Advisory Notes

December 2022

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Inflation: When Will the Rate Hikes Stop

During the fourth quarter, the Federal Reserve down shifted its rate hikes from 75 basis points (bps) to 50 bps, hopefully signaling that the aggressive monetary policy was taking hold. The Fed tempered that news with tough talk at Powell's conference signifying rates may have to go higher than expected. (See article *The Fed That Stole Christmas*, page 2.) With the Fed's tough talk, the markets did an about face in December after posting positive results in October and November, but still culminated a positive return for the quarter end, the only one of the year. (See Market Table)

Large cap tech stocks led the way down during the year, as higher interest rates led to lower price/earnings multiples on the stocks. These were the largest capitalized companies which are the most widely held through indexes and ETFs. Now that the Fed has put the income back into fixed income, the highest in the past 15 years, investors have reallocated funds in the face of inflation. Investors traded risk assets for the sure thing with short-term Treasuries and tradeable CDs.

The job market has provided little relief to the rate hikes and a shortage of workers still exists, although some large scale companies have laid off employees or scaled back hiring. The inflation data has moved from more commodity based to a more "sticky" wage and employment inflation. The trend since the 1980s has the Fed holding

See **Inflation** *on Page 2*

Market Table

Valicenti Advisory Services, Inc.
Comparative Index Period Returns
From 12-31-21 THROUGH 12-31-22

	DJIA	S&P 500	NASDAQ	Russell 2000 Index	BBG Barclays AGGR Bond Index	BBG Barclays Muni Bond Index	FTSE Corporate Bond Index	U.S. Treasury Bill Index (90 day)
12-31-21 to 03-31-22	-4.10	-4.60	-8.95	-7.53	-5.93	-6.72	-7.53	-0.12
03-31-22 to 06-30-22	-10.78	-16.10	-22.28	-17.20	-4.69	-3.19	-7.16	-0.26
06-30-22 to 09-30-22	-6.17	-4.88	-3.91	-2.19	-4.75	-3.77	-4.99	-0.38
09-30-22 to 12-31-22	16.01	7.56	-0.79	6.23	1.87	4.48	3.37	-0.25
YTD Return: 12-31-21 to 12-31-22	-6.86	-18.11	-32.54	-20.44	-13.01	-9.20	-15.68	-1.01

The highest compliment our clients can give is the referral of their friends and family. Thank you for your trust!

Director's Chair: The Fed that Stole Christmas

After the release of the October Consumer Price Index (CPI) inflation report on November 10, the market began another rally attempt boosted by yet another cooler CPI print for November. The S&P 500 rallied from 3,748.57 peaking at 4,100 twice over the next five weeks, a 9.4% rally that pulled equity markets out of bear territory. The Federal Reserve (Fed) had indicated that continued cooling of inflation would be a catalyst for stopping interest rate hikes and the market believed the CPI reports were sufficient.

At the Federal Open Market Committee (FOMC) meeting on December 14, the Grinch, as in *How the Grinch Stole Christmas*, showed up to take away all the gains of the rally. The Fed hiked the Federal Funds interest rate 0.5% to a range of 4.25%-4.5%, as expected. Then, the Fed's written statement calling for "ongoing rate hikes will be appropriate" began to unsettle markets along with a peak funds rate forecast that now stood at 5.1% from an earlier 4.6% and market expectations of 4.85%. The Fed also predicted the unemployment rate for 2023 would be 4.6% from earlier projections of 4.4%.

Fed Chairman Powell's comments during the press conference brought a further dour outlook as he stated "there was more work to do" in arresting inflation and the Fed was "taking forceful steps to moderate demand." This was because the "demand exceeds the supply of available workers." The Grinch, I mean the Fed Chairman, is indicating he will need a higher unemployment rate to feel comfortable that inflation has been tamed. Not the usual season's greetings that are shared at this time of year.

While goods inflation is abating, services inflation continues to be sticky. Typically, whenever inflation is not tamed early it moves from goods to services and wages. Since the Fed wasted all of 2021 saying the inflation was "transitory" while taking no action to curb it, the Fed allowed inflation to transfer into services and wages. Wages are sticky as people are unwilling to take pay cuts, so the usual way to lower wage rates is through higher unemployment. What will Cindy Lou Who say when she gets a pink slip?

No jobs equals no packages, boxes or bags much less the roast beast for the feast. It can be said that the Fed even took the last can of Who hash. The only ones who will dance with jing-tinglers, blow who-whoobas and bang their gar-ginkas will be the Fed when another million Americans lose their jobs.

We will have to see if the Fed Chairman's heart grows three times in size averting more interest hikes to curb employment.

Louis F. Ruize
Director of Research/Portfolio Manager

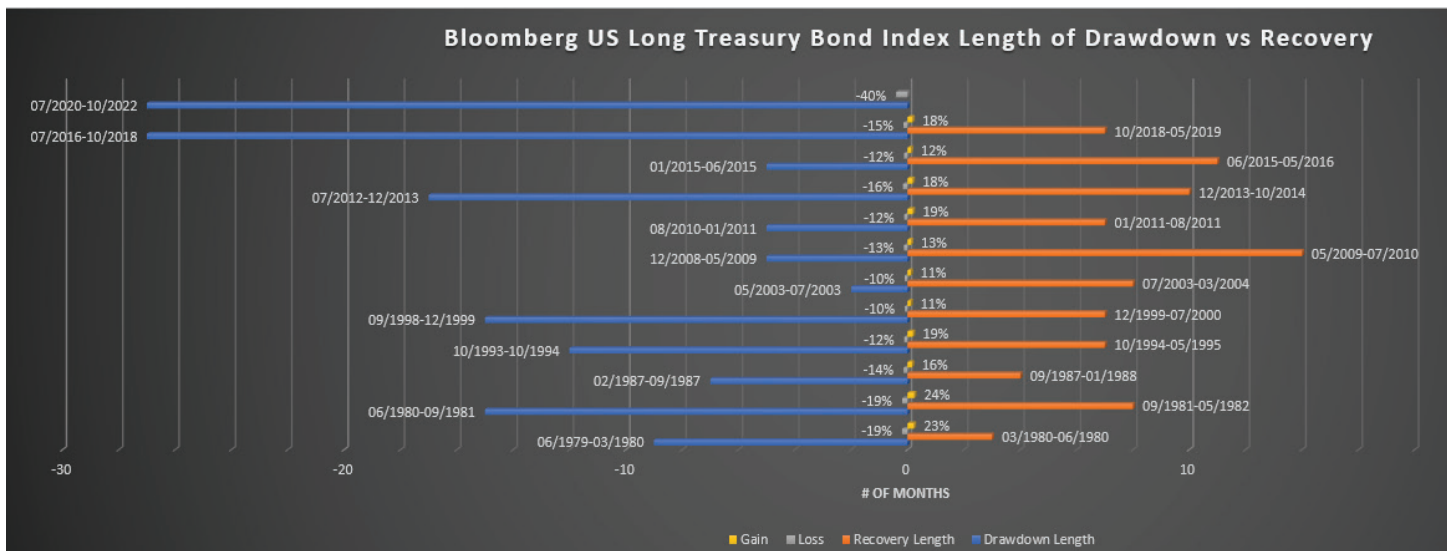
Inflation
(Continued from Page 1)

rates high for as little as three months and as long as 18 months (See Bloomberg Graph below). The yield curve and the dot plots show that rate cuts are projected sometime in mid to late 2023, as the fears of long-term inflation subside.

With all this in focus, we will continue to invest in quality companies with strong balance sheets, high cash liquidity and top management and products. We will continue to focus on your individual long and short-term goals and objectives.

All of us at VASI wish you and your family a very happy, healthy and prosperous New Year!

Joseph M. Valicenti
President/CEO



Source: Bloomberg

Delayed 1099-K Reporting

The new reporting for the Form 1099-K was originally set to start for the 2022 tax year, but has been delayed until the 2023 tax year. Next year many taxpayers will receive Form 1099-K, Payment Card and Third Party Network Transactions, due to the new reporting requirements. The IRS issued a reminder that taxpayers must report all income on their tax return unless it is excluded by law, whether they receive a Form 1099-K, Form 1099-NEC, Form 1099-MISC or any other information.

Currently, Form 1099-K is issued for third party networks transactions only if the total number of transactions exceeded 200 for the year and the aggregate amount of these transactions exceeded $20,000. Taxpayers should receive Form 1099-K by January 31, 2023, if they received third party payments meeting this criteria.

The American Rescue Plan Act of 2021 lowered the reporting threshold for third party networks that process payments for those doing business. Next year a single transaction exceeding $600 can require the third party platform to issue a 1099-K. Money received through third party payment networks from friends and relatives as personal gifts or reimbursements for personal expenses is not taxable. However, if you receive a Form 1099-K reporting incorrect income, you cannot ignore this statement. If the information is incorrect on the 1099-K, taxpayers should contact the payer immediately, whose name appears in the upper left corner of the form. The IRS cannot correct it. If it is not corrected and this income is not reported on your tax return, you will receive a notice from the IRS.

Elizabeth A. Zarnoch, EA
Vice President of Tax and Business Services

Thank You!

As we complete our 38th year, we have much for which to be thankful – our loyal and diverse clients that give us the opportunity to know them, to work with them and to help them along their "financial journey." At the same time, a thank you to our wonderful, dedicated and hardworking staff.

During 2022, we had some updates to our 400 E. Water Street offices. Since our paperless initiative started for our offices, we have been able to free up space to allow for more expansion. This allowed us to build two extra offices and an enhanced investment trading conference room. The area for our administrative team was modified so that they now have private offices. Another space was converted to a signing room and our kitchen/breakroom was expanded and updated. All offices were painted and updated when things were completed. In addition, we updated both our hardware and software, continuing our commitment to technology.

From all of us to all of you, we wish you a prosperous and safe New Year!

Ralph H. Roberts, Jr.
Vice President of Client Services

Happy New Year!

The year of 2022 presented many challenges to the economy and the markets, with the focus on the Federal Reserve's efforts to slow inflation through a series of bold rate increases. This acted as a headwind to both equity and fixed income markets during 2022.

The economic data points created mixed signals during the second half of 2022 and the Federal Reserve found enough evidence that their actions were aiding in slowing inflation and thus slowed the pace of rate hikes toward the end of 2022. The Federal Reserve will most likely continue rate increases in the first quarter of 2023, but at a reduced pace.

With many of the same conditions and concerns of late 2022 still present in the first quarter of 2023, our equity focus remains on companies with strong balance sheets, strong cash flows and stable earnings, as we believe that quality matters. In addition, we continue to focus on higher quality fixed income, as we believe investment grade bonds provide good opportunities in 2023, with a potential of a rebound from 2022.

With market volatility likely for the near future, we will remain flexible with our asset mix of:

- Money markets and shorter term Treasuries 5-10%
- Fixed income 30-40%
- Equities in a range of 50-60%

This asset mix will vary based upon client specific directives, needs for income and risk levels.

Jeffrey S. Naylor
Executive Vice President/CFO

Analyst Corner

The final quarter of 2022 saw some reversal of risk asset weakness seen in the prior quarter, as hotter CPI inflation prints were flipped on their head and instead came in weaker than expected for October and November. This ignited the idea of an earlier pivot away from current hawkish Fed policy. The final quarter of the year saw the S&P 500 rally 7.56% as the FTSE Corporate Bond Index gained 3.37%.

While market based measures of expected inflation for the year ahead soften, we are left with the reality that both action and rhetoric out of the Federal Reserve still appear to be in a tightening mode, albeit not at the torrid pace seen earlier in the year. The same policymakers caught behind the curve in 2022 are now continuing to signal further tightening into 2023. Some uncertainty about what comes next is the backdrop we find ourselves in as we head into the New Year. More recently, market action seems to be more on the side of current policy being closer to the end of a tightening cycle than not.

The 10-Year Treasury yield lifted from 1.51% at the beginning of the year, all the way to 3.88% by year-end as stickier inflation and the means of fighting it kicked in. This was the main story of 2022. With this kind of adjustment, many risk assets price adjusted downward. The S&P 500 was off -18.11% year-to-date on a total return basis and the FTSE Corporate Bond Index was off -15.68%. This dynamic presented a difficult headwind to balanced stock and bond portfolios throughout 2022.

The Energy sector was the only area of industry in significant positive territory by year-end. It was up 65.43% with Utilities being the only other sector eking out a positive return of 1.56%. With both sectors having relatively smaller market capitalizations, it was the larger sectors of Communication Services, Consumer Discretionary and Information Technology, which were down -39.89%, -37.03% and -28.19% respectively that led to the overall index being decisively down.

Positive Market Influences	Negative Market Influences
China Re-Opening	Tightening of Global Financial Conditions
Business Cycle Resilience	Geopolitical Friction
Inflation Cooling	Leading Economic Indicators
	Overall Uncertainty

Positive Market Influences

- **China Re-Opening** – The last several years have seen China run a zero-Covid domestic policy which was defined by strict internal control measures that likely impacted domestic growth. The country's re-opening may have some reflationary impact on the global economy and is being watched by market watchers.
- **Business Cycle Resilience** – While many data sets are weakening and growth expectations are being reigned in, the resilient strength in the labor market up to this point, is one factor that has prevented the economic cycle from turning down decisively.
- **Inflation Cooling** – CPI inflation has seemed to reach a peak with data coming in softer than expected the last two months. Additionally, the absolute level of the pace of inflation is heading lower. It is a complicated topic and inflation watchers will be on the lookout for this trend to either continue or reverse. For now, it is a positive step in the right direction that markets like.

Negative Market Influences

- **Tightening of Global Financial Conditions** – The European Central Bank has raised interest rates and the Bank of Japan has adjusted the yield curve control bound to enable slightly higher long term rates. The fact that other major central banks are moving in a more restrictive direction may be significant for market outcomes in 2023.
- **Geopolitical Friction** – The conflict in the Ukraine has increased awareness of geopolitical risks that now may need to be considered a bit more in relation to resulting impacts on risk assets.
- **Leading Economic Indicators** – The Conference Board's Leading Economic Index has been in a downtrend since May of 2022. While the current cycle has not turned over, these leading indicators may portend economic weakness ahead.
- **Overall Uncertainty** – While there is a narrow consensus around the risks associated with slowing growth and a potential recession over the intermediate term, understanding how policymakers may react to market realities and any growth slowdown will require constant re-evaluation, as data comes in over the next several months and quarters. That it is perceived that we may be closer to turning points in policy and possibly the business cycle itself creates a level of uncertainty for market participants about outcomes that must be dealt with.

Daniel P. Burchill
Security Analyst

Changes That May Affect Your 2022 Tax Refund

No additional stimulus payments. Unlike 2020 and 2021, there were no new stimulus payments for 2022, so taxpayers should not expect to get an additional payment in their 2023 tax refund.

No above-the-line charitable deductions. During COVID, taxpayers were able to take up to a $600 charitable donation tax deduction on their tax returns, however, in 2022, this deduction will return to pre-COVID rules, which will not allow those who take a standard deduction to make an above-the-line deduction for charitable donations.

Some tax credits return to 2019 levels. This means that affected taxpayers will likely receive a significantly smaller refund compared with the previous tax year. Changes include amounts for the Child Tax Credit (CTC), Earned Income Tax Credit (EITC) and Child and Dependent Care Credit.

Those who got $3,600 per dependent in 2021 for the CTC will, if eligible, get $2,000 for the 2022 tax year.

For the EITC, eligible taxpayers with no children who received roughly $1,500 in 2021 will now get $500 in 2022.

The Child and Dependent Care Credit returns to a maximum of $2,100 in 2022 instead of $8,000 in 2021.

More people may be eligible for the Premium Tax Credit. For tax year 2022, taxpayers may qualify for temporarily expanded eligibility for the Premium Tax Credit. For tax years 2021 and 2022, the American Rescue Plan Act of 2021 (ARPA) temporarily expanded eligibility for the premium tax credit by eliminating the rule that a taxpayer with household income above 400% of the federal poverty line cannot qualify for a premium tax credit. Remember that simply meeting the income requirements does not mean you're eligible for the premium tax credit. You must also meet the other eligibility criteria.

Elizabeth A. Zarnoch, EA
Vice President of Tax and Business Services

Budget Bill with "Secure 2.0"

On December 23, 2022, President Biden signed the $1.7 trillion budget bill that includes retirement savings legislation, or the "Secure 2.0 Act of 2022." This Act consists of additional provisions intended to build upon the improvements to the retirement system from the Secure Act of 2019. A few of the updates are listed below:

Most notably, the required minimum distribution age has changed. The age to start required minimum distributions from retirement plans has been age 72. The new bill increased that age from 72 to 73, beginning January 1, 2023 and then to age 75 in 2033.

Beginning in 2023, the penalty for failing to take a required minimum distribution is reduced to 25% from the current 50%. The penalty drops further to 10% if you take the necessary RMD by the end of the second year following the year it was due.

One of the changes will include requiring automatic 401(k) enrollment for employees. Employers will be required to automatically enroll employees in their 401(k) plan with some exceptions for small businesses.

Effective in 2024, employers will be able to make matching contributions to a retirement plan based on an employee's student loan payment amount.

There will be larger "catch-up" contributions in 401(k)s and IRAs. Under current law, if you are 50 and older, you may contribute an additional $6,500 annually in your 401k. Starting in 2025, the new provisions will allow the limit to increase to an additional $10,000 for those 60 to 63. After 2025, catch up amounts will be indexed for inflation.

Another provision, to begin in 2024, will allow employees to withdraw up to $1,000 from their retirement account for emergency expenses without having to pay the 10% tax penalty for the early withdrawal if they are under 59.5. This could only be taken once per year, however, if you choose not to repay the distribution within a certain time, you will not be allowed any other emergency distributions from the plan for 3 years. Companies may also let workers set up an emergency savings account through auto payroll deductions, with a cap of $2,500.

We will continue to keep you updated with any changes in retirement planning. As always, if you have any questions, please contact us.

Ann S. Nolan, FPQP™
Administrative Assistant

Schwab Updates

Improvements to your Charles Schwab statements are coming. Starting in the first quarter of 2023, statements will include the cost per position basis.

What is cost basis? Cost basis is the original price of an asset, which is used in determining capital gains. It usually is the purchase price, but in the case of an inheritance, it is the appraised value of the asset at the time of the donor's death.

If you have any questions on this update, please give us a call.

Celebrating Our Team!

At Valicenti Advisory Services, we are extremely proud of our team. Whether they have worked with us for one month or over 30 years, we couldn't be more proud of the team we have built and being able to watch them cultivate relationships with clients with care and the compassion. It is no wonder that they came up with the motto "Our Clients Come First."

A group becomes a team when each member cares the way our employees do and, for that, we say thank you. Below is how many years each employee has been with our firm as the end of December 2022.

Name	Years
Joseph M. Valicenti	31 years
Jeffrey S. Naylor	29 years
Ralph H. Roberts, Jr.	28 years
Tracy L. Jenkins	24 years
Theresa R. Stewart	21 years
Ann S. Nolan	19 years
Elizabeth C. Stage	15 years
Melissa B. Mickley	14 years
Kelly S. Diehr	11 years
Elizabeth A. Zarnoch	11 years
Andrew S. Cartwright	10 years
Mary Jo Naida	9 years
Daniel P. Burchill	8 years
Amy S. Chacho	7 years
Molly L. Ray	7 years
Louis F. Ruize	6 years
Ann E. Connolly	5 years
Jessica M. Brenzo	4 years
Samson D. Lin	1 year
Trevor L. Welch	1 year
Nathaniel C. Adams	< 1 year

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- Business retirement plans
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- 401(k) review and analysis • Retirement

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- Long Term Care
- Disability

Business Insurance

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- Liability
- Automobile
- Professional Coverages
- Workers Compensation
- NYS Disability

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- Dental Insurance
- Life Insurance
- Disability Insurance
- Customized Benefit Insurance

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