First Carolina Wealth

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THOUGHTS TO START YOUR WEEK

What Investments Are Appropriate For IRAs?

Many investors find self-directed IRAs appealing—no professional management fees paired with the opportunity to invest in whatever appeals to you. While this may sound great, it often is wrong for numerous reasons. First, since you will likely be living off this money, you should have it professionally cared for. Additionally, the IRS looks at self-directed IRAs and their investments very closely, and if you are found to have broken the rules, the penalties include a deemed distribution in the current tax year, all as ordinary taxable income. This is an unexpected and very expensive advance of your retirement asset distributions at a very high marginal tax rate. In spite of this risk, I lose track of how many times I have been approached by prospective clients to hold occupied beach houses; principal residences; lots adjoining these properties; restaurants owned, managed, and operated by the prospect; or loans to family members.

This discussion involves two overlapping sets of rules: permissible IRA investments and prohibited IRA actions. Permissible investments include almost any type of marketable security, including stocks, bonds ETFs, annuities, and even real estate. Prohibited investments include insurance policies, option trading, and collectibles such as artwork, rugs, antiques, most coins, and alcoholic beverages. The basic objective of the IRS is that the assets included in retirement plans be marketable and relatively liquid, in exchange for the tax deferral granted them.

This becomes more complex when you apply the additional filter against prohibited transactions. IRAs (and all retirement vehicles) are subject to the same broad rules that apply to charitable endeavors (foundations and charitable remainder trusts). The IRS believes that if you are involved with a tax deferred or subsidized vehicle, you need to "play by the rules" and not treat the funds as an alternative pocketbook. Of the broad expanse of prohibited transactions, the one most affecting IRAs is the prohibition against self-dealing. You cannot use invested assets in the IRA for your own benefit; they have to be purely investments. Accordingly, you can hold investment real estate in your IRA, but not the beach house you use or the lot that adjoins it that would enhance the value of what you own personally. You can invest in a restaurant, but it cannot be your occupation, as you cannot be paid for managing an asset of your IRA. You can own bank stock in your IRA, but not bank stock for which you serve as a director and these shares provide the statutorily required minimum share ownership as a director. When approached by a client or prospect to manage their IRA, I always ask two questions:

1) How will the investments be handled, and
2) if they wish to designate assets to be held, what involvement do they personally have with these assets, and what benefit could they derive from these particular assets being held in their IRA?

Generally, the individual will forgive me for asking after I explain the significant downside to being caught by the IRS in violation of these rules. This equates to the four quadrants of insurable

risks—this is a low probability of happening (being caught), but a very high penalty if it happens (deemed taxable distribution of total IRA assets in current tax year). It might be an insurable risk, but it is not a risk to take with your retirement assets.

Weekly Economic Insights From Our Investment Managers

Stocks rallied last week, bolstered by impressive earnings from major banks and relatively mixed economic data. Both the S&P 500 and Dow Jones reached new highs, reflecting broad investor confidence. This positive momentum was fueled by mixed economic data: unchanged wholesale inflation (PPI) signals potential progress in controlling price increases, while hotter-than-expected inflation data (CPI) earlier in the week kept uncertainty alive around the Federal Reserve's future rate decisions. A negative jobless claims report was shrugged off as "temporary" due to recent storms and strikes, and investor sentiment remained upbeat, with all major indices posting weekly gains.

In currency markets, the dollar index climbed to nearly two-month highs as the yield on the 10-year US Treasury note held near its highest level since late July, around 4.1%. The mixed inflation data, coupled with relatively strong economic growth data, lowered investor expectations of the Fed cutting by another .50% at the next meeting. Gold traded relatively flat due to the strong dollar and rising treasury yields while Industrial metals and oil traded lower over Chinese growth concerns.

SYMBOL	NAME	5D PERF	YTD PERF	1Y PERF
$INDU	$INDU - Dow Jones Industrial Average	+1.21%	+13.73%	+26.80%
$COMPQ	$COMPQ - Nasdaq Composite	+1.13%	+22.19%	+34.29%
$MID	$MID - S&P 400 Mid Cap Index	+1.13%	+13.38%	+25.88%
$SPX	$SPX - S&P 500 Large Cap Index	+1.11%	+21.91%	+32.86%
$USD	$USD - US Dollar - Cash Settle	+0.91%	+2.18%	-3.01%
$GNX	$GNX - S&P GSCI Commodity Index - Spot Price	+0.41%	+4.48%	-3.04%
$SML	$SML - S&P 600 Small Cap Index	+0.33%	+7.11%	+23.02%
GLD	GLD - SPDR Gold Shares	+0.19%	+28.40%	+41.25%
EFA	EFA - iShares MSCI EAFE ETF	-0.30%	+11.13%	+21.73%
AGG	AGG - iShares Core U.S. Aggregate Bond ETF	-0.46%	+3.04%	+9.69%
DBB	DBB - Invesco DB Base Metals Fund	-1.04%	+14.86%	+23.82%

Source: Stockcharts.com

Key Takeaway:

Last week's economic data highlighted firmer inflation alongside slower growth, a combination that would typically lead to a significant dip in stock prices. However, the Federal Reserve's clear preference for lower rates has tempered the market's reaction to weak data. Additionally, current jobless claims data may be skewed by temporary factors, such as recent hurricanes and labor

strikes, reducing the impact of these figures. As a result, neither the inflation uptick, nor the softer growth trajectory, weighed on stocks as heavily as they might have under different conditions.

The Week Ahead:

Thursday's retail sales report will be a hot topic this week. It is expected to show a 0.3% increase in September, which would help bolster investor sentiment and alleviate concerns over slowing consumer spending trends. Other key economic data out this week include the typically volatile NY Empire State Manufacturing Index and Philadelphia Fed Manufacturing Index before it's all about housing on Friday. You'll also notice that several Fed members are speaking this week. In addition to the Economics calendar, the earnings season will enter full swing with several companies reporting quarterly results including UnitedHealth, J&J, Bank of America, Goldman Sachs, Citigroup, Charles Schwab, Abbott, Morgan Stanley, Netflix, Blackstone, P&G, and American Express.

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 are just off the lows of the year*

Sentiment:

- *Credit spreads have retreated to cycle lows.*
- *The VIX (CBOE Volatility Index) remains elevated at this time.*
- *The CNN Fear & Greed Index is nearing Extreme 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 recently on the heels of the first rate cut in over four years and new data supporting a solid growth outlook, leaving the bulls with the proverbial torch amid historically high valuations and a solid backdrop.

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 be held, 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 seemingly 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, and 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, 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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