Legacy Financial INDEPENDENT ADVISORS

4th Quarter | 2023

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Why We Are Buying Bonds Now

Quite simply–interest rates on bonds have more than doubled in the past two years. After years of historically low interest rates, we have seen rates rise to their highest levels in 15 to 20 years.

Why not just buy CDs? CDs currently offer an attractive yield near 5%, but CDs are generally offered for shorter time periods. We believe CDs are an attractive option for a portion of your safe money. But we are of the mind, that if you like 5% for one year, why not invest a portion of your safer money in intermediate- and longer-term bonds, thereby locking in the higher current rates for the future? (Legacy Financial offers FDIC-insured CDs.)

Can I sell my bonds before they come due? Bonds can be sold before maturity, and trade every day. For example, if after 3 years you were to sell a 5% $10,000 10-year bond, the value of the bond would depend on the current interest rates at that time. If interest rates have risen further after three years to 6%, you could sell your bond, but at a discounted value, of say $9,500. If interest rates had declined to 4%, you could sell your bond at a premium value of say $10,500. In either case you receive the interest earned up until the day you sell the bond.

Why buy bonds now? As mentioned, interest rates are at the higher end of the past 20 years. These recent higher rates have begun to dampen inflation and may lead to slower growth in the economy. While rates could always go higher, we believe that the lower inflation will eventually lead to interest rates coming down in the not-too-distant future.

Why we prefer investing in individual bonds over bond funds. While bond funds are an attractive investment currently, we prefer investing in individual bonds directly. Bond funds can provide a diversified portfolio of hundreds of different bonds with various maturities ranging from less than a month to 30+ years. But because bond funds are an open-ended investment they do not have a fixed interest rate or guaranteed maturity value. We prefer investing in a diversified portfolio of individual bonds. For clients looking for income, we currently recommend a portfolio of investment-grade bonds with maturities of 5-12 years as part of their overall diversification strategy. Owning individual bonds means you get a fixed income and a guaranteed maturity value.

What we are recommending now. We believe higher interest rates will continue to slow inflation and lead to lower interest rates in the future. Additionally, the longer interest rates remain high the more likely the economy could be dragged into the long-predicted recession. This could possibly be early next year, pulling corporate profits and the stock market down. We believe today's higher interest rates make bonds an attractive investment. We remain defensive and have reduced exposure in the stock market, shifting more into bonds.

What we know, what we think

This quarter we're introducing a new section to our newsletter. "What we know, what we think" is part of how we provide you with specific, informed insights into the market and economy.

	What we know	What we think
INFLATION	The September inflation rate was up 3.7% versus last year. This is down from last year's peak of 9.1%	The higher interest rate policy of the past year has been successful in bringing down inflation. We remain concerned that the higher rates may slow the economy enough to lead to a recession next year.
STOCK MARKET	The Dow Jones Industrial Average was up nearly 7% and the S&P 500 14% through the end of the third quarter.	This year's strong stock market coupled with relatively weak earnings has caused the market to become somewhat overvalued.
INTEREST RATES	Fed Funds rates have gone from .25% to 5.5% since last spring. The Fed has indicated they may "pause" before deciding if rates need to increase more.	Short term rates are currently above the inflation rate. Interest rates are likely to level off before coming down next year.

Smart Year-end Tax Strategies

It's the time of year to take advantage of tax-mitigation strategies

by Christopher R. McCrea, CFP®

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The McCrea - Bollinger Group

Here are four ways we help clients reduce taxes now or in the future, upon conversion or liquidation. ***These strategies require careful professional help*** to calculate, set up and convert, but more importantly to understand contribution limits, income limits, pro-rata pre-tax versus after-tax contributions, and changes for 2024.

Backdoor Roth IRA: This is best for high-earners who have reached the income limit on Roth contributions, i.e., $153,00 for single filers, $228,000 for married filing jointly. Put after-tax (non-deductible) money in a traditional IRA (thereby avoiding the Roth income limits), then immediately convert that contribution to a Roth IRA. The money in the Roth will continue to grow tax-free.

Qualified Charitable Distribution out of your IRA: Investors over age 70 1/2 can donate up to $100,000 from their IRA directly to a charity and avoid taxes on the amount donated. These donations can meet all or part of the IRA's RMD for the tax year.

IRA to Roth conversion: If there's room for additional earned income before triggering the next tax bracket, consider converting a traditional IRA to a Roth, and paying taxes on the earnings at the time of conversion, i.e., this tax year.

Roth or traditional contribution and catch-up contribution: Make a $6,500 contribution to your Roth, plus a $1,000 catch-up contribution if over the age of 50. For married filing jointly that's $15,000 that will continue to grow tax-free or tax deferred.

As part of our active management of your portfolio, we consider tax strategies throughout the year. As part of your financial plan, we are here to guide you through the complex IRS rules*, and manage your accounts to take advantage of available strategies.

*Ultimately, it is essential to consult a tax professional or tax advisor who is well-versed in tax rules and regulations, can provide personalized guidance based on your specific situation and help you navigate the complexities of tax.

The Use of Index Funds

And the value of actively managed portfolios

by TC Falkner, CFP®

An index fund holds a portfolio of companies that attempts to mimic a benchmark or index. Commonly known as passive funds, instead of relying on a manager to try to ***beat*** the market these funds attempt to ***match*** the broader market, Since 1975, investors have allocated billions of dollars to this passive, low-cost, diversified strategy. While one of the best known is an S&P 500 index fund, you can now find hundreds of different index funds designed to track many of the different benchmarks or indexes.

Index funds could be a good solution for part of your investment plan, but most likely not all of it. Before investing in index funds, we recommend you first determine an overall risk balance that is appropriate for your portfolio. You should then develop a diversification strategy to select how many and which index funds fit best. Finally, you should decide how actively you want to rebalance your index funds and periodically review your investment performance.

Many times, our market outlook differs from the broader market. While index funds can be a good investment, our investment strategy constantly strives for a well-balanced, well-diversified portfolio that best fits your long-term financial plan. If you would like to learn more about how index funds work and how they might fit into your strategic plan, give us a call.

At Legacy Financial, we provide peace of mind for your financial future.

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