

October 7, 2024

THOUGHTS TO START YOUR WEEK

Trusts as IRA Beneficiaries

As the Trust Department for First Carolina Bank, we at First Carolina Wealth (FCW) eat and sleep trusts. We cannot get enough of trusts; we live for trusts, **EXCEPT** sometimes when trusts are the beneficiaries of decedents' IRAs. Generally, IRA owners name individuals as primary or contingent beneficiary of their IRAs, but there are times when a trust would be a better beneficiary :

- Maintain control of assets after death
- Control spendthrift heirs
- Provide for special needs beneficiaries
- Limit access to children or grandchildren until their age of majority
- Creditor protection layering, as IRAs offer their own creditor protection
- Use funds to pay for estate expenses
- Take care of a surviving second spouse during life, with a conduit trust for the surviving spouse based on life expectancy, with the children of the first marriage as remainder beneficiaries of the trust (subject to a 10-year payout in full)

These considerations may outweigh the counterarguments of the accelerated trust income tax rates and the additional complications and costs of forming and administering a trust.

If an IRA beneficiary trust is a qualified "see-through trust" (either conduit or accumulation), it is subject to the Secure Act's 10-year payout rule with annual Required Minimum Distributions (RMDs) each year, but a full distribution must be made by December 31 of the tenth anniversary of death.

- Conduit Trust passes IRA distributions through to the individual beneficiary as received. Eligible Designated Beneficiaries (surviving spouse, children, disabled beneficiaries, special needs trust or charitable remainder trusts) can still use the stretch IRA over the life of the beneficiary. Otherwise, the 10-year rule applies with RMDs if the deceased IRA owner was past Required Beginning Date.
- Accumulation Trust allows IRA distributions to remain in the Trust rather than immediate payout to individual beneficiary. Payouts determined by Trust terms, but full payout within 10 years. Of course, the income accumulated in the trust is subject to 37% tax rate at \$14,450, compared to a married couple filing jointly reaching 37% at \$693,750 of annual income.

While trusts remain a worthwhile consideration as beneficiaries of IRAs, the owners establishing their estate plans should consider their priorities before establishing a trust as the beneficiary of their large IRAs.

- Control of your assets from the grave might sound appealing, but what if it costs significantly higher income taxes to the beneficiaries?

- While paying a professional trustee to manage your IRA assets in trust is generally a laudable use of funds (excuse my lack of objectivity in this matter), is it worth it to also pay attorneys to draft it and accountants to file annual tax returns, even while the beneficiaries might have to draw the IRA down quicker than if they were individual beneficiaries?

I would forgive an IRA owner who decided to bypass naming an IRA as beneficiary of his/her large IRA.

Weekly Economic Insights From Our Investment Managers

Markets largely chopped around last week despite positive results from three of the most important monthly economic reports (ISM Manufacturing, ISM Services, and the jobs report). While these data points combined with the recent rate cut certainly support the soft-landing thesis, escalating geopolitical tensions and bounce in Treasury yields kept markets at bay.

Commodities rallied on news of Iran sending 200 missiles at Israel and the vowed retaliation, while Treasury yields spiked as Fed-speak lowered investors' hopes for larger than .50% rate cuts into the year end.

SYMBOL	NAME	5D PERF	YTD PERF	1Y PERF
\$GNX	\$GNX - S&P GSCI Commodity Index - Spot Price	+4.59%	+4.06%	-3.86%
\$USD	\$USD - US Dollar - Cash Settle	+1.97%	+1.45%	-3.11%
DBB	DBB - Invesco DB Base Metals Fund	+1.48%	+16.07%	+24.98%
\$SPX	\$SPX - S&P 500 Large Cap Index	+0.22%	+20.57%	+34.88%
\$COMPQ	\$COMPQ - Nasdaq Composite	+0.10%	+20.83%	+37.03%
\$INDU	\$INDU - Dow Jones Industrial Average	+0.09%	+12.37%	+27.84%
GLD	GLD - SPDR Gold Shares	-0.01%	+28.16%	+44.85%
\$MID	\$MID - S&P 400 Mid Cap Index	-0.03%	+12.11%	+27.75%
\$SML	\$SML - S&P 600 Small Cap Index	-0.75%	+6.77%	+25.72%
AGG	AGG - iShares Core U.S. Aggregate Bond ETF	-1.22%	+3.52%	+11.38%
EFA	EFA - iShares MSCI EAFE ETF	-1.63%	+11.47%	+26.59%

Source: [Stockcharts.com](https://stockcharts.com)

Key Takeaway:

Leaving this here again, as there have been no material developments recently:

At the moment, the short-term outlook for stocks remains broadly favorable. The primary risk to this rally (outside of geopolitical issues) is unexpectedly weak economic growth. However, with a relatively quiet economic calendar between now and early October, it may take a major negative surprise to trigger a wave of selling. Moreover, Q3 earnings season doesn't kick off until the second week of October, and no major market-moving companies seem to be reporting before then. Given these conditions, the market is currently benefiting from:

- *Moderating inflation*
- *A more dovish Federal Reserve*
- *Decelerating, but steady, economy*
- *Overall solid corporate earnings*

- *Enthusiasm surrounding AI*
- *Positive momentum*

As such, we could see stocks continue to climb the “wall of worry” gradually in the near-term, even if this leads to stretched valuations.

From a tactical perspective, if the rally persists, we would expect cyclical and value sectors to take the lead, with broader market segments potentially outperforming the tech sector. Sectors such as materials, consumer discretionary, industrials, staples, and real estate investment trusts (REITs) are positioned to benefit, as investors seemingly remain hopeful for stronger growth and lower interest rates.

In summary, the market is inclined to push higher, and the Fed’s recent rate cut only strengthens this drive. It may take relatively significant negative economic data to disrupt this bullish trend, and with few major catalysts currently on the horizon before October, that risk appears limited for now.

The Week Ahead:

This week’s economic calendar is light with several FOMC members speaking early in the week before the official minutes are released on Wednesday. We then get a look at inflation on Thursday and Friday with the CPI and PPI reports and cap off the week looking at the University of Michigan Consumer Sentiment data. I’m not expecting any data this week to materially impact the markets.

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” participating in returns

Current Tailwinds:

- Optimism surrounding Artificial Intelligence (AI), though it is recently waning
- The Federal Reserve has begun their rate-cutting cycle and vows more cuts in the future
- Strong labor market (signs of rising unemployment are showing up, yet jobs are available)
- Solid economic growth
- Continued earnings growth (the pace of which may be slowing)
- Momentum
- *10-year Treasury yields are just off the lows of the year*

Sentiment:

- Credit spreads, which recently returned to historically low levels following a spike, have strangely been widening a bit lately.
- *The VIX (CBOE Volatility Index) remains elevated at this time.*
- *The CNN Fear & Greed Index is nearing Extreme Greed status.*

Intermarket Trends:

- *The major indices (Dow Jones Industrial Average, S&P 500, and NASDAQ) are trading at or near all-time highs, signifying a positive trend.*
- Interest rates have been volatile lately and appear to be trending lower.
- The US Dollar has broken its upward trend line over the past several weeks and is trending downward.
- Gold recently broke out of its trading range to record highs.
- Industrial metals, which have been trending lower lately, have reversed course and have been gaining traction.
- 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:

The markets posted fresh all-time highs recently on the heels of the first rate cut in over four years, and new data supporting a solid growth outlook left the bulls with the proverbial torch amid historically high valuations and a solid backdrop.

My confidence in this current bull market remains cautiously optimistic, as the general trend is positive, and the overall fundamental backdrop appears to support these levels. My conviction will strengthen if the new all-time highs can hold, and we continue to push even higher. It's important to recognize at this juncture that the recent rotation out of AI/technology-related stocks and into "other areas of the market" increases the challenge for the indices to continue to make new highs, since the technology sector represents a huge portion of several of the indices we use to track the markets (S&P 500, NASDAQ, etc.); therefore, it will take a stronger "push" by the other sectors to obtain this goal.

One can measure that "push" by looking under the hood of the market to gauge the broader participation, using measures of "market internals." The most widely used measures of internal strength are things such as the Advance-Decline line and its corresponding AD Volume derivative. At the present time, the Advance-Decline metrics are trending upward, which shows that more and more stocks are moving up and they are doing so with strong volume, compared to those that are taking a break or moving downward.

This broad participation is a healthy attribute and fits well within the context of the current fundamental backdrop where we have robust economic growth, historically low unemployment, and inflation trending down. During periods like this, we may expect companies tied to the more cyclical sectors (Industrials, Materials, Financials, etc.) to perform well, as it would be based on



recent earnings reports. Capital is also flowing into these areas, as we see stocks in these categories generally rising; however, we continue to see stronger flows into the more defensive sectors (Utilities, Healthcare, and Consumer Staples). This emerging outperformance of defensive sectors is a dynamic we'd generally expect to see during the later stages of the business cycle, when concerns over future growth begin to appear.

This backdrop calls for careful monitoring, especially as stock valuations remain high and appear to be pricing in an optimistic outcome. The Federal Reserve faces the challenging task of achieving a “soft landing”—bringing inflation down to its target without stifling economic growth or increasing unemployment.

Our strategy blends macroeconomic insights with technical and intermarket analysis, and investor sentiment, to inform our tactical decisions in real time. At present, we generally recommend maintaining exposure to equities, with an emphasis on high-quality, low-volatility stocks. We also advocate for holding a healthy allocation to longer-duration, investment-grade bonds, which we believe can reduce portfolio risk while offering compelling returns.

Lastly, I want to emphasize that the most effective strategy in all market environments is to ensure one's overall portfolio aligns with their risk tolerance and long-term goals while keeping emotions at bay. The markets often overreact to both positive and negative news, so having a sound plan, a cool head, and an understanding of the current sentiment is crucial. Staying disciplined and focused on your long-term objectives, rather than being swayed by short-term volatility, will help navigate uncertainty and capitalize on opportunities as they arise.

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