Roberts Wealth Advisors

In This Issue:

- The Missing Impact of Borrowing Costs
- What is a Donor Advised Fund and How Does it Work?
- Portfolio Activity
- End-of-Year Wealth Planning Checklist
- Featured Stock: NextEra Energy (NEE)
- **Topic Spotlight:** The Return of The Student Loan
- Firm Announcements

The Missing Impact of Borrowing Costs

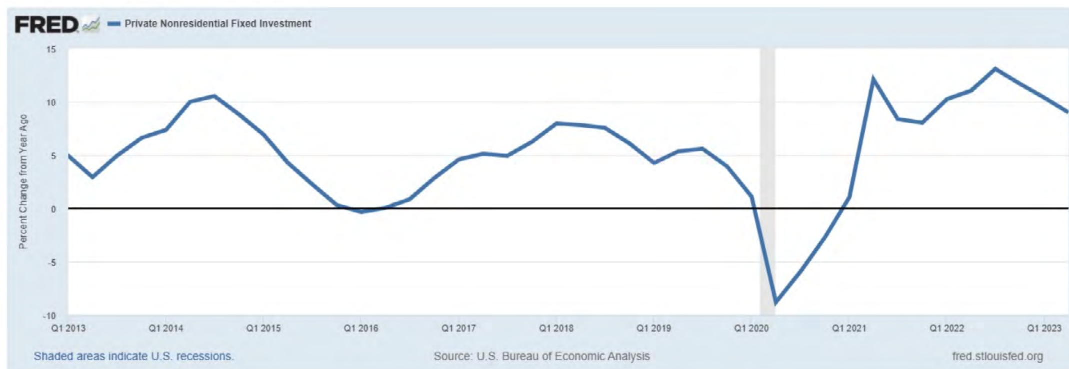
The third quarter of 2023 was most notable for the things that did not materialize, rather than the impact of events that did develop. Principal among them was the anticipated effect of higher interest rates. Common thinking would suggest that elevated interest rates, and by association, increased borrowing costs, would have both a dramatic and negative influence on factors of the United States's economic engine that would ultimately lead to suppressed growth. Instead, in several important indicators, decision makers shrugged off these higher costs, continuing to pursue opportunities to invest in projects or purchases with confidence of a strong economic outcome. It is important to monitor the strength of U.S. corporations along with the U.S. consumer, as together their activity generates nearly 85% of economic output. Two measures to gauge the health of corporations and consumers are the year over year change in business investment and the strength in the U.S. housing market.

Business investment has historically been a solid indicator of the confidence corporate managers have in their respective organization's opportunities. Bond yields, an indicator of cost for corporations to borrow for highly rated companies, are the highest they have been in over 15 years. Despite the elevated cost of capital, companies continue to borrow. In fact, on one day alone in early September, bond sales totaled over $38 billion, the highest level since early in the pandemic when interest rates were near zero.

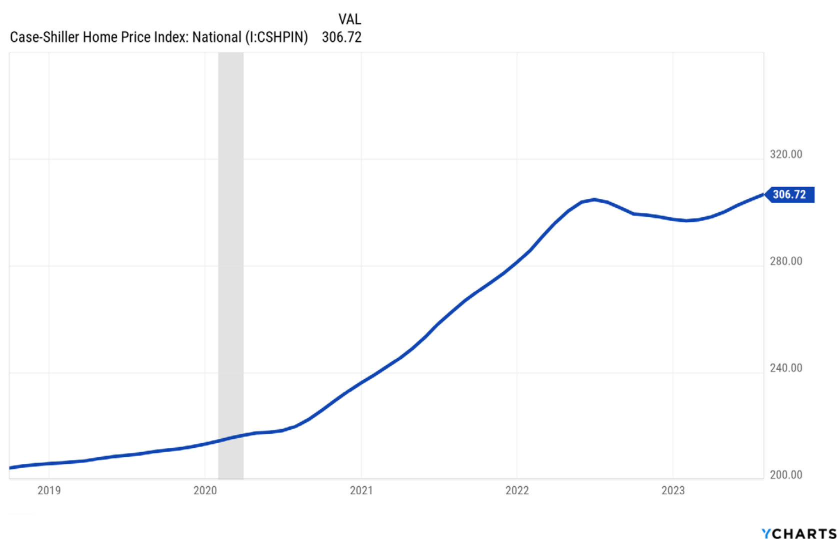
As is the case with many economic indicators, there are multiple ways to interpret this activity. We choose to accept the optimistic view that despite the higher hurdle rate, the mid to long-term business environment remains attractive. Government funded programs enacted since late 2021, like the Inflation Reduction Act, the Infrastructure Investment and Jobs Act, and the CHIPS Act are expected to deliver over a trillion dollars in new spending, which is spurring activity in areas such as the development of semiconductor chip manufacturing facilities.

Continued from page 1

Additionally, further inspection of recent earnings announcements from S&P 500 companies indicates that over 60% of them increased investment over the past year. Entering 2023, many economists believed the impact of higher rates would be felt by the business community and reduce their willingness to spend. To date, measurements like business investment instead suggest that the appetite remains despite elevated borrowing costs.



The residential housing market was widely anticipated to suffer as 30-year mortgage rates ballooned from below 3% in late 2021 to their current level above 7.3%. Like business investment the expectation was, as affordability declined, transaction volume and pricing would naturally and necessarily decline to attract buyers. Home buyers have proven to be resilient and housing prices have instead increased in the United States when compared to 2022 levels. Again, a myriad of factors continues to impact housing prices. Inventory remains low and builder incentives have improved affordability, but the U.S. homebuyer continues to be employed at historically high levels and has benefited from an improving wage environment.



The highly anticipated economic recession, expected to begin in the second half of the year, has not materialized, leading to a shift in the narrative toward whether the Federal Open Market Committee (FOMC) has engineered a difficult "soft landing" that is snuffing elevated inflation levels while maintaining economic growth. The capital markets remain dubious that the FOMC has indeed successfully pulled off the delicate maneuver.

The equity markets, particularly those with a concentration in growth-oriented companies, yearn for an environment of accommodative monetary policy. The lower interest rates are, the more valuable future growth opportunities become when measured in today's dollars. On the heels of the regional banking crisis, which seemed destined to thrust the U.S. economy into a recession, growth stocks rallied in anticipation of the FOMC responding by reducing interest rates. Policymakers instead stayed the course, raising the benchmark Fed Funds rate to 5.5% at the June meeting. Faced with the possibility that rates may indeed be "higher for longer," valuations contracted through the latter part of the third quarter. The S&P 500 fell 3.3% during the quarter, accelerating on the downside during the month of September. The Nasdaq and small company indices each fared worse, falling -3.9% and -5.1% respectively. Value oriented stocks, who historically have accessed the debt markets more routinely, did not fare much better, also falling in the quarter as concerns continued about the impact of higher interest payments on profit margins. The Dow Jones Industrial Index declined -2.1% during the third quarter. A disproportionate amount of the return in the market this year has been derived from large companies, particularly large growth. The technology sector fell -5.6% in the quarter, but it was the REITS (-8.9 %), Utilities (-9.3%), and Staples (-5.9%) sectors, that were most challenged in the summer quarter.

The fixed income markets are also adjusting to the increased probability of the FOMC keeping rates high. The 10-year bond, which yielded below 3.8% three months ago is now over 4.6%. During the same period, the 1-year bond shifted only slightly from 5.4% to 5.5%. The upward shift in rates impacted the longer maturity bonds, and the Bloomberg Aggregate Bond Index declined by -3.2%.

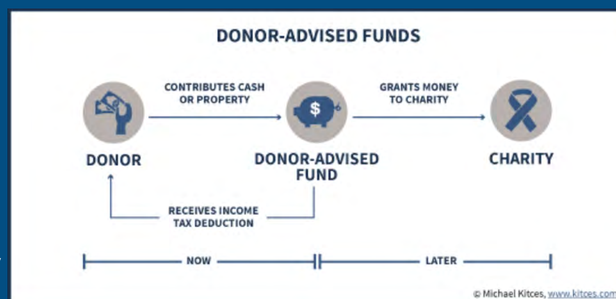
We maintain our optimism that the U.S. economy remains on solid footing. The markets' retreat in the third quarter is likely to continue but has provided an entry point for quality companies that are poised to participate in the spending plans spurred by the government's strategic spending in infrastructure and manufacturing. Investors will continue to seek out the negative impacts of higher rates, whether it be in the corporate or consumer sectors. Corporate earnings and economic indicators will help to allay the concerns of a looming recession, enabling the solid investment returns built in the first half of 2023 to be kept through the end of the year.

What is a Donor Advised Fund and How Does it Work?

In 2022, Americans donated almost $500 billion to charitable organizations. Gifting to a charity in need is not only great for its mission but can also be satisfying to the donor. An added benefit is knowing there may also be some tax relief from the donation. Depending on your tax situation, you could qualify for a full or partial deduction for charitable donations, but in some cases, you may not be allowed to deduct it at all. Using a Donor Advised Fund is a strategic way to ensure you are getting the most bang for your charitable buck.

A Donor Advised Fund (or DAF for short) is an investment account, specifically ear-marked for charitable giving, typically set up at a charitable organization under the umbrella of a financial services firm (e.g., Schwab Charitable). It allows donors to make a charitable contribution of either cash or property at their discretion, while receiving an immediate tax deduction (if the taxpayer itemizes their deductions). The donor can then propose grants from the fund to their favorite charities over time. The main goal of a DAF is to separate the timing of when the tax deduction occurs from when the charity ultimately receives the money.

The Internal Revenue Service places a limit on charitable contributions one can deduct from income. For cash contributions, the deduction is limited to 60% of Adjusted Gross Income (AGI), and for non-cash assets held more than one year (e.g., appreciated stock) it is limited to 30% of AGI. This means contributing to a DAF can be particularly effective in a "big income" year where AGI is higher due to a major liquidity event (e.g., the sale of a business, the execution of stock options, or a Roth conversion). So, for those planning to make substantial ongoing charitable contributions, there is an advantage to "front-loading" those contributions in a year where the entire deduction can be taken at once.



When it comes to charitable gifting, cash isn't always the most effective asset to donate. Donating non-cash assets with significant appreciation, such as stocks with a large unrealized gain, allows the donor to receive a tax deduction equal to the market value of the stock while avoiding the capital gains tax that would result from the sale of those assets. By avoiding capital gains tax, the end charities receive more money. Assets contributed to a DAF can be invested for tax-free growth, ultimately increasing your giving power.

EXAMPLE *Sara works for a start-up technology company and usually has income of ~$100k/year, but this year she experienced a significant liquidity event due to the sale of her company stock after her employer had a highly successful IPO. This boosted her current year income by $1 million. Sara has always been inclined to give charitably, and given her newfound wealth, she would like to donate $150k to charity in the coming years, but she's not ready to donate it all at once and she's concerned that after her income goes back to her usual level, she won't be able to claim a full charitable deduction. Accordingly, Sara decides to contribute all $150k to a donor-advised fund this year, claiming a full $150k charitable deduction (as that is well below the AGI limits in her current "big income" year). Sara can let that money grow overtime and then make periodic gifts from her DAF whenever she wants, without worrying about the deductibility limits along the way.*

Another tax efficient gifting strategy to consider is a Qualified Charitable Deduction (QCD). A QCD is a direct transfer of funds from your Individual Retirement Account (IRA) to a qualified charity. You must be 70½ or older to be eligible to make a QCD and can donate up to $100,000 per person annually. QCDs help to satisfy your required minimum distribution for the year, reducing taxable income. Also, a QCD does not require that you itemize deductions on your tax return, which due to recent tax law changes, means you can choose to take advantage of the potentially higher standard deduction, and still use a QCD for charitable giving.

Please reach out to us if you are interested in learning more about a Donor Advised Fund or a Qualified Charitable Donation.

Portfolio Activity

Our main focus during the third quarter turned to adding to existing names within our portfolio as well as adding new names at prices that we found very attractive in the current risk environment. In contrast to last quarter, our purchases largely outpaced our sales but were somewhat balanced between equities and fixed income holdings. For fixed income allocations, we focused on the higher yielding short end of the curve, looking to generate higher income while avoiding the risk of longer maturities.

The new additions to our equity allocations were NextEra Energy (NEE), in which we took an initial position and added to it several weeks later, and Nike (NKE) which we felt had been unfairly punished alongside other retail names.

As we mention in our "Featured Stock" article, NextEra Energy is a company that we have had on our radar for years, but have remained disciplined in adding to our portfolio, given the stock's historically strong performance. The company is the nation's largest utility and runs the world's largest solar and wind business. This combination elevates it to the forefront of the inevitable transition to cleaner energy sources. The future of a cleaner grid is likely to depend on a greater need for community and utility-level clean energy, which is a space where NextEra is uniquely positioned to succeed.

Nike is a name that has been on our radar for several months. The decision to add the position to our portfolio was based on our beliefs that valuation had become attractive, and several catalysts will materialize to push the stock higher. In terms of valuation, Nike had declined to the low end of a range it has traded around for the last 10 years, and we felt that at least part of that decline was due to temporary factors that are beginning to unwind, including the company's sales in China.

Index Performance	Q3	YTD
Dow Jones Industrial	-2.10%	2.37%
Standard & Poor's 500	-3.27%	12.97%
Nasdaq Composite	-3.94%	27.06%
MSCI EAFE (Europe, Australasia, Far East)	-4.11%	7.08%
Russell 2000 (Small Company)	-5.13%	2.54%
MSCI ACWI (All Country World Index)	-3.40%	10.06%
Barclays Intermediate Term Bond	-3.23%	-1.21%
Barclays Municipal Bond	-3.95%	-1.38%
Barclays Short Term Bond	0.21%	1.40%

The company is also making a notable move into women's athletics and is looking to grow the segment into one competitive with the men's side, which is currently two and a half times larger. There have been some successes already, including a slate of partnerships with prominent female athletes. The push is still in its infancy, and we expect a great deal of runway in the years ahead. We also believe that Nike is poised to benefit from the focus on health and wellness in the U.S. being led by the advancement of personalized health data and new pharmacological solutions.

TOP 10
U.S. HOLDINGS

- Microsoft
- Apple
- Alphabet
- Amazon
- Trane Technologies
- J.P. Morgan
- Cisco Systems
- Visa
- Zoetis
- Linde

End-of-Year Wealth Planning Checklist

Have You Maximized Your Tax-Deferred Accounts?

- Employer-sponsored Retirement Plan e.g., 401k (12/31/23 deadline)
  $22,500 or $30,000 for 50+
- IRA *or* ROTH IRA (04/15/24 deadline)
  $6,500 or $7,500 for 50+
- Health Savings Account (04/15/24 deadline)
  Individual $3,850 or $4,850 for 55+
  Family $7,750 or $8,750 for 55+

Execute Your Gifting Strategy

- Make an irrevocable donation to a Donor Advised Fund or make a Qualified Charitable Donation from your IRA (See "What is a Donor Advised Fund and How Does it Work?" on page 3).
- Utilize the annual gift tax exclusion of $17,000 per individual.
- Fund education by contributing to a 529 plan for a child or grandchild.

Check For Unclaimed Property

- Did you know that one in seven people are entitled to unclaimed property being held by state treasurers? Common unclaimed assets include returned security deposits, inactive checking accounts, missed paychecks, etc. Search for yourself on **MissingMoney.com** to see if this applies to you.

Review Your Beneficiary Designations

- Review your retirement accounts, trusts, insurance policies, and transfer on death accounts (TOD). Have you named both a primary and secondary beneficiary for these assets?

Utilize RWA's Tax Planning Services

- Letting our team review your most recent tax return is the easiest way for us to ensure that we are being as tax efficient as possible in the current year and years to come. Our clients can expect to receive communication before the year end with a secure link to upload a copy of your return.

Featured Stock: NextEra Energy (NEE)

NextEra Energy, Inc. (NEE) is a leading American electric utility and renewable energy company headquartered in Juno Beach, Florida. Founded in 1984, NextEra Energy is the largest utility company in the country, with a strong focus on sustainability and clean energy solutions. NextEra operates through two primary subsidiaries: Florida Power & Light Company (FPL) which generated 80% of the total $21 billion in revenue in 2022, and NextEra Energy Resources (NEER) which generated the remaining 20%. FPL is one of the largest electric utilities in the U.S., serving more than 5.8 million customer accounts in Florida. To manage fuel price volatility, the company continues to add more solar to the power grid, with the company now operating a solar portfolio of nearly 5,000 megawatts, which is the largest solar portfolio of any utility in the country. FPL currently has 71% of its electricity generated by natural gas and 5% generated by solar but expects solar, battery storage, and green hydrogen to become 83% of the source of electricity by the year 2045.

NextEra Energy Resources (NEER) is responsible for the company's renewable energy generation and development efforts with 31 gigawatts of clean energy in operation, 75% of that coming from wind energy. The company continues to make substantial investments in wind, solar, and battery storage technologies with renewable energy assets spread across North America.

NextEra Energy is also the leader in green hydrogen production which is a process of creating hydrogen as a source of electricity using other renewable energy such as wind and solar. Hydrogen production from renewable electricity is expected to play a key role in reaching long-term decarbonization goals and improving energy security. While less than 1% of global hydrogen production comes from renewable energy sources today, renewable hydrogen is receiving increasing policy attention. A total of 25 countries, plus the European Commission, have announced plans that include hydrogen as a source of clean energy, and several have begun to introduce financial support schemes. With green hydrogen driving growth, the overall market could grow substantially, from a total addressable market of $160 billion in 2022, to more than $640 billion in 2030 and $1.4 trillion in 2050. Back in May of 2023, the company announced a $20 billion investment in green hydrogen, pioneering the technology.

As the largest utility in the space with its massive existing infrastructure and deep market expertise, NextEra should be able to pioneer the development of green hydrogen technology and could continue to position the company to outpace the industry growth with its long-term strategy geared towards the future. We believe the company has a clear path to becoming the largest renewable energy provider in the U.S. and for these reasons, we added NextEra to our portfolio in the third quarter.

The Return of The Student Loan

Topic Spotlight

The three-and-a-half-year moratorium on federal student loans has come to an end. As part of the debt ceiling resolution that was reached at the end of June, these loans began to accrue interest at the end of August and payments officially resumed October 1st. For those who are unable to begin repaying the loans, the Department of Education did establish a one-year grace period that will last until October 1st, 2024. During that period, borrowers who miss or are late on their payments won't be reported to credit rating agencies or be considered in default, but their balances will continue to accrue interest and thus, the total amount owed will continue to increase until repayments begin.

According to the U.S. Federal Reserve, there are around 44 million Americans who owe federal student debt, or approximately 13% of the U.S. population. The cumulative amount of debt owed by this group is more than $1.6 trillion, meaning the average borrower owes nearly $37k in student loans. On a monthly basis, that implies the average student loan borrower owes about $300 in interest and principal payments, which is similar to the average level of interest payments prior to the pandemic given the majority of outstanding student loans were issued at lower rates. In theory, that $300 a month represents either cash that has supported the economy via discretionary spending or has been stocked away in bank or investment accounts (which would total $12.5k if saved for 42 months).

According to Morgan Stanley, there are substantial demographic differences in terms of who holds federal student debt. Individuals between the ages of 25 and 34 are the most likely to hold student debt, but for those 62 and older, debt as a percentage of disposable income is the highest at 77%. Southern states are also more likely to have higher loan balances as a percent of disposable income, while states in the Northeast have the lowest percent. Lastly, women were roughly 10% more likely to hold student loans than men.

The inevitable question is, "Will consumer discretionary spending fall as borrowers are forced to reallocate their incomes and savings to debt repayment?" One major data point in support of that argument is consumer delinquencies on loans and card payments. Bank of America reported in mid-September that more of its customers are falling behind on credit card payments and the delinquency rate continues to trend upwards, though it is still below 2019 levels. According to JPMorgan Asset Management, the percent of auto and credit card loans among all U.S. consumers that are delinquent have nearly doubled from the levels in late 2021.

We won't know the full effect until the data begins to roll in later this year and into early next year. There are additional outlets of relief for struggling borrowers like the Biden administration's SAVE (Saving on A Valuable Education) which is estimated to lower the average monthly payment on student loan resumptions by about one-third. For now, we believe it's reasonable to expect some degree of headwinds to consumer spending, but we will continue to evaluate the situation as it unfolds.

Firm Announcements

RWA is thrilled to congratulate our Director of Wealth Planning, Suzanne Herman, on attaining the CERTIFIED FINANCIAL PLANNER™ certification. The CFP® designation is the highest standard of excellence in the financial planning industry. As a CFP® professional, Suzanne has fulfilled considerable education and hourly requirements and is dedicated to the CFP Board's ethical standards that require putting clients' needs first. We are so proud to recognize Suzanne for this significant accomplishment!

Past performance is not necessarily a guide to future performance. There are risks involved in investing, including possible loss of principal. This information is provided for informational purposes only and does not constitute a recommendation for any investment strategy, security or product described herein. Please contact us for a complete list of portfolio holdings.
For additional information on the services of Roberts Wealth Advisors, or to receive our newsletters via e-mail or be removed from our mailing list, please contact us at 650-240-2410.

© 2023 Roberts Wealth Advisors