

# INVESTOR'S Edge

Third quarter, 2022

## What do rising interest rates mean?

The Federal Reserve raised interest rates a few times already this year and is expected to approve additional increases through the rest of 2022 in an effort to curb inflation.

What does an interest rate hike mean for investors? Here are a few considerations:

### Fixed income

In the United States, the fixed-income family includes many types of investments, including bonds, certificates of deposit and mortgage-backed securities. We'll focus on bonds to show the possible impact of rising interest rates.

When markets start to anticipate an increase in rates, bond yields can head higher.

Interest rate moves can be challenging for bonds as the price of bonds tends to have an inverse relationship with interest rates. As one of a few factors that bonds are sensitive to (inflation risk and credit risk are others), interest rate risk refers to the risk of rising interest rates and a reduction in the market value of a bond. Why does this happen? A bond's price may fall to reflect its lower coupon rate relative to comparable bonds issued more recently at higher rates. At the same time, as its price declines, the bond's yield moves higher, keeping it competitive in the market.



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While the price of existing bonds may drop as rates rise, interest income could benefit if reinvested at a higher rate. Existing bonds in the market might also be available at higher yields, or new bonds may be issued with more attractive coupons.

Bond issuers must pay competitive interest rates to get investors to buy their bonds. Investors who have existing bonds with potentially lower interest rates will find their bonds less valuable; however, new bonds may be more attractive for a portfolio.

Short-term and long-term bonds tend to be affected differently by rising interest rates, with long-term bonds experiencing the greatest price changes.

### Keep in mind

- Holding a bond until it matures means fluctuations in its market price would have less impact on the holder. That's because interest payments are predictable over the life of the bond, and the principle would likely be paid out upon maturity, providing the issuer doesn't default.
- While fixed-income returns may come under pressure in the short term, a strategic allocation to fixed income is still considered by many to be a key ingredient in a well-diversified portfolio.

### Stocks

Traditional thinking is that rising interest rates create difficult investing opportunities for equities. There are a few reasons behind this point of view:

- Higher rates can mean higher borrowing costs for companies, which risks impacting their return on capital.
- Higher rates can sometimes make more secure, interest-bearing instruments like bonds more attractive to investors, which may result in lower demand for stocks.
- Higher rates may mean companies spend more to service debt and less on capital investments, which may affect future earnings growth.

It's important to keep in mind the reasons behind interest rate hikes. For some companies, a strong economy can help drive corporate earnings.

The Fed's decisions on interest rates have a larger impact on investors than affecting loan rate values. Because bond prices/yields and stock earnings can fluctuate based on market influences, it's important for investors to keep a close eye on their portfolios during influential market swings like changing interest rates. It's important to meet with your financial professional to review your bond and stock investments to determine if changes are needed for your overall portfolio to reduce potential impact of rate changes.

## Time to start planning for TCJA sunset

In 2017 when the Tax Cuts and Jobs Act (TCJA) was passed, it may have felt like the proposed sunset for many of the Act's provisions was years away. With several provisions set to expire at the end of 2025, this is a good time to start considering potential changes to your estate plans. Meet with your financial professional early to discuss ideas for your estate that may help you navigate potential changes in political power through the next few years.

### What's expiring?

The following provisions will change as of January 1, 2026.

**Income taxes and deductions** — For individual taxpayers, the top individual, estate and trust income tax bracket goes back up to 39.6% from the current rate of 37%.

**Charitable giving** — In general, a tax deduction for charitable donations was preserved. In fact, for 2018 through 2025, the annual deduction limit for cash contributions to public charities increased from 50% of adjusted gross income (AGI) to 60% of AGI, and will sunset back to 50% in 2026.

**Estate and gift tax** — For many baby boomers, the sunset of the current estate and gift tax provisions provides the greatest concern. The TCJA doubled the estate and gift tax exemption to \$11.2 million for single filers, \$22.4 million for couples, and continued to index the exemption levels for inflation.

In 2022, the federal estate and gift tax threshold increased to \$12.06 million per individual, \$24.12 million for couples. In 2026, the estate and gift exemption will revert back to pre-TCJA levels, effectively reduced by half, and is expected to be in the ballpark of \$6.5 million per individual or \$13 million for a married couple.

This sunset of the estate and gift exemption will have a significant impact on many baby boomers. For families with a net worth exceeding \$24 million it is important to shore up their estate plans, and where possible, take advantage of the high exemption amount using estate and gifting strategies.

The IRS has provided clarity on how significant gifts will be accounted for prior to 2026 when a death occurs in 2026 or later. In general, you benefit if you gift more than the estate and gift exemption amount expected for 2026. For example, if an individual gifts \$12 million now and the gift and estate exemption become \$6.5 million in 2026, they have moved an additional \$5.5 million out of their estate tax free.

This gets complex really quickly and should only be done with the guidance of your estate attorney and accountant. For baby boomers in the position of having a taxable estate above \$13 million now or by 2026, they need to plan around an impending federal taxable estate. Estate planning services will become equally important to these families as their wealth grows and they experience additional wealth events.

It's also important to mention that if you live in a state with a state estate tax or inheritance tax, you likely already have cause for estate planning services. There are a host of estate and gifting strategies to explore.

Working together with a team of advisors—such as your financial professional, your attorney and your tax advisors—to put a complete plan in place (understanding both the tax provisions today and in 2026) may help make any sunset what it should be—great.





## Health and well-being funds can help ESG investors align portfolios with wellness values

During the pandemic, approximately four in 10 adults in the United States reported symptoms of anxiety or depressive disorder, an increase from one in 10 adults who reported those symptoms during 2019, according to Kaiser Family Foundation.

In response, growing numbers of employers looked for new ways to support their workforce. According to research published in the *Journal of Occupational and Environmental Medicine*, companies with strong employee health and well-being programs significantly outperform the S&P 500.

And just as health and well-being have become a greater focus for many employers, they have also grown in importance for many environmental, social and governance (ESG) investors.

Indeed, ESG investors may have always considered the social impact of the companies in which they invest. But until 2020, health and well-being very likely was not as large a part of the “S” of ESG. That’s started to change, and especially over the last year, mental health became a focus area for ESG investing.

More than \$20 billion is currently invested in equity funds focused on a theme of health and well-being, according to RBC research, and net flows into these funds have risen consistently since March 2020. Additionally, a number of new funds focused on health and well-being launched in 2021, indicating investors’ increasing interest in this theme.

### How health and well-being funds align with ESG values

ESG investors can consider the health and well-being impacts of any potential investment by looking into whether the company they’re evaluating prioritizes the health and wellness of its employees. Before the pandemic, companies may not have disclosed such an impact in a standard or transparent way. But with health and well-being becoming a larger focus for employers and investors alike, companies have begun reporting statistics that will make evaluation easier.

Another way to prioritize health and well-being through investing is to invest in the health-related companies that are moving the wellness of our society forward. As an example, companies in the health care sector that find new ways to improve health outcomes while also cutting costs.

For example, new wearable technologies allow patients to do things like monitor blood oxygen levels with their smartphones. Or consider companies that are finding new ways to improve health outcomes while also reducing costs.

Additionally, new approaches to drug delivery, such as the mRNA-vaccine process and the development of more effective drugs so people don’t need to take as much medicine, are lowering costs and improving outcomes.

And while all companies have some ESG risk, the social impacts of traditional health care companies—such as drug recalls, damaging medications and failed trials—have developed into increasingly important issues to ESG investors.

As a result, health care has become an area of increased focus for ESG investors, and the pandemic has brought a new awareness to things like product safety, product quality, governance overseeing product development and fairness to governments and groups who need the products.

### How to invest in health and well-being funds

Investors who believe in the importance of health and well-being—for both social and financial outcomes—can incorporate that mindset into their portfolios. You can do this by investing specifically in ESG funds focused on health and well-being, or by looking for funds that include highly ranked health-related companies.

Make sure it’s not just a bucket of health-care-related companies that may not be forward thinking. For example, investing in a telehealth company is potentially more forward thinking than investing in traditional hospitals. Follow the trends, rather than just assuming that all health care companies will do well because of the pandemic.

## How to raise hardworking kids—even when they don't have to work

Parents sometimes think they don't need to worry about teaching financial responsibility and instilling a work ethic in kids when they're young. But if they don't, it can be challenging to change a 12-year-old's behavior and even more difficult to change a 17-year-old's habits and expectations.

“Encouraging a hunger to achieve as early as possible is how a work ethic is nurtured,” says Joline Godfrey, author of “Raising Financially Fit Kids” and CEO of The Unexpected Table, a gathering place for thriving families to explore important issues. For example, Godfrey recommends giving kids challenging things to do from their earliest age, such as working with them to assemble a tall tower of blocks. The concept is to intentionally nurture delayed gratification and to not “give in” just to quiet their complaining or frustration.

“The idea is to help children stretch their ability to persist, to try again, to meet the goal,” says Godfrey. “By the time they're seven or eight, you can take them on hikes that seem a little too long, or ask them to finish tasks that are a little too hard, such as making their bed or vacuuming the playroom. This is how you prepare them for harder tasks when they're 12, 13 or 14. I wish there was a better way to prepare kids to be hard workers, but the evidence is painfully clear: doing the hard things, from an early age and repeatedly, is how the qualities of persistence and endurance are developed.”

While challenging kids to achieve goals is an important element of instilling a work ethic, it's also important for kids to understand the finite resources of money. For example, if your child wants the latest Xbox, discuss the price, how much the child has saved and what the child could do to earn money to pay for it, such as mowing the lawn six times.

And it can be equally important that kids learn to understand the purpose of earning money, with a mindset that they have a plan for spending, saving and giving. Parents can help by matching their kids' saving and giving plans—amplifying the benefit.

### Getting a job instead of a handout

For families that run a business, it can be a natural progression to have the kids participate in various ways depending on their age. For older kids, paid work should be emphasized for life experience, says Godfrey.

“Kids should have at least two or three really boring jobs, so they learn to take pride in their work and to stick with it,” says Godfrey. “But, too often, parents tell their kids to get a job and then tell them to take time off to go to Paris with the family in July and to take time off for a family gathering in August. That sends a mixed message from the parents and implies that work isn't that important.”



Some families believe that academic achievement is more important than a job when it comes to future success. Godfrey believes that hard work, including boring and repetitive work, is essential to learn life skills such as resilience and endurance.

Working hard should also translate into helping others. For example, some families take their children on mission trips to help improve the lives of people living in developing countries. These types of family mission trips can be a great way to spend quality time with your kids while modeling hard work with a more meaningful purpose.

### Earning their future

In addition to life skills gleaned from a job and schoolwork, children can be taught to understand the connection between endurance and resilience and financial success.

While it's tempting for parents of means to hand their kids great educational and life experience opportunities on a silver platter, kids also need to be grounded with realistic money management lessons.

Whether your kids go into the family business, work for the family's foundation or create their own business, it's important to make sure they understand their future is on them. They need to understand that their own hard work is what's needed to provide the lifestyle they want for themselves and their future family.

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