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2023 MARKET ANNUAL REVIEW

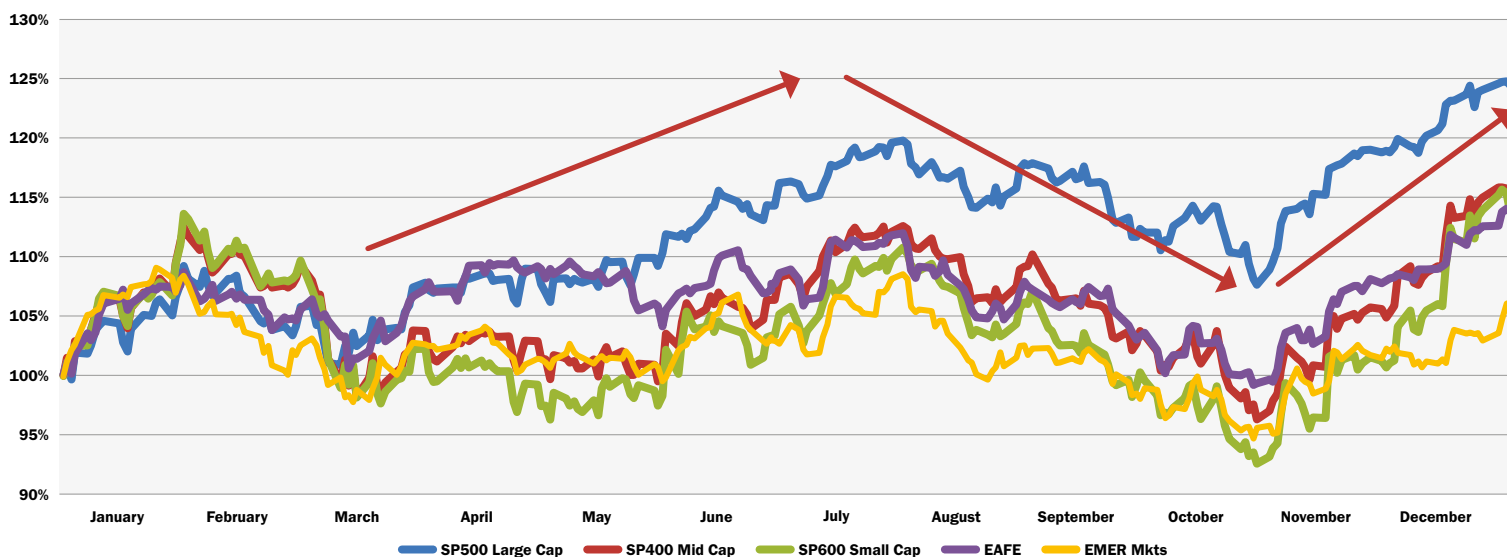


By **Richard A. Hewitt, CFP®**

As mentioned in my President's Commentary, markets never move in a straight line. Attempting to predict the weekly twists and turns will drive anyone mad. 2023 was a tale of three market periods, illustrated by the red arrows below.

Overall, the Large Cap S&P500 returned +25% while the Mid Cap S&P400 and Small Cap S&P600 each returned +15% and +14%, respectively. Internationally, both Developed and Emerging Markets closed the year positive (Developed Markets +14% and Emerging Markets +6%). China (while technically still an emerging market) continues to struggle with its emergence from COVID-19 and an overhang of real estate issues that will be a drag for the next 24 months (at a minimum).

2023 U.S. & International Equity Market Performance



Source: Yahoo! Finance & MSCI

Our outlook for 2024 includes an equity market return between +7.5% and 10%. There are several tailwinds aiding markets as we enter the new year. First, the Federal Reserve has expressed that they are done with hiking rates for now. While some prognosticators are calling for six rate cuts next year, Praetorian Guard is not in that camp. We see at most two rate cuts in 2024—likely happening in the June or July meetings. After that, barring an exogenous economic shock, we believe the Fed will want to distance itself from the political fray in November '24. After all, the Fed—like us—can read a calendar.

We remain overweight on Technology, Consumer Discretionary, Communication Services and Energy. Finally, in fixed income markets, yields have peaked and stabilized. Corporate bonds with maturities of five years are yielding slightly more than 5% and Municipal bonds are yielding approximately 3.5%. 🍷

HANDLING TAX BURDENS FOR NEXT-GEN BENEFICIARIES



By **Drew W. Nelson, CFP®**

Often when people plan for their next generation, a common thought that arises is something to the effect of: “Oh it’s fine, I’ll just leave everything to my kids.” The sentiment of this thinking is sincere but often insufficient. Without proper planning, it’s very possible to leave the next generation with headaches when we thought we were doing them favors. Fortunately, there are many tax strategies available to ensure we leave the next generation relatively headache-free.

ROTH CONVERSIONS DURING LOW TAX BRACKET YEARS

It’s no secret amongst Praetorian Guard’s clients that we are big fans of Roth dollars. These are after-tax dollars that grow tax-deferred and come out tax-free if the account has been open for five years and the owner is over age 59½. This holds true for Roth account beneficiaries as well, giving them an advantage over their Traditional account counterparts, where Required Minimum Distributions (RMDs) are required for most beneficiaries. In certain circumstances, a prudent planning strategy can include systematic Roth Conversions (i.e., moving Traditional IRA dollars into a Roth IRA over a period of years) during low tax bracket years, generating multiple benefits: paying fewer taxes on the Traditional IRA dollars, more tax-free income during retirement, and improving the inheriting conditions for beneficiaries.

Traditional IRA distributions get taxed no matter how they exit the account. By converting these dollars to a Roth IRA in low tax-bracket years the account owner pays fewer taxes than they would otherwise. Additionally, children or grandchildren often inherit these IRAs during their peak earning years. Due to the RMD rules they must empty the account within ten years, driving up their income during those years. If they inherit a Roth IRA, however, they are still required to empty the account within ten years, but do not pay taxes on the distributions.

Another consideration when planning for the next generation is to gift children (or grandchildren) money to pay the tax on their own Roth Conversions. For example, if a child has a large IRA balance at age 50, parents can gift up to the annual gift tax exclusion amount (in 2024—\$18,000 for one parent or \$36,000 with spousal gift splitting) per year as “tax money” so the child can complete their own systematic Roth Conversions and not have to worry about paying the tax out of their own pocket. This will give the child tax-free income in retirement and helps to reduce the parents’ taxable estate.

OFTEN WHEN PEOPLE PLAN FOR THEIR NEXT GENERATION, A COMMON THOUGHT THAT ARISES IS SOMETHING TO THE EFFECT OF: “OH IT’S FINE, I’LL JUST LEAVE EVERYTHING TO MY KIDS.”

GIFTING ASSETS PRIOR TO PASSING

The lifetime exclusion amount increases to \$13.61 million per person (doubled to \$27.22 million with spousal portability) in 2024. Barring new legislation from Congress, in 2026 these limits get reset to their amounts in pre-2017 tax legislation to \$5.6 million per person and \$11.18 million with spousal portability, subjecting many more Americans to the 40% estate tax. These amounts are indexed to inflation. If clients expect to be close to these numbers in the future, it may be prudent to begin thinking about ways to reduce their chances of having to pay that tax.

One approach is to gift certain assets prior to passing (or the second spouse’s passing for married couples) and remove them from the estate. Examples of useful things to gift are high-basis assets (minimal appreciation in value), property that is likely to appreciate (removes future value from estate), or out-of-state property (avoids ancillary probate). In contrast, assets that should not be gifted prior to passing are highly appreciated assets, such as older homes or investments with a low-cost basis. If these assets are gifted prior to passing, the low-cost basis carries over to the receiver and when that person eventually sells the asset, they will incur any existing capital gains. Instead, highly appreciated property should remain in the estate so it receives a “step up” in cost basis on the date of death, which resets to the property’s value on that date. This could save the beneficiary many thousands of dollars in taxes!

CHARITABLE STRATEGIES TO REDUCE YOUR TAXABLE ESTATE

Finally, for clients with charitable intentions, there are a variety of strategies available that simultaneously benefit the ultimate charity and reduce their taxable estate. The first example is a donor advised fund (DAF) whereby the client makes an irrevocable gift to the DAF and then recommends a grant to a specific charity (a DAF is a notable exception to the “highly appreciated asset” rule above: these assets can be gifted to the DAF tax-free). Gifts to a DAF get the double benefit of being free of gift tax and their value is removed from the donor’s estate, which make them a great gifting vehicle.

Other charitable vehicles to consider could be a variety of charitable trusts, most notable are Charitable Remainder Trusts (CRT) and Charitable Lead Trusts (CLT). The main difference between these trusts is who receives money while the donor is alive: a CRT pays the donor a fixed percentage while alive and then the remainder goes to the charity at passing, while the CLT works the opposite. These can be useful if there is an income need for the donor’s family, but if the main intention is gifting to charity, a DAF is a more pragmatic solution. 🌱

RETIREMENT PLAN ACCOUNTS—DID YOU KNOW?



By **Marc A. Wehmeyer, CFP®**

January is the time of New Year's resolutions, playoff football, and new beginnings. It is also the time annual statements will be generated for workplace retirement plans, giving you an opportunity to review your current holdings and the prior year's activity. If you participate in a workplace retirement plan, you are probably familiar with the basics of your plan—things like the matching schedule, the vesting schedule, the investment options, and the availability of a designated Roth option. There are several additional characteristics you may not know that could increase your financial options:

1. If you are considering early retirement, you can withdraw funds without penalty from certain retirement plans like a 401(k), 403(b), or TSP if you separate from service with your employer after reaching age 55 (or age 50 if you are a qualified public safety employee). Normally there is a 10% penalty if you take a withdrawal prior to reaching age 59 ½. This exception applies to your current employer and not to retirement plan accounts you may have with previous employers.
2. You may have the ability to borrow money from yourself through a plan loan. Not all retirement plans offer loans. Check with your plan sponsor first. The maximum amount you can borrow is 50% of your vested account balance or \$50,000, whichever is less. Loans generally must be repaid within five years (unless used to purchase a primary residence), and you must make at least quarterly payments with interest to repay the loan. If you are married, your spouse may have to consent to the loan. If you leave the company before a loan has been fully repaid, you may be required to pay off the loan, or recognize the remaining balance as current income (and potentially pay the 10% early distribution penalty). If you fail to meet the participant loan requirements, the unpaid loan balance may turn into a deemed distribution subject to income tax and possible 10% early withdrawal penalty.

3. You can avoid Required Minimum Distributions (RMDs) from your current employer's plan if you continue to work past age 73 (unless you own 5% or more of the company). Beginning in 2024, RMDs are no longer required from designated Roth accounts.
4. You may have the ability to take a hardship distribution from your plan. Again, check with your plan sponsor first. The hardship must be made on account of an immediate and heavy financial need of the employee. The amount of the distribution is limited to the amount necessary to satisfy the need and could not reasonably be obtained from other sources. Unlike a loan, you do not have to repay the hardship withdrawal amount to your account. However, the funds are subject to income tax (unless they are from Roth contributions) and may be subject to the 10% early distribution penalty.

PRAETORIAN GUARD CAN PROACTIVELY MANAGE YOUR WORKPLACE RETIREMENT PLAN ACCOUNT THROUGH OUR RELATIONSHIP WITH PONTERA.

There are additional details related to each of the four items above that go beyond the scope of this article. Please reach out to us if you would like to find out more about any specific item and how it might apply in your situation.

Praetorian Guard can proactively manage your workplace retirement plan account through our relationship with Pontera. We have implemented Pontera's technology and have the ability to monitor/trade/report workplace retirement accounts just like we do with all of your accounts at Pershing. This includes portfolio rebalancing, incorporating new investment options, and providing combined reporting and performance history. Let us know if you are interested in getting started and adding this service. 🙌

PRESIDENT'S COMMENTARY



By **Richard A. Hewitt, CFP®**

The close of 2023 demonstrated once again that facts are stubborn. The first (and most relevant) fact is that markets never move in a straight line. The second fact is that the world is messy, complicated and dangerous.

Markets did their best Secretariat impression to end 2023, with virtually all segments shaking off the doldrums of the August–October periods. More importantly, this market rally was a broader one (more than just the “Magnificent 7”), bolstered by contributions

from the small and mid-cap asset classes.

Internationally, the heinous and cowardly attack by Hamas on Israel on October 7 likely put an end to the two-state solution. This will roil the Middle East for years to come—perhaps until America decides to reestablish deterrence in the region. In reality, the actions of the United States in the next 12 months will heavily influence the outcomes in Ukraine, Taiwan, and Israel. We dither at a dangerous cost. 🙌

2024 ECONOMIC OUTLOOK AND POTENTIAL ELECTION IMPACTS



By **Joseph P. Clark, CFP®**



The U.S. economy was incredibly resilient in 2023 and many economists are still predicting a “soft landing” with modest 2024 GDP growth of between 0.5% and 2.0%. However, leading up to the 2024 presidential election, much of the country is still quite pessimistic.

Inflation, as measured by the Consumer Price Index (CPI), slowed significantly this past year, falling from 6.3% year-over-year in January to 3.1% in November. This comes after inflation peaked in June 2022 at over 8.9%. A slowdown in price increases for food, energy, and goods has helped inflation drop within reach of the Federal Reserve’s 2% target. However, many Americans are still feeling the effects of rising prices for shelter, clothing, and groceries, which, as of November, were up 5.5%, 1.1%, and 1.7% respectively. In November, a CNN poll of nearly 1,800 people had 84% saying they were somewhat concerned about the economy and 43% saying they were very worried. Given a vast majority of Americans are concerned about the economy, the current administration could be in trouble. Additionally, a November New York Times survey indicated that 57% of respondents felt economic issues would be the most important factor in their vote, compared to only 29% who said social issues would be their prime factor.

GDP growth in 2023 was bolstered by strong consumer spending despite high inflation. There are two reasons this trend will likely not continue in 2024. First, households are running out of the excess savings they built up during the pandemic years. In 2022, accumulated excess savings peaked at over \$2.0 trillion, but as

Americans continued to spend in 2023, that number fell to less than \$0.5 trillion. Second, student loan payments will continue to weigh on the spending ability of borrowers. On October 1st, federal student-loan payments resumed after a three-year pause. As of June 2023, federal student loan debt was a combined \$1.64 trillion, held by 43.6 million people and averaging approximately \$38,000 per borrower. For many borrowers, the resumption of payments will consequently reduce their personal savings and spending. Nearly nine million student-loan borrowers missed their first payments in October—about 40% of those who entered repayment a few months ago. This is further evidence of how Americans are struggling to cover their monthly bills while paying off these loans.

A potential drop in 2023’s escalated mortgage and credit card rates could spur consumer spending in 2024. The Fed raised rates four times in 2023 (which have held steady since July) with a benchmark borrowing rate between 5.25%-5.5%. The Fed has indicated rate cuts are coming in 2024 in hopes of bringing the Fed funds rate down to 2%-2.25% by 2026. Credit card interest rates are at a record-high average of 20.7% according to Bankrate, while 30-year fixed mortgage rates are hovering around 6.65% nationally (making it more difficult for new homebuyers). Relief in these areas could increase both consumer spending and consumer sentiment as we get closer to the general election, which is only 10 months away. One thing is for sure; it is going to be an interesting year with the presidential election as we have not seen anything quite like these two leading candidates. 🇺🇸

TALK vs. DO

TALK
TALK
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DO!

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CLOSING THOUGHT

“A positive attitude may not solve all your problems, but it will annoy enough people to make it worth the effort.”

—Herm Albright

PRAETORIAN
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