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REGISTERED INVESTMENT ADVISER

FINANCIAL NEWSLETTER

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SPRING 2021

THE CRYSTAL BALL

When the new year unfolded, we were all wondering how long it would take before things were back to "normal." Well, we are coming into the halfway mark of 2021, and although there is a beacon of light shining all around, there are still plenty of shadows that make us uncertain about what the rest of the year will bring.

The Crystal Ball section of our newsletter comments on the investment environment, not necessarily on the political and societal issues we face daily. Although those subjects do impact the investment environment, we all get enough of that in the newspapers, on the internet, and on TV. Let's take a needed break.

Here is what is going on now in the investment arena. The market indexes like the Dow Industrial Average or the S&P 500 are at or near all-time high levels. House prices are at extremely high altitudes in part due to diminishing supply. This is the economic rule of supply and demand at its finest.

Interest rates have risen on the 10-Year Treasury (a good benchmark) from below 1% to over 1.7%. That is a big percentage jump. You might figure that rates are rising because the economy is recovering from the COVID lockdowns. That would make sense and that's what we think. But you also might ask, "Isn't it bad for the stock market when interest rates rise?" The answer to that is "no," but it is not a strict "no." If rates get up to levels where investors start shifting money into CDs or treasuries because rates now compete with yields that come from stocks (without as much of the perceived risk), then you could see a shift out of the stock market and an ensuing correction in the stock indexes. However, it doesn't appear that we are there quite yet. Many individual company stocks have had 20-30% corrections already. There is a sector rotation going on and it tells us that money isn't necessarily coming out of the stock market, it is just moving around.

What about inflation? We've heard Fed Chairman Powell dismiss an inflation problem as being unlikely. But is it? Look at asset prices now from stocks to bonds to real estate to collectibles. It sure looks like we have seen quite a bit of inflation, just not in the categories that the government deems important for their inflation figures. Think about the monetary and fiscal stimulus that is occurring and add in the fact that households have in general shored up their balance sheets and now have a higher capacity to spend and borrow. The Fed has a 2% inflation target. They should be able to hit that but anyone who lived through the big inflation of the 70s here in the United States has to be concerned about the "Inflation Genie" getting out of the bottle.

The bottom line is this: Just like the weather, the investment climate changes. Successful investors adapt. We'll likely look back on 2021 as a transition year. Tax increases, inflation scares, market volatility, political turmoil… you name it and we'll probably see it. But just as we've experienced things in the past, we'll get through them again this time. Of course, we'll look back and wonder how we did it. And then we'll look forward to the challenges and excitement that the future always brings. It's the way of the world. Be ready.

Overheard

"It's been a strange day. First, I find a hat full of money, then I get chased by an angry man with a guitar."

STOCK CORNER

Many investors "cringe" at the thought of taking profits because of the capital gain taxes that will be due. That certainly is a fair point. However, here is another way of thinking. If you don't do anything, there are three possible outcomes…

1) No movement in the stock price, so you are even-steven.
2) The stock price rises thus intensifying the capital gain "problem" you are trying to dodge.
3) The stock price falls, reducing the gain and the taxes that would go with it if you sold.

Here's a final thought: The purpose of investing is to make money. So, if you purchase a stock and it hits your target price (and you can't justify a higher price), then taking a profit is not a bad outcome, even if you have to share with Uncle Sam. Doesn't that make sense?

UNSOLICITED (BUT GOOD) ADVICE

If you get caught up in the SPAC (Special Purpose Acquisition Company) or the NFT (Non-Fungible Token) or the Cryptocurrency excitement, here's the advice: Before considering the ***Rewards***, first consider the ***Risks***.

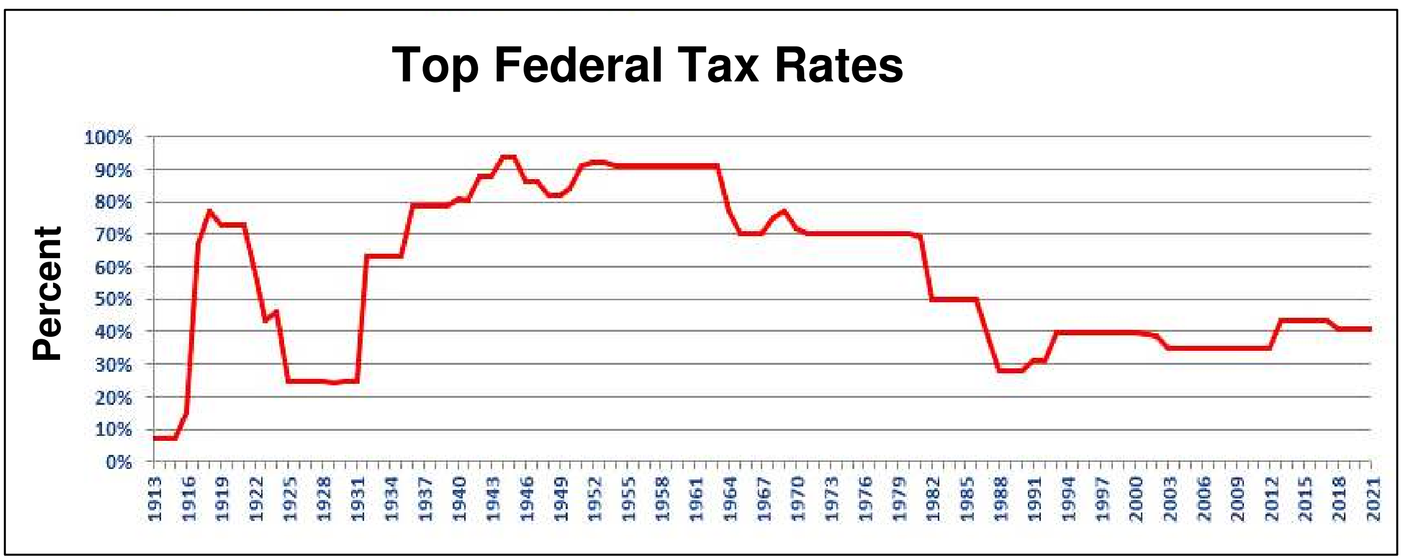
Something to Remember

"When the weather is good for the crops, it is also good for the weeds."

TIPS FOR A FIRST-TIME HOME BUYER

If you are a first time home buyer or a parent assisting your child with a house purchase, here are some suggestions to consider:

- **Know what you can afford.** There are no hard-and-fast rules for how much debt you can take on—though if your mortgage is insured by the Federal Housing Administration, your housing costs generally shouldn't be more than 31% of your gross monthly income. No matter what calculation you use, the key is to not overburden yourself.
- **Check your credit score.** Having a better credit score can mean lower mortgage rates. Paying your bills on time and keeping your credit card balances low can help.
- **Understand the other costs involved.** Buying a home could involve more than just monthly mortgage payments. You will also have to pay property taxes and will likely have to carry some kind of homeowners' insurance. If you're looking at a condo that offers shared facilities such as a pool, you might also have to pay monthly association fees. Such expenses could become a headache in the event of a job loss or financial setback.
- **Plan to put down at least 20%.** Most lenders won't require you to put at least 20% down these days, but it's a good idea to do this anyway. Otherwise, your lender will probably require you to carry private mortgage insurance (PMI). In general, the higher your down payment, the easier it will be to qualify for a mortgage loan and negotiate the lowest rate. Also, the more you agree to put down, the likelier the chance that your purchase is competitive with other bids.
- **Get pre-approved for a loan.** Getting pre-approved lets you know how much home you can buy before you go house hunting. Plus, it lets real estate agents and sellers know that you're a serious buyer because your financing is already arranged.



TOP FEDERAL TAX RATES

On the previous page, we show a chart of the Federal Income Tax rates since inception in 1913. As you can see, at first the tax rates were low but it didn't take long for the slippery slope of tax increases to find their way into people's pocketbook. Over time, the top rates have been over 90% (talk about a disincentive to work!). Rates aren't quite that high now, but they will be rising from their recent levels. Could they go higher? Of course, just look at the chart! The only thing we can say is to be prepared and not surprised if you find you are paying more taxes in the future. Whether or not you agree with the government stimulus spending plan, someone is going to pay, and not surprisingly that someone is us.

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CHARITABLE GIFTS

Here are two good tax efficient ways to make a charitable gift.

The first is the QCD or Qualified Charitable Distribution. This can be done from an IRA for anyone over 70½. The donation is paid from the IRA directly to the charity and the distribution will count toward the annual Required Minimum Distribution, and will not be taxed as income to the IRA owner or the charity. The maximum limit on a QCD is $100K per year per person.

A second option is to "gift" appreciated stock from your trust account. This is beneficial in that the charity can sell the stock, realizing the gain, and is not required to pay tax on the gain. There is no limit on the amount you can donate, but your deduction is limited to 30% of your adjusted gross income if the stock being sold would generate long-term gains. You also have to itemize to get credit for charitable deductions. Call with any questions.

PERSONAL NOTES

Dorothy B. – Happy 100th! You are such a great person and thanks for allowing us to be part of the celebration!

Sheldon and Susan – Happy upcoming 50th anniversary!

Kyo M. – Our respect for your calm wisdom is immense.

Karen H. – Thanks for your "guardian angel" thoughtfulness!

WHEN LONG-TERM CARE RATES INCREASE

There's been an unfortunate, but recurring situation going on within the Long-Term Care (LTC) insurance arena involving rate increases. While each carrier can have their own reasons for a rate increase, a common theme has been that the actuarial assumptions assumed at policy issue have not been the reality for the insurance carrier. Stated plainly, insureds are often keeping these policies longer than expected, and the amount of claims has been more than planned for by the carrier.

Except in unique circumstances, LTC policy premiums are not guaranteed, but are issued on a "level" pay (non-increasing basis). A LTC insurance company cannot simply choose to raise rates on an individual policy holder (say for having made a claim), nor can they raise rates at their discretion on a group of policy holders. To raise rates, the carrier must demonstrate to their state department of insurance that an increase is necessary to maintain the financial security of the company and meet their claims exposure. While a carrier may make a case for a set increase, it is the state department of insurance that decides what will be approved and this can be less than what was applied for.

While a carrier makes their case to the department, some may elect to stop offering new policies in order to cap their risk prior to the increase. The process within a given state can be lengthy, so this can keep premiums unaffected until an increase is ultimately approved. If approved, policyowners are typically offered choices since the increase has been forced upon them.

The first is to accept the increase and keep benefits under the policy unaffected. The second is to permit the policyowner to reduce benefits under the policy to lower the post-increase premium back to a pre-increase level. This is often done by changing (or dropping) inflation protection or lowering the duration in which benefits are paid. While this may keep the future cost on par with the original level, it also leaves the policyowner more exposed due to the reduction in benefits.

A final option is known as Contingent Nonforfeiture. This option is only available when the carrier raises rates. Here, the insurance company will offer a benefit equal to total premiums paid (less any prior claims). No future premiums will be due, but benefits are severely reduced and will not grow.

When faced with an increase on LTC, it is best to carefully review the pros and cons of all options with the agent who sold the policy or the insurance carrier.

For those who may face that with us, know we will be here to help!

A STORY

It was a new route for the airline, and by a twist of fate, two rookie pilots were at the controls while descending for landing. The first pilot looked out of the window of the cockpit and said to the second pilot, “Whoa, look how short that runway is…I’ve never seen one that short.”

The copilot said, “Jeez, you’re right. That is ridiculous. Do you think we can make it?”

“We don’t have a choice.” said the first pilot. “We have to land because we are out of fuel.”

The pilot got on the intercom and calmly said, “Prepare for an emergency landing.” The passengers shrieked in fear.

He then set the flaps to full down and slowed the plane to just over stall speed.

The jet came screaming in. The pilots’ hands were sweaty and shaking. They touched down and the plane went screeching off the tarmac and bounded 500 yards into a field before coming to an abrupt stop. “Wow, that was close!” yelled the pilot. “That runway was unbelievably short!”

His copilot agreed, shaking his head and adding, “Well, even though it was short, it sure was wide!”

THINGS I’VE LEARNED

- You gotta make an effort.
- Always deliver more than expected.
- Cost only becomes an issue in the absence of value.
- “It’s not the critic who counts…not the one who points out how the strong man stumbled or how the doer of deeds could have done better.”
- To have a friend, you have to be a friend.
- A cat that jumps on a hot stove will never jump on a hot stove again, but it will never jump on a cold one either.
- It is better to look forward to something, than to look back on something.
- The palest ink is better than the best memory.
- You make your choices, so deal with the consequences because you own them.
- It’s not a good thing when everyone is on one side of the boat.
- It’s easier to say “no” than to say “yes”.
- It’s ok to give the benefit of the doubt. Once.
- Sometimes it’s better to just pay the darn taxes.

Phil’s Opinions and Judgments…

On a Ridiculous Pandemic Protocol …

When I read that amusement parks would be opening soon, I thought, “That’s a good light at the end of the tunnel.” Then I read that screaming on a roller coaster ride would be prohibited! That sure seems like a tough rule to enforce!

On the NCAA Basketball Tournament …

If you had the good fortune of watching the Gonzaga vs. UCLA semifinal NCAA March Madness basketball game, you know that you witnessed perhaps one of the greatest games ever in college basketball tournament history. You don’t have to be a sports fan to appreciate the competitive spirit of these two teams. What a game!

On Canaries in the Financial Coal Mine …

This year, we’ve already had one family office hedge fund and one large British finance company bite the dust. What was the common denominator? **LEVERAGE/DEBT**. Every financial crisis has the same common denominator. Here’s hoping that our Federal Government comes to their senses about piling debt upon debt.

On the Planned Tax Increases …

Invariably, when the government says that they are raising taxes only on the “rich”, they end up with a direct hit on the middle class. Just watch, it will happen again.

Until next time,

Phil Paul Clete Vance Sylvia