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The Financial Solutions Advisor

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Economic & Market Perspectives

After the big year-end run up, capital markets are priced for a near perfect economic and inflation outcome. While the macro backdrop of steady global economic growth, falling inflation, and anticipated central bank rate cuts is positive for both stocks and bonds, it is already discounted in asset prices, and some investors have taken profits as 2024 opened.

We remain of the view that economic growth will slow during the course of 2024. But currently, the US economy continues to show resilience.

The euro area economy disappointed in 2023 but easing inflation should bolster consumer confidence and spending the coming months. China's economy still faces structural headwinds, but growth has proven sturdier than many feared. We are less sanguine than the consensus that inflation can remain as calm as investors and central banks anticipate the Fed to validate the approximately 150 basis points of rate cuts expected this year.

Moreover, with G7 10-year government bond yields down nearly 100 basis points since late October, corporate bond spreads at the low end of their historical ranges, several equity bellwethers at or near highs, long-term inflation expectations already low and the US equity market 12-month forward P/E ratio at an elevated 20x, the path ahead for capital markets is likely to be much choppier than the macroeconomic outlook suggests.

Equities will continue to have macro tailwinds in the near term, but valuations indicate good news is already discounted. While earnings should trend higher in the year ahead, upside is constrained by already high profit margins. The big theme should be the catch-up of last year's laggards, which favors select non-US markets, along with small caps, value stocks, and equal weighted indexes. The big risk to equities is another upleg in bond yields, since valuations are already full.

Short-term pain can lead to long-term gain. Bond investors should keep that adage in mind, having endured two years of negative total returns because of rising interest rates. But higher interest payments offset declines in bond prices, raising expected total returns over the long term. Reinvestments and new money going into fixed income are attractively valued. This doesn't mean volatility is behind us. Market participants eagerly anticipate policy rate cuts in 2024, which economists foresee beginning in the second half of the year. However, there are differences in the assessment of how far short-term rates will fall. Further, central banks' unwinding of their bond-buying programs could reduce liquidity and raise the risk premium (investors' requirement for higher yield as compensation for the risk of interest rate changes over a bond's lifetime).

Unlike two years ago, the yield curve today is close to its fair-value range based on historical relationships with current fundamentals. If anything, bonds at the long end of the maturity spectrum may be somewhat undervalued. The bottom line: Rather than a bane, the rise in interest rates is the single best development for bond investors in 20 years.

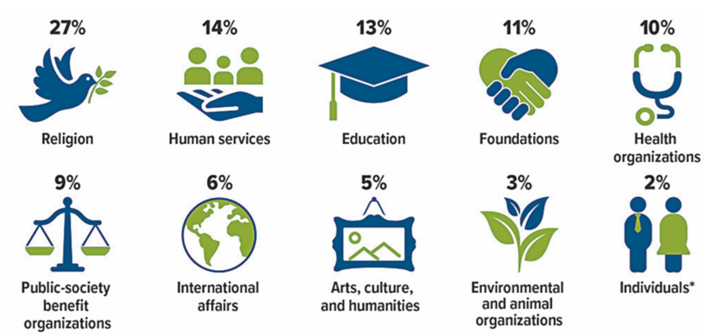
Source: Robert C. Doll (Crossmark Global Investments). Vanguard Research.

2023 Returns

S&P 500	*26.29%*
NASDAQ	*55.13%*
Russell Small Cap	*16.93%*
Russell Mid Cap	*17.23%*
MSCI EAFE	*18.24%*
MSCI World	*23.79%*
Barclay US Agg. Bond	*5.53%*
Barclay Municipal Bond	*6.40%*

Decline in Charitable Giving

Americans gave almost $500 billion to charity in 2022 — a strong show of generosity but a 3.4% decline (10.5% adjusted for inflation) from record giving in 2021. This was only the fourth time in the last 40 years that charitable giving fell in current dollars. The stock market downturn, high inflation, and other economic uncertainties caused many households to cut back on giving. Even so, a wide range of charities benefited from generous donations. Here are the types of recipients, by percentage of total charitable contributions.



*Primarily donations of medications from pharmaceutical company foundations

Source: Giving USA 2023

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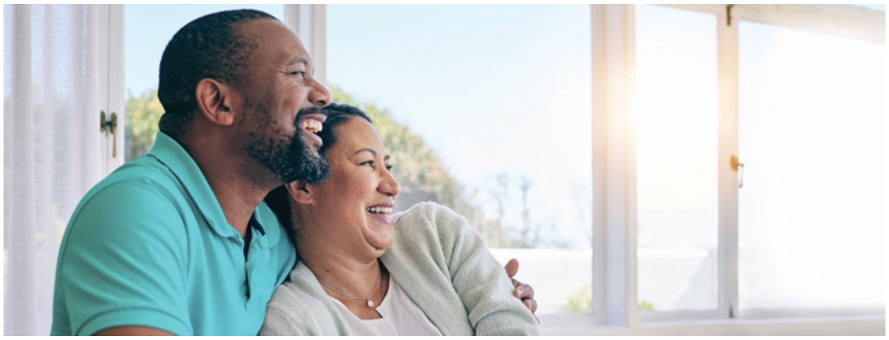


Estate planning is the process of managing and preserving your assets while you are alive, and conserving and controlling their distribution after your death. There are four key estate planning documents almost everyone should have regardless of age, health, or wealth. They are: a durable power of attorney, advance medical directive(s), a will, and a letter of instruction.

Durable power of attorney

Incapacity can happen to anyone at any time, but your risk generally increases as you grow older. Consider what would happen if, for example, you were unable to make decisions or conduct your own affairs. Failing to plan may mean a court would have to appoint a guardian, and the guardian might make decisions that would be different from what you would have wanted.

A durable power of attorney (DPOA) enables you to authorize a family member or other trusted individual to make financial decisions or transact business on your behalf, even if you become incapacitated. The designated individual can do things like pay everyday expenses, collect benefits, watch over your investments, and file taxes.

There are two types of DPOAs: (1) an *immediate* DPOA, which is effective at once (this may be appropriate, for example, if you face a serious operation or illness), and (2) a *springing* DPOA, which is not effective unless you become incapacitated.

Advance medical directive(s)

An advance medical directive lets others know what forms of medical treatment you prefer and enables you to designate someone to make medical decisions for you in the event you can't express your own wishes. If you don't have an advance medical directive, health-care providers could use unwanted treatments and procedures to prolong your life at any cost.

There are three types of advance medical directives. Each state allows only a certain type (or types). You may find that one, two, or all three types are necessary to carry out all of your wishes for medical treatment.

- A living will is a document that specifies the types of medical treatment you would want, or not want, in a particular situation. In most states, a living will takes effect only under certain circumstances, such as a terminal illness or injury. Generally, one can be used solely to decline medical treatment that "serves only to postpone the moment of death."
- A health-care proxy lets one or more family members or other trusted individuals make medical decisions for you. You decide how much power your representative will or won't have.
- A do-not-resuscitate (DNR) order is a legal form, signed by both you and your doctor, that gives health-care professionals permission to carry out your wishes.

Will

A will is quite often the cornerstone of an estate plan. It is a formal, legal document that directs how your property is to be distributed when you die. Your will should generally be written, signed by you, and witnessed. If you don't leave a will, disbursements will be made according to state law, which might not be what you would want.

There are a couple of other important purposes for a will. It allows you to name an executor to carry out your wishes, as specified in the will, and a guardian for your minor children.

Most wills have to be filed with the probate court. The executor collects assets, pays debts and taxes owed, and distributes any remaining property to the rightful heirs. The rules vary from state to state, but in some states smaller estates are exempt from probate or qualify for an expedited process.

Letter of instruction

A letter of instruction is an informal, nonlegal document that generally accompanies a will and is used to express your personal thoughts and directions regarding what is in the will (or about other things, such as your burial wishes or where to locate other documents). This can be the most helpful document you leave for your family members and your executor.

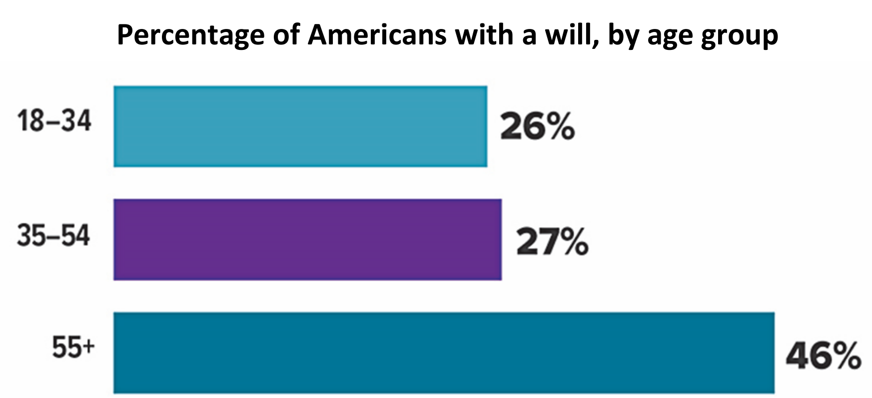
Unlike your will, a letter of instruction remains private. Therefore, it is an opportunity to say the things you would rather not make public.

A letter of instruction is not a substitute for a will. Any directions you include in the letter are only suggestions and are not binding. The people to whom you address the letter may follow or disregard any instructions.

Take steps now

Life is unpredictable. So take steps now, while you can, to have the proper documents in place to ensure that your wishes are carried out.

Source: Caring.com 2023



Reviewing Your Estate Plan

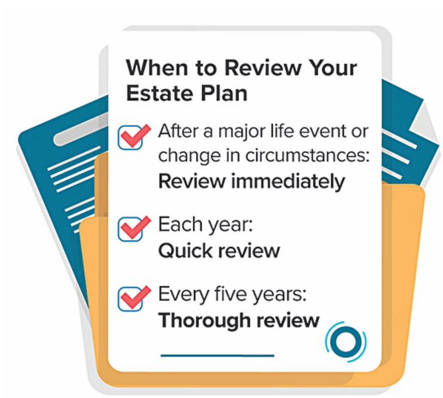
An estate plan is a map that explains how you want your personal and financial affairs to be handled in the event of your incapacity or death. Due to its importance and because circumstances change over time, you should periodically review your estate plan and update it as needed.

When Should You Review Your Estate Plan?

Reviewing your estate plan will alert you to any issues that need to be addressed. For example, you may need to make changes to your plan to ensure it meets all of your goals, or when an executor, trustee, or guardian can no longer serve in that capacity. Although there's no hard-and-fast rule, you'll probably want to do a quick review each year, because changes in the economy and in the tax code often occur on an annual basis. At least every five years, do a more thorough review.

You should also revisit your estate plan immediately after a major life event or change in your circumstances.

- There has been a change in your marital status (many states have laws that revoke part or all of your will if you marry or get divorced) or that of your children or grandchildren.
- There has been an addition to your family through birth, adoption, or marriage (stepchildren).
- Your spouse or a family member has died, has become ill, or is incapacitated.
- Your spouse, your parents, or another family member has become dependent on you.
- There has been a substantial change in the value of your assets or in your plans for their use.
- You have received a sizable inheritance or gift.
- Your income level or requirements have changed.
- You are retiring.
- You have made (or are considering making) a change to any part of your estate plan.



Some Things to Consider

- Who are your family members and friends? What is your relationship with them? What are their circumstances in life? Do any have special needs?
- Do you have a valid will? Does it reflect your current goals and objectives about who receives what after you die? Is your choice of an executor or a guardian for your minor children still appropriate?
- In the event you become incapacitated, do you have a living will, durable power of attorney for health care, or do-not-resuscitate order to manage medical decisions?
- In the event you become incapacitated, do you have a living trust or durable power of attorney to manage your property?
- What property do you own and how is it titled (e.g., outright or jointly with right of survivorship)? Property owned jointly with right of survivorship passes automatically to the surviving owner(s) at your death.
- Have you reviewed your beneficiary designations for your retirement plans and life insurance policies? These types of property pass automatically to the designated beneficiaries at your death.
- Do you have any trusts, either living or testamentary? Property held in trust passes to beneficiaries according to the terms of the trust. (The use of trusts involves a complex web of tax rules and regulations, and usually involves upfront costs and ongoing administrative fees. You should consider the counsel of an experienced estate professional before implementing a trust strategy.)
- Do you plan to make any lifetime gifts to family members or friends?
- Do you have any plans for charitable gifts or bequests?
- If you own or co-own a business, have provisions been made to transfer your business interest? Is there a buy-sell agreement with adequate funding? Would lifetime gifts be appropriate?
- Do you own sufficient life insurance to meet your needs at death? Have those needs been evaluated?
- Have you considered the impact of gift, estate, generation-skipping, and income taxes, both federal and state?

This is just a brief overview. Each person's situation is unique. An estate planning attorney may be able to assist you with this process.

How Much Income Does Social Security Replace?

Social Security can play an important role in funding retirement, but it was never intended to be the only source of retirement income. The Social Security benefit formula is based on a worker's 35 highest-earning years (indexed for inflation), and the percentage of pre-retirement income replaced by the benefit is lower for those with higher earnings, reflecting the assumption that higher earners can fund retirement from other sources.

Here are replacement rates — based on five levels of earnings — for someone who claims benefits at full retirement age (FRA) in 2024 (i.e., born in 1958 and claiming at age 66 and 8 months). Rates would be similar for those who claim at FRA in other years.

Bond Yields Are Up, but What Are the Risks?

After years of low yields, bonds are offering higher yields that may be appealing to investors regardless of their risk tolerance. While bonds could play a role in any portfolio, they can be a mainstay for retirees looking for stability and income, and near-retirees might consider shifting some assets into bonds in preparation for retirement.

Bonds are generally considered to have lower risk than stocks — one good reason to own them — but they are not without risk. In fact, bonds are subject to multiple risks. In considering the brief explanations below, keep in mind that coupon rate refers to the interest paid on the face value of a bond, whereas yield refers to the return to the investor based on the purchase price. A bond purchased for less than face value will have a higher yield than the coupon rate, and a bond purchased for more than face value will have a lower yield than the coupon rate.

Interest rate risk (or market risk) — the risk that interest rates will rise, making the coupon rate on an existing bond less appealing because new bonds offer higher rates. This typically lowers the value of a bond on the secondary market, but it would not change the yield for a bond purchased at issue and held to maturity. As the Fed has rapidly raised rates to combat inflation, the potential resale value of existing bonds has plummeted. However, rates may be nearing a peak, which potentially could make it a more opportune time to purchase bonds. If interest rates drop, the value of a bond will typically increase.

Duration risk — the risk that longer-term bonds will be more sensitive to changes in interest rates. Duration is stated in years and based on the bond's maturity date and other factors. A 1% increase in interest rates typically will decrease a bond's value on the secondary market by 1% for each year of duration. For example, a bond with a duration of seven years can be expected to lose 7% of its value on the secondary market.

Opportunity risk (or holding period risk) — the risk that you will not be able to take advantage of a potentially better investment. The longer the term of a bond, the greater the risk that a more attractive investment might arise or other events might negatively impact your bond investment.

Inflation risk — the risk that the yield on a bond will not keep up with the rate of inflation. This might be of special concern in the current environment, but high inflation is the reason that the Fed has been raising interest rates. If inflation cools, bonds with today's higher yields could outpace inflation going forward.

Call risk — the risk that an issuer will redeem the bond when interest rates are falling in order to issue new bonds at lower rates. Investors can avoid this risk by purchasing non-callable bonds.

Credit risk (or risk of default) — the risk that the bond issuer is unable to make promised interest payments and/or return principal upon maturity. Credit-rating agencies analyze this risk and issue ratings that reflect their assessment. Higher-rated bonds are considered "investment grade." Lower-rated bonds, commonly called "junk bonds," are non-investment grade. They generally offer higher yields and are considered speculative with higher credit risks.

Some lower-rated bonds may be insured, so the bond carries two ratings, one for the bond and one for the insurance company. Bond insurance adds a potential layer of protection if an issuer defaults, but it is only as good as the insurer's credit quality. An investor should not buy bonds based solely on the insurance.

The principal value of bonds may fluctuate with market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk.

Standard & Poor's	Moody's	Fitch
AAA	Aaa	AAA
AA+/–	Aa1–3	AA+/–
A+/–	A1–3	A+/–
BBB+/–	Baa1–3	BBB+/–
BB+/–	Ba1–3	BB+/–
B+/–	B1–3	B+/–
CCC+/–	Caa1–3	CCC+/–
CC/C	Ca	CC/C
D	C	RD/D

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