

July 15, 2024

THOUGHTS TO START YOUR WEEK

Recent U.S. Supreme Court Decision May Negate the Benefit of Your Company's Insurance-Funded Buy-Sell Agreement

We take a brief respite from our expedition through the IRA jungle to consider a recent U.S. Supreme Court decision that may be of great importance to you. If not, come back next time.

- The Court in **Connelly v. U.S.** held that the valuation of stock in a closely-held company in the estate of a deceased shareholder was required, for federal estate tax purposes, to include the value of life insurance obtained by the company on the life of the deceased shareholder, despite the company's obligation to use the life insurance proceeds to redeem the deceased shareholder's interest.
- The company obtained the insurance to fund its redemption obligation in the company's buy-sell agreement between the two brothers who owned the company.
- The Court found that the insurance proceeds hit the company's balance sheet at the date of death but should not be offset by the future obligation to use the proceeds to redeem the deceased's shares.
- To determine if you need to be concerned about this Court ruling, please consider the following:
 - Are you a shareholder in a closely held business that has entered into a buy-sell agreement funded by life insurance owned by the company as part of your succession planning?
 - This is a redemption-styled buy-sell, rather than a cross-purchase style where the shareholders own insurance policies on each other to fund the purchase of a deceased's shares from the estate. This ruling only applies to companies that receive the insurance proceeds and then subsequently use them to redeem the shares.
 - Alternatively, life insurance on each shareholder could be held in a trust or paid to an escrow agent, rather than the shareholders or the company being required to maintain them.
 - Or, an LLC owned by the shareholders could be used to hold the life insurance policies. Upon the death of the shareholder, the LLC would receive the proceeds and distribute them to the remaining shareholders to purchase the decedent's shares.

If your company has, or is considering adopting, a redemption agreement funded by life insurance, review your agreement and make necessary changes to avoid an expensive estate tax experience. We are available to discuss this with you if appropriate. If this does not affect you, congratulations, and return next time to our exploration of the IRA jungle.

Weekly Economic Insights From Our Investment Managers

The S&P 500 reached another record high as the Consumer Price Index (CPI) rose less than expected, indicating slowing inflation, while Jobless Claims came in smaller than anticipated. Stocks shrugged off Friday's slightly hot Producer Price Index (PPI) report as investor expectations for a September rate cut and potentially one more in 2024 grew. A notable rotation away from mega-cap tech stocks towards the "rest of the market" took place with cyclical stocks and interest rate sensitive issues outperforming.

The Dollar Index declined following the better-than-expected CPI report, as markets priced in two rate cuts in 2024. Treasury yields dropped moderately as the smaller-than-expected increase in CPI pressured yields, and the 10-year yield plunged to the lowest levels since March of this year.

Despite a weaker dollar, commodities in general experienced a modest decline due to concerns about global growth. Oil prices were seemingly weighed down by these worries, while gold saw a modest rally thanks to the lower dollar rallying back towards the 2024 record highs.

Key Takeaway:

The horrific attempted assassination of former President Trump over the weekend has sent equity futures higher. Markets tend to favor Republican candidates as they are seen as pro-business. The events of the weekend are largely being viewed as increasing the odds of a Trump win and a Republican sweep in the November elections, but I will caution you that political events are typically very short-lived market factors.

What really drives the markets longer term are economic trends, and last week's demonstration of cooling inflation, coupled with a strong labor market, were no doubt a positive. Investors and analysts also tend to begin focusing on next year's corporate earnings mid-summer, and those estimates are looking strong. Most important to me was the rotation into other areas of the market, namely the cyclical stocks and smaller companies as rotations such as these indicate overall positive sentiment and are the building blocks of broad-based rallies.

The Week Ahead:

This week's key report will be Tuesday's Retail Sales, as we want to see a strong consumer on the heels of "growth" reports from the past few weeks that have showed a potential loss of momentum occurring in the economy. We will also get a look at recent growth metrics via the Empire Manufacturing Index and the Philly Fed Survey on Monday and Wednesday. These reports give the first glimpse at this month's activity; however, they can be volatile so are not deemed as important as other key data points

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 declined last week to their lowest levels since March of this year*
- *Very narrow market participation, apparently driven primarily by mega cap tech and AI-related companies, has dominated the indices; however, last week, we witnessed a broadening effect with “the rest of the market” showing stronger returns*

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) remains near the lower levels of the complacency zone.
- *The CNN FEAR & Greed Index ticked up into the Greed category, as investor sentiment grew on the positive inflation data and strong employment numbers 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:

Four main factors have seemingly been supporting the markets: strong growth, falling inflation, expectations of Fed rate cuts, and AI enthusiasm. These drivers remain intact; however, some key economic data points are flashing warning signals at the present time. While the economy is not weak, some of the data suggests a weakening trend, and this is a concern given the markets are not acknowledging the possibility of any sort of economic contraction. Current valuations have certain equities priced for perfection, so it would be fair to say that any type of growth scare could result in extreme volatility in the short run.

The past week's rotation into sectors of the market that have underperformed is a welcome sight. Markets need broad-based participation to be "healthy," so we will definitely want to keep an eye on this potential new trend, as it could lead to much higher prices in the future and provide insights into expectations of future economic expansion.

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 end the current bull market we are all currently enjoying. For now, the positives meaningfully outweigh the negatives, and as long as these conditions persist, the environment remains favorable for risk assets.

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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