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"THE MARKET'S OVERPRICED"

For 34 years, I've been tuned into the financial media, and I can tell you with some certainty that the mainstream perspective takes one of two stances.

After stocks have a pullback, the bears come out to play, and maybe we're even threatening a recession. Journalists are right there to tell us that yes, while stocks have gotten cheaper, they still can get a whole lot cheaper and we're probably staring in the face of a financial crisis. Don't buy.

And after stocks have gone up, those same journalists tell us markets are overvalued and stocks are overpriced. They really can't go up any further, so … don't buy.

As I sit here on a chilly February morning in South Florida (it's a ghastly 53 degrees—not sure how we're even able to live like this), I'm trying to recall a time when the financial media gave a resounding "BUY" call on capital markets. Perhaps it's the effect of the cold, but I really can't recall any.

Yet, if you had invested $100 into the S&P 500 in 1990 (when I started my career), you would have about $2,604 today. That's an annualized 10.17% return, and you would have beaten inflation by about 7.43% annually. One would think there would have been at least a few moments in that time span when "Don't buy" wasn't very good advice.

What we are talking about here is market timing. Is there a way to judge if markets really are overpriced and perhaps it is in your best interest to sit it out and buy that attractive 5.1% CD instead?

I won't disagree that with the S&P hovering just below 5,000, its price-to-earnings ratio is higher than average. Looking up FactSet's consensus earnings estimates for 2024, the P/E is 20.0 for 2024, well above the 10-year average of 17.6 and the 30-year average of 16.6.

Some recent perspective: In March 2000, the 12-month forward consensus P/E was 25.2, and in January 2022, it was 21.4. So yes, 20.0 is definitely on the high side of the average, but it is certainly not unprecedented. (On a side note, a dollar invested in March 2000 would be about five dollars today. I'd wager there are a lot of people today who've been trying to time the markets these past three to four years that would be very happy to have gotten that return.)

So, is valuation a useful and accurate market-timing tool? I contest that the overwhelming statistical evidence I've seen over these past 34 years suggests it's not—and that neither is anything else. Markets can't be consistently timed, primarily, I believe, because the economy can't be consistently forecasted.

I like what the late Charlie Munger (Warren Buffett's closest partner and right-hand man, whom we lost in

November 2023) said about long-term equity investing and compounding: “The first rule of compounding is never to interrupt it unnecessarily.” Sage advice.

—Allen Giese, CLU®, ChFC®, ChSNC®

GOODBYE TO SOME MEMORABLE ETF TICKERS

Last year saw the closure of 224 exchange-traded funds—the second most in history behind only the year 2020. This is notable for a couple of reasons. First, it’s a reminder that ETFs are not impervious to attrition, highlighting the importance of evaluating portfolios based on the underlying investment approach and how it aligns with an investor’s long-term goals. And ETFs catering to flavor-of-the-month themes are less likely to stand the test of time.

The mass closures also provide an opportunity to eulogize some memorable tickers in the space. These are a handful of my favorites:

LJIM: RIP to the ETF composed of Jim Cramer’s recommendations. It’s ironic this one was outlasted by SJIM, the ETF shorting his recommendations.

TUNE: The music industry-themed ETF shut down after just a few months of operation. I don’t think they can blame Napster.

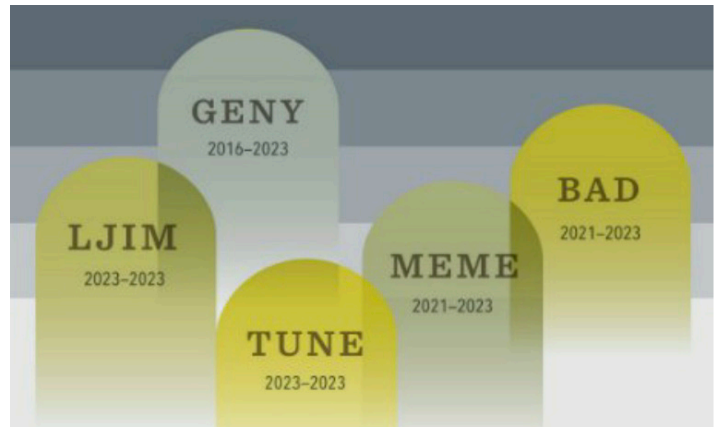
GENY: Is a work tenure of seven years on brand for a millennial-themed ETF?

BAD: Maybe investors were disappointed that this ETF had nothing to do with Michael Jackson’s album. The fund closed before the December holidays, which seems ill-advised for a “sin stock” strategy.

MEME: The meme stock ETF’s creators apparently felt demand for this ticker would be to the moon, but the tendies never came.[1]

Fund closures have been a fixture in the mutual fund space over the last 20 years. That might be a preview of what to expect from ETFs over the next 20.

— Wes Crill, Dimensional Fund Advisors



Source: Dimensional Fund Advisors.

Footnotes
1. “To the moon” and “tendies” were common slang expressions used on message boards during the meme stock craze in 2021. They refer to a large increase in value and profits, respectively.

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"BACKDOOR" ROTH IRA—IS THAT EVEN LEGAL?

For retirement savings, it's hard to beat the advantages a Roth IRA brings to the table. Funded with after-tax dollars, Roth IRAs grow tax-free, and provided you don't take a distribution until after age 59 ½ and the account has been open for at least five years, the dollars inside the Roth are available tax-free. For long-term savers, that's hard to beat.

However, a drawback to the Roth IRA is that it comes with earnings limits on income. If you make too much income, you can't contribute. To get around that, high-income savers can use something called a "backdoor Roth IRA."

A backdoor Roth IRA is a financial strategy employed by individuals whose income exceeds the limits for direct contributions to a Roth IRA. While the name may suggest something clandestine, it is a legal and widely acknowledged method within the framework of U.S. tax laws.

As I mentioned, Roth IRAs offer a unique advantage in that withdrawals, including earnings, are tax-free. However, the income limits dictate who can contribute directly to a Roth IRA. As of 2024, the ability to make direct contributions to a Roth IRA begins to phase out for individuals with a modified adjusted gross income (MAGI) above $146,000 (single filers) or $230,000 (married couples filing jointly).

The backdoor Roth IRA strategy allows individuals to navigate these income limits and still benefit from the advantages of a Roth IRA. Here's a breakdown of how it typically works:

1. Contribution to a traditional IRA: High-income earners who are ineligible for direct Roth IRA contributions can make a nondeductible contribution to a traditional IRA. Unlike Roth IRAs, traditional IRAs do not have income limits for contributions.

2. Conversion to a Roth IRA: After contributing to the traditional IRA, the individual then executes a Roth conversion. This involves transferring the funds from the traditional IRA to a Roth IRA. Importantly, there is no income limit for Roth conversions.

3. Tax considerations: While the initial contribution to the traditional IRA might not be tax-deductible, the conversion to a Roth IRA is a taxable event—but only on the gains. So, if the initial contribution to the nondeductible traditional IRA is made on day one (and not invested into any securities) and then on day two, those dollars are converted to a Roth IRA before they've had a chance to grow, there would be no taxable event since there are no gains to tax!

It's crucial to understand that the backdoor Roth IRA strategy is entirely legal, provided it is executed according to tax regulations. Additionally, tax laws can change, and it's advisable to consult with a financial advisor to ensure compliance with the latest rules and regulations.

The backdoor Roth IRA strategy is not without its considerations. One key factor is the pro-rata rule, which takes into account all traditional IRA assets when determining the tax consequences of a Roth conversion. If an individual has other traditional IRA funds, including deductible contributions and earnings, the tax implications of a backdoor Roth IRA conversion become more complex.

The backdoor Roth IRA is a legitimate and widely used financial strategy for individuals seeking to contribute to a Roth IRA despite income limitations. By understanding the rules and potential tax implications, individuals can make informed decisions to optimize their retirement savings.

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It's important to approach this strategy with transparency and compliance with tax laws, seeking professional advice to navigate any complexities and changes in regulations.

—Allen Giese, CLU®, ChFC®, ChSNC®, and ChatGPT

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