Strategies for Financial Wellness: Managing Debt, Cash Flow and Savings

Sarah Ruef-Lindquist, JD, CTFA

In the Spring 2018, I wrote about Financial Wellness in general, and how good financial planning and cash-flow management can support overall health and well-being. A lot has changed in the past two years, and the topic is more relevant than ever.

Given what many are calling the most severe economic downturn since the Great Depression in the wake of the pandemic, I would like to explore what often become the most significant issues for people facing a financial crisis – and how to build resiliency to downturns – drawing on material published by our colleagues at Commonwealth Financial Network (CFN).

Debt. Generally, people carry some amount of debt: a student loan, mortgage, or car loan. It can be financially smart to make a large purchase using someone else's money. Borrowing allows one to purchase big-ticket items with less out-of-pocket cash. And, with today's attractive interest rates, at a relatively low cost. Taking on any amount of debt comes with risk; A financial setback can reduce your ability to repay a loan, and debt may prevent taking advantage of other financial opportunities.

How Much Debt is OK?

Take a close look at your personal finances, focusing on the following factors:

Liquidity. If there is anything many people have learned in 2020 is that it's a good idea to maintain an emergency fund to cover three to six months' worth of expenses. CFN warns us to guard against keeping more than 120 percent of your six-month expense estimate in low-yielding investments. And don't let more than 5 percent of your cash reserves sit in a non-interest-bearing checking account.

Current debt. CFN also stresses that total monthly debt payments like mortgages should not exceed 36 percent of monthly gross income. Consumer debt payments—credit card balances, automobile loans and leases, and debt related to other lifestyle purchases—they also say should total less than 10 percent of your monthly gross income. If your consumer debt ratio is 20 percent or more, avoid taking on additional debt.

Housing expenses. Monthly housing costs—including mortgage or rent, home insurance, real estate taxes, association fees, and other required expenses—shouldn't amount to more than 31 percent of monthly gross income, according to CFN. Lenders use their own formulas to calculate how much home you can afford based on your gross monthly income, your current housing expenses, and your other long-term debt, such as auto and student loans. For a mortgage insured by the Federal Housing Administration (FHA), your housing expenses and long-term debt should not exceed 43 percent of your monthly gross income. With mortgage interest rates dropping to historic lows, many are refinancing or considering refinancing. If you are in the first few years of your existing mortgage, this can make sense, or if you would like to reduce payments to improve cash flow, this can be a great strategy. If you're close to paying off your mortgage, however, it may not make sense given how the interest portion of payments are smallest as the mortgage reaches maturity.

Evaluating Mortgage Options. If you're in the market for a new home, the myriad of mortgage choices can be overwhelming. Fixed or variable interest rate? Fifteen- or thirty-year term? If it were merely a question of which mortgage provided the lowest long-term costs, the answer would be simple. In reality, the best mortgage for a particular household depends on how long the homeowner plans to stay in the house, the available down payment, the predictability of cash flow, and the borrower's tolerance for fluctuating payments.

How long will you be in that home? One rule of thumb is to choose a mortgage based on how long you plan to stay in the home. If you plan to stay 5 years or less, consider renting. If you plan to live in the house for 5 to 10 years and have a high tolerance for fluctuating payments, consider a variable-rate mortgage for a longer term, such as 30 years, to help keep the cost down. If the home is a long-term investment, choose a fixed-rate mortgage with a shorter term, such as 15 or 20 years.

Is a variable-rate mortgage worth the risk? Keep in mind that it's generally not wise to take on a variable-rate mortgage simply because you qualify for one. With interest rates at historic lows, the direction they are likely to go is up. Although these mortgages offer the lowest interest rate, they're also the riskiest, as the monthly payment can increase to an amount that may prove difficult to meet. Selecting a shorter loan term, such as 15 years, can help lessen this risk.

Remember, when it comes to taking on debt, the loan amount you qualify for and the amount you can comfortably afford to repay may not be one and the same. Be sure to consider your special circumstances before taking on debt to buy a home or make another major purchase.

Savings. A standard recommended savings rate is 10 percent of gross income, but your guideline should depend on your age, goals, and stage of life. For example, as retirement nears, you may need to ramp up your savings to 20 percent or 30 percent of your income. Taking full advantage of tax-deferred retirement savings and employer match programs are almost always good ideas. Direct deposits, automatic contributions to retirement accounts, and electronic transfers from checking accounts to savings accounts can help you make saving a habit.

This material has been provided for general informational purposes only and does not constitute either tax or legal advice. Although we go to great lengths to make sure our information is accurate and useful, we recommend you consult a tax preparer, professional tax advisor, or lawyer.

A Best Place to Work in Maine

Allen Insurance and Financial was recently named as one of the 2020 Best Places to Work in Maine. This is the company’s ninth consecutive year on the list.

The awards program was created in 2006 and is a project of the Society for Human Resource Management – Maine State Council and Best Companies Group. Partners endorsing the program include: Mainebiz, the Maine State Chamber of Commerce and Maine HR Convention.

This statewide survey and awards program was designed to identify, recognize and honor the best places of employment in Maine, benefiting the state’s economy, its workforce and businesses. The 2020 Best Places to Work in Maine list is made up of 84 companies in three size categories: small (15-49 U.S. employees), medium (50-249 U.S. employees) and large (250+ U.S. employees). With 70 employee-owners, Allen Insurance and Financial is in the medium size category.

Companies from across the state entered the two-part process to determine the Best Places to Work in Maine. The first part consisted of evaluating each nominated company’s workplace policies, practices, and demographics. This part of the process was worth approximately 25% of the total evaluation.

The second part consisted of an employee survey to measure the employee experience. This part of the process was worth approximately 75% of the total evaluation. The combined scores determined the top companies and the final rankings. Best Companies Group managed the overall registration and survey process in Maine and also analyzed the data and used their expertise to determine the final rankings.

Allen Insurance and Financial will be recognized in the Oct. 19 edition of Mainebiz where the rankings will be released for the first time.

Checklist: Winter Storage for Boats

Source: PatriotInsuranceco.com

Sadly, boating season will come to an end soon, and Old Man Winter will be paving the way for snowmobiles. Winter storage for boats takes some careful planning. If you follow a checklist, winterizing your boat can be easy, ensuring your boat will be in great shape come spring.

For safe winter storage for your boat, follow our checklist:

Inspect for damage.

- Thoroughly inspect the boat for any damage. Repair now, if possible.
- Check electrical systems and appliances to make sure they are functioning properly (make repairs before storing the boat, if possible).
- Check the battery to make sure it is fully charged before storing.

Prep the fuel system.

- Fill the fuel tank but leave enough room for expansion.
- Treat the fuel with a stabilizer, then run the engine for 10 minutes to get it circulating throughout the engine.

- Seal the fuel valves.

Winterize the engine.

- Change the oil and replace filters.
- Flush the engine with fresh water, then let it drain.
- Wash the engine with soap and water. Rinse thoroughly.
- Fog the engine cylinders with an aerosol fogging solution.
- Lubricate the engine’s grease fittings.

Flush the cooling system.

- Drain any remaining coolant.
- Run a less toxic propylene glycol antifreeze through the system.

Clean inside and out.

- Clean the boat inside and out, removing any plant life or barnacles.
- Remove any valuables from inside the boat.
- Take out any food or drinks.
- Bring home any cushions and store them in a cool, dry place.

Store your boat.

- Remove the battery and store it in a safe, dry spot.
- Consider purchasing a dehumidifier for the storage area to help prevent mildew.
- Lock your boat (and leave a key with the marina manager, if applicable).
- Cover and store your boat.
- Check your boat periodically or have the marina check it and report to you.

Then, when spring comes around, make sure you have the right protection for your boat. Talk to an Allen Insurance representative about boat insurance.

You’re New to Maine. Did You Know Your Medicare Coverage May Not Travel With You?

Original Medicare, Parts A & B, travel with you, no matter where you go in the U.S.

On the other hand, Medicare Part C (advantage plans) and Medicare Part D (drug plans) don’t travel so well – you will want to make sure your plans will work for you in your new service area.

If you have moved from one state to another, you are eligible for what the Centers for Medicare and Medicaid Services (CMS) calls a Special Election Period. This SEP typically lasts two months but we recommend quick action to be sure costs you incur are covered when you need them to be.

Questions? Ask Allen. We’re here to help. Anna Moorman and Jo-

Ann Neal of Allen Insurance and Financial are licensed insurance agents specializing in Medicare and are appointed with many of the major insurers in the State of Maine to help you find a product that's the right fit for you.

Upcoming Medicare Workshops – Register Today!

Allen Insurance and Financial is holding a series of free Medicare 101 workshops in September. All are Zoom presentations with specific meeting information provided by email.

- Thursday, Sept. 10, 5 to 6:30 p.m. Register with Belfast Area Adult Education: 338-3197
- Monday, Sept. 21, 5 to 6:30 p.m. Register with Five-Town Adult Ed: 236-7800 x3274
- Thursday, Sept. 24, with the Bremen Public Library, 7 to 8 p.m. Rregister with Jo-Ann Neal via email: jneal(at)allenif.com.
- Wednesday, Sept. 30, 5 to 6:30 p.m. Register with Medomak Valley Adult Ed: 832-5205.

Anna Moorman and Jo-Ann Neal of Allen Insurance and Financial's Benefits Division will help answer questions, including:

- What does Medicare cover?
- What does Medicare NOT cover?
- When can I enroll in Medicare?
- What is a Medicare Advantage Plan?
- What is a Medicare Supplement Plan?
- What plan is best for me?

Anna Moorman and Jo-Ann Neal specialize in Medicare and will be available for a question and answer session following the presentation.

Estate Planning Update: How the SECURE Act Affects IRA Beneficiaries

In December 2019, Congress passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which is changing retirement and estate planning for many. One major provision of the law affects those who inherit individual retirement accounts (IRAs). So, whether you might be inheriting an IRA or are planning on leaving one to your heirs, you should understand how the SECURE Act has changed the rules for beneficiaries. The IRA strategies discussed below could help enable a sound financial plan for a rewarding retirement—for both you and your heirs.

What's Different for IRA Beneficiaries?

The SECURE Act changes the time frame allowed for withdrawals from an inherited IRA. As you probably know, owners of a retirement account (other than original owners of a Roth IRA) generally must withdraw a minimum amount of money every year after they reach a certain age. These withdrawals are called required minimum distributions (RMDs).

Prior to the act, individual beneficiaries were entitled to take the RMDs from an inherited retirement account over the course of their life expectancy. By choosing to stretch their RMDs over time, they could benefit from tax deferral on any growth in the account. This situation has changed. Now, per the SECURE Act, many individual beneficiaries must completely withdraw the funds in an inherited retirement account within 10 years of the original owner's death.

Exceptions to this rule include account owners who are:

- A beneficiary who inherited an IRA from someone who died before January 1, 2020
- The surviving spouse of the IRA owner
- A child under the age of majority (Once a child reaches maturity, however, the 10-year rule applies.)
- A disabled or chronically ill individual
- An individual who is not more than 10 years younger than the IRA owner

As you can see, for many beneficiaries, the new 10-year withdrawal rule could result in substantially less tax-deferred growth, as well as more taxes due on withdrawal. Fortunately, there are steps you can take to help mitigate the tax burden on these IRA beneficiaries.

IRA Strategies to Consider

To help avoid any negative consequences of the 10-year withdrawal rule, the following strategies may be useful.

Converting to a Roth IRA. Although inherited Roth IRAs are subject to the new rule, distributions remain tax free. With tax rates at historic lows, you might want to consider a Roth conversion. Converting now would mean your beneficiaries (who may be in a higher tax bracket) could potentially avoid being heavily taxed on distributions.

Refusing to accept the IRA. You can refuse or disclaim inherited assets without tax implications. A qualified disclaimer must be in writing and submitted within nine months of the IRA owner's death. In addition, the beneficiary must not have received or exercised control over the IRA, and the IRA must pass to someone other than the person who refused it.

This strategy may work well for a surviving spouse who doesn't need the funds in the IRA. If the IRA passes to other beneficiaries (such as children), they would avoid a larger share of assets being distributed over a single 10-year period. In this case, one 10-year period would begin upon the death of the IRA's original owner and a second 10-year period would begin for the remaining balance of the account upon the death of the surviving spouse.

Naming a trust as beneficiary. With this option, the trustee can exercise control over when IRA distributions are made. If you named a trust as beneficiary of an IRA *before* the implementation of the SECURE Act, however, you should review your estate plan with an attorney. In some instances, trusts drafted before passage of the SECURE Act may now be obsolete, resulting in a distribution pattern that works against the original intent of the trust.

Paying premiums on life insurance. Depending on your insurability, you may want to explore taking a withdrawal from the retirement account and use it to pay premiums on a life insurance policy. With this strategy, the beneficiaries of your policy would be set up to eventually receive a tax-free payout. This scenario might be more advantageous than leaving your retirement account to your heirs.

Making a qualified charitable distribution. If you're older than 70½, you're entitled to make a qualified charitable distribution (QCD). This is a tax-free gift of up to $100,000 per year from an IRA, payable directly to a charity. QCDs may become more advantageous under the SECURE Act because IRAs might be considered a less attractive inherited asset due to the elimination of the lifetime withdrawal rule.

Revising the estate plan. Working with your attorney, you might want to revise your estate plan to take an asset-by-asset approach rather than assign assets to your heirs using a percentage. For example, you might earmark IRA assets to be distributed to minors or individuals in lower tax brackets and designate a larger proportion of nonretirement assets to those with higher incomes.

Helping Secure the Future

The changes adopted as part of the SECURE Act are complex, so it's important to work with a tax attorney to understand them. Given the new rules that affect many individuals who will inherit an IRA, you should consider a review of your estate plan and designated beneficiaries as a priority. Although many of the SECURE Act's changes benefit those saving for retirement, it's wise to be aware of all the options that can help you and your heirs better prepare for the future.

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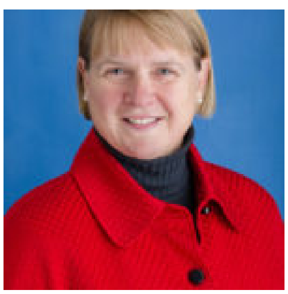
Managing Risk Through Diversification…Now, More Than Ever

By Sarah Ruef-Lindquist, JD, CTFA



By Sarah Ruef-Lindquist, JD, CTFA

Every client has heard me talk about the keys to managing risk in their portfolios. One of those keys is diversification. This can be hard for people who are convinced they know what industry or sector is going to 'always' do well, so they are willing to overconcentrate there, or have stock they've held for a long time or received as a gift or inheritance and have grown emotionally attached or sentimental about it.

If history is a guide, then diversification is key to managing risk in a portfolio. Looking over the last 10 years, beginning with 2010 and looking at 14 recognized asset classes, like Small-Cap Growth, Real Estate, High-Yield bonds, Large-Cap Value, and their rank each year from highest to lowest return, the numbers tell the story.

For instance, some investors feel that owning large-cap growth stock is the key to their long-term success. It certainly is a strong performer but relative to the 13 other asset classes in this chart, it has been the top performer only 2 out of the past 10 years (2015 @ 5.67% and 2019 36.39%).

Small-Cap Growth has also been the top performer for 2 out of those 10 years with impressive numbers (2010 @ 29.09% and 2013 @43.3%). Ironically, Money Market was the top performer in 2018, in a year when Large-Cap Growth was 5th on the list, and Small Cap Growth was 10th. In 8 of the 10 years studied, Money Market is in the lower 7 classes out of the 14, sometimes with less than 1% performance, but never negative over those 10 years…with at least one sector performing below Money Market 7 out of 10 of those years.

Diversification can allow an investor to have at least a toe hold in as many asset classes as possible to reduce the risk that comes with investing. Some people achieve diversification by buying stocks and bonds in as many classes as feasible, although an even higher level of diversification can be achieved with mutual funds or exchange-traded funds that hold a diversified portfolio either by sector, capitalization or in the case

PERIODIC TABLE OF ASSET CLASSES (NO ALTERNATIVE INVESTMENTS)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Highest Return	Small-Cap Growth 29.09%	Muni National Intermediate 10.70%	Mid-Cap Value 18.51%	Small-Cap Growth 43.30%	Real Estate 28.82%	Large-Cap Growth 5.67%	Small-Cap Value 31.74%	Emerging Markets 37.28%	Money Market 1.87%	Large-Cap Growth 36.39%
	Real Estate 26.97%	Core Fixed Income 7.84%	Emerging Markets 18.22%	Mid-Cap Growth 35.74%	Mid-Cap Value 14.75%	Muni National Intermediate 3.30%	Mid-Cap Value 20.00%	Large-Cap Growth 30.21%	Short-Term Bond 1.58%	Mid-Cap Growth 35.47%
	Mid-Cap Growth 26.38%	Real Estate 7.48%	Small-Cap Value 18.05%	Small-Cap Value 34.52%	Large-Cap Value 13.45%	Real Estate 1.28%	High-Yield 17.49%	Mid-Cap Growth 25.27%	Muni National Intermediate 1.28%	Small-Cap Growth 28.48%
	Mid-Cap Value 24.75%	High-Yield 4.38%	Large-Cap Value 17.51%	Large-Cap Growth 33.48%	Large-Cap Growth 13.05%	Core Fixed Income 0.55%	Large-Cap Value 17.34%	International 25.03%	Core Fixed Income 0.01%	Mid-Cap Value 27.06%
	Small-Cap Value 24.50%	Large-Cap Growth 2.64%	International 17.32%	Mid-Cap Value 33.46%	Mid-Cap Growth 11.90%	Short-Term Bond 0.54%	Small-Cap Growth 11.32%	Small-Cap Growth 22.17%	Large-Cap Growth −1.51%	Large-Cap Value 26.54%
	Emerging Markets 18.88%	Short-Term Bond 1.55%	Real Estate 16.47%	Large-Cap Value 32.53%	Muni National Intermediate 9.05%	Money Market 0.02%	Emerging Markets 11.19%	Large-Cap Value 13.66%	High-Yield −2.26%	Real Estate 24.33%
	Large-Cap Growth 16.71%	Large-Cap Value 0.39%	Mid-Cap Growth 15.81%	International 22.78%	Core Fixed Income 5.97%	Mid-Cap Growth −0.20%	Mid-Cap Growth 7.33%	Mid-Cap Value 13.34%	Mid-Cap Growth −4.75%	International 22.66%
	Large-Cap Value 15.51%	Money Market 0.07%	High-Yield 15.58%	High-Yield 7.42%	Small-Cap Growth 5.60%	International −0.81%	Real Estate 7.14%	Small-Cap Value 7.84%	Real Estate −5.83%	Small-Cap Value 22.39%
	High-Yield 15.19%	Mid-Cap Value −1.38%	Large-Cap Growth 15.26%	Real Estate 1.26%	Small-Cap Value 4.22%	Small-Cap Growth −1.38%	Large-Cap Growth 7.08%	High-Yield 7.48%	Large-Cap Value −8.27%	Emerging Markets 18.90%
	International 7.75%	Mid-Cap Growth −1.65%	Small-Cap Growth 14.59%	Short-Term Bond 0.36%	High-Yield 2.50%	Large-Cap Value −3.83%	Core Fixed Income 2.65%	Muni National Intermediate 5.45%	Small-Cap Growth −9.31%	High-Yield 14.41%
	Core Fixed Income 6.54%	Small-Cap Growth −2.91%	Muni National Intermediate 6.78%	Money Market 0.05%	Short-Term Bond 0.62%	High-Yield −4.64%	International 1.00%	Real Estate 3.74%	Mid-Cap Value −12.29%	Intermediate-Term Bond 8.72%
	Muni National Intermediate 2.38%	Small-Cap Value −5.50%	Core Fixed Income 4.21%	Core Fixed Income −2.02%	Money Market 0.03%	Mid-Cap Value −4.78%	Short-Term Bond 0.89%	Core Fixed Income 3.54%	Small-Cap Value −12.86%	Muni National Intermediate 7.54%
	Short-Term Bond 2.35%	International −12.14%	Short-Term Bond 0.43%	Muni National Intermediate −2.55%	Emerging Markets −2.19%	Small-Cap Value −7.47%	Money Market 0.25%	Money Market 0.86%	International −13.79%	Short-Term Bond 3.55%
Lowest Return	Money Market 0.13%	Emerging Markets −18.42	Money Market 0.07%	Emerging Markets −2.60%	International −4.90%	Emerging Markets −14.92%	Muni National Intermediate 0.25%	Short-Term Bond 0.42%	Emerging Markets −14.58%	Money Market 2.28%

Source: Morningstar® Direct

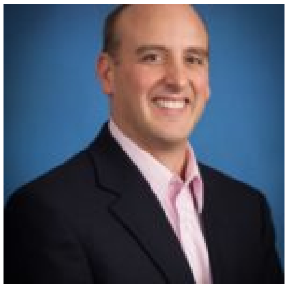
This example is for illustrative purposes only. Performance data quoted represents past performance. Past performance does not guarantee future returns. Investors should note that diversification does not assure against market loss and that there is no guarantee that a diversified portfolio will outperform a nondiversified portfolio. The return and value of investment products will fluctuate with market conditions. Indices are unmanaged and investors cannot invest directly in an index. The above asset classes are represented by the following indices: Large-Cap Growth—Russell 1000 Growth; Large-Cap Value—Russell 1000 Value; Mid-Cap Growth—Russell Midcap Growth; Mid-Cap Value—Russell Midcap Value; Small-Cap Growth—Russell 2000 Growth; Small-Cap Value—Russell 2000 Value; International—MSCI EAFE; Emerging Markets—MSCI Emerging Markets; Intermediate-Term Bond—Bloomberg Barclays U.S. Aggregate Bond Index; Short-Term Bond—Bank of America Merrill Lynch U.S. Treasuries 1–3 Yr TR USD; Muni National Intermediate—Bloomberg Barclays U.S. Municipal Bond; Real Estate—MSCI U.S. REIT; High-Yield—Bank of America U.S. High Yield Master II; Money Market—Bank of America U.S. 3-Month T-Bill.

These asset classes for the most part do not take into account another dimension of diversification, which is industry sector, like industrials, energy, consumer staples. Diversifying among sectors within a portfolio is also a layer of this strategy to reduce the likelihood that one sector's underperformance will disproportionately impact the performance of a portfolio.

In 2020, during the first half of the year, looking at the 11 sectors of the S&P 500, technology stocks outperformed the other sectors at 15%, while energy underperformed the sectors and -35.3% according to Fidelity, https://www.fidelity.com/viewpoints/investing-ideas/quarterly-sector-update. The average performance of all the sectors in the S&P 500 was -3.1%. Contrast 2010, when energy performed at 20.46% and technology at 10.22% according to Invesco, https://www.invesco.com/pdf/U-SPSECTOR-FLY-1.pdf.

In conjunction with your financial advisor, in addition to defining goals and risk tolerance, consider a level of diversification that aligns with both. Having exposure in many asset classes and sectors can help a portfolio weather the volatility that can negatively impact value.

Tom Chester Earns CPFA Designation



Thomas C. Chester, CFP™, AIF®, CPFA

Thomas C. Chester, a financial advisor at Allen Financial in Camden, has earned the designation of Certified Plan Fiduciary Advisor from the National Association of Plan Advisors.

The Certified Plan Fiduciary Advisor (CPFA) credential – developed by some of the nation’s leading advisors and retirement plan experts – demonstrates knowledge, expertise and commitment to working with retirement plans.

Plan advisors who earn their CPFA demonstrate the expertise required to act as a plan fiduciary or help plan fiduciaries manage their roles and responsibilities.

Chester has been with Allen Financial since 2005. He has FINRA Series 6, 7, 63, and 66 registrations and he is a CERTIFIED FINANCIAL PLANNER™ Professional and Accredited Investment Fiduciary®.

Despite Bumps Along the Way,

Road to Economic Recovery Shows Promise

Halfway through 2020, we’ve already had enough news (and then some) to fill up an average year. So far, we’ve seen a pandemic explode—then moderate. The stock market crashed—then recovered rapidly. There were protests around the nation—and we don’t know what will come next there. In addition to these major events, politics has steadily become more confrontational, and we know it will likely get worse as we move toward the November elections.

Given the headlines, the key to figuring out what is likely to happen over the rest of the year is to focus on the most important trends, which for our industry means the coronavirus pandemic, the economic response to it, and the financial markets.

Despite Rising Coronavirus Cases, Positive Economic Signs Emerge
The real question about the coronavirus for the rest of 2020 is not if there will be a second wave, but whether it will be large enough to derail the economic recovery underway. So far, it does not look like it will. As of early July, we are seeing significant second waves in several states, and rising case counts in many others. It is quite possible we will see lockdowns locally, but a national shutdown looks unlikely, which should allow much of the recovery to continue. Although there are risks to that outlook, it remains the most probable case for the rest of the year.

Despite the rising case counts, the economic reopening is making solid progress. Job reports so far have indicated the damage has peaked and many have returned to work, leading to a bottoming out and rebound in consumer confidence. Surprisingly strong consumer spending data has validated this, as consumers spend only when employed and confident. Business confidence has rebounded as well, bringing it close to or above pre-pandemic levels.

The recovery has benefited from two major factors. First, the virus was brought under control faster than expected. Although that improvement has paused—we are seeing localized outbreaks in several states and rising case counts in others—the spread of the virus remains moderate in much of the country. Second, the Federal Reserve (Fed) provided substantial monetary support at the same time the federal government provided trillions in stimulus payments. The combination acted as life support until the economy could reopen, and that life support appears to have worked.

Financial markets have also responded to the surprisingly positive outcome so far. After an initial drop and what looked like an impending depression, they recovered strongly because of federal support and control of the virus.

Looking forward, while the risks of a national resurgence remain, the more probable outcome is that localized outbreaks will be contained as local authorities take appropriate measures. Even if cases increase nationally, the bulk of the damage will likely be confined to a limited number of states. Local shutdowns are to be expected as states respond, but we are still far away from even considering national measures, which means the economic recovery is likely to continue through the end of the year.

In fact, it may accelerate. So far, many metrics have recovered much faster than expected. Mobility data is already above pre-pandemic levels, while consumer spending has regained a substantial share of its losses. Auto sales and the housing industry have also shown significant bounces. Overall, for much of the economy, if we trend the recovery over the past several weeks through the end of the year, we could be close to where we were at the start.

Chances are that won’t happen, of course, and setbacks are likely. Still, based on the data so far, the chances of continued improvement look to be well supported. If we do suffer setbacks, the government is likely to provide more stimulus to close the gap. All in all, these trends should counteract any damage.

With Recovery Expected, Markets Are Holding Steady

This is exactly what financial markets are expecting—continued progress on controlling the virus and a smooth economic recovery. Markets have returned close to pre-pandemic highs, and, despite some recent volatility, are holding steady even in the face of state outbreaks and fears from the Fed. Markets expect a positive outcome across the board, and that remains very possible.

The expectation that everything will proceed smoothly, however, limits potential appreciation through the end of the year. With all the good news priced in, valuations are quite high—the highest level in the past decade based on expected earnings. For markets to appreciate beyond that, things have to go even better than expected, which will be difficult.

Markets, for example, now expect earnings for S&P 500 companies to rebound to levels we saw in 2019, which would be an amazing recovery. Stocks, however, are well above the levels we saw then—which also suggests limited future appreciation. A great deal of good news is already priced in, which means there are downside risks if things do not go as well as expected.

Looking at the numbers, the economy will still be in recession in the third quarter but should recover substantially from what looks to be a very weak second quarter. The fourth quarter should see the economy close to breakeven, with the very real prospect of a return to growth at the start of next year.

The stock market, in the form of the S&P 500, will likely finish the year around current levels, maybe a bit higher. Interest rates will remain low, as inflation remains under control and the Fed refrains from any increases.

Positive Momentum Should Continue Through 2020

The story for the rest of 2020 is continued healing—from the pandemic, economic damage, and market turbulence. Although real risks remain and setbacks are inevitable, the outlook is positive. For the coronavirus, we know what to do and are addressing renewed outbreaks. For the economy, the current momentum should keep us improving through the end of the year. And the market's confidence in a positive outcome is a good sign for the future.

Despite the headlines, despite the risks, and despite everything, we move into the second half of the year in a better place than anyone expected a couple of months ago. That is a very good place to start.

Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. All indices are unmanaged and are not available for direct investment by the public. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. The S&P 500 is based on the average performance of the 500 industrial stocks *monitored by Standard & Poor’s. Emerging market investments involve higher risks than investments from developed countries, as well as increased risks due to differences in accounting methods, foreign taxation, political instability, and currency fluctuation.*

Test Your Knowledge of the Federal Tax Exclusion for Home Sales

A home residence can become a valuable asset in your net worth. But what happens if you decide to move? If your home has appreciated, capital gains tax may be recognized upon the sale.

True or False?

As long as you purchase another home and roll the sales proceeds into the new home, you can defer recognition of the taxable gain.

Answer: False

Previously, you could roll your capital gains into another home to avoid recognition of taxable gain; however, this option is no longer available. Currently, when you meet the qualifications, the federal tax exclusion is limited up to $250,000 (single) or $500,000 (married) on the taxable gain on the sale of a home. This exclusion is available only once every two years. To qualify for the exclusion, you must meet the following requirements:

- **Ownership requirement**: You must own the home.
- **Residence requirement**: You must have lived in the home as your primary residence for at least 2 of the past 5 years.

If you are married, only one spouse needs to have owned the home to meet the ownership requirement. To meet the residence requirement, however, both spouses must have lived in the home for at least 2 of the past 5 years.

A partial exclusion may be available under specific circumstances, such as a job change (more than 50 miles away), health issues, or additional unforeseen situations. In addition, certain exceptions applyâ€"for example, if you were separated or divorced, if your spouse passed away, or if you were a service memberâ€"that may make you eligible for the exclusion.

A tax advisor can help you navigate the rules and determine if you qualify for the federal tax exclusion on the sale of your home.