Financial Services Advisory
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First Quarter 2024
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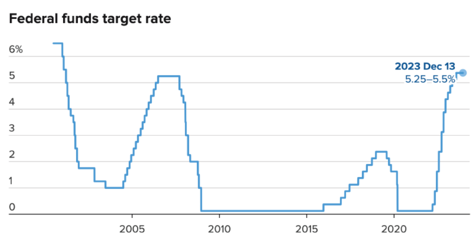
Fed Funds Rate Watch

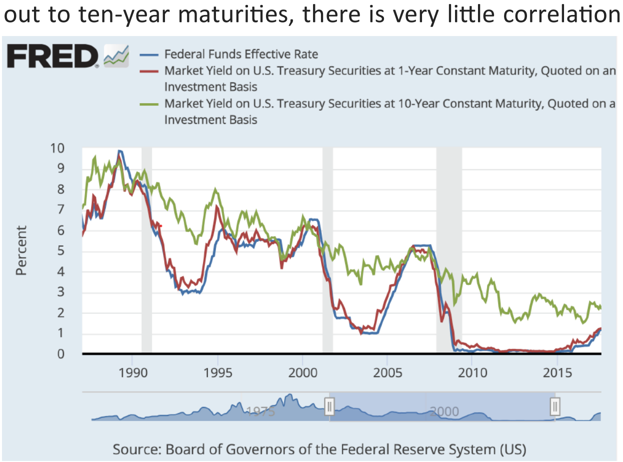
Most of the investing world is a bit weird about the Federal Open Market Committee meetings, which is where the nation's central bank announces its latest interest rate policy. The announcement concerns the overnight borrowing rate for banks that need short-term financing if they run (temporarily) short on liquidity. The idea is that if the Fed raises or lowers this rate, then interest rates throughout the economy will bounce up or down accordingly, raising or lowering the cost of financing for America's corporations and potentially leading to recession (and lower stock prices) or economic prosperity (and higher stock prices).

If you believe any of that, then the FOMC news on December 13, 2023, was good: The committee economists and bankers voted unanimously to keep the benchmark overnight borrowing rate somewhere between 5.25% and 5.5%. They also projected (no guarantees of course) that there would be three rate cuts in the coming year, which observers assume will be 0.25% each. In their first meeting of 2024, the Fed decided to leave rates where they are.



It's worth noting that the Fed has initiated 11 rate hikes in the last two and a half years (see chart), taking the fed funds rate to its highest level in more than two decades. If you follow the logic that drives people to obsess over FOMC announcements, then you might think that this was a sure recipe for economic disaster. But in fact, the most recent economic reports have shown extraordinary growth in the U.S. economy (5.2% annualized in the third quarter), and the U.S. investment markets have only recently topped their all-time highs.

We might also wonder if it's true that changes in the Fed Funds rate have a direct impact on interest rates. A recent study by the Federal Reserve Bank of St. Louis, a particularly astute group of Fed economists, shows that short-term (1-year) Treasury rates tend to follow the Fed Funds rate pretty closely. But when you move out to ten-year maturities, there is very little correlation. Long-term rates, whether it be government securities, corporate, or municipal obligations, are driven by market forces, supply and demand, and buyer expectations around inflation and the economy as a whole. Corporations and consumers can lock in these longer-term rates or yields pretty much independently of whatever is announced at the FOMC meeting.



Does that mean we should ignore the Fed's periodic announcements? The answer for the average investor is probably yes. At FSA, we keep up with the financial news for you and take it into consideration when doing financial planning. That said, it is only one of various factors we account for when helping clients make long-term decisions.

From Our FSA Family

Happy New Year to everyone! The new year is a great time to get organized, set goals, and reflect on the progress and successes from the year before. As FSA reflects on 2023, we wanted to share a few of our achievements with you:

- To better manage our client data, enhance reporting, and streamline our workflows, we upgraded our client relationship manager (CRM). This was a huge project!
- FSA is growing! In 2023, we added new employees to the advice, client service, operational, and investment teams. The new employees are integrating with the rest of the team extremely well.
- On the financial planning side, we've added new tax planning software that helps us review your tax returns and illustrate strategies, including Roth conversions, qualified charitable distributions, and more.

As your financial planners, we want to help you set, work towards, and accomplish your goals. When you meet with your advisors this year, tell us about how your 2023 went and what you are looking forward to in 2024. We will help you celebrate the wins from 2023 and plan for your goals in 2024.

Cheers to the new year!

Good and Bad Debt

You've probably read articles that talk about "good" and "bad" debt, but what, exactly, is the difference? The simple answer is that good debt is borrowing to enhance your future net worth or income. You might put a home mortgage in this category since, over time, homes tend to appreciate, and in the meantime, you have the roof over your head to keep off the rain.

Borrowing to pay for higher education might also be considered good debt, but there's a fine line there. If the degree you're financing doesn't lead to a job that will generate enough income to pay the interest and principal on the student loan, then the debt moves into the "bad" range.

Small business loans, if the money is used wisely, can be considered good debt; the firm will add staff or a marketing budget or otherwise use the loan proceeds to raise the value of the company. Of course, if the money is not deployed wisely or if the projects invested in don't bear fruit, then we can retroactively say it was bad debt. Almost a third of small businesses fail to survive their first two years, so startup money is more likely than not to eventually fall into the bad debt category.

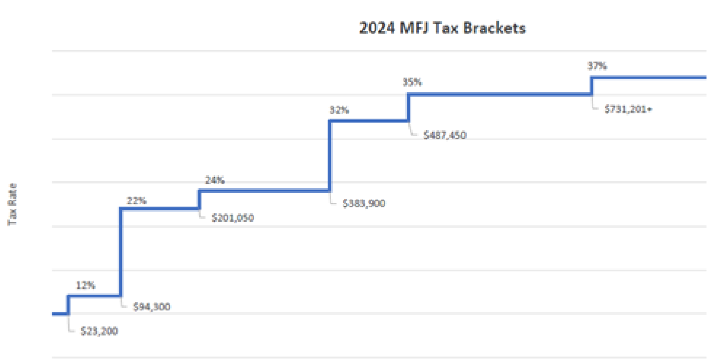
There are numerous examples of bad debt, but they tend to fall into a few categories. Buying luxury items that you don't necessarily need (think of an 80-inch TV to watch NFL games or a very expensive automobile that also happens to be a gas guzzler) immediately falls into the bad debt category; if you really want or need those things, it's better to save for them and avoid the interest rate charges.

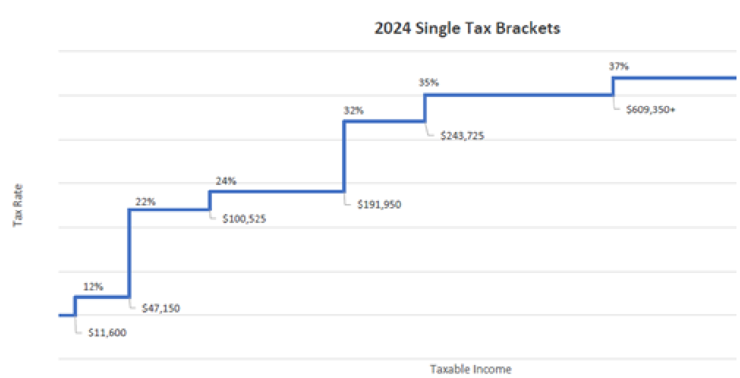
How do you know when you have too much debt? The Debt.org website suggests that if your monthly debt payments come to more than 43% of your monthly income, then it becomes a red flag to potential lenders. For instance, you probably won't be able to get a mortgage if your ratio exceeds that amount. We'd typically suggest keeping your debt payments even lower than this.

There are a variety of debt consolidation options that can help people who fall into this "deeply in bad debt" category, but they only work if the would-be consolidator is disciplined about paying off the consolidated debt on time each month and is able to control spending (i.e., not racking up more credit card interest) going forward. It always helps to have a plan, even when the financial plan is focused on the debt side of the balance sheet.

Next Year's Tax Brackets

The Internal Revenue Service has (finally!) released the tax brackets for 2024 which are annually indexed for inflation. The top bracket is always the strangest; you would think that the filing joint returns threshold would be double the single filer threshold, as it is for the other brackets, but... For example, single taxpayers with adjusted gross income of $609,350 will be in the 37% bracket next year, while joint filers making $731,200 or more will fall into that top bracket. Here's a graph with the 2024 tax brackets.





The standard deduction will also go up substantially to $14,600 for single filers and $29,200 for joint filers, with an additional $1,550 or $1,950 for married or unmarried seniors, respectively. People will pay no capital gains taxes on gains realized if their adjusted gross income is below $47,025 (single) or $94,050 (joint); above that, they will pay taxes on their capital gains at a 15% rate until they reach the 20% threshold at $518,900 (single) or $583,750 (joint).

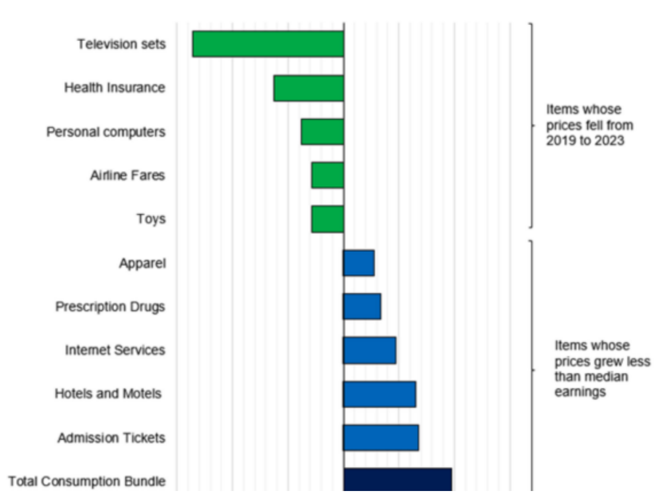
Wage Growth to Celebrate

There are a number of polls and reports indicating that the average American worker thinks that the U.S. economy is in a slump and that they're less well-off than they were before the pandemic tore through our society. But the statistics indicate this isn't 100% true.

A recent report by the U.S. Department of the Treasury has found that from 2019 to 2023, real weekly earnings, meaning earnings above the inflation rate, rose 1.7% for the median American worker. In other words, one week of pay for the median worker now buys more than a week of pay did in 2019, despite higher prices due to inflation. The study also found that the growth of real wages was faster over the past 12 months than it had been during the pre-pandemic expansion.

There are a variety of charts in the report. One of them shows the very uneven impact of inflation in different types of goods and services. Televisions now cost almost 30% less than they did before the pandemic, and health insurance, personal computers, airline fares, and toys all showed fairly significant price declines. Prescription drugs, internet services, and most living expenses went up over that period, but none of them as fast as earnings.

Of course, the earnings growth is only relevant for people who actually have a job. The good news is that unemployment is still down around record lows. For retirees, Social Security and pensions have received sizeable cost of living adjustments over the past few years to at least keep up with inflation. With your nest egg needing to cover the rest, investing in an appropriate investment strategy that matches your risk tolerance, and sticking to it when markets get rough, can help curb inflation long term.



Should You Buy Long-Term Care Insurance?

Whenever financial planners model the sustainability of clients' retirement, the Big Unknown is long-term care expenses. These costs are not covered under the Medicare policy, and they are not trivial. The median cost of a private room is now over $9,500 a month, according to SeniorLiving.org. The median annual cost of a home health aide is over $50,000 a year. The Senior Living website provides average costs in different states, and they vary considerably - more than $33,000 a month in Alaska to just over $6,000 a month in Louisiana.

The challenge is that most retirees won't be plagued by dementia or other handicaps, but an estimated 7 out of 10 will spend some time in a facility, and there is no way of knowing which of us may be looking at half a million dollars or more of these unexpected expenses.

The government and state programs can cover some long-term care costs, but the Medicaid coverage only becomes available when a retiree has largely exhausted his or her other financial resources, and anecdotal evidence suggests that the least attractive facilities are the ones that accept government payments.

Retirees can insure against any future long-term care costs with long-term care insurance, but it might pay to shop early. The average annual premium for a 55-year-old runs to roughly $3,000; that goes up to more than $50,000 for an 82-year-old. There's a calculator showing different premiums and total benefits available in different states at https://ltcr.com/calculator/.

Some people avoid paying long-term care premiums because the money they're paying for coverage will be lost if they're one of the lucky ones who never have to move into a nursing facility or pay for skilled in-home care. But those same people buy home and auto insurance policies that will cover catastrophic losses, and (thankfully) in nearly all years, the money spent on those premiums doesn't result in an insurance payout. Insurance is there for peace of mind. The real question that people should be asking themselves is, "Does it make sense to protect against the biggest unknown expense in a retirement plan's later years?" For some folks, yes it does, for others they may be what's called "self-insured" from the risk. FSA is here to help you find your answer!

Convenient Crypto Accessibility

Are you looking to invest in a relatively new type of asset that is roughly four times as volatile as the S&P 500 Index? Then you might be interested in some new ETFs that have come on the market.

The 11 new ETFs, some from venerable names like Franklin Templeton, Invesco, Fidelity, Blackrock, and iShares, with others from firms like Valkyrie and Bitwise, have one thing in common: They were set up to invest in a cryptocurrency called Bitcoin. They all put their investor money directly into the tokens which are stored in digital wallets, meaning their returns will mirror the bumpy price trajectory of Bitcoins in the crypto marketplace.

That can be a good thing or a bad thing, depending on how you view investing. The first thing to know is that the Bitcoin tokens, like all of the 1,000+ cryptocurrency tokens circulating on various exchanges, are not backed by any government or tangible asset, and the Securities and Exchange Commissions seems to be bending over backwards to tell the world that these are highly-speculative investments.

The second thing is risk (often measured by volatility of returns) vs. return. Bitcoin fell more than 81% in 2022 and 72% in 2018. But it gained 160% in 2023 and 302% in 2020. If you were lucky enough to buy $100 worth of Bitcoin when the tokens were first issued in 2008, you would be a multi-millionaire today. If you had purchased in the middle of 2013, you would have enjoyed a 2,500% return by the end of 2023. Proponents will point out that Bitcoin has outperformed all other asset classes over various time periods. Detractors will note that Bitcoins exist only as blips in a computer network called the Blockchain, unlike tangible assets like gold or silver, unlike shares of actual companies like Apple and Amazon.

Who's right? Who knows. This technology is still very new. But the point of the ETFs is that they allow ordinary investors who wouldn't know how to exchange dollars for Bitcoin on the Coinbase exchange, who don't have the expertise to move Bitcoins to a cold wallet to protect them from poaching hackers, can now invest in the asset in a relatively convenient manner. It's helpful to remember the SEC's characterization of the tokens; most investors would be wise to limit their Bitcoin exposure to 5% of the overall portfolio at most for aggressive investors, 1% for a reasonably cautious investor, and 0% if you're not willing to invest in something that might lose all its value at a moment's notice.

Effective vs. Marginal Tax Rates

What you think is your tax rate may not actually BE your tax rate. For instance, if you report just over $182,100 in taxable income as a single filer in 2023, the tax table says you're in the 32% tax bracket. But you aren't going to be paying anywhere near 32% of your reported income to Uncle Sam.

There is often a big difference between your effective tax rate and your marginal tax rate. The marginal rate is the amount of tax that applies to each dollar of your income above certain thresholds, while the effective tax rate is the share of your total annual income that you will need to pay in taxes.

To calculate the difference, imagine that you, a single filer, have earned exactly $182,101 in adjusted gross income for tax year 2023, and you see from the tax tables that this would put you one dollar into the 32% rate. But if you took the $13,850 standard deduction, that brings the amount down to $168,251. The first $11,000 of that is taxed at a 0% rate; the next $33,725 is taxed at a 12% rate ($4,047 in taxes); the next $50,650 will be taxed at a 22% rate ($11,143 in taxes); and the remaining $73,276 is taxed at the 24% rate ($17,586.24 in taxes). Uncle Sam has received a check for $32,776.24 which is actually about 18% of the taxable income you earned. Not 32%.

The easy way to calculate your effective tax rate is to divide your tax bill by your adjusted gross income. You might still grumble about your greedy Uncle Sam, but you might also feel better that your actual tax rate is lower than the published ones on the tax tables.

BTC Prices 2013 - 2023

S&P 500 Index, 2013 - 2023

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