FINANCE FOCUS

Q4 2023

All Eyes on the Earnings Picture

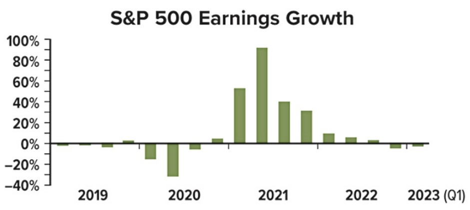
Publicly traded companies are required to disclose their financial performance to regulators and shareholders on a quarterly basis. News organizations and investors pay close attention to these reports because they tend to impact stock prices, with strong earnings driving share prices up, and vice versa.

In the first quarter of 2023, the earnings of companies in the S&P 500 Index declined 2.2%. This was a much stronger showing than Wall Street analysts expected after profits fell 4.6% in the previous quarter. On a positive note, revenues grew 2.9% in Q1 as consumer spending faced down inflation.[1–2]

Earnings season can be a volatile six-week period for stocks. As investors digest and respond to new data, the marketplace rewards some companies and punishes others.

Hindsight Offers Perspective

Stock prices tend to be forward looking, which is one reason they don't always move in the same direction as earnings. For example, the S&P 500 Price Index returned nearly 29% in 2019 and more than 16% in 2020, even though earnings growth was negative in six of those eight quarters.



Measuring Performance

A quarterly report typically includes unaudited financial statements, a discussion of the business conditions that affected financial results, and some guidance about how the company expects to perform in the following quarters. Financial statements reveal the quarter's profit, or net income, which must be calculated according to generally accepted accounting principles (GAAP). This typically involves subtracting operating expenses (including depreciation, taxes, and other expenses) from gross income.

Pro-forma (or adjusted) earnings may present an alternative view of financial performance by excluding nonrecurring expenses such as restructuring costs, interest payments, taxes, and other unique events. Although the Securities and Exchange Commission has rules governing pro-forma financial statements, companies still have a great deal of leeway to highlight the positive and minimize the negative in these reports. There may be a vast difference between pro-forma and GAAP earnings.

Earnings per share (EPS) represents the portion of total profit that applies to each outstanding share of company stock. EPS is often the figure that makes headlines, and the financial media tends to focus on whether companies meet, beat, or fall short of the consensus estimate of Wall Street analysts. A company can see its stock price surge by losing less money than expected or can log billions in profits and still disappoint investors who were counting on more.

Shaping Perception

Due to the potential effect on stock prices, companies often take steps to avoid big surprises, mostly by managing the market's expectations. This may involve issuing profit warnings or positive revisions to previous forecasts, which may cause analysts to adjust their estimates accordingly. Companies may also be able to time certain business moves to help meet quarterly earnings targets.

In addition to filing regulatory paperwork, many companies announce their results through press releases, conference calls, and/or webinars so they can try to influence how the information is judged by analysts, the media, and investors.

Diving Deeper

Investors who look beyond the headline performance metrics may find other meaningful details in a company's quarterly report. Expansion plans, research and development, new products, consumer trends, government policies, and shifts in domestic or global economic conditions can all affect a company's financial results, either immediately or in the future.

Bear in mind that reported earnings generally reflect the company's recent performance, which in some cases may have little to do with its longer-term prospects. Moreover, some companies and/or industry sectors are likely in a better position to withstand economic challenges than others.

The return and principal value of stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. The S&P 500 Index is an unmanaged group of securities considered to be representative of the U.S. stock market in general. The performance of an unmanaged index is not indicative of the performance of any specific investment. Individuals cannot invest directly in an index. Past performance is no guarantee of future results. Actual results will vary.

1) FactSet, 2023
2) The Wall Street Journal, April 30, 2023

IN THIS ISSUE

Coming in 2024: New 529 Plan-to-Roth IRA Rollover Option

In December 2022, Congress passed the SECURE 2.0 Act. It introduced two new rules relating to 529 plans and student debt that will take effect in 2024.

The first provision allows for tax- and penalty-free rollovers from a 529 plan to a Roth IRA. The second provision allows student loan payments made by employees to qualify for employer retirement matching contributions.

529 Plan to Roth IRA Rollover

529 plans are tax-advantaged savings accounts specifically geared to saving for college. In an effort to broaden their flexibility in situations where families have extra funds in an account, Congress created a new rollover option. Starting in 2024, 529 plan beneficiaries can roll over up to $35,000 to a Roth IRA over their lifetime. Here are the specific rules:

- Any rollover is subject to annual Roth IRA contribution limits, so a beneficiary can't roll over $35,000 all at once. For example, in 2023, the Roth IRA contribution limit is $6,500 (for people under age 50) or earned income, whichever is less. If the limit remains the same in 2024, a beneficiary would be able to roll over up to $6,500.
- In order for the rollover to be tax- and penalty-free, the 529 plan must have been open for at least 15 years. If the 529 account owner (typically a parent) changes the beneficiary of the 529 plan at any point, this could potentially restart the 15-year clock.
- Contributions to a 529 plan made within five years of the rollover date can't be rolled over — only 529 contributions made outside of the five-year window can be rolled over to the Roth IRA. For more information on determining the date of contributions, contact the 529 plan manager.

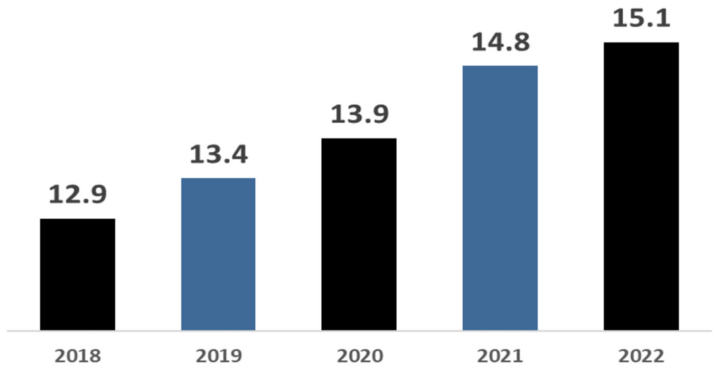
Example: Kate opens a 529 account for her son Joe when he is three years old. Kate contributes to the account for 15 years. At age 18, Joe enters college. Kate continues to contribute to the account while Joe is in college. Joe graduates, and there is money left over in the 529 account. Because the account has been open for at least 15 years, Joe is eligible to roll over funds from the 529 account to a Roth IRA in his name. He can roll over an amount up to the annual Roth IRA contribution limit, provided he doesn't transfer any contributions made to the 529 account in the past five years. Joe can continue rolling over funds from the 529 plan to the Roth IRA (consecutive years or intermittent years) until he has reached the $35,000 lifetime limit.

Student Loan Payments Can Qualify for Employer Retirement Match

Employees with student debt often have to prioritize repaying their loans over contributing to their workplace retirement plan, which can mean missing out on any potential employer retirement matching contributions. Starting in 2024, the SECURE 2.0 Act gives employers the option to treat an employee's student loan payments as payments made to a qualified retirement plan (student loan payments will be considered an "elective deferral"), which would make those contributions eligible for an employer retirement match (if an employer offers this benefit).

There are generally fees and expenses associated with participation in a 529 plan. There is also the risk that the investments may lose money or not perform well enough to cover college costs as anticipated. The tax implications of a 529 plan should be discussed with your legal and/or tax professionals because they can vary significantly from state to state. Most states offering their own 529 plans may provide advantages and benefits exclusively for their residents and taxpayers, which may include financial aid, scholarship funds, and protection from creditors. Before investing in a 529 plan, consider the investment objectives, risks, charges, and expenses, which are available in the issuer's official statement and should be read carefully. The official disclosure statements and applicable prospectuses, which contain this and other information about the investment options, underlying investments, and investment company, can be obtained by contacting your financial professional.

Number of 529 college savings plan accounts, 2018–2022, in millions



Source: ISS Market Intelligence, 529 Market Highlights, 4Q 2019–2023

REITs, Rates, and Income

Real estate investment trusts (REITs) can offer a consistent income stream that is typically higher than Treasury yields and other stock dividends (see chart).

A qualified REIT must pay at least 90% of its taxable income each year as shareholder dividends, and unlike many companies, REITs generally do not retain earnings, which is why they provide higher dividend yields than most other stock investments. You can buy shares in individual REITs, just as you might buy shares in any publicly traded company, or you can invest through mutual funds and exchange-traded funds (ETFs).

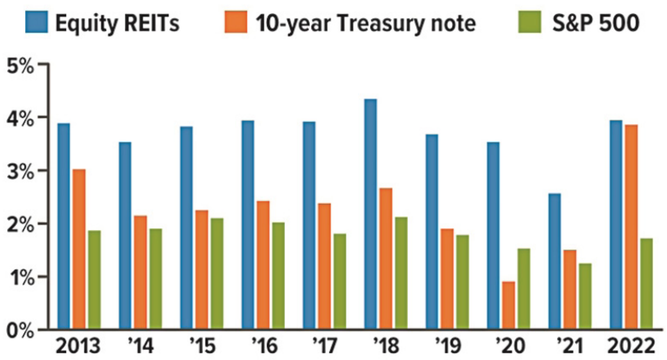
Share Price Volatility

While REITs may offer solid dividends, share prices tend to be volatile and are especially sensitive to rising interest rates. The most common type of REIT is an equity REIT, which uses capital from a large number of investors to buy and manage residential, commercial, and industrial income properties. These REITs derive most of their income from rents and may be directly affected by rising rates, because companies often depend on debt to acquire rent-producing properties — and higher rates can push real estate values downward. Also, as interest rates rise, REIT dividends may appear less appealing to investors relative to the stability of bonds offering similar yields.

Considering these factors, it's not surprising that equity REIT shares struggled in 2022 — declining 25% in total returns — as the Federal Reserve raised rates to combat inflation. However, REITs soared in 2021, returning 41%, and may be poised for better performance in 2023 and beyond, as interest rates settle. In Q1 2023, REIT fundamentals such as funds from operation and net operating income were solid, and occupancy rates for industrial and retail properties surpassed pre-pandemic levels. (Apartment occupancy was down slightly, and office occupancy was still about 5% lower than before the pandemic.)[1]

Consistent Yields

Over the last decade, equity REITs maintained dividend yields that were higher than yields on the 10-year Treasury note and dividend yields on stocks in the S&P 500.



Sources: National Association of Real Estate Investment Trusts, 2023 (Equity REITs); Federal Reserve, 2023 (10-year Treasury note); S&P Dow Jones Indices (S&P 500). The S&P 500 Index is an unmanaged group of securities considered representative of the U.S. stock market in general. The performance of an unmanaged index is not indicative of the performance of any specific security. Individuals cannot invest directly in an index. Past performance is not a guarantee of future results. Actual results will vary. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest. The principal value of Treasury securities fluctuates with market conditions. If not held to maturity, they could be worth more or less than the original amount paid.

Diversification and Asset Allocation

Along with providing income, REITs can be a helpful tool to increase diversification and broaden asset allocation, because REIT shares do not always follow the movements of stocks or bonds. Over the 10-year period ending in 2022, equity REITs had a correlation of 72% with the S&P 500 and 50% with the corporate and government bond market. The correlation was even lower over 30 years.[2] As this suggests, REITs are in some respects a unique asset class.

Diversification and asset allocation are methods used to help manage investment risk; they do not guarantee a profit or protect against investment loss.

Real Estate Risks

There are inherent risks associated with real estate investments and the real estate industry that could adversely affect the financial performance and value of a real estate investment. Some of these risks include a deterioration in national, regional, and local economies; tenant defaults; local real estate conditions, such as an oversupply of, or a reduction in demand for, rental space; property mismanagement; changes in operating costs and expenses, including increasing insurance costs, energy prices, real estate taxes, and the costs of compliance with laws, regulations, and government policies.

The return and principal value of all investments fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk.

Mutual funds and ETFs are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

1–2) National Association of Real Estate Investment Trusts, 2023

60%

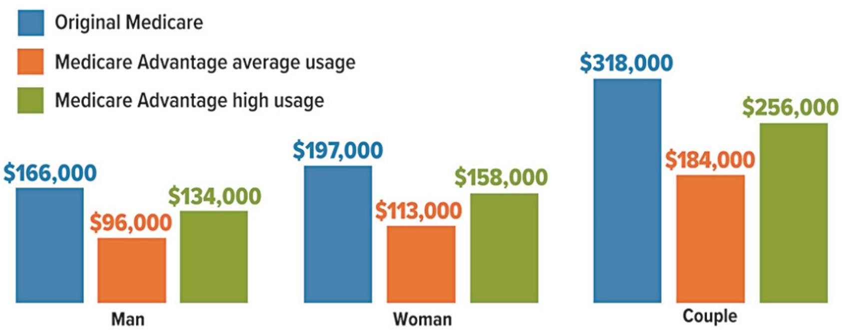
Share of health-care expenses for Medicare beneficiaries age 65 and older that was covered by Medicare in 2020 (most recent data available). Private insurance covered 17% and out-of-pocket spending accounted for 12%.

Source: Employee Benefit Research Institute, 2023

Saving for Retirement Health-Care Costs

The chart below shows the savings that a man, a woman, and a couple who retired at age 65 in 2022 might need to meet retirement health-care expenses, assuming median prescription drug expenses. The Original Medicare estimate includes premiums for Medicare Parts B and D, the Part B deductible, out-of-pocket prescription drug spending, and premiums for Medigap Plan G, which would pay most other out-of-pocket costs.

Medicare Advantage Plans — offered by private companies under Medicare oversight — require the Medicare Part B premium and typically combine hospital, medical, and prescription drug coverage. They often have limited networks and may require approval to cover certain medications and services.



Source: Employee Benefit Research Institute, 2023. Projections are based on a 90% chance of meeting expenses and assume savings earn a return of 7.32% from age 65 until expenditures are made. Does not include vision, hearing, dental, or long-term care expenses. Some Medicare Advantage Plans require additional premiums, which are not included.

Do your family and friends have financial questions? We would be pleased to assist.

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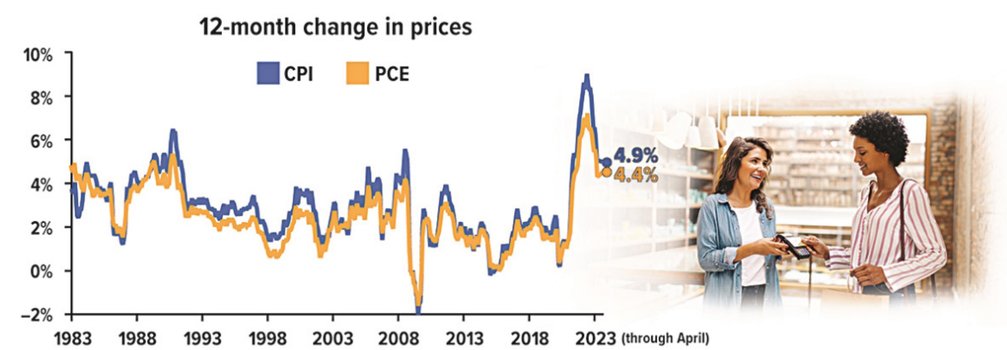
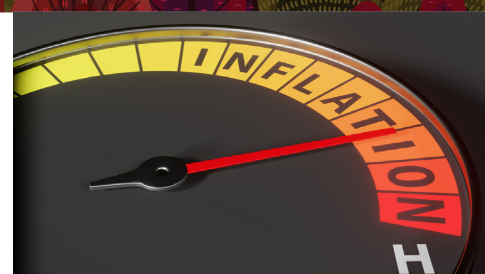
Inflation Gauges Don't Always Paint the Same Picture

Economists and investors rely on the Consumer Price Index (CPI) and the Personal Consumption Expenditures (PCE) Price Index to track the path of inflation over time. The two indexes use different formulas and data sources — CPI gets data from consumers and PCE data comes from businesses. PCE is broader in scope and some expenditure categories are weighted very differently. In late 2022, the difference between annual inflation as measured by CPI and PCE was the widest it has been since the 1980s.



Sources: U.S. Bureau of Labor Statistics, 2023; U.S. Bureau of Economic Analysis, 2023 (data through April 2023)



4.6%

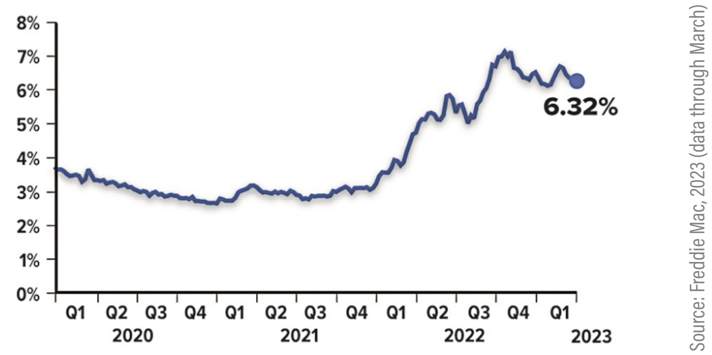
Annual rate of "supercore" inflation in April 2023. Supercore is a metric that excludes goods, food, energy, and shelter, which are all categories that have been especially volatile over the last year. By contrast, the Consumer Price Index for all items increased 4.9%.

Source: Bloomberg, May 26, 2023

Financing Options to Help You Ride the Mortgage Rate Roller Coaster

The mortgage industry has been on a roller coaster ride over the last couple of years. Interest rates for fixed-rate mortgage loans were at historical lows during the beginning of the pandemic in 2020, rising to a 20-year high in late 2022 — and fluctuating ever since.[1] Many buyers are finding it difficult to afford a new home with traditional fixed-rate mortgage loans in such a high interest rate environment. As a result, more buyers are relying on alternative financing options to help lower their interest rates.[2]

30-Year Fixed Mortgage Interest Rates, January 2020 to March 2023



Adjustable-Rate Mortgages

With an adjustable-rate mortgage (ARM), also referred to as a variable-rate mortgage, there is a fixed interest rate at the beginning of the loan which then adjusts annually for the remainder of the loan term. ARM rates are usually tied to the performance of an index. To determine the ARM rate, the lender will take the index rate and add it to an agreed-upon percentage rate, referred to as the margin. Most lenders offer ARMs with fixed-rate periods of five, seven or 10 years, along with caps that limit the amount by which rates and payments can change.

The initial interest rate on an ARM is generally lower than the rate on a traditional fixed-rate mortgage, which will result in a lower monthly mortgage payment. However, depending on interest rates, buyers with ARMs may find themselves with significantly higher mortgage payments once the fixed-rate period ends. Buyers should only consider ARMs if they can tolerate fluctuations in their mortgage payments or plan on refinancing or selling the home before the initial interest rate period ends.

Temporary Buydowns

A temporary buydown provides the buyer with a lower interest rate on a fixed-rate mortgage during the beginning of the loan period (e.g., the first one or two years) in exchange for an upfront fee or higher interest rate once the buydown feature expires. Buydowns typically offer large interest rate discounts (e.g., up to one to three percentage points, depending on the type of buydown). The costs associated with the buydown feature can be paid for by the home buyer, seller, builder, or mortgage lender.

While a buydown can make a home purchase more affordable at the beginning of the loan period, the long-term interest rates and mortgage payments on the loan can end up being substantially higher. This is why a borrower usually must initially qualify for the loan based on the full interest rate in effect after the buydown expires.

Assumable Mortgages

Assumable mortgages may be another way for buyers to circumvent high mortgage rates. An assumable mortgage is when a buyer takes over a seller's existing loan and loan terms and pays cash or takes out a second mortgage to cover the remainder of the purchase price.

This type of loan could be advantageous if the existing loan has a low enough interest rate, and the buyer has enough access to cash or financing to cover the difference between the sale price and outstanding balance of the assumed loan. Not all mortgage loans are assumable — generally they are limited to certain types of government-backed loans (e.g., FHA, VA loans).

Other Incentives

One type of incentive offered by lenders is for a buyer to pay an upfront fee at closing, also known as points. By paying points at closing, buyers can reduce their interest rates — usually by around .25 percent per point — and lower their monthly mortgage loan payments. To make paying points cost effective, buyers should plan on staying in the home for several years so that they can recoup the costs. Sometimes a home builder or seller will offer to pay for points on a mortgage in order to attract more potential buyers.

Another incentive, often referred to as a "future refi," is one that allows borrowers to purchase a home at current interest rates, with the ability to refinance their loans at a later date. The refinancing can be free or the costs can be rolled into the new loan, depending on the lender and loan type. Keep in mind that there is typically a set time period for refinancing with these types of loans.

1-2) Consumer Financial Protection Bureau, 2022

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What Real People Think About Artificial Intelligence

When U.S. adults were asked about the expanding presence of artificial intelligence (AI) technology in daily life, 38% said they were more concerned than excited, while just 15% were more excited. Many people were still on the fence, as 46% felt equally concerned and excited about the life-changing potential of AI.

Among those who were more concerned, percentage who said the following was the main reason

Source: Pew Research Center, 2022–2023

62%

Share of Americans who said AI will have a major impact on workers generally in the next 20 years. Only 28% believed it will have a major impact on them personally.

Source: Pew Research Center, 2023