

# Breed's Hill Newsletter

## Planning Your Financial Future

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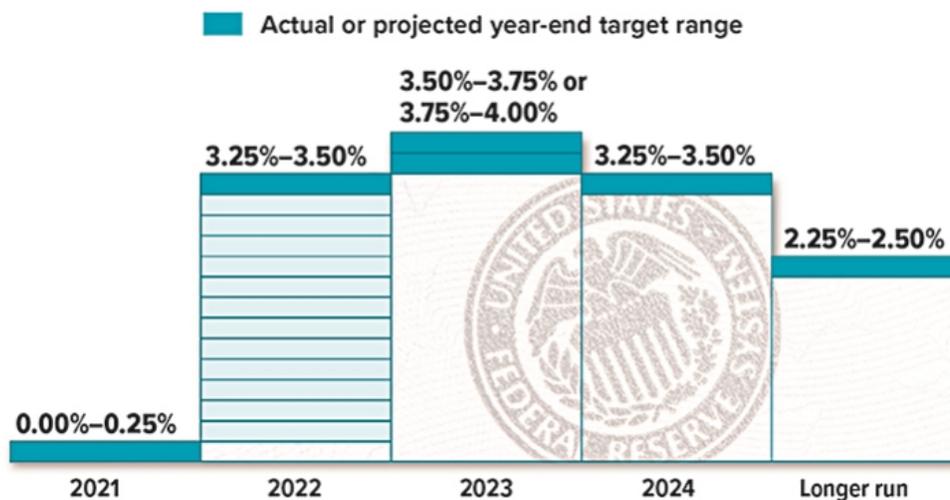


## Rising Interest Rates

After dropping the benchmark federal funds rate to a range of 0%–0.25% early in the pandemic, the Federal Open Market Committee (FOMC) of the Federal Reserve has begun raising the rate aggressively in response to high inflation. Raising the funds rate places upward pressure on a wide range of interest rates, including the prime rate, small-business loans, home-equity lines of credit, auto loans, credit-card rates, and adjustable-rate mortgages (with indirect pressure on fixed-rate mortgages).

This chart illustrates the federal funds target range at the end of 2021 and future year-end projections released after the FOMC June 2022 meeting, when the Committee raised the range to 1.50%–1.75%.

**Blue boxes represent actual or projected 0.25% federal funds target ranges**



Based on assessments of the majority of Committee members.

Source: Federal Reserve, June 2022. These are only projections, based on current conditions, subject to change, and may not come to pass.

# Dividends for Income and Total Returns

John D. Rockefeller, one of the wealthiest Americans in history, loved receiving stock dividends. "Do you know the only thing that gives me pleasure?" he once asked. "It's to see my dividends coming in."<sup>1</sup>

There may be many things other than money that give you pleasure, but you can still appreciate the stabilizing role that dividends might play in your portfolio.

## Steady and Dependable

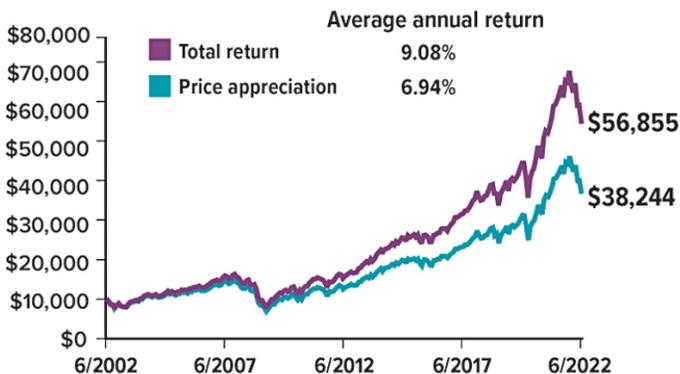
Dividends can be a dependable source of income for retirees and others who want an income stream without selling their underlying investments. If you do not need your dividends for current income, reinvesting these relatively small payments can become a powerful growth engine (see chart). Because dividends are by definition a positive return, they can boost returns in an up market and help balance declining stock prices in a down market.

Whereas stock prices are often volatile and may be influenced by factors that do not reflect a company's fiscal strength (or weakness), dividend payments tend to be steadier and more directly reflect a company's financial position. Larger, well-established companies are more likely to pay dividends, but many midsize and smaller companies do as well. Stock funds usually pay dividends based on the dividends of the stocks held by the fund. Some funds focus specifically on dividend stocks.

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## The Power of Reinvestment

Growth in value of a hypothetical \$10,000 investment in the S&P 500 index for the 20-year period ending in June 2022, comparing price appreciation and total return, which includes reinvesting dividends.



Source: Refinitiv, 2022, for the period 6/30/2002 to 6/30/2022. The S&P 500 index is an unmanaged group of securities considered representative of U.S. stocks. Expenses, fees, charges, and taxes are not considered and would reduce the performance shown if included. The performance of an unmanaged index is not indicative of the performance of any specific investment. Individuals cannot invest directly in an index. Past performance is not a guarantee of future results. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

## Quarterly Payments

Dividends are typically paid quarterly but quoted by the annual dollar amount paid on each share, so your annual income from an individual stock can be estimated by multiplying the dividend payment by the number of shares you own. Of course, the income will change if the dividend increases or decreases, or you obtain additional shares.

Dividends are also expressed as yield — the annual dividend income per share divided by the current market price. By this measure, the yield increases as the share price decreases, and vice versa, assuming the dividend payment remains the same. Current dividend yields can be helpful in deciding whether to invest in a stock or stock fund, and historical yields can provide insight into what you might expect from dividends over the long term.

At the end of June 2022, the average yield of dividend-paying stocks in the S&P 500 (about 79% of companies) was 2.18%, but the yield of the S&P High Dividend Index, which focuses on 80 stocks that pay higher dividends, was 4.11%.<sup>2</sup>

## Some Caveats

The flip side of dividend power is that dividend-paying stocks may not have as much growth potential as non-dividend payers that plow their profits back into the company. And there are times when dividend stocks may drag down, not boost, portfolio performance. Dividend stocks can be particularly sensitive to interest-rate changes. When rates rise, as in the current environment, higher yields of lower-risk, fixed-income investments may be more appealing to investors, placing downward pressure on dividend stocks. As long as a company maintains its dividend payments, however, lower stock prices could be an opportunity to buy shares with higher dividend yields.

Investing in dividends is a long-term commitment. Dividends are typically not guaranteed and could be changed or eliminated. The amount of a company's dividend can fluctuate with earnings, which are influenced by economic, market, and political events. The return and principal value of all investments fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments offering the potential for higher rates of return also involve higher risk.

*Stock funds 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. Be sure to read the prospectus carefully before deciding whether to invest.*

1) BrainyQuote.com, 2022; 2) S&P Dow Jones Indices, 2022

# How Life Insurance Could Help Mitigate Taxes in Retirement

Higher taxes could follow in the wake of soaring government spending on pandemic relief measures — a likelihood that shines a new light on the tax advantages of life insurance. Permanent life insurance offers a tax-free death benefit, and a portion of each premium goes into a cash-value account that accumulates on a tax-deferred basis. The policy owner may also access the cash value, if needed, without triggering income taxes.

Assets in tax-deferred retirement accounts will eventually be taxed as ordinary income — whether distributions are taken by the current owner or a beneficiary who inherits the account — so taxpayers with well-funded retirement accounts should bear in mind that today's historically low income tax rates are scheduled to expire after 2025.

Taking IRA distributions while taxes are low and shifting the money to life insurance could provide a hedge against future tax increases. Here are three ways in which permanent life insurance can be used to fund retirement and estate strategies.

## Supplement Retirement Income

The cash value is available for emergencies as well as for normal retirement expenses such as housing costs and health care. You can generally make tax-free withdrawals (up to the amount paid in premiums) or use loans to tap into the accumulated cash value. Although policy loans accrue interest, they are free of income tax (as long as they are repaid) and usually do not impose a set schedule for repayment.

Still, you should generally have a need for life insurance protection and evaluate a policy based on its merits as such. Loans from a life insurance policy will reduce the policy's cash value and death benefit, could increase the chance that the policy will lapse, and might result in a tax liability if the policy terminates before the death of the insured. Additional out-of-pocket payments may be needed if actual dividends or investment returns decrease, if you withdraw policy cash values, or if current charges increase.

## Help Pay for Long-Term Care

Many retirees worry that their savings could be depleted later in life by the escalating cost of long-term care. A long-term care rider attached to a life insurance policy could help pay for these expenses if they are ever needed. Any payouts for covered expenses would reduce (and are usually limited to)

the death benefit, and they are typically much less generous than those of a traditional "use-it-or-lose-it" long-term care policy. Optional benefit riders are available for an additional cost and are subject to the contractual terms, conditions, and limitations outlined in the policy; they may not, however, benefit all individuals.

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## Budgeting for Long-Term Care

Medicare pays for up to 100 days in a skilled nursing facility after a qualifying hospital stay of three or more days, and provides limited coverage for home health care. Medicaid pays for some long-term care services, but eligibility is based on the person's income and assets, and often requires "spending down" to qualify.

### National monthly costs, 2021



\*Based on 44 hours per week

Source: Genworth Cost of Care Survey, 2022

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## Leave a Tax-Free Legacy

Most nonspouse beneficiaries who inherit IRAs must now empty the account within 10 years, and heirs who are forced to take distributions in their peak earning years could face large income tax bills. By contrast, the death benefit from a life insurance policy could provide a tax-free inheritance.

*Before implementing a strategy involving life insurance, it would be prudent to make sure you are insurable. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. In addition to the life insurance premiums, other costs include mortality and expense charges. If a policy is surrendered prematurely, there may be surrender charges and income tax implications. Any guarantees are contingent on the financial strength and claims-paying ability of the issuing insurance company.*

# Uncle Sam Wants to Know About Your Gig Income

If you earn money through an app or online digital platform, you may be affected by a tax reporting change that took effect on January 1, 2022. A provision of the 2021 American Rescue Plan requires third-party payment processors to report business transactions totaling over \$600 per year by issuing a Form 1099-K to the taxpayer and the IRS. In prior years, the reporting threshold was much higher (200 business transactions and \$20,000).

Here are a few things you should probably know about this far-reaching new rule.

**It's not personal.** Business transactions are defined as payments for goods or services, including tips. Money received from the online sale of personal items like old clothing or furniture, which are normally sold at a loss, is not taxable and does not need to be reported. However, those in the business of reselling goods for a profit should carefully track the original costs of their purchases. Peer-to-peer payment apps are not required to report personal transactions intended as gifts or used to pay back friends for dinner or trips, or to split other costs. How will third-party apps know the difference? The payer will be asked to indicate the purpose of each transaction so it can be categorized correctly.

**It's not a tax change.** Taxpayers who sell goods, regularly rent out a vacation home, walk dogs, or perform any other type of freelance work through

digital platforms were already responsible for self-reporting all income for tax purposes. But now the IRS will have a way to cross-reference the information sent by third parties with amounts reported by individuals and businesses on their tax returns.

**It's not foolproof.** This change may cause confusion that could result in costly mistakes. If a payer (such as a roommate making a shared rent payment) accidentally clicks on the wrong box, the recipient could receive a Form 1099-K for a transaction that is not taxable. It's also possible that a freelancer will receive a Form 1099-K from the payment processor and a Form 1099-MISC from the client for the same transaction. In such cases, the taxpayer may need to explain the discrepancy to the IRS.

Using separate accounts for business and personal digital transactions could make things simpler at tax time. Keeping detailed and organized records will help ensure that your tax return is accurate, so you don't overpay or raise any red flags with the IRS.

Because the new reporting requirement may have unintended consequences that frustrate taxpayers, some lawmakers have proposed raising the threshold to a less onerous level. While it's far from certain that Congress will backtrack on this issue, you may want to watch for future developments. If you have questions about how the new rule might affect you, don't hesitate to consult a qualified tax professional.

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