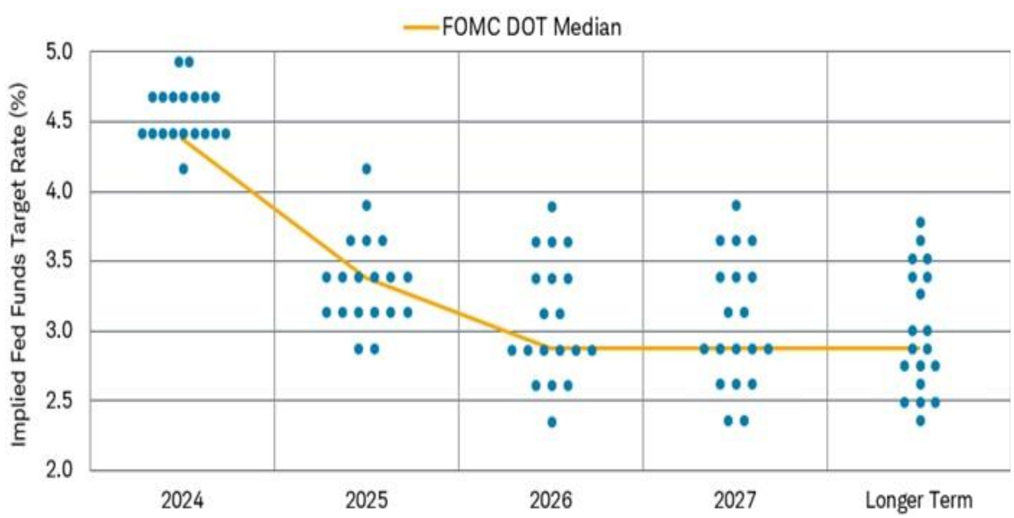
BKMWM Newsletter October 2024

Topics:
1. Interest Rates
2. Social Security Redo
3. Diversification & the Efficient Frontier
4. Considerations if Taxes Rise

1) Interest Rates

The Federal Reserve Open Market Committee (FOMC) lowered their benchmark interest rate target by a half percentage point to 4.75%-5.00%. They are attempting to stimulate the economy and support the labor market, while also keeping inflation at bay.

The September cut is expected to be just the first of many. The chart below, known as the "dot plot", illustrates each of the FOMC member's best guess as to where interest rates will be over time. You'll notice that median expectation is that rates will be near 3% in 2026.



Source: Bloomberg. FOMC DOT Plot as of 9/18/2024

On the next page we discuss what it may mean for borrowers and savers, but please contact us to discuss your personal situation.

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Q) What does it mean for borrowers?
A) Interest rates and the cost to borrowers may decline for:

- Adjustable-rate mortgages
- Small business lines of credit
- Fixed-rate mortgages (not as closely tied to the Fed's short-term rates)
- Credit cards
- Auto loans
- Student loans (not as closely tied to the Fed's short-term rates)

Q) What does it mean for short-term savers?
A) Yields should decline in step with the Fed:

- Savings accounts
- Money market funds
- Brokerage firm cash sweep accounts
- 1–18 month CDs

Q) What does it mean for long-term savers?
A) The answer is not straight forward. The Fed's benchmark rate doesn't always have an immediate, direct, clear effect on longer term rates or the stock market.

- Stocks: May look more attractive compared to holding cash. Corporate earnings may also benefit from lower borrowing costs.
- Longer-term CDs and bonds: The Fed lowered short-term rates. This does not mean that intermediate and long-term bond yields must decline, and bond prices must move up. In fact, through the end of September, yields and prices for bonds maturing 2-10 years out have barely budged since the Fed's first rate decrease. It may be prudent to consider "locking in" today's rates by buying fixed-rate 2-7 year bonds/CDs rather than holding variable-rate cash/money markets over the same period.

2) Social Security Redo

Nearly 30% of retirees claim their minimum Social Security benefit.[1] Many make the choice with incomplete information and/or based on gut feeling. Social Security can represent a sizeable portion of your retirement income, so it is important to make sure you make the right decision.

If you or your spouse have claimed Social Security benefits, but your financial situation has since changed, you may be relieved to hear that your initial decision doesn't have to be your final decision. You have the option to change your mind and stop taking benefits. You can request to "pause" your Social Security benefits to be resumed later. For each year you delay your benefits in this way up until age 70, your benefits will increase by 8%.

For a married spouse who has the higher of the two Social Security benefits, the payoff of waiting can be immense since this lifetime benefit increase will apply for the duration of both your lifetimes.

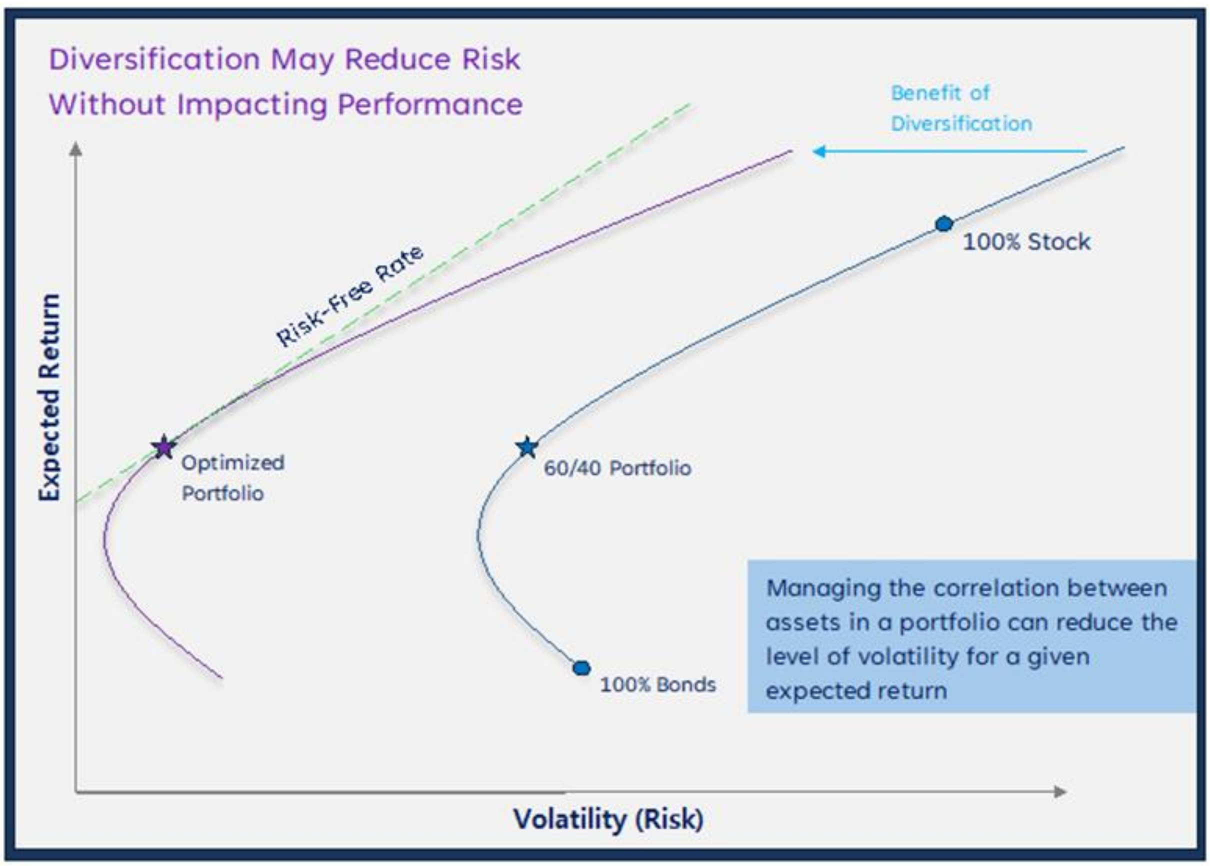
If your circumstances have changed, such as receiving an inheritance, gaining a better understanding of your cash flow since you first started taking benefits, or simply changing your mind, it might be worthwhile to consider pausing your benefits. Please contact us to discuss your Social Security analysis and planning.

Source: 1) https://www.ssa.gov/policy/docs/statcomps/supplement/2023/6b.html#table6.b5.Minimum benefit defined as earliest available benefit, often at age 62.

3) Diversification and the Efficient Frontier

Building a prudent investment portfolio is about more than arbitrarily allocating across asset classes in the name of diversification. The Efficient Frontier is a hypothetical set of optimal portfolios displayed as a hyperbolic line by plotting expected return alongside level of risk as measured by volatility. When properly done, diversification brings a portfolio towards this boundary of optimal efficiency.

Modern Portfolio Theory (MPT) tells us that we can use the correlation of assets in a portfolio – the way various assets move in the market in relation to each other - to fine-tune the expected behavior of the portfolio as a whole. This means that for a desired degree of risk, there is a way to maximize the expected return, or for a given level of expected return, there is a way to minimize the risk (as measured by volatility).



Understanding correlation between assets when diversifying has the potential to benefit your portfolio by reducing the amount of volatility you experience without impairing your returns.

4) Considerations if Taxes Rise

With the presidential election just around the corner, both candidates are laying out the basics of their tax agendas. If you are concerned about what the election may mean for your portfolio, please refer to our February newsletter which is available at www.bkwm.com. If you are concerned that your personal income tax rates may increase in the future, below are some key strategies to consider.

A. **Accelerate Income**
   It might be beneficial to accelerate income into the current year when rates are lower. This can include:
   a. Receiving Bonuses Early: If possible, negotiate with your employer to receive bonuses or other compensation before the end of the year.
   b. Roth IRA Conversions: Converting a traditional IRA to a Roth IRA now means paying taxes at the current lower rate, and future withdrawals will be tax-free.

B. **Defer Deductions**
   Conversely, you might want to defer deductions to future years when they could be more valuable due to higher tax rates. This can include:
   a. Charitable Contributions: Consider postponing charitable donations to future years.
   b. Medical Expenses: If you have flexibility in timing, delay elective medical procedures.

C. **Maximize Tax-Advantaged Accounts**
   Contributing to tax-advantaged accounts can help reduce taxable income now and provide tax-free growth or withdrawals later:
   a. 401(k) and Traditional IRA: Contributions to these accounts reduce your taxable income in the current year.
   b. Health Savings Accounts (HSAs): Contributions are tax-deductible, and withdrawals for qualified medical expenses are tax-free.

D. **Invest in Tax-Efficient Vehicles**
   Consider investments that offer tax advantages:
   a. Municipal Bonds: Interest from municipal bonds is generally tax-free at the federal level and may be exempt from state taxes.
   b. Index Funds and ETFs: These typically generate fewer taxable events compared to actively managed funds.

BKM Wealth Management*, together with your tax advisor, can help you prepare for higher future tax rates. Contact us to create or review your plan.

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