Insight Newsletter
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Litman Gregory
WEALTH MANAGEMENT

What's Inside

Investment Commentary: Year-End 2022

Within a difficult and volatile year in the financial markets, U.S. stocks, as measured by the S&P500 index, began the fourth quarter with a sharp rally in October and November, gaining back 14%, but then dropped 5.8% in December to close out the year with an 18.1% loss. The annual decline for 2022 was the largest for the S&P 500 since 2008.

Foreign stock markets had a very strong fourth quarter, with developed international stocks (MSCI EAFE Index) gaining 17.3% — one of their best quarters ever — and emerging market stocks (MSCI EM Index) up 9.7%. For the full year, developed international stocks, though faring better than U.S. stocks, were down 14.5% (in dollar terms), while EM stocks were down 20.1% for the year.

A major headwind for non-U.S. stocks was the strength of the U.S. dollar, which appreciated 8.3% for the year (based on the DXY index), reducing dollar-based foreign equity returns one-for-one. However, in the fourth quarter, the dollar dropped 7.7%, providing a boost to EM and international equity returns for U.S. investors to end the year.

Turning to the fixed-income markets, core investment-grade bonds (Bloomberg U.S. Aggregate Bond Index, aka the "Agg") had a solid fourth quarter, gaining 1.9%. But 2022 was still the worst year for core bonds in at least 95 years, with the Agg dropping 13.0%. The key driver, of course, was the sharp rise in bond yields; the 10-year Treasury yield ended the year at 3.9%, up from just 1.5% a year prior. High-yield bonds (ICE BofA Merrill Lynch U.S. High Yield Index) had a strong fourth quarter, up 4.0%, but were down 11.2% for the full year.

Alternative strategies and nontraditional asset classes outperformed traditional stock and bond indexes. The standout within the alternatives category was trend-following managed futures strategies, which gained roughly 28% (SG Trend Index) for the year, despite fourth-quarter losses. Flexible/nontraditional bond funds (Morningstar Nontraditional Bond category) were down roughly half as much as core bonds.

Investment Outlook and Portfolio Positioning

Inflation and monetary policy remain the financial markets' key macro focus. U.S. inflation data have improved, suggesting we've seen the peak in inflation for this cycle. But core inflation remains far above the Federal Reserve's 2% target, and the Fed's message is that it intends to maintain restrictive (tight) monetary policy throughout 2023. On the economic growth front, key leading indicators deteriorated further in the fourth quarter, which along with tight monetary policy point to a likely recession in the year ahead. On the positive side, it should be milder than the 2007-08 and 2000-01 recessions.

Our portfolios are built using long-term "strategic" allocations that are matched to a client's risk tolerance and goals. So while our investment approach is not based on short-term stock market forecasts, we do assess shorter-term (12-month) downside risk in our portfolio construction and management. We continue to believe that the current price of the S&P 500 does not adequately discount the likelihood and potential magnitude of a coming earnings recession. This was our view one quarter ago, and since that time the S&P 500 has climbed a few percent while the economic data has worsened. Analysis of past data on recessions, earnings declines and stock valuations suggest a realistic possibility of further double-digit declines in the S&P 500 from current levels. Meanwhile, with yields much higher than a year ago, core bonds are now relatively more attractive versus stocks and we maintain a small underweight to global equities in favor of core bonds.

Higher core-bond yields mean both better absolute returns and greater downside protection than what we saw a year ago when yields were at historically low levels and vulnerable to rates being driven up by inflation. In our base case economic scenario we expect core bonds to deliver a positive return if a recession plays out, providing valuable portfolio ballast while riskier assets such as equities get hit. For example, if the 10-year Treasury yield were to decline 75 bps (to 3.10%) over the next 12 months, we estimate the core bond index (the Agg) would return close to 9% (from yield plus price gains). And while we consider 12-month downside in managing portfolios, we also seek to be opportunistic and take advantage of compelling opportunities that arise when markets swing too far. To that point, our core bond allocation also acts as "dry powder" that we can tactically allocate into stocks and other higher-returning assets at much more attractive prices should they occur. In all, the improvement in core bonds from a year ago, combined with our confidence in the long-term return outlook for stocks (especially non-U.S. at current valuations) leaves us satisfied with our positioning and unwilling to make more defensive bets based on predicting the shorter-term, which is not part of our approach.

Beyond core bonds, there are other fixed-income sectors that offer attractive risk-return potential, which we access via our selected active managers. Within our global equity allocation, we have a modest tactical tilt to emerging markets that we believe will benefit over the next few years from faster sales growth, improving profit margins and the tailwind of a declining U.S. dollar.

Finally, we maintain core positions in trend-following managed futures and other marketable (liquid) alternatives. Managed futures returns were strongly positive in 2022 as traditional bonds and stocks,the building blocks of many portfolios, saw large declines. These alternative strategies, with their differing sources of return and risk, should continue to provide tactical and longer-term strategic benefits to our balanced portfolios.. They are much less dependent than traditional investments on the type of macro regime that unfolds over the coming years (e.g., deflation, stagflation, inflation, or growth).

Closing Thoughts

As 2022 has reminded investors, we should "expect the unexpected, and expect to be surprised." This is expressed in our portfolio construction and investment management via balanced risk exposures, diversification and forward-looking analysis that considers a wide range of potential scenarios and outcomes.

We believe 2023 will likely present us with some excellent long-term investment opportunities. Although in our base case we also expect we'll first have to go through a recessionary bear market with possibly significant market volatility including further declines in global equity prices.

While challenging, it is important for long-term investors to stay committed to their strategy through rough periods in the market. Riding out shorter-term turbulence and discomfort is necessary to earn the long-term "equity risk premium" – the additional return from owning riskier assets such as stocks that most investors need to build long-term wealth and achieve their financial objectives.

Outside of the U.S. stock market, we already see attractive medium-term expected returns from international and emerging markets stocks. (With a recession they will likely get more attractive.) A declining dollar, as we expect medium-term, would further fuel non-U.S. equity returns.

Fixed-income assets and high-quality bonds are also now reasonably priced with mid-single digit or better expected returns. Core bonds will also provide valuable portfolio ballast in the event of a 2023 recession. Our investments in alternative strategies and trend-following managed futures strategies provide further resilience to our portfolios no matter how the next year (and years) play out.

From all of us, we thank you for your trust and wish you and yours a healthy, happy, and prosperous New Year.

—Litman Gregory Investment Team

Research Update: Trend Following with Managed Futures

We have long been proponents of managed futures strategies for their powerful diversification benefit, and more specifically for their ability to deliver positive contributions to a portfolio at times when nothing else seems to be working. Understanding how trend-following managed futures' strategies work, and how they take advantage of market and investment trends, is important for setting expectations for what is behind their performance. The evidence of the long-term value that managed futures bring to a balanced portfolio of stocks and bonds is compelling, however there can be shorter periods where sharp see-saw patterns can lead to disappointing returns. But in a year like 2022 that saw significant declines for both stocks and bonds, managed futures experienced large gains (see table below) and were one of the only asset classes to provide meaningful downside protection.

What Are Managed Futures and Trend-Following Strategies?

Managed futures strategies are employed by investment managers who are registered with the Commodities Futures Trading Commission ("CFTC') as Commodity Trading Advisors (CTAs)– a designation that establishes proficiency requirements and oversight for those advising on and trading in derivatives including futures contracts.

Managed futures strategies can be market-neutral, where they seek to identify securities mispricings and can play spreads or use arbitrage to capitalize on them, or trend following, where they can use technical or fundamental data to inform buying or shorting futures to capture either rising or falling price trends in various markets such as stocks, bonds, commodities and currencies. Our due diligence work has led us to favor quantitatively driven trend-following managed futures strategies, for several reasons. While most strategies we look at bring the benefit of very low correlation to core asset classes like stocks and bonds, we have more confidence in the trend-following strategies because of the ongoing persistence of trends which are a primary driver of absolute returns for these quantitative approaches. Strategies that use fundamental analysis can be more dependent on qualitative judgments and in theory this can reduce the reliability of the diversification benefit during periods when it's needed most.

But trend following strategies require the existence of trends in order to work. Periods with weak or choppy trends and poor relative performance from trend following managed futures strategies inevitably lead some to question whether fundamental changes to investor behaviors – perhaps driven by information technology, automated trading, artificial intelligence, etc. – mean the kinds of trends we've seen in the past are unlikely to occur in the future. While we acknowledge and observe that there are periods where trends are weaker, we see no evidence suggesting that going forward we are unlikely to continue to see the kinds of trends that managed futures strategies can take advantage of to produce positive returns for investors.

A very simple way to think about the persistence of trends over time in this investment context is well described by The Hedge Fund Journal[1], which writes:

> **...many managed futures strategies profit from sustained capital flows in financial markets. These flows occur as a particular market moves from a state of imbalance toward a new equilibrium. Capital flows can take the form of rising markets as well as falling markets..."**

What that description captures nicely is the point that trends aren't just seemingly random ebbs and flows that may or may not persist for any particular duration. They are deeper rooted and connect to innate investment behavior in which it takes time for "water to find its own level" as underlying fundamentals change and are eventually reflected in pricing.

What We Look for in Managed Futures Strategies

The sometimes black-box nature of the quant approaches adds to the challenge of identifying managers likely to deliver the complementary performance we seek from owning managed futures. While managers are not likely to share exact details on the inner workings of their proprietary models, our research on the strategies we have selected has allowed us to gain a strong sense of their overall approach, including:

- The use of shorter-term, mid-term or longer-term trend signals
- The degree to which these can dynamically change
- How various signals are weighted (e.g., always constant versus overweighting stronger signals)
- Which markets are traded and how they weight various markets and contracts
- Their volatility target and whether it can change
- How allocations to other strategies involving factors like carry or mean reversion are determined (if any are used, as these are much less common than trend following and have different return profiles)

In assessing performance, we look at attribution to understand how various aspects of the strategy have contributed to performance during historically relevant periods. The more models they use and markets they trade the more difficult it can be to accurately determine attribution, especially during periods with weaker trends. However, during periods of stronger performance for trend followers, like 2008, 2014 and 2022, attribution becomes more clear and helps us set performance expectations in different market environments with somewhat more confidence.

That said, just as with equity managers, some managed futures approaches will work better during certain market environments than others. Given that we don't believe it's realistic to predict those environments over shorter periods, we want manager diversification in our managed futures allocation. The attributes we look for in managers we use in our portfolios include:

- Intellectual honesty and humility about the inherent limitations of creating, evaluating and adapting models
- Reasonable level of transparency around model specifications and portfolio construction
- Sensible and clear approach to risk management

- Balance of trying to improve the process over time (in terms of models, portfolio management, trading costs, etc.) without over-optimizing for recent performance/market environment
- Good historical performance, obviously, but performance that makes sense in the context of the manager's investment style
- There should be periods of poor performance and the manager should be open in explaining them and, again, it should make sense in the context of their investment process/style
- Strong firm-level infrastructure and operational capabilities

Our due diligence work on managers and the strategies they employ helps us create a diversified allocation to managed futures where in aggregate we have confidence in the benefit it brings to the portfolios we manage — namely that they improve the risk-return profile through their strong diversification benefit.

Diversification Benefits of Managed Futures

Managed futures are regarded as an "alternative" asset class, in that their role is to provide diversification and mitigate the volatility and downside risk of a portfolio primarily comprised of more traditional investments, such as stocks and bonds. And the compelling evidence that managed futures improve the long-term risk return profile of an otherwise-diversified portfolio convinced us a number of years ago to include managed futures in our standard client portfolios. We will walk through some of the more compelling evidence by looking at portfolios with and without managed futures in terms of their long-term returns, volatility and drawdowns in bad market environments.

If you look at adding managed futures pro rata to a 60/40 portfolio (60% stocks/40% bonds) at various allocation levels, starting with 5% managed futures and increasing at 5 percentage point increments up to 25% managed futures (1/1/2000 through 9/30/2022, rebalancing annually), each additional notch higher in the managed futures allocation modestly increases returns since inception, and significantly decreases the portfolio's standard deviation (which measures the volatility of returns), thus also materially increasing risk-adjusted return measures (shown as the Sharpe Ratio and Sortino Ratio).[i]

Time Period: 01/01/2000 - 12/31/2022	Annualized Return	Cumulative Return	Standard Deviation	Sharpe	Sortino
45% US Stocks, 30% Agg Bond, 25% SG CTA	5.77	263.35	7.01	0.60	0.93
48% US Stocks, 32% Agg Bond, 20% SG CTA	5.79	264.96	7.38	0.58	0.88
51% US Stocks, 34% Agg Bond, 15% SG CTA	5.80	266.09	7.79	0.55	0.83
54% US Stocks, 36% Agg Bond, 10% SG CTA	5.81	266.72	8.25	0.53	0.78
57% US Stocks, 38% Agg Bond, 5% SG CTA	5.81	266.85	8.75	0.50	0.74
60% US Stocks, 40% Agg Bond	5.81	266.46	9.28	0.48	0.70

See below for important composite disclosure[2]

These measures are impressive, but — to mangle an investment adage — you can't eat Sharpe Ratio. The investor experience is usually driven much more by absolute numbers, positive or negative. Looking at the reduction in drawdowns in various crisis periods may be the most valuable way to understand the real-life implications of a managed futures allocation.

Below we show the reduction in drawdowns of a 60/40 portfolio with the managed futures combinations, using as examples the bear market following the Tech Bubble (2000-02); the Global Financial Crisis bear market (2007-09); and the current inflation-/interest-rate- driven bear market. Seeing historical data showing a benefit probably has some resonance, but there's nothing quite the same as actually living through a bear market like the current one to reinforce the power of diversifying strategies.

Tech Bubble Drawdown	Max Drawdown	Peak Date	Trough Date	Recovery Date
45% US Stocks, 30% Agg Bond, 25% SG CTA	-10.61	2/1/2001	9/30/2002	5/31/2003
48% US Stocks, 32% Agg Bond, 20% SG CTA	-12.31	2/1/2001	9/30/2002	9/30/2003
51% US Stocks, 34% Agg Bond, 15% SG CTA	-14.34	9/1/2000	9/30/2002	10/31/2003
54% US Stocks, 36% Agg Bond, 10% SG CTA	-16.73	9/1/2000	9/30/2002	12/31/2003
57% US Stocks, 38% Agg Bond, 5% SG CTA	-19.07	9/1/2000	9/30/2002	12/31/2003
60% US Stocks, 40% Agg Bond	-21.37	9/1/2000	9/30/2002	2/29/2004

GFC Drawdown	Max Drawdown	Peak Date	Trough Date	Recovery Date
45% US Stocks, 30% Agg Bond, 25% SG CTA	-20.59	11/1/2007	2/28/2009	3/31/2010
48% US Stocks, 32% Agg Bond, 20% SG CTA	-22.67	11/1/2007	2/28/2009	3/31/2010
51% US Stocks, 34% Agg Bond, 15% SG CTA	-24.73	11/1/2007	2/28/2009	4/30/2010
54% US Stocks, 36% Agg Bond, 10% SG CTA	-26.76	11/1/2007	2/28/2009	10/31/2010
57% US Stocks, 38% Agg Bond, 5% SG CTA	-28.77	11/1/2007	2/28/2009	10/31/2010
60% US Stocks, 40% Agg Bond	-30.75	11/1/2007	2/28/2009	12/31/2010

2021/2022 Drawdown	Max Drawdown	Peak Date	Trough Date	Recovery Date
45% US Stocks, 30% Agg Bond, 25% SG CTA	-8.60	1/1/2022	-	-
48% US Stocks, 32% Agg Bond, 20% SG CTA	-10.91	1/1/2022	-	-
51% US Stocks, 34% Agg Bond, 15% SG CTA	-13.22	1/1/2022	-	-
54% US Stocks, 36% Agg Bond, 10% SG CTA	-15.54	1/1/2022	-	-
57% US Stocks, 38% Agg Bond, 5% SG CTA	-17.85	1/1/2022	-	-
60% US Stocks, 40% Agg Bond	-20.16	1/1/2022	-	-

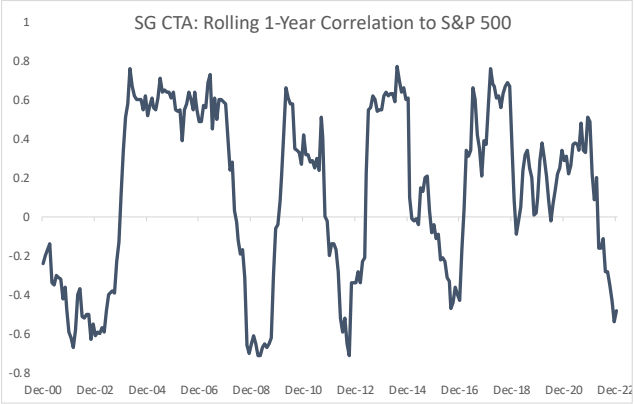
Once again, the numbers are impressive. Even a small 5% allocation to managed futures would have saved you about 2.3 percentage points of performance this year – reducing a loss of 20.2% to 17.9%. A 10% allocation would have come close to cutting losses by a quarter.[ii]

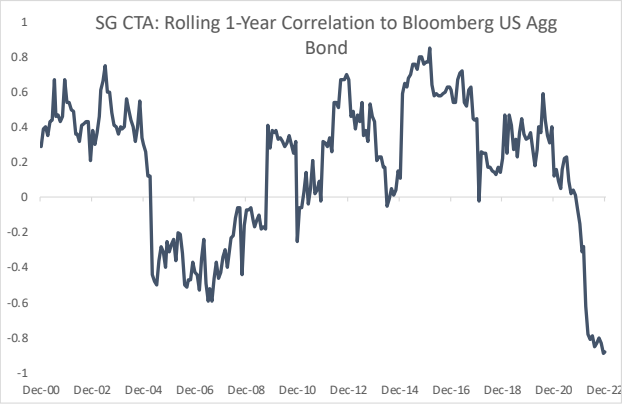
How We Allocate to Managed Futures

The answer doesn't come from looking at an asset allocation optimizer. If the goal is increasing risk-adjusted returns, an optimizer would tell you to allocate more than most investors are comfortable with, typically in the range of one-third of the portfolio[iii] with some variation higher or lower depending on the measurement period. This is one case where the decision should clearly be based on more than numbers.

A practical constraint on sizing allocations to highly diversifying strategies like managed futures is how much of a portfolio we are comfortable holding in an unconventional strategy that may experience extended periods of underperformance relative to other portfolio investments. This can be particularly challenging during periods when traditional stocks and bonds are doing well while managed futures are struggling.

Why would an optimizer tell you to invest so much in managed futures? Simply put, because the strategy (as measured by the SG CTA Index) has generated similar long-term returns to a 60/40 portfolio[iv], but with essentially zero long-term correlation to both stocks and bonds: specifically, -0.09 correlation to the S&P 500 Index from January 2000 through September 2022, and 0.08 correlation to the Bloomberg Aggregate Bond Index (using monthly returns). Rolling 12-month correlations range between about -0.8 and +0.8 for both, with the potential for dramatic shifts over short timeframes. This makes intuitive sense given the potential for managed futures to be long or short any asset class. The combination of long-term positive expected returns with no correlation (and a propensity to perform well during market dislocations) we feel makes the strategy an incredibly valuable addition to a portfolio.





Source: Morningstar Direct as of 12/31/2022

How Should You Fund a Managed Futures Allocation?

Because managed futures have essentially no long-term correlation to anything, it makes sense to fund them pro rata from an existing allocation. The existing allocation has presumably been balanced for the investor's return goals and risk tolerance based on the performance and correlation characteristics of its underlying components. Funding pro rata from these sources should preserve the expected return profile of the portfolio's core, while adding the diversification benefits and (likely) crisis alpha of managed futures.

A reasonable case could also be made to fund an allocation more than pro rata from bonds, given stocks outperform bonds over long time horizons, and managed futures tend to perform well during extended stock market weakness (i.e., periods of weeks to months, not days to weeks). The "optimal" allocation depends on what is being optimized (risk-adjusted returns, expected maximum total return, etc.).

Opportunity costs factor into our calculus, particularly as an allocation becomes larger. To pick an extreme (and unrealistic) example for effect, if a managed futures allocation was funded entirely from equities beginning in 2015, the opportunity cost of that decision would have been huge over the next five years, as managed futures were essentially flat cumulatively, while the S&P 500 was up over 70% and a 60/40 portfolio was up almost 50%. One could of course find counterexamples, but the point is simply that the further one moves away from pro rata funding, the more it becomes an active "bet" against existing asset allocation, and the greater the chance of an extreme outcome that could derail an otherwise successful investment plan by potentially leading an investor to throw in the towel.

Summary

By virtue of their almost total lack of long-term correlation to other asset classes, combined with their ability to generate a modest long-term absolute return, trend following managed futures are a powerful diversifier to broader portfolios that include a traditional mix of stocks and bonds. They generally improve risk-adjusted returns and have provided downside protection during periods when stocks and bonds experienced large downturns. An added benefit in today's economic environment is that historically managed futures have also been an effective inflation hedge during periods of elevated inflation.

But managed futures are complicated, in more ways than one. The trend following strategies used and the asset class itself can be difficult to understand and that can impact investors' comfort. We hope the information we presented here helps to demystify this space and explain the fundamental aspects of what these investment strategies do and how they work.

Beyond the complexity, managed futures can sometimes be frustrating to own given their tendency to generate lower absolute returns relative to stocks and bonds during extended periods when those assets classes are performing well. This was the case for a lengthy stretch prior to 2022, and some investors found

it difficult to stick with their allocation to managed futures. Now, after a difficult year for traditional stock and bond markets, and where managed futures had very strong absolute and even stronger relative performance, it is a good time to remember that it may be necessary to be patient in order to gain the diversification and downside mitigation benefits that managed futures can bring over the long term.

Tax Planning Opportunities from the SECURE Act 2.0

At the end of last year, the long-awaited SECURE Act 2.0 of 2022 ("the Act") was passed by Congress and signed into law. As an update to the "Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019" the Act expands on the earlier provisions with a continued goal to encourage retirement savings and expand the opportunities available to individuals centered around contributions and eventual distributions.

Effective January 1, 2023, the Act includes many new and revised provisions, with the most notable related to the following planning issues which we will be reviewing with our clients.

Notable Updates & Revisions in Secure Act 2.0

- **Changes to retirement account required minimum distributions (RMDs):**
  - Starting in 2023, the new required start year for retirement account required minimum distributions (RMDs) has been delayed to age 73 (from age 72), and starting in 2033 the required start year will be delayed to age 75.
  - The penalty assessed for previous RMD amounts not taken has been reduced from 50% to 25%. This penalty will be further reduced to 10% if the IRA owner withdraws the amount not taken and submits a corrected tax return in a timely manner.
  - Beginning in 2024, RMDs will no longer be required from employer sponsored plan Roth accounts.
- **Increase to retirement account catch-up contributions:**
  - Starting in 2025, the age-based annual catch-up contributions allowed for 401(k), 403(b) and 457(b) plan participants 50 or older will increase and apply to participants ages 60-63. In most cases, the catch-up contribution will bump up to $10,000 and be indexed for inflation annually.
    - There is an exception to these increased catch-up amounts: Plan participants who earned $145,000 or more in the prior calendar year will be required to make all catch-up contributions into a Roth plan account. In other words, for those participants, catch-up amounts will be made after-tax and will not receive the typical tax deduction that pre-tax contributions receive.
  - Beginning in 2024, IRA's catch-up contribution limit for ages 50 or older of $1,000 will be indexed for inflation and could therefore increase each year.
- **529 plans:**
  - Starting in 2024, 529 plan accounts held for 15 years or longer are eligible for the owner to choose to roll assets from the plan into a Roth IRA in the name of the beneficiary.
  - These Roth IRA rollover contribution amounts from a 529 plan cannot exceed the annual Roth IRA contribution limits each year and cannot exceed a total lifetime limit of $35,000.
- **Employer matching Roth contributions:** Employers can now provide employees with the option to receive matched contributions to a Roth plan account; however, it may take time for employers to be set up to offer this benefit. Up until now, employer matching contributions have been made on a pre-tax basis.

- **Qualified Charitable Distributions (QCDs):**
  - Beginning in 2023, individuals age 70.5 or older may elect to use part of their annual QCD limit (currently $100,000) to make a one-time gift, limited to $50,000 adjusted annually for inflation, to a charitable remainder unitrust, a charitable remainder annuity trust or a charitable gift annuity.
  - In considering this new option, it will be important for IRA owners to weigh the cost of setting up a charitable trust entity against the tax benefit of using this technique to make a charitable gift out of an IRA at the allowed gift level.

If you would like to see how any of the above planning topics apply to your situation, please reach out to your Litman Gregory Wealth Management advisor to discuss them further. We can also coordinate with your tax advisor to determine how these changes may impact you and your tax preparation.

Other Key Tax Changes in 2023

In addition to the changes that came as a result of the SECURE Act 2.0, several other tax related changes went into effect that may impact your tax planning situation. Here are a few key highlights for changes effective starting 2023:

- **401(k), and other employer-sponsored plan contribution limits:** The annual contribution limit for 401(k)s and similar plans increased to $22,500 (up from $20,500). Those age 50 or older can still make an extra "catch-up" contribution of now $7,500, for a total of $30,000.
- **IRA contribution limits:** Traditional IRA and Roth IRA contribution limits (combined) increased to $6,500, or $7,500 with the catch-up for those age 50 or older. The modified adjusted gross income limitation to make Roth IRA contributions also increased to $153,000 for those filing single, and $228,000 for those filing joint tax returns.
- **Annual gift tax exclusion limits:** The annual amount that any individual can give to another individual without the gift being reportable to the IRS as a taxable gift (or require the use of part of a lifetime gift and estate tax exemption amount) is now $17,000 (up from $16,000 in 2022).
- **Estate and gift tax exemption limits:** The federal estate and gift tax exemption amount is now $12.92 million per person, up from $12.06 million in 2022. However, it is important to note that as the estate tax law currently stands, this exemption amount will "sunset" after 2025 and revert to the 2016 limit of $5 million, indexed for inflation.

Unpacking the Benefits of Property & Casualty Insurance

The start of a new year can present an opportunity to refocus on health and wellness, including financial protection and well-being. As we look to find ways to ensure our financial house is in order, it is important to include an annual review of the insurance that protects your actual house, property and general liability to ensure you have sufficient and optimal coverage before you may need it.

The insurance that provides this kind of coverage is aptly called "property and casualty" insurance. Property insurance helps cover the "stuff" you own, like your home(s) or your car(s). Casualty insurance provides liability coverage (often referred to as "umbrella" coverage) to help protect you and your financial assets in the event you are found legally responsible for an accident or incident where another party is impacted.

Even though this kind of coverage is important for most people, being under-insured is not uncommon. Life gets busy. Equity grows. Remodels happen. Investment properties and teenage drivers creep into the mix. Suddenly your coverage may not be sufficient.

A regular review of your insurance can help identify exactly what your policies cover, and where there could be gaps. Many insurance laws have also changed in recent years, so what's required may have changed, or coverage in certain areas can be more difficult to obtain. So, a periodic discussion with your Litman Gregory Wealth Management advisor and your insurance professional can help identify areas to consider.

What should you be looking for in your coverage or discuss with your property/casualty insurance professional?

We suggest you ask about...

- The **common causes of claims in your area**. The answers might surprise you, e.g., water leaks, sewer backup, litigation, wildfire.
- Whether your **policy includes sewer backup** (yuck!) coverage. It's not something people want to talk about but is a relatively common claim and many policies offer low if any coverage.
- If you have a **second property or rental, what is covered**? VRBO or Airbnb? It's a good idea to check to see that the policy is written specifically for and covers these uses.
- Whether you have **adequate replacement cost coverage** if you needed to rebuild. Construction costs have spiked in recent years. After a local disaster, there can be a surge in demand for contractors. Does your policy include language covering even higher replacement costs in the event of a demand surge? How much will the policy cover for bringing repaired items up to current building codes? Often this is not covered by "replacement" cost and requires additional coverage.
- Will your policy **pay for a rental** while you are making repairs?
- Will your policy **pay you cash if you don't want to rebuild** or want to rebuild elsewhere?
- If you have **considered potential liabilities** that could arise at your home, rental or while driving your car. It is important to understand which liabilities your policy will cover and determine if coverage is sufficient with or without an umbrella policy.

In addition to the above, here are some questions to consider, as these situations would be important to mention to your insurance provider so they can evaluate any changes needed to your coverage:

- Are you living in a new home, or plan to make a change soon?
- Has your home value increased significantly since your coverage was purchased?
- Did you recently remodel or install a swimming pool?
- Do you have teenage drivers?
- Do you use your car for business?
- Has your wealth increased significantly?
- Did you recently adopt a pet?
- Do you own an investment property?

Property and casualty insurance is one of the common planning topics we discuss with our clients to ensure that the proper coverage is in place to protect them and their property in the event of loss or liability. What we've covered in this post are only some of the key areas to consider, so we recommend reaching out to your advisor to discuss your situation further. If needed, your advisor can also provide a referral to a trusted property/casualty insurance professional to review the details of your existing coverage.

Wealth Management Team Updates

We are committed to providing a quality team of experienced professionals to support our clients' financial success in the decades and generations to come. Below, we share news of the recent advancements within the Litman Gregory Wealth Management team.

Gretchen Hollstein and Monica Muñoz Named as 2023 Forbes Top Women Wealth Advisors Best-in-State

Litman Gregory Senior Advisors Gretchen Hollstein, CFP® and Monica Muñoz, CFP® have again been named by Forbes as Top Women Wealth Advisors Best-in-State for 2023. This year's list spotlights 1,697 advisors nationwide who collectively manage $2.3 trillion for clients.

Gretchen has previously been recognized by Forbes as one of the Top Women Wealth Advisors and Best-in-State Wealth Advisors in both 2020 and 2021. Gretchen has been providing advisory services for over 25 years and working with Litman Gregory clients since 2005. Her experience includes extensive work in personal financial analysis, asset allocation, retirement planning, and multi-generation family legacy planning.

"We are grateful to be included in a list of top women wealth advisors," said Gretchen. "This recognition is only possible because of the wonderful team here at Litman Gregory Wealth Management, and I am proud of our woman-majority work force! It's a honor to work alongside the men and women here to guide our clients through many market environments and personal financial transitions. Many thanks to Forbes and SHOOK Research for shining a light on our efforts."

Monica has previously been named as one of Forbes' Top Women Wealth Advisors in 2022 and Top Next-Gen Wealth Advisors in 2021, and has been serving Litman Gregory clients since 2007. Monica provides wealth planning and investment advisory services to individuals, families, and nonprofits, with a specialty in next generation wealth.

"It is an honor to be recognized by Forbes alongside my colleague, Gretchen Hollstein" said Monica. "It is a privilege to be entrusted by our clients to help them through different stages of their financial lives as we aim to help them gain more financial peace of mind through the work of our entire incredible team ."

Data provided by SHOOK® Research, LLC — Data as of 9/30/22. America's Top Women Advisors ranking was developed by SHOOK Research and is based on in-person, virtual and telephone due diligence meetings to evaluate each advisor qualitatively, a major component of a ranking algorithm that includes: client impact, industry experience, review of best practices and compliance records, firm nominations; and quantitative criteria, including: assets under management and revenue generated for their firms. Investment performance is not a criterion because client objectives and risk tolerances vary, and advisors rarely have audited performance reports. SHOOK's research and rankings provide opinions intended to help investors choose the right financial advisor and are not indicative of future performance or representative of any one client's experience. Past performance is not an indication of future results. Neither Forbes nor SHOOK Research receive compensation in exchange for placement on the ranking. For more information, please see **www.SHOOKresearch.com**. *SHOOK is a registered trademark of SHOOK Research, LLC.*

Litman Gregory Advisors In the News

We are proud that our team can be a resource to industry writers and news publications as they research information about financial management issues. This Fall, two of our Litman Gregory Advisors were quoted in local and national news articles.

Most recently, Gretchen Hollstein was quoted by Karen Hube in "The Conundrum of Donor-Advised Funds" in the December 5th Barrons' PENTA.

"The original interest has been as convenient pass-throughs to charity that help people track all of their gifts from one place," says Gretchen Hollstein, a senior advisor at Litman Gregory in San Francisco. "But there are a lot more tax and estate-planning reasons high-net-worth individuals and families are starting to use DAFs." **Read the article**

Earlier this Fall, Chris Wheaton was quoted by Kathleen Pender in "Here are 7 things investors can do as stocks keep falling – without trying to time the market" in the September 30th San Francisco Chronicle.

"The one- or two-year Treasury has one of the best risk-reward profiles you will see in the marketplace now," said Chris Wheaton, senior investment adviser with Litman Gregory Wealth Management in Larkspur. **Read the article**

Please feel free to reach out to your Litman Gregory advisor if you have any questions about the financial topics covered in these, or any, industry publications.

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Footnotes

[1] **Source: The Hedge Fund Journal ; originally published June 2013 ; https://thehedgefundjournal.com/an-overview-of-managed-futures/*

[2] *US Stocks represented by S&P 500, a market-cap weighted index that includes 500 of the largest companies. Agg Bond represented by Bloomberg US Aggregate Bond Index, a broad-based benchmark that includes U.S. dollar denominated investment-grade bonds. SG Trend Index is designed to track the largest trend following CTAs and represent the trend followers in the managed futures space.*

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A list of all recommendations made by LWM within the immediately preceding one year is available upon request at no charge. For additional information about LGWM, please consult the Firm's Form ADV disclosure documents, the most recent versions of which are available on the SEC's Investment Adviser Public Disclosure website (www.adviserinfo.sec.gov) and may otherwise be made available upon written request to compliance@lgam.com

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The Standard & Poor's 500 Composite Stock Price Index is a capitalization-weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the U.S. economy. Stocks in the Index are chosen for market size, liquidity, and industry group representation.

The MSCI ACWI Index represents the performance of large- and mid-cap stocks across 23 developed and 24 emerging markets. The index covers 2,900 constituents across 11 sectors and approximately 85% of the free float-adjusted market capitalization in each market. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. With 799 constituents, the index covers approximately 85% of the free float- adjusted market capitalization in each country.*

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 23 emerging market country indexes: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar- denominated, fixed-rate taxable bond market.

The US High-Yield Market Index is a US Dollar-denominated index which measures the performance of high-yield debt issued by corporations domiciled in the US or Canada.

The ICE BofA US High Yield Index is market capitalization weighted and is designed to measure the performance of U.S. dollar denominated below investment grade (commonly referred to as "junk") corporate debt publicly issued in the U.S. domestic market.

The ICE U.S. Dollar Index is a geometrically-averaged calculation of six currencies weighted against the U.S. dollar.

The S&P/LSTA Leveraged Loan 100 Index (LL100) dates back to 2002 and is a daily tradable index for the U.S. market that seeks to mirror the market-weighted performance of the largest institutional leveraged loans, as determined by criteria. Its ticker on Bloomberg is SPBDLLB.

The Morningstar LSTA US Leveraged Loan 100 Index is designed to measure the performance of the 100 largest facilities in the US leveraged loan market.

The MSCI Hedged Indexes include all of the securities and weights of each corresponding unhedged MSCI Parent Index, enabling investors to measure the impact of hedging currency, for all the constituents of the Parent Index.

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Estimated Returns Disclosure

Scenario Definitions

Downside: The economy falls into a deep and sustained recession for any of various reasons, such as deleveraging/deflation, unexpected systemic shock, geopolitical conflict, Fed or fiscal policy error, etc. At the end of our five-year tactical horizon, S&P 500 earnings are below their normalized trend and valuation multiples are below-average reflecting investor risk aversion. Inflation and 10-year Treasury nominal and real yields are very depressed.

Base: Consistent with long-term economic and market history, reflecting economic and earnings growth cycles that are interspersed with recessions around an upward sloping normalized growth trendline. Inflation is at or moderately higher than the Fed's 2% target level and 10-year Treasury real yields are around zero percent to slightly positive. For the S&P 500, we now bookend our base case with a lower-end and upper-end estimate:

At the lower end of our base-case fair-value range, reflation efforts are successful and nominal economic growth is higher than the average. However, the economy overheats, and valuation multiple and some margin compression largely offset the favorable macro backdrop.

At the upper end, reflation efforts are also successful, nominal economic growth is higher than observed since the 2008 financial crisis on average, profit margins move slightly higher, and valuation multiples are also slightly higher than the recent historical average.

Upside: S&P 500 earnings end the period well above their long-term (base case) normalized trendline. Valuation multiples are well above average and higher than the upper end of our base case. The Fed exits its accommodative policy without major economic or market disruptions, although a normal recession within the five-year period is still possible. Inflation is around or moderately higher than the Fed's 2% average target. Real 10-year Treasury yields are around zero percent to negative as the Fed succeeds in keeping rates from materially rising.

Endnotes

[i] *We start to see diminishing marginal benefits to annualized returns at a 25% managed futures allocation, though the marginal benefits to risk-adjusted returns are still very strong. An optimization would still be increasing the allocation, but we limit our analysis to 25% as the high end of the range that bold advisors might be comfortable with, although we suspect that the practical limit for the vast majority is lower than 25%.*

[ii] *We should note that this year the value in reducing losses is somewhat greater than in prior crises since stocks and bonds have declined simultaneously, whereas in prior downturns bonds have cushioned the losses from stocks. Although this relative level of protection may not be the norm, we think it still reinforces one of the more attractive features of managed futures: the flexibility of the strategy offers the potential to protect against a variety of dislocations (including ones considered unlikely, or more importantly, ones that are not even contemplated at all).*

[iii] *We used the optimization tool at PortfolioVisualizer.com to look at Sharpe Ratio optimization for two-asset portfolios of VBIAX (Vanguard Balanced Index Fund) and a managed futures mutual fund (either AQMIX (AQR Managed Futures Strategy Fund) or ASFYX (AlphaSimplex Managed Futures Strategy Fund), two of the oldest managed futures mutual funds, both dating back to 2010. Even starting at the beginning of the decade where 60/40 dominated, an optimization through September 30, 2022 produced a portfolio of 65% VBAIX and 35% managed futures, regardless of which fund was chosen, despite their differing total long-term returns.*

A CME Group study cited by RCM Alternatives (https://www.rcmalternatives.com/2016/04/the-optimal-allocation-to-managed-futures) found the optimal allocation to managed futures for the 20 years ending February 2008 (right before the worst of the GFC) to be 20%. RCM did the same exercise for the period of January 1994 through December 2015 and found the updated optimal allocation to be 35%, though ending the study any year end 2008 through 2012 would have resulted in a 40% managed futures allocation.

[iv] *This is highly endpoint sensitive, as managed futures outperformed the 60/40 portfolio significantly for the decade of the 2000's, the reverse was true in the 2010's, and the advantage has shifted back to managed futures thus far in the 2020's. An optimization exercise run strictly during one decade versus another (much less one year versus another) could show either dramatically more benefits from including managed futures or essentially no benefit. We think this long-term view that includes strong and weak periods for the strategy is a fair way to look at the question, and we'd note that timing an allocation is not a realistic strategy.*

Contact

Contact our team for more information on our services

415-461-8999 | INFORMATION@LGAM.COM | WWW.LGAM.COM