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REGISTERED INVESTMENT ADVISER

FINANCIAL NEWSLETTER

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THE CRYSTAL BALL

Back in 1977, Van Morrison released an album titled "A Period of Transition." It appears that the year 2026 will be looked back in history as "a year of transition." Politically, geo-politically, financially, and technologically, no verdict has yet been delivered. How these issues are going to play out in the coming year is unclear. Heck, even the weather can't be counted on to be historically consistent. The jury is still out and we are all waiting, some patiently, most impatiently for answers.

Let's focus on the financial aspect and how to deal with this transitory time and the uncertainty we are feeling and seeing.

Many believe that there has been a giant misallocation of capital this year. Circular financing of the Artificial Intelligence companies leads us to wonder how we will be able to figure out who is making money and who is going to be left holding the bag in the future.

Using baseball parlance, we hear from pundits that AI is only in the 2nd or 3rd inning of its buildout. Sure, that might be true, but it is also true that sometimes there are rain delays during a ballgame. And sometimes the game gets rained out. Right now, the AI market is anticipating clear blue skies. The key investment factor will be how these AI companies are able to monetize their investments and convince investors that they will show profits in the future. Needless to say, the market is betting heavily on AI. A lot of money has been made in this sector. If you have been fortunate enough to benefit from the reality and the expectations, it might make sense to revisit your investment objectives and make sure you are not misallocating your personal capital too heavily in this sector. Remember, the S&P 500 Index has close to a 50% allocation to the wider AI-linked industries. So, when you might think you are massively diversified owning a fund that mimics the index, you might think again.



That said, the big show in the financial markets isn't the midterms, the war, or even AI. The bond market is leading the parade. Interest rates are going up and are now hitting levels we haven't seen in a couple of decades. It's not only happening in the United States but internationally as well. France seems to have become the poster child of the sovereign debt crisis in Europe. Zero growth in their economy and major structural deficits don't bode well for the near term in France. Governments might now be waking up to the fact that overspending is the problem. Whether they have the will to do something about this is the big question. So far, the answer is no.

Many wonder whether or not the stock market can handle a 10-year Treasury rate of 5% (which is where we are at right now). The indexes certainly have proven that they can handle these higher rates, however if you look under the surface, we see that the majority of stocks in the S&P 500 Index are in corrective modes or are in bear markets. The top 10 stocks in the index have held the index near record territory. Actually, this has been going on for a while so there is nothing to say that a handful of stocks can't continue to make things look good.

So, what to do? Review your portfolio and make sure you are not top heavy in the tech highfliers. If you are, reduce exposure while you can; not when you must. Many say that owning bonds isn't smart now that rates are rising. We disagree. Keep your bond exposure short term, less than 5 years. There is no reason to buy a 30-year bond. Let the insurance companies do that. Locking up 4%-5% on short term bonds is not a bad deal. Hold back some cash for emergency and for opportunity. Both will come, so be prepared.

It seems like we are in crazy times right now. In one of the lyrics in the above-mentioned Van Morrison album, he sings, "you gotta make it through the world, if you can." We can and we will. Be ready.

QUOTE

*Wisdom is the quality that keeps you
from getting into situations where you need it...*

Doug Larson

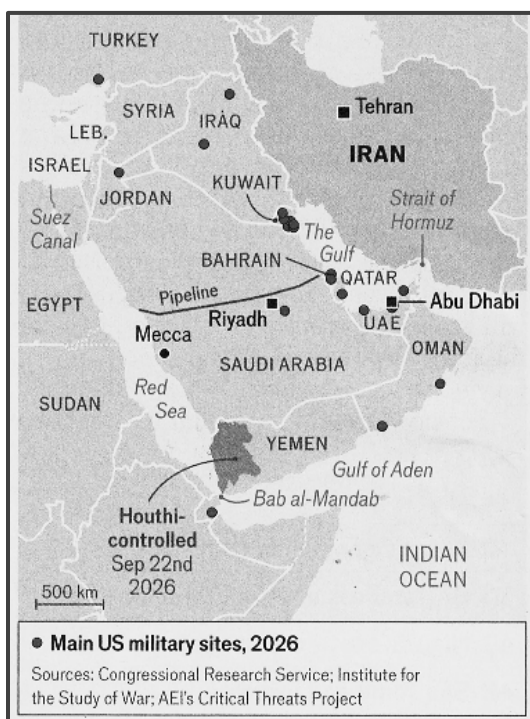
PREFERRED STOCKS

Preferred stocks sit in the middle ground between common stocks and corporate bonds. They are used by investors looking for income. They provide distinct advantages, but like everything else they don't provide a "free lunch." The advantages are mainly the high yields they offer. Preferred stocks typically pay higher dividend yields than common shares or standard bonds. They have an income priority claim in the event of a corporate liquidation. Companies that issue Preferred stock must pay dividend obligations to Preferred shareholders before distributing any dividends to common shareholders. Many Preferreds are issued at \$25/share, so unless they are bought below this level, they have limited upside (unlike common stocks).

On the negative side, Preferred stock prices move inversely to interest rates, so as rates rise the value of a fixed yield Preferred stock tends to fall. We are seeing this now. They also typically lack voting rights on corporate governance matters. When you buy a Preferred stock, you are buying it for the income it generates. Expect price weakness in the environment we are in now. It appears that this year, Preferred stocks will offer tax loss offsets against previously taken capital gains. Remember, no free lunch.

GEOGRAPHY

Purportedly, Ambrose Bierce remarked that "War is God's way of teaching Americans geography." Maybe, but nonetheless, here is an interesting map showing where U.S. military bases are located in the Middle East.



THE RETIREMENT PAYCHECK

For forty years, a paycheck showed up every two weeks. Then you retire, and it stops. That change is harder than most people expect. Spending savings can feel wrong, even for people who have saved plenty. After a whole career of adding to your accounts, taking money out may feel like going backwards. The balance moves every day with the market, and without a paycheck, it's hard to know what's safe to spend.

As a result, many retirees feel uneasy about trips and gifts they can afford and may worry more than they need to about running out. One way to make it easier is to turn your savings back into a paycheck. It starts with knowing what your life costs each month, including bills that come only once or twice a year. Next is the income that's already coming in, like Social Security, a pension, or rental income. For most retirees, that covers a chunk of the bills. Savings only have to fill the gap.

With this paycheck plan, the amount you've determined moves into checking on the same day every month. Keeping the next year or two of paychecks in cash means a bad market doesn't affect this month's spending. Building in money for travel, gifts, and time with the grandkids makes that spending part of the plan, so it doesn't feel like a splurge.

Here's a hypothetical example. A retired couple spends \$10,000 a month. Social Security, a pension, and other income cover \$5,000 of it. Their savings needs to cover the remaining \$5,000. We help clients calculate a safe withdrawal rate; which is how much they can take from savings each year, so the money is expected to last. We also help determine which accounts are the most tax-advantageous to pull from first, since taxable accounts, IRAs and Roth accounts are each taxed differently.

A review once a year is usually enough to check that the plan is on track and to raise the paycheck for inflation. A steady monthly paycheck makes it easier to spend your savings with confidence, even when the market moves.

UN-COMMON SENSE

Everyone seems to tell you when to invest... here is when not to invest: 1) the investment return is well above a guaranteed rate of return and you are told that the risk level is actually quite low; 2) you think you are getting something for nothing; 3) somebody tells you it is essential for you to invest right now; 4) you are offered a hot tip by a friend of a friend; 5) everything looks just perfect; 6) you don't understand what you are buying; 7) cash is burning a hole in your pocket; and 8) you think there was a good chance that you might be a participant in the greater fool theory.

WHAT TO DO WITH EXCESS 529 FUNDS

Saving too much for college may sound like a good problem to have—and it is. But if you find yourself with money remaining in a 529 College Savings Plan after education expenses are covered, what can you do with the excess? Fortunately, you have several options.



Change the Beneficiary: You can generally change the beneficiary to another eligible family member, such as a sibling, child, or first cousin, and use the funds for that individual's qualified education expenses. In most cases, changing the beneficiary does not create a tax liability.

Save for the Next Generation: You can also leave the money in the 529 plan and allow the current beneficiary to use it for their children in the future. Keeping the funds invested allows them to continue growing for qualified education expenses. Over time, that growth could provide a meaningful head start for the next generation. Because Generation-Skipping Transfer Tax rules may apply in some situations, consult your CPA before pursuing this strategy.

Consider a Roth IRA Rollover: Recent changes allow certain 529 funds to be rolled directly into a Roth IRA for the current beneficiary. The 529 must generally have been open for at least 15 years, contributions made within the last 5 years do not qualify, and the beneficiary must have earned income. The rollover is subject to the annual Roth IRA limit (\$7,500 in 2026) and a \$35,000 lifetime limit. Because the rules are detailed, be sure to review your situation with your financial and tax professionals.

Take a Non-Qualified Distribution: Finally, you can withdraw the excess funds for non-education purposes. Contributions are generally returned tax-free, but earnings are subject to income tax and typically a 10% federal penalty. State and/or AMT taxes or penalties may also apply.

The Bottom Line: An excess 529 balance gives you flexibility—but the best strategy depends on your family's circumstances and long-term goals. Before making a withdrawal or rollover, consider discussing your options with your financial advisor and CPA.

AN OVERLOOKED RETIREMENT ASSET – THE HSA

The Health Savings Account (HSA) is often viewed as a way to pay current medical bills, but its tax treatment makes it one of the most efficient long-term savings vehicles available. It is the only account available to most households that offers three distinct federal tax benefits: contributions are deductible, investment earnings accumulate without tax, and distributions for qualified medical expenses are tax-free. Contributions made through payroll deduction are also exempt from Social Security and Medicare taxes.

To contribute, you must be covered by a high-deductible health plan. For 2026, the contribution limit is \$4,400 for self-only coverage and \$8,750 for family coverage. For 2027, these limits increase to \$4,500 and \$9,000, respectively. Individuals age 55 and older may contribute an additional \$1,000, and contributions for the 2026 tax year may be made through April 15, 2027.

The account's long-term value depends on how it is used. For households able to pay current medical expenses from cash flow, we generally recommend investing the HSA as part of a long-term allocation rather than holding the balance in cash, allowing it to compound over time. Because there is no deadline for reimbursing qualified expenses incurred after the account was established, retaining documentation of those expenses allows them to be reimbursed tax-free in later years.

In retirement, the HSA becomes more flexible. After age 65, it may be used tax-free to pay Medicare Part B, Part D, and Medicare Advantage premiums, including any IRMAA surcharge. Distributions for non-medical purposes are taxed as ordinary income without penalty, consistent with the treatment of a traditional IRA, and the account is not subject to required minimum distributions.

Because the HSA is designed to be used during your lifetime, it also warrants attention in your estate plan. A surviving spouse may treat an inherited HSA as his or her own and retain its tax benefits, but any other individual beneficiary must include the full account value as taxable income in the year of death. For that reason, the HSA is generally best drawn on during retirement, with a spouse or a qualified charity named as beneficiary and other assets directed to children or other heirs.

California residents should note that the state does not conform to Federal HSA tax treatment. Contributions are included in state taxable wages, and interest, dividends, and realized capital gains within the account are subject to California income tax each year. The Federal tax benefits described above are fully intact.

Used in this way, the HSA serves as a dedicated, tax-free reserve for one of the most significant costs in retirement. Please contact us with any questions about how a HSA may fit within your broader financial plan.

A STORY

As a young portfolio manager strolled along the Mississippi River, a gold glimmer in the sand caught his eye. The young man bent down and quickly unearthed a small bronze lamp. Shaking his head in disbelief, he gave the lamp a sarcastic rub. A great cloud of smoke erupted from the lamp. As the smoke cleared, a genie stood before the young Wall Streeter and said, "for freeing me from this lamp I will grant you one wish." The young portfolio manager gathered himself and said, "I've been around long enough to know that wishes always have some kind of negative aspect to them, so if my wish was to beat the S&P 500 Index by 10% every year as long as I'm a portfolio manager, what would my life look like in 30 years?" The genie replied, "Your children won't speak to you and will see you as distant and greedy. Three wives will have left you. You'll have ulcers, hypertension, and significant weight gain. You'll have a nasty drinking habit. Your industry peers will hate you and the general public will despise you." The young man paused for a moment and said, "Yeah, yeah, yeah, but what's the catch?"

OVERHEARD:

*If you are yearning for the good old days,
just turn off the air conditioning...*

Griff Niblack

PERSONAL NOTES

*Danny S. – It's terrific to hear about your
baseball coaching success. Keep it up!*

*Mark and Lucretia – Your positive attitude are
bright lights to those who know you.*

*Mike and Susan W. – You have been great clients
for many years. It's a pleasure to work
with you.*

Mike and Tracy T. – Welcome aboard!

*Jeff Y. – While Sioux Falls is a ways away, it is
always good to hear from you.*

Phil's Opinions And Judgments...



On Innovation...

Whoever invented the *ratchet belt* deserves a ton of kudos. My brother told me he has had one for 10 years but I just discovered this low fashion accessory recently. If you wear a belt, you might want to check it out. If you get a good one, I think you'll be pleased.

On Music...

Billy Strings is a young musical phenom. There is one particular jaunty song of his that's quite cool titled I'm One of Those. Good lyrics, excellent vocal, great music. What's not to like?

On Artificial Intelligence Worries...

I'm in the camp that says AI is not going to wipe out humanity. However, here is what I worry about with AI: its potential ability to create some type of a cyberattack. How this issue is going to be circumvented is the big question and I'm not sure anyone has the answer yet.

On Economic Systems...

This is kind of old, but the punchline is still funny.

Socialism: You have two cows. Give one cow to your neighbor.

Communism: You have two cows. Give both cows to the government and they may give you some of the milk.

Fascism: You have two cows. You give all the milk to the government and the government sells it.

Capitalism: You have two cows. You sell one cow and buy a bull.

Until next time,


Phil Paul Clete Vance Sylvia

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