Roberts Wealth Advisors

Quarterly Commentary

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Upward Surprise of Market Returns

A year ago, investors braced for what economists had predicted to be the most widely anticipated recession ever. The looming economic dark cloud was expected to lead to severe corporate earnings declines and resulting job losses. Economic forecasters focused on the sharp increase in interest rates, and the impact they were having on valuations, both of publicly traded and privately held companies. Inflation was running at elevated levels and the Federal Open Market Committee (FOMC) was steadfast in fighting it with further rate increases.

Those prognosticators were correct in anticipating the FOMC would be relentless in their desire to stem price increases by adjusting the Federal Funds rate, as policymakers raised another full percent, to 5.50% with four rate hikes in 2023. The result was not the anticipated cratering of economic growth, but instead the intended consequence of moderating inflation while the economy continued to churn forward on strong employment and wage growth.

Those rate increases did, in fact, cause a major disruption in the banking industry, but rather than send the market on a downward spiral, investors shifted investment to companies that were laden in cash reserves and that enjoyed revenue streams that had become essential in the expanding digital economy. The business of banking will continue to be challenged as lending margins are compressed with high short-term rates and lower medium-term rates. Observers will have additional scrutiny on the quality of bank loan portfolios as the solvency of some smaller regional banks will be dependent on the cash flow generated by those loans.

Broadening Of Market Returns. Wall Street loves their nicknames and 2023 saw the birth of the Magnificent Seven group of stocks, stealing the moniker from the movie of the same name. This Magnificent Seven includes Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla and represents the largest seven names in the S&P 500 index. These seven stocks had incredible returns in 2023, averaging 106% in appreciation, after falling the previous year 45% on average. Despite the volatility in the names, they were thought to be a safe haven in the environment of heightened borrowing costs as none of these companies are dependent on debt to fuel earnings growth. The companies have become a significant weight in the S&P 500 Index, representing nearly 30% of the S&P 500 value in aggregate.

As inflation numbers moderated in the late summer and the FOMC signaled an end to the raising cycle, the market broadened significantly to include returns from more than just those seven stocks. Small Company stocks shot up in the final quarter of the year to lead all indices over that time period, with a 14.03% return. Fears of rising debt costs for borrowers subsided with price stabilization, leading to a shift in appetite for investors toward the debt heavy companies that underperformed in the first half of the year. The S&P Value Index (+7.9%) outperformed the S&P Growth Index (+6.6%) in the second half of the year.

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A Bond Market Round Trip. The bond market is often thought of as the more conservative asset class utilized to achieve predictable returns, but in periods of significant changes in interest rates, bond prices can be equally volatile as their stock counterparts. The yield on a 10-Year Treasury bond started the year at 3.88% and ended the year at 3.84%. The similarity in the two data points belies the volatility in the yield that reached as high as 5.00% contributing to the Bloomberg Aggregate U.S. Bond Index falling over 7% from its high during the year, only to fully recover by year end. The round trip in bond yields is an indication that investors are confident that the FOMC has reached the end of their raising cycle and comfortable that inflation is under control.

Source: YCharts

If the lens of observation is extended to include the last two calendar years, investment market returns suggest both policy makers and investors are struggling to understand the impact of pandemic era monetary and fiscal policy. The whipsaw of inflation levels, borrowing rates, and stock and bond market returns contrast with the stability of some of the fundamental factors that support market levels. Three factors that will play a role in the coming year are the health of the consumer, corporate earnings growth, and a legislative stalemate.

A Healthy Consumer. The U.S. consumer is the largest contributor to the U.S. economy, representing over two-thirds of the spending. In 2023 the consumer proved to be one of the biggest surprises as real consumption spending grew 2.4%, exceeding the forecasts of 0.5%. Trends and fashions can make the ability to predict how a consumer will spend difficult, but the ability for the U.S. consumer to spend can be attributed to employment rates and wage growth. Current measures suggest continued health of consumer spending. Wage growth has moderated in recent months, but still is growing above trend. Unionized workers had a busy year with strikes that included Hollywood's writers and actors, Las Vegas casinos workers, and workers in the auto industry. The concessions gained were both wage and non-monetary improvements that add to employment stability for hundreds of thousands of U.S. workers.

Corporations Continue To Increase Their Earnings. Company shareholders benefit from a growth in earnings, which can be derived from a myriad of factors. Over the last two decades, corporate earnings have benefitted from a combination of revenue growth and improved profitability. For S&P 500 companies, the average growth in earnings has been 8.4%. From year to year, those earnings will deviate from the average, but the trend supports value creation for investors who are patient with that volatility. Opportunities for company growth continue to be plentiful. Artificial Intelligence took center stage in early 2023 and provides one of the newest avenues for future expansion. Deep pocketed entrants into the healthcare industry by big tech stalwarts Apple, Amazon, and Oracle, portend disruption and opportunity of the economics in that space. A more predictable rate environment allows corporate decisionmakers to make expenditures with more confidence.

Election Year Stalemate. The U.S. economy is not without its problems. Federal and state governments have run increasingly large deficits to navigate challenges like the financial crisis and a global pandemic. The U.S. government has run a fiscal deficit for 22 straight years, adding to the total debt in each of those years. Addressing growing debt will require a combination of reduction in government expenditures and an increase in tax revenues. Neither of these would be popular nor likely in the coming election year. It is much more likely that little is accomplished from federal lawmakers providing a stable legislative environment for companies and consumers.

The investment markets are set up to enjoy a year of solid returns. The absence of major legislation will provide a consistent environment for companies and consumers to continue to spend with confidence, leading to increased company share prices. The recent trend of broadening market returns will continue into the new year providing opportunities for a well-diversified portfolio.

Roth IRA for Kids

Roth Individual Retirement Accounts (Roth IRA) are an incredible tax planning tool due to their after-tax contributions ability to grow and be distributed tax free in retirement, but they are not just for adults. Minor children can contribute to a Roth Custodial IRA*. In fact, there are only two requirements to contribute to a Roth: 1) an individual must be below the applicable income threshold (phased out between $146,000 and $161,000 for single filers in 2024); and 2) they must have earned income. Thus, unless a minor child has a substantial amount of earned income, they will be eligible to make a Roth IRA contribution in 2024, up to the lesser of $7,000 or their actual earnings.

As long as a child does not earn more than the standard deduction for a single filer ($14,600 in 2024), their tax rate is 0% and can be exempt from withholding. Using today's 0% tax rate to contribute to a Roth IRA is a great way to build a sizeable, completely tax-free nest egg. Thanks to the power of long-term compounded growth, these early contributions could have a material impact on the child's retirement savings. For instance, by contributing the maximum amount in 2024 of $7,000 to the child's Roth IRA each year from ages 15 through 17 (just three years of contributions), by the time the child reaches 65 they will have accumulated nearly $580,000 of tax-free retirement money, assuming a 7% annual rate of return.

It's also worth noting that while the child needs to have compensation to be eligible to contribute, the child doesn't have to be the one to make the contribution. A parent can let the child keep their wages and contribute their own money in the child's Roth IRA (presuming the parent has not already capped out his/her annual gift limit to the child).

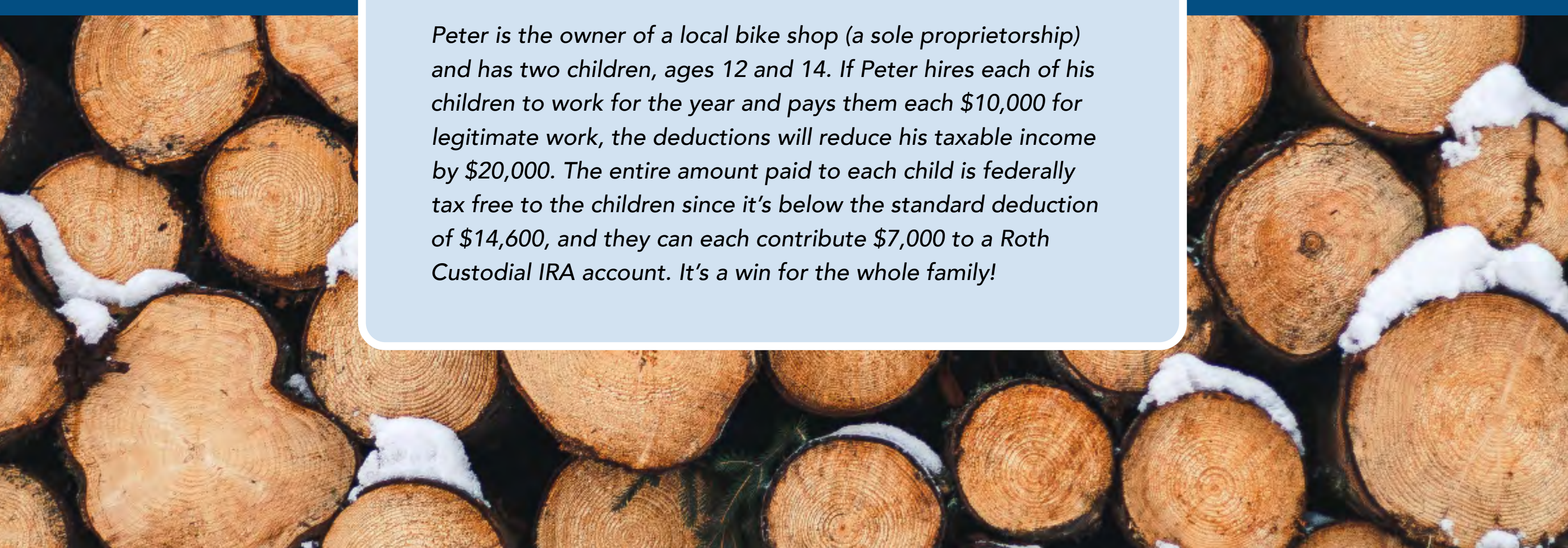
If you are the owner of an unincorporated business (sole proprietorship, partnership, or limited liability company) employing your minor child can present a double-whammy tax benefit. Your business not only gets to deduct the wages you pay your child, but it also enjoys payroll tax savings since children under age 18 are exempt from FICA taxes (Social Security and Medicare). This ultimately allows you to keep more money within your family.

Important Considerations:
You cannot simply put your child on the company payroll; you must hire them for an actual job that is age-appropriate to the relevant Federal and state child labor laws. Common services a minor can perform include cleaning, data entry, answering the phones, managing social media, or even being a "child model" by using their images in the business' marketing materials. In addition, you must pay your child a reasonable wage for the work they do. For example, if you pay them up to the standard deduction amount of $14,600 and they work one hour per week, that equates to an hourly rate of $280. The IRS would likely deem that an unreasonable wage for a minor.

* With a Roth Custodial IRA, an adult maintains control of the account until the child reaches a certain required age at which control must be transferred (typically 18 or 21, depending on the state where the minor lives).

EXAMPLE

Peter is the owner of a local bike shop (a sole proprietorship) and has two children, ages 12 and 14. If Peter hires each of his children to work for the year and pays them each $10,000 for legitimate work, the deductions will reduce his taxable income by $20,000. The entire amount paid to each child is federally tax free to the children since it's below the standard deduction of $14,600, and they can each contribute $7,000 to a Roth Custodial IRA account. It's a win for the whole family!



Portfolio Activity

Portfolio activity in the fourth quarter centered around selling existing names in equities while adding names that we feel could benefit from the potentially lower interest rate environment in 2024. In fixed income, we continued to invest in the higher yielding short-end of the curve, keeping the same balance between equities and fixed income holdings as in the third quarter. As the market rallied through the end of the year, we were net sellers of equities as we completely exited two positions.

Our equity sales focused on two names: Roper Technologies (ROP), where we have enjoyed gains over the past years but no longer felt the catalysts of growth could continue long-term, and Illumina (ILMN), where company transition led to significant underperformance.

Illumina stock has been under pressure for the past three years, with the unauthorized acquisition of Grail in 2021 continuing to garner more negative attention in the news. After an extended regulatory battle, divestiture of Grail is now underway with the new CEO stepping in. The company forecasts 2024 results to be in line with 2023, with a higher potential for negative revenue growth in 2024. We exited this position during the quarter both due to lack of conviction in near-term catalysts as well as part of our portfolio management tax loss overlay. While we view gene sequencing as a major theme for personalized medicine and health, the company's near- to medium-term outlook is negative in our view.

Roper Technologies is a name that has been in the portfolio for some time and has done well over the past few years. The company has a portfolio of 28 stand-alone businesses serving niche end markets in noncyclical industries with software-based assets comprising the majority of the portfolio. Despite the company's high margin and high cash flow assets, the decision to exit the position was based on two thoughts: 1) The company's business model of acquiring stand-alone businesses without integration is not a sustainable business model as the company's growth in the long-term is largely dependent on acquisitions. Roper Technologies essentially operates like a private equity firm without any exit plans for the assets it acquires, and we did not believe in the long-term prospects of the company's potential growth based on acquisitions. 2) Valuations risk was another key factor in exiting this name. The company does not provide financial data for all 28 assets in its portfolio, making it impossible for investors to understand which of their assets are over- or under-performing to determine the overall value of the company. They are involved in many different niche end markets; it is difficult to find proper comparisons with other software players to decide a fair value for the company.

We added Rockwell Automation (ROK) to our portfolio in part to replace Roper Technologies. Rockwell is a leader in industrial automation and digital transformation offering hardware and software systems for automating industrial machinery and processes and integrating IT and data management to optimize production control systems. Though not apples to apples, we viewed that Rockwell's business model was better suited for the long-term than Roper Technologies as Rockwell's integration of data-driven software solutions and potential use of artificial intelligence could have a positive impact for the entire enterprise. Roper Technologies cannot capture the scale of advancing technologies to its portfolio of assets due to their stand-alone nature. The decision to add the position to our portfolio in the fourth quarter was based on beliefs that valuation had become attractive and we believe in their growth story of being the outsized beneficiary of secular drivers including: semiconductors, electric vehicles, and energy transition.

In addition to initiating the position in Rockwell Automation, we took advantage of weaknesses in NextEra Energy (NEE) and GSK, PLC (GSK) to add to each of those portfolio positions.

TOP 10
U.S. HOLDINGS

- **Microsoft**
- **Apple**
- **Alphabet**
- **Amazon**
- **Trane Technologies**
- **J.P. Morgan**
- **American Tower**
- **Qualcomm**
- **Zoetis**
- **Visa**

Index Performance	Q4	FY23
Dow Jones Industrial	13.09%	16.18%
Standard & Poor's 500	11.69%	26.29%
Nasdaq Composite	13.79%	44.64%
MSCI EAFE (Europe, Australasia, Far East)	10.42%	18.24%
Russell 2000 (Small Company)	14.03%	16.93%
MSCI ACWI (All Country World Index)	11.03%	22.20%
Barclays Intermediate Term Bond	6.82%	5.53%
Barclays Municipal Bond	7.89%	6.40%
Barclays Short Term Bond	3.44%	4.89%

Secure 2.0 in 2024

The Secure 2.0 Act, signed in December of 2022, reshaped the landscape for retirement planning with nearly 100 provisions intended to help more Americans save for retirement. Below is a refresh on some key changes that will take effect in 2024.

Student Loan Payment Employer Match

Beginning in 2024, employers can treat an employee's qualifying student loan repayments as elective deferrals or after-tax contributions for purposes of the company retirement plan's matching contribution. The total amount of the individual's matching contribution, including both elective deferrals and loan repayments, cannot exceed the lesser of the employee's compensation or the annual deferral limit ($23,000 in 2024). This applies to 401(k), 403(b), SIMPLE IRAs, and governmental 457(b) plans.

529 Plan Rollovers

The Secure 2.0 Act allows an account owner to roll unused 529 plan assets (up to a lifetime amount of $35,000) into a Roth IRA in the name of the account beneficiary, without incurring the usual 10% penalty for nonqualified withdrawals. The 529 plan must have been open for 15 years before it can be rolled over. Contributions made in the last five years prior to distributions are ineligible for a tax-free rollover; this includes associated earnings. The beneficiary of the 529 plan must become the account holder of the Roth IRA and the annual rollover limit is the lesser of their earned income during the year or the Roth contribution limit ($7,000 in 2024).

Emergency Expense Distributions

Effective in 2024, the Secure 2.0 Act permits an early "emergency" distribution from your retirement account for unforeseeable or immediate financial needs. The emergency distribution of up to $1,000 can only be taken once during the year, and while taxable as income, it is not subject to the 10% early withdrawal penalty.

Roth Required Minimum Distributions

Designated Roth assets in 401(k), 403(b), and governmental 457(b) plans are no longer subject to pre-death required minimum distributions.

On Pause

Under the initial Secure 2.0 provisions, catch-up contributions for those ages 50 and older who earn more than $145,000 per year, would need to be made on a Roth basis, using after-tax money. However, in late August 2023, the IRS announced relief to those subject to the rule, stating that Roth catch-up contributions for high income earners over the age of 50 will not be required until 2026

Featured Stock: Nike (NKE)

Nike is the largest athletic footwear and apparel company in the world by stock market valuation and is also a leader in the health and fitness category on a broader level. The company's business can be broken down several different ways – into men's, women's and children's shoes, apparel, and equipment; geographically across nearly every country on earth; and by overall brand category including Nike, Jordan, and Converse. No matter how you break it down, Nike is overwhelmingly a retailer of footwear (~70%).

RWA initiated a position in Nike in 2023 based on a number of reasons that station it for long-term success, with perhaps the most obvious being a return to margin growth. Nike's margins rose throughout the early days of the pandemic only to be challenged by supply chain headwinds and higher freight/logistics costs that eventually gave way to bloated inventories as pandemic sales slowed down. That pressure appears to have peaked earlier this year, and we believe that the company's management team has made some important structural changes that will pair well with the undoing of some of those higher costs as we move into next year.

In addition to margins, we think that one of the biggest opportunities for the athletic clothing industry, for Nike in particular, is the women's fashion segment. The men's offering at Nike is by far the largest component at more than 50% of total sales, while women's footwear and apparel represents only around 20% of the total. Nike's management has emphasized this differential as a major priority for the company which we find evident in the way it has redesigned its sales strategy in China as well as its burgeoning partnerships with female athletes. Nike has worked with and created clothing/footwear lines for male athletes for decades, but the launch of its partnership with WNBA phenom, Sabrina Ionescu, in September of this year marked a new chapter. The Sabrina 1 shoe has seen substantial crossover to the male athlete side with a number of notable NBA players wearing the shoe as well, which presents further opportunity down the line.

Finally, a more aspirational but reasonable catalyst supporting our investment in Nike has been the proliferation of anti-obesity medications in the U.S. While the pharmaceutical companies retailing the drugs have seen their stocks appreciate as consumption has risen, we believe one of the longer-term side effects of the drug trend could be increased focus on a healthy lifestyle. Health and fitness are two themes that we feel Nike is better suited to dominate than almost any other brand, which is further enhanced by the company's partnerships with the world's leading athletes.

Source: YCharts

Financial Scam Awareness

Topic Spotlight

The advances in technology and birth of generative artificial intelligence have elevated financial scams to a frightening level. One of the more common schemes today is called Vishing, a portmanteau of "voice" and "phishing." It is a fraudulent technique where attackers use phone calls to trick victims into divulging sensitive information or performing actions that benefit the attacker. It's essentially phishing, but through phone calls instead of emails or text messages. Below is a real-life example of a vishing scam.

The victim answers a phone call from what appears to be their grandchild. The caller ID shows the grandchild's contact name and phone number. The grandchild claims to be in jail after causing an automobile accident. This is followed by another phone call from a different number, where the scammer is posing as the grandchild's attorney, and requests payment for legal fees, bond money, and medical expenses for a purportedly injured person involved in the accident. The scammer instructs the victim to maintain secrecy, referring to a judge-imposed gag order, which, if broken, will result in the grandchild going to jail or incurring more fines. The scammer directs the victim to send funds via a few options- a wire transfer, cash packaged in magazines/books and sent through the U.S. mail; or to provide the money to witting or unwitting couriers, such as Uber or Lyft drivers, who retrieve the money in person at the victim's residence.

The details of a scam can vary significantly, but scams almost always have these same components.

- The attacker contacts you oftentimes from a seemingly legitimate source like a relative, your bank, a government agency, or a tech support company. They have the ability to spoof the phone number to make it appear real.
- The attacker crafts a story that creates a sense of urgency or panic, like your account being compromised, your computer being infected with malware, or a legal issue requiring immediate attention.
- The attacker will then pressure you to take immediate action to resolve the issue, such as providing personal information like your Social Security number or credit card details, downloading software, or sending money via an obscure payment method (PayPal, wire transfer, prepaid phone cards…).

Tips To Protect Yourself:

- Avoid answering telephone calls from numbers you do not recognize.
- If you receive an unsolicited or suspicious call from someone claiming to be a family member and urgently requesting money, hang up immediately. Verify the story with your family member by calling them directly. If you cannot reach them, call someone else in your family, even if scammers told you to keep it secret.
- Limit the personally identifiable information you post on social media and dating websites. Scammers do their research and may use this information to create a more convincing story.
- If an unknown individual contacts you online or by phone, do not release financial or personally identifiable information and *DO NOT* send money.

Scammers like to target the elderly, but anyone can be a victim. Please be aware and share this message with your loved ones.