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With Artificial Intelligence (AI) dominating the market headlines recently I thought maybe I would just have Chat GPT write my introduction but alas, I decided to go “old school” and provide you my own human thoughts. It has been a busy start to the year for our team at First Merchants as we have executed a number of projects to improve our technology and advance the digital experience for both you and our team. While those projects could have been a distraction for our team, we always kept our clients at the forefront of our daily activities. We were able to continue partnering with individuals, families, and institutions to provide comprehensive solutions and personal service in pursuit of a secure financial future. I hope you enjoy our team’s thoughtful work in this edition of *Perspectives*. Thank you for taking time to engage with the thoughts of our team and to benefit from our perspective.

Michael Joyce  
President, Private Wealth Advisors



## INVESTMENT MANAGEMENT



### 2024 Mid Year Review

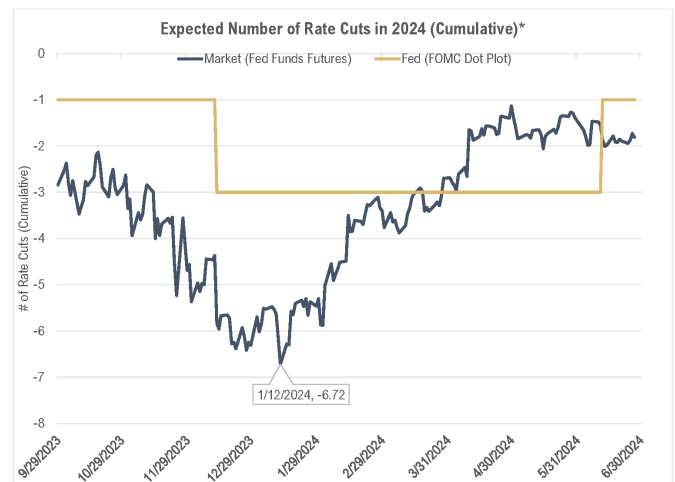
Interest rate cuts were top of mind for market watchers entering 2024. After an aggressive rate hike cycle that saw eleven hikes over a 16-month period from March 2022 to July 2023, the Fed Funds futures began the year pointing to the possibility of as many as seven rate cuts in 2024.

The inflation rate was in the spotlight, and if the data continued to show the rate falling back toward the Federal Reserve’s target of 2%, the prospects for multiple rate cuts looked good. However, what unfolded over the first half of the year wasn’t exactly as forecasted. As the monthly inflation numbers rolled in, a concerning trend began to show. The December inflation number was higher than expected, followed by the January inflation number coming in above expectations, then the February number, and the March number. By the time of the March Fed meeting, it was clear that inflation was proving more stubborn than originally thought, and the March Fed meeting came and went without a rate cut.

Both the stock and bond markets adjusted quickly to the prospect of “higher for longer” interest rates. Stocks declined for several weeks in April and bond yields moved higher as the markets prepared for an extended period of

higher rates. Other indicators also signaled there was not an immediate need for rate cuts. The unemployment picture remained strong, with the national unemployment rate at 4% or below. Consumer spending also remained robust, supporting the notion that rate cuts weren’t necessary to stimulate the economy. Fed Chairman Jerome Powell even stated in late March: “This doesn’t feel like an economy that is suffering from the current level of rates.” The inflation data improved in April and May, coming in at or below expectations. The Federal Reserve stuck with the wait and see approach at the June meeting, again electing not to cut rates but pledging to continue to watch inflation, employment, and other economic indicators for signs of economic stress. We reached the half-way point of the year with no rate cuts and both the futures market and the Federal Reserve dot plot forecasting just one rate cut for the year, most likely in September.

Save for the brief interruption in April to digest the absence of a rate cut, the stock market advanced steadily through the first half of the year. Led once again by very strong returns from a small group of stocks, the S&P 500 had a total return of 15.3% through the first half of the year. The narrow breadth was a continuation of a trend that emerged in 2023, when seven leading stocks were given the name Magnificent 7 or “Mag 7.” Comprised primarily of technology companies, these seven stocks (Alphabet, Amazon, Apple, Microsoft, Meta, Nvidia, Tesla) have collectively advanced by more than 110% from the end of 2022 through May 2024. Over the same period, the S&P 500 as a whole has returned approximately 38% excluding dividends. It would be an understatement to say that the contribution of the Mag 7 stocks has been significant. If you include Broadcom and Eli Lilly in the mix in place of Tesla, those 8 stocks represent 73% of the return for the entire S&P 500 index so



\*Assumes quarter percentage point cuts



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far in 2024. The excitement surrounding Artificial Intelligence (AI) has been a catalyst behind the success of the Mag 7 as investors jostle for position in what they hope to be the early innings of the next technological revolution. Specifically, the largest stock gains have come from companies whose products include microchips used in AI applications, like Nvidia and Broadcom who both recently announced 10-for-1 stocks splits to make their share price more affordable to the masses. As the AI revolution gains momentum, other large tech companies like Apple, Microsoft and Amazon rely on these chips to power their products and services.

Taking a deeper dive into the success of these stocks leads to some interesting observations. Most notably, the headline grabbing returns of the Mag 7 could very well be masking the reality of challenges across the rest of the market. In fact, the earnings growth for the S&P 500 excluding the Mag 7 has been negative for 5 straight quarters. All of the earnings growth for the S&P 500 in 2023 came from the Mag 7. Just two industry sectors, Technology and Communication Services, have contributed 72% of the overall return for the S&P 500 so far in 2024. This is in contrast to 2022 when the Mag 7 stocks detracted from earnings growth and returns of the overall market. Forecasts show the gap in earnings growth between the Mag 7 and the rest of the S&P 500 is expected to narrow in the quarters ahead, but it definitely bears watching.

Politics will take center stage in the second half of the year, leading up to the US Presidential election on November 5th. While a Democrat sweep looks unlikely at this point, a Republican sweep is not out of the realm of possibility. The combination of increased support for former President Trump after the failed assassination attempt, Democrat voters who may be not comfortable voting for Vice President Harris as a late replacement for President Biden on the ticket, and a Senate class that includes many more vulnerable Democrat than Republican seats, could produce a Republican president and GOP control of both houses of Congress. The most likely outcome, however, is a split government with no single party control over all three pillars. A divided government is becoming more common, with the US not experiencing consecutive presidential terms with all three pillars under one party since 2007. In the 20th century, a party held the House for 12 years on average and the Senate for 8.5 years on average after winning a majority. This century, that number has fallen to 4.8 years in both chambers. Both parties are responsible for adding to the nation's growing debt burden; Republicans through tax cuts and pandemic stimulus, and Democrats through continued post-COVID deficit spending. Specifically, as it relates to the

budget deficit and national debt, a divided government may be the best-case scenario. Worldwide, this is a record-breaking year for elections as more than two billion voters in 50 countries will be heading to the polls, potentially bringing dramatic change to the global political landscape.

There is no shortage of themes to watch in the second half of the year. In recent years, geopolitical risks appear to be getting hotter, rather than cooler. Greater uncertainty surrounding the future path of policy leading up to the election may contribute to increased market volatility, especially given current market valuations. We have come to expect at least one "October Surprise" in election years. Labor markets deserve attention, as large-scale layoffs and rising unemployment often signal a coming recession. The inflation numbers will be closely watched as well, with strong demand for services and housing leading to sticky inflation so far. Cracks in the housing market, signified by pullback in housing demand and falling home prices, would be another recession signal. While the long-held belief is that the stock market likes lower interest rates, the reality is that a Federal Reserve that is lowering rates, and even more so one that is aggressively lowering rates, means that the economy has stalled or slowed enough that it needs stimulating. Since the market is constantly forward-looking, often the best returns come while anticipating lower interest rates, as we have seen over the past year. By the time the actual rate cuts occur, whatever the reason for the cuts may be enough to dampen market enthusiasm. No matter the circumstances, as always, your team at First Merchants Private Wealth Advisors will be monitoring the situation closely, providing advice, and positioning your investments to give you the best possible chance for success.

Travis McEowen  
Portfolio Manager



## WEALTH MANAGEMENT



### Popular Tax Favored Strategies

Tax-favored strategies such as Roth IRA and Roth 401Ks, 529 plans, and HSAs (Health Savings Accounts) are essential tools for US taxpayers seeking to optimize their financial planning while minimizing tax liabilities. These strategies serve specific purposes:

Roth IRAs and Roth 401Ks are primarily used for retirement savings, with

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contributions made after taxes but withdrawals, including earnings, being tax-free. As of 2024, individuals can contribute up to \$7,500 annually (\$8,000 if aged 50 or older), subject to income limits that phase out eligibility starting at \$144,000 AGI.

529 plans, on the other hand, are tailored for saving towards qualified education expenses like college tuition. Contributions are made with after-tax dollars, and withdrawals for educational purposes are tax-free. Contribution limits vary by state but can be substantial, with potential gift tax considerations if contributions exceed \$18,000 annually per beneficiary. Many states also offer tax incentives such as income tax deductions or credits for contributions to these plans. As of 2024, 529 plan account owners or beneficiaries can roll over 529 funds into a beneficiary-owned Roth IRA tax free and penalty free. However, the 529 plan must have been active for at least 15 years before it is eligible for rollover. The maximum amount of the rollover is \$35,000 and is subject to annual Roth IRA contribution limits.

Meanwhile, HSAs enable individuals covered by high-deductible health plans (HDHPs) to save pre-tax or tax-deductible funds for qualified medical expenses, with withdrawals for such purposes being tax-free. For 2024, contribution limits are set at \$3,000 for individuals and \$7,200 for families, with an additional \$1,000 catch-up contribution permitted for those aged 55 or older. Eligibility hinges on meeting specific HDHP requirements regarding deductibles and out-of-pocket maximums established by the IRS annually.

These accounts are designed with specific rules and benefits to help taxpayers save, invest, and plan effectively for retirement, education, and healthcare expenses while enjoying tax advantages that enhance their financial outcomes. This article outlines the fundamentals of highly used tax favored strategies. For more advanced strategies, such as Roth conversion, HSA accumulation or Dynasty 529s, we can assist with the process. The choice of strategy depends on individual circumstances, goals, and preferences. Each option has specific rules and considerations, so it's essential for taxpayers to consult with a Wealth Manager or tax professional to determine the best strategies based on their individual circumstances and goals.

Kevin Gentner  
Wealth Advisor



## PRIVATE BANKING



### Navigating Borrowing Costs in Private Banking: What Clients Should Expect

In the realm of private banking, where tailored financial solutions meet personalized service, understanding borrowing costs is crucial for making informed decisions.

Whether you are considering a mortgage, a line of credit, or financing for investments, the current economic landscape and future expectations play a pivotal role. Here's a comprehensive look at what private banking clients should know about borrowing costs in today's market.

### Current Interest Rate Environment

Interest rates are a cornerstone of borrowing costs, directly impacting the expense of loans and credit facilities. Over the years, central banks globally have adjusted rates in response to economic conditions, aiming to balance growth with inflation. In times of economic expansion, rates may rise to cool down inflationary pressures, while during economic downturns, rates typically decrease to stimulate spending and investment.

# 2024

Throughout the course of the past year, interest rates have been increased in unprecedented fashion in response to stubbornly elevated inflationary concerns. Private banking clients should stay informed about these trends as they directly influence the rates offered by financial institutions.

### Factors Influencing Borrowing Costs

Beyond central bank rates, several factors influence borrowing costs in private banking:



**Creditworthiness:** Your personal financial profile, including credit score, income stability, and balance sheet composition, significantly influences the interest rate you are offered. Private banks often provide tailored rates based on these factors, aiming to reflect your credit risk accurately.

**Loan Type and Term:** Different types of loans (e.g., mortgages, personal loans, or margin financing) and their respective terms (fixed vs. variable rates, short-term vs. long-term) carry varying interest rates. Variable rates are a prevalent option for many private banking clients as borrowing needs most often bridge funding gaps between liquidity events. These financing vehicles are structured as lines of credit as a mechanism to uniquely leverage the strength of a personal balance sheet without the need to liquidate assets. Establishing personal lines of credit are highly recommended to maintain in place as a part of your overall balance sheet management.

**Market Conditions:** The broader economic environment, including inflation expectations, geopolitical events, and market sentiment, can impact borrowing costs. For instance, periods of economic uncertainty may result in higher rates to account for increased risk.

### **Expectations Moving Forward**

Looking ahead, private banking clients should consider the following expectations regarding borrowing costs:

**Potential Rate Changes:** Anticipate fluctuations in interest rates as central banks adjust policies in response to economic indicators. Stay informed through your private banker or financial advisor about how these changes might impact your borrowing costs.

**Customized Solutions:** Private banks excel in offering customized financial solutions tailored to individual client needs. This includes not only competitive rates but also flexibility in structuring loans and credit lines to optimize financial strategies.

**Risk Management Strategies:** Given the dynamic nature of financial markets, implementing risk management strategies is crucial. This may involve diversifying your borrowing across different types of loans, incorporating a strategy of floating or fixed rate options to maximize an interest rate environment or hedge against potential rate increases.

### **Conclusion**

In conclusion, understanding borrowing costs is fundamental for private banking clients seeking to optimize their financial strategies. By keeping abreast of current interest rate trends, factors influencing borrowing costs, and future expectations, clients can make informed decisions that align with their long-term financial goals. Leveraging the expertise and personalized service of your private banker ensures you navigate borrowing costs effectively in a rapidly evolving economic landscape.

Navigating the realm of borrowing costs in private banking requires vigilance, but with the right knowledge and guidance, clients can seize opportunities and mitigate risks effectively.

Nancy Leming  
Director, Private Banking