Gerstein's
BROOKLYN TAX SERVICE

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Bracing For Recession in a Bear Market

Stocks have been in a bear market since June 13, 2022. The decline began after January 3rd, worsened in February when Russia invaded Ukraine, and sank deeper after the Federal Reserve in March began an aggressive series of interest-rate hikes to fight inflation. despite the many crises.

In recent months, the S&P 500 index declined from the heights of late 2021. The decline brought the price of the stock index right at its historical trend rate of 7%. This indicates stocks are not overpriced now, as they were in the tech-stock bubble, which began in 1997 and

The price of the Standard & Poor's 500 index and historical financial crises since 1957, shown in black in the accompanying chart, is a reminder that the U.S. economy and stock indexes have endured many setbacks and bear markets throughout modern U.S. history. The dotted line in red shows the average annual growth rate after the S&P 500 stock index was 7% since 1957, peaked in 1999 and 2000. Yet the economy is hobbled by high inflation, and the stock market decline is unnerving. How bad do things look to leading economic experts?

According to the latest *Wall Street Journal* quarterly survey of 60 leading economists, the consensus forecast is for a recession in the first

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Don't Let Financial Anxiety Bring Out Bad Investor Traits

2022 was a bad year for investors. After hitting a record closing-price high of 4,796.56 on January 3, the Standard & Poor's 500 index fell into bear-market territory on June 13.

Meanwhile, the 12-month U.S. inflation rate soared to a 40-year high, and a European ban on buying Russian oil and gas could send energy prices higher and exacerbate Covid-related supply-chain problems through the end of the year, further hindering consumer spending, which drives 80% of the U.S. economy.

Inflation, Russia, and the pandemic are risks, and any one of them could send stocks tumbling again. It's a time of high financial anxiety. The drop in stock prices could resume.

Times like these heighten financial stress and can bring out the worst traits in some investors. If you are checking your investments daily and obsessing about your account values more than usual, or if you are feeling anxious about your portfolio strategy, please feel free to contact us.

For us, great service is about staying in contact with our clients. Should you have any questions or comments, whether about the newsletter or anything else, drop us a line or give us a call. Thank you for your continued trust, confidence, and good word.

Warm regards,
The Gerstein's Brooklyn Tax Service Team

“Simplification” of College Financial Aid Requires Attention Now

The Consolidated Appropriations Act (CAA) of 2021, signed into law December 27, 2020, by President Donald J. Trump, was a massive $2.3 trillion spending bill. At 5,593 pages, Wikipedia says, it was also “the longest bill ever passed by Congress.”

Buried in CAA is a section on college-student aid dubbed “FAFSA Simplification.” It reduces the number of questions on the Free Application for Federal Student Aid (FAFSA) form from 108 to 36. It affects your college-funding financial plan starting in 2022.

A FAFSA form must be completed by current and prospective undergraduate and graduate college students to determine their eligibility for student financial aid for a given academic year. The form must also be submitted to determine eligibility for many scholarships and merit-based college-funding programs, in addition to need-based college financial aid.

“The simplification of the FAFSA form effectively redefines how eligibility for aid will be determined,” says Kalman Chany, founder of Campus Consultants in New York City and author of *Paying for College, 2022: Everything You Need to Maximize Financial Aid and Afford College*. “There will be winners and losers.”

In changing the eligibility criteria, “simplification” is expected to set off financial and administrative difficulties for many students. Many families eligible for needs-based federal aid under the current criteria will no longer be eligible under FAFSA Simplification.

Since 1986, Mr. Chany has authored and annually updated his book on college funding and financial aid. He says the new FAFSA formula will no longer boost aid for families with more than one child in college. This single adjustment may slash the amount of aid families receive by thousands of dollars per student.

Another important change is that the FAFSA form will no longer consider pre-tax contributions to 401(k), 403(b), and other qualified retirement account assets as untaxed income. However, the FAFSA formula will continue to count contributions to traditional IRA, Keogh, Simple IRA, and SEP accounts in your adjusted gross income as untaxed income.

The changes in the FAFSA formula were supposed to go into effect beginning with the 2023-2024 academic year. However, because of technology and other issues, the U.S. Department of Education has asked Congress to delay implementation of the law until the 2024-25 academic year.

“The 2024-25 school year may seem far off, but aid eligibility that academic year will be based in part on your 2022 income, due to a two-year look-back for income,” says Mr. Chany.

Aid calculations are based on individual student and family circumstances, and the new FAFSA formula that is scheduled to go into effect in 2024-25 could yet be further delayed. However, it is prudent for parents and students to know about the major changes in the FAFSA formula coming in the months ahead and to begin planning now, even if you are not sure you will qualify for aid. ●

Answering Some Difficult Personal Financial Questions

At age 65, only about 20% of American retirees have family and financial resources to cover intensive care for at least three years. More than 25% cannot afford any help at all. The remaining half of older adults lie somewhere in between not being able to afford any care and having a long-term safety net should they be stricken by a prolonged health crisis.

These are the grim conclusions of The Center for Retirement Research (CRR) at Boston College. Part of a consortium of research groups funded by the U.S. Social Security Administration since 2018, CRR’s research paints a gloomy picture of the retirement struggle most Americans are facing.

In a September 2021 research brief, CRR examined the resources 65-year-olds have to meet their potential needs for different long-term services and support (LTSS). CRR’s analysis considered “informal” care from family members, as well as care paid for out of a retiree’s pocket, and it categorized older adults by their ability to afford minimal-, moderate-, and severe-care needs.

With close to a third of America’s retirees lacking resources for even minimal-care, and only a fifth able to afford care for a severe personal health crisis, such as a stroke or chronic disease, this situation is expected to cause enormous social and political problems in the decades ahead as Baby Boomers age. However, even if you have family support and enough money to get you through a severe health event requiring long-term care, proper planning requires answering some difficult personal financial questions:

- Can you afford to self-insure in your old age?
- Have you done the financial math to ensure you could pay for a severe-care event in your retirement

Managing Your Wealth

Financial services giants make financial planning and wealth management sound very simple in slick TV ads, but they're not. Managing wealth requires knowing a lot about highly technical topics in math, taxation, and finance as well as history, psychology, and communication with loved ones about sensitive issues. This article highlights some of the knowledge needed to manage wealth and why they're so daunting without the help of a personal financial advisor.

Estate tax is in flux. The $12 million personal exemption from estate tax is set to expire at the end of 2025, where it could revert to a smaller amount, potentially in the $5million - $6million range. However, this could change, depending on Congress and financial, economic, and political events.

Income tax brackets are also uncertain, and income tax planning includes watching Washington and acting strategically.

Charitable strategies are always important just because giving back is the right thing to do. Supporting a cause can build on your legacy and inspire the next generations in your family to keep your causes top of mind.

IRAs are more important than ever in creating a strategic financial plan because so many Americans rely on them for their retirement funds. After retirement, assets in 401(k) accounts can be rolled over into IRAs. For income tax purposes, IRAs are treated the same as 401(k), 403(b), and other federally qualified retirement accounts. They grow tax-deferred until you wish or must by law withdraw money, and withdrawals are taxed at your ordinary income tax rate. However, earnings and withdrawals on Roth IRAs are tax-free if you own the Roth for at least 5 years and are 59 ½ or older.

Converting a 401(k) to an IRA, converting a traditional IRA to a Roth IRA and planning how your IRA accounts will be distributed to loved ones or charity upon your demise requires understanding the federal laws on qualified retirement accounts and knowledge of financial economics.

Psychology's pivotal role in financial decisions has come to be recognized only in the last few decades. The burgeoning field of behavioral finance is now part of the investment knowledge needed to avoid making mental mistakes, reacting emotionally to bad news, and recency bias.

Modern families require new legal and accounting strategies to protect family members from becoming horror stories in estate planning. People are living longer than ever and are wealthier than ever. With half of all marriages ending in divorce, families are split asunder by injustice and argument over assets.

After a 50-year marriage and raising two children, Edith, a 75-year-old succumbed after a long battle with cancer. Ed, her 75-year-old spouse, could not stand to live alone and remarried a server he met at the casino. A year after marrying Rita, a 50-year-old with two children, Ed dies. Rita, and her children, inherit Ed's $3 million portfolio and two homes. His children get nothing because he never created a will.

Another example is the couple who, upon the marriage of their child, give the newlyweds a $1 million down payment on a home. Ten years later, when the child is divorced, the value of the home must be split evenly with their child's spouse.

Trusts, prenuptial agreements, insurance, and qualified retirement accounts can be structured to protect your children, spouse, and other loved ones from losing control of assets you give them when you die. That's part of the new landscape of financial planning for modern families.

Business owners contend with a unique set of circumstances involving:

- corporate forms of business entities (LLC, S-Corp, Corporation, etc.)
- partnerships
- equity ownership
- business and personal liability for debts and other risks
- income earned annually
- buy/sell agreements
- impact on families
- taxation of the business

Real estate investors and doctors have to consider all of the same variables with some twists. For instance, owners of apartment buildings with swimming pools may face a large liability if someone drowns. Protecting yourself from slip-and-fall lawsuits and other risks inherent in developing and owning real estate is just one example of knowledge needed to invest wisely in real estate. Successful business owners often find it advantageous to purchase a building to house their business by setting up a real estate entity that owns the building and leases it to the operating business. This is a common real estate strategy for doctors as well as business owners.

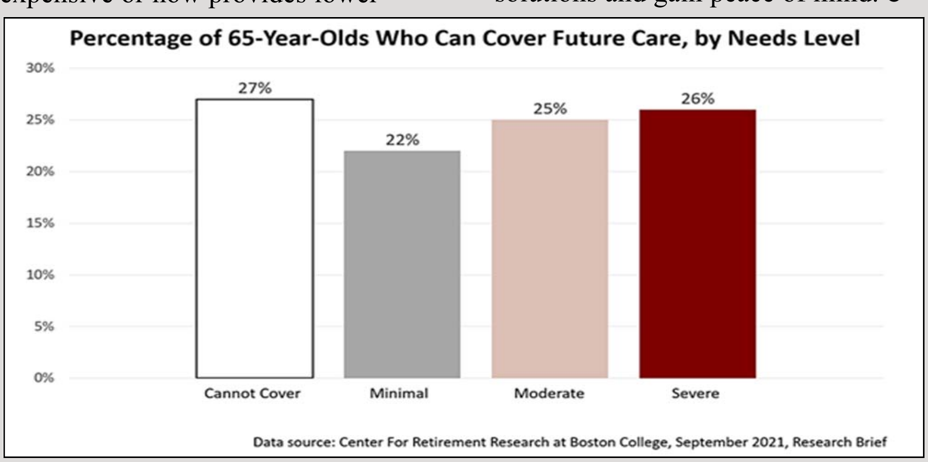
Investing is thought by many individuals to be the only knowledge required to manage wealth and make a sound financial plan, but it is only one aspect of the job. Investing is important but the other aspects listed above are often just as important.

Retirement is a mashup of all of the topics discussed above. To create a smart retirement plan requires knowledge of investing, taxes, and the full range of topics mentioned here. ●

years, figuring on living through age 85 or 90?

• Have you paid for long-term care insurance that has grown more expensive or now provides lower benefits than it used to?

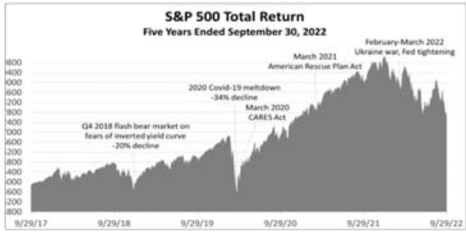
The earlier you get started on planning your retirement portfolio and income needs, the easier it is to find solutions and gain peace of mind. ●



Market Data Bank: 4th Quarter 2022

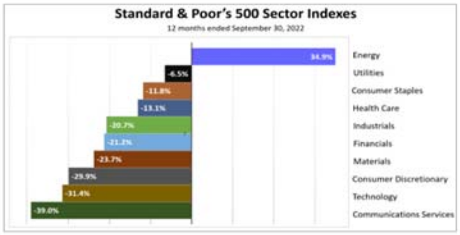
THE BEAR MARKET OF 2022

The pandemic, Russian war on Ukraine, soaring inflation, rising interest rates, and growing fears of recession triggered a –4.9% loss in the third quarter, a -16.1% loss in 2Q 2022, and a -4.6% loss in 1Q 2022. On June 13, 2022, the S&P 500 dropped more than -20% from its Jan. 3, 2022, all-time high and a bear market started.



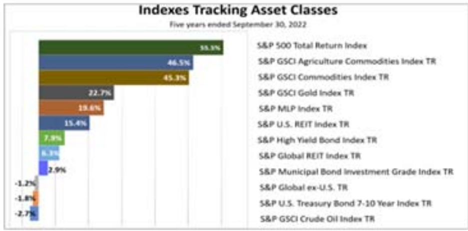
FOUR BEAR MARKETS IN FIVE YEARS

Despite three, consecutive quarterly losses, the S&P 500 stock index over the five years ended September 30, 2022, showed a total return, including dividends, of +55.5%. The period included four bear markets, inlcuding the pandemic meltdown of February and March 2020, when the S&P 500 lost -34% of its value.



INDUSTRY SECTORS

Higher energy prices propelled energy companies to the top of the 10 industry sectors in the S&P 500 stock index, with a +34.9% return in the 12 months ended September 30. Energy was No. 1 for the past four quarters but it was the worst performer for the five previous quarters starting in 4Q 2019.



INDEXES TRACKING 13 ASSET CLASSES

Despite the bear market, No. 1 of the broad array of 13 indexes representing investments for the five years ended September 30, 2022, was U.S. stocks. Bonds and foreign equities were laggards. While energy was a leader in the last year, the index of crude oil investments lost -2.7% versus the +55.5% on the S&P 500 index.

VOLATILITY SPIKES

This chart shows all the one-day drops of 3% or more since 2014 in the S&P 500. Since the beginning of 2022, volatility has increased. Without bear markets and spikes in downward volatility, however, investors would not have an opportunity to earn a return in excess of fixed income investments.

NO SUCH THING AS A FREE LUNCH

Although stocks are a risky asset, subject to periodic bear markets drops of 40% or even 50%, they paid a premium annually over risk-free 90-day U.S. Treasury Bills for the past 20 years, which included bear markets in 2002, 2008, and early 2020 as well as the 2022 stock market downturn.

Past performance is never a guarantee of your future results. Indices and ETFs representing asset classes are unmanaged and not recommendations. Foreign investing involves currency and political risk and political instability. Bonds offer a fixed rate of return while stocks fluctuate. Investing in emerging markets involves greater risk than investing in more liquid markets with a longer history. Indices are unmanaged and not available for direct investment. Investments with higher return potential carry greater risk of loss. Sources: Sector performance data from Standard and Poor's. Household net worth data through March 2022 from Federal Reserve Bank of St. Louis, released June 9, 2022; Equity risk premium data from Craig Israelsen, Ph.D., of Advisors4Advisors..

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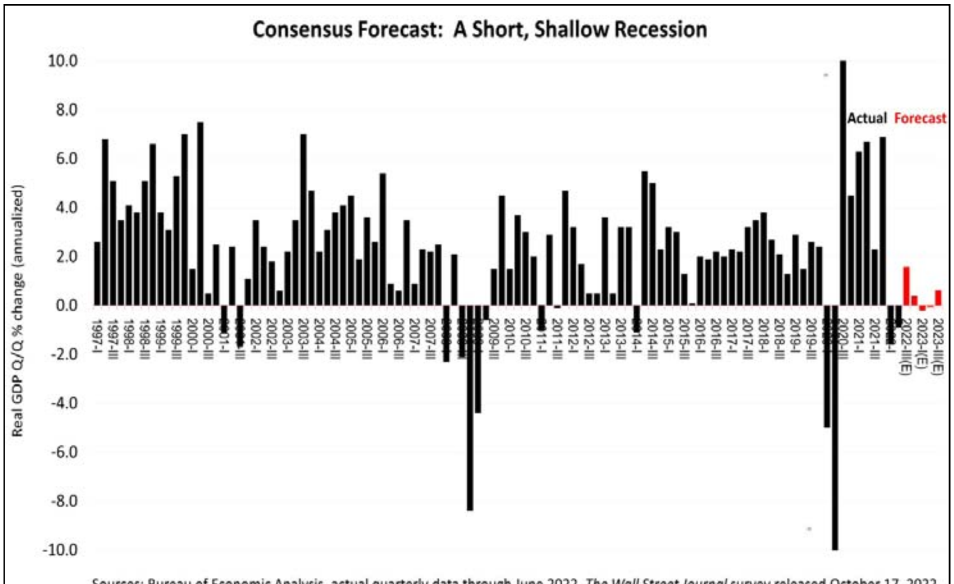
and second quarter of 2023, but a downturn will be short and shallow, and they call for a return to positive growth of six-tenths of 1% in the third quarter. To be clear, more pain is ahead, and stocks may decline further, but the consensus of the leading economists is for growth to return to the economy in the third quarter of 2023, and that's a reminder to investors as we brace for a recession amid a bear market.●



Sources: Bureau of Economic Analysis, actual quarterly data through June 2022. *The Wall Street Journal* survey released October 17, 2022.