Copperwynd Financial
14256 N. Northsight Blvd
Suite B-115
Scottsdale, AZ 85260

Office: 480-348-2100
Toll Free: 877-658-2100

https://www.copperwyndfinancial.com

David Daughtrey, CFA, CFP®
Lynda Elley, CTLC, CCFS® CFP®
Erick S. Newton, CFP®
Jake Eggett, CFP®

Your Copperwynd Financial Newsletter: September 2022

Market Commentary

Mt Nebo (11,929 ft) is the highest peak in Utah County along the Wasatch Mountains. This is a popular hike, so the trail is well maintained and easy to follow. Around 9,000 ft a bench trail runs level North to South, as it reaches Wolf Pass at an elevation of 10,643 ft. From there, you look up to a peak and the trail begins to rise sharply. This becomes the most strenuous part of your journey, and you begin to climb a 30-40% grade and in ½ mile you've just gained ~800 ft in vert.

As you crest the top, your legs are exhausted, you're breathing heavier and to make matters worse, you realize, it's a false summit!

A false summit, in mountaineering speak, is a point on a trail that fools you into thinking you've made it when you still have a lot more ground to cover. This is typically caused when the ridge or features of the mountain in front of you limit your line of sight. This can be very disheartening — especially if you've already been hiking for hours!

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From here, it's not a bad idea to take a short break, get your legs under you and then begin the last leg of the journey scrambling along the rugged ridge and then up to your end goal. The views of the valley are breathtaking!

So why am I sharing this story?

The markets can often feel like an extended backpacking trip with several false summits along the way. Since the lows in mid-June, the market had advanced roughly 17% before rolling back over. This strong recovery had many asking, is this recent rally in the market the beginning of a new bull market or just a bear market rally? A bear market rally has a similar feeling of when you reach a false summit. Just when you think you have made it through the worst, the market starts trending back down again. Time will tell if we'll hit some new lows or advance higher with a sustainable rally. Either way, now is a good time to build up your emotional reserves, plan for some false summits and keep your eyes trained on a longer horizon.

Market Performance

After a strong July, the major asset classes declined in August.

Equities	August	2022 YTD
S&P 500	-4.08%	-16.18%
Mid Cap	-3.17%	-13.62%
Small Cap	-2.00%	-17.13%
International Developed	-6.12%	-19.81%
Emerging Markets	-0.46%	-15.99%
Fixed Income	**August**	**2022 YTD**
Bloomberg Aggregate Bond Index	-3.04%	-10.68%
High Yield Corporates	-4.22%	-12.83%

***Source:** YCharts, 7/31/2022-8/31/2022, Total Return Data using SPY, IJH, IWM, EFA, VWO, AGG, and JNK*

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4 Major Headlines

1) Bear Market Rally or Start of a New Bull?

The market, as measured by the S&P 500, declined over 23% from its high and entered bear market territory, but by mid-June we started to see that trend reverse. Have we ever seen a rally greater than 17% with a bear market not being over? In the last 25 years, we have seen this happen several times. In 2000-2002 and in 2007-2008, we saw the S&P 500 rally between 18-24% five separate times and then go on to hit lower lows in the months and years ahead. However, in 1998, 2011, 2018 and 2020 the market dropped at least 20% and then rallied and never looked back. It's entirely possible this is a rally off a sustainable bottom, and stocks will move to new highs; however, history does not imply that outcome is likely, and so far, this rally falls well into the category of a "bear market rally" according to history.

Figure 1

2) Why Has This Rally Occurred?

Comparing market moves to history is a helpful guide, but to better understand whether this is a bear market rally or the start of a bottoming process, we must understand WHY the rally occurred from mid-June to mid-August.

We would point to four main ideas:

- Fed Tightening Expectations
    - Likely the primary reason for the strength of the rally comes in the hope that if inflation is peaking, the Fed will slow down their interest rate hikes. In fact, the market seemed to be pricing in the lowering of rates next year and that was dispelled by numerous Fed officials and directly by Fed Chairman Powell in his Jackson Hole speech last Friday. Given that we have only had one inflation report showing signs of decline, the Fed will require a sustained downward trend of inflation before they start to change course.

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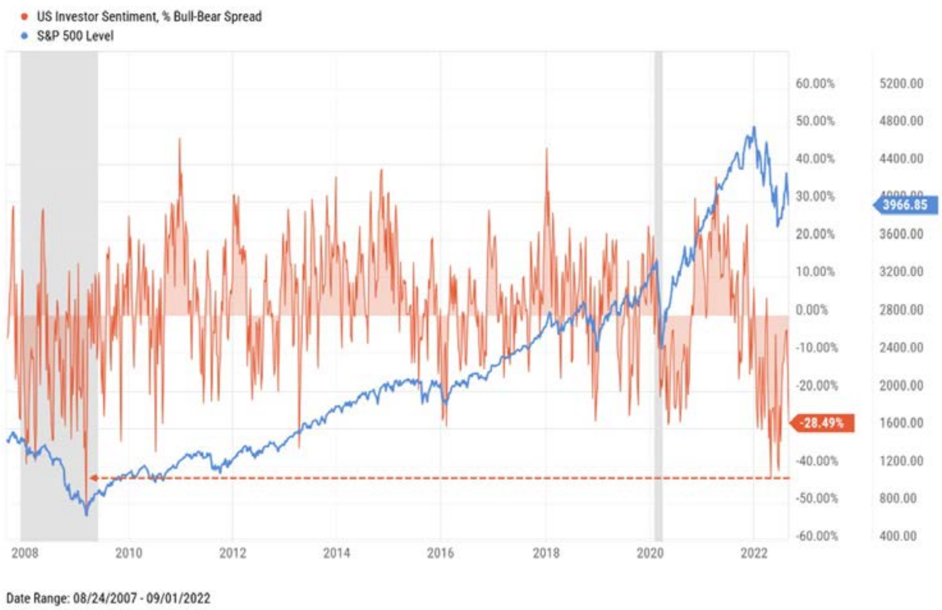
- Extremely Negative Sentiment
  - Following the stronger than expected inflation (CPI) report, markets collapsed, and sentiment became historically negative. We must go back to 2008-2009 to see readings this low! These extreme levels are usually found near market lows and often is considered a contrarian indicator. For now, some of that negativity appears to have worked itself off, but it remains negative.

Figure 2

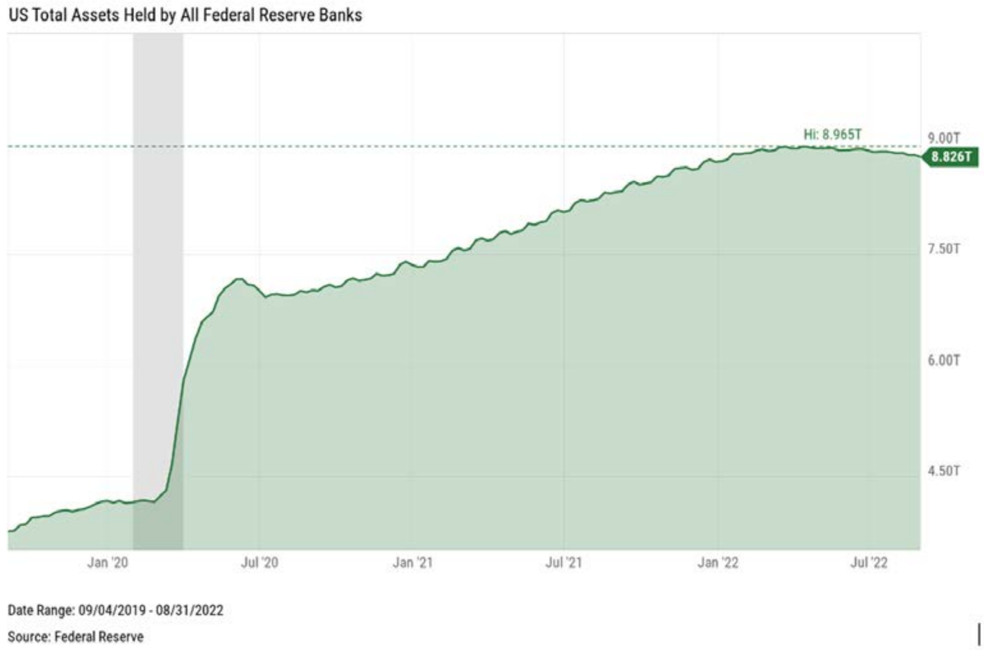


- Better than expected earnings
  - The Q2 earnings season was better than feared. Not only have the vast majority of companies beat estimates, but most importantly the expected 2023 earnings didn't materially decline.
- Signs inflation may have peaked
  - This rally gained steam when several commodity prices began to drop and manufacturing surveys and indices declined, which led many investors to start pricing in peak inflation, and then the July inflation (CPI) report confirmed those expectations. The August inflation report will be released on September 13th and the hope is that we continue to see signs of inflation trending downward.

In order for this rally to be sustainable, we would like to see earnings remain strong and continued improvement on inflation, which should allow the Fed to ease their tightening process.

3) Fed Balance Sheet Reduction Ramping Up

One of the biggest unknowns for the market is the impact of the whopping 95 billion per month reduction in the Fed's balance sheet that is scheduled to start this month. We are in uncharted territory at a level none of us (including the Fed) has ever seen before. Some have argued that balance sheet reduction may have just as much or more impact than rising rates. At this point, we believe this will continue to be a headwind on the markets and even though it may mean some additional pain in the short run, getting inflation under control and having the Fed's balance sheet reduced in the long run will be better for our economy.



4) The Price of Admission

During volatile times, the day-to-day or month-to-month fluctuations can drive investors to make some very emotional decisions and often we have found that emotion is the enemy to good investing. These are the monthly returns in the S&P 500 so far this year:

January **-5.2%**
February **-3.0%**
March **+3.7%**
April **-8.7%**
May **+0.2%**
June **-8.3%**
July **+9.2%**
August **-4.08%**

There have been 3 months already this year when the market fell 5% or more. That didn't happen once last year, and it only happened twice in 2020 and didn't happen in 2017, 2016, 2014 or 2013. In fact, down 5% in one month doesn't happen very often but they're not completely out of the ordinary as they historically happen about once a year.

The last time we had this much month-to-month volatility was 2008, when the market fell more than 5% in 5 different months.   On the flip side, volatility tends to cluster during downtrends so some of the strongest monthly returns happen around the weakest months.

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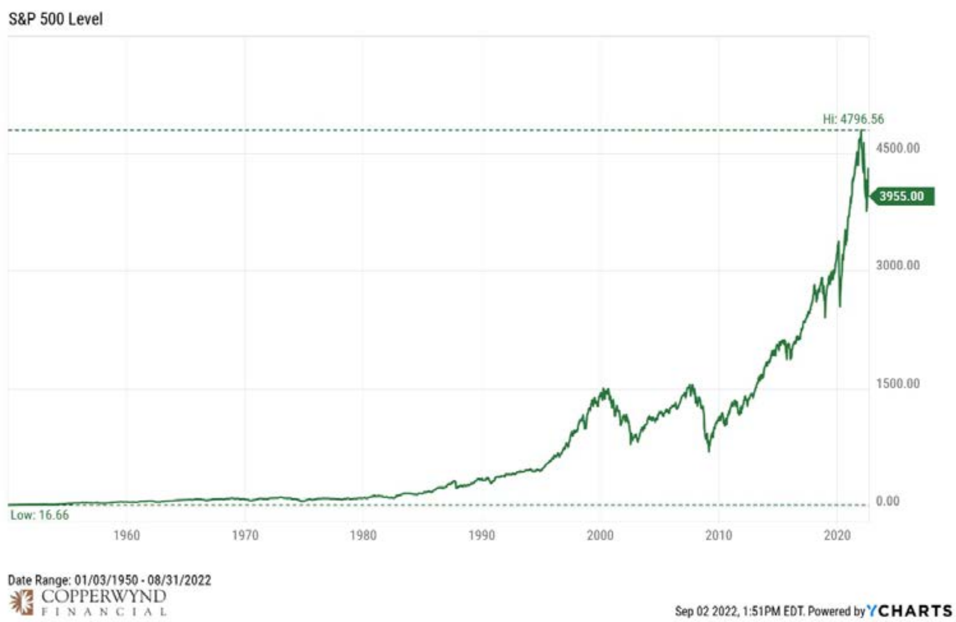
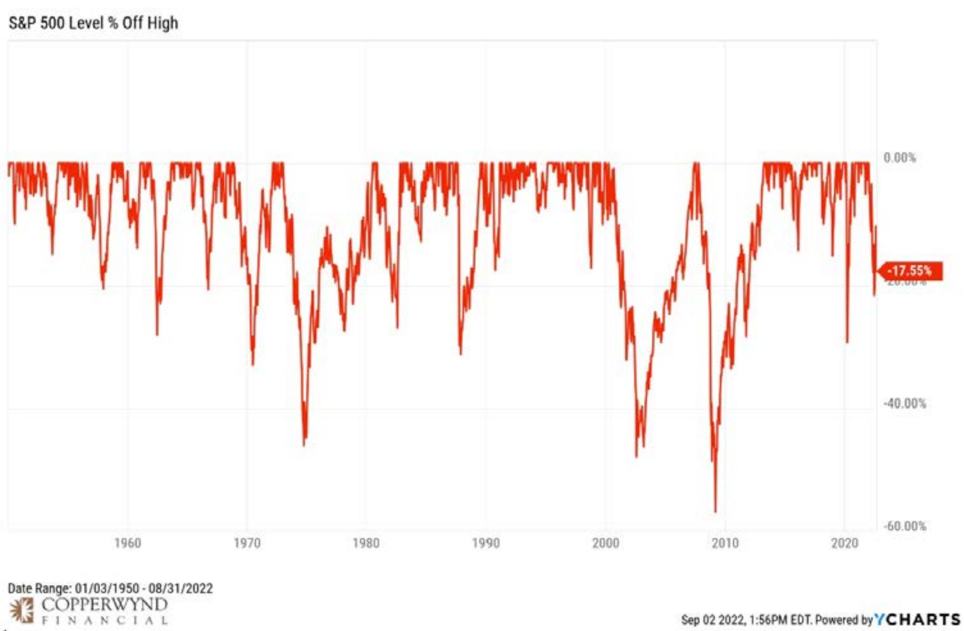
The price of admission to the stock market is dealing with volatility that will inevitably bring up those painful emotions when you witness a chunk of your life savings evaporate before your eyes. The trade-off for dealing with that emotional roller coaster is long-term returns above the rate of inflation and experiencing the compounding effect of one of the greatest wealth-building machines ever created.

You don't get this:



…without experiencing this:



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That is the nature of the markets.

In your portfolios here during the month of August, we have shifted back mostly to cash within our bond strategy as interest rates resumed their upward trend and volatility returned. On the stock side, we have also reduced our exposure and we continue to maintain our defensive stance. As always, if you are feeling uneasy about the market volatility, please reach out to us and we can revisit your situation.

Lastly, as we enter the last 4 months of the year, we'll begin our year-end planning discussions and hope to continue to find creative ways for you to be more tax efficient with your investments, required distributions and charitable donations. The holidays will be here before you know it.

We hope everyone had a fun and safe Labor Day weekend.

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Financial Planning

According to the Federal Bureau of Investigation (FBI), in 2021, there were 92,371 older victims of fraud resulting in $1.7 billion in losses. This was a 74% increase in losses compared to 2020. Unfortunately, it may be even more than that. It's hard to truly understand how widespread fraud is because the data is often underreported. It's important to protect yourself and your loved ones by being able to identify a scam or fraud and know what to do if something happens.
There are many types of fraud out there and it would be impossible to go over every single one that's been reported. We are going to take a deeper dive into the top five scams that are targeting adults. If you want additional information on current scams, there are multiple websites that you can check out: Fraud.org, IC3, Consumer Finance Protection Bureau, and FBI.

1. **Government impersonation scams** — A scammer will call pretending to be from a government agency, like the IRS, Social Security Administration, or Medicare. Right now, there have been reports of multiple different tactics that scammers use to either get personal identifying information or some form of payment. They may say the victim has unpaid taxes and threaten arrest if they don't pay up immediately or that benefits will be cut off if the victim doesn't provide personal identifying information. Be extra careful because the scammers may even "spoof" their phone number so it shows on caller ID from a government agency!

2. **Sweepstakes and lottery scams** — A scammer will call and tell the victim that they've won the lottery or a prize and to claim their winnings, they must send money up front to cover fees and taxes. Many of these scammers will continue to call for months and even years.

3. **Robocalls and phone scams** — One of the most common robocalls is the "Can you hear me?" call. When the victim says "yes," the scammer records their voice and hangs up. This recording can then be used as a voice signature to authorize charges or withdraw funds from certain accounts. Other common calls are the robocall claiming that a car warranty is expiring, and a payment is needed now to renew it or that there is an "impending lawsuit" and if a fee is not paid immediately, it will lead to an arrest or being sued.

4. **Computer tech support scams** — A pop-up message or blank screen will appear on a computer or phone and states that the device is damaged and needs fixing. When the victim calls the support number for help, the scammer may either request remote access to the device or demand a fee to have it repaired. It's important to remember that tech support will never proactively reach out to fix an issue.

5. **Grandparent scam** — There are multiple versions of this scam: either the scammer pretending to be a grandchild with an urgent request for money or pretending to be a police officer, doctor, or lawyer that is helping a grandchild. This scam tugs on the heartstrings and plays with the victim's emotions, which can result in funds being sent quickly.

Other noteworthy scams are romance scams, investment scams, Medicare scams, email fraud, phishing text messages, and, most recently, COVID-19 scams.

Now that we have outlined some of the more common scams, it's important to know what to do if you think you are being targeted for a scam and how to protect yourself. Remember these tips: Keep your personal information secure. You can do this by setting the highest level of security on any online accounts (including social media), shredding documents before putting them in the trash and not giving anyone your Social Security number, birth date, or financial account numbers, especially over the phone or internet.

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Always ask for detailed information if someone proactively contacts you and look it up before providing any personal information or sending funds (representative's name, the organization's address, and phone number, etc.).

Never make an upfront payment to someone who proactively reached out to you for a promised prize or service you didn't request, especially if you are required to make immediate payment. Be smart about who you connect with and what information you share online. If you think you are getting a phone call or message from a scammer, hang up and don't respond.

Set-up a "Trusted Contact" on your financial accounts. In a lot of fraud cases, the victim is instructed not to tell anyone. Having a trusted contact on file allows your financial advisor or representative to reach out to someone close to you if they notice suspicious behavior (i.e. withdrawing significant amount of funds, wires to unknown accounts, etc.).

Remember, scammers can be very convincing, and they are good at what they do. If you are ever unsure about a situation, talk to your financial advisor for help. One of the benefits of having an advisor is having a second set of eyes and a different perspective look at the situation, which can make the difference on being able to avoid potential scams. If you do find yourself in the unfortunate situation of being scammed, it's important that you report it. When you report a scam, authorities can use the information to build cases against scammers, spot trends, educate the public, and share data about what is happening out there.

Sources: https://www.aging.senate.gov/imo/media/doc/Fraud%20Book%202021.pdf &
https://www.theguardian.com/money/2022/aug/15/identity-theft-how-to-protect-yourself-fraud-personal-information

David Daughtrey, CFA, CFP®
Lynda Elley, CTLC, CCFS® CFP®
Erick S. Newton, CFP®
Jake Eggett, CFP®

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Tax Planning - Back Door Roth Strategy

For wage earners who earn too much income to contribute directly to a Roth IRA, there is another way in – but you'll need to understand some of the details to make it work properly. Perhaps you have heard the term "Back Door Roth" (BDR) but didn't know if this might apply to you. Essentially it allows you to make a non-deductible contribution to a traditional IRA which, in turn, can be converted into a Roth IRA, allowing the money to grow tax free. Even though you didn't qualify to contribute to a Roth, you get to go in the back door anyway, no matter what your income. It's akin to entering your home through the back door, so that's where the name stems from.

When should I consider a "Back Door Roth" contribution?

For starters, you'll need to have two things:

First, you or a spouse will need to have "Earned Income" - think salary and commissions, not income from investments, social security, pensions, or distributions from IRA's.

For 2022, if your income is below $144,000 for single filers and $214,00 for married filing jointly then you can contribute directly to a Roth IRA (just go through the front door); however, for those that find themselves above these income levels, this is where the back door might be a good solution for you.

Secondly, you'll typically want to make sure you don't have any existing IRA accounts in your name with a balance; otherwise, you'll run into a problem with the IRA Aggregation rule - more on that below.

What is the process to create a back door Roth IRA?

The process is straightforward:

1. **Contribute to a traditional IRA account** - given that your income is too high, this will be considered a "non-deductible" contribution. For 2022, the contribution limits are $6,000 if you are under age 50 and $7,000 for those that are 50 and older.

2. **Convert your contribution to a Roth IRA** – since the contribution was "non-deductible", the conversion to a Roth IRA will be tax free (assuming you didn't have any existing IRA balance and didn't earn any money while the funds were in the IRA)

Working with your tax advisor or financial advisor can help ensure this process goes smoothly.

What do I need to know when filing my taxes?

Come tax time, a tax form 1099-R will be generated when you complete the conversion from your IRA to your Roth. This tax form shows distributions from your IRA; however, the custodian will just assume that the distribution is taxable even though it was from a non-deductible contribution. ***You'll need to make sure that your tax advisor knows that this distribution was from a non-deductible contribution, or you may find yourself paying taxes on money that has already been taxed! If you do your taxes yourself, you'll want to be sure you entered it correctly with the online software.***

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Also, you can expect to receive a tax form 5498 in May from your custodian that shows contributions and rollovers into the Roth IRA. Keep the tax form 5498 for your tax records, no further action is needed.

<u>What if I already have an IRA?</u>

The situation can be a bit tricky if you already have made tax deductible contributions to an existing Traditional IRA, SEP IRA, or a SIMPLE IRA or have rolled over an employer plan, such as a 401k, into an IRA. In this case, the IRA aggregation and pro-rata rule will apply. The IRA aggregate rule stipulates that when an individual has multiple IRAs, they will all be treated as one account when determining the tax consequences of any distributions (including a distribution out of the account for a Roth conversion). The standard rule for IRA (and Roth conversions) is any after-tax (deductible) contributions come out along with any pre-tax (non-deductible) assets on a pro-rata basis.

This creates a significant challenge for those who wish to do the back door Roth strategy but have other existing IRA accounts already in place. Depending on the situation, we may be able to find a work around to make this strategy a possibility so please reach out to us so we can discuss your individual circumstances.

And a word about timing: the IRS applies the IRA aggregation to your total IRA balance at year-end, not at the time of conversion.

Note: The IRS does not view a 401k as an IRA, so by having a 401k it will not factor into the IRA aggregation rule.

Need to know more?

Although this strategy has existed since 2010, the IRS has not officially commented or provided formal guidance on whether it violates the step-transaction rule. (When applied, this rule treats what are several different steps as if they were a single transaction for tax purposes.) Experts have mixed opinions on the likelihood of this happening, but the lack of a definitive ruling means there is some risk involved. Before trying to implement the back door Roth strategy, we'd like to discuss this with you and your tax preparer. This will allow us to review the pros and cons, make sure it makes sense for your individual situation, and that it is done properly.

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401(K) Allocation

There are trades.

Neither bear markets nor bull markets are exclusively vertical events … both are typically accompanied by recoveries or retracements along the journey! July sparked hopes of a return to the bull market of last year but appears to be one of those air pockets we get along the course. While stocks gave back some of their gains from July, it was bonds that were most impacted by Chairman Jerome Powell's comments following the Federal Reserve meetings in Wyoming this month where he reiterated the aggressive stance on raising interest rates and holding that line until there is continued improvement in the inflation numbers. As a reflection of that, most bonds have returned to bear market territory and we are returning you to your "safe" place for your "stay safe" money and moving back to short-term bonds, or stable value funds. We are leaving the stock allocation as is for the time being.

If you need any assistance in reallocating your 401K / 403b / 457 plan or have not yet had us create your custom "decoder ring", please give us a call at the office and we're happy to help!

Sept 2022		Agg. Growth *100% Equity*	Growth	Moderate	Balanced	Conservative
Bonds / Cash		**20%**	**35%**	**50%**	**70%**	**85%**
	Stable Asset - OR - Short Term Bond	*20%*	*35%*	*50%*	*70%*	*85%*
	Total Return	*0%*	*0%*	*0%*	*0%*	*0%*
	*High Yield Bonds***	*0%*	*0%*	*0%*	*0%*	*0%*
	Inflation Protected Bonds	*0%*	*0%*	*0%*	*0%*	*0%*
Large Cap:		**65%**	**50%**	**40%**	**25%**	**15%**
	Large Cap Growth	*30%*	*20%*	*15%*	*10%*	*5%*
	Large Cap Value	*35%*	*30%*	*25%*	*15%*	*10%*
Mid Cap:		**10%**	**10%**	**5%**	**5%**	**0%**
	Mid Cap Growth	*0%*	*0%*	*0%*	*0%*	*0%*
	Mid Cap Value	*10%*	*10%*	*5%*	*5%*	*0%*
Small Cap:		**5%**	**5%**	**5%**	**0%**	**0%**
	Small Cap Growth	*0%*	*0%*	*0%*	*0%*	*0%*
	Small Cap Value	*5%*	*5%*	*5%*	*0%*	*0%*
International:		**0%**	**0%**	**0%**	**0%**	**0%**
	Developed International	*0%*	*0%*	*0%*	*0%*	*0%*
	Emerging Markets	*0%*	*0%*	*0%*	*0%*	*0%*
		100.00%	100.00%	100.00%	100.00%	100.00%

** If High Yield Bonds are not an option in your 401k, you can allocate that portion to a Total Return or Short Term bond fund

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