First Carolina Wealth

September 23, 2024

THOUGHTS TO START YOUR WEEK

Inherited IRAs—Great Benefits…Nettlesome Rules

We all remember the 'good old days' when we inherited an IRA from our father and had our entire life expectancies to take distributions from the IRA. In recent years, we have realized significant gains in the number of inherited IRAs, unfortunately from our deceased former clients. The increase in volumes has resulted in an increase in attention from our lawmakers and regulators, as evidenced by the recent SECURE Act I, 2.0, and the volumes of implementing regulations (250 pages in the most recent release) accompanying them. Be thankful that able professionals have spent, and continue to spend, hundreds of hours discerning the hidden wonders in these laws and regs, so you need not.

In a move to shore up budgetary gaps, the federal government has accelerated required distributions from inherited IRAs. These dollars have not been taxed previously, so why not accelerate their distribution and taxing? Inherited IRAs are important assets for surviving spouses, minor children, chronically ill and disabled individuals (defined as "Eligible Designated Beneficiaries" (EDBs)), so they have been grandfathered into the old rules and have more flexibility in taking distributions. Let's review the new rules at a high level. These rules have been in place since 2022, but any penalties are waived through 2024, so the effective date is practically January 1, 2025.

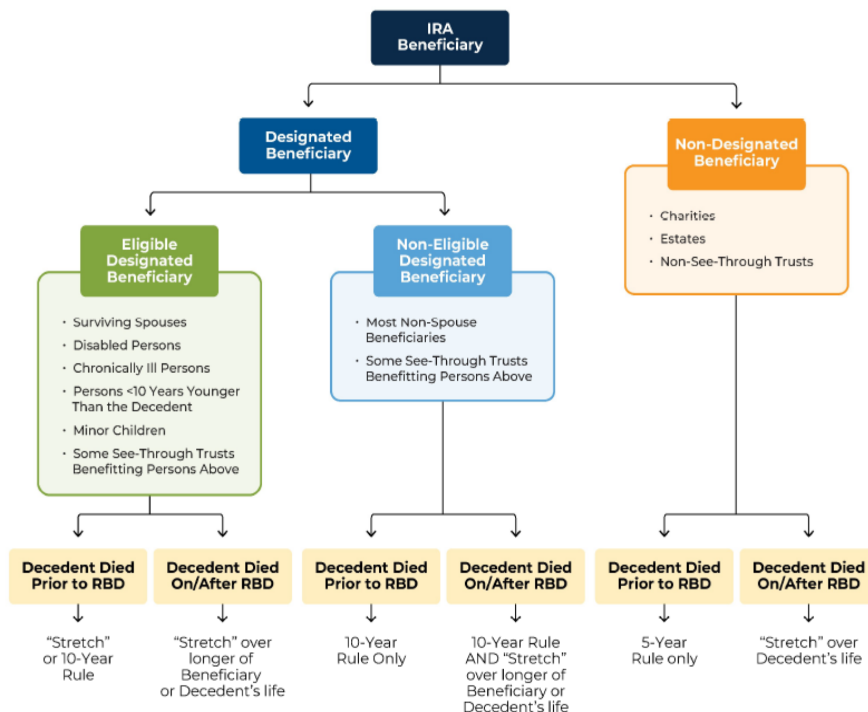
- Required Minimum Distribution (RMD) Required Beginning Dates (RBDs) have recently been delayed.
    1. For instance, if you were born in 1951-1958, your RMD age is 73 and, if in 1960 or later, it is 75.
    2. The new regulations call for different distributions for inherited IRAs depending on whether the decedent had reached his/her RMD age.
- Surviving spouses have three alternatives:
    1. You can add the inherited IRA assets to your own IRA assets of the same type (Roth to Roth, Traditional to Traditional).
        - Spouse's own age is used for RMD calculations.
        - Spouse can convert part or all of combined IRA to Roth IRA(s).
    2. You can re-register it as an inherited IRA.
        - Surviving spouse must take RMDs based on the single life expectancy tables.
        - If decedent spouse had reached RBD, surviving spouse must take any remaining RMDs not taken by decedent in the year of death and continue taking RMD distributions based on his/her life expectancy in the year following death.
        - If decedent had NOT reached RBD, surviving spouse has the option to start life expectancy RMDs either:

- By December 31 of the year following the year of death, or
- By the end of the year the original owner would have reached their RBD.

3. You can take a lump-sum distribution and front-end load your tax liability or apply the 10-year rule discussed next.

- Non-EDBs (children) can no longer use the “stretch IRA” to take distributions over their lifetime. Instead:
  1. If IRA owner died before RBD, the IRA must be fully distributed by the end of the 10th year, or
  2. If death after RBD, the IRA must be fully distributed by the end of the 10th year AND RMDs must be taken each year based on the inheritor’s life expectancy.
- If you inherit an IRA that was previously inherited, the Rules are beyond explanation, and you should consult your tax advisor.
- Similarly, if you wish to use a trust as beneficiary of your IRA and have several hours, read the appropriate sections in the new regulations. Otherwise, give us a call.

Below, these rules are depicted in a flow chart. Hopefully, this clarifies our discussion today. If these rules are intimidating for you, fear not, they are intimidating for professionals as well. Please consult your skilled tax advisor on these matters. As Albert Einstein once said, “The hardest thing in the world to understand is the income tax.”



Source: Kitces.com

First Carolina Wealth

Weekly Economic Insights From Our Investment Managers

Markets rallied to fresh all-time highs last week on the heels of the FOMC meeting where the Fed cut rates for the first time in over four years and did so by a decisive measure of 0.50%. While the odds favored the 50-bps cut, many were still thinking we'd only get 25-bps. The message to the markets was clear: the Fed does not want to fall behind the curve and hurt growth. "Soft Landing" hopes were reinvigorated, and money flowed into risk assets as can be seen in the grid below.

The commodity space welcomed the larger cut and saw growth sensitive assets, such as oil and industrial metals, post gains. Gold benefitted from lower short-term rates and increased inflation odds, while the dollar traded mostly flat. Longer-dated Treasury yields actually ticked up a bit; however, they had already moved to new yearly lows ahead of the announcement and may have been a little ahead of themselves.

SYMBOL	NAME	5D PERF	YTD PERF	1Y PERF
$GNX	$GNX - S&P GSCI Commodity Index - Spot Price	+2.76%	-0.42%	-13.19%
$MID	$MID - S&P 400 Mid Cap Index	+2.27%	+11.57%	+21.93%
$SML	$SML - S&P 600 Small Cap Index	+2.24%	+7.34%	+21.26%
$INDU	$INDU - Dow Jones Industrial Average	+1.62%	+11.60%	+22.13%
$COMPQ	$COMPQ - Nasdaq Composite	+1.49%	+19.56%	+33.26%
GLD	GLD - SPDR Gold Shares	+1.48%	+26.70%	+35.05%
$SPX	$SPX - S&P 500 Large Cap Index	+1.36%	+19.55%	+29.54%
EFA	EFA - iShares MSCI EAFE ETF	+0.90%	+11.08%	+19.33%
DBB	DBB - Invesco DB Base Metals Fund	+0.61%	+8.25%	+14.37%
$USD	$USD - US Dollar - Cash Settle	+0.53%	-0.06%	-4.08%
AGG	AGG - iShares Core U.S. Aggregate Bond ETF	-0.26%	+4.77%	+10.37%

Source: Stockcharts.com

Key Takeaway:

At the moment, the short-term outlook for stocks remains broadly favorable. The primary risk to this rally (outside of geopolitical issues) is unexpectedly weak economic growth. However, with a relatively quiet economic calendar between now and early October, it may take a major negative surprise to trigger a wave of selling. Moreover, Q3 earnings season doesn't kick off until the second week of October, and no major market-moving companies seem to be reporting before then. Given these conditions, the market is currently benefiting from:

- Moderating inflation
- A more dovish Federal Reserve
- Decelerating, but steady, economy
- Overall solid corporate earnings
- Enthusiasm surrounding AI
- Positive momentum

As such, we could see stocks continue to climb the "wall of worry" gradually in the near-term, even if this leads to stretched valuations.

From a tactical perspective, if the rally persists, we would expect cyclical and value sectors to take the lead, with broader market segments potentially outperforming the tech sector. Sectors such as materials, consumer discretionary, industrials, staples, and real estate investment trusts (REITs) are positioned to benefit, as investors seemingly remain hopeful for stronger growth and lower interest rates.

In summary, the market is inclined to push higher, and the Fed's recent rate cut only strengthens this drive. It may take relatively significant negative economic data to disrupt this bullish trend, and with few major catalysts currently on the horizon before October, that risk appears limited for now.

The Week Ahead:

According to statistics derived from the options market, this week's "Expected Move" (EM) for the S&P 500 is +/- 112 points, versus last week's 114-point EM.

This week is chock-full of key economic data. Thursday's Durable Good's report will give clues as to business spending trends, while this morning's Flash PMIs will offer a near term look at activity. Later in the week we will also hear from Fed Chair Powell and get another look at inflation via Core PCE, the Fed's preferred inflation gauge.

Tidbits & Technicals: (New developments will be denoted in *italics*)

Current Headwinds:

- Valuations seem frothy given the current rate environment, leaving the markets subject to a potential swift pullback
- "Higher for Longer" – Risk that the Federal Reserve waits too long to begin lowering rates and threatens economic growth
- Very narrow market participation, apparently driven primarily by mega cap tech and AI-related companies, has dominated the indices; however, over the last couple of weeks, we have witnessed a significant broadening effect with "the rest of the market" participating in returns

Current Tailwinds:

- Optimism surrounding Artificial Intelligence (AI), though it is recently waning
- *The Federal Reserve has begun their rate-cutting cycle and vows more cuts in the future*
- Strong labor market (signs of rising unemployment are showing up, yet jobs are available)
- Solid economic growth
- Continued earnings growth (the pace of which may be slowing)
- Momentum
- *10-year Treasury yields continuing to trade lower to new annual lows*

Sentiment:

- *Credit spreads, which recently returned to historically low levels following a spike, have strangely been widening a bit lately.*
- *The VIX (CBOE Volatility Index) has settled down somewhat but remains elevated when compared to this year's lower trend.*
- *The CNN Fear & Greed Index has moved to Greed status.*

Intermarket Trends:

- *The major indices (Dow Jones Industrial Average, S&P 500, and NASDAQ) are trading at or near all-time highs, signifying a positive trend.*
- Interest rates have been volatile lately and appear to be trending lower.
- The US Dollar has broken its upward trend line over the past several weeks and is trending downward.
- Gold recently broke out of its trading range to record highs.
- Industrial metals, which have been trending lower lately, have reversed course and have been gaining traction.
- Oil futures are in the middle of their one-year trading band and appear to be stuck in a trading range.

Tying it all together:

The markets posted fresh all-time highs last week on the heels of the first rate cut in over four years, leaving the bulls with the proverbial torch amid historically high valuations and solid, yet moderating, economic backdrop. Employment is showing signs of cooling; the yield curve is emerging from inversion after a prolonged period; and credit spreads are widening, yet optimism for equities remains strong.

My confidence in this current bull market remains cautiously optimistic, as the general trend is positive and the overall fundamental backdrop appears to support these levels. My conviction will strengthen if the new all-time highs can hold, and we continue to push even higher. It's important to recognize at this juncture that the recent rotation out of AI/technology-related stocks and into "other areas of the market' increases the challenge for the indices to continue to make new highs, since the technology sector represents a huge portion of several of the indices we use to track the markets (S&P 500, NASDAQ, etc.); therefore, it will take a stronger "push" by the other sectors to obtain this goal.

One can measure that "push" by looking under the hood of the market to gauge the broader participation, using measures of "market internals." The most widely used measures of internal strength are things such as the Advance-Decline line and its corresponding AD Volume derivative. At the present time, the Advance Decline metrics are trending upward, which shows that more and more stocks are moving up, and they are doing so with strong volume, compared to those that are taking a break or moving downward.

This broad participation is a healthy attribute and fits well within the context of the current fundamental backdrop where we have robust economic growth, historically low unemployment, and inflation trending down. During periods like this, we may expect companies tied to the more cyclical sectors (Industrials, Materials, Financials, etc.) to perform well, as it would be based on recent earnings reports. Capital is also flowing into these areas as we see stocks in these categories generally rising; however, we continue to see stronger flows into the more defensive sectors (Utilities, Healthcare and Consumer Staples). This emerging outperformance of defensive sectors is a dynamic we'd generally expect to see during the later stages of the business cycle, when concerns over future growth begin to appear.

This backdrop calls for careful monitoring, especially as stock valuations remain high and appear to be pricing in an optimistic outcome. The Federal Reserve faces the challenging task of achieving a "soft landing"—bringing inflation down to its target without stifling economic growth or increasing unemployment.

Our strategy blends macroeconomic insights with technical and intermarket analysis as well as investor sentiment to inform our tactical decisions in real time. At present, we generally recommend maintaining exposure to equities, with an emphasis on high-quality, low-volatility stocks. We also advocate for holding a healthy allocation to longer-duration (intermediate rather than short) investment-grade bonds, which we believe can reduce portfolio risk while offering compelling returns.

Lastly, I want to emphasize that the most effective strategy in all market environments is to ensure one's overall portfolio aligns with their risk tolerance and long-term goals while keeping emotions at bay. The markets often overreact to both positive and negative news, so having a sound plan, a cool head, and an understanding of the current sentiment is crucial. Staying disciplined and focused on your long-term objectives, rather than being swayed by short-term volatility, will help navigate uncertainty and capitalize on opportunities as they arise.

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