First Carolina Wealth

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THOUGHTS TO START YOUR WEEK

Final IRS Regs for Inherited IRAs

I am sure many of you readers share my quadrennial depression at the end of the Summer Olympics. Regardless of the historic level of U.S. success, I mourn the passing of binge-watching the world's youth performing astonishing feats of physical prowess. Fortunately, the IRS foresaw this sudden vacuum of entertainment and issued the final Required Minimum Distribution regulations in mid-July. I am sure you share my awe and puzzlement as to which section of these lengthy regs is the most enthralling, but today we consider their impact on inherited IRAs. As baby boomers retire and roll their defined contribution 401(k) plans into IRAs, more and more assets are passing to the next generation through these tax inefficient distribution vehicles that few understand—and those that do are confounded by a perpetual sea of changing rules. These regs will affect you whether or not you understand them, so it is best to familiarize yourself with them.

- Required Beginning Date ("RBD") was changed in Secure Acts I and II.
  - If born before 1/1/1960, your RBD is age 73. If after, 75.
- Some definitions need to be understood.
  - **Designated Beneficiary** or **Eligible Designated Beneficiary**—any ***individual*** designated as beneficiary or by the default terms of the IRA.
    - An estate, non-qualifying trust or charity is a **Beneficiary**, but not a **Designated Beneficiary**.
  - The Secure Act provides that if an IRA owner dies prior to his/her RBD without having a **Designated Beneficiary**, the 5-year rule applies, and the balance of the IRA must be distributed prior to the end of the fifth year following death.
  - The Secure Act provides that if there is a Designated Beneficiary the 10-year rule applies instead of the 5-year rule, but also replacing the prior ability to distribute over the lifetime of the decedent or the Designated Beneficiary. This applies whether death is before or after the RBD.
  - **Eligible Designated Beneficiaries** receive special treatment, including surviving spouses, children below age of maturity, disabled or chronically ill people, or people no more than 10 years younger than the decedent.
    - If a surviving spouse inherits an IRA where the decedent died prior to the RBD, he/she may wait to begin distributions until the deceased spouse would have reached RBD and may treat the inherited IRA as such, or roll it over to his/her IRA or qualified plan or treat it as his/her own IRA, allowing distributions under his/her lifetime distribution rules. This is the most liberal distribution provision and seems appropriate for widows or widowers.

The above is an attempt to simplify (perhaps over-simplify) complex rules. The upshot of the government's efforts with IRAs is to accelerate the distribution of the IRA assets and the payment of the corresponding income tax. This is consistent with fairly liberal accumulation rules with tax-

free contributions and growth, but aggressive distributions during retirement and upon inheritance to create tax revenue for the federal treasury. The government subsidizes the accumulation of adequate retirement assets, but then requires distributions of these previously untaxed assets during retirement.

Please do not try this at home. Consult your tax advisor before venturing down any of these paths. They are likely working overtime to stay abreast of these changing rules. Your tax savings should exceed professional fees by many multiples.

Weekly Economic Insights From Our Investment Managers

Last week marked the most significant spike in volatility we've seen in a long time, as investors faced a trifecta of potential challenges: concerns over economic growth, the unwinding of the yen carry trade, and the rotation out of technology stocks. Despite the turbulence, the S&P 500 ended the week essentially unchanged thanks to the Bank of Japan reassuring investors they would not raise rates further in this volatile time (which calmed the carry trade fears), a solid ISM Services Index report that put us back in the economic expansion camp, and other important economic releases—namely, Thursday's unemployment report, which came in softer than expectations.

As could be expected, it was a wild ride in the bond market, as interest rates initially fell to their lowest levels of the year. The 10-year treasury yield briefly traded down to 3.6% to start the week, and the dollar followed suit along with most commodities. But just like equities, the risk-off tone changed almost immediately, and each of these markets ended the week right back where they left off the prior Friday.

SYMBOL	NAME	5D PERF	YTD PERF	1Y PERF
$GNX	$GNX - S&P GSCI Commodity Index - Spot Price	+1.69%	+1.20%	-9.31%
$USD	$USD - US Dollar - Cash Settle	+0.69%	+2.14%	+0.49%
EFA	EFA - iShares MSCI EAFE ETF	+0.51%	+4.49%	+10.24%
DBB	DBB - Invesco DB Base Metals Fund	+0.05%	+1.80%	+8.55%
$SPX	$SPX - S&P 500 Large Cap Index	-0.04%	+12.04%	+19.62%
$COMPQ	$COMPQ - Nasdaq Composite	-0.18%	+11.55%	+22.03%
GLD	GLD - SPDR Gold Shares	-0.35%	+17.47%	+26.31%
$MID	$MID - S&P 400 Mid Cap Index	-0.42%	+5.54%	+10.13%
$INDU	$INDU - Dow Jones Industrial Average	-0.60%	+4.80%	+12.45%
AGG	AGG - iShares Core U.S. Aggregate Bond ETF	-0.78%	+2.46%	+6.33%
$SML	$SML - S&P 600 Small Cap Index	-1.04%	+1.37%	+6.94%

Source: www.stockcharts.com

Key Takeaway:

The past couple of weeks have been marked by volatility, yet trading has remained orderly, with no signs of liquidity issues—a reassuring sign. It's also encouraging that markets responded

positively to economic data, rather than ignoring it as they might have if sentiment had turned completely negative.

The yen carry trade, which we discussed last week, has significant implications for global markets. When combined with other factors, it has the potential to create substantial market movements. The carry trade, along with recent economic data suggesting a moderation in the strong trends of the past year, certainly deserves our attention. In light of these developments, the Sahm Rule Recession Indicator recently flashed a warning signal, which is noteworthy given its perfect track record in predicting future recessions. Additionally, we've witnessed the longest inverted yield curve in history—where short-term interest rates exceed long-term rates—which has also been a precursor to past recessions. Over the past few weeks, high-yield spreads have risen by nearly 25%, reflecting the increased risk premium demanded by investors for holding debt from lower-credit-quality companies. Rapidly rising credit spreads have also been a sign of potential trouble ahead as sophisticated bond investors begin positioning their wealth away from companies with poorer credit quality leads one to believe they are fearing those firms' ability to repay their debts in the future.

While these risks should not be dismissed, I don't believe they signal the end of the bull market. There are still many positives at play, including economic growth, strong corporate profits, historically low unemployment, and declining inflation. Now is an opportune time to review portfolios and ensure they align with our risk tolerance. If certain sectors or asset classes have become disproportionately weighted, it may be wise to rebalance to a more appropriate mix.

The Week Ahead:

According to statistics derived from the options market, this week's "Expected Move" (EM) for the S&P 500 is +/- 141 points. This is 21 points less than last week's EM, but still large.

Key Events:

This week is packed with earnings, as 975 companies are scheduled to report. We also have a busy week for economic data, with the key reports being Tuesday's Producer Price Index (PPI) on wholesale inflation and Wednesday's Consumer Price Index (CPI) on retail inflation.

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 have recently raced higher by 25%, as bond investors are requiring a significantly higher risk premium for holding the debt of less creditworthy companies.*
- The VIX (CBOE Volatility Index) has leapt higher, suggesting fear among investors at the present time.
- The CNN Fear & Greed Index has moved to Extreme Fear.

Intermarket Trends:

- The major indices (Dow Jones Industrial Average, S&P 500, and NASDAQ) recently posted new highs, signifying a positive trend; however, in the short term, they are trending downward.
- Interest rates have been volatile lately and are trending lower.
- *The US Dollar has broken its upward trend line over the past several weeks and is beginning to trend downward.*
- Gold recently broke out of its trading range to record highs and appears to be consolidating at this time.
- 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:

I'm keeping the below paragraphs from my prior reports, as they really sum up expectations and what is currently taking place:

"In the long term, economic growth is the primary driver and, while growth remains robust, we are now seeing signs of moderation. This does not mean everything is falling apart; in fact, this was the Federal Reserve Board's intention. They have held interest rates high for a long time to combat inflation, and the expected result of such policies is economic moderation and a cooling of the labor market. The Fed is shooting for a soft landing, a scenario whereby inflation returns towards their 2% target without destroying economic growth, and so far, that scenario appears most likely.

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, like rising unemployment, 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. 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.

I will reiterate that the best approach in these environments is to ensure that one's overall portfolio aligns with their risk tolerance and long-term goals and add to this the importance of keeping emotions at bay. Markets tend to overreact to both positive and negative data and keeping a calm perspective has always proven prudent."

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