Trust Company Oklahoma

INVESTMENT PERSPECTIVES

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MIDTERM MARKET IMPACT

How the upcoming elections could be affecting U.S. stock markets

This year has certainly been challenging for investors. Supply chain complications resulting from the continuing COVID-19 pandemic, the highest inflation rates in more than 40 years, and Russia's invasion of Ukraine have contributed to sharp declines in both the stock and bond markets.

There is, however, another variable worth considering. For investors familiar with the four-year presidential election cycle, the present direction of the stock market may not be totally unexpected. After all, 2022 is a midterm election year, and data going back more than a century show that midterm election years have generally been the weakest for the stock market in a presidential term.

Since 1950, the average midterm election year correction for the S&P 500 has been 17%.

For example, the market experienced strong gains early in President Trump's

Tim Hopkins
CFA
Senior Vice President

term in office, but in 2018 — the midterm year — at one point the S&P 500 declined by more than 18%. Similarly, stocks had strong gains early in President Biden's term, only to decline more than 23% at its trough so far this year.

Midterm election years underperform all others in presidential terms

This difficult pattern isn't a constant throughout history, but it has occurred quite frequently in presidencies dating back to 1900. After a weak stretch in the midterm year, the stock market has typically rallied. Consider the following data, which are the median annualized returns from 1900 through 2021 as tabulated by Ned Davis Research for the years of a presidential term, using the Dow Jones Industrial Average:

- 12.7% for year 1, the first year of the presidential term
- 3.1% for year 2, the midterm year
- 14.8% for year 3, the pre-election year
- 7.4% for year 4, the election year

In addition to lower returns, midterm election years are usually the most volatile over the four-year presidential cycle. The higher volatility could be, at least in part, a product of politicians drawing attention to problems facing the country. Campaigns also increasingly employ negative messaging. Those factors, coupled with the fact that markets don't like uncertainty, have resulted in midterm election years experiencing greater market declines at some point during the year than other years. In fact, since 1950, the average midterm election year correction for the S&P 500 has been 17%, with the other years averaging about a 13% drawdown (see table on page 2).

Market corrections offer buying opportunities

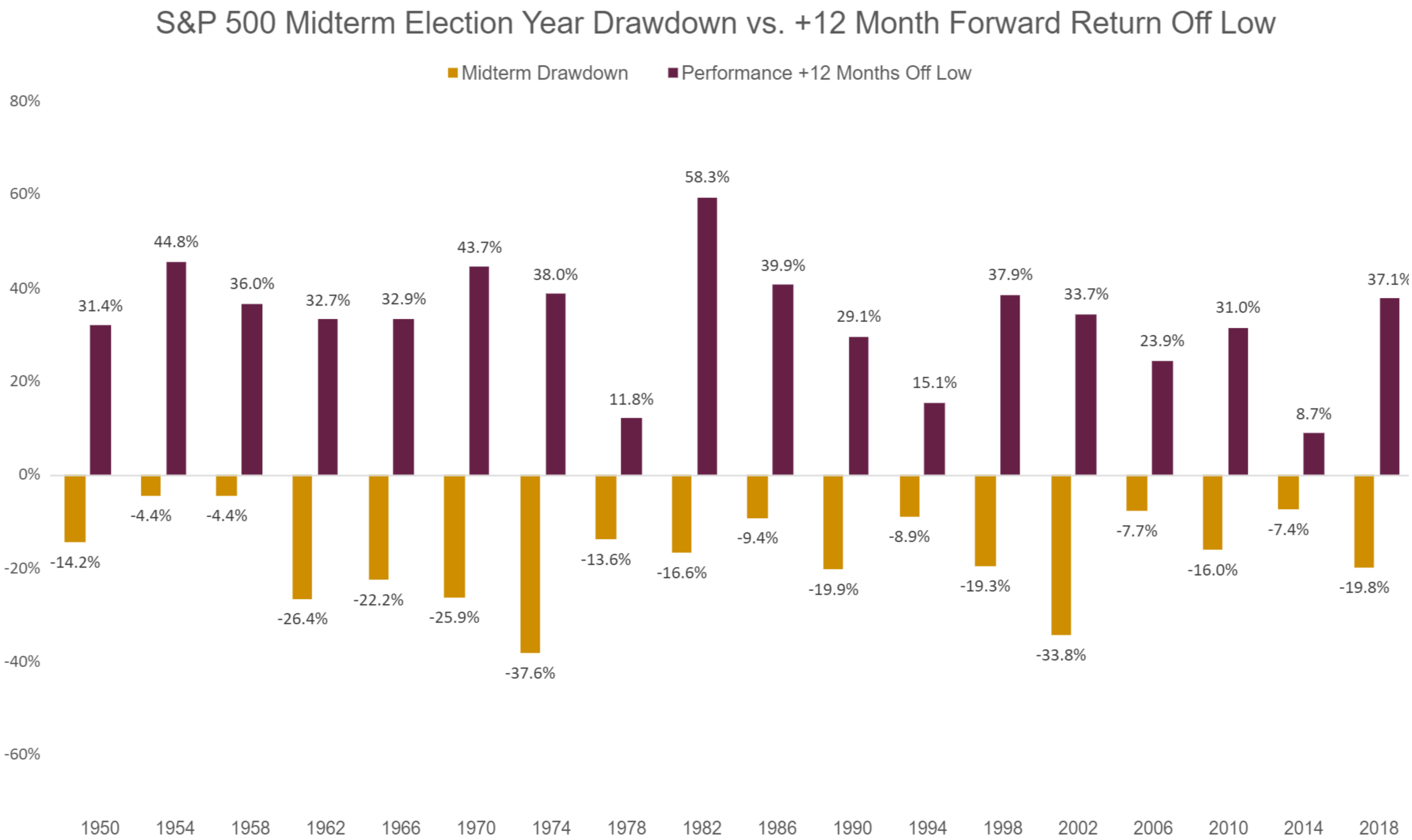
The good news is that these corrections have historically turned out to be great buying opportunities, with stocks up one year from the midterm low every time since 1950, and by an average of 32%. Taking this one step further, the S&P 500 has not declined in the 12 months following a midterm election since 1946, with an average gain of 15% versus an average gain of 7.1% for all other years.

Continued on page 2

MARKET RECAP

Stocks and bonds both turned in their second consecutive quarter of negative returns. This rare situation has only occurred five times since 1976, and it reflects the Fed's ongoing efforts to contain inflation.

	Past 3 Months	YTD	Past 12 Months
S&P 500	-16.1%	-20.0%	-10.6%
EAFE (International)	-14.5%	-19.6%	-17.8%



Source: Strategas Research Partners

Midterm elections dating back to 1982 show the highest ratio of Federal Reserve rate hikes to cuts.

Why this sharp rebound following midterm declines? Perhaps it has something to do with the fact that most presidents suffer major losses in their first midterm election. Following these electoral defeats, equity markets normally begin to price in looser fiscal policy, knowing that presidents want to boost the economy ahead of the next election.

Interestingly, data back to 1982 also reveals that midterm election years have the highest ratio of Federal Reserve rate hikes to rate cuts. Meanwhile, the Fed is historically most accommodative in the year following the midterm election, ahead of the presidential election. Thus, equity markets may also anticipate additional monetary support post-election, boosting equity values. With the Fed poised to raise interest rates at least seven times this year (as of the time of this writing), the potential for this same cycle to play out in the year ahead appears much more likely.

It’s important to know every year is different.

Midterm election years tend to be a grind for U.S. stocks with the S&P 500 historically bottoming in early October, rallying into the election, and then taking off after the election. As such, simply holding the midterm election has been

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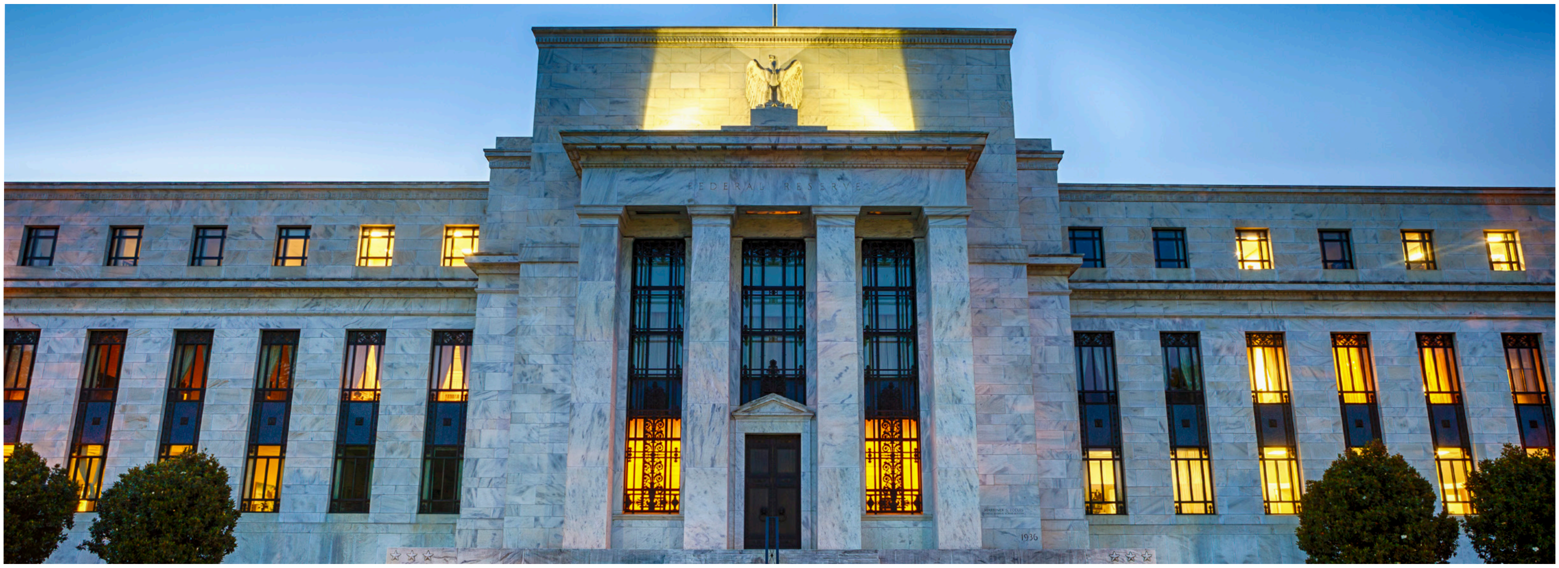

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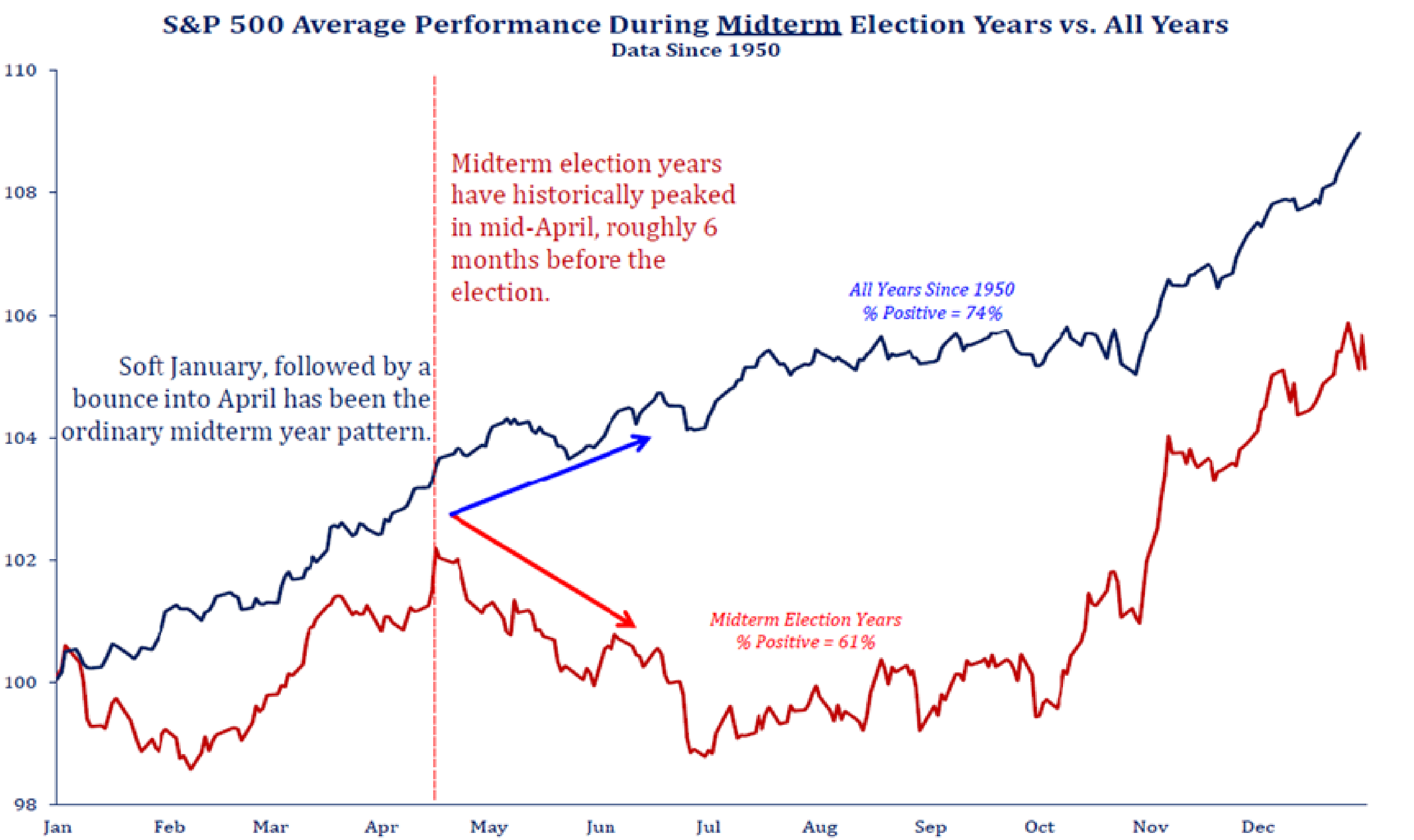
the real catalyst for stocks regardless of which party wins in the election.

Limitations of midterm market forecasting

It is interesting to review how equity markets have historically fared as both parties vie for additional seats in Congress. However, this information alone does not provide the basis for a strategy for trading in and out of the market. Nor should trading be based on political views or beliefs during a midterm election year, or for that matter, any year.

U.S. midterm election years may have exhibited these trends over long periods of time, but it is important to keep in mind that every individual year is different. Each midterm year is likely to have its own set of circumstances that influence financial markets in addition to the midterm election year factors. For example, in 2022 geopolitics have taken center stage given Russia's invasion of Ukraine. Furthermore, the Fed is trying to lower inflation substantially from the highest level in more than 40 years. And after unprecedented fiscal policy during COVID-19, budget deficit reduction this year will be the largest since 1947, resulting in less stimulus for the economy.

U.S. midterm elections — and politics as a whole — come with a lot of noise and uncertainty, but ultimately investors shouldn't let that be a distraction from the fact that long-term equity returns are generated by the value of individual companies over time. The prudent investor should look past the short-term spikes in volatility that elections can bring and maintain a long-term focus.



Source: Strategas Research Partners

SECURE ACT 2.0

How the proposed bill could change retirement savings

Ryan Short
CFP ®
Senior Vice President

In December 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act became the law of the land. As we have described in prior newsletter articles, SECURE made significant changes to the rules governing the retirement savings landscape. While many of the law's features worked to expand access to savings vehicles for workers, the most noteworthy changes affected the Required Minimum Distribution (RMD) rules for retirement accounts. Only two years later, Congress has returned to the retirement well in another bipartisan effort called the Securing a Strong Retirement Act, colloquially known as SECURE Act 2.0.

In March, the House of Representatives passed the SECURE Act 2.0 by a vote of 414–5. With the Senate set to consider the bill in the fall, SECURE 2.0 now appears likely to find itself under the President's pen in late 2022. In its current form, the proposed bill builds on the effort to expand access and savings opportunities for workers. While these changes are valuable, this article will focus on two proposed changes that will primarily affect retirees and those approaching retirement: RMD rules and catch-up contributions.

Retirement account distributions could start even later under proposed rule changes

Since the late 1980s, IRA owners have been allowed to defer distributions from their IRA until reaching the applicable RMD age. Once that age is reached, the IRA owner must withdraw a certain percentage from their IRA each year based on life expectancy. Prior to 2020, retirees were forced to begin RMDs after reaching age 70 and a half. Starting in 2020, SECURE pushed the applicable starting age for RMDs to age 72.

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SECURE 2.0 would once again delay the onset of RMDs. Gradually over the span of ten years, the act would ultimately push the age at which RMDs begin to age 75. Why would Congress take this approach? Longevity risk — the risk of outliving your savings — is one of the primary challenges for retirees. In delaying the onset of RMDs, Congress has clearly recognized that longer life expectancies are expected to put pressure on retirees' ability to sustain their retirement goals in the coming years.

Of course, nothing in the proposal prevents eligible distributions from retirement plan accounts prior to the applicable RMD age. Simply, the new law would give retirees a few additional years of flexibility in deciding how to spend their assets — whether from their taxable accounts or tax-deferred accounts — and to consider optimization techniques, like Roth conversions.

How catch-up contribution changes could affect your 401(k)

Under the current law, 401(k) plan participants can make additional, annual catch-up contributions of $6,500 to their retirement plan at age 50 either on a pre-tax or post-tax basis. The current version of SECURE 2.0 would increase the catch-up contribution amount to $10,000 for participants aged 62 through 64.

While this additional saving opportunity can help older workers increase their plan balances prior to retirement, the proposal comes with a significant caveat. In its current form, the proposal requires that all catch-up contributions would be treated as post-tax contributions to the plan. Should this change become law, workers would be taxed on catch-up contributions as a part of their regular income for the year. Although catch-up contributions would be allowed to grow tax-free in the plan, this change may actually discourage workers from making these additional contributions at all. If catch-up contributions no longer lower a worker's taxable income in the year of the contribution, workers may opt to spend the earned income rather than contribute it to their 401(k).

While there is still time for Congress to alter or even scrap these proposals, it appears likely that some version of SECURE 2.0 will take effect in 2023. To the extent that SECURE 2.0 becomes law, we will review the final version in future articles. In the meantime, the best retirement planning advice is still to save as early as you can as often as you can.

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ARE YOU BEING CHARGED MORE FOR MEDICARE?

Why your Medicare premiums might be higher than expected

You are officially retired. It's time to load up the RV, hit the golf course, or perhaps get to the stacks of books you haven't been able to read until now. You've squared away the budget, enrolled in Medicare, and even picked out your supplement and Part D prescription drug plan. Things are looking good until one day you notice a letter from the Social Security Administration (SSA) you weren't expecting. It's called an initial determination notice, and if you think it says you owe more than the stated Part B premium amount, you are correct.

What is IRMAA and how does it affect Medicare Premiums?

The standard, monthly Part B premium for 2022 is $170.10, so why are some retirees finding themselves paying hundreds of dollars more per month? Let me introduce you to the Income-Related Monthly Adjusted Amount, more affectionately known as IRMAA. These

Whittney Stauffer
CFP ®
Senior Vice President

graduated surcharges added to Part B premiums kick in when a couple filing jointly has modified adjusted gross income (MAGI) of more than $182,000 or an individual's MAGI is greater than $91,000.

Your Part D premiums for your prescription drug plan can be affected too. According to the Centers for Medicare and Medicaid Services, 7% of recipients will have to pay these charges. If you are one of these folks, you too will receive a letter from the SSA, putting you on notice.

What can you do to lower income-related charges?

SSA uses your MAGI from two years prior, so for 2022 they look at your 2020 tax return. If you have had a life-changing event during the last two years and your income situation is very different now, it may be worth asking for a reconsideration. Work stoppage, work reduction, divorce, and death of a spouse, among others, all qualify as life-changing events. You need to complete Form SSA-44 downloadable from the SSA website to file this appeal.

If you haven't experienced one of these events, you still have options for lowering your MAGI. Understand what IRMAA bracket you fall into and how close you are to moving up or down into the next one. Retirement distributions from an IRA or 401(k) plan count toward your income, so efforts to reduce those when possible can help. If you make charitable gifts, consider giving them directly from your IRA as a qualified charitable contribution. Explore the idea of Roth conversions. And revisit your withdrawal strategy to ensure you are tapping accounts in the most efficient way possible.

SPOTLIGHT

To learn more about this organization and how to assist in its mission, visit **newhopeoklahoma.org.**

NEW HOPE OKLAHOMA

New Hope Oklahoma is a Tulsa-based 501(c)(3) nonprofit whose mission is to end generational incarceration, one-child at a time. It began over 30 years ago as a single summer camp, and has since served thousands of children in the Oklahoma community.

Oklahoma incarcerates over 1% of its population each year, giving us the highest rates of incarceration in the world. As a result, over 135,000 children in Oklahoma have had a parent in prison during their lifetime. This represents an astounding 15% of all children in Oklahoma.

To achieve its mission, New Hope provides afterschool and community -based programs to children impacted by incarceration. These programs focus on social and emotional wellbeing, literacy development and healthy lifestyles, to ensure that children have positive role models consistently present in their lives.

In addition, New Hope offers a summer camp in June for youth impacted by incarceration, ages 8-15. The camp affords youth with opportunities to socialize and escape the stressors of daily life, while helping them to gain lifelong friends and valuable life skills.

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Antoine de Saint-Exupéry

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