Market Insights & Planning Highlights

Q4-2023

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INVESTMENT STRATEGY

Cash Is Not Always King

by Matt Ringle

In recent months, the amount of interest you can earn on your cash (e.g., High-Yield Savings Accounts, Money Markets and short-term CDs) has been all the rage. Even if you aren't a market watcher, you've likely heard the chatter about the "high" interest that people are earning at banks or elsewhere. However, it's very easy in this environment to fall into the trap of over-funding your short-term cash reserves.

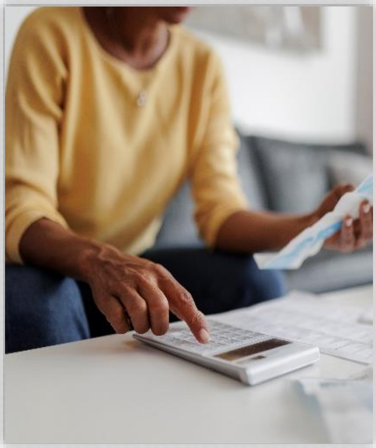
Let's first make a clarification. We are not saying to drain your bank accounts and leave yourself no emergency cash cushion. What we *are* saying is to not fixate on short-term rates to the point that you hold way more than you need in cash reserves.

What is an Appropriate Level? Most tend to follow the golden rule of setting aside three to six months' worth of expenses in a liquid account in case of emergencies. We think that's fine. For those funds, you absolutely should seek high returns with no risk. The next question you may ask is "if I'm not investing in cash, is there a better place long term?" We like to answer these questions the DLAK way…with math!

Inside This Issue

INVESTMENT STRATEGY

Cash Is Not Always King (continued)



Let's go back in history to a time that feels very similar (at least from an interest rate perspective) Many of you may remember that one-year CD rates in the early 1980s were highly popular. It seemed like every bank window was plastered with the latest high-rate offer to entice you to bring in your cash. Were you really better off long-term by doing so?

Let the numbers decide. Below are the historical ten-year returns which followed the 1982 rate peak and subsequent drop:

- From 1982 to 1992, stocks gained 16.96% per year on average.
- Over that same period, bonds gained 10.91% per year on average.
- Finally, cash-like investments earned only 7.56% annually over the ten years.

History Holds the Key

In conclusion, cash is NOT king for a long-term investor. It may be the hot thing today, but investing is always about looking forward and staying ahead of the pack. History doesn't always perfectly repeat itself, but it sometimes looks pretty similar. If the 1980s are the pattern, the math is clear: you will be significantly better off when invested in stocks and bonds over cash.

As always, we here at DLAK welcome discussions about your personal situation and stand ready to help position you appropriately to achieve your financial goals.

Sources:
https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html
https://www.bankrate.com/banking/cds/historical-cd-interest-rates/

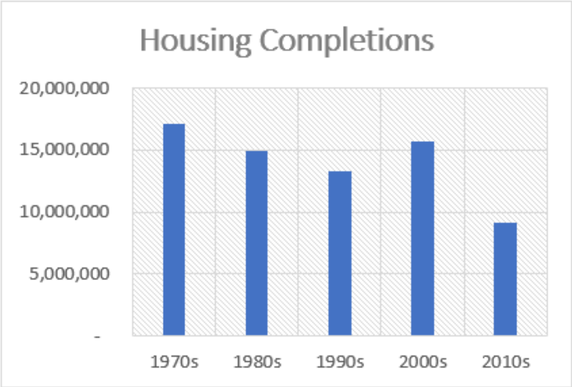
REAL ESTATE

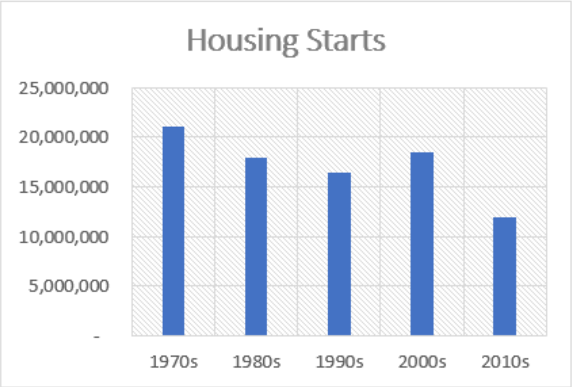
When Will the Housing Market Normalize?

By Anthony Scassellati

Among the many issues facing the larger economy, one is increasingly coming to the forefront: housing. As interest rates and prices rise, the market continues to struggle with supply (see charts below). Let's explore the reasons for these problems plaguing the market, why they are occurring and what might be done to fix them.

Critical factors include cost of labor and land, current homeowners not selling, overvalued homes, weakened buying power and low demand for new housing.





Cost of Labor and Land

It is growing more difficult for companies to find skilled workers. *"Labor is our biggest pain point,"* said Chad Weaver, president of Weaver Homes, a Pittsburgh construction firm. *"A lot of the older craftsmen are retiring. You don't have the people coming into the trades, whether to be a plumber, or a mason, or an electrician."* Missing those skilled workers means labor costs go up, which further drive up construction costs. In a three-year span before and after COVID, Weaver said his costs went up by 35% to build a home.

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When Will the Housing Market Normalize? (continued)

It is expensive to purchase and develop land partly because of certain zoning/lot-size laws, and lack of available lots to build per district. The national housing shortage is also the product of local restrictive zoning policies and other regulatory barriers that make it difficult to build a range of housing types at different price points.

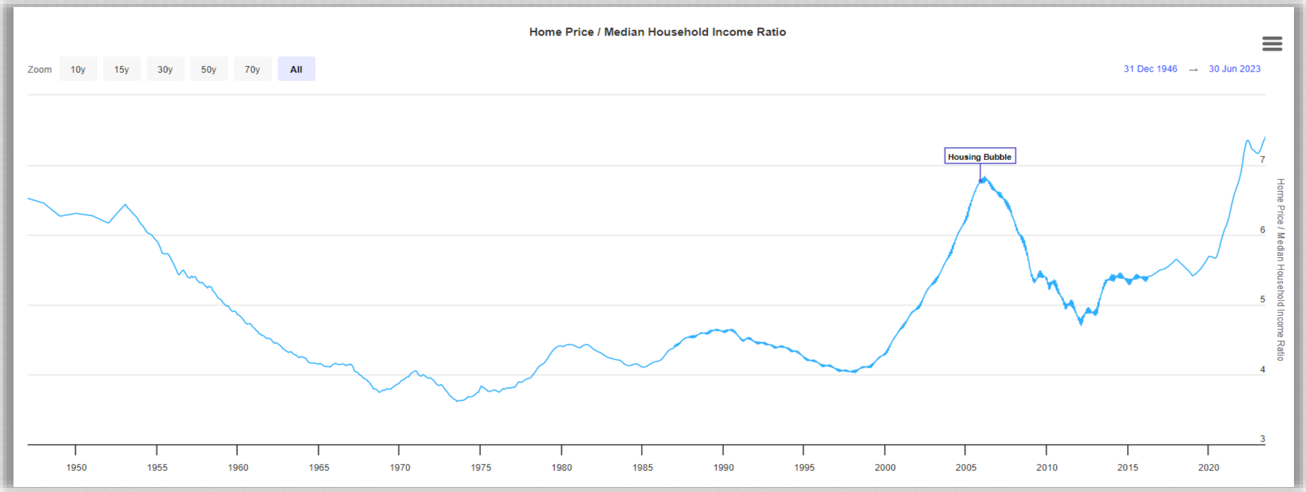
A key feature of zoning is minimum lot sizes. These mandate that homes include a certain amount of land, regardless of owner preferences. These rules raise prices by forcing buyers to buy larger, pricier parcels and by reducing the number of homes which can be built in a district. Builders then raise prices to make a profit.

Homeowners Staying Put

When rates are high, sellers stay put. Owners are usually safer from tighter financial conditions because they have locked in cheaper mortgages for years. More than 60% of outstanding U.S. mortgages have a rate below 4%. This has caused supply to dwindle as owners who would like to sell up sit tight to keep mortgage costs low.

Overvalued Homes

The above factors have led to overvaluation in the residential market. Prices are at all-time highs, especially at monthly cost vs. income (the variable that matters most). It even exceeds the 2006-2007 bubble.



When Will the Housing Market Normalize? (continued)

Affordability Struggles

Starter home costs continue an upward trajectory that has put homeownership further out of reach for those already constricted by limited savings and incomes that cannot keep pace with higher monthly payments. First-time home buyers hoping to buy a starter home will need to earn about $64,500 a year—13% more than a year ago, according to Redfin. A typical starter home hit an all-time high of $243,000 in June. Those earning $75,000 a year can afford a $256,000 home.

What Needs to Happen

For prices to go down, and the market to improve, the economy needs to slow. There are two outcomes of such.

- Rates will decrease.
- A slower economy loosens up the employment market meaning more people looking for jobs, resulting in it becoming easier for construction companies to find employees at a more reasonable pay scale.

The best outcome is that additional inventory would ease the pressure on prices, leveling or decreasing them from their current peak. We also need to see less restriction on zoning for residential properties, allowing more units to be built in zones will increase available supply and lower costs. Finally, let's hope consumers embrace the concept of living within one's means. Years ago, most people making $100K a year were happy to live in a $300K home, not a $500K beyond-their-means one. By embracing that lifestyle, we might prevent the government from trying to fix housing. No good would come from that.

https://www.sungazette.com/news/business/2023/08/labor-shortages-red-tape-mean-high-home-prices-months-of-delay/, https://dailyreporter.com/2023/09/05/construction-adds-22000-jobs-in-august-industry-warns-of-infrastructure-red-tape/, https://www.usbank.com/investing/financial-perspectives/investing-insights/interest-rates-impact-on-housing-market.html, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/09/lot-size-reform-unlocks-affordable-homeownership-in-Houston, https://www.wsj.com/economy/housing/wall-street-thinks-americas-homes-are-overvalued-435e9c42?mod=hp_lead_pos4, https://investors.redfin.com/news-events/press-releases/detail/930/nearly-everyone-with-a-mortgage-has-an-interest-rate-below, https://fred.stlouisfed.org/series/MSPUS, https://www.census.gov/construction/nrc/xls/starts_cust.xls, https://www.census.gov/construction/nrc/xls/co_cust.xls, https://www.longtermtrends.net/home-price-median-annual-income-ratio/#:~:text=Home%20Price%20to%20Median%20Household%20Income%20Ratio%20(US)&text=Historically%2C%20the%20average%20cost%20of,times%20the%20yearly%20household%20income.

THE LABOR MARKET

A Real Crisis: America's Labor Force

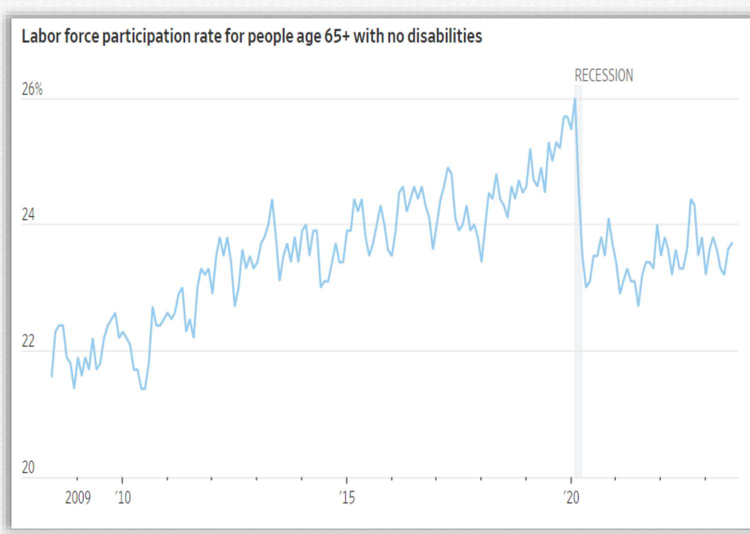
by Rob Koscik, Jason Phipps & Matt Ringle

The past year's tight labor market, headlined by automaker and airline labor fights, is nothing new. Today, post-pandemic worker shortages are turning into a crisis that is pushing wages and employee turnover ever higher. The charts below detail the issue and provide insight into what's happening from a statistical perspective.

The Participation Plunge

Why has the labor force participation rate stagnated? The experts will tell you that it's due to boomer retirements, low birthrates, immigration, etc. All are factors but labor participation and worker productivity were at their healthiest when younger Americans wanted more for themselves and understood the commitment it required to attain such. This desire for the family to have more was led by a single earner and a stay-at-home parent, and in many instances both spouses working. It could be argued these families were more tightly focused on long-term income generation than modern ones just getting by on essentially part-time jobs and gig work. A workforce driven by ambition and financial gain will always be more productive.

Without those motivations, the economy will be relying on Artificial Intelligence to solve the labor crisis. In my opinion AI will boost productivity, but we can only rely on so much. In fact, the Department of Labor projects employment to grow at a rate of only 0.3% per year until 2032—significantly slower than the 1.2% rate over the past decade.

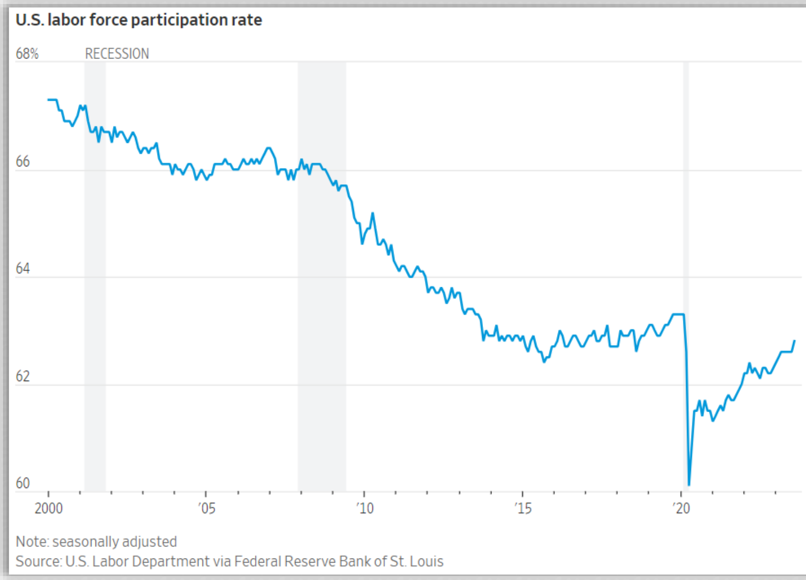


Source: https://fred.stlouisfed.org/series/CIVPART

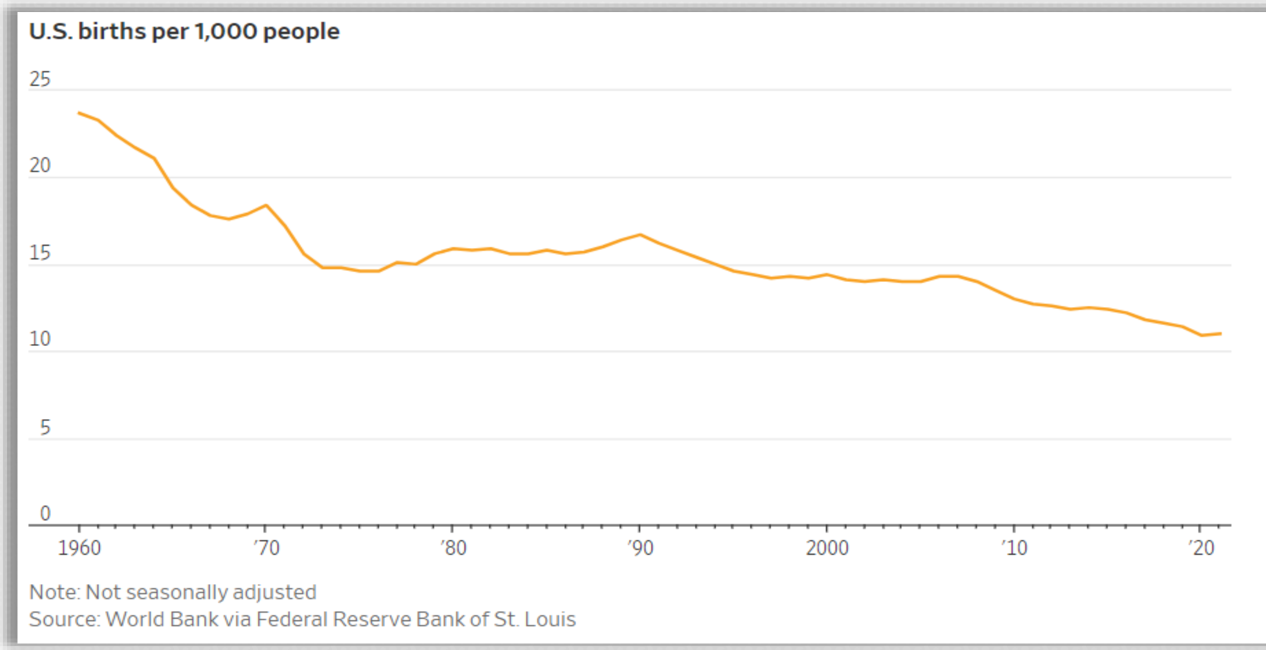
THE LABOR MARKET

A Real Crisis: America's Labor Force (continued)

As per the chart at right, the participation rate peaked in early 2000 at 67.3%. This was during a period when baby boomers were in their prime working years and the U.S. was enjoying an economic expansion brought on by the Internet boom. Ever since that time, the participation rate has been in an overall decline.



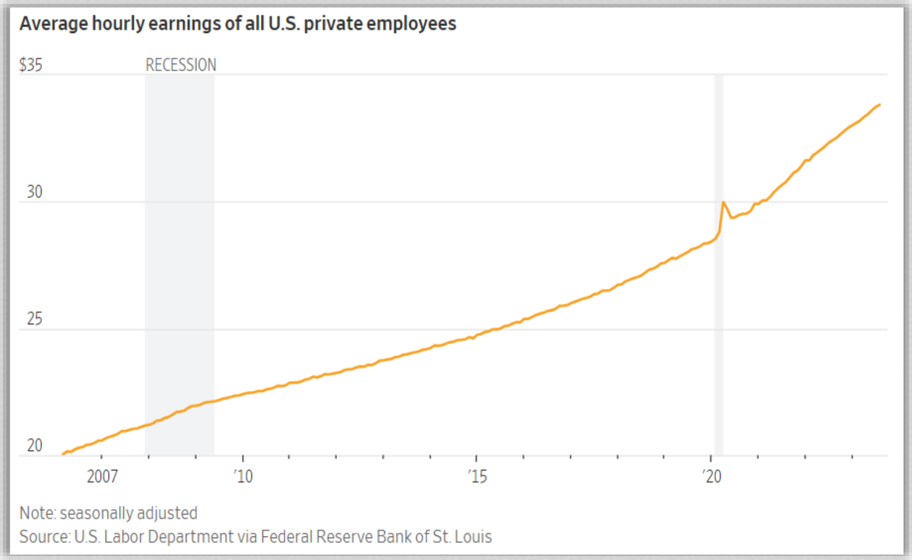
The U.S. birthrate is also a factor, as it has been in decline since the heights of the baby boomer era. Births per 1,000 people now stands at its lowest rate since 1960.



A Real Crisis: America's Labor Force (continued)

Earnings Boost

Given the continued labor shortages, those who *are* working should continue to benefit. As per the chart at right, average hourly earnings have been rising steadily for a number of years.



The Search for Solutions

As a general rule, an economy is able to grow about as quickly as its workforce, plus workforce productivity. But productivity is hard to measure, and current estimates are pretty lackluster, rising about 1.4% a year over the past decade. There are certainly ways to fill the void of a labor shortage. The obvious solution is accelerating hiring and boosting productivity. Participation can be increased through immigration, outsourcing more work overseas, tapping underutilized labor pools such as people with disabilities and the formerly incarcerated, and improving productivity through automation, training and refining business and production processes.

But as we stated at the outset, the ultimate solution may very well be an attitude adjustment. Unless bread winners recapture a single-minded desire to ***win more bread,*** the labor force won't be much of a force at all.

Source: https://www.wsj.com/economy/jobs/labor-supply-economy-jobs-charts-3285a5b7?mod=hp_lead_pos9

NEWS TO USE

Make Your Home Safer for the Future

by Kelli Helvey

There's no avoiding the fact that age will eventually catch up to all of us. As our muscles become a little more achy and our bones more brittle, there's no time like the present to ensure a safe home for the future.

That said, here's a helpful room-by-room list to do just that.

Bathroom

- Install a walk-in shower to avoid falling.
- Place a shower chair or bench in the shower for bathing.
- Swap out a showerhead for a handheld nozzle to enable sitting while rinsing.
- Install grab bars near the toilet and shower (plus slip-resistant floor strips).
- Swap out your toilet for a taller version or give it a boost with a toilet riser.
- Opt for lever-style faucets if arthritis or joint pain becomes an issue.

Bedroom

- If stairs are hard to navigate, convert a downstairs office into a bedroom.
- Make sure your bed is easy to get in and out of. Purchase risers, if needed.
- Invest in an adjustable bed for extra comfort.

Kitchen

- Purchase a stove with safety features that alert you when a burner is on.
- Adjust the location of major appliances so they are easier to reach.
- Get a refrigerator with handles accessible from a wheelchair or walker.
- Add slide-out drawers or trays to existing cabinets for better access.

Make Your Home Safer for the Future (continued)

Furniture

- Declutter and get rid of extra furniture to make rooms easier to navigate.
- Opt for chairs with armrests to make it easier to stand and sit.
- Purchase a lift chair that you can control for safe sitting and standing.
- Keep electric cords out of pathways—but don't put them under rugs.

Lighting

- Install easy-access light switches at room entrances.
- Have ample lighting to create safe navigation in basements, attics and closets.
- Use night-lights, especially in bedrooms and bathrooms.

Flooring/rugs

- Have non-shag carpeting installed over concrete, ceramic and marble floors.
- Avoid use of scatter rugs that can be a tripping hazard.
- Secure area rugs with double-faced tape or slip-resistant backing.

Doors

- Swap doorknobs for lever handles, which are easier to use with stiff hands.
- Widen doors to accommodate wheelchairs or walkers.

Stairs

- Install a sturdy railing and make sure lighting is adequate.
- Carpet stairs and highlight the outlines with colored tape to create contrast.
- Install an electric stair lift if needed to help you safely get up and down the stairs.

Entries

- Keep steps in good repair with no loose stone, concrete or rotted wood.
- Create at least one no-step entry into the home.
- Put a bench in the foyer to sit on when removing shoes.
- Clear entryways and walkways of tripping hazards.

GOVERNMENT LEGISLATION

Medicare Drug Price Negotiation – by Anthony Scassellati

One of the most notable things to emerge from the Inflation Reduction Act is Medicare Drug Price Negotiation. The new drug law allows Medicare to negotiate directly with pharmaceutical companies to improve access to some of their costliest Medicare Part B and Part D drugs. This means that people with Medicare will have increased access to innovative and life-saving treatments at lower costs. The law also requires pharmaceutical companies who raise their prices faster than the inflation rate to pay Medicare a rebate. This will help current and future enrollees of Medicare and discourage any unreasonable drug price increases from companies.

Changes in the Part B program will improve access to high quality, affordable generic version of drugs for people with Medicare as well as impose a $35/month cost-sharing cap on insulin used in durable medical equipment pumps.

Drugs Selected for the First Cycle of Negotiation

Centers for Medicare & Medicaid Services (CMS) has announced the first 10 drugs covered under Medicare Part D selected for negotiation. The negotiations with participating drug companies will occur in 2023 and 2024, and any negotiated prices will become effective beginning in 2026. Upcoming key dates:

- Aug 1, 2024 – negotiation process ends.
- September 1, 2024 – CMS publishes the max fair prices for the first 10 drugs.

GOVERNMENT LEGISLATION

Medicare Drug Price Negotiation (continued)

Costs for Part D

The drugs selected for negotiation accounted for $50.5 billion in total Part D gross covered prescription drug costs, or about 20% of those costs between June 1, 2022, and May 31, 2023. Enrollees who took the 10 drugs covered under Part D selected for negotiation paid a total out of pocket cost of 3.4 billion in 2022 alone. **Selected drugs and the total enrollees who used them during the period are as follows…**

- Eliquis (blood clot prevention): 3,706,000
- Enbrel (arthritis treatment): 48,000
- Entresto (heart failure): 587,000
- Farxiga (high blood sugar for type 2 diabetes): 799,000
- Imbruvica (cancer): 20,000
- Januvia (high blood sugar for type 2 diabetes): 869,000
- Jardiance (high blood sugar for type 2 diabetes): 1,573,000
- Novolog, Fiasp (high blood sugar for diabetes): 777,000
- Stelara (plaque psoriasis and Crohn's): 22,000
- Xarelto (blood clot prevention): 1,337,000

Total Out-Of-Pocket $ costs and [2022 Average Spending Per Enrollee]

- Eliquis: 1,546,358,000 [441]
- Enbrel: 43,187,000 [921]
- Entresto: 185,802,000 [357]
- Farxiga: 166,026,000 [260]
- Imbruvica: 116,489,000 [5247]
- Januvia: 238,891,000 [270]
- Jardiance: 383,346,000 [290]
- Novolog, Fiasp: 92,672,000 [121]
- Stelara: 41,099,000 [2058]
- Xarelto: 591,609,000 [451]

Other Part D Benefits

- Insulin available at $35/month per covered prescription.
- Access to recommended adult vaccines without cost-sharing.
- A yearly cap ($2,000 in 2025) on out-of-pocket prescription drug costs.
- Low-income subsidy program to 150% of federal poverty level starting in 2024.

Sources: https://www.cms.gov/files/document/fact-sheet-negotiation-process-flow.pdf, https://www.cms.gov/files/document/fact-sheetrevised-drug-price-negotiation-program-guidance-june-2023.pdf, https://www.cms.gov/files/document/fact-sheet-medicare-selected-drug-negotiation-list-ipay-2026.pdf

RETIREMENT PLANNING

The Ins and Outs of RMDs

by Jason Phipps

If you are nearing or in retirement, you've very likely heard the term Required Minimum Distributions (often referred to as RMDs). In this article, we will discuss the basics of RMDs and also share several facts that you may not know.

For starters, current federal law requires that you begin withdrawing from your IRA by April 1st of the year following reaching the age of 73. You will continue to take RMDs each year after that.

Inherited IRAs

If you inherit an IRA or another tax-deferred account from someone other than your spouse, a recent change from previous rules requires that inherited IRAs be fully withdrawn in 10 years. These distributions are taxable, and proper planning is required to minimize the tax impact of these distributions.

Multiple IRAs

If you own multiple IRAs, you have the ability to take the RMD over all of the accounts or you can take the RMD out of a single IRA. This flexibility allows you to strategically take your RMD factoring in your specific investments. For example, if you own a fixed annuity that is paying 3% you could take more of your RMD from that account and leave money in bonds that are currently yielding 5% or more.

Differences in 401Ks and IRAs

Unlike IRAs, the IRS does not permit the aggregation of employer-sponsored plans to meet your RMD. If you have 401ks or 403bs, you must take an RMD from each account based on your life expectancy. If you are still working at 73, you can delay RMDs from your 401k until retirement. If you have an IRA and are still working at 73, you must begin RMDs without exception.

RETIREMENT PLANNING

The Ins and Outs of RMDs (continued)

Tax Withholding on RMDs

The standard withholding for RMDs is typically 10%, but you have the choice of holding more than 10% or less than 10%. You can customize your withholding to your individual tax situation by notifying the provider of your IRA. You are responsible for paying taxes based on your ordinary income tax rate. When you file your taxes, you will either get a refund or owe money to the IRS based on your income and withholding.

Penalty for Missing an RMD

If you fail to withdraw the required RMD amount, you will be assessed a 25% penalty on that amount. This penalty can be lowered or waived in certain situations. For example, if you take the RMD by the end of the year following the year in which it was due, the penalty drops to 10%. If you can convince the IRS that the missed distribution was due to a reasonable error, the penalty can be waived. In order to qualify, you will need to file IRS form 5329 with a letter of explanation.

QCDs

If you are over 70.5 and you are giving money to charities, you should consider doing Qualified Charitable Contributions or QCDs. This allows you to give up to $100K a year to charities directly from your IRA income tax free! If you are giving $5,000 per year to your church from your bank account, you should consider a QCD.

If RMDs have you confused, don't worry. We can help you navigate the ever-changing rules to make sure you don't miss your distribution. And we'll help you choose an optimal account and withdraw as tax-efficiently as possible.

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NEWS TO USE

Did You Know?

Mexico Overtakes China

For the first time since April 2003, Mexico imports into the US exceeded imports from China. Since peaking at a 22% 12-month average in March 2018, China imports have accounted for just 14% of imports over past 12 months vs. 15% from Mexico.

Wealthy Rely on Advisors

In a Harris poll, 70% of millionaires said they use a financial advisor vs. 37% for the U.S. 53% said their advisor is their most trusted source, with spouses/partners at 11%.

(Source: Northwestern Mutual)

Deeply Inverted Curves Hold Clues

Deeply inverted yield curves have typically preceded periods of below average equity market returns. Following periods when the 10y-3m US Treasury yield curve was inverted by more than 100 basis points, the S+P 500's average return over the following year has been a gain of 1.6% with positive returns just 44% of the time.

(Source: Bespoke)

Artificial Intelligence (AI) Auditors May Be Coming

The IRS will be using AI to help identify large partnerships and wealthy individuals that may owe more in taxes. The agency said it would soon be sending audit notices and 'compliant' alerts to the identified parties. According to the Government Accountability Office (GAO), 80% of IRS audits don't find any non-compliance.

(Source: New York Times)

NEWS TO USE

Did You Know?

Seven Looks Unlucky

The Conference Board Leading Economic Index (LEI) continued its weakness in August as the ratio of Leading to Coincident Indicators hit a 10-year low for the third month in a row. Since 1930, the ratio has hit a ten-year low for at least three straight months in seven separate periods, and all seven of them occurred during recessions. (Source: Conference Board)

Housing Starts are Slowing

August housing starts were well below forecasts on 9/19, falling 11.3% on a month-to-month basis to their lowest since June 2020. While the headline reading was weak, nearly all of it came from multi-family unit starts which had the largest m/m drop since Aug 2020 (-26.3%) and the largest year decline since Feb. 2020 (-41.6%).

(Source: U.S. Census)

Last But Not Least!

Important Tax Mailing Dates:

- 1099Rs will be mailed on January 31st 2024.
- 1099Bs will be mailed by March 15th 2024
- 5498s will be mailed by May 31st 2024
- Reminder: these aren't needed for tax filing.

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