will make opportunistic trades more likely.

TAKE NOTE:

DATES TO REMEMBER

1

SEPTEMBER 1

OPEN ENROLLMENT ANALYSIS BEGINS

2

OCTOBER 1

TAX PLANNING BEGINS

3

OCTOBER 1

FAFSA OPEN DATE

4

OCTOBER 17

2021 TAX FILING EXTENSION DEADLINE

5

DECEMBER 31

401(K) CONTRIBUTION DEADLINE

6

DECEMBER 31

IRA REQUIRED MINIMUM DISTRIBUTION DEADLINE

7

DECEMBER 31

2022 TAX YEAR CHARITABLE GIVING DEADLINE

8

JANUARY 1

BEGIN 2023 RETIREMENT CONTRIBUTIONS

9

APRIL 15

2022 TAX FILING DEADLINE

10

APRIL 15

2022 IRA CONTRIBUTION DEADLINE (OR TAX FILING DATE IF EARLIER)

YOUR GUIDE TO OPEN ENROLLMENT & EMPLOYEE BENEFITS

BY: TREVORE MEYER, CFP®

What is open enrollment? When we work for our employers, we have many benefits beyond what our employers pay us. These could be benefits like: health insurance, disability insurance, life insurance, legal plans, 401(k) or 403(b) plans, FSA, or Health Savings Accounts (HSA).

All of these things make up the entirety of our enrollment package provided through employers. Some of these options can only be changed once a year. This period of time is called open enrollment. It's when everything is open for you to enroll, disenroll, or make changes to your benefit packages. Now how do you know which employee benefits are right for you?

OPEN ENROLLMENT BENEFIT OPTIONS

We have several options for retirement saving strategies for high income earners. You have to be very careful, so please work with a financial professional or tax accountant before changing retirement accounts or acting on any other options below.

Health Insurance

Let's start with health insurance. This is often the biggest benefit employers provide. It is really important to make an intentional choice for you and your family. A couple things you need to look out for are the deductibles, the out of pocket maximums, and the premium amounts. You should account for all these variables combined, and your anticipated medical needs in the upcoming year. Then you can start to determine what is the right plan for you.

Disability Insurance

Now, after health insurance, let's talk about disability insurance. None of us think we are ever going to be disabled, but the reality is something could happen. If your employer offers disability insurance, quick note that not every employer does, but there are two things we would encourage you to look at. One is short term disability (STD) and the second long term disability (LTD).

The more important of these options is the long term disability plan. This is because if you have an extended disability, you will receive a monthly payment from this disability insurance plan to replace your income. If you aren't working, it is important that you have an income replacement. Now I said the short term plan isn't as important because a core part of your financial plan is having an emergency fund. You should have saved up to 3 months of your expenses, or more, that way you can weather the storm in case something does happen.

Life Insurance

Next up, life insurance. We encourage you to take whatever your employer gives for free. Often this is an amount around $45,000-$50,000 or a percentage of your current salary. If this life insurance plan is free of charge, that's a no brainer to take it without question. However, what you might want to question is if you have to pay premiums. If you have to pay the premiums on the policy, you might want to look and see if these premiums are cheaper than what it would cost you to take out your own life insurance policy.

Sometimes you might be in a situation where you have an illness or disease where it is hard for you to qualify for coverage outside of this benefit. Through your employer, you might have the option to buy up more years or multiples of your annual salary. We would encourage you to take a look at that as it will help not having to jump through extra underwriting hoops to qualify.

Legal Plans

Now onto legal plans. In certain circumstances, you might have a need for an attorney. These instances could be like getting estate plans and adjusting your power of attorney, or could even be as small as dealing with a traffic ticket. Be mindful that through your employer, you might have access to a legal plan. Generally, you pay a very small amount from your paycheck. Your employer then gives you access to an attorney at significantly reduced costs than if you hired them directly or separately. We often encourage use of a employer legal plan for clients to get estate plan documents completed. One reason is these estate planning documents are expensive, challenging to change, and require lots of time. If there is an option to reduce this cost while getting the same documents in place, it makes sense to go that route.

401(k) or 403(b)

Moving onto 401(k)s and 403(b)s. This is one of the few options you can change that is not required to go through the open enrollment process. However, because you will already be going through your benefits it makes sense to double check that your elections are set up properly. Are your contribution amounts set up properly according to your financial plan? Do you have the right investments associated with your accounts? Are your beneficiaries elected and who are they? As you go through the once a year open enrollment process, we encourage you to also check your 401(k) or 403(b) plans. You don't want to leave anything to chance.

FSA or HSA

Finally, let's talk about your FSA and HSA accounts. These accounts coincide with your health plan. The FSA is something you can only change once a year. However, with the HSA, you should be able to make changes to these throughout the year. It is important to note that your ability to contribute to these accounts is directly related to the particular type of health insurance you have with your employer. As a rule of thumb, if you have a high deductible plan, you generally can enroll in an HSA. If you don't have a high deductible plan, you would be looking at the FSA. The FSA is a contribution that can only be changed at open enrollment period.

OPEN ENROLLMENT IS WHEN YOU MAKE CHANGES

It is important to make sure your benefits are set up the way you need as they only change once a year. The insurance benefits you can only change during open enrollment are health, disability, life, legal, and FSA. Benefits you can change anytime, but you should review at open enrollment, are 401(k), or 403(b), and HSA.

Now, there are circumstances when you can change these benefits at another time during the year. This is called a qualifying life event (QLE). This is a time period when you have a significant change in your life circumstances: you get married, change jobs, lose a job, your spouse loses a job, you have a kid, or you adopt a child. Any event like this opens a 30 day window for you to change all the benefits we have mentioned above. Keep in mind with your 401(k) or 403(b) you should still be able to make changes to these throughout the year, however we would still encourage you to evaluate these during open enrollment period.

We have said that enrollment is a super short period, often only two weeks with some employers. Generally this time period falls within the latter part of the year, lasting from around September until November. These benefits usually start on the calendar year. So your employers want to know which benefits you are electing into before the start of the year so that they can prepare their systems ahead of time.

Need Help with your Open Enrollment Benefits?
Now, we understand there is a lot that goes on with these open enrollment periods, and a lot with these benefits in general. It would be way too challenging to break these down for each person here. But, if you have questions about your open enrollment or want to learn more about which benefits your family needs, reach out! We would love to help you sort it all out.

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Know someone who wants to receive this newsletter?

Send us the mailing address at **team@financialdesignstudio.com** If you prefer to no longer receive this newsletter please email us at **team@financialdesignstudio.com**

"AN INVESTMENT IN KNOWLEDGE PAYS THE BEST INTEREST."

- BENJAMIN FRANKLIN

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