GATEWAY
INVESTMENT MANAGEMENT
OF
RAYMOND JAMES®

THE COMMUNIQUE

July 2024

MAJOR INDICIES	LAST	MTD	QTD	YTD
S&P 500	5633.91	**3.18%**	**3.18%**	**18.12%**
Dow Jones Industrials	39721.36	**1.54%**	**1.54%**	**5.39%**
NASDAQ Composite	18647.45	**5.16%**	**5.16%**	**24.22%**
New York Stock Exchange	18215.18	**1.05%**	**1.05%**	**8.08%**

U.S. TREASURIES	YIELD
2-yr Treasury Note	4.63%
10-yr Treasury Bond	4.29%
30-yr Treasury Bond	4.49%

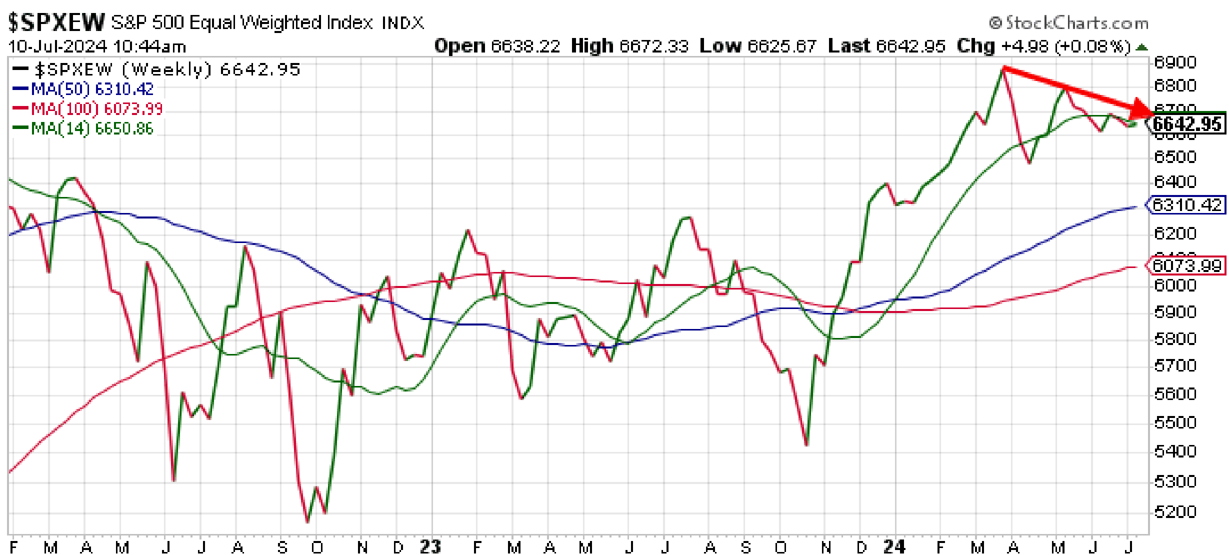
Information as of July 10, 2024 Source: FactSet

MARKET COMMENT

Mid-Year Update

We hope everyone had a wonderful 4th of July celebrating the birth of our great nation – it truly is an incredible story. I spent some time on the 4th re-reading the Declaration of Independence, a remarkable historical document that helps me put our unsettling current political situation in perspective. If you haven't read it in a while, I would encourage you to do so. Now, let's have a brief review of the past 6 months in the markets.

From our perspective, the first half of the year can be summarized in three themes: the economy, interest rates, and NVIDIA (the semi-conductor company). We'll discuss these three items below, but first, let's take a moment to compare the following charts of (1) the S&P500 market-capitalization-weighted index and (2) the S&P500 equal-weighted index.



First half of 2024 printed a return of 14.5% for the S&P500 market weighted, while the equal-weighted produced a return of 5.1%. Why such a discrepancy if all the companies are the same? The equal-weigh index treats each of the 505 stocks with the same percentage, while the market-weighted index continues to increase the percentage of stocks that are the biggest. According to Raymond James investment management's 2nd quarter report (dated July 3rd, 2024), NVIDIA's stock performance accounted for 40% of the S&P 500's 14.5% return and 30% of the six month return. Likewise, the Magnifcient-7 stocks (NVIDIA, Amazon, Microsoft, Alphabet, Apple, Meta, and Tesla) accounted for 66.6% of the year-to-date gains in the S&P 500. That's 7 stocks – out of 505 total companies in the index – representing 2/3rds of the total gain. There is a common theme driving the Mag-7 stocks: Artificial Intelligence. AI has grabbed investors' attention much the same way the Dot.Com stocks did in the late 1990's, ending in the painful market decline in 2000. In fact, the technology sector of the S&P 500 market-weighted index is now at 32.5% weighting, the highest since the Dot.Com bubble.

The other two main themes, the economy and interest rates, have greatly surprised investors who were originally forecasting six interest rate cuts by the Federal Reserve this year due to a slowing economy, which didn't materialize. The economy continued to grow with inflation slowly declining, unemployment slowly increasing, and corporate earning continuing to grow with a resilient U.S. consumer. It seems the Federal Reserve might just orchestrate a "soft landing" for the economy,

without the pain of a recession. What is most interesting (and encouraging) is how well the stock market held up (no major corrections) considering the disappointment of no interest rate cuts thus far – especially when six were originally expected. However, if we look "under the hood" of the stock market, we see many stocks selling near their lows for the year and it seems that we may have had a "stealth" correction in many stocks while the Mag-7 seemed to have propped up the S&P 500. The next 6 months should be interesting with the Presidential election, possible Federal Reserve interest rate cuts finally coming, and unemployment slowly ticking up. Stay tuned!

As always, we appreciate your continued trust and confidence, it is greatly valued.

PLANNING STRATEGY

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Will the Sun Set on Generous Estate & Gift Tax Exemptions in 2026?

High-net-worth individuals and families who benefit from the historically high federal estate and gift tax exemption may soon see it reduced by half. Favorable increases in the estate and gift tax exemption created by the Tax Cuts and Jobs Act of 2017 (TCJA) are scheduled to sunset at the end of 2025 along with other changes the law made, including an increase in the standard deduction and the charitable giving deduction, as well as reductions in individual income tax rates.

With so many tax provisions scheduled to revert back to pre-TCJA levels in under two years, consider moves you might need to make to minimize your tax burden and support your financial goals.

How the lifetime estate and gift tax exemption changed under the TCJA

The TCJA went into effect on January 1, 2018, and doubled the estate and gift tax exemption from $5 million to $10 million for individuals and $10 million to $20 million for joint filers. This exemption is indexed for inflation, so by 2023 it had risen to $12.92 million per person and $25.84 million per married couple.

The lifetime exemption amounts for estate and gift taxes are the same, which is why they're discussed together. In addition to the estate and gift tax exemption amounts, you may make annual gifts up to $18,000 (per receiver) in 2024 without utilizing any of your gift tax exemption.

The estate tax exemption in 2024 is $13.61 million for individuals and $27.22 million for couples. But because the TCJA sunsets on December 31, 2025, the estate tax exemption in 2026 will fall back to $5 million for individuals and $10 million for couples, indexed for inflation, unless Congress acts to extend the provisions.

> If Congress doesn't take any action, the exemption for federal estate tax will be reduced by half after 2025.

How the exemption changes work

For example: A married couple with $25.84 million in assets in 2023 gifted their child $17,000 that year. Because the gift amount didn't exceed the gift tax exemption for 2023, they didn't have to pay gift taxes

on that gift. But they also made a second gift that year to their child of $25,823,000 – the remaining amount of their lifetime estate and gift tax exemption (as of 2023).

Did the couple have to pay taxes on that generous second gift? No. Even though the second gift is taxable, the IRS applies a credit against the gift tax based on the total estate and gift tax exemption. In other words, the IRS in effect says to such a couple, "You don't need to pay now for that taxable gift; we'll settle up with you on all your lifetime gifts and estate taxes when you die."

Now imagine that this couple passes away in 2024. The TCJA is still in effect, and the couple's estate ends up paying nothing in gift or estate taxes for either the first or second gift because those two gifts equal $25.84 million, which is less than the 2024 lifetime gift and estate tax exemption of $27.22 million. If at the time of their death the couple's remaining assets are worth $1.5 million, their estate also wouldn't need to pay taxes on $1.38 million of those assets because they are covered under the remainder of the $27.22 million exemption.

But suppose this couple instead dies in February of 2026, after the TCJA has ended, and Congress hasn't acted to extend the provisions. Let's assume that the indexed gift and estate tax exemption for 2026 is $10.4 million.

Does the expiration of the TCJA mean the couple now has to pay taxes on the amount of their second gift that is above $10.4 million? No. The IRS issued a rule in 2019, clarifying that it won't "claw back" gifts made during the period when the TCJA was in effect. So the estate in 2026 can calculate its gift and estate tax exemption using the exemption under the TCJA.

The nuances of which particular year of the exemption would apply (whether 2023 or 2025) would be best to discuss with your financial advisor. But the larger point is this: If you act before 2026, you can take advantage of the TCJA to lock in its higher lifetime gift and estate tax exemption even if you expect to live long past December 31, 2025.

Gifts and other strategies

Outright gifts directly to your loved ones are not your only option for taking advantage of the high lifetime gift and estate tax exemption under the TCJA. Based on your circumstances and goals, you might consider several other strategies.

Gifts to an irrevocable trust
You could create an irrevocable trust with designated beneficiaries and distributions based on the terms you choose. Any gifts to this trust can take advantage of the TCJA lifetime gift and estate tax exemption.

Gift to a spousal lifetime access trust (SLAT)
If you're concerned that giving large gifts directly to others or to a trust might leave you too short on funds to support yourself while you're alive, you might want to consider a spousal lifetime access trust (SLAT). A SLAT is created by one spouse for the benefit of the other spouse. Any gifts the SLAT creator puts into the trust will be distributed to the beneficiary spouse, who can then use those distributions for joint expenses. You can also configure a SLAT so that its assets pass to your descendants upon the death of both you and the beneficiary spouse.

Gifts the donor sponsor gives to the SLAT are exempt from tax up to the donor spouse's available exemption amount. In 2024, a donor could gift $13.61 million without paying a gift tax.

While the donor won't be taxed on contributions below the exemption amount, the beneficiary may well owe tax on distributions from the SLAT, as these are treated as taxable income. And assets distributed to the beneficiary spouse can increase their estate. That increase could be subject to the estate tax or its exemption.

Establishing other types of trusts
There are many other types of trusts that might serve your particular needs. These include dynasty trusts, irrevocable life insurance trusts, and a qualified personal residence trust. Your financial advisor can most effectively evaluate what option or combination of options will achieve your goals.

If your gifts to your SLAT will use up your gift and estate exemption, but you also have a significant life insurance policy, an irrevocable life insurance trust may be a way to prevent the life insurance policy from counting as part of your estate. That way, your beneficiaries benefit from the life insurance payout without being subject to high estate taxes.

A good time to review your estate plan

Although there's a chance that new tax legislation may take effect between now and 2026 that extends or builds upon the TCJA provisions, it's still advisable for families to review their estate plan with their financial advisor as soon as possible. Waiting until the latter months of 2025 might limit the strategies available to you to take advantage of the TCJA estate tax exemption provision. Even if you're confident that the TCJA sunset won't affect your estate plan, it's still important to check it regularly.

Raymond James does not provide tax or legal advice. Please discuss these matters with the appropriate professional.

LIFE & LEISURE

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Social Security's Uncertain Future?

While you may not hear a clear answer, you can rest assured that Social Security is not going bankrupt.

Social Security benefits are primarily funded by the payroll taxes collected from today's workers. Money goes into a pot called (believe it or not) the Old-Age and Survivors Insurance Trust Fund, and benefits are dispersed from there. It's a pay-as-you-go system, so as long as workers are paying payroll taxes, Social Security benefits will be paid.

The problem isn't bankruptcy – it's that the program faces a long-term funding shortfall that, left unaddressed, will mean a reduction in benefits for future retirees.

For every person drawing Social Security benefits, there are just 2.7 workers paying into the system.
For decades, the Social Security system collected more in payroll taxes and other income than it paid out in benefits, building up a large reserve. In 2021, when the program's costs began exceeding its income, Social Security started drawing from this reserve fund to make up the difference. When those reserves are depleted – an event expected in about 10 years – benefits will be reduced by an estimated 23%. If Congress takes no action to head this off, people who are 57 years old today will receive 77% of today's benefits when they reach regular retirement age.

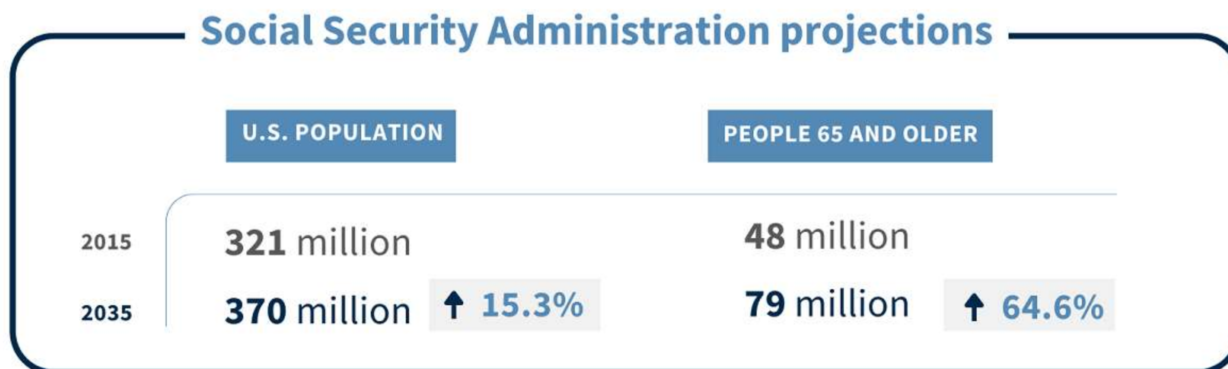
For the average dual-income couple retiring in 2033, that's $17,400 less.

The problem is mostly a demographic one. In 1940, a 65-year-old had a life expectancy of less than 14 years. For today's 65-year-olds, that expectancy has increased to 20, and a staggering 10,000 baby boomers are retiring every day.

At the same time, younger generations are getting smaller, which means fewer workers paying into Social Security. In 2022, there were just 2.7 workers paying into the program for each person drawing Social Security benefits. By 2035, that number is projected to go down to 2.3.

Additionally, a smaller percentage of Americans' income is subject to the payroll taxes that fund Social Security because the earnings of the highest-paid workers have grown faster than those of the average worker. In 1937, 92% of earnings were below the taxable amount. By 2020, it was just 83%.

Since 67 million Americans receive Social Security payments each month – it's the main source of income for people 65 and older – it's not hard to see why politicians are on the hot seat about fixing it.



To patch the shortfall, Congress has a few options – none of them particularly appealing.

Option 1: Increase tax revenue

The most obvious way to increase funding to Social Security is to raise payroll taxes. Currently, employers and employees each pay 6.2% for Social Security. Increasing that rate to 7.75% could assure solvency for 75 years. However, this solution may be unaffordable for lower-income workers.

Another option is to add new tax sources. One possibility, floated by the American Academy of Actuaries, is to tax investment income or increase estate and gift taxes – an idea that's likely to face resistance.

Option 2: Reduce benefits or increase taxes for high earners

The Social Security tax rate applies only to annual wages currently set at $168,600. If Congress removed that cap and taxed all earned income, the additional revenue would wipe out 78% of the shortfall. Traditionally, earners above $160,200 are subject to a wage cap to prevent higher taxation that may not justify the benefits. Social Security's political support comes from the idea that you can receive back a benefit you have paid into. Not capping the amount subject to taxation would fundamentally alter the program and political support.

Another idea is to reduce benefits for high earners who aren't yet eligible for Social Security – not those who are already collecting – based on the idea that those people will be less reliant on those benefits. However, this measure alone would not curb Social Security expenditures enough to address the problem.

Option 3: Raise the retirement age

Arguably the most popular solution is to raise the retirement age. Today, Americans can start collecting Social Security benefits at 62, but the benefits increase the longer you wait, reaching a maximum monthly payout at 70.

The full retirement age (FRA) was 65 for much of the program's existence. Today, FRA is 66 years plus two months for people born in 1955 and increases gradually to 67 for anyone born in 1960 or later.

Some lawmakers advocate for increasing FRA to 70 to bring it in line with today's longer life expectancy. This change alone could eliminate nearly a third of the Social Security trust fund's 75-year deficit. However, having to work to an older age could be especially challenging for low-income Americans and people working in jobs that are physically demanding.

The last time Congress overhauled Social Security was in 1983, when the program was just months away from not being able to pay full benefits. The Democratic House, Republican Senate and Republican President Ronald Reagan agreed to gradually raise the full retirement age from 65 to 67, which was reached in 2022. This effectively cut benefits by 13% while increasing payroll taxes.

No easy answers

Odds are a solution would comprise some combination of these actions – higher taxes for some, lower benefits for some and more years on the job for some. And any proposal is likely to face stiff political opposition.

The sooner policymakers act, the more options they will have, and the more time pre-retirement Americans will have to prepare for changes. Acting early allows for any tax increases or benefit reductions to be phased in gradually (rather than, say, implementing a 25% payroll tax increase come 2034). Early action would also enable lawmakers to make adjustments for people who will start receiving Social Security benefits within the next 10 years, before the reserves run dry.

One thing's for sure: The longer they wait, the more abrupt and painful the changes will be.

Sources: ssa.gov, newsweek.com, npr.org, Investopedia.com, cnbc.com, money.com, cnn.com, cbpp.org, asppa.org

Quote of the Month: "Stories change people while statistics give them something to argue about." – Bernie Siegel

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