THE LIGHT

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HELPING INDIVIDUALS NAVIGATE THEIR FINANCIAL LIVES

A CASE FOR BONDS

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Bonds are boring. Try talking about bonds at a dinner party and then set a timer to see how long until the room clears. Even writing this article was hard to get excited about. It's natural to feel this way about bonds especially compared to their counterpart stocks. Due to their lack of thrill, it's not surprising that a lot of people don't understand how bonds work, so I thought it would be good to establish a simple definition. "Bonds are investment securities where an investor lends money to a company or a government for a set period of time in exchange for regular interest payments. Once the bond reaches maturity, the bond issuer returns the investor's money."

This is different from how stock ownership works. Stocks offer significantly more upside usually in a much faster time frame. Look at NVIDIA for example, riding the wave of AI and the demand for the chips they make, the stock is up 250% in the last 12 months! Bonds on the other hand are slow, steady, and generally more reliable, especially when analyzing them in a short time frame. The path to growing your money in bonds is much slower. Since 1926 the average yearly rate of return for the S&P 500 is 10.26% vs the 4% to 6% range bonds yielded. Long-term investors can appreciate the relationship between risk and reward and these historical rates of return fit nicely into the methodology that to get more return you must take on more risk. *(Continued on page 2)*

MARKET RECAP

DOW JONES INDUSTRIAL AVERAGE

1Q 2024: 5.5%

S & P 500 COMPOSITE

1Q 2024: 10.1%

RUSSELL 2000

1Q 2024: 4.7%

BARCLAYS AGGREGATE BOND

1Q 2024: -1.3%

NASDAQ COMPOSITE

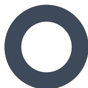
1Q 2024: 9.1%

**All indices are reported Total Return which includes Dividends*

A CASE FOR BONDS *(Continued from page 1)*

So why invest in bonds at all, especially if the return over the long run is inferior? The simple answer to that is that bonds help smooth out the ride for investors. Human nature, which we're all subject to, often wants us to react instinctively when our accounts are caught in a downward spiral. Bonds help provide stability when the stock market is volatile. Notice the difference between a portfolio that is 100% stocks versus a portfolio that is 50% stocks and 50% bonds.

100% Stocks



100% Stocks
0% Bonds

Historical Risk/Return (1926-2020)	
Average annual return	10.3%
Best year (1933)	54.2%
Worst year (1931)	-43.1%
Years with a loss	25 of 95

50% Stocks / 50% Bonds

50% Stocks
50% Bonds

Historical Risk/Return (1926-2020)	
Average annual return	8.7%
Best year (1982)	33.5%
Worst year (1931)	-22.5%
Years with a loss	20 of 95

Obviously, the average rate of return for the 100% stock portfolio is higher, but also notice the worst year for each portfolio. 1931 was a doozy, down - 43.1% for the all-stock allocation but nearly half that for the 50/50 allocation at -22.5%. When we talk about smoothing out the ride with our clients this is a great example of that. Not everyone can stomach the ups and downs that aggressive investors tolerate.

We feel bonds offer a great opportunity for investors to earn an attractive rate of return with much less risk than stocks. With the Federal Reserve raising rates so quickly the last couple of years, bonds offer significantly more yield than we've seen over the last decade plus. At the moment, yields for bonds are hovering in the 5% to 6% range, pretty solid! Depending on what inflation does, the Fed is poised to start lowering rates this summer. When this happens, we expect the price of bonds to appreciate. Combine the yield of 5% and the price appreciation of the bond (1%-2%) and you have a really solid risk-adjusted rate of return. We're not suggesting this for everyone across the board, but with markets at all-time highs and stock valuations running above average, we think it's a good idea to make sure your portfolio is well diversified. Aesop's "Tortoise and the Hare" can very much apply to the investing world as well. Boring? Maybe. But reliability isn't a bad thing.

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An estimated 85-90% of taxpayers use the standard deduction when filing taxes, thanks in large part to tax reform created by the 2017 Tax Cuts and Jobs Act. While not having to track down itemized deductions does help simplify tax prep, the use of the standard deduction effectively eliminates the charitable contribution deduction as a tax benefit. For taxpayers age 70 ½ and older, however, there is another option that may prove to be just as beneficial, if not more so. Such individuals can still help reduce their tax bill by making what are referred to as qualified charitable distributions (QCDs) directly from their IRAs.

Generally, a QCD is an otherwise taxable distribution from an IRA, owned by an individual who is age 70½ or over, that is paid directly from the IRA to a qualified charity. Each person can donate the full amount of his or her RMD, up to a maximum of $100,000 annually, effectively reducing the taxable amount of their mandatory withdrawal. Making a qualified charitable distribution not only lowers taxable income, but it also has the potential advantage of decreasing the amount of Social Security benefits subject to tax, as well as potentially reducing future Medicare premiums.

QCDs COULD YOU BENEFIT BY MAKING CHARITABLE DONATIONS FROM YOUR IRA?

Each person can donate the full amount of his or her RMD, up to a maximum of $100,000, annually. If you're a married couple filing jointly, and you each have your own IRA, you each can use the $100,000 QCD rule.

It's permissible to use less than the full RMD for the charitable distribution. So, for example, if you have an RMD of $6,000 and you wish to give only $4,000 to charity, you still would need to withdraw the remaining $2,000 and pay taxes on it. (As you are likely aware, taking less than the full amount for your RMD could result in a tax penalty.)

It is also permissible to make a QCD that exceeds your RMD for a given year. However, that extra distribution won't carry over to meet RMDs for future years.

The first dollar out of an IRA is considered to be the RMD. So, if you take money out early in the year, that distribution would count toward your RMD, and you could potentially lose some of the tax benefits of a QCD. Say, for example, Joe takes his full RMD in February. In November, he wants to do a QCD. Joe cannot retroactively deem the February distribution to be a QCD. He must take an additional distribution if he still wishes to do a QCD for that calendar year. That income can be excluded, but it won't offset the income from the RMD taken earlier in the year.

You should work with your IRA custodian to correctly accomplish a QCD. Make sure you do not withdraw the funds or deposit the RMD into your personal bank account and then write a personal check. The donations must be made payable directly from the IRA to the charity. (Most IRA custodians, including Charles Schwab, mail the check to the IRA owner; who then mails/gives the check to the charity.)

Be sure to inform your tax preparer that you made a QCD. Your IRA custodian will send you a 1099 showing the total annual distributions that have occurred, but the 1099 does not distinguish QCD amounts. Be sure to communicate the QCD amount to your tax preparer, so that it is correctly accounted for on your tax return or your taxable income won't be correctly reduced.

You can distribute the money to multiple charities if you choose. The $100,000 per person limit applies to the sum of all QCDs taken from all your IRAs in the tax year. You can make one large contribution or several smaller contributions to one or more charities.

Donors cannot receive any benefit for making a qualified distribution to a charity. So, for example, you can't use a QCD to purchase something at a charity auction or tickets to a charity event.

For a QCD to count toward your minimum annual IRA distribution, it must meet the same deadline as a normal distribution. (Usually December 31.)

Not every organization or cause qualifies for a QCD. The organization must be a 501(c)(3). A QCD can't be made to donor-advised fund sponsors, private foundations, or supporting organizations. Before you arrange for the transfer of funds, be sure the charity is eligible.

If you're 70 ½ or older and interested in this strategy, then reach out to your investment advisor before withdrawing RMDs this year. We are here to guide you through the process.

Now that you have a general understanding of QCDs, here is a hypothetical example to further illustrate. Let's say Bill and Bonnie Prospect are 73-year-old taxpayers with a taxable income of $120,000. Included in their taxable income are IRA distributions from Bill's RMD of $8,000 and Bonnie's of $12,000. The Prospects are quite charitable and historically give $12,000 annually to their local church. In years past, their charitable contributions, when combined with real estate taxes, mortgage interest, etc., qualified the Prospects to itemize. However, with the 2017 tax reform, and the increase to the standard deduction, they no longer have enough deductions to itemize, and they now take the standard deduction. The $12,000 donated to their church provided no tax benefit.

Now let's change the circumstances, and assume the Prospects took full advantage of their ability to make QCDs from their IRAs. Before taking any RMDs for the year, Bill and Bonnie contacted their investment advisor and advised that each wished to make QCDs of $6,000 to their church. Doing so reduced the taxability of Bill's RMD distribution from $8,000 to $2,000 and Bonnie's from $12,000 to $6,000. Schwab wrote two $6,000 checks to the Prospect's local church and mailed them to the Prospect's home address. The Prospects delivered the checks to their church, completing the $12,000 donation they had already intended, while also effectively reducing their taxable income by $12,000. In this example, their taxable income has them in the 22% federal bracket, meaning federal tax savings of $2,640. This also reduces state taxable income, meaning there would be state tax savings, as well.

As mentioned above, since Bill and Bonnie used less than their full RMD for their charitable distributions, they will still need to complete the rest of their RMDs and will be responsible for the tax on the remaining portion. However, they've effectively reduced their taxable income by $12,000, while also making their intended church donation. If there were other donations they wished to make, they would have the option of making further QCDs. Even though the Prospects no longer itemize, they still found a way to receive substantial tax benefits for their charitable giving.

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