Legacy Financial INDEPENDENT ADVISORS

4th Quarter | 2024

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What Could go Wrong?

For years, many have accused us of being permanently optimistic. When the market is down, we look for what could go right. But our approach has always been practical. As the market climbed in 2024, we advised caution and increased exposure to bonds as interest rates climbed.

Barring a significant drop by year-end, the S&P 500 will achieve two back-to-back years of 20%+ returns. In the past 50 years this has happened only one other time: from 1995-1999, when the market had five consecutive years of 20%+ returns.

The financial markets have surged recently, fueled by several positive factors. Nevertheless, we have significant concerns that the market might be overextended.

Some Positive Factors:

- **Continued Economic Growth:** The economy continues to show signs of growth. While unemployment rose in 2024, it remains historically low, consumer confidence is up, and businesses are expanding.
- **Fed Lowering Rates:** The Fed's decision to lower short-term interest rates is providing a near-term boost and is driving the market's enthusiasm.
- **Artificial Intelligence (AI) Driving Productivity:** The integration of AI into various industries enhances productivity, streamlines operations, and drives innovation which positively impacts companies' market valuations.

Our Concerns:

- **Valuation Disconnect:** A primary concern is the disconnect between market valuations and underlying economic fundamentals. Our hypothesis is that investors are paying a premium stock price because they overvalue the potential benefits of AI and other growth drivers to propel future growth and profitability.

Our Concerns (Continued):

- **Long-term Rates Are Rising:** While the Fed has lowered short-term interest rates by 0.75%, long-term rates have actually gone UP 0.75%. Higher long-term rates can increase borrowing costs for homeowners and businesses over time, potentially dampening growth prospects and market valuations.
- **Expect Economic Growth Driven by Government Spending to Slow:** Government spending and stimulus measures have driven much of the recent economic growth. As these measures wind down, we may see economic expansion slow.
- **The Crowding Out Effect:** As borrowing costs rise, additional government borrowing and spending risks crowding out consumer and business spending. The federal budget deficit was 6.2% of GDP in fiscal year 2023. For 2024 and the foreseeable future, we expect this borrowing rate to remain above 6% per year. To put this in perspective, the US did not run a budget deficit of more than 6.0% of GDP for any year from 1947 until the Great Recession of 2008-09.

Our Recommendation:

While several positive short-term factors fuel the current market optimism, it is crucial for investors to remain cautious and mindful of risks. With the recent rise in long-term interest rates and an overvalued stock market, Legacy will continue reduce portfolio risk and add more to bonds. Our balanced approach considers both the short-term gains and long-term sustainability to mitigate potential downsides. As always, we will keep you informed about and prepared for market fluctuations as we navigate these uncertain times.

What We Know, What We Think

	What We Know	What We Think
MARKET	In the third quarter (Q3), the market continued to hit record highs. The S&P 500 was up 5.9% in Q3, while the NASDAQ rose 2.6%, lagging the broader market. Year-to-date, the S&P 500 is up over 20%.	Near term, we believe the market may be getting ahead of itself, but broader participation by other industries should prevent a significant pullback.
ECONOMY	The unemployment rate has increased in four of the past five months, climbing from 3.5% in July to the current 4.2%.	The unemployment rate's rise indicates a significant economic slow down and increases the likelihood of a recession. Fed rate cuts may be behind the curb.
INTEREST RATES	The Fed reduced short-term interest rates by 0.5% in September for the first time in over three years. In November, they reduced rates by 0.25%, suggesting more interest rate cuts to follow.	Since the 0.5% cut in the Fed Funds rate, yield on the 10 year treasury moved up, indicating what we believe is a bottoming in longer term bond rates.

Year-end Tax Savings Strategies That are Best for You

by Bryan McCrea

We help clients employ strategies to minimize taxes so that they reach their short-term and long-term financial goals. The best strategy for you depends on your personal situation.

- **Traditional IRAs vs. Roth IRAs:** Traditional IRAs allow you to claim your contribution as a tax deduction, reducing your taxable income. In contrast, you cannot deduct your Roth contribution now but will not have to pay taxes on it in the future. Contribution limits on both vary by age. If you are under 50, you can contribute $7,000 ($14,000 for joint filers), while those over 50 can contribute up to $8,000 ($16,000 for joint filers).
- **High Earners:** A Backdoor Roth IRA is for those reaching the Roth contribution income limit. In 2024 that limit is $146,000 for single filers and $230,000 for joint filers; in 2025, that goes up to $150,000 for single filers and $236,000 for joint filers. To do this, put after-tax (non-deductible) money into a traditional IRA, and convert it to a Roth IRA, which will continue growing tax-free.
- **Older than 70½:** Qualified Charitable Distributions from your IRA allows you to donate up to $100,000 from your IRA directly to a charity. The amount donated will not count toward your adjusted gross income and will reduce your taxes. Donations can meet all or part of your IRA's RMD for the tax year.

Call your Legacy advisor to discuss which strategies are best for you. We use our professional expertise to manage your accounts and help you navigate the complex IRS rules.*

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

Consider a Health Savings Account in 2025

by TC Falkner, CFP®

A health savings account (HSA) was specifically created to help cover healthcare costs. From a tax perspective, HSAs have a triple tax benefit of deductible contributions, tax-free growth, and tax-free distributions for qualified expenses. HSA owners fund their HSA each year and invest the contributions until they are needed. As the account grows, they can withdraw from it to cover their family's medical expenses. HSAs have annual contribution limits, similar to other accounts. In 2025 individuals can contribute up to $4,300 or $8,500 for family coverage, with those over 55 allowed to contribute an additional $1,000.

Since Congress has earmarked HSAs for medical expenses, there is a 20% penalty for distributions that do not qualify as healthcare expenses. Fortunately, the IRS drops this penalty once you reach 65. At that point, the account acts like a hybrid IRA, where distributions for medical expenses are tax-free and non-medical distributions are taxed as income.

To qualify qualify for an HSA account, you must enroll in a high-deductible health plan (HDHP). The tradeoff that an HDHP offers is a reduced monthly premium in exchange for a higher deductible. This generally means insurance will cost less each month, but also will cover less if you need it. If you and your family are relatively healthy, this could pay off, and you could use an HSA to create tax-free wealth for the future. On the other hand, those with a lengthy medical history may not benefit from the additional risk of an HDHP or an HSA.

Call us to discuss whether an HSA is right for you. Our goal is to always look at your broader financial situation to determine which tax and investment strategies can best maximize your wealth.

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

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