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REGISTERED INVESTMENT ADVISER

FINANCIAL NEWSLETTER

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WINTER 2025

THE CRYSTAL BALL

When the Federal Reserve cut interest rates at their September meeting, immediately the narrative turned to how many more rate cuts will we get this year. Judging by the stock market and its recent eclipse of previous all-time highs, there is a major bet that rates are going to fall further. But should they? If rates come down too quickly, we run the risk of inflation rearing its ugly head again. On the other hand, with the economy slowing, not doing anything could lead the country into recession territory. The Chairman of the Federal Reserve is in quite a predicament now. Along with this dilemma, he will also most likely have a "shadow Fed Chairman" looking over his shoulder and possibly second guessing everything he does. Do you think Jay Powell might be relieved that his term ends in May 2026?! Anyway, whoever gets the nod to replace Mr. Powell will likely be tested in some way with a crisis, a problem, or some new challenge. This comes with the territory. Here's hoping that he or she will pass the test and the markets will respond with approval.

The Fed can only impact short-term rates and unfortunately, this means the yields we've been getting on our CDs, Treasury bills and money market accounts are going to go down. We don't think they will go to zero again but down 1% to 1 1/2% from current levels is in the cards.

The bond market controls long-term rates. The financial markets have proven that they can handle yields in the 5%-6% range, although many would prefer to see long rates come down. Regrettably, it is tough to see how long-term rates can get much lower with the mountain of debt the government has on the books. Investors hope that the economy will grow its way out of this problematic situation. Keep your fingers crossed because the other solutions to the high debt load are all bad: higher taxes, higher inflation or even default (yikes!), but let's take that off the table.

Right now, stock prices are high relative to historical norms. Of course, that doesn't mean they can't go higher and get even more out of whack when compared to the past. The rallying cry of stock market bulls is "Don't fight the Fed." As mentioned, the Fed is currently on an accommodating path. This might be part of the reason we are seeing such an issuance of Initial Public Offerings (IPOs). Over $14 billion has been raised in IPOs since July, according to Renaissance Capital. In addition, a huge supply of junk bonds has also hit the market to meet the insatiable demand from investors seeking high current yields. It's hard to see how this will end well.

It is very interesting to see precious metal prices surge with a bull market run that hasn't been seen since 1979. Many see precious metals as inflation hedges. We are more in the camp that sees these commodities as a hedge against the government's mishandling of their finances and Congress's inability to show any kind of leadership. Confidence is as low now as the winter temperature on Mars. Maybe that will change in the future; we'll see.

Bottom Line: There are still a lot of headwinds in the market; go ahead and add political dysfunction to that list. We'll soon witness how things play out. Maybe good or maybe not so good. For our clients and our readers, we'd continue to manage portfolios in a manner that seeks to meet objectives. When circumstances change, adjustments must be made. There is no magic wand that can be waved to solve every financial circumstance. But living within your means, investing wisely, owning value, avoiding FOMO and staying patient are some of the many keys to success. That is what we strive for when financial achievement is the goal.

OVERHEARD:

"I checked into the Hokey Pokey Clinic and turned myself around."

THE AI BOOM: GREAT NEWS, BUT WATCH THE PRICE TAG

Artificial Intelligence (AI) is undoubtedly the biggest news in markets for 2025. It's the engine that has pushed stock values—especially in big tech—to record highs. Everyone, from massive chipmakers to cloud companies, is benefiting, and the growth potential is huge.

The story is simple: AI requires enormous computer power, so companies are spending hundreds of billions of dollars to build giant data centers filled with specialized chips. The companies selling those chips and building those centers are making a fortune right now.

The Warning Light: Too Much, Too Fast?

The problem is the price tag. When you see stock prices jump this high, this fast, it creates a risk. Here's why investors are starting to get nervous:

Hope vs. Reality: Right now, stock prices are based on massive hope that AI will quickly generate huge profits for the companies *using* it. If those profits don't come as fast as investors expect—and some studies suggest the real-world impact is still slow—then the stock prices are too high.

The Big Spending Cycle: Companies are borrowing and spending an unprecedented amount of money on AI infrastructure. If they can't make that investment pay off quickly, their profits will suffer, and the entire market could drop. This is the classic setup for a **"bubble"**—where excitement outruns business reality.

No Safety Net: Because the prices are so high (the "valuations" are high), there's little room for error. Any bad news—a slow-down in spending, a failed product, or an economic surprise—could cause a sharp, painful drop.

Keep Your Head Up:

AI will change the world, and many of these companies will be big winners long-term. But the current market is running on high adrenaline. Be happy about the growth, but be cautious about how much you pay for it. The immediate, easy gains from the AI boom are likely over. From here on, the focus shifts to which companies can actually turn their massive spending into real, sustainable profits.

MANDATORY ROTH CATCH-UP DEFERRALS IN 2026

If you are age 50+ and make salary deferrals to your 401(k) (or similar) plan, and if your W-2 wages exceed $145,000 in 2025, then you will be required to make the catch-up portion of your contribution as a Roth deferral in 2026. This change stems from a provision in the Secure Act 2.0 from 2022 but will become effective next year. In 2026, the contribution limits from the IRS are expected to be a base deferral of $24,500 with an $8,000 catch-up (for those aged 50+). The Roth deferral mandated under the new regulations will only apply to the $8,000 catch-up in 2026, and that's where things can get tricky.

For those aged 50+, catch-up contributions can only be made after the base deferral has been completed. However, for those who crossed the $145K W-2 limit in 2025, you must be sure that payroll will begin submitting your catch-up portion on an after-tax/Roth basis after you have maximized the base. In a perfect world, you would hit $24,500 at the end of one payroll and start funding the $8,000 as Roth on the next. However, chances are the base limit will be hit in the middle of a contribution, and the payroll system will have to "know" to put the brakes on pre-tax and switch to after-tax so that things go in correctly. There's certainly a wide margin for error on this, so watch things closely.

One solution is to consider making all your 2026 deferrals on an after-tax, Roth basis. Doing so will ensure all your contributions are made correctly. Many savers are finding that by the time they've reached their 50s, they have built up a good share of pre-tax funds within their plans that will be taxable as income in retirement. By changing to Roth, current year tax savings are lost, but the funds will remain tax-deferred while in the plan and can be later withdrawn tax-free. Not owing tax on plan distributions in retirement is a key advantage of the Roth. Finally, please note that if your employer contributes money to the plan, those contributions will continue to be submitted on a pre-tax basis. Statements from the custodian maintaining your plan should delineate pre-tax vs. Roth deferrals, so watch those along with your pay stubs in 2026!

QUOTE

"I've had many crises in my life, and most of them never happened…"

Great-Great-Grandad of Monnie Wills

IS REVERSE MORTGAGE RIGHT FOR YOU?

A reverse mortgage can be a helpful financial tool for older homeowners looking to supplement their income during retirement. But it's not for everyone. Understanding how it works, its benefits, and its risks is crucial before making a decision.

A reverse mortgage is a special type of loan available to homeowners aged 62 or older that allows them to convert part of the equity in their home into cash. Unlike a traditional mortgage where you make monthly payments to a lender, with a reverse mortgage, the lender pays you — and you're not required to repay the loan as long as you live in the home.

If you are at least 62 years old, own your home outright or have a significant amount of equity, you are current on property taxes, homeowners' insurance and maintenance, and the property and your home is your primary residence, you are eligible to apply for a reverse mortgage.

When you are approved you can receive funds in the form of monthly payments, a line of credit, a lump sum or a combination of the above. The advantage of such a loan is the fact that you don't have to make payments on this type of loan. It gets repaid when you sell the home, you move out permanently or you pass away. The loan balance (including interest and fees) gets repaid when the house is sold. If the home's sale value exceeds the loan balance, any remaining equity goes to you or your heirs.

The advantages of having a reverse mortgage are tax-free income, no required payments and most of all it allows you to stay in your home. However, it's important to understand though that a reverse mortgage may reduce the value of your estate and your heirs may have to sell the property to repay the loan. In addition, fees and closing costs can be high.

A reverse mortgage can be a lifeline for seniors who need extra income while staying in their homes. It is, however, a complex financial product with serious long-term implications. Before deciding, it is wise to speak with both your financial advisor and your family to determine whether this is the best option for your situation.

INVESTING VS. SPECULATION

A key aspect of sound money management is to determine, prior to allocating capital, if you are making an investment or speculating. Investing involves purchasing an asset for less than your estimate of its fair value, with an expectation that your return will be driven by the fundamental ability of the asset to generate income or profits. Speculation is buying an asset not because of what it is worth, but because you believe someone else will pay more for it later irrespective of value.

At its core, the value of any financial asset is based on the present value of the future cash flows it will produce. A bond pays a fixed stream of interest in exchange for the use of your capital, and its price is determined by how those payments compare to other investments of similar risk. A stock represents ownership in a business, and your return ultimately comes from the company's future earnings which may be distributed as dividends or reinvested to generate additional growth.

While speculating may be rewarding in the short run, it is often done while ignoring or underestimating the risks involved. Before committing capital, it is worth asking yourself one simple question: am I buying this because I understand and believe in its value, or because I hope someone else will pay more? With much of today's market concentrated in just a few large companies, even broadly owned indices deserve a closer look to confirm you are not unknowingly speculating.

A POEM FOR THESE DAYS AND TIMES

Yes, we are aware this is a financial newsletter but sometimes it's more than that.

The Painter Who Put Down His Brush

A painter once set down his brush,
Convinced he'd found a quicker rush.
"The market pays me more," he'd say,
"I make in hours what took all day."

His ladder rested in the shed,
Dust gathered where the paint once spread.
No sunburnt days, no splattered jeans,
Just more gains while hands stayed clean.

But days of ease can't match the pride
That comes from work done bona fide.
When the music stopped his profits dropped,
And work undone was all he'd swapped.

So he wiped the dust from his old tray,
Mixed his colors for the day.
Windfall highs had turned to hush —
So back he went — and raised his brush.

A STORY

One day three men were hiking and unexpectedly came upon a large raging violent river. They needed to get to the other side but had no idea how to do so. The first man prayed to God, saying, "Please God, give me the strength to cross the river." Poof! God gave him big arms and strong legs and after almost drowning a couple of times, he was able to swim across the river in about two hours. Seeing this, the second man prayed to God, saying, "Please God, give me the strength and the tools to cross the river." Poof! God gave him a rowboat and after almost capsizing the boat a couple of times he was able to row across the river in about an hour. The third man had seen how this worked out for the other two and he also prayed to God saying, "Please God, give me the strength and the tools and the intelligence to cross the river" and Poof!, God turned him into a woman. She looked at the map, hiked upstream a couple hundred yards, and walked across the bridge.

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COMICAL COMMENTARY ON THE STOCK MARKET

Today, helium was up, feathers were down. Paper was stationary. Fluorescent tubing was dimmed in light trading. Knives were up sharply. Pencils lost a few points. Hiking equipment was trailing. Elevators rose, while escalators continued their slow decline. Weights were up in heavy trading. Mining equipment stocks hit rock bottom. Diapers remained unchanged. The market for raisins dried up. Balloon prices were inflated.

PERSONAL NOTES

Tom and Laura S. – We go back a long way…it is very special to work with you.

Ron K. – Your enthusiasm and optimism is inspirational.

Don G. – The next adventure awaits you.

Jeff and Anna M.– It is such a pleasure to work with you.

Dickson C. – I like saying, "day yat!" Thanks for the context!

Phil's Opinions And Judgments…

On Music…

I'm a sucker for a well-written country song. "Next Thing You Know" is sung by Jordan Davis. It's a bittersweet song about the passing of time and the events in between. I'd avoid the official video (too sappy, in my view) and just listen to the song on your music streaming system. I think you might like it.

On Sports Teams Valuations…

Many were shocked when the Los Angeles Lakers announced they were purportedly sold for $10 billion. At the time, that was this highest price ever paid for a sports franchise. Sure, that does seem high but compared to public companies that are spouting trillion dollar valuations, or new companies with no revenues and only blue sky potential IPOing at $20 billion dollars, maybe that price isn't too ridiculous. Look for more team sales at much higher prices.

On Congress and Government Shutdowns…

"The American people deserve a functioning Congress that makes clear fiscal choices, takes accountability for them and restores integrity to the federal government's fiscal position. Automatic continuing resolutions may prevent shutdowns but they can't substitute for the real reforms we need."….Paul Winfree, in a letter to the *Wall Street Journal*. I couldn't have said it better in a million years. And the funny thing is we all know it.

On Advice…

There is plenty of good advice out there. "Pay attention" is as good as any advice you can give to or accept from anyone.

Until next time,

Phil Paul Clete Vance Sylvia