July 22, 2024

THOUGHTS TO START YOUR WEEK

Inherited IRA Issues Under the Final SECURE Act 2.0 Regulations

Remember a few issues ago when we discussed the SECURE Act, the SECURE Act 2.0, and the proposed regulations issued by the IRS. Late last week, the IRS issued a few hundred pages of Final Regs on Required Minimum Distributions (RMDs), in large part adopting the Proposed Regs as presented. Your author has not enjoyed the opportunity to dissect these Final Regs yet, but preliminary conclusions follow.

Harkening back to the halcyon days before the SECURE Act, inheriting an IRA was a more pleasurable experience than today's stark realities. Back in the day, if you inherited an IRA from a decedent who had started taking RMDs prior to death, you could take IRA distributions over your remaining life expectancy. This generally allowed a leisurely pace of withdrawal having little incremental tax effect. The SECURE Act changed all of this, allowing only surviving spouses and handicapped beneficiaries to withdraw over their life expectancy, and all others must withdraw in full within 10 years of death of the employee. The Final Regs continue to accelerate tax revenue by requiring RMDs for each year until full withdrawal within 10 years.

This acceleration of withdrawals and payment of tax eases revenue issues for the federal government and may actually be beneficial to the beneficiaries. **Threshold Planning** attempts to spread income across multiple years to take advantage of lower tax brackets over time. By spreading distributions over the full 10 years, the beneficiary can take advantage of lower tax brackets each year and avoid creeping into higher brackets. The total difference in taxes can be meaningful while still allowing some tax deferred growth within thew remaining balance of the inherited IRA.

This **Threshold Planning** is also used in deciding when to make Roth IRA conversions, when the taxpayer fills up lower tax brackets with Roth IRA conversion but stops before kicking up to a higher marginal tax bracket.

Weekly Economic Insights From Our Investment Managers

The equity markets started strong last week following the attempted assassination of former President Trump and a favorable Retail Sales report. Major large-cap stock indices hit new highs, but the momentum shifted on Wednesday when mixed results from a couple of semiconductor companies seemingly caused a decline in some of the larger tech stocks, which significantly influence the S&P 500 and NASDAQ indices. As a result, the capitalization-weighted S&P 500 closed down nearly 2%. However, the equal-weighted S&P 500 only fell by 0.2%, and many value-oriented and cyclical stocks posted gains for the week, driving the Dow Jones Industrial Average up nearly three quarters of a percent.

The Dollar Index and Treasury yields were relatively calm last week, with the 10-year yield closing up a few basis points at 4.23%. This along with a mixed-up geopolitical picture allowed gold to reach new highs while oil and industrial metals continued their drift lower due to the uncertain global demand.

Key Takeaway:

The market rotation trade continues to gain momentum. Small-cap stocks, which were down by for the year just two weeks ago, are now up around 10% year-to-date. Mid-caps have risen similarly from showing just modest gains two weeks ago, and the Dow is now up nearly 7% year-to-date.

Although the S&P 500 and NASDAQ are still leading, the performance gap has narrowed significantly in a very short period of time. I've been writing for a long time about the very narrow leadership with major indices being driven by just a few large tech firms, and I view this "rotation" into the rest of the market as possibly a healthy sign of things to come.

The Week Ahead:

A busy week of data starts Thursday with Durable Goods and Preliminary GDP estimates. These important growth metrics will be accompanied by Thursday's jobless claims, which have been attracting more attention lately. On Friday we will get Personal Income and Spending reports along with the Fed's preferred inflation gauge, the Core PCE Index. And if all that wasn't enough, the University of Michigan will release its Consumer Sentiment report on Friday, which provides a dynamic look at how the actual consumer views their own financial situation and prospects for the future economy.

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" showing stronger returns*

Current Tailwinds:

- Optimism surrounding Artificial Intelligence (AI)
- Fed potentially cutting in the future
- Strong labor market
- Solid economic growth

- Continued earnings growth (the pace of which may be slowing)
- Momentum
- *10-year Treasury yields continue to hover near their lowest levels since March of this year*

Sentiment:

- Credit spreads remain tight, hitting their lowest levels since peaking in 2022, signaling the bond market (aka "smart money") is not worried about a recession in the near future.
- *The VIX (CBOE Volatility Index) exploded higher last week on mixed semiconductor earnings reports and political unrest.*
- *The CNN Fear & Greed Index returned to Neutral last week.*

Intermarket Trends:

- The major indices (Dow Jones Industrial Average, S&P 500, and NASDAQ) recently posted new highs, signifying a positive trend.
- Interest rates have been volatile lately but appear to be retreating at the present time.
- The US Dollar is trading near the upper end of this year's trading range due to foreign central banks being the first to cut rates and others taking further rate hikes off the table while the Fed continues its campaign of tough rhetoric.
- *Gold broke out of its trading range to record highs.*
- *Industrial metals, which raced higher recently, have retraced all recent gains and are back in the middle of the large consolidation zone of the last year.*
- *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:

Four main factors have seemingly been supporting the markets: strong growth, falling inflation, expectations of Fed rate cuts, and AI enthusiasm. These drivers remain intact; however, some key economic data points are flashing warning signals at the present time. While the economy is not weak, some of the data suggests a weakening trend, and this is a concern given the equity markets are not acknowledging the possibility of any sort of economic contraction. Interestingly, commodities seem to be reacting to the data. Current valuations have certain equities priced for perfection, so it would be fair to say that any type of growth scare could result in rather extreme volatility in the short run.

The past couple of weeks' rotation into sectors of the market that have underperformed is a welcome sight. Markets need broad-based participation to be "healthy," so we will definitely want to keep an eye on this potential new trend, as it could lead to much higher prices in the future and provide insights into expectations of future economic expansion.

In the long term, economic growth is the primary driver and, while growth remains robust, we must remain vigilant for signs of a slowdown, as this could end the current bull market we are all

currently enjoying. For now, the positives meaningfully outweigh the negatives and as long as these conditions persist, the environment remains favorable for risk assets.

Historically, the best approach in such environments is to ensure that one's overall portfolio aligns with their risk tolerance and long-term goals.

Edward J. Sabo
Chief Investment Officer
Capital Investment Advisory Services, LLC

John Slayton, CFP®
Managing Director
First Carolina Wealth