BKM WEALTH MANAGEMENT

BKMWM Newsletter August 2024

Topics:

1. Stock Market Update
2. A Benefit of Portfolio Rebalancing
3. Clarification on Inherited IRAs
4. Using 529 Plans to Pay for College

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1) July Stock Market Update

If you've been reading our newsletters or weekly emails, then you know that for many months the stock market's performance has been largely driven by the "Magnificent Seven" large tech stocks consisting of Apple, Microsoft, NVIDIA, Amazon, Meta (Facebook), Alphabet (Google) and Tesla. Through June 30th, the NASDAQ 100, an index largely weighted toward the Magnificent Seven, was up 23.4% while the Russell 2000, an index of smaller companies, was up just 0.7%.

In July we saw the opposite. Small and non-tech stocks moved up while the Magnificent Seven largely faltered. The Russell 2000 index rose more than 10% in July while the NASDAQ 100 fell 0.48%.

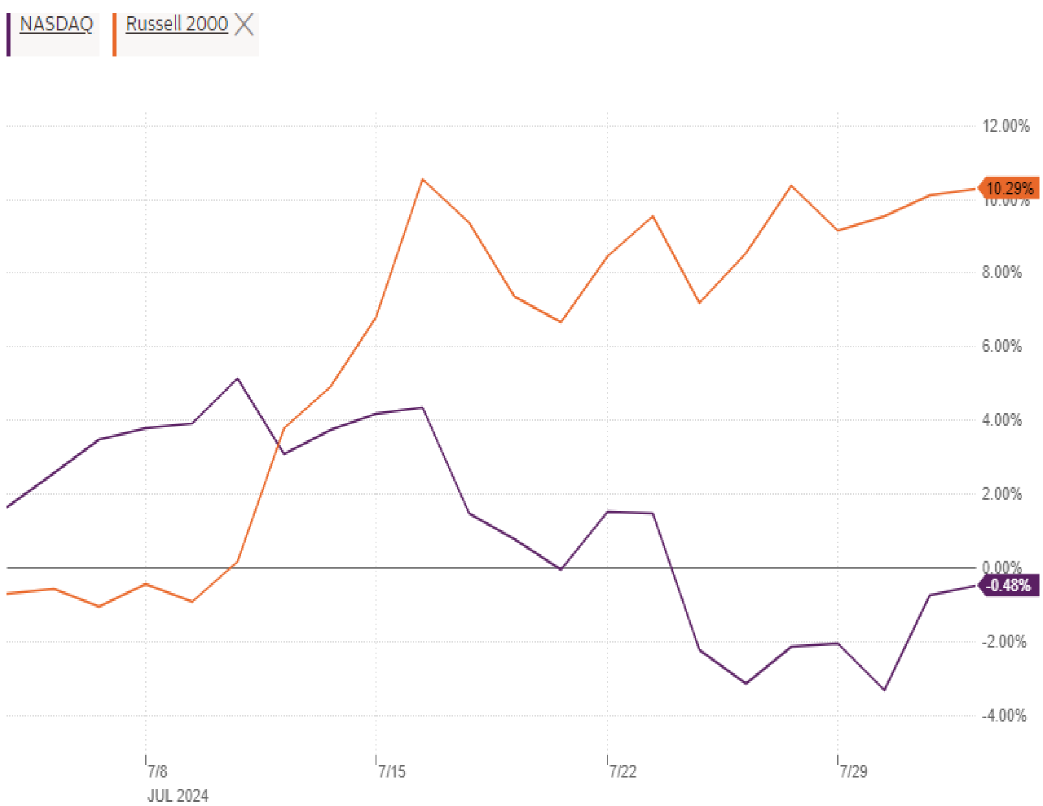


Chart source: Wells Fargo Clearing Services/TradePMR Access Online

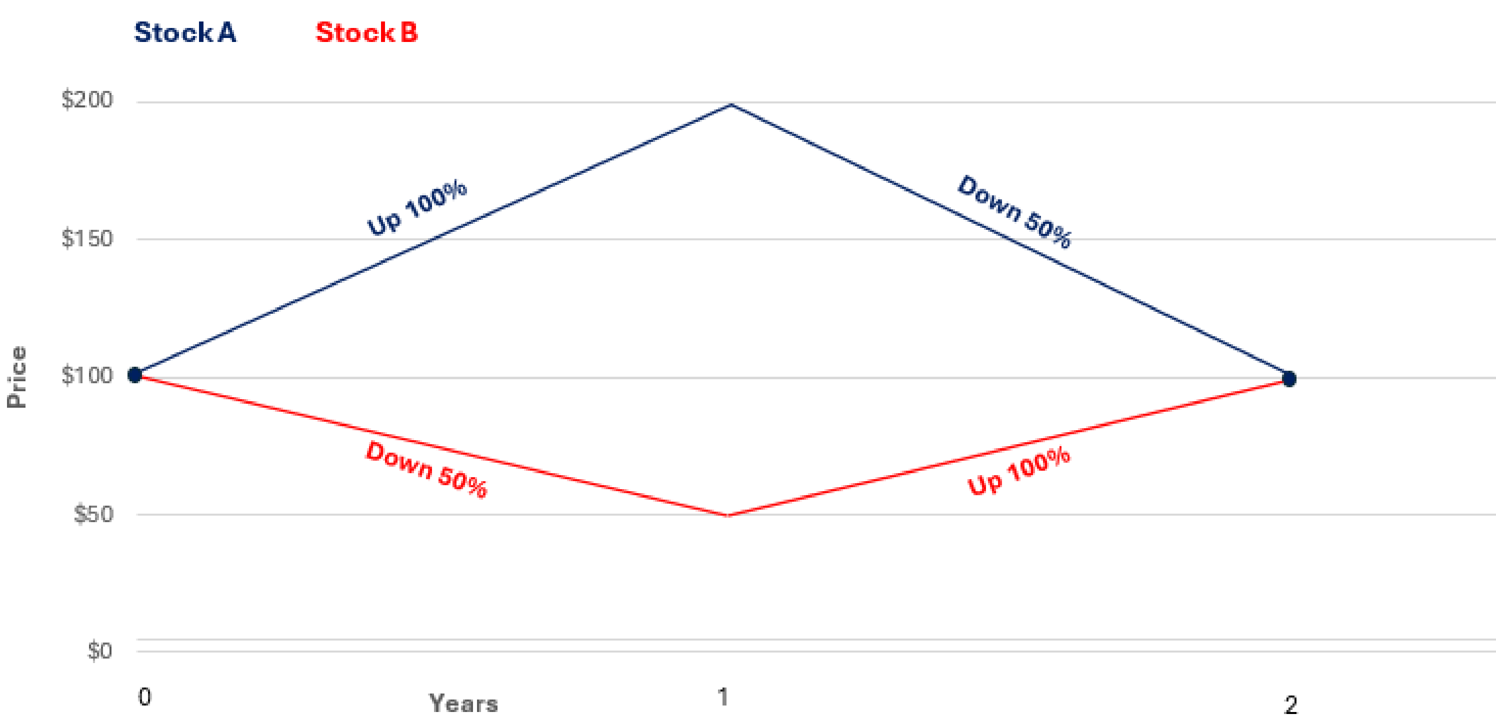
For our clients, who tend to be well-diversified and income/value oriented, this new trend is welcomed. Despite the recent pullback, many tech stocks still appear richly valued while their value and small cap counterparts still trade at reasonable valuations. We encourage investors to remain patient and diversified.

2) A Benefit of Portfolio Rebalancing

BUY & HOLD

Imagine that you purchase two stocks, each at a price of $100, and hold them for two years. In the first year, Stock A goes up 100%, and Stock B goes down 50%. In year 2, Stock A goes down 50% while Stock B goes up 100%. Each stock began at $100, and ended the 2-year holding period at $100. Your overall portfolio went from $200 at the start, to $250 at the end of year 1, and back to $200 by the end of year 2 with nothing to show for it.

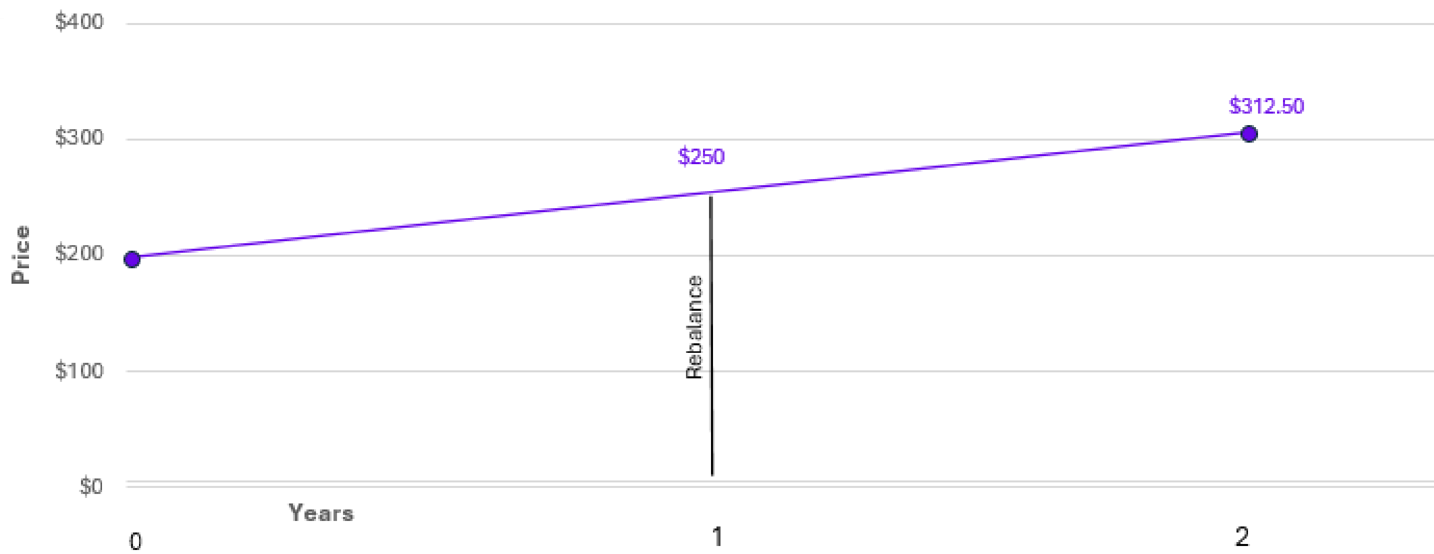
Two Individual Stocks with a 50/50 Weighting



PORTFOLIO WITH ANNUAL REBALANCING

Now instead let's look at what happens if you purchase the same portfolio of two stocks but maintain that 50/50 equal weighting through annual rebalancing. At the end of year 1, your portfolio is again valued at $250, with Stock A having grown from $100 to $200 and Stock B having declined from $100 to $50, but this time you rebalance so that at the start of year 2, you now own $125 of Stock A and $125 of Stock B. Stock A now declines to $62.50, and Stock B appreciates to $250, growing your overall portfolio to $312.50.

Blend of the Same Two Stocks with a 50/50 Rebalance at the End of Year 1



By harnessing the power of rebalancing, the performance of the portfolio has improved and turned a net zero investment into positive returns.

The analysis contained herein is offered for general informational purposes only, and not intended as a specific recommendation of an investment strategy or a financial or insurance product, a solicitation to buy or sell an investment, or tax, legal or investment advice.
These views are subject to change at any time.
Investments are subject to risk and potential loss of principal. Investors should always consult with their financial professional.

3) Clarification on Inherited IRA Rules

The IRS has finalized rules on the required timing of withdrawals for inherited IRAs. With few exceptions, the Secure Act of 2019 eliminated the ability for a non-spouse who inherited an IRA to “stretch” distributions over the course of their expected life. As of 2020, most non-spouse beneficiaries were instructed that they have 10 years following the original owner’s death to deplete IRAs. After several years of confusion, the IRS has clarified that most heirs will need to begin yearly required minimum distributions (RMDs) from inherited accounts and will require annual distributions starting next year, 2025.

Withdrawals from an inherited IRA (aka: beneficiary IRA) incur regular income taxes in the year distributions are taken. Taking withdrawals equally over the ten-year distribution period may make it less likely that the final distribution will trigger a larger than necessary tax bill in year 10. If possible, plan your withdrawals strategically so that the size and timing do not bump you into a higher tax bracket.

If a beneficiary inherits a Roth IRA, withdrawals are not subject to annual RMDs, but the Roth IRA must be depleted by the end of the tenth year after the original owner’s death. Heirs do not owe income taxes on Roth withdrawals, so if you do not need the money, consider keeping it invested in the inherited Roth IRA for maximum growth potential until year 10.

While Beneficiary IRAs must remain separate from other types of retirement accounts, they can still be incorporated into your overall retirement income plan. Contact us to discuss the complicated rules surrounding inherited IRAs.

Sources: You Inherited an IRA. Here’s How to Avoid a Huge Tax Bill. - Barron’s (barrons.com)
IRS issues final rules for inherited IRA withdrawals — what to know (cnbc.com)

4) Using 529 Plans to Pay for College

If your child or grandchild is going to college in the fall, you may be wondering, how do I get money out of my 529 plan? Easy! Just contact your BKM financial advisor, or your 529 plan's custodian. They can transfer money to your bank account as reimbursement, or directly to your school. No complicated accounting or tax filing is needed. Be sure to keep your receipts/proof of qualified higher education expenses (details below) in the event of an audit.

If you have younger children or grandchildren, 529 savings plans can be a great way to save for their college expenses. Many states, including Wisconsin, allow you to deduct a portion of your contributions from your state income taxes. Investments can grow federally tax-deferred, and importantly, withdrawals, including investment gains, are not taxed when used for qualified higher education expenses.

Qualified higher education expenses include tuition, fees, books, computer equipment and technology, and supplies required for enrollment or attendance at the eligible institution. Room and board are qualified expenses for students who are at least half time. Rules apply for on and off campus housing. Qualified expenses also include fees, books, supplies, and equipment required for registered apprenticeship programs and qualified student loan repayments for a designated beneficiary or siblings (up to $10,000 lifetime each, not annual).

Other key advantages of 529 plans include:

- No income limitations for participation. There are no income restrictions for contributing to a 529 plan, which is a benefit for higher-income families.
- Substantial contribution amounts. Contribution limits are significantly higher than those allowed for an Education Savings Account (ESA). Maximum account balance limits vary from state to state. In Wisconsin, the limit is $567,500.
- Minimal burden of investment decisions. Your financial advisor and/or the plan's chosen investment manager will be responsible for the day-to-day portfolio management of all contributions. Generally, you may change only twice every calendar year and/or with a beneficiary change.
- Secure Act 2.0 allows a direct trustee to trustee rollover from a 529 plan to a ROTH IRA for the 529 plan beneficiary, subject to certain limits and requirements. State laws may vary.
- Qualified withdrawals can also be used towards tuition at a primary or secondary public, private or religious school (up to a maximum of $10,000 of distributions per taxable year per beneficiary).

College can be expensive. Your BKM financial advisor can help you create a tax-efficient savings strategy which may include the use of 529 plans, Roth IRAs, Educational Savings Accounts as well as UGMA/UTMA accounts.

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Financial advisors whose mission is to positively impact lives.