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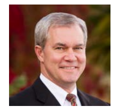
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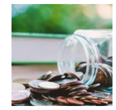
529 COLLEGE SAVINGS PLANS—HOW FLEXIBLE ARE THEY?
By Richard A. Hewitt

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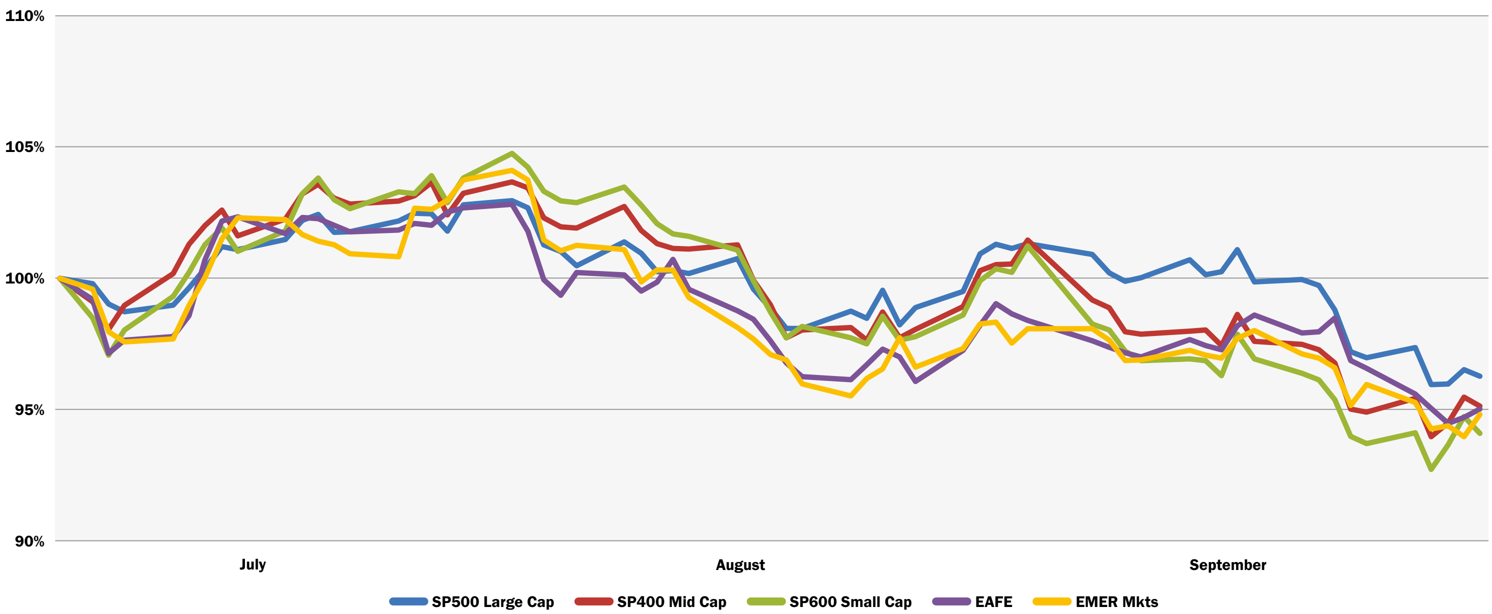
THIRD QUARTER 2023 MARKET REVIEW

By **Joseph P. Clark, CFP®**

After positive returns in July, markets faced downward pressure in August and September. The end result was negative third quarter equity returns for all the major indices.

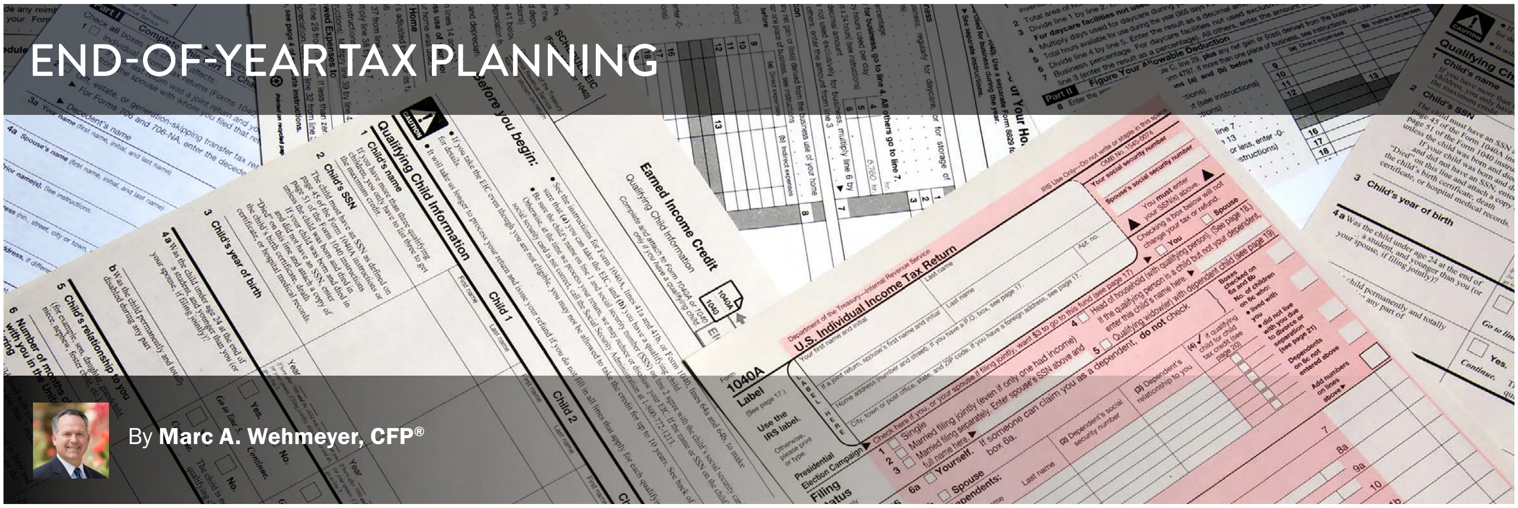
Third Quarter 2023 U.S. & International Equity Market Performance



Source: Yahoo! Finance & MSCI

The emerging markets and small cap indices have posted negative returns of -1.0% and -0.4% YTD (year to date) respectively. However, the other major indices remain in positive territory for 2023, with the S&P 500 leading the way with a return of 12.1% YTD. We continue to be concerned that market breadth is narrow with gains confined primarily to large cap stocks. The shift in Fed policy to raise short-term interest rates disproportionately impacts smaller businesses, which rely more on borrowing than larger companies that may turn instead to issuing new equity to raise capital.

If the market is going to continue in an upward direction for the remainder of 2023, improvement will be needed for mid and small cap asset classes. There is no guarantee, but historically small cap companies rebound well after they initially struggle in periods of monetary tightening. Over the last six instances, small-cap returns have provided positive average returns during the 12, 18 and 36-month periods following Fed tightening. We continue to maintain allocation to this asset class as part of a well-diversified portfolio.



END-OF-YEAR TAX PLANNING

By **Marc A. Wehmeyer, CFP®**

When you hear the word “October”, you may think about cooler temperatures, falling leaves, football, and Halloween. You probably do not think about taxes, but we think you should. Now is a great time to do some end-of-year tax planning. You may be able to identify specific actions you can take now to improve your 2023 tax situation and be better prepared for the 2024 tax year.

The first step is to estimate your 2023 total income, adjusted gross income (AGI), and taxable income. You can start by listing the income entries on your 2022 tax returns and subsequently update the entries based on known or anticipated changes for 2023. For example, you may have received a raise at work, changed jobs, or experienced changes in net self-employment income. You may have changes to income from sources like Social Security, pensions, military retirement, annuities, rental real estate, royalties, or retirement account distributions. You may have changes for interest and investment income. For each source of income, you want to take the year-to-date amount and project it forward for the remainder of the year to estimate the full year amount.

Then add up all the individual income estimates to determine your estimated 2023 total income. Once you know this amount, you can estimate your AGI, which is simply your total income minus certain adjustments, also known as above-the-line deductions, with the “line” being the line where AGI is reported on Form 1040, 1040-SR, or 1040-NR. You can find a complete listing of adjustments to income for tax year 2022 on Schedule 1, Part II. Some of the more common adjustments to income include educator expenses, contributions to Health Savings Accounts (HSAs), military moving expenses, the deductible portion of self-employment tax, allowable contributions to self-employed retirement plans, self-employed health insurance deduction, deductible alimony paid (for divorces prior to January 1, 2019), deductible contributions to Traditional IRAs (subject to limitations), and student loan interest payments (subject to income limitations).

Knowing your estimated AGI is important because many tax code preferences “phase out” for higher income taxpayers at various levels of modified adjusted gross income (MAGI). MAGI is your AGI with an adjustment for certain tax deductions and credits. MAGI is not listed on your tax return, and it may be calculated differently depending on the tax benefit. Some common income phaseouts include the Child Tax Credit, Roth IRA contributions, the Clean Vehicle Credit, the American Opportunity Tax Credit, the Lifetime Learning Tax Credit, Coverdell Education Savings Account contributions, and the Education Savings Bond Program.

If you are close to one of more of the phase out levels, you may be able to take action now to reduce your AGI before December 31st in order to qualify for a particular tax benefit. In addition to the above-the-line deductions discussed above, other ways to reduce your AGI could include making additional pre-tax contributions to workplace retirement accounts (up to $22,500 for tax year 2023, plus $7,500 in catch-up contributions for those age 50 and over) or selling some taxable investment assets with unrealized losses. You may also be able to defer income from 2023 to 2024. For example, if you are selling your home for a gain, closing after January 1st would delay any taxes owed until the 2024 tax year. If you will receive a year-end bonus at work, it may be more beneficial to receive it in the new year rather than in December. If you have a Schedule C or Schedule E net income, you may be able to accelerate anticipated or recurring expenses from 2024 to 2023 to reduce your net income.

Finally, you can estimate your taxable income by taking your AGI and subtracting either your itemized deductions or your standard deduction. Depending on your situation, you may also be able to subtract the Qualified Business Income deduction. Most taxpayers now use the standard deduction following the 2017 Tax Cuts and Jobs Act. However, if you are still itemizing or anticipate a change to itemizing — maybe you are a new homeowner and can now deduct qualified mortgage interest — there is a technique called “bunching” you can use to magnify the impact of your itemized deductions in a given tax year. For example, if you make contributions to qualified charitable organizations, you could double your contribution this year and skip your donation next year. If you have qualified mortgage interest or property taxes, you may benefit from accelerating your January payment of these items into December. Remember there is currently a $10,000 cap on deducting state and local taxes. If you have qualified, unreimbursed medical and dental expenses above 7.5% of your AGI, it may make sense to accelerate additional anticipated expenses to 2023 (if you can control the timing).

Once you know your estimated taxable income, you can determine your expected tax bracket based on your filing status. Then you can better evaluate the impact of strategies like executing Roth Conversions, delaying/accelerating IRA withdrawals (not including required minimum distributions), or completing Qualified Charitable Distributions. Knowing your estimated taxable income can also help inform the decision to make Traditional or Roth qualified retirement plan contributions, participate in a non-qualified deferred compensation program (if offered by your employer), or invest in tax-exempt municipal bonds versus taxable corporate bonds.

Estimating your 2023 total income, adjusted gross income, and taxable income will take some work. Depending on the complexity of your situation, it could be a relatively straightforward task or much more involved. If you have any questions about the information discussed in this article (or would like assistance in reviewing your tax returns to help identify strategies that may apply in your situation), please don’t hesitate to reach out to us.

THE ECONOMY COOLS DOWN, BUT THE PRESIDENTIAL RACE HEATS UP

By **Drew W. Nelson, CFP®**

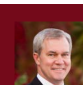
It has been a tumultuous 18-month period for the U.S. economy, with the Fed implementing the fastest interest rate increase cycle in history. It has had a domino effect throughout the economy, most notably in the housing sector: 30-year mortgage rates are at 21-year highs (approximately 7.6%) at the time of publishing, locking many first-time homebuyers out of ownership and strongly discouraging current homeowners (many of whom refinanced during the pandemic to 3-4%) from selling. This rhymes with the auto industry as well, where new auto loan rates are in the 7-8% range with new car payments reaching all-time highs at an average of $725 per month. Consumers also borrowed during the pandemic with other debt instruments, like home equity lines of credit (HELOCs) and credit cards (that are now seeing their rates reset to all-time highs). The once-affordable payments on these instruments are much less affordable as the Fed continues to raise the target Fed Funds rate. Additionally, there is $1.75 trillion in total student loan debt in the U.S. Borrowers have not been required to make payments towards this debt for the better part of three years, in addition to 0% interest rates for that time. The interest started accruing again on September 1st and payments were due October 1st. The more than 43 million student loan borrowers will need to divert some of their monthly spending towards these payments, which we predict will have impacts on the economy, most notably in the discretionary spending sector.

Almost perversely, but intentionally, the Fed wants all of this to happen to slow down the economy and limit the ability of consumers to borrow & spend, which helps to curb the 40-year high inflation numbers we've been seeing for the better part of the last 18 months. The Board of Governors for the Fed are attempting their best Nik Wallenda balancing act and as long as no one looks down, we predict the economy will make it safely to the other side and stick the soft landing.

On the political front, the 2024 Presidential race is starting to heat up, with two Republican debates having come and gone. So far, no one has managed to close the gap with former President Trump in the polls, who still maintains a 30%+ lead in the Republican primaries. However, according to RealClearPolitics, the former president is the only Republican candidate who is not leading President Biden in a head-to-head matchup, suggesting that the majority of Americans do not want a 2020 rematch. Further evidence of this can be found in a recent Wall Street Journal poll, which found that 73% of voters feel that President Biden is too old to seek a second term and only 31% who find former President Trump likeable.

It is still very early on in the race, with the general election being held in about 13 months. Former President Trump is facing four indictments (with 91 criminal charges) and President Biden is facing an impeachment inquiry over allegations he colluded with foreign governments for the benefit of his son. It is unprecedented to have leading candidates on both sides of the aisle who are being investigated. This is sure to bring the popcorn out for voters as 2024 approaches, but perhaps what America needs is a drama-less bore fest with respectable candidates who are able to unify and heal her divisions.

PRESIDENT'S COMMENTARY



By **Richard A. Hewitt, CFP®**

Some quarters are harder than others — this was one of them. Markets are struggling with acceptance of the Fed's "Higher-For-Longer" stance after a decade of nearly free money. This is a necessary lesson economic participants need to relearn — we can live with a Fed Funds rate in the range of 4-6%. Secondly, the dumpster fire that is our current political discourse shows no indication of running out of fuel — both sides have sinned. A basic math refresher for Congress would be helpful to highlight that unless your party has the numbers 1, 60 and 218, you have to compromise (1 President, 60 Senators and majority control of the House).

529 COLLEGE SAVINGS PLANS—HOW FLEXIBLE ARE THEY?

By **Richard A. Hewitt, CFP®**

Saving for college for children or grandchildren is almost always a universal goal if one has offspring. The concerns arise when questions about "What happens if Junior does not use/need all of the 529 funds?"

Let's start at the beginning and cover the almost infinite flexibility of 529 plans:

Who can be a beneficiary? Anyone with a physical address in the United States and a SSN or Taxpayer ID number. Also, different individuals can open a 529 account for the same beneficiary.

Who can make contributions? Essentially anyone, not just the account owner — that can include friends, grandparents and aunts/uncles. It is also possible to "front end load" five years of the annual gift tax exclusion of $17,000 (double with a spouse – so that you can fund $170,000 at one time). Be aware that the gifting person(s) need(s) to file a Form 709 that tax year. Each state will set a limit on the account balance for all 529 accounts for the same beneficiary. That value is *very* high (e.g., Utah's plan has a limit of $540,000).

What are Qualified Withdrawals? These are withdrawals made for "Qualified Education Expenses" in the same period as the beneficiary pays the expenses. Examples include Qualified Higher Education Expenses (college tuition, mandatory books, computers and peripheral equipment while enrolled). It can also include room and board comparable to the charge set by the college. Also, K-12 tuition (up to $10,000 per year), student loan repayment (up to $10,000 total per beneficiary) and finally, apprenticeship fees/books and equipment.

What if my beneficiary does not need all the funds? This is where the flexibility really begins — you can do a transfer to another "member of the family" defined about as widely as you can imagine (NOTE: this is not an exhaustive list): father/mother or ancestor of either parent; a child or descendant of a child; brother/sister or child of either; spouse of beneficiary; stepson/daughter.

Are withdrawals limited to undergraduate studies? No, if your beneficiary got a full scholarship for an undergraduate degree, their 529 funds can be used for graduate or post- secondary training. The worst-case outcome is that if you have NO ONE to name as a new beneficiary and withdraw the funds, you pay income tax and an additional 10% tax penalty on the earnings.

Are there ANY exceptions to the 10% penalty? Yes, if the beneficiary dies or becomes disabled, receives a scholarship or attends one of the military academies (there really is only one…!!!).

ABLE Accounts. A rollover from a 529 account to an ABLE account will count against the $17,000 annual account contribution limit. This option is scheduled to expire on 12/31/2025 but we expect it to get extended.

Rolling funds over to a Roth IRA. This was created as part of SECURE Act 2.0 in late December 2022 (but implementing regulations are not yet firm enough to use). What we do know is that the lifetime limit of $35,000 must go to the beneficiary, not the account owner. Additionally, it cannot be done in a lump sum but rather is subject to the annual Roth contribution limit (currently $6,500). The beneficiary must earn taxable compensation and the 529 account must be open for more than 15 years. We are awaiting more details and regulations from the IRS.

FINE LINE

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CLOSING THOUGHT

"This country has come to feel the same when Congress is in session as when a baby gets hold of a hammer."

—Will Rogers

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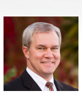

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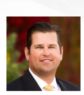

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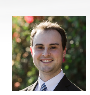

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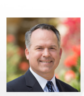

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