2024 Kick-Off

Disclaimers

- The information in this material is not intended as tax or legal advice. Please consult legal or tax professionals for specific information regarding your individual situation.
- The content herein was developed from sources believed to be providing accurate information.
- All investing is subject to risk, including the possible loss of the money you invest.
- All final investment and planning decisions are at the discretion of the client.

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Introduction

- Our focus on a long-term outlook and strategic allocation of investments guides us to limit reactions to short-term market actions or predictions.
- That said, we need to be sensitive to short-term financial market factors which have a bearing on your financial plan and strategy. Such factors include interest rates, inflation, tax policies and macro-economic events (wars, embargos, pandemics, etc.).
- I believe the beginning of a new year is a great time to re-assess your financial goals, critique your progress over the past year, and revisit your financial plan.
- This client resource is intended to summarize key metrics and trends from 2023, correlate them to long-term metrics and trends, explain their impacts and preview what we need to prepare for in 2024.

Interest rates - background

- The federal funds rate is one of the Federal Reserve's key tools for guiding U.S. monetary policy to manage inflation and employment. This is the interest rate at which U.S. commercial banks borrow and lend their excess reserves to each other overnight and is related to other lending rates such as the prime interest rate and discount rate.
- The federal funds rate impacts the interest rate on mortgages, credit card balances and consumer loans; it also affects the interest rate paid on savings accounts and other fixed-income investments.
- When the Fed Funds rate is raised, as in 2022-2023, short-term borrowing costs increase, leading to a reduction in inflation. An increase in the Fed Funds rate will typically also lead to higher interest payments on investments such as bank accounts, CDs, bonds and money-market accounts.
- In general, interest rates and the U.S. stock market have an inverse relationship: when interest rates rise, the broad stock market typically declines (and vice versa). This is because rising interest rates adversely impact borrowing costs and consumer's disposable income, leading to lower corporate revenue and profit.

Interest rates – recent effects

- The federal funds rate was between 0% - 0.25% as recently as March 2020.
- As of December 2023, it was between 5.25% - 5.50%.
- Positive effect 1: the higher interest rates led to opportunities to move assets from low-yielding bank savings and checking accounts into CDs and Money Market mutual funds. This led to a significant increase in the yield on cash assets.
- Positive effect 2: the inflation rate has declined since June 2021, leading to a stabilization in the cost of many consumer staples and services.
- Negative effect 1: for those looking to buy a home, the rise in the 30-year mortgage rate from 2.67% at the end of 2020 to a recent level of >6.5% has made home ownership much more costly.
- Negative effect 2: consumer borrowing (auto loans, credit card balances, student loans, etc.) has become more expensive. This leads to an increase in monthly budget allocations for these expenses.

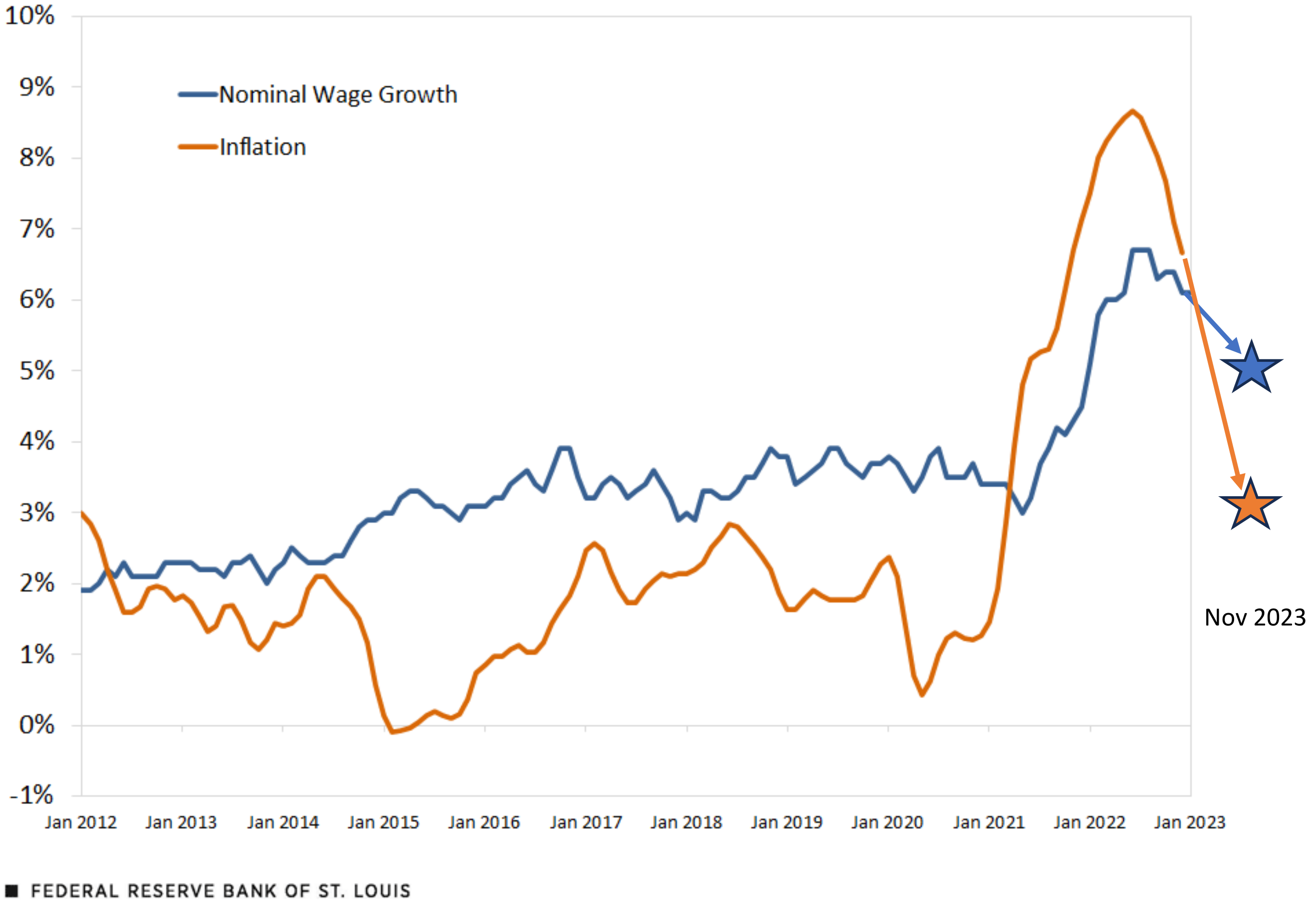
Inflation - background

- Inflation is the increase in the price of goods and services, which reduces the purchasing power of each unit of currency.
- Rising inflation can be harmful: consumers may lose purchasing power unless their incomes rise more than the inflation rate – this is referred to as Purchasing Power Risk.
  - Example: if the inflation rate is 5% annually, a product that cost $1.00 today will cost $1.05 in a year. Investments and income will need to grow >5% per year to allow the consumer to maintain or improve their purchasing power.
- Federal Reserve actions to reduce inflation by increasing interest rates may adversely affect investment returns and employment rates.
  - The Federal Reserve has a long-term inflation goal of 2%.
  - In recent years, the inflation rate was at a low of 0.12% in May’20, hit a peak of 9% in Jun’22, and has declined to 3.1% in Nov’23.
- Various inflation rate metrics exist; we focus on the Consumer Price Index.

Inflation effects (1)

Wage growth vs. Inflation

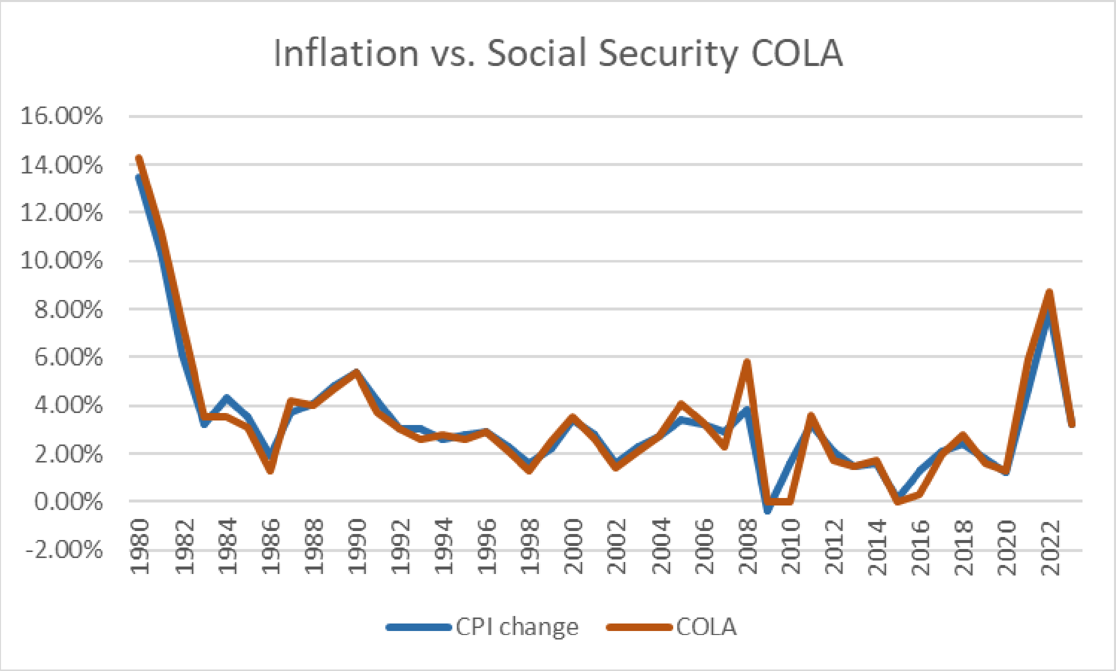
- "Real" wage growth = Nominal wage growth MINUS the rate of inflation.
- When wage growth outpaces inflation:
  - The worker's employment compensation allows them to buy more goods and services per unit of time worked, OR
  - They can buy the same amount of goods and services and have more left over to save for future needs and goals.
- Referencing the chart to the right, you can see that wage growth had been outpacing inflation from 2012 through 2020.
- In 2021-2022, inflation soared and outpaced wage growth. This situation forces workers to use savings or debt to maintain their standard of living.
- In 2023, wage growth outpaced inflation with the most-recent data for Nov 2023 showing wage growth at ~5% and inflation at ~3%.



Inflation effects (2)

People on fixed incomes (pensions, annuities, Social Security)

- Fixed incomes include Social Security, pensions and annuities.
  - Social Security payments are adjusted annually with relation to the Consumer Price Index.
  - Many pensions do NOT have inflation adjustments.
  - Most Annuities do NOT have inflation adjustments.
- When the inflation rate exceeds Cost of Living Adjustments (COLAs) for pensions and SS, or guaranteed returns for annuities, the purchasing power of the recipient declines.
  - In this scenario, the fixed income recipient can't afford to maintain their standard of living without using other savings or leveraging debt.
- The effects of inflation on fixed incomes is an important part of post-retirement financial planning.



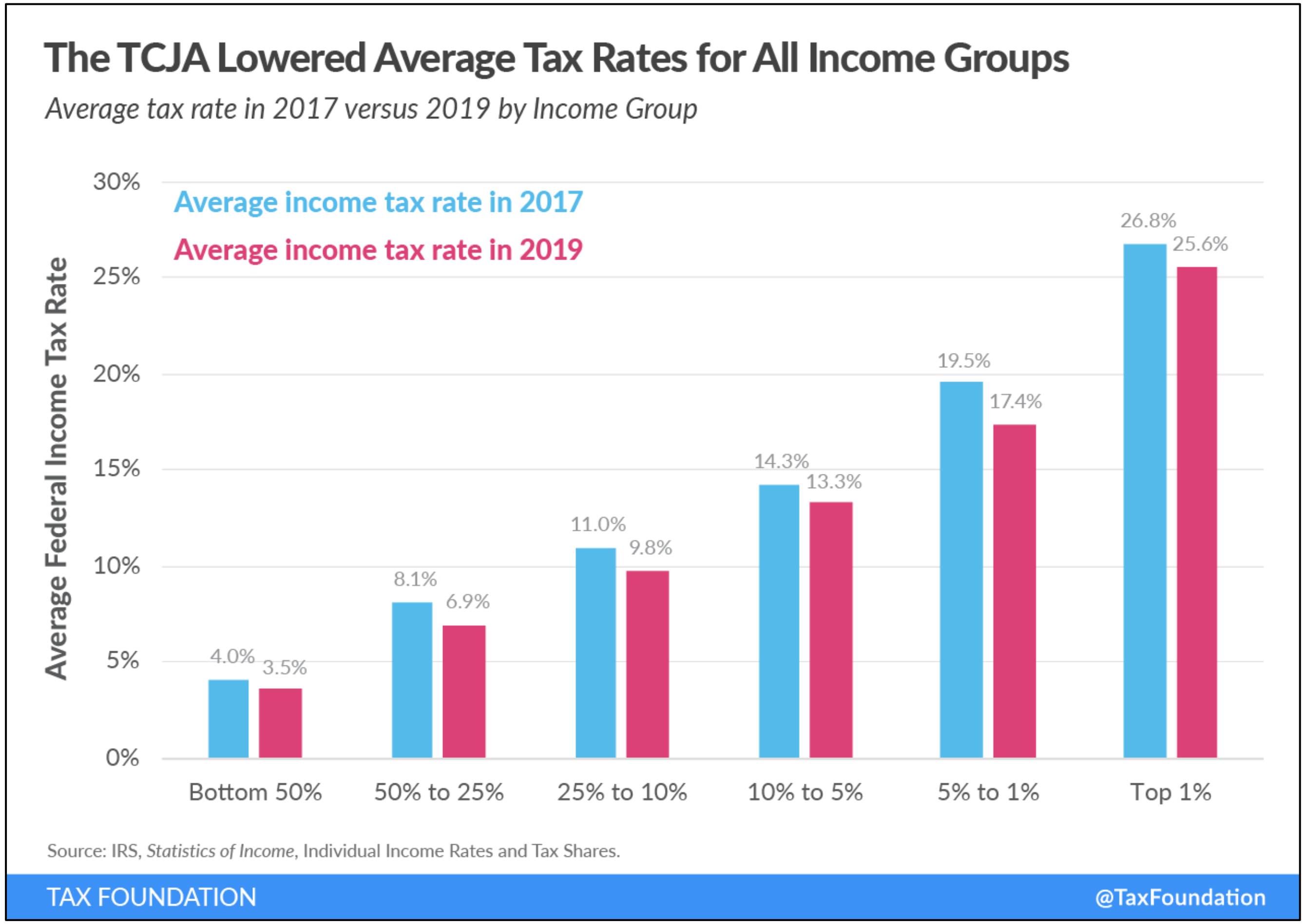
Inflation effects (3)

Investment returns vs. Inflation

- Inflation is a significant factor affecting your net or “Real” rate of investment return.
- An example, using the inflation data presented earlier:
  - An investor’s return was -5% in 2022 and +20% in 2023.
  - Inflation was 9% in 2022 and 3.2% in 2023.
  - **Inflation Adjusted Return = (1 + investment_return) / (1 + inflation_rate) – 1.**
  - The inflation-adjusted investment return was -12.8% in 2022 and +16.3% in 2023.
- The effects of inflation must be accounted for when assessing investment returns, as many fixed income options such as bank accounts and bonds have had lower returns than the inflation rate in recent years.
- In addition to inflation, factors such as investment expenses and taxes will also impact your net investment return.

U.S. Tax Policies

- The 2017 Tax Cuts and Jobs Act (TCJA) enacted many tax code changes that are beneficial to most taxpayers:
  - Reduced marginal tax rates.
  - Increased the estate tax exemption.
  - Increased the standard deduction and child tax credit.
  - Increased the Alternative Minimum Tax exemption.
- These changes are scheduled to expire 12/31/2025.
  - Due to the federal debt and spending levels, I believe there is a high chance they will be allowed to expire.
  - Thus, I encourage clients to be aware of the likely impacts in 2026 and beyond related to tax planning and estate planning.



Markets and Investments

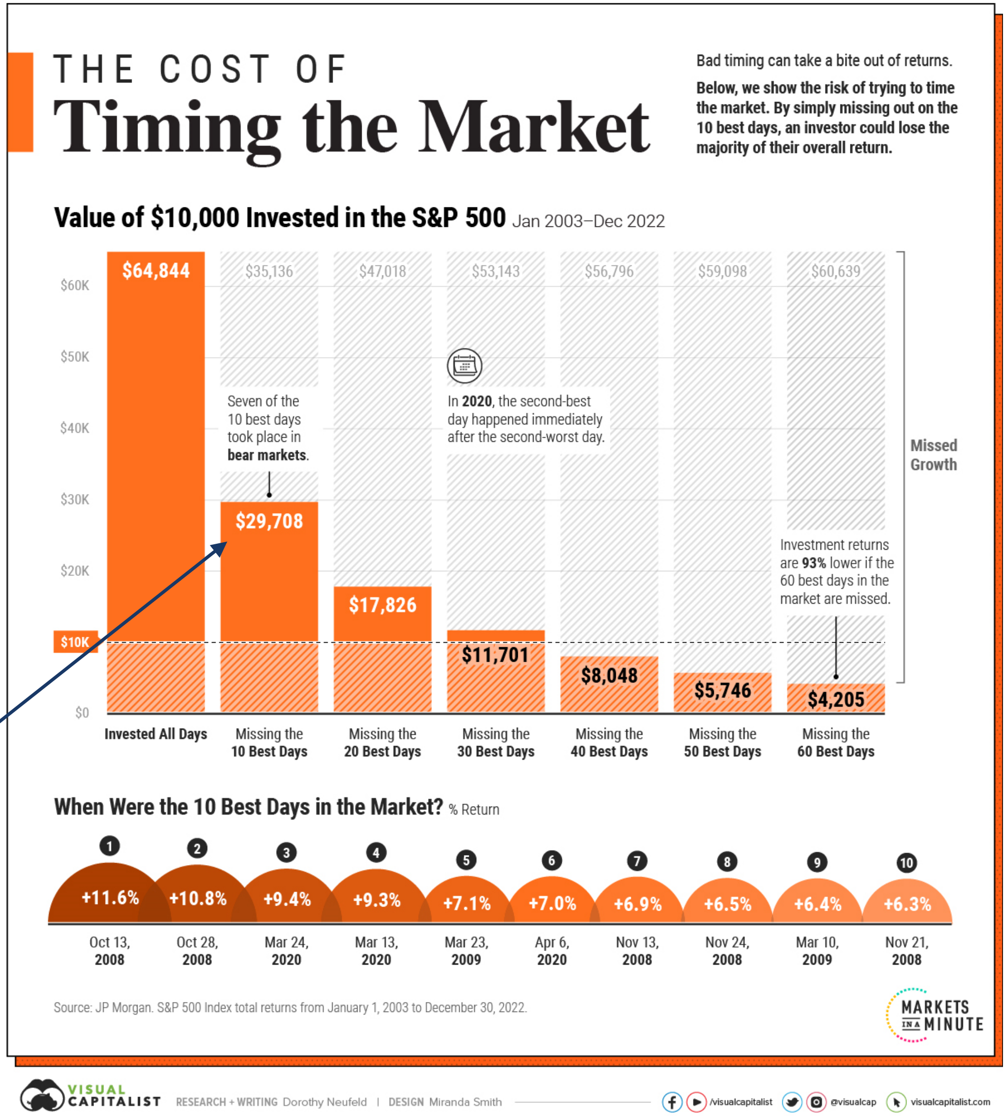
- We remain optimistic that the stock market will continue to appreciate over time, and a diversified portfolio of stocks (or stock-based funds) and fixed-income investments is applicable for most personal investors.
- As of 12/31/2023, the average yearly return of the S&P 500 is 10.5% over the last 100 years.
  - This assumes dividends are reinvested. Dividends account for about 40% of the total gain over this period.
  - Adjusted for inflation, the 100-year average stock market return (including dividends) is 7.4%.
- S&P 500 returns have varied significantly in recent years:
  - 2018: -4.2%; 2019: +31.2%; 2020: +18%; 2021: +28.5%; 2022: -18%; 2023: +24%.
- Our investment strategy remains consistent to the principles we have presented in our training modules and research articles, which remain the foundation of our financial planning policies.
  - Emergency funds and short-term goal funds should be invested in low-risk assets such as CDs, high-yield saving accounts and money market mutual funds.
  - Longer-term goal funds should be invested per a Strategic Allocation defined in your Investment Policy, which considers your investment timeline, risk tolerance and specific goals.

Markets and Investments (continued)

- Be aware of interest-rate sensitive matters such as bank account yields, loan rates, credit card balance interest rates and the rates paid on your investment account settlement funds.
  - The significant increase in interest rates since 2022 has offered opportunities to increase your yield on cash assets.
  - However, this same increase adversely affects the amount of interest owed on credit card balances and loans.
- Manage your own budget and be sensitive to how other budgets may affect you.
  - U.S. consumer debt, besides mortgages, surpassed $5 trillion for the first time in Nov’23.
  - U.S. government debt recently surpassed $34 trillion, a record high, and is projected to continue to rise.
    - The sustained government spending, well beyond its budget, has led to the recent surge of inflation which led to an increase in interest rates.
    - Just like for consumers, an increase in interest rates makes the cost of U.S. government debt rise.
  - Such excessive debt leads to a greater portion of a budget being used to pay off the debt, which reduces the portion of the budget which can be invested or spent on discretionary items. This reduction in investing and spending creates the risk of a slow-down in U.S. economic growth.
  - Another risk related to the U.S. government debt is an increase in taxes, which adds to the chances of a slow-down in U.S. economic growth
- Be wary of concentrations in particular investment types, and don’t try to time the markets….

Advantage of the Buy-and-Hold strategy

- The chart at the right highlights the risk of not staying invested in a broad portfolio over time, and the advantage of a buy and hold strategy vs. most tactical allocation methods which use short-term market trends to adjust portfolio allocations.
- As noted in the chart, many of the best days for positive market returns immediately followed bad days or took place during bear markets.
- Over the 20 years analyzed, missing the 10 best days (out of a total of ~5,000 trading days during that span) reduced the investment return by 64%.



Summary

- As we enter 2024, this presentation begins a calendar of financial management activities built to keep the effort manageable, focus on your overall financial situation, and build confidence in your plan via a focus on education.
- Financial management can seem overwhelming at times. My objective is to help you follow a well-defined process to define your goals, analyze your options, define and execute a plan, and monitor progress.
- Please feel free to contact me if you have questions about the information covered in this presentation or other matters related to your financial plan.