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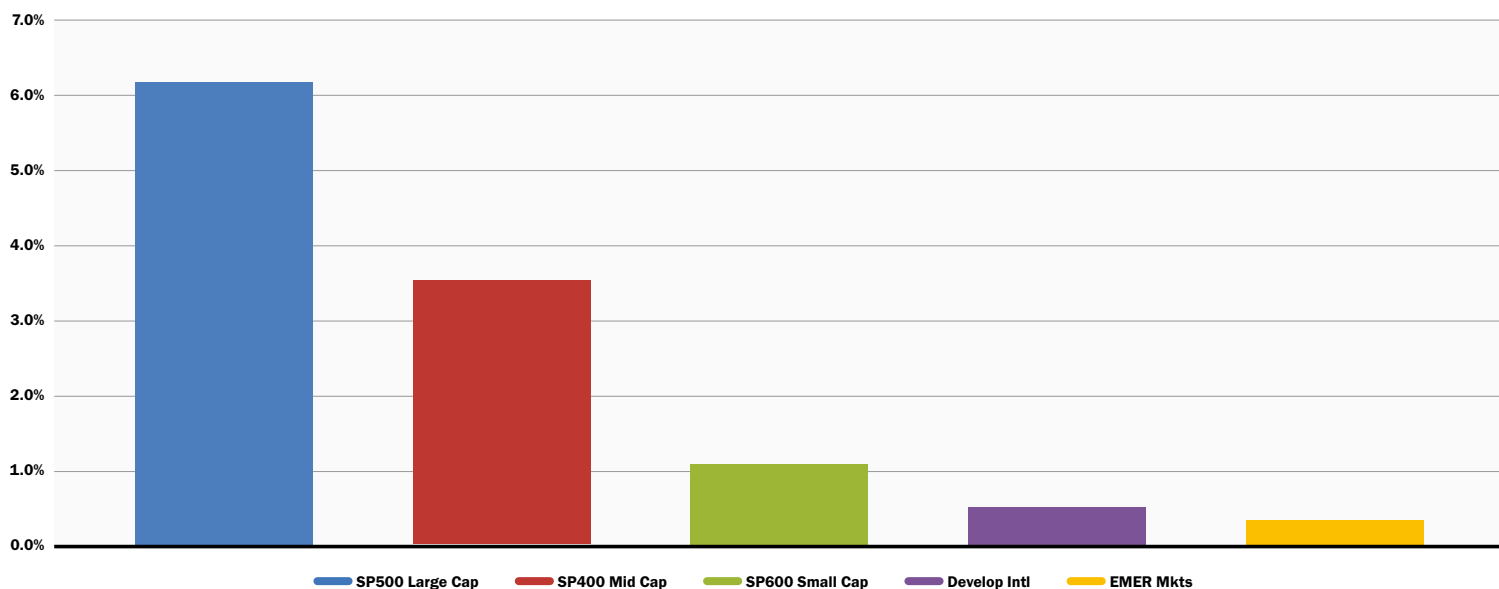
SECOND QUARTER 2023 MARKET REVIEW



By **Richard A. Hewitt, CFP®**

All equity markets continued to recover from 2022 with positive returns for the second consecutive quarter. The S&P 500 ended its bear market with a +22.4% rise from the lows on October 12, 2022.

Q1 2023 Return



Source: Yahoo! Finance & MSCI

While the returns are unquestionably positive, there are a few observations to note. Market breadth, indicating how broadly stocks are advancing, is narrower than we would prefer. This narrow market breadth is mainly a function of a strong rebound for several significant companies (mainly in the technology space) that deeply struggled during the 2022 market downturn. The more important question is if a more sustainable rally can be maintained—for that to happen, we need to see mid cap and small cap stocks increase their rate of recovery.

For the second half of 2023 we believe the tailwinds of a resilient

U.S. economy, strong labor markets, and the Federal Reserve reaching the end of its tightening effort all bode well for a positive market environment through the end of the year.

A specific area we are watching is energy—after the spike following Russia's invasion of Ukraine in February 2022, oil prices are holding around \$70 a barrel. In addition, continued supply chain improvements will also help as an agreement was reached between the Pacific Maritime Association and the Longshore/Warehouse Union. This agreement will keep the major west coast ports open and productive which will limit the time needed to dock and unload container ships. 🌐

SOCIAL SECURITY: BASICS & FAQs



By Drew W. Nelson, CFP®

Social Security is a complicated government program. The program's copious rules and regulations can be difficult to remember, as some have been in place since the program's inception in 1935 (such as the lump-sum death benefit of \$255 for a surviving spouse). The program has been making news headlines in recent months regarding its current and future funding, as well as future benefits. This article addresses some fundamentals of Social Security (and how it works) and addresses some common client questions regarding these headlines.

SOCIAL SECURITY FUNDAMENTALS

Most working Americans pay Social Security taxes every pay period (some exceptions include self-employed workers, railroad employees, some state employees and teachers, and students working for a college) which helps determine their Primary Insurance Amount (PIA) or monthly benefit, at their Full Retirement Age (FRA; this is age 67 for those born after 1959). The more Social Security taxes one pays, the higher the PIA. A worker's 35 highest earning years are factored into the PIA calculation, along with some national income indexing and cost-of-living adjustments (COLAs) to arrive at a final monthly retirement benefit.

However, to qualify for retirement benefits, a worker must have attained at least 40 quarters of work (4 quarters per calendar year) to become "fully insured". Until this work experience has been met, a worker is considered "currently insured" and is only eligible for surviving spouse benefits and dependent benefits.

Once a worker is fully insured, the universe of eligible benefits expands to include four other categories. Again, the rules are very complicated and to cover every category even in minor detail is beyond the scope of this article.

FREQUENTLY ASKED QUESTIONS (FAQS)

Will Social Security still be there when I retire?

Yes. Social Security benefits are largely funded by workers' taxes, which requires the number of workers to exceed the number of retirees to cover the benefits. As the population ages and the number of people in the workforce declines—due to falling birth rates after the baby boom and a persistently large increase in unfilled jobs from the pandemic—we are experiencing an inversion in the worker-to-retiree ratio. This will make it difficult to pay all promised benefits in the future, which is what media headlines have focused on in recent months.

It is currently projected that worker taxes will fund about 80% of retiree benefits by 2035. To keep this percentage at 100%, Congress will either need to increase the payroll tax or adjust the PIA calculation down to reduce benefits, or a combination of both. However, don't hold your breath for this to be addressed in the near-term.

Are my benefits reduced if I file at age 62?

Yes. In fact, monthly benefits are reduced for each month that you file before your FRA begins, and this is a permanent reduction. For example, if your FRA is age 67 and you file for benefits at age 62, you will receive 30% less in benefits for the rest of your life. If you wait to file until age 70, you receive roughly 24% greater benefits for the rest of your life. Having said that, you have the option of a "do over" where you can withdraw your application if less than 12 months have passed since you were first entitled to benefits. However, this approach requires a person to repay all Social Security benefits received during that timeframe.

What happens if I start receiving benefits while I continue to work?

If you have reached your FRA, file for benefits, and continue to work, you keep all your benefits regardless how much you earn. If you file for benefits prior to your FRA and continue to work, your benefits will be reduced by \$1 for every \$2 earned—essentially a 50% reduction—above \$21,240 (this threshold is indexed to inflation).

The COLA for 2022 was 8.7%. Did I miss out if I did not file for benefits in 2023?

No. COLAs are compounded each year you delay benefits after age 62, increasing your PIA, whether you have started benefits or not. This is true for retiree, spousal and survivor benefits. These compounding COLAs also do not affect the increase in benefits if you wait until age 70 to file—you receive both increases.

I fall under a category of workers who do not pay Social Security taxes. Does this mean I do not receive any retirement benefits?

Not necessarily. However, if you did not pay Social Security taxes for some of your earnings, you may be impacted by the Windfall Elimination Provision (WEP) and/or the Government Pension Offset (GPO). 🙄

POLITICAL AND ECONOMIC ENVIRONMENT



By **Marc A. Wehmeyer, CFP®**

This time next year the country will be gearing up for the 2024 national elections scheduled for Tuesday, November 5. Current polling indicates the most likely matchups for the presidential election will be a repeat of the 2020 election between President Joe Biden and former President Donald Trump, or between Biden and Florida Governor Ron DeSantis. If Biden is the Democratic candidate, he would be in position to extend his record as the oldest serving president. He was 78 years, 61 days at his inauguration in 2021, and would be 86 by the time he finished a second term. If Trump is the Republican candidate, he would be in position to break Biden's current record as he would be 78 years, 220 days at inauguration in 2025.

In addition to Trump and DeSantis, there are at least 10 other current declared candidates for the Republican nomination, including former Vice President Mike Pence. The leading Democratic challengers to President Biden's re-election bid are Robert F. Kennedy, Jr., and Marianne Williamson. In the event Biden changes his mind, Vice President Kamala Harris could enter the race, or perhaps Hillary Clinton or Gavin Newsom would make a run.

Regardless of the eventual matchup, the actual election will likely be decided in a handful of swing states. Five states switched from Republican to Democrat in the 2020 presidential election—Arizona, Georgia, Michigan, Pennsylvania, and Wisconsin. These states could once again play a major role in determining the next president.

The race for control of the Senate will feature 33 seats for regular election, and one special election in Nebraska (currently held by a Republican) to complete the remaining two years of the six-year term. Democrats will be defending 23 of the 33 seats up for regular election. The Republicans need to win a net of two seats in the Senate to retake control. Democrats need to win a net of six seats to retake control of the House of Representatives.

Historically, the state of the economy plays a major role in determining the outcome of U.S. elections and 2024 should be no different. The economic impact of the Federal Reserve's series of interest rate increases is ongoing. Inflation decreased for the 11th consecutive month in May 2023 to 4.0% year-over-year, down from 9.1% in June 2022. After making no increase at their last meeting in June following 10 consecutive hikes, the Federal Reserve Board

signaled they could raise rates two more times this year (out of four meetings remaining), depending on what happens with the data.

In addition to inflation, the Fed is watching economic growth and unemployment. The ideal scenario would be a so-called "soft landing" in which the Fed's interest rate increases would reduce inflation without inducing a recession. The last time the U.S. experienced a soft landing was in 1994-1995. The Federal Reserve is monitoring the following economic data to determine its next rate hike decision:

- U.S. gross domestic product grew at an annual rate of 2.0% during the first quarter of 2023, down from 3.2% in Q3 2022 and 2.6% in Q4 2022.
- The unemployment rate was 3.7% as of May 2023 and has remained at or below 4.0% since December 2021. Excluding the pandemic, the last time the unemployment rate was above 5.0% was April 2016.
- The release dates for June 2023 unemployment and CPI were July 7th and July 12th, respectively, and the advance estimate of Q2 2023 GDP will be released on July 27th. All will provide further evidence on whether the economy will be able to avoid a recession this year.

If the Federal Reserve is indeed able to engineer a soft landing, this would be the best-case outcome for President Biden and the Democrats going into the 2024 elections. President Biden's job approval rating was at 43% in June and has not been above 50% in over two years. If the economy continues chugging along into 2024, other election issues could become more prominent, such as foreign policy, abortion rights, education, immigration, and crime. If the economy ends up experiencing a hard landing, we can expect both parties to blame the other for the situation. There is little consensus about which way we are headed and the resulting impacts. As we have said before, trying to outsmart the collective markets has historically been hazardous to your financial health. Exposure to some degree of market risk is required to continue making progress towards achieving your financial goals. Feel free to reach out to us if you would like to discuss any aspects of your investment plan and whether we need to make any adjustments for your current situation. 🍷

PRESIDENT'S COMMENTARY



By **Richard A. Hewitt, CFP®**

One crisis is behind us (Debt Ceiling) and a new one is approaching—a Federal Government Shutdown in early October unless all funding bills are agreed to (which has essentially no chance of getting done given the chasm between the two parties' positions). I'd put the likelihood of a 1-2 week shutdown at more than 65% (and it won't be the end of the world). Both political parties feel they have something

to gain heading into the next election cycle by not compromising, so here we go.

The Federal Reserve skipped an 11th consecutive rate increase in June, but we expect two more in the latter half of 2023, not at consecutive meetings (as had been the pattern). That puts the Fed Funds target rate at just under 6% to end this tightening cycle. 🍷

TAX PLANNING NOW FOR THE TCJA EXPIRATION AT THE END OF 2025



By Joseph P. Clark, CFP®

The current tax code has been in place since the Tax Cuts and Jobs Act (TCJA) was signed into law in 2017. Unless Congress acts, most provisions, including personal income tax rates and brackets, expire at the end of 2025. Below is a comparison of current (2023) and 2026 projected tax rates for a married couple filing a joint return.

TAXABLE INCOME	2023 TAX RATES	PROJECTED TAX RATES	DIFFERENCE
\$0 - \$22,000	10%	10%	0.0%
\$22,001 - \$89,450	12%	15%	3.0%
\$89,451 - \$180,000	22%	25%	3.0%
\$180,001 - \$190,750	22%	28%	6.0%
\$190,751 - \$274,400	24%	28%	4.0%
\$274,401 - \$364,200	24%	33%	9.0%
\$364,201 - \$462,500	32%	33%	1.0%
\$462,501 - \$490,000	35%	33%	2.0%
\$490,001 - \$553,600	35%	35%	0.0%
\$553,601 - \$693,750	35%	39.6%	4.6%
Over \$693,750	37%	39.6%	2.6%

Projected tax rates are estimated and based on an analysis of 2017 tax rates prior to passage of the TCJA, with tax bracket figures adjusted to account for annual inflation adjustments through 2023. Couples with adjusted gross income (AGI) of \$180,001 to \$364,200 are hit hardest, but couples with AGI over \$553,601 will be negatively affected as well. At the expiration of the TCJA, the standard deduction will be cut approximately in half, which will hurt the families in the lower tax brackets the most. The \$10,000 limit on state and local tax deduction (SALT) will go away, but because of the Pease limitation, the full deduction amount will start to phase out for those couples over \$313,800 AGI. In 2023, the amount an individual can gift within their lifetime (or upon their death), without

tax consequences, is \$12.92 million. On January 1, 2026, the exclusion amount will “sunset” and revert to the 2017 amount of \$5 million, adjusted for inflation. Given this information, here are some potential tax planning considerations for 2023 through 2025:

- Those with considerable assets may want to consider making some significant gifts before the current estate and gift tax exclusion amount drops in 2026. If those assets are expected to appreciate from now through the end of 2025, then gifting earlier in 2023 or 2024 may make sense to use a smaller portion of the total exemption.
- Consider partial Roth conversions to increase tax diversification of retirement savings. Taxpayers with a mix of pretax and Roth retirement savings may be able to better control their tax bill in retirement by drawing from pretax sources when they are in lower tax brackets and drawing from Roth sources when in higher tax brackets.
- Look for other alternatives for funding Roth accounts such as “backdoor” Roth IRA contributions or making contributions into a designated Roth account within an employer retirement plan.
- Consider accelerating income before the tax rates expire at the end of 2025 such as exercising stock options, avoiding deferred compensation, or electing out of installment sales.
- Consider taking larger Required Minimum Distributions (RMDs) from IRAs than required to “fill up” favorable tax brackets.
- For those subject to the 10-year rule on inherited IRAs, consider taking larger distributions before the TCJA expires (if concerned about higher tax rates later in the 10-year window required to fully distribute the account).

You should discuss these courses of action with your financial advisor, but given the uncertainty around future tax policy and rates, it is also critical to work with a qualified tax professional on timing of income, deduction, or losses since each taxpayer's situation is different. 🙏

BUDGETING EQUALS AWARENESS

BUDGETING = AWARENESS*
(*AND WHO DOESN'T WANT THAT?)

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CLOSING THOUGHT

“Things are never so bad that they can't be made worse.”

—Humphrey Bogart

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