Financial Services Advisory
GROW WISER.

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The Cure

My goodness; stocks are taking a terrible beating these days. From the way the market is behaving, one might think that some of the world's largest and most profitable companies are suddenly becoming dramatically less valuable. Are they all laying off workers, slashing prices, closing factories, and declaring imminent bankruptcy?

If this is sending you to anxiously scanning the headlines, don't bother; none of that is happening. Stock prices have never been a precise indicator of what companies are worth. They are a very good indicator of what people are willing to pay for their shares, and right now there seems to be more sellers than buyers.

Why? The reasons for bear markets are seldom rational, which, of course, is why bear markets end and stocks return to (and always, in the past, have surpassed) their original highs. What's happening right now is not unlike what happens when one of our children is diagnosed with an illness and the remedy is a daily dose of some awful-tasting medicine. The illness, in this case, is inflation which absolutely has to be cured if we are to experience a healthy economic life. Few things are worse than having the money you've saved up deteriorate in value at double-digit rates, which is precisely what has been happening this year.

The cure, which any child will tell you is more unpleasant than the illness itself, is the U.S. Federal Reserve raising interest rates, which is its way of reducing the amount of cash sloshing around in the economy. Rising consumer prices, just like rising stock prices, come about when there are more buyers than sellers. Reducing the available cash reduces the number of buyers in relation to sellers (ironically, both in the consumer marketplace and on Wall Street) and finally slows down the inflation rate to manageable levels.

We can already see how this works in the housing market, where, just a few short months ago, multiple would-be buyers were bidding against each other to pay more than the asking prices. As mortgage rates have risen, the frenzy has dissipated. The process takes longer in the consumer marketplace at large, but you can bet it's working behind the scenes.

Doesn't less spending mean less economic activity? Doesn't that lead to a recession? The answers, of course, are yes and maybe. But at this point, a recession might not be all bad for the economy. Recessions act like a cleansing mechanism, exposing/eliminating waste and inefficiency, ultimately creating a healthier economy when we come out the other end.

So right now, we're taking our medicine, and boy does it taste awful. We are also, collectively, suffering an economic illness. Anybody who has come down with a bug and taken medicine to cure it knows that the former unpleasantness doesn't last forever, and therefore, neither does the latter.

From Our FSA Family

As we venture into the holiday season, we want to remind you that not everyone is jolly and full of cheer. Even amidst the most wonderful time of the year, there are hackers and scammers trying to get your information to steal your identity, open new accounts, or even commandeer your money. Some people can be such grinches!

A few rules of thumb for all to hear:

- Use long, unique passwords that use variations of capitalized and uncapitalized letters, numbers, and symbols. Do your best to avoid reusing passwords. Yes, even on your social media sites.
- Always be vigilant when clicking on links and responding to emails. It takes one good scammer impersonating Amazon to get access to your passwords and credit card information. If you get a suspicious email from a company, don't respond to the email; instead call the company directly.
- Utilize dual-factor authentication whenever it is offered. Most financial institutions will offer two-factor authentication where they send you a text message with a temporary code in addition to your username and password to verify it is you.
- You can take dual-factor authentication one step further by using third-party apps for the authentication codes. This keeps you safe from sim-swapping where hackers try to get cell phone companies to switch your cell service to their phones so they can intercept the authentication texts.

At FSA, privacy and security are of top importance. Before the holidays ramp up, we encourage you to review your cybersecurity defenses so you can focus on the more important things this holiday season, being thankful and spending time with family and friends.

Cheers to the holidays and the upcoming new year!

Recession Report

Many times, consumers and the person on the street recognize that the U.S. economy has entered a recession long before the economists get around to declaring it. That appears to be the case today. The U.S. Bureau of Economic Analysis announced earlier this year that the U.S. gross domestic product (GDP), the broadest measure of economic activity, declined at a 0.9% annualized rate in the second quarter of 2022. That follows a 1.6% annualized decline in the first quarter. Two straight quarters of negative GDP meets the unofficial definition of a recession.

The report noted a decrease in retail trade and residential investment and sluggish personal consumption expenditures, perhaps triggered by surging inflation. Even so, the National Bureau of Economic Research (NBER), which is technically in charge of declaring recessions, has not yet made that declaration and probably will not until (believe it or not) the recession is over. The committee meets in secret and often takes a year to decide whether it believes a recession has taken place.

The hesitation may be warranted this time around. The NBER economists tend to look beyond GDP statistics to company payrolls and consumer spending. Unlike most recessionary periods, the U.S. job market remains strong; indeed, the nation added more jobs in June than expected, and as the GDP announcement was coming out, applications for unemployment insurance had dropped. The unemployment rate is still at a nearly unprecedented low of 3.6% (although it has been increasing since). And consumer spending, while moderating, has still grown during the first six months of the year.

Nevertheless, the signs and omens are fairly clear. The Federal Reserve has signaled that it plans to continue raising short-term interest rates, which will curb

corporate spending and generally reduce economic vibrancy. Meanwhile, the most popular signal for an economic downturn, an inverted yield curve, is flashing brightly. Yield curve inversions are defined as times when you can get a higher yield on short-term bonds than on longer-term issues, a counterintuitive situation that signals uneasiness about the future. As of today, people can get a 4.45% annualized yield on 6-month Treasury notes but just 4.14% a year if they buy 10-year bonds.

The Big New Bill

Just when you thought Congress couldn't get anything done, Congress passed an enormous piece of legislation that touches just about every aspect of American lives. The full extent of the Inflation Reduction Act of 2022 is too large to completely cover here, but the highlights are interesting.

The most visible elements of the bill are likely to be the 15% minimum tax on corporations with over $1 billion in revenues (generating an estimated $222.2 billion in additional tax revenues) and a 1% excise tax on companies that engage in buying back their own stock (another $73.7 billion). For older Americans, the new law gives Medicare the green light to negotiate collectively on drug prices, plus a $35 cap on Medicare Part D co-payments for insulin treatments. Those Americans who are not yet age 65 will see $64.1 billion in subsidies to expand the Affordable Care Act and counteract rising health insurance premiums.

The bill also includes tax credits for wind, solar, geothermal, and nuclear electricity facilities and clean energy rebates for residential buildings and electric cars, basically providing tax subsidies for installing heat pumps and solar panels and purchasing cars that don't run on gasoline. The U.S. Postal Service will get zero-emissions trucks, and companies will be able to qualify for tax incentives if they find ways to manufacture using fewer emissions and less electricity.

What's missing? Any additional taxes on American citizens, as well as the child tax credit and paid family leave provisions that were in the original bill passed by the U.S. House of Representatives. A provision for universal preschool for three and four year olds was cut from the bill, as were affordable housing and immigration reform provisions. You may have also heard about a proposed surtax on all income above $10 million; that, too, was eliminated from the final bill.

In all, when all the revenue raising and spending estimates are tallied up, the Inflation Reduction Act is projected to reduce U.S. federal deficits by roughly $275 billion over the next ten years. Whether it will live up to its name and reduce inflation remains to be seen.

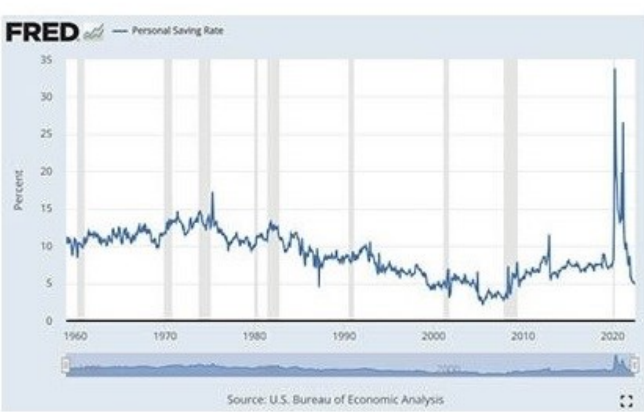
Personal Savings Rate Up, Then Down

One of the most remarkable - and under-reported - consequences of the COVID epidemic is how it triggered a temporary spike in the U.S. personal savings rate, that is, the percentage of income that was not spent and could therefore be saved and invested. If you look at the chart, you see that the savings rate since around 1960 had been gradually declining up until the 2008-2009 Great Recession at which point we began to see modest increases that still didn't get above the normal rates between 1960 and 1990.

Then came COVID and look what happened. Savings rates jumped upwards above 30%, fell to a little under 15% (which is still higher than historical peaks), and jumped back up over 25% as the next round of the pandemic hit the country.

Since then? The savings rate today is at or near 5%, which is a few ticks above the historical lows that we saw from 2002 to around September of 2008. Most advisors would say that a healthy balance sheet would see people save between 10%-15% (15%-20% for younger folks) of their income, so this rapid decline could be a warning sign that today's workers will be unprepared for retirement at some point in the future. It could also mean that a higher number of people will be trapped in high-interest credit card debt if they experience even a modest financial emergency.

Now those savings rates are rules of thumb, and we all know finances should be personally customized to fit your needs and goals. That's why FSA works with you to determine a savings plan to balance living now and savings for later. There's always a plan or strategy that's right for you!



Student Loan Update

If you have children or grandchildren who qualify for student loan forgiveness, there's good news and bad news. The bad news is that the forgiveness effort has been temporarily blocked by the U.S. Court of Appeals for the 8th Circuit following a lawsuit by six state attorney generals. The good news is that the district judge, who issued the ruling that has been appealed, seems to be perplexed by the lawsuit, and originally ruled that the states have not, so far, articulated the type of harm that they would suffer if some of their residents were forgiven $10,000 or $20,000 of their student debt.

The Biden Administration seems confident and is encouraging students and former students to proceed with forgiveness applications. In all, some 8 million Americans are likely to qualify; the program stipulates that individuals with taxable income under $125,000, or couples with income under $250,000, will be able to apply for forgiveness if they hold direct federal loans, federal family education loans, or loans from the Federal Perkins Loan Program. Unsubsidized Stafford, Parent PLUS, and Graduate Plus loans held by the U.S. Department of Education also qualify for $10,000 of loan forgiveness. Students who received a Federal Pell Grant in college and meet the income requirements are eligible for $20,000 in debt relief.

The rules are somewhat complicated for students who are currently enrolled. If parents claim the current student as a dependent on their taxes, then the income threshold applies to the parents, not the student. Meanwhile, students and former students who took out private loans to pay for college will not be eligible for forgiveness under the current program.

The application process is fairly simple, which means it is very different from normal government red tape. The borrower can go to a government website (https://studentaid.gov/debt-relief/application) and fill out name, date of birth, phone number, email address, and Social Security number. The form then asks the borrower to attest that he or she reported less than the qualifying income threshold on their tax forms, and the government uses the Social Security number to check line 11 of the tax form to ensure that the attestation is true.

The government also has the data on Department of Education loans, but the checking process is not instantaneous; it can take up to six weeks for the forgiveness to reflect on loan balances. Assuming, of course, that the lawsuits challenging the program are unsuccessful.

Roths on Sale

Every year around this time, financial planners talk to clients about Roth conversions. But this year, there are a few extra reasons to consider moving money from a traditional IRA into a Roth.

Roth IRAs are attractive for several reasons. With traditional IRAs (and qualified plans like 401(k)s), the money one contributes is not taxed, but you have to pay ordinary income taxes whenever you take money out of the account, which might be years in the future. The Roth reverses this; your contribution is made with after-tax dollars, but then there's no tax whenever the money is distributed during retirement.

If you believe, as many financial professionals do, that tax rates are going to go up in the future, then paying taxes now and eliminating future taxes provides a net gain.

Another interesting thing about Roths is that, unlike traditional IRAs, they don't have any minimum distribution requirements once you turn age 72. So long as the money remains in the account, both Roths and traditional IRAs give you the benefits of tax deferral, which eliminates a significant drag on the growth of your money. If you can afford to keep your money in the Roth account and take retirement income from other sources, then the deferral can go on longer.

Finally, having money in a Roth account gives you a lot more control over your tax bracket in retirement. For instance, you might take out just enough from your traditional IRA distributions to fill the 22% bracket and then take the rest of your living expenses out of your taxable accounts and Roth. This kind of planning might help higher-income retirees reduce taxes on their Social Security income and avoid higher Medicare premiums.

The Roth account will still be subject to estate taxes, and your heirs (not your spouse) will have to take the money out of the account over the ten years after the inheritance. But if they inherit a Roth account, they won't have to pay taxes on the distributions they receive, a nice additional gift for your children or grandchildren.

So why is this an especially good year to consider Roth conversions? With the markets down by more than 20%, people can transfer more stock shares today than they could have last year for the same tax payment.

Put another way, Roth conversions are more than 20% cheaper, taxwise, today than they were at this time last year. Still another way, Roth conversions are on sale. but this may be only temporary. Every situation is different, so we encourage an individual assessment of your situation before you pull the conversion trigger.

The Ever-Stronger Dollar

There's an old joke that's kind of funny: During a time when the U.S. dollar is weak against other currencies, we see a patient at the end of a checkup sitting on the doctor's table with his shirt off, and the doctor is saying: "You're sound as a dollar. If you think about that for a minute, you'll check right into the hospital."

But today, "sound as a dollar" is not just good news; it would be great news. The U.S. dollar, compared to other currencies, is more valuable today than it has been in two decades. For the first time, you can buy a euro with a U.S. dollar on the currency markets and very nearly buy a British pound. That same dollar will buy 145 Japanese yen, 60 Russian rubles, and 82 Indian rupees. If you desire a lot of folding money, you can exchange that dollar for 42,350 Iranian rials.

Overall, the U.S. Dollar Index, which measures the greenback's ever-fluctuating value against a basket of significant trading partners, is up 20%, one of the few things that IS up this year. That's good news for anyone buying imported products; they are proportionately cheaper than they were when today's almighty dollar was merely strong. And traveling abroad is now less expensive than it was 12 months ago.

But a muscular dollar also carries an economic price. Anything manufactured in the U.S. and exported abroad has become roughly 20% more expensive this year, making American companies less price-competitive with companies that produce locally or in countries with cheaper currencies.

As you can see from the chart, the change in the dollar's value has been a bit startling, and the ramifications abroad are only now starting to be felt. Emerging market countries that have debt denominated in dollars are finding it more expensive to make their interest payments. And since most of the world's commodities are priced in dollars, essentials like oil, wheat, and soybeans are more expensive globally.

Will this trend continue? It could. Whenever the Fed raises interest rates, as it has several times in its attempt to reduce domestic inflation, the dollar picks up more value. More rate hikes are expected, meaning an even stronger currency - and cheaper international trips for Americans - in the foreseeable future.

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