



OUR MISSION IS TO CHANGE LIVES. ONE "HEMINGTON" AT A TIME.

HEMINGTON NEWSLETTER

WINTER 2022

Making Sense of the Bond Market

By Amy Mitchell, CFA, CFP®

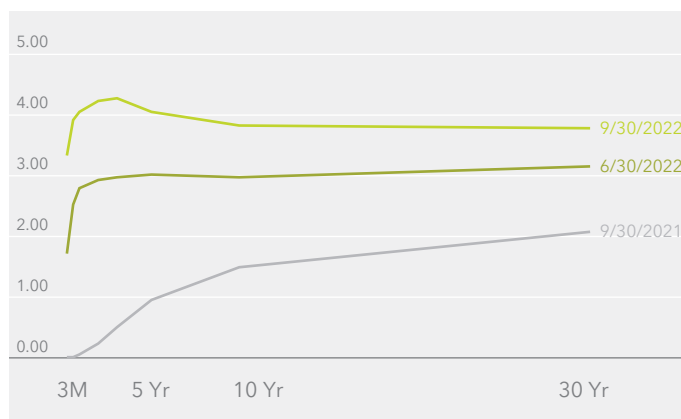
This year has been challenging for investors. While investors generally expect a bumpy ride in equity markets, the bond markets have given an unexpectedly difficult ride, too, with the worst performance for fixed income on record. Never before has the Bloomberg U.S. Aggregate Bond Index experienced three negative quarters in a row, as bond prices have taken a hit. The reward? Fixed income investments now offer higher yields, which investors have been clamoring for over the past decade.

HOW DO BONDS WORK?

A bond is a security that represents a debt instrument. Bonds are essentially loans between an investor and a borrower, typically a government or business. Bonds are called fixed income investments because they carry a set interest rate on the loan principal (usually paid semi-annually) and have a set maturity when the principal investment is returned to the investor. Unlike stock dividends, bond interest payments are contractual. If the bond issuer does not pay on time, the bond may go into default. Bondholders generally have priority over equity shareholders in a bankruptcy situation.

Bond returns come from two sources: interest income and price fluctuations. While a fixed income investor expects to receive regular interest payments and the return of principal at maturity, a bond's fair market price will fluctuate during the term of the bond. For example, if an investor owns a bond that pays 1% and the prevailing rate is 4%, then the price of the investor's bond would decrease. Said another way, the 1% bond does not pay as much interest income as a new bond – no one wants to pay full price for less cash flow, so the bond would be sold at a discount.

US Treasury Yield Curve (%)



Source: Federal Reserve

Interest rates increased across all bond maturities in the U.S. Treasury market in the third quarter.

WHAT IS THE ROLE OF BONDS IN MY PORTFOLIO?

Bonds play an important role in portfolios by providing a ballast that tempers the volatility of stocks. While bond returns have been down this year, bonds have fared better than stocks and have helped to mitigate equity losses. Over the years, Hemington has made incremental changes to its fixed income allocations to enhance returns, while staying true to our philosophy of investing in high quality, relatively short duration bonds. Many other advisory firms sought higher yields by taking on additional term risk (by going farther out in bond duration), credit risk, or both, with painful results.

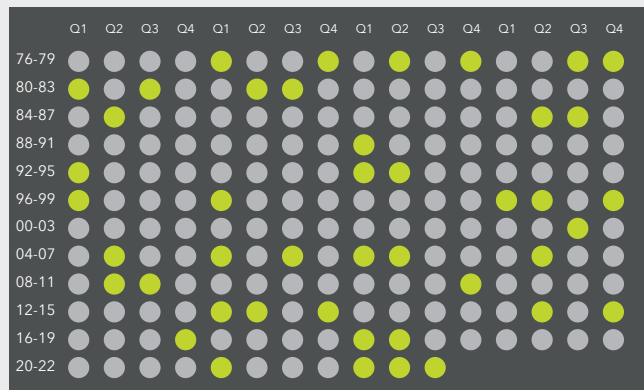
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Fixed Income Quarterly Returns

January 1, 1976 - June 30, 2022



Source: Bloomberg U.S. Aggregate Bond Index

Green dots represent negative quarterly returns for the U.S. Agg.

Bonds experience negative returns more often than most investors realize. From January 1976 to June 2022, fixed income quarterly returns were negative 23% of the time, as represented by the Bloomberg U.S. Aggregate Bond Index (see chart above). In comparison, during this same time period, the S&P 500 equity quarterly returns were negative 27% of the time. However, only 9% of the time were both fixed income and equity quarterly returns negative – not surprising given the lower correlation between bonds and stocks. Also, the range of returns is much narrower for bonds than stocks. The largest annual decline for the U.S. Agg was -2.94% in 1994, while the largest equity decline during the same period was -36.55% in 2008.

SHOULD I HOLD INDIVIDUAL BONDS TO AVOID LOSSES IN MY BOND PORTFOLIO?

Some clients ask about holding individual bonds instead of bond mutual funds. While it is true that an individual bond repays its principal at maturity (barring default), there is a mistaken belief that individual bonds experience no losses. First, creating a bond portfolio with individual securities is less diversified, expensive, and difficult to maintain over time. Importantly, individual bonds experience the same market fluctuations as bonds packaged into a bond mutual fund or exchange traded fund – the difference being that people typically do not mark an individual bond to its market price to arrive at its true fair market value, so they do not “see” the unrealized losses. Said more simply, any paper gains or losses are still there but are not being acknowledged.

WHY SHOULD WE STAY THE COURSE? ISN'T IT BETTER TO DO SOMETHING?

At Hemington, we follow an investment philosophy grounded in financial science. We do not base our investment choices on predictions of what will happen in the economy or the “noise of the day.” Markets quickly incorporate new information, including expectations about higher rates and inflation. Research tells us that investors who try to time the market by holding onto cash or changing their asset allocation fare worse than investors who stay the course.

For each client, Hemington manages the household's accounts as “one portfolio.” We execute this strategy, in part, to be able to optimize asset location, i.e., the type of account where an asset is held. Bond holdings are often located in retirement accounts to defer taxes on interest income.

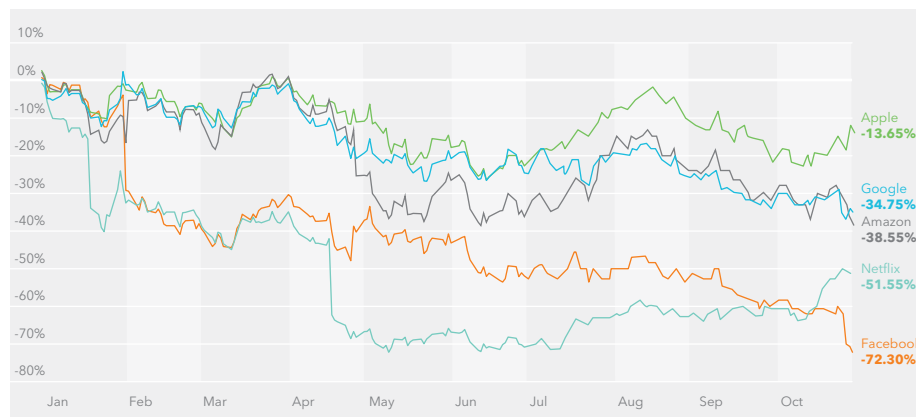
Technology Stocks

In the aftermath of COVID, a common client question was “Why aren't Hemington portfolios overweight to technology stocks?” While many clients are reassured with Hemington's consistent investment philosophy, which does not change in reaction to the news of the day, some clients raised the point that it seemed “obvious” that tech stocks would outperform in the coming years.

The chart at right shows year-to-date returns for FAANG stocks, highlighting that past performance is not a guarantee of future results.

Cumulative Returns of FAANG Stocks

January 1, 2022 - October 31, 2022



Source: Morningstar



WHAT'S NEW AT HEMINGTON?



Hemington Wealth Management has been included for a 6th time in the listing of **Financial Advisor Magazine's Top RIA Ranking** based on assets under management at the end of 2021. Financial Advisor Magazine annually reports an exclusive list of the nation's leading independent financial advisory firms based on their total discretionary and nondiscretionary assets.



Northern Virginia Magazine recognized **Eileen O'Connor** as a Top Fee-Only Financial Planner for 2022. The magazine surveyed financial professionals in northern Virginia and asked them to recommend other financial professionals to whom they would refer family and friends. Those who made the list received the most nominations.



Hemington Wealth Management was recognized in the top 8 of **Washington Business Journal's Largest Wealth Management Firms in Greater DC List** for 2022. The depth of Hemington's metro-area advisors along with its annual revenue and fee-only financial planning focus were positive consideration factors that put it at the top of the list against other wealth management firms in the Northern Virginia, Maryland, and Washington DC area.



Jen Dawson was a featured guest on the Top Advisor Marketing Podcast entitled, "Every Reason to Build a Hyper-Focused Niche Practice," and shared her methodology for discovering and cultivating her specialty as the advisor for women lawyers. Hemington is committed to raising the bar for women investors, and sharing our philosophy and approach with other advisors in the industry.



Eileen O'Connor was a panelist for Dimensional Fund Advisor's Women & Wealth group. She came together with other leading women advisors to discuss "Creating Connective Content" for clients.

To wrap up summer, the Hemington team enjoyed a day at the Washington Harbor.



This year Hemington had one high school graduate. **Sarah Mitchell** graduated from Bishop O'Connell High School and attends James Madison University in the Honors College. She intends to major in Nursing.



Year-end Planning Priorities

As we approach the end of 2022, below are some planning items to consider.

- » **Max out your 401(k) / 403(b) / TSP:** \$20,500, or \$27,000 if age 50+. Consider increasing contributions for the remainder of the year to maximize contributions, if needed.
- » **Contribute to a Traditional or Roth IRA:** \$6,000, or \$7,000 if age 50+. You have until April 17, 2023, to contribute for 2022 (April 15th will fall on a Saturday).
- » **Roth IRA for Kids:** If your child has earned income in 2022, from a summer job for example, then consider opening and funding a Roth IRA. The maximum contribution is the amount of earned income or \$6,000, whichever is less. You have until April 17, 2023, to contribute for 2022.
- » **Required Minimum Distributions (RMDs):** We assist clients age 72 and over with RMDs well before year-end to avoid IRS penalties.
- » **Qualified Charitable Distributions (QCDs):** Gifting IRA distributions directly to charity is a great strategy if you do not need your RMDs for current income and you do not itemize your deductions. QCDs are excluded from gross income rather than being reported as a charitable deduction.
- » **Health Savings Accounts (HSAs):** \$3,650 for individuals, \$7,300 for families, and an additional \$1,000 for individuals age 55+.
- » **529 Plans:** Contributions must be made by year-end to be deductible on your state income tax return, if applicable. Also, distributions from 529 plans for eligible expenses incurred in 2022 must be taken by year-end.
- » **Gifting Stock:** Gifting appreciated stock to charities (instead of cash) can be a good strategy. TD Ameritrade's deadline is mid-December.
- » **Family Gifting:** The annual gift exclusion for 2022 is \$16,000 per giftee.

UPDATE ON THE TD AMERITRADE & SCHWAB MERGER

In 2019, Charles Schwab initiated the purchase of TD Ameritrade, and in 2020 the Department of Justice approved the merger. Since then, both firms have been working together on their integration, and the final conversion date is targeted for August 2023.

Our team is in close contact with representatives of both TD Ameritrade and Schwab to get ahead of the upcoming transfer of client assets to the new platform. We have received assurances that the transfer will be paperless, with a key caveat.

It is important that each account holder logs into his or her accounts – for example, each spouse, adult child, trustee, or other owner, as appropriate. This will help to ensure all attributes of existing client accounts will come over during the transfer, including transactional history and standing letters of instruction.

There is one main action item for all Hemington clients: Please make sure to log into TD Ameritrade's client portal at www.advisorclient.com/login.

If you need help, please reach out to your Hemington team.

About Hemington Wealth Management

Hemington Wealth Management provides high net worth individuals and families with a broad range of wealth management services including portfolio management. We are collaborative, accessible and responsive, making it easy for clients to work with our team.

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