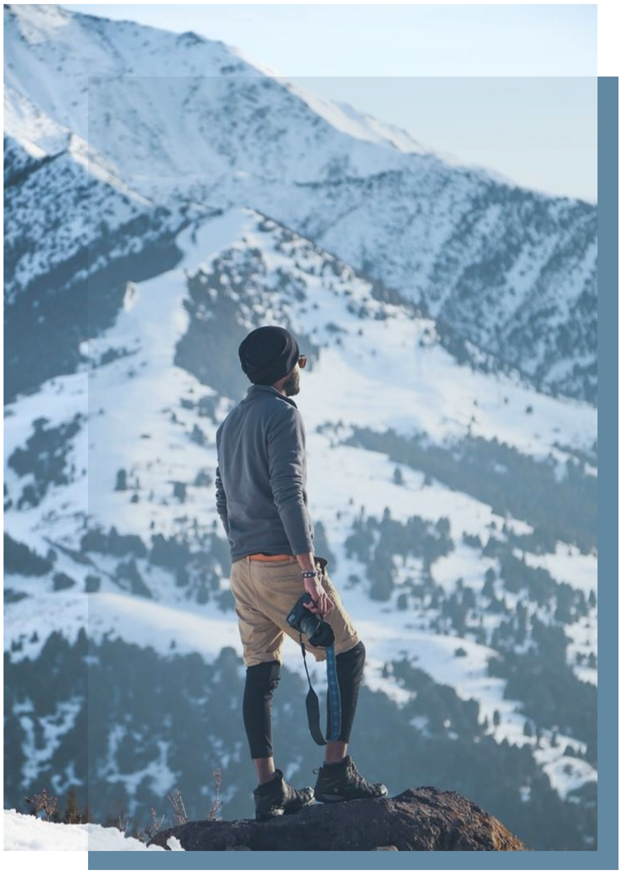
PERSPECTIVES

Benefit Financial Services Group Newsletter

Quarter Ending December 31, 2023



What's New

Market Recap

Patrick Powers, CFA®, CPA/PFP, CFP® (Principal)

2023 was quite a ride for investors. Take the S&P 500 Index[1] for example: It was up 6.29% in January and gave 2.51% back in February. It had a real nice run March – July (up 18.51% at the end of July), only to give back 8.88% August through October. Finally, it rallied nicely in November and December to finish up 24.23% for 2023. Remember that the stock market fell nearly 20% in 2022, so the run-up in 2023 just got us back to where we were at the end of 2021. In fact, the S&P 500 closed 2023 just shy of its 2021 record high.

International stocks also faired well but followed a similar path of volatility as U.S. stocks. The MSCI World ex USA Index[2] total return was 18.85% - not quite as strong as the S&P 500 Index.

Despite production cuts from OPEC, a war involving energy exporter Russia and another in the Middle East, U.S. benchmark crude oil dropped nearly 11% in 2023, and a whopping 21% in the final three months of the year.

Bonds appeared to be headed for a third losing year in a row until things turned around starting in late October. Excitement about potential rate cuts to interest rates by the Federal Reserve sent bond prices soaring and yields dropping. The yield on the 10-year Treasury, which hit 5% in October, fell to 3.88% by the end of the year and near where it started 2023. The Bloomberg US Aggregate Bond Index[3] was up 5.53% for the year, however that was on the heels of a 13% decline in 2022.

We would like to remind our readers that the wind in the sails of stock markets is population growth – i.e., more people to consume goods and services. We hit 7 billion people on Earth in 2011. Now we are just above 8 billion people (in spite of the pandemic!). The world population is projected to reach 8.5 billion in 2030, and to increase further to 9.7 billion in 2050 and 10.4 billion by 2100.[4] Yes, we will have our ups and downs in the stock market, but increasing population is "growth" and this should equate to rising stock prices over time. Stay the course and enjoy.

Wishing you all a happy and prosperous New Year!

Forecast

Steven Yamshon, Ph.D. (Managing Principal)

The U.S. Federal Reserve Bank (the “Fed”) made what looks like a pivot to lower interest rates. It is possible, because of this, that both U.S. stock markets could even go further in an already overvalued market. According to Validea Research, the large capitalization technology stocks are already overvalued by 19%. How stretched can valuations get?

The vast majority of the 2023 market gains were the result of a terrific run-up in just seven technology related stocks - the so called “Magnificent Seven” (Apple, Amazon, Google, Meta, Microsoft, Nvidia, and Tesla). The Magnificent Seven saw a 97% surge when lumped together and accounted for about two-thirds of the gains in the S&P 500 Index. If you did not own those stocks, you did not have much of a chance in 2023! In late November and December 2023, the stock market rally broadened out and upward returns became more commonplace. Hopefully, in a richly valued U.S. stock market, the laggards will start to pick up.

Although the economy remains strong, higher interest rates should slow the economy down and with it, corporate profits. It typically takes about 12 to 18 months for interest rates to bite. If labor demand doesn’t fall off, then inflation pressures likely will continue, and the Fed will have no choice but to keep interest rates high. Otherwise, inflation expectations would be imbedded in people’s minds and that could lead to a wage-price spiral, something we saw last year with all the labor strikes and restaurants jacking up their prices. Not to mention new minimum wage laws taking effect this year.

Although the possibility of a “soft landing” has increased, I believe there could be a “no landing.” A no landing is a pickup in economic activity with inflation falling slower than what the Fed would like, and investors expect. This could result in a dashed hope for significant interest rate cuts and could lead to the U.S. stock market at first marching higher until investors realize that inflation is stickier and that there may not be as many rate cuts as investors predict.

Interest rate cuts, in my opinion, would be small through June 2024 and if a recession looks likely, then they could accelerate at a faster pace. However, one must remember that although the market is giddy about interest rate cuts, any substantial cuts would signal that the economy is faltering. If the economy slides, then too will corporate profits and stocks could go down with it. If the economy remains strong, inflation will ensue, and interest rates would have to stay higher for longer. James Kenneth Galbraith, the great economist, said that “economic forecasting makes astrology look respectable.” Investors should take heed.

Portfolio Management

Michael Allbee, CFP® (Principal/Senior Portfolio Manager)

There was heightened uncertainty heading into 2023 and the consensus opinion called for a U.S. recession. BFSG also forecasted greater odds of a recession occurring at some point in 2023. Instead, Gross Domestic Product (GDP) grew at a faster-than-2% annual rate in the first half of the year, then accelerated to 4.9% in the third quarter. The fourth quarter is on pace for annualized GDP growth of 2.5%.[5]

Even with our views of a potential recession that never came to fruition (at least not yet), we did not jump in and out of the market to avoid every potential economic problem that popped up through the year that could have tipped the U.S. economy into a recession (a U.S. regional banking crisis, wars involving Ukraine and Israel, last-minute deals to avoid a U.S. government shutdown, strikes effecting Hollywood, railroads, auto manufacturers, and more, just to name a few). There will always be background noise and fearmongers pushing scary scenarios that may (but do not usually) happen. We let others act on it. In our opinion, trying to time the market is a fool’s errand.

The goal of investing is not to predict what interest rates or inflation will be or when the next recession will occur to try to time the market. Instead, we use our economic outlook and valuation framework to tilt the portfolio in one direction or the other. Based on our outlook for 2023, we positioned portfolios more defensively (i.e., favoring large cap stocks vs. small-mid cap stocks, short- to intermediate-term high quality bonds, and a tilt towards dividend paying stocks). While this defensive posture detracted some from overall results in 2023, we felt that we built a portfolio that our clients can stick with that holds a diversified basket of good, growing companies from around the world, and bonds that protect the portfolio from unexpected risks that arise in the short run.

Over time, the broad stock market has been a remarkable driver for long-term growth of wealth while overcoming countless periods of market anxiety and short-term drawdowns. The best way to do that is uninterrupted. The “trick” is that realizing these long-term outcomes requires staying the course during heightened uncertainty and that emotional investment decisions are a common way to lose money. In fact, check out our latest BFSG short video series on YouTube on behavioral investing to learn about the many biases and habits that lead to poor investment decisions.

Talk With Us!

Paul Horn, CFP®, CPWA® (Senior Financial Planner / Wealth Manager)

In the landscape of investments, dividends play a significant role, particularly for investors seeking steady income. Among the various types of dividends, "qualified dividends" stand out due to their favorable tax treatment. Let's explore what qualified dividends are, how they work, and see an example to better understand their impact.

What is a Dividend?

As a stock shareholder, you are an owner of the company. At the end of the year, the company can choose to take its profits and reinvest them into the company or pay them out to the company owners. If they choose to pay them out to the owners, then the stockholder will receive this payment called a dividend. All dividends are the same, but they can be treated differently from a tax perspective.

Taxation of Dividends

An ordinary dividend is taxed at your normal income tax rates that range from 10% - 37% at the federal income tax level. Qualified dividends benefit investors through reduced tax rates. These rates are significantly lower than ordinary income tax rates and are categorized based on the taxpayer's income bracket. These rates are 0%, 15%, 18.8%, 20%, or 23.8% at the federal tax level, depending on the investor's taxable income.

For a dividend to be qualified, it must be paid by a corporation and meet certain holding period requirements. The shares must be held for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is the day after which new buyers of the stock will not receive the declared dividend.

Example of Stock Qualifying for a Qualified Dividend

To understand how a stock qualifies for a qualified dividend, it's crucial to delve into the specific criteria set by the IRS.

Here’s an example that illustrates the process:

Let's consider a hypothetical U.S. corporation, TechGrow Inc., which is listed on the New York Stock Exchange (NYSE). An investor, Jane, purchases 200 shares of TechGrow Inc. TechGrow Inc. declares a dividend of $1.50 per share.

<u>Criterion to qualify as a qualified dividend</u>

Holding Period:

- Ex-Dividend Date: Assume the ex-dividend date is June 15th.

    - **Holding Period Requirement**: Jane must hold the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date.

- Jane bought the shares on May 1st.
- The 121-day period for TechGrow’s dividend starts on April 16th (60 days before June 15th) and ends on August 15th.
- Jane’s holding period starts on May 1st. To meet the requirement, she must hold the shares until at least July 1st (more than 60 days within the 121-day window).

If Jane holds her shares until at least July 1st, the dividends she receives from TechGrow Inc. would be considered qualified dividends, regardless if she decides to keep the shares or sell them afterward.

Tax impact

Jane receives $300 (200 shares x $1.50) as a dividend from TechGrow Inc. Since she met the holding period requirement the $300 dividend is taxed at the lower long-term capital gains rate, rather than the higher ordinary income tax rate. If we assume Jane is in the 15% long-term capital gains rate, she will pay $45 in taxes. In contrast, if these are ordinary dividends taxed at 24% then the tax would be $72.

Key Takeaways

1. Tax Efficiency: Qualified dividends offer a way to reduce the tax burden on investment income.
2. Holding Period: Investors need to be mindful of the holding period to ensure their dividends qualify.
3. Investment Strategy: Incorporating stocks that pay qualified dividends can be a strategic move for long-term investors, particularly those in higher tax brackets.

Qualified dividends represent an attractive aspect of income investing due to their favorable tax treatment. Investors should, however, be aware of the specific requirements to take advantage of this benefit. If you are interested in learning how these dividends fit into your overall investment strategy, please **Talk With Us**!

In the News

- Welcome to the BFSG team – Melissa Ronnie!
- Retirement plan contribution limits for 2024.
- Check out our Fall Webinar Series replays and more on YouTube in our BFSG University playlist.

The Score Board

	12/31/2023	YTD Change
Dow Jones Industrial Average	37,689.54	16.18%
S&P 500*	4,769.83	24.23%
NASDAQ Composite*	15,011.35	43.42%
MSCI EAFE (USD)*	2,236.16	15.03%
Bloomberg Commodity Index	98.64	-12.55%
U.S. Aggregate Bond Index	2,162.00	5.53%
10 Yr U.S. Treasury Bond Yield	3.88%	11 bps
30 Yr Fixed Mortgage Rate	6.99%	33 bps
Prime Rate	13.33%	583 bps
Crude Oil ($ / Barrel)	$71.65	-10.72%
Gold ($ / Oz.)	$2,062.95	12.15%
U.S. $ / Euro €	$0.91	-3.37%
Core Inflation (excluding food / energy)**		4.0%
Inflation (including food / energy)**		3.1%

**Without Dividends; **Unadjusted 12-Months ended November 2023; bps (1 Basis Point = 1/100%); UNCH (Unchanged)*
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

Sources:

1. The S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The MSCI World ex USA Index captures large and mid-cap representation across 22 of 23 Developed Markets countries (excluding the U.S.) and 24 Emerging Markets countries.
3. The Bloomberg U.S. Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market. The index was created on July 7, 1973.
4. Source: United Nations. https://www.un.org/en/global-issues/population
5. Source: Atlanta Federal Reserve's GDPNow model (as of 01/03/24). https://www.atlantafed.org/cqer/research/gdpnow

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