Demming
Financial Services Corp.

***"PLANNING LIFE
WITH A MARGIN OF SAFETY"***

October 2023 – December 2023

4th Quarter 2023

Special Notes:

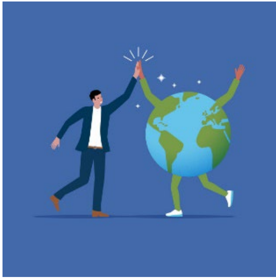
Please send us your 2023 Taxes when you receive them from your tax preparer.

Please remember to remind your tax preparer about any QCD's that you may have completed in 2023.

We will continue to host events for our clients in the future! If you would like to be included, please email Mike at: michael@demmingfinancial.com

Demming Dispatch

- Happy New Year! We hope that you had a wonderful holiday season as we look forward to another great year here at Demming Financial Services.
- When the transition to Schwab occurred, we (and many of you) noticed that Schwab did not automatically create monthly statements for all accounts. We have now remedied that, so all clients should receive monthly statements for all their accounts going forward.
- If you'd like to received paperless statements, please see the next page of this newsletter to learn more about how to enroll.
- Follow us on LinkedIn to stay up to date with blog posts, news, and more.



You have clients who opted into paperless statement delivery on advisorclient.com. To keep those same preferences at Schwab, **your clients will need to create their Schwab Alliance login credentials before March 27, 2024.**

Fortunately, creating credentials is as easy as logging in to Schwab Alliance. Once your clients log in for the first time, their settings will automatically roll over.

We're inviting those clients who are opted in to paperless preferences and who do not have Schwab Alliance credentials to take action before March 27, 2024. **Your affected clients will receive an invitation email from Schwab Advisor Services the week of January 15, 2024.**

Check out our resources in the Service Guide on Schwab Advisor Center® to view your clients' experience, learn how to customize Schwab Alliance for your practice, and more.

Here's how to invite clients to Schwab Alliance:

1. Go to the **Accounts** section in the Schwab Advisor Center, click **Profiles**, choose the appropriate master account, and select **Schwab Alliance & Paperless.**
2. To view clients who do not have access to Schwab Alliance, go to the **Web Access** drop-down and select **No,** and click **Apply Filters**.
3. Since the **Enroll** column defaults to the **Paperless** option, expand the column and select **Alliance**.
4. Select the checkbox next to each account you want to invite to Schwab Alliance.
5. Scroll to the bottom of the page and click **Start Enrollment** to send individual emails to all the clients you've selected.
6. On the confirmation screen, review the information, confirm that your clients have a valid email address, and, if necessary, update the email addresses by clicking Edit.
7. If there are any missing email addresses, click **Add**, enter the email address, and click **Update**. Your clients will receive an email letting them know that their email address was changed.
8. Click Send **Enrollment Emails** and your clients will be sent an email with instructions on how activate their Schwab Alliance online account. The email will direct your clients to schwaballiance.com to activate their account.
9. For security reasons, the link will work for only seven days.

Preparing for the Sunset

When the Tax Cuts and Jobs Act (TCJA) Act passed in 2017, we were told that all of the provisions—lower tax rates, much more generous estate tax exemption—would sunset at the end of 2025. That seemed a long way off back then. But now it's 2024, less than two years before what could be a jarring shift in our tax regime. Soon, the top marginal tax rate is due to revert back to 39.6%. The standard deduction will drop to roughly half of today's $14,600 (single) or $29,200 (joint). Most significantly, the estate tax exclusion—the amount that can be passed on to heirs without being taxed at the federal level—will drop from $13.61 million this year to somewhere around $6.5 million.

Of course, the sunset will not be all bad. After 2025, the $10,000 cap on state and local tax deductions will go away, the the limit on how much mortgage interest is deductible will go up from the first $750,000 in debt back to $1 million, and a bunch of miscellaneous itemized deductions, including investment/advisory fees, legal fees and unreimbursed employee expenses will be restored. People in lower income brackets will get back a personal exemption amount of (inflation-indexed) $4,700, phased out as taxable income goes up.

How should taxpayers prepare for these various changes, to take advantage of today's rates or exemptions? The answer varies widely with individuals, but there are some strategies that are widely-applicable. Some tax experts with a terrible sense of humor say they are recommending that if their clients are in poor health, they should plan on dying before the sunset. Less macabre strategies include strategically taking capital gains out of taxable portfolios at today's (and next year's) lower tax rates, and holding off harvesting capital losses until 2026.

Families who might bump up against the lower estate tax exemption could gift assets from one spouse's lifetime exemption while preserving the other spouse's. Since these exemptions are portable, either spouse will be able to use the other one's upon the death of one spouse, so nothing is lost by taking this route. There are various trust strategies that will move assets out of the taxable estate—the most-often-cited are the spousal lifetime access trust and the grantor-retained annuity trust, both of which use the gifted assets to provide lifetime retirement income to the donors.

But as you consider these strategies with your advisor, it's helpful to remember that Congress might intervene between now and January of 2026, and pass entirely new tax legislation. As you can see from the chart, it's happened a few times before.

2023 Fourth Quarter Investment Report

Last year, stocks were buffeted by the Federal Reserve Board's aggressive rate hikes (the fastest since the 1980s stagflation era) and the reverse of the QE policies which, for a decade or more, flooded the markets with liquidity. There were persistent fears of a recession and market economists were comparing this perfect storm of headwinds to the declines triggered by the 2008 financial crisis. In one poll taken at this time last year, 85% of distinguished economists predicted a recession.

What happened? In a word, the pundits were wrong. Throughout 2023, particularly in the final quarter, the markets blew through the headwinds and posted unusually high gains nearly across the board.

A breakdown shows that just about every U.S. investment category was showing double-digit gains. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—gained 12.10% in the 4th quarter, and ended the year with a 26.10% gain. The comparable Russell 3000 index gained 7.73% in the month of December, and finished the year up 17.23%.

Looking at large cap stocks, the Wilshire U.S. 2500 Large Cap index was up 12.08% in the fourth quarter, and posted a 26.38% gain for 2023. The Russell 1000 large-cap index finished the year with a 26.53% gain, while the widely-quoted S&P 500 index of large company stocks gained 11.24% during the year's final quarter and overall finished up 24.23% in calendar 2023.

Meanwhile, the Russell Midcap Index finished the 2023 calendar year up 17.23%.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies received a 13.54% gain for the last quarter, for a gain of 19.50% for the year. The comparable Russell 2000 Small-Cap Index posted a 16.93% gain in the past 12 months. The technology-heavy Nasdaq Composite Index was the biggest gainer in 2023; after dropping 28.27% of its value in 2022, it rebounded to gain 43.14% in 2023.

The foreign markets moved generally in lockstep with the U.S. gains. The broad-based EAFE index of companies in developed foreign economies gained 10.09% in the final quarter of 2023, to finish the year with a 15.03% gain in dollar terms. In aggregate, European stocks were up 16.68% in 2023, while EAFE's Far East Index was up 12.77%. Emerging market stocks of less developed countries, as represented by the EAFE EM index, gained 7.04% in dollar terms on the year.

"MY ADVICE IS: WAIT UNTIL THE VERY END, WHEN EVERYONE IS GETTING OUT OF THE MARKET-- THEN BUY!"

Real estate securities surprised on the upside, given widely-publicized woes in the world of office buildings. The Wilshire U.S. REIT index posted a 16.10% gain in 2023, all of it coming from the 16.30% gain in the final three months of the year. On the other side of the ledger, the S&P GSCI index, which measures commodities returns, posted an alarming 12.14% loss in the 4th quarter, ending the year down 12.20%. Utility stocks lost 10.20% in 2023.

The dramatic interest rate movements in 2022, which led to unusually steep losses in bond portfolios, thankfully didn't carry over to 2023. Yields on 10-year Treasury bonds rose from 3.87% to 4.76% currently. 30-year government bond yields rose incrementally from 3.96% at this time last year to 4.03% as of the start of the new

year. Five-year municipal bonds have dropped from a 2.56% annual rate down to 2.22% in aggregate, while 30-year munis moved from 3.63% at the beginning of the year to roughly 3.40% today.

2023 was undeniably an eventful market year. While the Fed was raising interest rates, three regional banks failed, and analysts cited the headwinds of interest rates and depositors making unusual runs on their lending institutions. Rising mortgage rates cooled the housing market, and Congress flirted with defaulting on the U.S. debt through headline-grabbing brinkmanship over the debt ceiling. Gasoline prices fell and a decline in manufacturing and industrial production flew under the radar.

The inflation rate was constantly in the headlines, as it steadily dropped from the near-10% range in the middle of 2022. Prices are still rising at a 3% annual rate, which is higher than the Federal Reserve target. The U.S. Central Bank is still engaged in quantitative tightening, shrinking its $9 trillion balance sheet by roughly $100 billion a month.

Perhaps the most under-noticed market story was how a very small number of stocks have come to dominate the robust returns of the U.S. indices. Seven stocks–Apple, Microsoft, Amazon, Nvidia, Alphabet, Meta Platforms and Tesla–accounted for 65% of the returns of the S&P 500, and because the index is capitalization-weighted (larger stocks count more than smaller ones), they now make up 28% of its weighting. The other 493 stocks in the large cap index, in aggregate, were actually underperforming.

For people with very long memories, this performance by the so-called ‘magnificent seven’ brings back echoes the ‘Nifty Fifty’ bubble in the 1960s and 1970s, when a small number of stocks (Xerox, IBM, Polaroid, Coca Cola, etc.) rose for decades, and seemed poised to rise to the moon. The shorthand version of the ending is that investor expectations of more of the same cause them to become overpriced, and they crashed in the 1973-74 bear market.

Will the future bring a similar result? Of course, we don't know, but perhaps we can take comfort in the fact that we're not alone. Most of the predictions made a year ago at this time turned out to be wrong, and they were offered by economists and others with fancy degrees and a lot of social media facetime. It's becoming increasingly possible that the Fed–viewed as reckless for most of last year, will finally get inflation under control and achieve that mythical 'soft landing' for the economy. It's possible that artificial intelligence and a higher-tech economy will drive those seven stocks higher in the foreseeable future.

But whenever you see complacency, it's time to be wary. A recession is still possible, and the markets are priced as if there is a certainty of good economic and company profit news in the year ahead. The unemployment rate has managed to stay at near-record lows for a surprisingly long time, and consumer spending continues to surprise on the upside. There is no guarantee that will continue. It's worth noting that the S&P 500 index is currently sporting a 25.35% price-earnings ratio, which means that investors are paying between 71% and 129% more for a dollar of earnings today than they have over the long-term history of the markets.

These tea leaves aren't telling us much, but in general, when markets are pricey and everybody seems to be expecting good news, it's often a good time to stay cautious and control our expectations. Economists predicted a recession, which would have triggered a stock market decline. Instead, the economy remained steady and stock prices recovered from the down year of 2022. Today, a recent poll of economists showed that half of them now predict a soft landing, with more positive market returns going forward. Will the analysts and pundits be wrong again?

Sources:

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