Breed's Hill Newsletter

Planning Your Financial Future

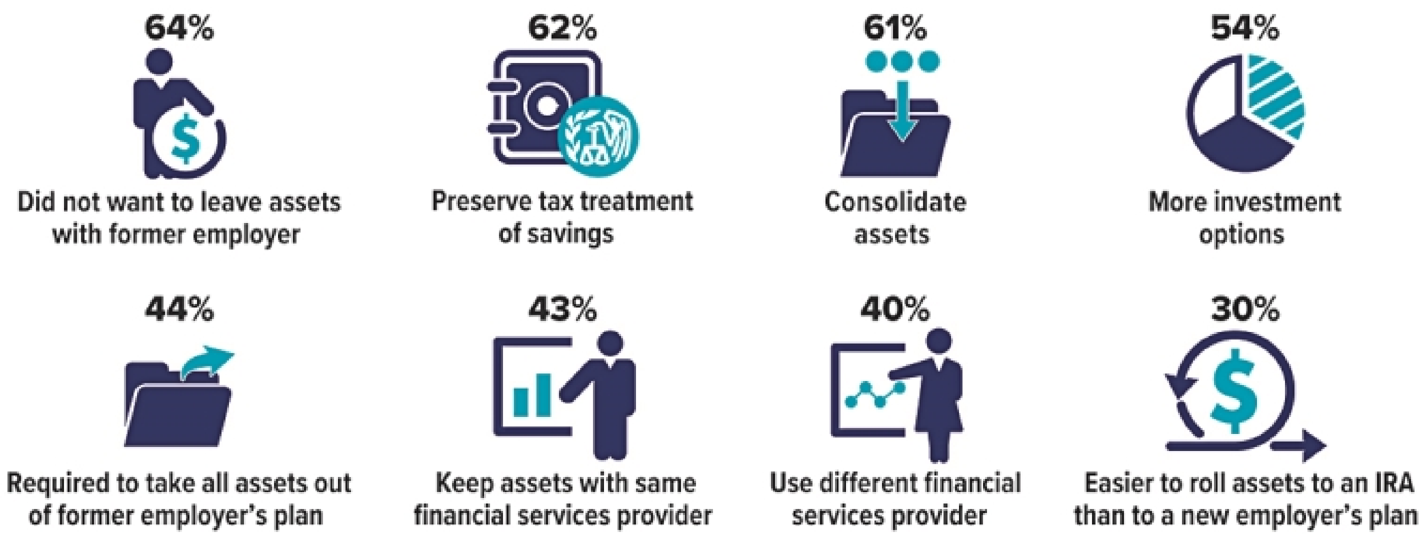
Dan Novotny, CRPC®,CFS®
Investment Advisors
Breed's Hill Wealth Management
Kirk Tassell, CFP®
301 North Park Avenue, Suite A • Winter Park • FL
800-599-5077 • 800-599-0338
dnovotny@breedshillwm.com • www.breedshillwm.com

Commonwealth

Reasons to Roll

When you leave your job or retire, you have an opportunity to manage your funds in an employer-sponsored retirement plan such as a 401(k), 403(b), or government 457(b) plan. Depending on the situation, you generally have four options.* The approach that typically gives you the most control over the funds is to transfer some or all of the assets to an IRA through a rollover.

Three out of five households who owned traditional IRAs in 2022 had executed at least one IRA rollover from an employer-sponsored retirement plan. These were the top reasons for the most recent rollover.



*Other options may include leaving assets in the former employer's plan, transferring assets to a new employer-sponsored plan, or withdrawing the money.

Source: Investment Company Institute, 2023 (multiple responses allowed)

How Taxes Impact Your Retirement-Income Strategy

Retirees face several unique challenges when managing their income, particularly when it comes to taxes. From understanding how taxes relate to Social Security and Medicare to determining when to tap taxable and tax-advantaged accounts, individuals must juggle a complicated mix of factors.

Social Security and Medicare

People are sometimes surprised to learn that a portion of Social Security income becomes federally taxable when combined income exceeds $25,000 for single taxpayers and $32,000 for married couples filing jointly. The taxable portion is up to 85% of benefits, depending on income and filing status.[1]

In addition, the amount retirees pay in Medicare premiums each year is based on the modified adjusted gross income (MAGI) from *two years earlier.* In other words, the cost retirees pay for Medicare in 2023 is based on the MAGI reported on their 2021 returns.

Taxable, Tax-Deferred, or Tax-Free?

Maintaining a mix of taxable, tax-deferred, and tax-free accounts offers flexibility in managing income each year. However, determining when and how to tap each type of account and asset can be tricky. Consider the following points:

Taxable accounts. Income from most dividends and fixed-income investments and gains from the sale of securities held 12 months or less are generally taxed at federal rates as high as 37%. By contrast, qualified dividends and gains from the sale of securities held longer than 12 months are generally taxed at lower capital gains rates, which max out at 20%.

Tax-deferred accounts. Distributions from traditional IRAs, traditional work-sponsored plans, and annuities are also generally subject to federal income tax. On the other hand, company stock held in a qualified work-sponsored plan is typically treated differently. Provided certain rules are followed, a portion of the stock's value is generally taxed at the capital gains rate, no matter when it's sold; however, if the stock is rolled into a traditional IRA, it loses this special tax treatment.[2]

Tax-free accounts. Qualified distributions from Roth accounts and Health Savings Accounts (HSAs) are tax-free and therefore will not affect Social Security taxability and Medicare premiums. Moreover, some types of fixed-income investments offer tax-free income at the federal and/or state levels.[3]

The Impact of RMDs

One income-management strategy retirees often follow is to tap taxable accounts in the earlier years of retirement in order to allow the other accounts to continue benefiting from tax-deferred growth. However, traditional IRAs and workplace plans cannot grow indefinitely. Account holders must begin taking minimum distributions after they reach age 73 (for those who reach age 72 after December 31, 2022). Depending on an account's total value, an RMD could bump an individual or couple into a higher tax bracket. (RMDs are not required from Roth IRAs and, beginning in 2024, work-based plan Roth accounts during the primary account holder's lifetime.)

Don't Forget State Taxes

State taxes are also a factor. Currently, seven states impose no income taxes, while New Hampshire taxes dividend and interest income and Washington taxes the capital gains of high earners. Twelve states tax at least a portion of a retiree's Social Security benefits.

Eye on Washington

Finally, both current and future retirees will want to monitor congressional actions over the next few years. That's because today's historically low marginal tax rates are scheduled to revert to higher levels in 2026, unless legislation is enacted (see table).

Help Is Available

Putting together a retirement-income strategy that strives to manage taxes is a complex task indeed. Investors may want to seek the help of a qualified tax or financial professional before making any final decisions.[4]

Tax Rates Scheduled to Rise

Unless legislation is enacted, federal marginal income tax rates are scheduled to rise in 2026.

Current rate	2026
10%	10%
12%	15%
22%	25%
24%	28%
32%	33%
35%	35%
37%	39.6%

1) Combined income is the sum of adjusted gross income, tax-exempt interest, and 50% of any Social Security benefits received.

2) Distributions from tax-deferred accounts and annuities prior to age 59½ are subject to a 10% penalty, unless an exception applies.

3) A qualified distribution from a Roth account is one that is made after the account has been held for at least five years and the account holder reaches age 59½, dies, or becomes disabled. A distribution from an HSA is qualified provided it is used to pay for covered medical expenses (see IRS publication 502). Nonqualified distributions will be subject to regular income taxes and penalties.

4) There is no guarantee that working with a financial professional will improve investment results.

Diversifying with Market Caps

The U.S. stock market struggled in 2022, with the S&P 500 index ending the year down more 19.4%.[1] The S&P 500, which includes stocks of large U.S. companies, is generally considered representative of the U.S. stock market as a whole, and it is a good benchmark for broad market performance. But there are thousands of smaller companies, and many of those held onto their stock value better during the market conditions of 2022.

The S&P MidCap 400, which includes midsize companies, ended the year down 14.5%, while the S&P SmallCap 600, which includes smaller companies, was down 17.4%.[2] Although these were losses, it was the first year since 2016 that midsize and small companies outperformed large companies (in this case, by having smaller losses). While large companies have registered the highest average annual returns over the last decade, midsize and small companies have been stronger over longer periods (see chart).

Extending Your Reach

As these trends demonstrate, companies of different sizes tend to perform differently in response to market conditions. This suggests that holding stocks in companies of varied sizes could help diversify the stock portion of your portfolio and allow you to pursue a broader range of growth opportunities. Diversification is a method to help manage risk; it does not guarantee a profit or protect against investment loss.

The most convenient and comprehensive way to diversify by size is through mutual funds or exchange-traded funds that track indexes based on *market capitalization,* calculated by multiplying the number of outstanding shares by the price per share. There is no standard classification system, but Standard & Poor's indexes offer a helpful comparison and are used as benchmarks for many funds.[3]

S&P 500: $14.6 billion or more

S&P MidCap 400: $3.7 billion to $14.6 billion

S&P SmallCap 600: $850 million to $3.7 billion

Russell indexes are also commonly used to construct funds based on market capitalization. The Russell 1000 includes large and midsize companies, while the Russell 2000 is a comprehensive small-cap index. Actively managed funds focusing on market capitalization typically include stocks chosen by the fund manager rather than following an index.

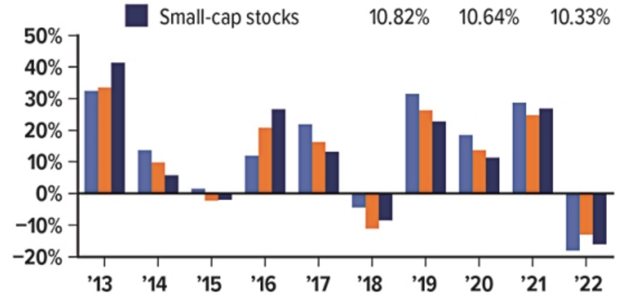
Stability, Growth, and Volatility

Stocks of larger companies, or large caps, are generally considered more stable than the stocks of smaller companies, because their size can help them weather rough economic times — as demonstrated by their strong performance during the pandemic. Large caps may provide solid long-term returns, but they typically have lower growth potential, because they have already experienced substantial growth. Many large U.S. companies have heavy overseas exposure, which makes them more sensitive to global economic forces, one reason they struggled in 2022.

Performance in Three Sizes

Even with poor performance in 2022, large-cap stocks have provided the highest returns over the last decade. However, mid caps were the leader over the last 20- and 30-year periods, with small caps not far behind.

Average annual return	10 yrs	20 yrs	30 yrs
Large-cap stocks	12.56%	9.80%	9.65%
Mid-cap stocks	10.78%	10.66%	11.09%
Small-cap stocks	10.82%	10.64%	10.33%



Source: Refinitiv, 2023, for the period 12/31/2012 to 12/31/2022. Large-cap stocks are represented by the S&P 500 Composite Total Return Index, mid-cap stocks by the S&P 400 MidCap Total Return Index, and small-cap stocks by the S&P 600 SmallCap Total Return Index. Expenses, fees, charges, and taxes are not considered and would reduce the performance shown if they were included. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

Mid caps may have greater growth potential than large caps, and midsize companies might react more nimbly to changes in the business environment. Mid caps are associated with higher risk and volatility than large caps, but are considered more stable than small caps.

Small-cap stocks might offer the highest growth potential of the three classifications, because they have the furthest to grow and are more likely to react quickly to market opportunities. However, they are typically the most risky and volatile class of stocks.

The investment return and principal value of stocks, mutual funds, and ETFs fluctuate with market conditions. Shares, when sold, may be worth more or less than their original cost.

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. You should read the prospectus carefully before investing.

1-3) S&P Dow Jones Indices, 2023

Virtual Health Care Is Here to Stay

The use of telehealth skyrocketed early in the COVID-19 pandemic, with the number of remote office visits and outpatient services 78 times higher in April 2020 than in February 2020. Usage has stabilized since then, but as of early 2021 remained 38 times higher than the pre-pandemic level.[1]

More recent data indicates that remote health care is here to stay. In August 2022, almost 23% of adults said they had an appointment with a health professional over video or phone during the previous four weeks.[2]

Remote Access

Telehealth encompasses a broad range of remote services including virtual office visits (also called telemedicine), remote patient monitoring, patient-physician communication through secure emails and websites, and online physician-to-physician consultation. Patients have immediate access to advice and treatment any time of the day or night, while avoiding unnecessary and costly emergency room visits. But telehealth is not only for emergency or off-hours situations; it also can be a more convenient and cost-effective way to get medical care that might normally be handled in a doctor's office.

Telehealth can be used to treat minor problems such as allergies and rashes, or for an urgent condition such as a high fever. It makes it easier to access therapy for mental health issues such as depression and anxiety, and can fill gaps in the availability of specialty care. In other cases, doctors can remotely monitor the vital signs of patients with chronic conditions or follow up after a hospital discharge, and physical therapists can lead patients through exercises and monitor their progress.

In 2021, 94% of large employers offered traditional telemedicine services, 28% offered a virtual behavioral health-care network, 25% offered targeted virtual health solutions for specific conditions such as diabetes and musculoskeletal problems, and 16% offered a virtual primary-care service or network. About 12% of eligible employees used a telemedicine service in the first half of 2021.[3]

Original Medicare and Medicare Advantage plans also cover a wide variety of telehealth services. Some of these were specifically added to coverage because of the pandemic and are scheduled to expire at the end of 2023.[4] Considering the convenience and cost savings associated with telehealth, it is possible they will be extended, but that remains to be seen.

If your health plan includes telehealth services, you might take a closer look at the details, download the app, and/or register for an online account. You'll be ready to log in quickly the next time you or someone in your family faces a medical problem.

1) McKinsey & Company, July 9, 2021; 2) Centers for Disease Control and Prevention, 2022; 3) Mercer, May 12, 2022; 4) Centers for Medicare & Medicaid Services, 2022