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PEOPLE HAVE MEMORIES. MARKETS DON'T

One of the best things about markets is that they don't have memories. They don't remember what happened last week or last year. They don't even remember what happened a minute ago. Prices change based on what's happening right now and what people think will happen in the future.

People have memories. Markets don't. And that's a good thing.

So as you start 2023, take a lesson from the market. Don't begin this new year bogged down by what happened last year. Give yourself the opportunity to start fresh.

Every day in publicly traded financial markets, buyers and sellers negotiate prices for every stock and bond. To agree, they have to find a price that they both think is a good deal. This happens over and over, millions of times a day. Then it starts all over again the next day. Unlike people, markets don't think about the past. It's about today and expectations for the future.

Markets must be forward-looking to set prices that entice buyers to buy. But prices can't be too low or sellers won't sell. Every piece of available information feeds into the decision-making process so everyone involved can agree on the price for a particular security at a particular moment.

Markets are smarter and faster than you and me. While you've been reading this, markets have probably factored in thousands of pieces of new information and adjusted the prices of thousands of different company securities.

That's good news. Markets do the work so you don't have to. You don't need to believe in magic or be able to predict the future to have a good investment experience. Some people might think I'm giving the market too much credit. But over more than 50 years in finance, I've come to realize that I'm just being realistic. Someone described it to me as "science-based hope."

Academic research gives us insights into investing. Over the past century, markets have returned on average about 10% a year, although almost never that amount in any given year.[1] And the annualized inflation-adjusted return on US stocks is 7.3% going back to 1926.[2] Because of big swings year to year, trying to time markets is a losing game. So don't try to outguess markets—go with them. Come up with a plan, take no more risk than you can tolerate, and go spend some time with your loved ones.

Investing has inherent risks. And no matter what anyone tells you, there are no guarantees. But if you don't have enough cash to live off for the rest of your life, what choice do you have but to invest? Control what you can control so you can set yourself up for

success, and then give yourself some grace. Judge yourself by the quality of your decisions and not by their outcomes. There are so many factors outside your control that can impact investment returns.

I believe one of the worst things investors can do is to impose their memory on their view of markets. Because then they might "see" patterns that aren't there and make choices that aren't based on research or evidence.

It can feel daunting to develop an investment plan you can stick with and determine the level of risk that's right for you. But few things are more important than how you invest your life savings. That's why most people would probably benefit from a financial advisor to help them talk it all out.

When it comes to investing, the key is not to try to outsmart the market, but to understand how it works and use that knowledge to your advantage. The market is a great information processing machine. It runs on human ingenuity, which is why returns tend to grow over time as people work to innovate and improve the value of the companies they work for.

So start the new year off with a clean slate—just like markets do every day.

—David Booth, Dimensional Fund Advisors

[1] In US dollars. S&P 500 Index annual returns 1926–2021. S&P data © 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

[2] Based on non-seasonally adjusted 12-month percentage change in Consumer Price Index for All Urban Consumers (CPI-U). Source: US Bureau of Labor Statistics.

Investments involve risks. The investment return and principal value of an investment may fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original value. Past performance is not a guarantee of future results. There is no guarantee strategies will be successful.

CORRECTION: SOCIAL SECURITY AND WORK

Thank you to an alert reader for identifying an error in the "Social Security and Work" article from January 2023. In that article, we correctly reported that if you continue to work after receiving retirement benefits, Social Security will withhold one dollar from you for every two dollars you earn over the income limit. However, the deduction is for the year, not every month.

For example, if you get a benefit of $2,000 per month and you earn $1,000 over the 2023 limit of $21,240, Social Security will withhold a total of $500 for the year (all from your first benefit check), not $500 from each monthly check. Big difference!

WHAT'S NEW IN SECURE ACT 2.0?

Late last year, Congress passed the second part of the SECURE (Setting Every Community Up for Retirement Enhancement) Act, which will bring many changes to retirement planning in the years ahead.

The first SECURE Act bill was passed in 2019, and among its provisions were:

- Raising the required minimum distribution (RMD) age for retirement accounts from 70.5 to 72
- Allowing long-term, part-time employees to participate in 401(k) plans
- Making it easier for small businesses to offer retirement plans by increasing the tax credit for start-up costs
- Repealing the maximum age for traditional IRA contributions
- Allowing penalty-free withdrawals for expenses related to the birth or adoption of a child
- Allowing 401(k) plans to cover their employees' student loan payments as a form of hardship withdrawal

The advisor community is still poring over SECURE 2.0—It's 4,155 pages long! Practically a Stephen King novel!—but here are a few highlights we've come across:

- For anyone who has not turned 72, the new RMD age is raised to 73 starting this year. It will increase to 75 in 2033.
- One of the most onerous penalties in all of retirement planning has been eased. The penalty on missed or short RMDs is reduced from 50% to 25%. It can be further reduced to 10% if the mistake is corrected within two years.
- Roth 401(k) account holders will no longer be required to take RMDs starting in 2024.
- Beginning in 2025, older investors will have a second tier of catch-up contributions to retirement accounts. Currently, people over age 50 can make a larger contribution to their retirement account: The 401(k) contribution limit for 2023 is $22,500, but workers over age 50 can put in an additional $7,500, or $30,000 total. Under the new act, beginning in 2025, workers age 60 to 63 can make an additional contribution equal to 50% of the age 50 catch-up amount. So if the current limits were the same, they could defer an extra $3,750 for a total of $33,750. (Note: Catch-up contributions will have to be made after-tax for higher earners starting in 2025.)
- The catch-up contribution for IRAs has been flat at $1,000 for some time, despite the regular amount increasing with inflation. Beginning next year, the catch-up amount will also be indexed to inflation.
- Starting a 401(k) for your small business will be easier than ever, with a "starter 401(k)" plan that simplifies requirements and expands tax credits. Starting in 2025, all employees will automatically be enrolled in a new plan and must "opt out" if they don't wish to be included. Additionally, their contribution amount will automatically increase each year unless they actively change it.
- Employers can allow employees with Roth 401(k) accounts to have their employer match to their Roth, rather than a separate non-Roth 401(k) account.

- Beginning in 2027, lower-income individuals will receive a "Saver's Match" from the federal government for their contributions to an IRA account of up to $2,000 per year.

There are many other interesting provisions and features in the new law. Here are some more:

- Starting in 2024, employers can match student loan payments directly into a 401(k) account, effectively reducing the need for employees with student loan debt to take a hardship withdrawal from their retirement account as allowed in SECURE 1.0.
- Starting in 2024, employees can make a penalty-free withdrawal from a Roth retirement account of up to $1,000 designated as a "rainy day fund" for emergencies like the type seen during the pandemic.
- Effective in 2023, victims of domestic abuse can withdraw up to $10,000 from their retirement account without penalty.
- Effective in 2023, victims of a federally declared disaster can withdraw up to $22,000 from their retirement account without penalty.
- Starting in 2024, unused money in a 529 college savings plan can be rolled into a Roth IRA in the name of the same beneficiary, provided the 529 account has been open for at least 15 years.
- A national "retirement savings lost and found" database will be created to help people find retirement accounts and benefits from previous employers.

There's definitely a lot there and a lot to digest. If any of these sound applicable or useful to you, give your advisor a call!

—Steve

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