ST. JOHN & ASSOCIATES
INTEGRATED FINANCIAL SERVICES

2024 2nd Quarter Financial & Investment Management General Commentary

This commentary serves as a second-quarter report for 2024. As usual, we apologize for the length, but there is a lot of material to cover. If you would like to discuss anything in this report**,** please feel free to call us.

This is a stressful time for some of our clients as the election approaches. For the Republican candidate, should he win, it will be his last term in office, which typically leads to more changes than the first term. For the Democrats, the shakeup after the primaries and so close to the election combined with the uncertainty if Biden will remain in office to complete his term is unprecedented. Together, this is expected to bring some volatility. So far, the markets have been agnostic to the rhetoric of the election, and volatility has been relatively low. This may change as we get closer to the election, as the markets do not like uncertainty. We do expect volatility to slow post-election as the uncertainty goes away. For now, inflation and interest rates seem to be the driving force behind the swings in the market, and we expect this to continue.

Financial Planning

Social Security

Will Social Security Be There for Me?

For our clients below the age of 60, the question of whether they will receive **any** Social Security benefits in their retirement years is a common concern. The short answer is yes, Social Security will be there, but it may not provide as much retirement income as it historically has.

Social Security is a program providing retirement, disability, and survivor benefits to over 66 million people. Funded by payroll taxes, known as FICA, paid by workers and employers, it's a transfer system where workers pay in and retirees take out. The FICA tax is crucial in funding the Social Security Trust Funds. Understanding that the money you contribute through FICA taxes is not stored in a personal account for your future use but instead goes towards supporting current retirees and beneficiaries is key. This knowledge empowers you to make informed decisions about your financial future, giving you a sense of control and confidence.

Will the Trust Fund Remain Solvent?

The annual Social Security Trustees Report provides information about the solvency of the Social Security Trust Funds. “Solvency” refers to the ability of the Trust Funds to pay 100 percent of currently scheduled benefits. The Social Security Trustees Report is produced by actuaries at the Social Security Administration (SSA) primarily for policymakers and the public's benefit. SSA actuaries project the cost of future benefits. They also look at current and projected payroll tax contributions that go into the Trust Funds. SSA actuaries use this information to determine whether there will be enough to pay all scheduled benefits.

The most recent Trustees Report, released in 2023, projects that the Trust Fund reserves will be depleted in 2034. **However, this does not mean that benefits will stop in 2034. If Congress does not take action to ensure the solvency of the Trust Funds, the Social Security program will have enough FICA taxes coming**

in to pay about 80% of scheduled benefits. Congress has previously acted to ensure the solvency of the Trust Funds and protect Social Security benefits.

Surviving Divorced Spouses

When it comes to Social Security, a surviving divorced spouse is a person who was married for more than ten years, got divorced, and sometime after the divorce, the ex-spouse passed away. This means that they may be eligible for survivor benefits. These benefits are similar to those of a widow or widower and can be especially helpful for individuals who may have sacrificed their own careers during the marriage.

If the ex-spouse passes away, the surviving divorced spouse may be able to receive full survivor benefits based on the deceased worker's record. This rule may come as a surprise to many people, but it's designed to equalize earnings between spouses somewhat. It's essential to understand the rules and eligibility criteria, as they can significantly impact financial planning for divorced individuals.

Staying on the topic of Social Security, we'd like to illustrate:

The Power of Continued Earnings.

Many experience years of low earnings early in their careers, which can be improved by working into their 60s and 70s. This can significantly impact your Social Security benefits. However, it may not be suitable for everyone, especially those with physically demanding jobs or unwillingness to keep working despite the potential benefits increase.

However, the other reality we must consider is longevity. Life expectancy for a 62-year-old male is about 81; for a female, it is 84. Half of us will live longer than this, and some of us will live much longer.

Working part-time may help preserve retirement assets, but it does not increase Social Security benefits. To boost Social Security payments, individuals should replace earlier years of lower earnings with later years of higher earnings. Continuing to work in their 60s may be preferable to dealing with financial anxiety or struggling to generate more income in their 70s or 80s.

Medicare

Medicare and Other Insurance: Who Pays First?

Understanding how Medicare coordinates with other insurance coverage can be complicated. When a client has both Medicare and supplemental insurance, the question of who pays first arises. If the client is still working and covered by an employer plan, the group insurer will pay first if the employer has 20 or more employees, and Medicare will pay second. However, if the employer has fewer than 20 employees, Medicare will pay first.

Six Things Everyone Needs to Know About Medicare by Age 65

1. Medicare is not automatic. Forgetting to sign up for Medicare when turning 65 can result in penalties and gaps in coverage. Even if you're receiving Social Security, you may not be automatically enrolled in Medicare. It's important to proactively enroll either when turning 65 (if retired) or when coming off an employer plan. Keep in mind that you can enroll in Medicare after age 65 even if covered by an employer plan. The decision will depend on the level of insurance coverage and cost that you prefer.

2. Medicare is not free. Part A is free if the client (or spouse) paid into Medicare for at least ten years, but there's a hefty deductible of $1,632 in 2024. Part B is not free and has a monthly premium of $174.70 in 2024, with a deductible of $240 before Medicare pays for doctor services.

3. Medicare does not cover everything. Medicare doesn't cover hearing, dental, or vision services, nor does it cover care delivered outside the U.S. It pays only 80% of the total bill, with no cap on the 20% coinsurance. Private health insurers offer Medicare supplement (Medigap) policies that cover the Part A deductible and 20% Part B coinsurance and provide additional benefits not covered by Medicare alone, such as dental, vision, and hearing services. Medicare Advantage plans also offer care under Parts A and B, along with extra benefits like gym memberships and transportation to and from the doctor's office. This allows individuals aged 65+ to have their medical care covered by insurance.

4. If you don't sign up on time, you'll pay more. If you miss the initial enrollment period for Medicare and don't sign up during the annual general enrollment period, you may face a late enrollment penalty. This penalty can increase your Part B premium by 10% and will last for the rest of your life.

5. If your income is high, you'll pay more. The income-related monthly adjustment amount (IRMAA) was introduced in 2003 to require higher-income beneficiaries to pay a larger share of their Medicare premiums. This can come as a surprise to those who enroll in Medicare while still working, as they might only discover the additional costs after enrolling.

6. You don't have a choice. Once you turn 65, Medicare becomes your primary insurer, but you can keep your retiree plan as supplemental insurance. Medicare generally does a good job of regulating costs and has the support of most doctors. However, its inadequate communication can lead to costly mistakes, especially regarding enrollment.

It's important to ensure that clients turning 65 understand the rules and make informed decisions regarding their Medicare enrollment. If you are a planning client and have any questions, email btotri@stjohnfinancial.com.

Retirement Planning

Retirement Income Plans: 3 Key Items to Consider

Retirement income is a major concern for clients, and for good reason. We all wish to live comfortably and healthily in retirement, and we can help clients achieve that dream through careful planning. To do so, we want to move our planning clients from being "good savers and lousy spenders" to using those savings to live the life they want to live. This means planning for longer lives, potentially higher tax bills, and inflation. This is the other side of retirement planning, the distribution phase of retirement.

Below, we highlight three pillars of retirement planning that will ensure you have a strong financial future ahead.

1. Living longer means planning for longer

One of the biggest fears retirees face is outliving their assets. Today, U.S. life expectancy is nearly at age 80, but many of our clients will live far longer than that as we hinted earlier in the Continued Earnings piece. **Indeed, when you have a healthy couple at age 65, there is a 50% chance that one of them will live until age 92.**

You should understand your portfolio's monthly income and Social Security limits. A Social Security analysis can help determine when to take Social Security and consider tax implications. Planning clients are provided a Social Security scenario analysis during our financial planning work together.

Additionally, it's important to consider the impact of the widow's penalty. This occurs when a spouse passes away, causing the surviving spouse to transition from married filing jointly to single, potentially leading to higher tax rates and Medicare surcharges. Keep in mind that a widow or widower also loses the Social Security income that ends once their spouse is deceased; he or she will continue to receive the higher of the two benefits, but not both.

2. Protect purchasing power

Inflation plays a big role in income planning, particularly lately. If you need $5,000 per month to live on today, then you will need $10,000 per month to live on in 20 years, if we assume 3% inflation, which is close to the historical average. And this doesn't even account for the recently high inflation rates that may continue to stay somewhat elevated, at least in comparison to recent history. Adding risk-managed growth to your investments is one way to maintain spending power.

Additionally, reducing taxes by applying tax logic where applicable using Roth conversions, charitable gifting, 401k Roth accounts, and health savings accounts, as well as preparing for a potentially higher tax environment, is an additional key to efficient retirement planning.

3. Having money for significant expenses, whether planned or unplanned. We use goal-based planning for planned expenses. Unplanned expenses are usually covered by cash flow or emergency funds. Planned expenses could be paying for a large wedding for a family member or post-retirement travel. Unplanned expenses could be just that—things you haven't considered, so an emergency fund makes a lot of sense.

Ensuring that clients have an idea of where they want to live and who will help take care of them is necessary to ensure that they have the money to live the way they want in advanced age.

Quite simply, the reality of retirement and aging has changed. People are living longer, more solutions for caretaking are emerging, and healthcare costs are increasing.

Through our planning, we hope to work together to translate living longer into the reality of living longer and better.

The Right Way to Do Business

The Final DOL Fiduciary Rule Has Arrived. Here's What It Means for Investors:

Needless to say, many wire-houses and insurance firms are not too excited about this new rule, and the legal challenges have already begun.

The Retirement Security Rule addresses investment advice made available to retirement savers. Financial professionals who hold themselves out as providing individualized, reliable recommendations will be held as fiduciaries and will have to give "prudent, loyal, honest advice free from overcharges. Here at St. John & Associates, we have been serving as fiduciaries long before it became popular to profess it.

Industry firms opposing the rule argue that it could limit consumers' access to financial guidance. They claim that requiring advisors to provide honest advice may restrict access to some products and strategies. However, the rule aims to ensure ethical financial advice for consumers. Analysts estimate potential savings of $55 billion over the next 10 years in fees for investors, as plan advisors would be less likely to recommend high-fee funds under the new fiduciary rule. Additionally, investors rolling over retirement account assets could save another $32.5 billion during the same period.

Study Finds Consumers Who Work with CFPs Live Better Lives

Working with a certified financial planner (CFP) leads to a more enjoyable life, better understanding of finances, and increased financial confidence. Here are the details.

Tax Planning

The Top 5 Funding Reminders for Roth IRAs

1. After-tax 401(k) contributions: an opportunity for tax-free conversions. After becoming eligible to make withdrawals from a 401(k) or other employer plan, eligible amounts can be rolled over to an IRA or another eligible retirement plan. A traditional IRA is a common choice for rolling over assets from 401(k)s. If the 401(k) includes after-tax amounts, they can be converted tax-free. The earnings on the after-tax amount would eventually become tax-free in a Roth IRA upon eligibility for a qualified distribution.

2. Micro conversions for tax management. Roth conversions are included in income, with any pre-tax amount being taxable for the year the conversion occurs. Converting small amounts over time can mitigate the tax impact. For example, an individual who wants to convert $500,000 could make $50,000 yearly conversions over ten years instead of converting the entire $500,000 all at once. This strategy is commonly referred to as micro-conversions. It can also be used to stay within a tax bracket.

3. Tax withholding is not conversion. If the Roth IRA owner asks to have taxes withheld from the conversion amount, the withholding tax is not included in the conversion and may be subject to a 10% early distribution penalty. For example, if a 45-year-old named Sean converts a Traditional IRA to a Roth IRA and withholds 20% for federal taxes, the amount withheld for taxes would be subject to the penalty. It's important to analyze if it makes good tax sense to perform a Roth conversion if it requires paying the income tax from the IRA.

4. Roth conversion amounts must be rollover eligible. When performing a Roth IRA conversion, remember that only eligible amounts can be included in the Roth IRA. For instance, if a client is at least 73 years old this year, they must take required minimum distributions from their traditional IRA **before** any Roth conversion. If the funds are in an employer plan and the Roth IRA owner is still employed by the plan sponsor, they should check with the plan administrator to determine if they must take an RMD for the year.

5. Let conversion amounts sit and stay for at least 5-years. A Roth IRA conversion is not subject to the 10% early distribution penalty, regardless of the age at which it occurs. However, distribution from a Roth conversion amount is subject to the 10% early distribution penalty if it occurs before it has aged in the Roth IRA for at least five years.

Example 2: Using the facts from Sean's example above, assume that the conversion was done in 2024. If Sean withdraws any amount from that $80,000 conversion before January 1, 2029, it would be subject to the 10% early distribution penalty unless he qualifies for an exception.

Reminder: The 10% early distribution penalty does not apply if the Roth IRA owner is at least age 59 ½ when the distribution is made or if the distribution qualifies for an exception to the penalty.

Are Tax Rates Set to Rise?

The Tax Cuts and Jobs Act's (TCJA) provisions are set to expire at the end of 2025, bringing significant changes to the U.S. tax landscape. It's crucial to prepare for the potential implications of these expirations for individuals and businesses.

Key areas to monitor include standard vs. itemized deductions, the qualified business income deduction, and various supporting schedules like Schedule A and Schedule C.

Taxpayers should also be aware of potential changes to adjusted gross income and taxable income due to modifications in tax brackets and deductions. For details, click here.

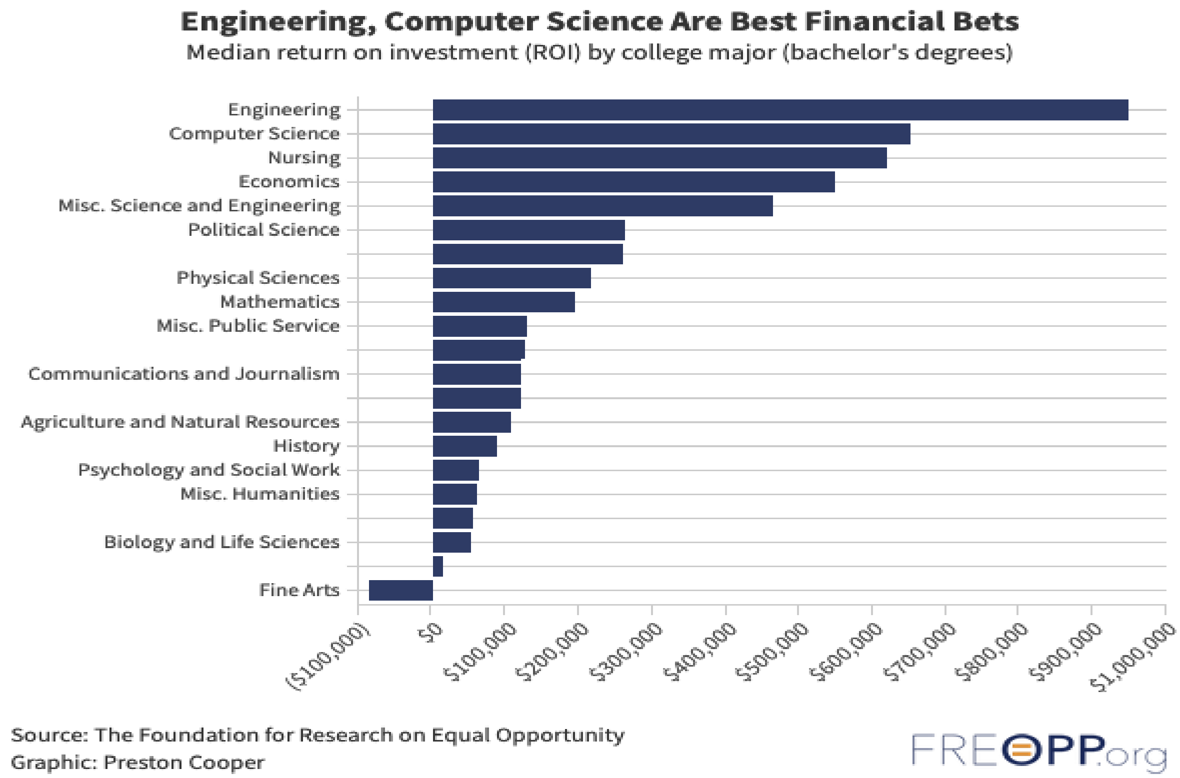
College Planning

Parents and students can use a valuable tool to understand the return on investment of different majors and courses at various institutions. This can help set individuals up for a successful career and potentially earn hundreds of thousands of dollars over their lifetime. The tool covers over 40,000 undergraduate degree programs and 10,000 graduate programs.

The Foundation for Research on Equal Opportunity, a nonpartisan think tank dedicated to improving the lives of Americans in the bottom half economically, created the ROI tool and an accompanying report. You can learn more about the methodology here.

The U.S. Bureau of Labor Statistics has calculated that Americans with bachelor's degrees earn 68% more than those with just a high school diploma. But that is just a median statistic. What is infinitely more valuable is delving deeper into the Return on Investment (ROI) question for individual majors at thousands of post-secondary institutions.

The programs in the FREOPP's dataset range from certificate programs at trade schools to medical schools.



<u>Financial Services</u>

This is a reminder to our valued financial planning clients: After you have filed your 2023 taxes, please make sure to send us a PDF copy of your complete tax return. You can use our secure portal or inquire if your tax accountant can send us a copy directly.

It's good practice to occasionally review who you have listed as beneficiaries on your IRA accounts to ensure that this is still the person(s) you originally intended. Let us know if you wish to review who you have on file as your beneficiary on these accounts and if you wish to make any changes.

Non-IRA accounts may benefit from transfer-on-death (TOD) registrations. Let us know if you have any questions on this.

<u>Investment Market Overview</u>

Global market returns were positive across the broad asset classes for the 2nd quarter. For both equities and fixed income, returns were positive at the aggregate level with mixed results within underlying sectors and regions.

Equities: Global equity investors were rewarded within technology/communication sectors in the US and select regional markets internationally. The predominantly large cap-oriented S&P 500 Index increased 4.3% for the quarter while mid-and small cap US markets were both down over 3%. Surprisingly, the Dow Jones Industrial index was negative for the quarter at -1.3%, providing further evidence of the dominance of the technology-oriented names driving the broader US equity market. Japanese equities struggled for the quarter, weighing down on developed market equity returns. Emerging market equities had a strong 2nd quarter at 5.0 %, led by strong returns in Asian markets to surpass developed market equity returns for the year to date.

Given the run-up in AI-themed stocks, the market appears overvalued on several metrics, and we feel there is potential for a significant pull-back. Tangible benefits of AI's transformative effects have yet to be seen, and as history repeats itself in financial markets, parallels to the late '90s/early 2000's come into view. While we cannot predict the timing of bad outcomes, we are comforted by the relative safety our dividend-oriented equity portfolio can provide in times of market turmoil, as evidenced by performance in previous market downturns.

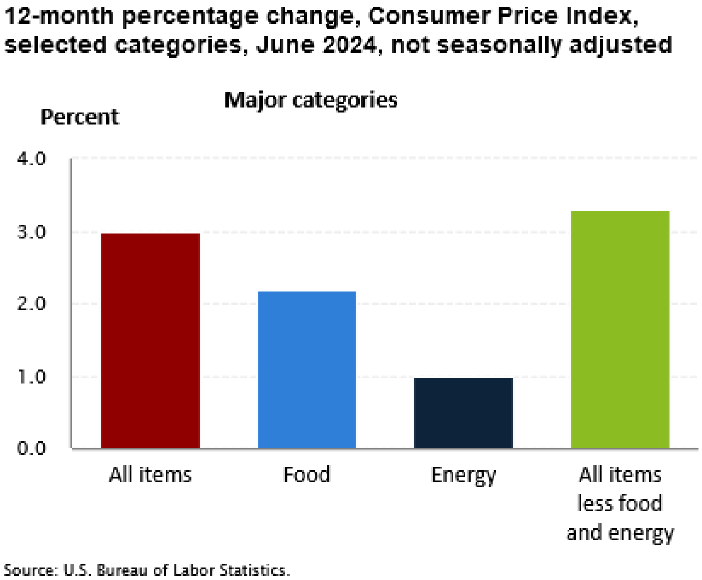
***Fixed Income*:** Bond yields continued to climb slightly through the quarter, dampening returns for longer-maturity bonds and providing for a flat Bloomberg Aggregate Bond Index return for the quarter but still negative year-to-date. Short-maturity and high-yield bonds posted modest returns for the period as they were immune from yield increases on the long end of the curve.

As we will cover in a later section, rates may remain higher for a longer time, with the potential for further increases in long-term rates. Given those conditions, we are still wary of fixed-income exposures with longer maturities and continue to prefer exposure to the front (short) end of the yield curve.

***Real Assets*:** Commodities performed well as short-term rates and inflation remained elevated. The Bloomberg Commodity Index posted a solid 2.9% return for the quarter, driven by strong performance from industrial and precious metals. Gold continued its upward climb for the quarter, returning over 5% as central banks continued their purchases and geopolitical risks remained elevated. We continue to hold some forms of commodity positions for inflation hedging purposes and general diversification in most portfolios.

Inflation

In June, the Consumer Price Index for All Urban Consumers fell 0.1 percent, seasonally adjusted, and rose 3.0 percent over the last 12 months, not seasonally adjusted. The index for all items less food and energy increased 0.1 percent in June (SA); up 3.3 percent over the year (NSA).



While current levels remain well above the Fed's 2% target level, recent figures show an encouraging disinflationary pattern. Perhaps these statistics are engineered to foster a pre-election interest rate reduction or a sign of things to come instead. Regardless, elevated prices in food, housing, energy, and healthcare continue to create a disconnect for the average consumer.

Interest Rates

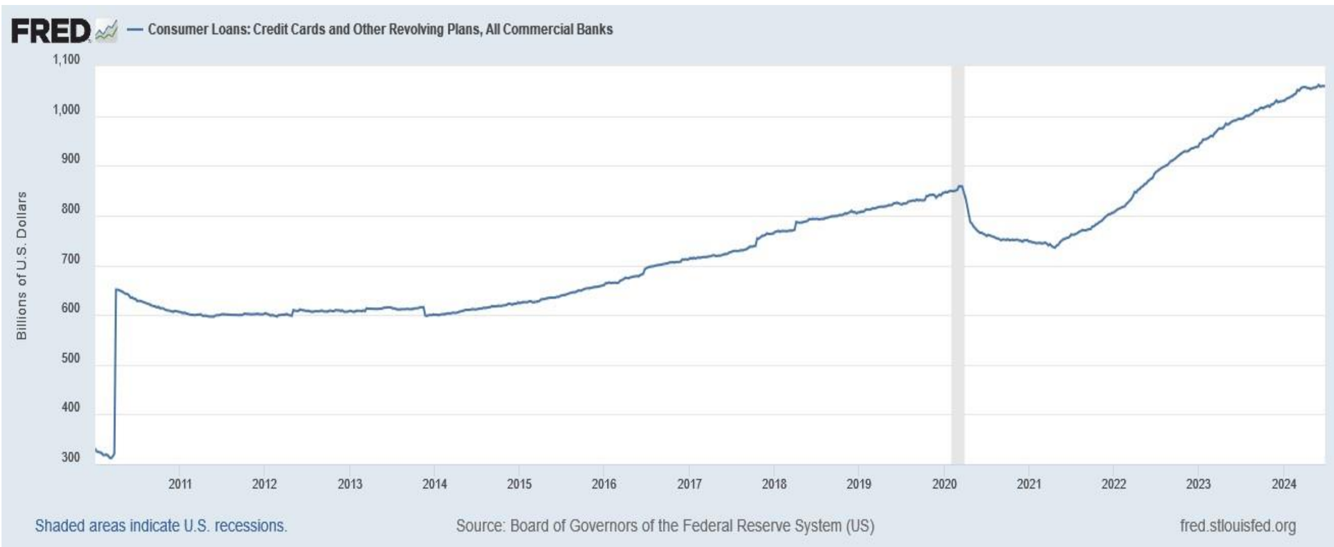
The latest CPI reading has significantly increased the odds of a rate cut in September. This would be welcomed by equity investors and borrowers and could pave the way back to a normal yield curve environment. Since July 2002, the US Treasury yield curve has been inverted, where short-term rates exceed longer-term rates. Elevated short-term rates (and long-term) pose a threat to governments, businesses, and consumers alike. Given a US National Debt balance of $34.9 Trillion and no measures taken to rein in inflationary spending, foreign governments and investors are diversifying away from the US Dollar. Coupled with last year's US Treasury rating downgrade from AAA to AA+ by Fitch Ratings, there will likely be continued upward pressure on long-term yields by foreign investors in terms of a required risk premium.

Putting it all together, what we can expect to see in the short-term as rate cuts begin is a flattening of the yield curve with 4-5% yields across maturities. In the longer-term it is plausible to see a return to a normal upward-sloping yield curve with short-term rates closer to the long-term inflation average of 2-3% and long-term rates at or above 5%. Until some fiscal discipline is established in Washington D.C., there is a serious possibility of rates staying higher for longer with further increases at the long end of the yield curve.

Jobs: In-line with the Fed's stable prices and employment mandate, any rate cut decision is also contingent on a softening labor market. As hiring slows or unemployment increases, there is more justification for the Fed to cut rates. Headline data suggests a robust job market, with low unemployment and stable job growth. This is exactly the narrative any administration desires during election season. Still concerning in these numbers is that the government appears to be the largest contributor to job creations and not the private sector. As with government data releases in recent years, favorable results are released with praise and then significant revisions follow with little to no mention. As with Gross Domestic Product (GDP) data releases, employment figures have been consistently revised downward, signaling that underlying fundamentals are likely not as they appear. Running up to the November election, it is possible to see muted job market data to appease the dueling objectives of the White House and the Fed.

Debt: Speaking of debt, the US Government is not the only ones with a spending problem. Post-Covid, the US Consumer has also ramped up spending via borrowed funds. The chart below highlights consumer/revolving loans and does not include any installment loans like auto or mortgages. Any pandemic-era debt reduction and/or savings accumulation is now an afterthought.

Consumer Loans: Credit Cards and Other Revolving Plans, All Commercial Banks



This is not a prediction for a credit event or increased delinquencies, but rather a reflection of the current situation we are facing: GDP growth through government spending and a consumer base that has limited means for greater consumption. As seen through lower corporate earnings announcements and guidance in retail/consumer goods sectors, consumers are cutting back as higher prices and interest payments work their way through their budgets. At the Federal level, higher rates for longer will also crowd out spending (from tax receipts) as increased interest expenses absorb a greater percentage of revenues.

Patience and Impatience

Investing is not intended to be a get rich quick endeavor. While some investors may take risks with high priced concentrated portfolios, this comes with high risk and any miss in the growth expectations could lead to catastrophic losses. Investing with a reasonable level of risk involves longer term planning. Being a long-term investor takes patience. While investing in the handful of high-flying stocks can be exciting, taking risk into consideration it is important to understand the value of being able to sleep at night not worrying of having all your eggs in one basket.

ST. JOHN & ASSOCIATES
INTEGRATED FINANCIAL SERVICES

Below are the returns for index categories making up the broader markets. Morningstar sourced these index returns. Returns beyond one year are annualized.

Asset Class	Benchmark	2nd Qtr. 2024	YTD 2024	1 Year Average	5 Year Average	10 Year Average
US Equity	DJ Industrial Average	-1.27	4.79	16.02	10.33	11.30
	Russell 1000	3.57	14.24	23.88	14.61	12.51
	S&P 500	4.28	15.29	24.56	15.05	12.86
	S&P 500 Growth	9.59	23.56	32.52	16.87	14.97
	S&P 500 Value	-2.10	5.79	15.29	11.89	9.89
	S&P MidCap 400	-3.45	6.17	13.57	10.27	9.14
	S&P MidCap 400 Growth	-3.38	11.70	18.82	10.49	9.71
	S&P MidCap 400 Value	-3.52	0.45	8.17	9.54	8.18
	Russell 2000	-3.28	1.73	10.06	6.94	7.00
	S&P SmallCap 600	-3.11	-0.72	8.66	8.06	8.24
	S&P SmallCap 600 Growth	-1.40	3.30	13.03	8.34	9.11
	S&P SmallCap 600 Value	-4.85	-4.72	4.20	7.42	7.18
	Russell 3000	3.22	13.56	23.13	14.14	12.15
	S&P 500 Equal Weighted	-2.63	5.08	11.79	10.94	10.04
Non-US Equity	MSCI World	2.63	11.75	20.19	11.78	9.16
	MSCI EAFE	-0.42	5.34	11.54	6.46	4.33
	MSCI EAFE Large Growth	-0.17	7.49	10.03	7.28	5.95
	MSCI EAFE Large Value	0.42	5.34	14.46	6.75	3.03
	MSCI EM	5.00	7.49	12.55	3.10	2.79
Real Assets	Bloomberg Commodity	2.89	5.14	5.00	7.25	-1.29
	MSCI USA IMI/Gold	16.16	4.29	4.69	4.79	6.63
	DJ US Real Estate	-1.73	-2.87	4.79	3.04	5.77
Fixed income	Bloomberg US Agg Bond	0.07	-0.71	2.63	-0.23	1.35
	Bloomberg US Agg Interm	0.46	0.04	3.55	0.22	1.33
Cash	Fidelity Money Market	1.29	2.57	5.19	2.02	1.42