First Carolina Wealth

July 1, 2024

THOUGHTS TO START YOUR WEEK

Hot Summer IRA Musings

As we lounge on the beach in the searing heat, our minds wander to thoughts of our retirement plans, specifically our IRAs. Today we start a journey into the intricate world of IRAs, a world we all must live in regardless of our interest or skills in it, or knowledge of it. Over the next several sessions, we will cut the IRA behemoth up into digestible pieces and discretely review each.

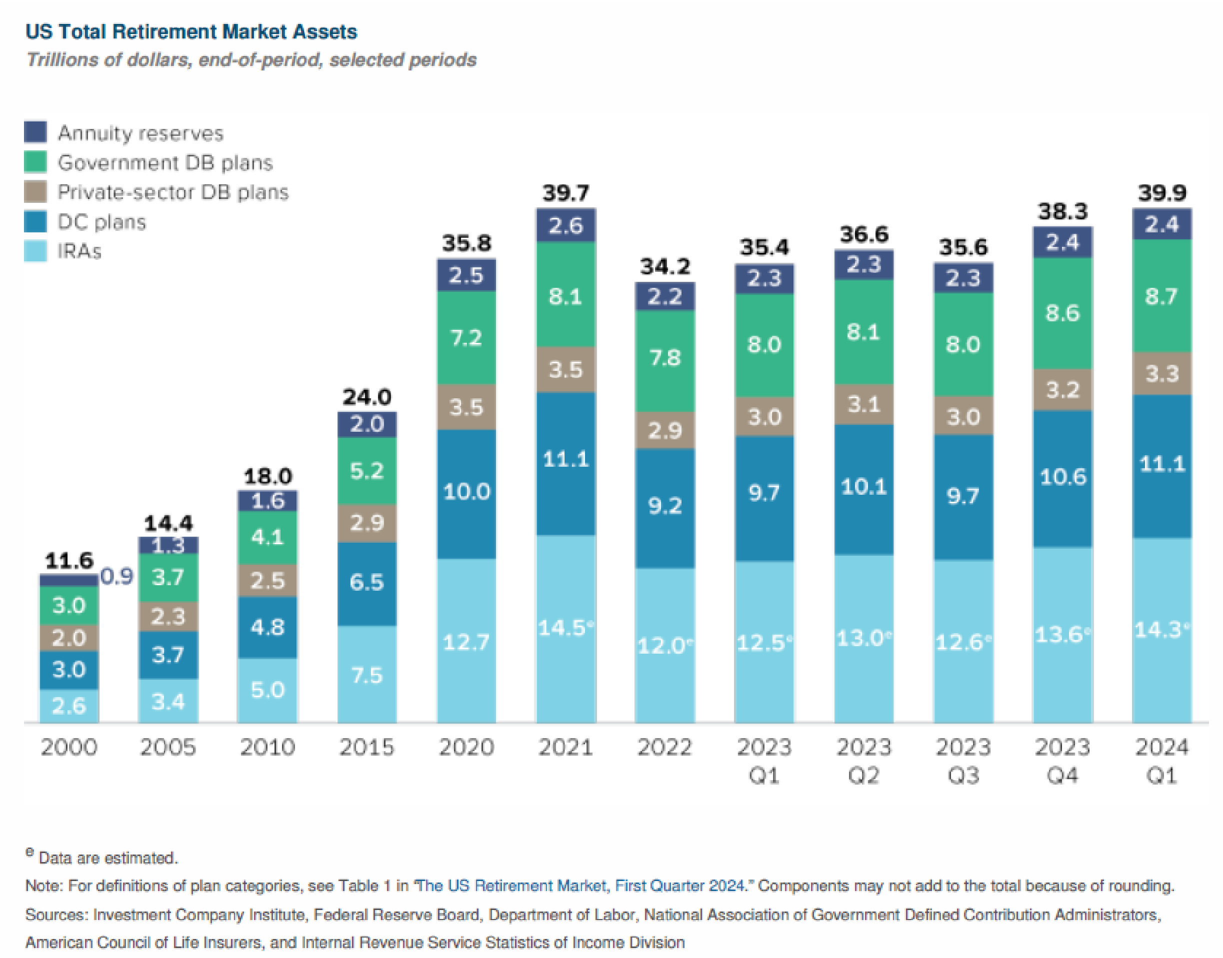
First, an historic note.

- IRAs were originally authorized by the Employee Retirement Income Security Act of 1974 ("ERISA") as a means of encouraging working people to save for retirement.
- Similarly, 401(k) plans were authorized by the Revenue Act of 1978, and rules permitting tax-free employee deferrals through salary reduction were adopted in 1981.
- Companies were attracted to the 401(k) option because it was cheaper and more predictable to fund that defined benefit plan pensions, which had long been the main source of retirement savings.
- Today, the defined contribution-styled 401(k) dominates the retirement landscape, and the defined benefit-styled pensions are relegated to governmental agencies funded with taxes and a number of private pensions representing a tiny reflection of a former halcyon day of employer largess and paternalism (and lower profits).

The basic program today is that, while employed, taxpayers fund 401(k) plans, with optional employer matches.

- Restrictions from early withdrawals attempt to keep the assets locked up until retirement age, 59 1/2.
- Upon retirement, assets are rolled over to IRAs tax-free and managed as individual accounts.
- Required minimum distributions ensure that the IRA assets are eventually distributed and subjected to income tax.
- Accordingly, 401(k) plans and IRAs are great accumulation tools, but are designed to distribute out and be taxed. They have never been efficient estate planning tools.

As depicted graphically below, the record-high $39.9 trillion in retirement assets at the end of the first quarter 2024 include $14.3T in IRAs, $11.1T in 401(k) plans, $8.7T in government pension plans and $3.3T in private pension plans. Two thirds of the entire retirement assets are flowing from 401(k) plans to IRAs.



Tune in next time, and we will venture forth into the IRA jungle.

Weekly Economic Insights From Our Investment Managers

Last week, the S&P 500 traded sideways in a choppy fashion before rallying to new record highs once again on Friday as the Federal Reserve's preferred inflation gauge (Core PCE) matched estimates, while rising odds of former President Trump winning the 2024 election—viewed positively by markets due to Republicans' typically pro-business stance—further buoyed investor sentiment. When it was all said and done, the S&P 500 ended the week slightly lower due to profit-taking and end-of-month/quarter positioning later in the day on Friday.

The 10-year Treasury yields slightly increased on the week, settling around 4.27% with no big moves in the dollar or commodities in general.

Key Takeaway:

Once again, last week's economic data did little to change the current backdrop. With Core PCE meeting expectations, investors can breathe a sigh of relief that inflation might be under control, but the current levels are largely already baked into investors' valuations. The political scene in many of the developed countries around the world is currently a mess, but this is nothing new. I will remind you that McDonald's continues to serve hamburgers and French fries despite the political narrative, as they have for the past 69 years, generating profits for investors. So, please do not get too caught up in all what is to come with the election scene heating up.

The Week Ahead:

The key economic reports this week include Gross Domestic Product (GDP), ISM Manufacturing PMI, ISM Services PMI, and the Jobs Report. These reports provide key insights into economic growth, manufacturing activity, services sector activity, and the labor market. There is a lot of data in just these, and more being released with limited trading time and volume due to the 4th of July, so things could be volatile.

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
- *10-year Treasury yields collapsed last week to their lowest levels since March of this year*
- *Very narrow market participation driven primarily by mega cap tech and AI-related companies*

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

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) is back to the lower levels of the complacency zone.
- The CNN FEAR & Greed Index ticked back into Neutral territory 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 has been consolidating near record highs.
- *Industrial metals, which raced higher recently, have consolidated gains and are largely trading sideways.*
- *Oil futures are in the middle of their one-year trading band but have "perked up" lately and are gaining momentum.*

Tying it all together:

The economy and market are currently stable, driven by four main factors since October: robust growth, falling inflation, expectations of Fed rate cuts, and the strength of tech stocks. These drivers remain robust despite occasional alarming headlines, which are often countered by subsequent data releases.

At the present time, large tech companies appear to be dominating the markets. These large companies carry a lot of weight in the S&P 500 and NASDAQ indices. Trade centered around Artificial Intelligence (AI) vaulted Nvidia's valuation past that of Microsoft last Tuesday, currently making it the most valuable publicly traded company with an enterprise valuation of $3.33 trillion. The "rest of the market" appears to be lagging but showed signs of interest this past week as quarter-end portfolio rebalancing might have landed some profit-taking in those areas of the market that have been overlooked and may be poised to benefit from the relatively strong backdrop we are currently observing.

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 negatively impact the markets. High interest rates are not a major issue, as long as growth remains solid. For now, the positives—full employment, declining inflation, economic growth, strong earnings — meaningfully outweigh the negatives. As long as these conditions persist, the environment remains favorable for risk assets. However, valuations are currently running high and broad equity participation is narrow.

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

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