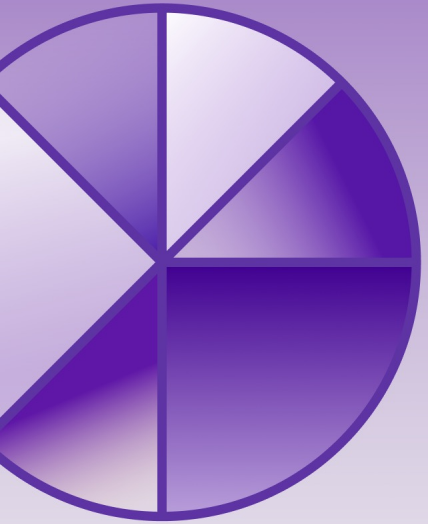
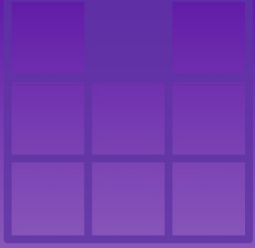


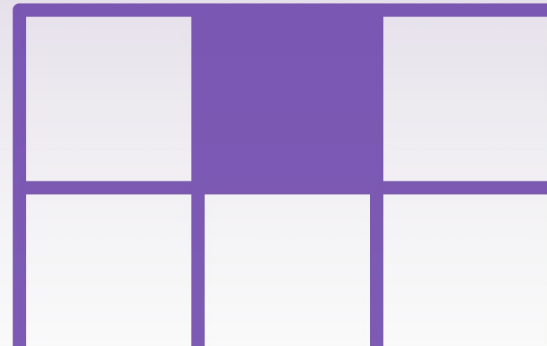
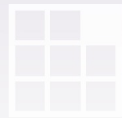
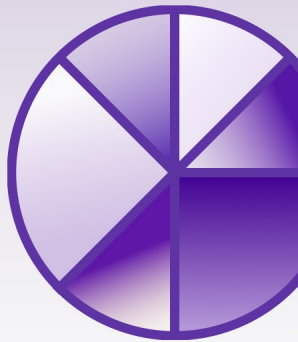
Your 2022 Mid-Year Portfolio Checkup

Christine Benz

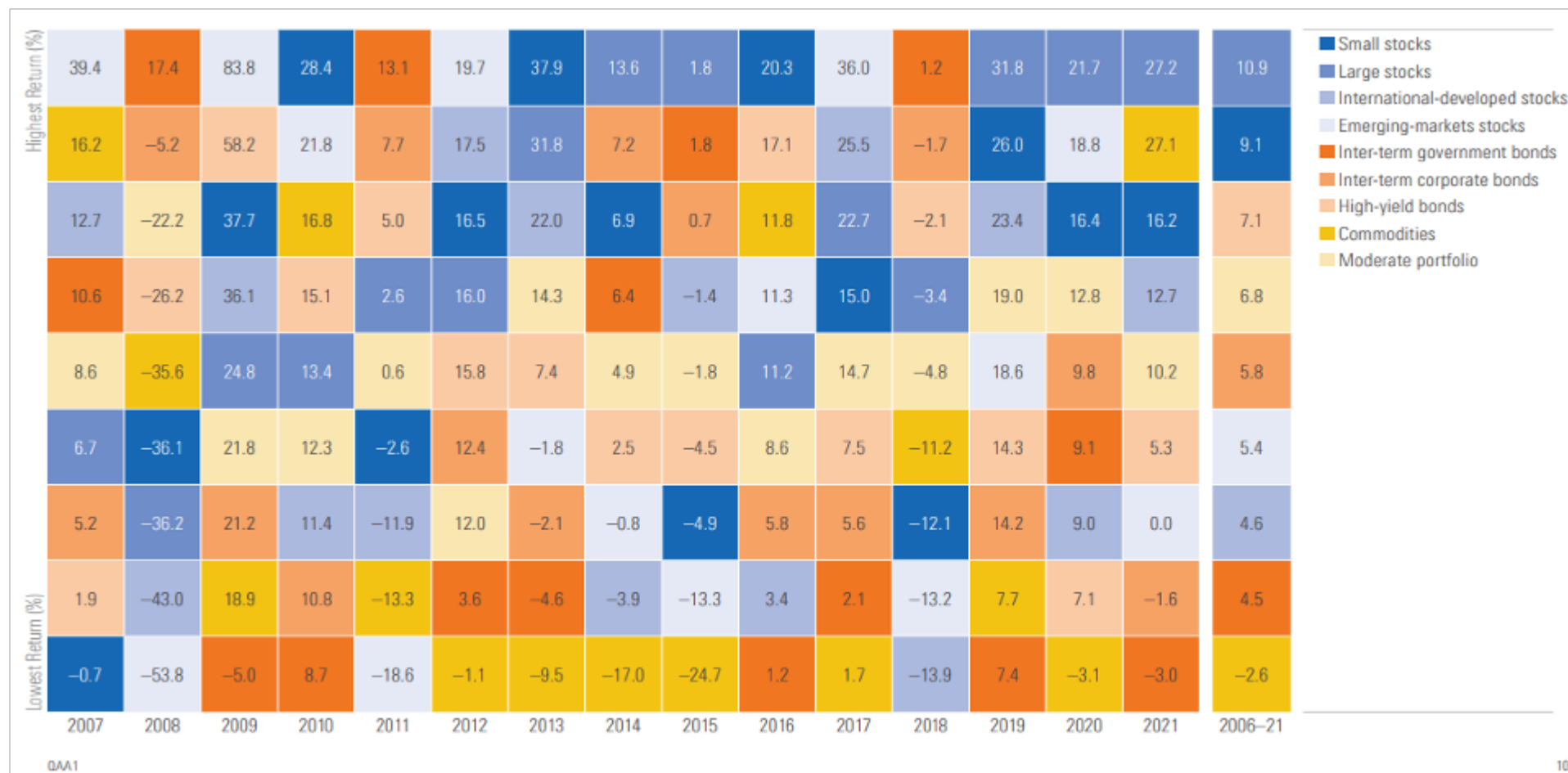
Director of Personal Finance & Retirement Planning
Morningstar, Inc.
July 2022



What Just Happened?



2007-2021: A Remarkably Strong Run for Stocks and Bonds



Source: Morningstar Markets Observer

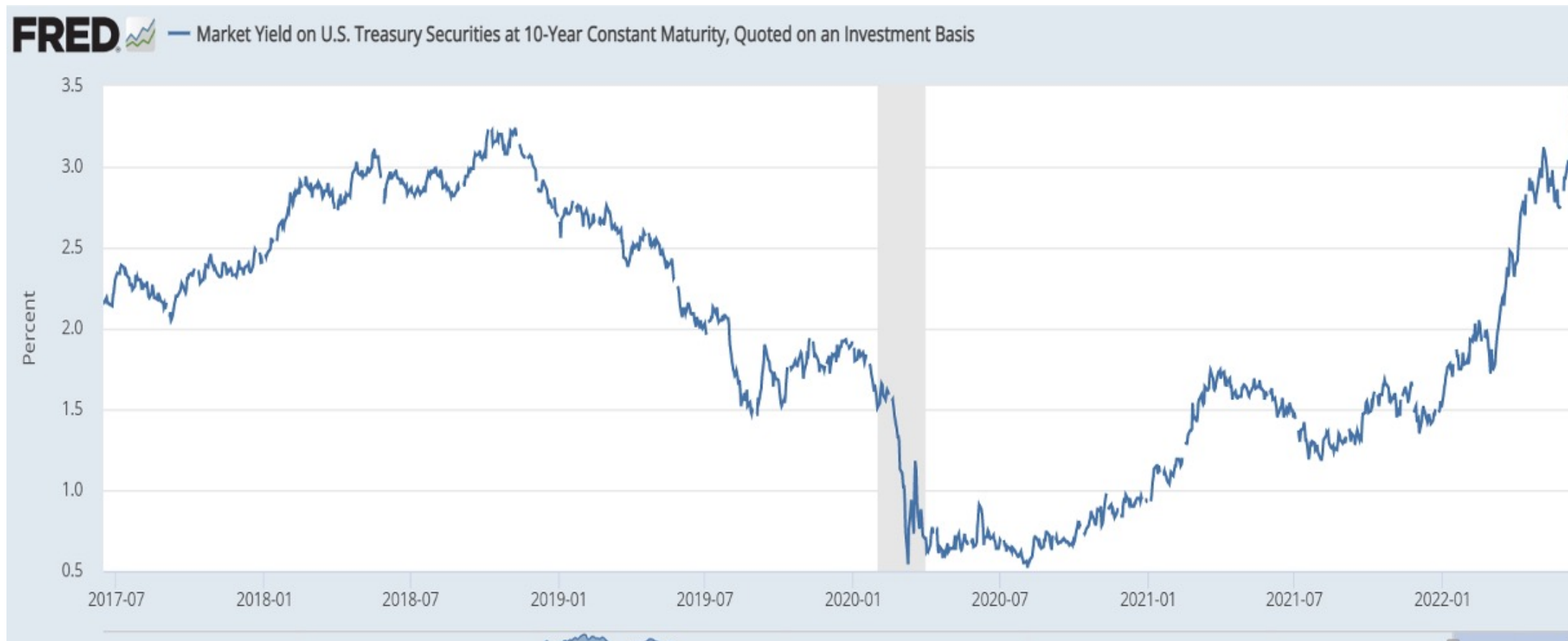
But Since Then...



Nowhere to Run, Nowhere to Hide

- Stocks have fallen sharply
- Morningstar U.S. Equity Index: –18% through mid-June
- MSCI EAFE Index: -19% through mid-June
- MSCI Emerging Markets Index: –18% through mid-June
- Bonds haven't cushioned the blow...for a change
- Bloomberg Barclays Aggregate Index: –12% through mid-June

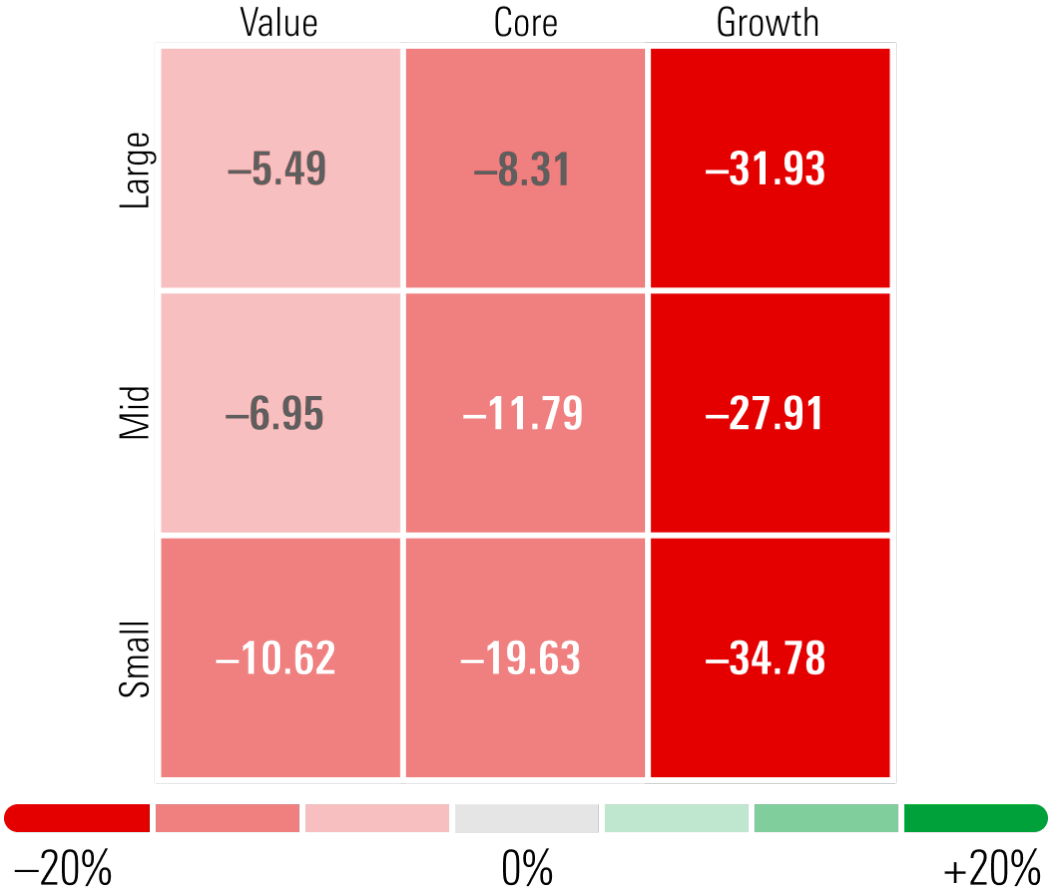
Rising Interest Rates Have Been the Main Catalyst



Source: fred.stlouisfed.org

Growth Stocks Especially Hard-Hit

U.S. Market Barometer



Source: investor.morningstar.com/markets

Few Pockets of Strength So Far in 2022

- Equity Energy: +31%
- Commodities (Broad Basket): +31%
- Systematic Trend: +21%
- Energy Limited Partnership: +9%
- Equity Market Neutral: +4%
- Money Market Mutual Funds: +0%

And Lots of Weakness

- Digital Assets (Funds): –60%
- Technology: –37%
- Mid-Cap Growth: –33%
- Small Cap Growth: –33%
- Consumer Cyclical: –33%
- Foreign Small/Mid Growth: –33%

Bond Market: Shorter Has Been Better

		Interest-Rate Sensitivity		
		Ltd	Mod	Ext
Credit Quality	High	-3.73	-7.94	-20.07
	Medium	-2.77	-9.04	-12.24
	Low	-4.11	-11.43	-14.02

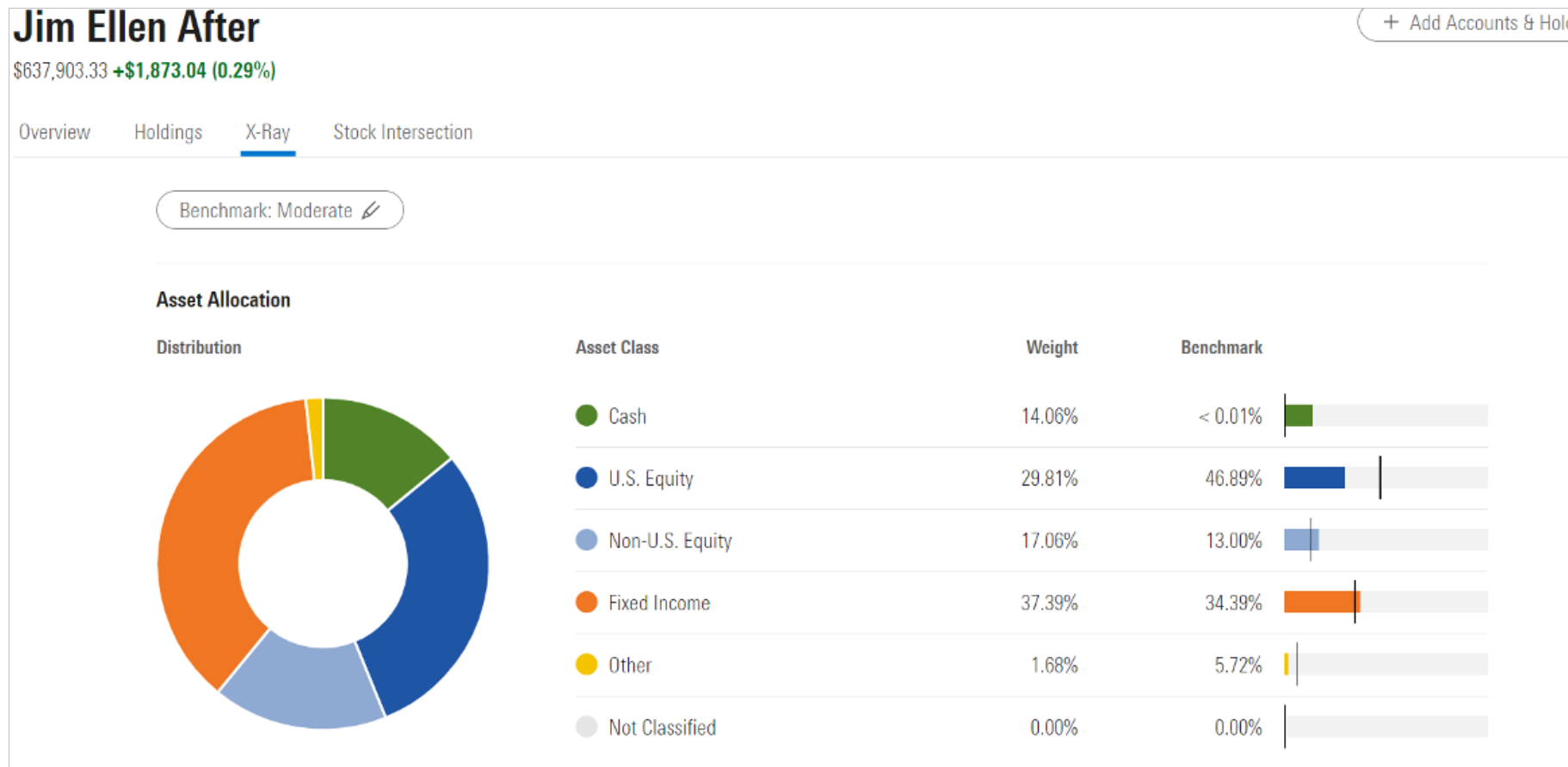
Source: Morningstar Direct. Data as of June 6, 2022.

Let's Talk Portfolio Strategy

Check Up on Asset Allocation

- Beyond how much you save and/or how much you withdraw, your asset allocation is the biggest determinant of how your portfolio behaves
- Morningstar's X-Ray tool a good starting point for gauging asset allocation
- Portfolio Manager enables you to X-Ray, as does Instant X-Ray

The Contents of Your Portfolio May Have Shifted



Source: Investor.Morningstar.com/portfolios

The Contents of Your Portfolio May Have Shifted

Select benchmark

Aggressive

Higher weighting of stocks,
minimal bonds and cash



U.S. Equity	67%
Non-U.S. Equity	25%
Fixed Income	5%
Other	3%

Moderately Aggressive

Slightly higher weightings in
stocks, less in bonds and cash



U.S. Equity	53%
Non-U.S. Equity	23%
Fixed Income	19%
Other	5%

Moderate

Balanced weightings of
stocks, bonds, and cash



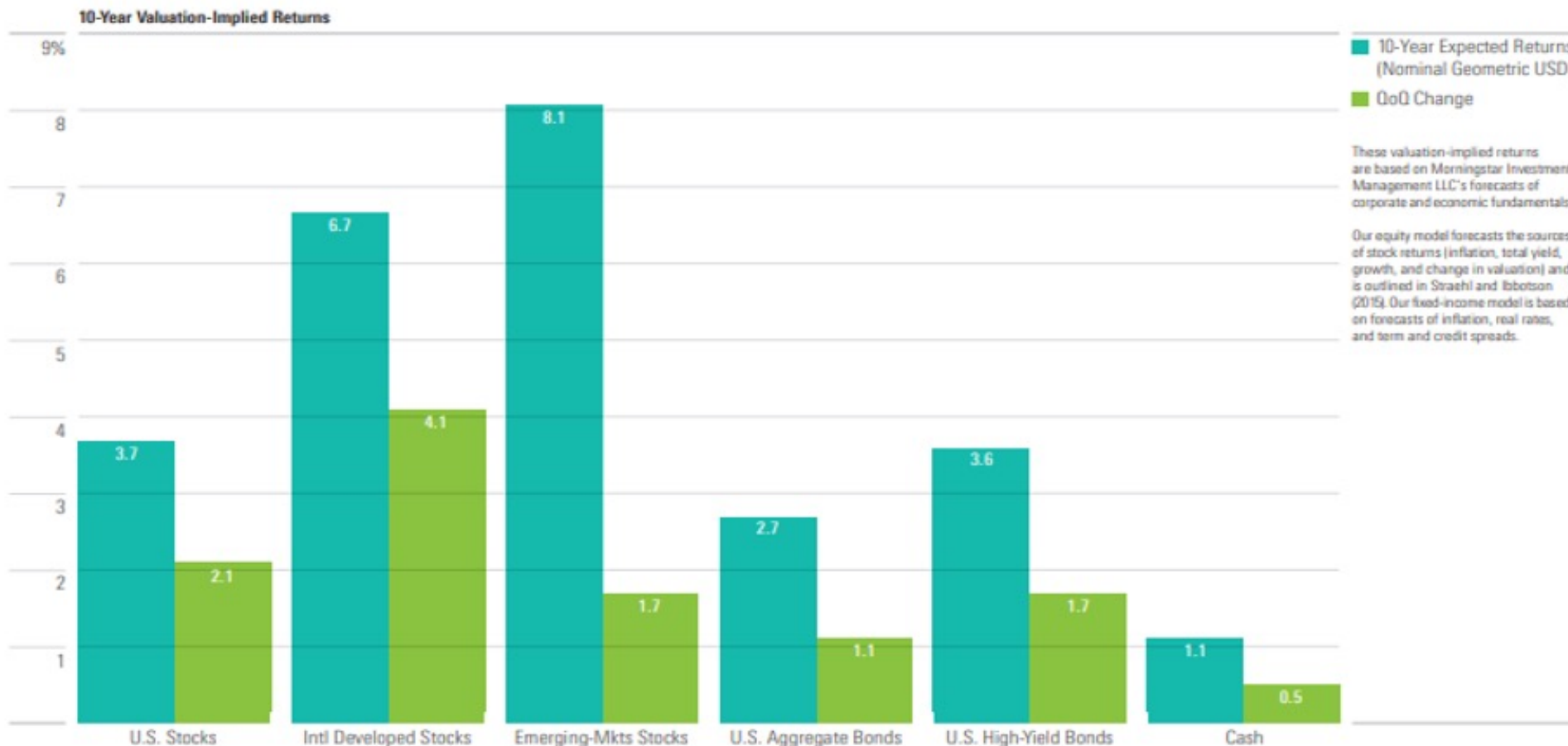
U.S. Equity	53%
Non-U.S. Equity	23%
Fixed Income	19%
Other	5%

Cancel

Save

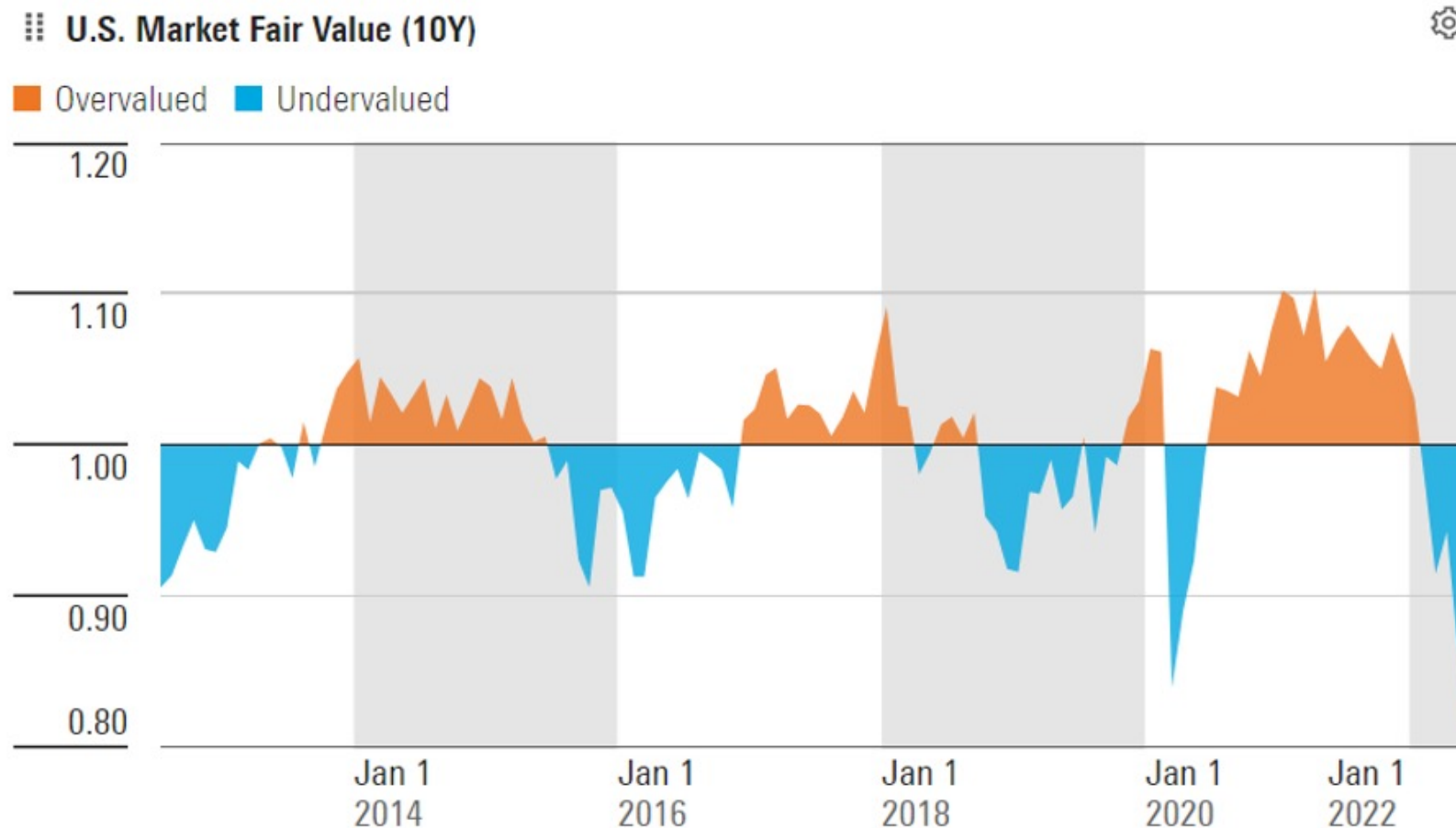
Source: Investor.Morningstar.com/portfolios

One Good News Story: Lower Prices Improve Return Prospects



Source: Markets Observer. Data as of March 31, 2022.

Stocks Also Look Cheaper on a Bottom-Up Basis



Source: investor.morningstar.com/markets

Every Style Box Square Looks Undervalued

	Value	Core	Growth
Large	0.80	0.87	0.80
Mid	0.76	0.82	0.80
Small	0.58*	0.75*	0.61*

Source: Morningstar Direct. Data as of June 16, 2022.

Big Shift Since Year-End 2021

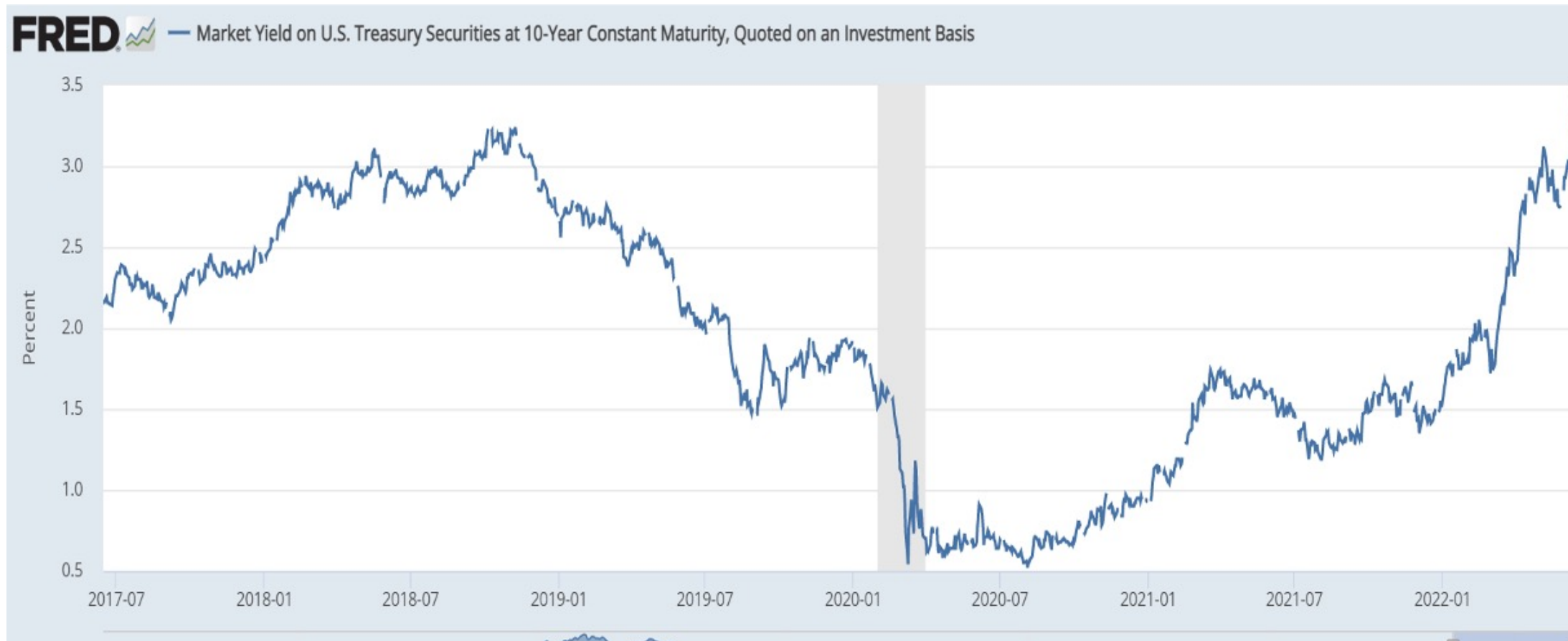
	Value	Core	Growth
Large	0.98	1.24	1.04
Mid	0.95	1.10	1.06
Small	0.80*	0.92*	0.82*

	Value	Core	Growth
Large	0.80	0.87	0.80
Mid	0.76	0.82	0.80
Small	0.58*	0.75*	0.61*

Source: Morningstar Direct. Data as of June 16, 2022.

How Rising Interest Rates Affect Investments and What to Do

Bond Yields Have Risen Very Quickly



Source: fred.stlouisfed.org

Your Portfolio Has No Doubt Already Felt the Pain

- The Fed's planned rate hikes put pressure on bond prices
- Among the hardest-hit bond types:
 - Long-term bond funds: –21% YTD through 6/16/22
 - Long-term government bond funds: –24% YTD through 6/16/22
 - Intermediate-term core bond funds: –12% YTD through 6/16/22
 - Intermediate-term core plus bond funds: –12% YTD through 6/16/22
- Fed has done a good job of telegraphing moves; near-term rate hikes already priced into bond market?

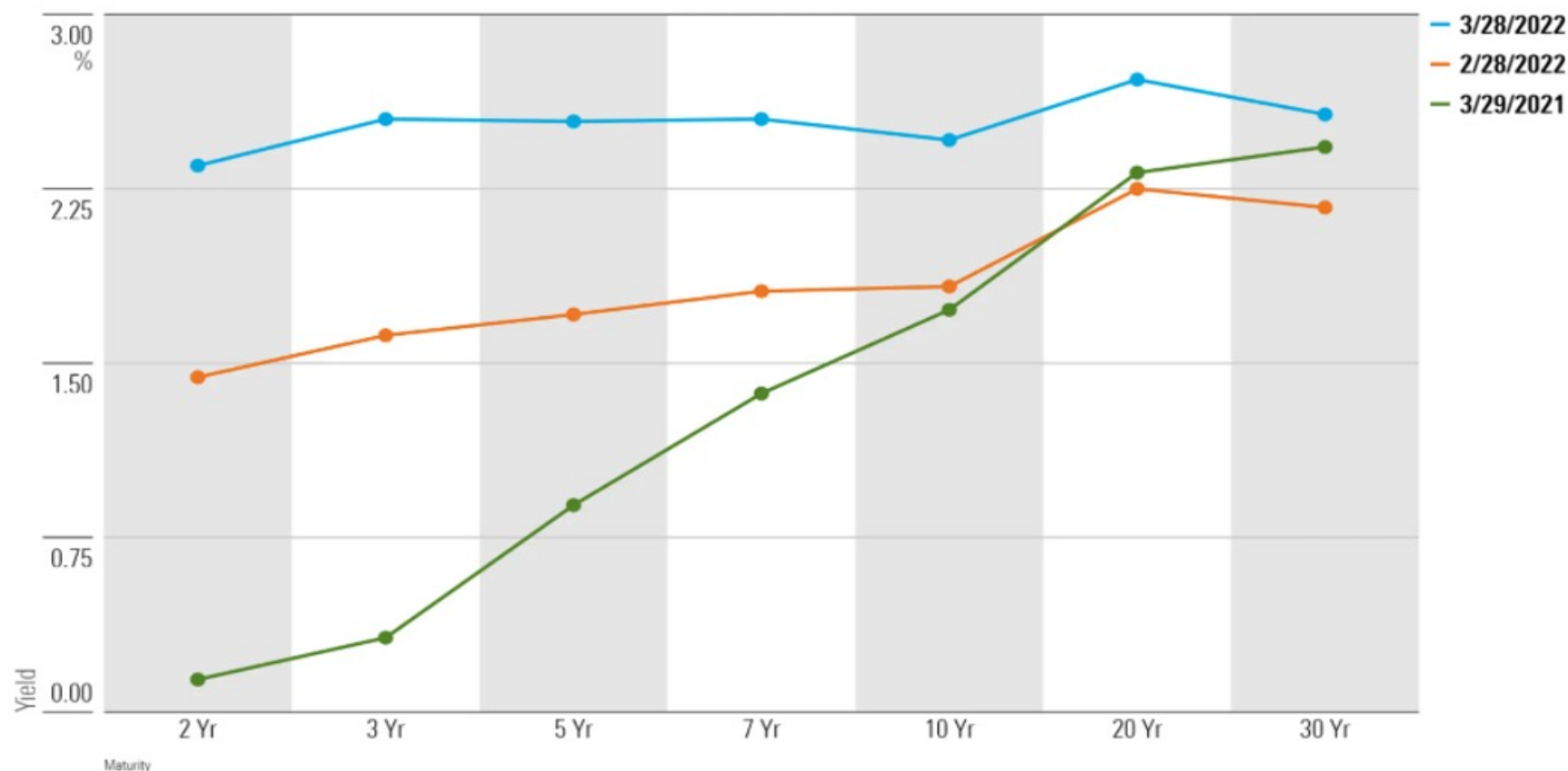
Assess Fixed Income Exposure/Rate Sensitivity

- Consider the following “duration stress test”
- The fund’s duration minus fund’s SEC yield = expected loss over one-year period if interest rates rose by 1 percentage point
- Long-term government bond funds’ average duration: 18 years
- Long-term bond government funds’ average yield: ~3.4%
- Duration of 18 minus 3% = ~15% loss if rates rose by 1 percentage point
- Hold short-term bonds for time horizons of 2–5 years and cash for very near-term expenditures (2 years’ worth of portfolio withdrawals if retired)

How to Build a Recession-Proof Portfolio

Bond Yields Have Been Flashing Warning Signals

U.S. Treasury Yield Curve



Source: U.S. Department of Treasury. Data as of March 28, 2022.

How to Build a Recession-Proof Portfolio: Bonds

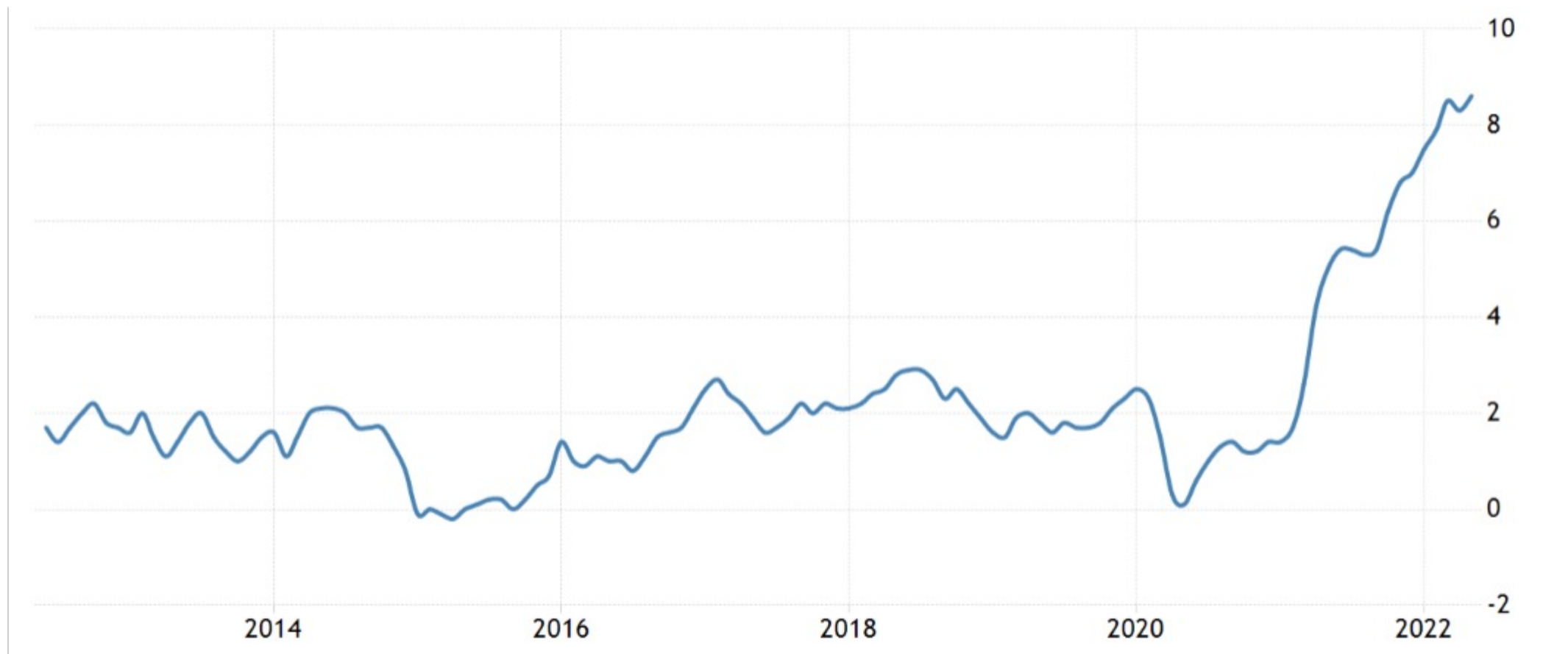
- Some of the very areas that have been hardest-hit in 2022 have tended to hold up best in recessionary environments
- High-quality bonds, especially long-term ones, will tend to fare best in periods of slack economic growth
- Beware of drastic measures: If Fed continues hiking rates, such bonds could get hurt

How to Build a Recession-Proof Portfolio: Equities

- Some of the areas that have held up best in 2022 could get socked in a recessionary environment
 - Energy
 - Commodities-linked investments
- Recessionary stalwarts typically include:
 - Health care
 - Consumer staples

How Rising Inflation Affects Investments and Your Financial Plan

Inflation Further Complicates Planning



Source: TradingEconomics.com.

Evaluate Inflation Protection

- Inflation (Consumer Price Index for All Urban Consumers) has been mild for decades but has been trending up very recently
- Most recent CPI-U reading: 8.6% (!)
- Inflation is the most worrisome for retirees, whose portfolio paychecks aren't inflation-adjusted
- Also consider your personal spending, calculate a customized inflation rate:
<https://www.morningstar.com/articles/1085820/whats-your-real-inflation-rate>

Evaluate Inflation Protection: Total Plan Level

- Consider how insulated your income is from inflation
- **Insulated:** Working income (usually), Social Security, government pensions
- **Not insulated:** Interest on fixed-rate investments, private corp pensions

Evaluate Inflation Protection: Portfolio Level

- Best sources of inflation protection for portfolio include the following:
 - Inflation-protected bonds (TIPS, I-Bonds)
 - Stocks, especially wide moats with pricing power and dividend growth firms
 - Real estate, commodities
 - Bank-loan investments, high yield bonds

Tax To-Dos: Tax-Efficient Investing

Bear Market Tax Strategy #1: Tax-Loss Selling

- If you have securities in your taxable portfolio trading below your cost basis, can sell and realize a loss.
- Losses can be used to offset capital gains and if no capital gains, \$3,000 in ordinary income.
- Unused losses can be carried forward into future years.

Bear Market Tax Strategy #1: Tax-Loss Selling

- Tax-loss selling will be most useful for recently purchased positions
 - Use specific share identification method for cost basis
 - If you have already used average method (funds) you can't switch
- Stay mindful of the wash sale rule
 - Cannot re-buy the same security or a substantially identical one within 30 days of selling
 - If do, will disallow the tax loss

Bear Market Tax Strategy #2: IRA Conversions

- IRA conversions are best undertaken if:
 - Your personal tax rate is low for some reason (e.g., low income year, lots of deductions)
 - Your balance is depressed
- Many investors' IRAs have lost value in 2022
- Name of the game is to convert enough to avoid pushing yourself into a higher tax bracket
- Partial conversions often add up

Thank you for watching

Still have questions?
the.shortanswer@morningstar.com

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