First Carolina Wealth

November 4, 2024

THOUGHTS TO START YOUR WEEK

Qualified Charitable Distributions

Dear Tax Geek,

I am a 74-year-old charitably inclined IRA owner who is frustrated at having to take taxable annual Required Minimum Distributions (RMDs) from my IRA. I no longer have enough deductions to justify itemizing deductions and wind up taking the standard deduction on my Form 1040 and getting no benefit from my significant and worthwhile charitable contributions. Please advise me how to avoid this travesty of justice and restore the rightful tax benefit from my charitable contributions!

Confused, Cross, and Cantankerous

I wish I always had answers to client questions as I do for this reader. I present you the Qualified Charitable Distribution (QCD). Since the standard deduction was doubled in 2017, the number of tax filers filing itemized returns and claiming charitable deductions has dropped by 75%. Charitably inclined seniors risk receiving no subsidy from the government on their contributions, in the form of deductions. The QCD presents a solution with a manageable amount of hassle involved.

QCD Requirements include:

- IRA owner must be at least 70 ½.
- Cap of $100,000 per IRA owner per year. Married couple gets $200,000.
- QCDs can only be made out of IRAs, including inherited, not from SEP and SIMPLE IRAs or 401(k) Plans.
- Check for QCD must be payable to a 501(c)(3) charity (not a donor advised fund) but may be sent to and delivered to the charity by the IRA owner.
- A QCD can be used to satisfy an RMD if the RMD is not distributed before the QCD is processed. RMDs are always the first payments out of an IRA, so payment amounts prior to a QCD are counted for the RMD first.
- While QCDs are not deductible, the distribution from the IRA is not taxable. They do not add to Adjusted Gross Income (AGI). This matters because AGI is a key threshold for numerous items:
    - AGI determines the Medicare surcharges based on income—the more income you make, the more you pay for Medicare. In 2024, Medicare monthly premiums range from $175 to $594, dependent on AGI.
    - The 3.8% surtax on Net Investment Income for Medicaid is based off AGIs over $250,000 for a married couple.
    - Medical expenses are not deductible except if over 7.5% of AGI.
    - Credits, such as the child tax credit or educational expense credits, are capped by AGIs of various levels.

Lowering your AGI is always a good thing if you wish to pay lower taxes.

Now, for those manageable hassles [any time the Treasury subsidizes an activity, such as private philanthropy, the IRS is anxious to ensure the rules are being followed] :

- QCDs are more complex than giving with a check or credit card, involving several steps that must be tracked by the taxpayer. A financial advisor can assist, but the taxpayer will still be responsible for several tasks.
- QCDs must be complete, not simply started, by December 31 each year, so start the process early. IRA custodians are singularly busy at year-end, and you do not wish to miss the deadline.
- Some custodians will mail the check directly to the charity; others will deliver the check, payable to the charity, to you to personally deliver.
- Make sure to track that the charity receives the check. As with other charitable contributions, the giver of a QCD of $250 or more also needs a letter from the charity to file with his tax return, indicating no goods or services were provided.
- IRA trustees/custodians are required to report QCDs as regular taxable distributions on the Form 1099-R, despite the fact that a QCD is nontaxable. Your CPA is responsible for reporting the QCD as a non-taxable distribution on your Form 1040.
    - Always notify your custodian that you intend a distribution to be a QCD to ensure it is prepared payable to the charity.
    - Taxpayer is responsible for ensuring the charity qualifies and you are over 70 1/2.

Always consult your tax advisor on these QCD issues, as well as whether a QCD is better for you than donating appreciated assets to charity.

Weekly Economic Insights From Our Investment Managers

Stocks took another pause last week as major tech companies' earnings and forward guidance failed to excite investors, while relatively soft economic data seem to have continued to support the idea of more rate cuts from the Fed.

Interestingly, longer-term interest rates rose despite the enhanced odds of the Fed cutting short term rates. This put additional pressure on bonds, as the 10-year treasury yield climbed over 4.30% last week to its highest level since June. The US dollar traded slightly lower last week on firmer-than-expected European inflation readings but failed to boost the commodities markets, as the overall takeaway from last week's data implied a loss of economic momentum.

SYMBOL	NAME	5D PERF	YTD PERF	1Y PERF
$SML	$SML - S&P 600 Small Cap Index	-0.10%	+5.39%	+27.58%
$INDU	$INDU - Dow Jones Industrial Average	-0.15%	+11.58%	+26.38%
$MID	$MID - S&P 400 Mid Cap Index	-0.15%	+11.55%	+30.31%
GLD	GLD - SPDR Gold Shares	-0.34%	+32.07%	+37.58%
$USD	$USD - US Dollar - Cash Settle	-0.50%	+2.61%	-1.14%
AGG	AGG - iShares Core U.S. Aggregate Bond ETF	-0.57%	+1.52%	+8.90%
EFA	EFA - iShares MSCI EAFE ETF	-0.63%	+7.19%	+21.06%
DBB	DBB - Invesco DB Base Metals Fund	-1.11%	+11.75%	+18.96%
$SPX	$SPX - S&P 500 Large Cap Index	-1.37%	+20.10%	+35.18%
$COMPQ	$COMPQ - Nasdaq Composite	-1.50%	+21.51%	+39.65%
$GNX	$GNX - S&P GSCI Commodity Index - Spot Price	-2.11%	-0.16%	-7.04%

Source: Stockcharts.com

Key Takeaway:

Last week's labor reports were surprisingly soft, furthering investors' conviction that the Fed should cut rates so that current restrictive policy does not add further pressure on the jobs market. Normally, markets would cheer this type of data, but the truth is, rate cuts have already been priced in, and the market typically only discounts the same data once. Seemingly unrealistically high earnings expectations surrounding some of the largest tech companies led to disappointment, despite overall growth in profits and revenues, as the lofty valuations investors have placed upon these companies appear to be in question.

The Week Ahead:

We have another busy week of earnings ahead, along with the elections on Tuesday and the Fed meeting on Thursday. The current odds are fully suggesting the Fed will cut rates by .25%, but all eyes will be analyzing what the Fed sees for *future* rate cuts. We will also get a peek at business conditions with Tuesday morning's S&P Global and ISM PMIs.

Current Observations

Economic Growth: The economy appears to be growing at a moderate pace, not too hot. GDP expanded 2.7% year-on-year in the third quarter of 2024, slowing slightly from a 3% rise in the previous period, and has averaged 3.16 percent from 1948 until 2024 (S*ource: U.S. Bureau of Economic Analysis).*

Inflation: Inflation has been cooling over the past year but appears to be a little "sticky" in recent months. The annual inflation rate in the US slowed for a sixth consecutive month to 2.4% in September 2024, the lowest since February 2021, from 2.5% in August. The monthly core inflation rate (which excludes volatile items such as food and energy) remained at 0.3%, the same as in August.

Employment: The jobs market remains robust despite the recent rise in unemployment from historically low levels and the decreasing number of job openings. Put simply, the labor market was on fire just a few months ago and is cooling off to sustainable levels. The unemployment rate

in the United States fell to 4.1% in September 2024, the lowest in three months, down from 4.2% in the previous month *(Source: U.S. Bureau of Labor Statistics).*

Monetary Policy: Federal Reserve officials cut rates for the first time since 2020 in September by a large 0.50% in an effort to balance inflation confidence with labor market concerns. A Fed Funds Rate of 4.75-5% is still considered "restrictive policy," yet the Fed has telegraphed this is only the beginning of a rate cut cycle *(Source: Federal Reserve).*

Sentiment: Investor psychology is presently neutral with a slight bullish tilt. According to AAII, retail investor Bulls currently outweigh the Bears by a small margin, down considerably from recent euphoric observations. Active money managers appear to be near fully invested in stocks, with the NAAIM Exposure index sitting near 80%, while the CNN Fear & Greed Index, which measures seven different aspects of market behavior to gauge the "mood" of the stock market, resides in Neutral territory.

Volatility & Speculative Demand: Since returning down from its pronounced August spike, the VIX (CBOE Volatility Index) has been trending upwards with a series of higher highs and lows and currently resides at elevated historical levels- signifying heightened volatility expectations in the near term among investors. Alternately, the difference (or spread) between yields for junk bonds and safer government bonds is near historical lows at the present time- a sign that investors are willing to take on more risk with regards to their fixed income investments and confidence in the overall economy.

Stocks: The major Indices (Dow Jones Industrial Average, S&P 500, and NASDAQ) are trading at or near all-time highs, signifying a positive trend. Small Caps have recently broken out to new highs but have rejoined Mid-Caps by trading back into the consolidation zone that's persisted since July. Outside of the US, Developed and Emerging Markets Indices, which peaked in late September, have spent the last month retreating with their currency hedged counterparts holding up much better.

Bonds & Interest Rates: Bonds have had a rough time since the Fed cut rates in September. A wave of overwhelmingly positive economic data and election concerns has rekindled inflation fears and caused investors to recalibrate their upcoming rate cut expectations sending interest rates up and bond prices down (just a reminder, bond prices and interest rates have an inverse relationship).

Commodities & Currencies: The weak Chinese economy (2nd largest in the world) and strong US dollar continue to weigh on commodities. Oil, the largest component in the commodities space, has felt the demand pressure from China similar to industrial metals, while precious metals have been the standout, having recently traded to new highs.

The Federal Reserve is currently being viewed as the least dovish major central bank (read: keeping rates higher for longer), and the US dollar has remained strong vs. foreign currencies having recently traded back up into the higher end of the past two years trading range.

Breadth & Technicals: One of the major themes since the markets sold off in August has been expanding breadth. More and more stocks have joined the parade to higher prices, and that's a good thing. Recent economic data supports this breadth expansion to the more cyclical areas of

the market, while the trend towards lower interest rates and historically high valuations is supporting money flows into the more conservative sectors that typically include higher dividend paying stocks.

Over the past couple of weeks, we've witnessed fewer stocks advancing on their charts while new 52-week highs continue to outpace new lows. Over the same time period, the percentage of NYSE stocks on point & figure "buy" signals has declined about 10% from the previously overly exuberant levels. Overall, breadth still looks good, but there is no question that momentum has waned in the short term.

Tying it all together:

Stock market momentum remains strong, and for good reason. Inflation is gradually cooling, and interest rate cuts are providing a boost, while economic growth is robust, and the job market is showing steady resilience. On top of that, corporate earnings projections are climbing.

It looks like the Fed's strategy to guide the economy toward a "soft landing," a scenario where an economy slows down just enough to curb inflation without falling into a recession, seem to be bearing fruit, and the market is reacting positively.

The primary driver behind the stock market rally is the seemingly prevailing belief that the economy will avoid a severe downturn, achieving a soft landing instead, which, combined with potential Fed rate cuts, could create an ideal "Goldilocks" scenario for stocks. However, it's crucial to remain cautious, as challenges persist, and current valuations appear somewhat "frothy."

Encouragingly, investor sentiment is optimistic, but not yet euphoric, and stock price gains are now extending beyond just the technology sector. Broad sector participation is a positive sign for sustained market growth, and we are seeing this at a time when historically significant seasonal patterns are coming into play. The old adage, "Sell in May and go away" [until October], is ringing in the ears of Wall Street participants as we enter the traditionally "strong" season of November-through-April.

Recently, I have noted that volatility expectations are on the rise. Wall Streets "fear gauge," the VIX (volatility index), has been spending more time in the upper part of its range, which is somewhat puzzling given the strong investor sentiment readings and potential Goldilocks economic backdrop. Some of this can be attributed to the complex geopolitical landscape with the Israel-Hamas conflict, escalating tensions between Israel and Iran, the war in Ukraine, and a host of political elections throughout the developed world providing various future economic uncertainties. These types of events are nothing new to the markets but tend to foster headline reactions in the short-term rather than shape longer-term trends.

Volatility has also been particularly pronounced in the bond market this year, with long-term interest rates showing some of the most significant fluctuations in decades. The 10-year Treasury yield hit a peak of around 5% last October, started the year in the upper 3% range, rallied back to approximately 4.75% around May, and has since returned close to where it began this year. Meanwhile, short-term rates have remained more stable, aligning more closely with Federal Reserve policy and showing signs of easing as the first rate cuts have taken effect. Recently, a shift

has occurred in the yield curve: for the first time since mid-2022, long-term Treasury yields (10-year) exceeded short-term rates (2-year), breaking a historic inversion that lasted 783 days.

With the first rate cuts now implemented, it seems that the economic disruptions triggered by the COVID outbreak and governmental stimulus efforts—such as inflation, workforce challenges, and supply chain issues—are receding into the past. The primary focus has shifted back to future growth, earnings, employment, and innovation, signaling a potential return to "normal" in the markets, if such a state is indeed achievable.

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