NEW CANAAN GROUP

NEWSLETTER
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THE BEACON

INTRODUCTION

BY BENNETT PARDUE, CDFA ®

For our second edition, we touch on several topics that we are frequently asked about by our clients. First, our Director of Portfolio Strategy, Bradley Thompson, CFA®, will dive into the basics of building an investment portfolio.

Next, Michelle McGuire, CDFA®, RICP, will touch on some of the basics of financial planning in divorce. The division of assets during a divorce can have extensive ramifications, and there are several pitfalls to look out for.

Lastly, Partners Frank DeFrancesco and Joe Scappatura, CFP®, lay out some of the significant changes in the Secure 2.0 Act of 2022, which affects all retirement savers in the US.

We hope you continue to find these newsletters valuable, and if you have any questions about this month's topics, or any Financial planning & Wealth Management subject, please reach out to us.

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SOUND VIEWS

BY BRADLEY THOMPSON, CFA ®

In the past issue of Sound Views I covered some basics around planning and how to prepare yourself for changing markets. Building on the theme of education, I thought it best to talk through the things that go into a well-designed portfolio. First, we need to review two foundational concepts that apply for any investment discussion: diversification and volatility.

Many investors are familiar with the concept of “don’t put all your eggs in one basket” which refers to diversification. The idea is that by owning more than one investment, something should always be working in the portfolio. I think a better analogy is a paned window. When you have a multi-paned window, one or two panes might break, but hopefully the other pieces stay intact long enough for you to repair the rest of the window.

This is a more realistic depiction of how diversified portfolios work over time. There will be years where several investments do poorly while others do very well, for example stocks last year. That doesn’t mean you shouldn’t own them.

SOUND VIEWS

Over long periods of time, stocks have added to the return. You just want something in there to work while stocks are not. We believe that holding investments with low historical relationships can help smooth your overall return. Notice that I didn't say a necessarily higher return. When you're invested for long-term goals, the path of your returns matter and having a smoother ride can help keep you on track.

Regarding volatility, you have most likely heard at some point when turning on the news, "stocks had a volatile session on 'Wall Street.'" It's really a way for the talking heads to avoid using the word loss. They focus on the downside but it technically applies to the upside of the market as well. From a portfolio management perspective volatility measures the expected change in an investment or portfolio over a given period of time (1 day, 1 month, 1 year, etc.). It's a useful tool to help us evaluate the riskiness of our investments, even if the estimates aren't always reflective of reality. We think that by trying to limit volatility where we can, it will increase our clients' chances of success over sufficiently long periods, understanding that higher levels of risk may be appropriate depending on personal circumstances.

Like a home cooked meal there are many things that go into a well-designed portfolio. There are many recipes you can follow, and we believe ours has its own unique flavor. We start our process by defining the universe of investments we think are appropriate for investors to own, like picking the ingredients for our dinner. Once we've picked the ingredients, we put them in our pot to create the spectrum of risk for our clients. We believe that most investors' needs can typically be met through one of five primary investment styles. Those styles range from Conservative Income to Aggressive Growth, each holding a mix of at least 3 primary ingredients or asset classes: stocks, bonds, real assets.

- Stocks - engine for growth
- Bonds - provide income and stability
- Real Assets - help protect against things like inflation

We will touch on each of these asset classes in later editions of the newsletter.

Going back to the recipe analogy, changing the mix of these staple ingredients will change the flavor of the meal, but ultimately you still end up with a well-diversified portfolio.

Once our long-term portfolio is set, we apply a proprietary method to shift the pieces around and position our clients for the investing road ahead. This is called our tactical process and provides another opportunity to add to your long-term returns. By starting with a basic but robust allocation, aligning it with your individual goals, and applying thoughtful tilts we believe you can have a higher degree of success over your time horizon.

Investing in a well-diversified portfolio is typically not as exciting as buying a hot stock, and it probably won't make you rich, but like a well-cooked meal it can lead to a smoother experience and prove very satisfying when you need it the most.

*Diversification does not guarantee a profit or protection against loss.

SECURE ACT 2.0

BY JOSEPH SCAPPATURA, CFP ® & FRANK DEFRANCESCO

The SECURE (Setting Every Community Up for Retirement Enhancement) Act 2.0. is a follow up package to the original SECURE Act in 2019. It provides further flexibility to retirement and savings related issues. While the SECURE ACT 2.0 offers improved opportunities to save for retirement, everyone's financial situation is unique and different. It is always a best practice to consult your tax professional to understand how the SECURE ACT 2.0 may impact your personal situation. With over 90 new provisions we are going to highlight some of the key new provisions that will be going into effect over the next few years.

Required Minimum Distributions:

- The age to start taking RMDs increases to age 73 in 2023 and to 75 in 2033.
- The penalty for failing to take an RMD will decrease substantially and starting in 2024 RMDs will no longer be required for Roth accounts in employer retirement plans.

529 College Savings Plans:

- Allows more flexibility for certain assets in a 529 plan to be rolled over into a Roth IRA after 15 years.
- 529 plan assets will be subject to annual Roth contribution limits and an aggregate lifetime limit of $35,000.
- The rollover will be treated as a contribution towards the annual Roth IRA contribution limit.

Emergency savings:

- Helps to provide additional savings for short-term and unexpected expenses.
- Two different ways for participants to access emergency savings.

1. Participants can create a post-tax ESA (Emergency savings account) Starting in 2024 contributions would be limited to $2,500 annually or lower, as set by the employer. The first 4 withdrawals in a year would be tax and penalty-free.
2. The second provision allows employees the opportunity to withdraw up to $1,000 per calendar year without being subject to an early withdrawal penalty. Participants would need to repay the amount in three years and would not be able to withdraw again until the amount is repaid.

Student Loans:

- Starting in 2024, employers can make matching contributions to a defined contribution plan on qualified student loan payments. Ultimately giving workers an extra incentive to save while paying off educational loans.

DIVORCE PLANNING

BY MICHELLE MCGUIRE, CDFA ®

Thinking about the end of things is often not what people do when starting a new chapter in life. Thus, it is understandable when clients come in feeling overwhelmed when starting the process of separating from a spouse. Without a prenuptial agreement, they may have to navigate a complex division of assets, alimony, child support and business or real estate valuations while dealing with the changing dynamics of family and social circles.

It is common to seek out a mediator, collaborative divorce team, or attorney to help guide the process of what is customary and legal in your state. What they are less likely to talk about is the short and long-term impact of the different proposals in front of you.

We often see initial proposals where clients have added up the value of the house, retirement accounts, investments and cash then divided by two. The question is can you split assets that are taxed differently as though they are equal?

Let's consider a few examples knowing that there may be many variations.

- **A million-dollar house:** Not usually an accessible, or liquid, asset so it is important to consider what other sources will be available to live on if the house is a piece of the assets you want to keep. Find out how much gain there is in the house. Will that fall under the tax exemption if you have to sell it or will a portion of the gains be subject to tax? If you are splitting the house proceeds at some point in the future will that be before or after taxes?
- **A million-dollar 401k:** Your age will determine how accessible a retirement account is. There may be IRS restrictions and penalties on withdrawals plus taxes to access retirement accounts. Be mindful of when you need access and what the net value is estimated to be.
- **A million dollars in savings & non-retirement investments:** Has the benefit of being liquid and potentially a lower tax rate for capital gains, but the downside is the loss of tax deferral benefits. The tax question here is determined by what is held in these accounts, how they are taxed and your long-term goals. Do you need to use this asset to meet expenses, or do you plan to hold it as long-term investment?

As you go through the process of dividing assets, we would encourage you to determine if each asset is going to meet a short- or long-term need for you. Contemplating liquidity and the tax implications of assets can help you determine whether one dollar or another is a better fit for both of you.

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