

# **In Uncertain Times, at Least Two Things are Certain: Change and Taxes**

By Sarah Ruef-Lindquist, JD, CTFA



Potential for higher federal income taxes is anticipated by experts due to 1) a growing national debt increased by trillion-dollar stimulus spending and 2) possible election results that mean a change in administrations and congressional profile. Increasing taxes levied on high-income earners is nothing new, and reasonably anticipated.

## **Income Taxes**

Currently, the top federal rate is 37% (taxpayers with over half a million dollars a year) and could increase to 39.6%. It is also possible that those who do still itemize deductions will be limited to a cap of 28%.

## **Capital Gains**

Long-term capital gains taxes are currently limited to 23.8% (combined highest rate of 20% plus 3.8% net investment income tax) for taxable incomes with over \$441,450, but it is possible that rate could go to 39.6%, same as the top income tax rate.

These issues may impact the planning of high-income earners between the date of the election and year-end 2020. If you are at an income level that would be affected by these changes, good for you. Still consider talking with your financial and tax advisors soon about strategies that could be available to ameliorate the impact.

## **Tax on inheritances**

For many years, when people have inherited long-term appreciated stock, they were able to avoid the capital gain that had accrued prior to inheriting it. The “step-up” in basis provisions made it possible for heirs to reap the benefit of the full value of appreciated securities because their tax basis would be the date of death value of the stock. If they sold it, their capital gain would be limited to any accrued since they inherited the stock. Often this results in significant tax savings.

However, it is possible that this “step-up” provision will be eliminated with new tax legislation. It is important, therefore, for those including such assets in their estate plans to consider what options they might have to preserve as much of the value of those assets for heirs as possible.

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## **Are You an Intelligent Investor?**

Considered “the father of value investing,” Benjamin Graham wrote [\*The Intelligent Investor\*](#) more than 70 years ago, and the principles in his book are still highly respected today.

Investing legend Warren Buffet, who studied under Graham, called *The Intelligent Investor* “by far the best book about investing ever written.”

Despite what you might think, being an intelligent investor is not about your IQ. Rather, it’s learning how to harness emotions and think for yourself. Let’s explore how to do just that, by leaning on Graham’s advice.

## **What It Means to Be an Intelligent Investor**

*“An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative.”*

The above quote reflects Graham’s definition of defensive investing, which he originally described in his first book, [\*Security Analysis\*](#). Here, his focus is on distinguishing the best practices that separate a defensive investor from a speculator. Specifically, defensive investors reach their long-term financial goals by being sustainably and reliably right. In other words, you need to find a balance between controlling risk and maximizing gains, as well as curbing the self-defeating behavior that can reduce portfolio returns.

Consider what can happen when investors blindly follow the crowd. The January effect, for example, occurs when investors try to follow a mechanical formula for higher stock performance at the beginning of the year. But when investors pile in—assuming that stock prices will follow a traditional trajectory of going up in January after dipping in December—they can create a crowded trade and ultimately lead to underperformance.

## **Stay the Course and Follow Core Principles**

*“With every new wave of optimism or pessimism, we are ready to*

*abandon history and time-tested principles, but we cling tenaciously and unquestioningly to our prejudices."*

As market volatility resulting from the coronavirus pandemic demonstrated, investors tend to let their emotions sway their decisions. In volatile markets, some are tempted to abandon the sound investing principles that have stood the test of time. How can you help control those knee-jerk tendencies? Graham recommends the following for a defensive investing strategy:

- Start with a 50/50 portfolio design composed of high-quality stocks and bonds. (Graham defines *high quality* as stocks and bonds of important companies with long records of profitable operations and in strong financial condition.)
- Hold up to a maximum of 75 percent in stocks as the market drops or a minimum of 25 percent in stocks as the market rises. (Buy low and sell high—otherwise known as the rule of opposites.)

Under Graham's rationale, the intelligent investor may actually *welcome* a bear market as an opportunity to buy low. Other time-tested strategies include buying funds over individual stocks and dollar-cost-averaging into the market.

## **Determine a Criteria for Investment**

*"It is our argument that a sufficiently low price can turn a security of mediocre quality into a sound investment opportunity . . . For, if the price is low enough to create a substantial margin of safety, the security thereby meets our criterion of investment."*

The margin of safety is dependent on price paid, and it is defined as the favorable difference between price, on one hand, and the indicated or appraised value, on the other. To determine

the appraised (also known as intrinsic) value of a stock, Graham recommends finding companies that meet the following margin of safety criteria:

- Market cap of more than \$2 billion; no small-caps except through a small-cap index fund
- Strong financial condition; current assets are 2 times liabilities; long-term debt less than net current assets
- Continued dividends for at least the past 20 years
- No earnings deficit in the past 10 years
- 10-year growth of at least one-third in per-share earnings
- Stock price not more than 1.5 times net asset value
- Stock price not more than 15 times average earnings of past 3 years

The overriding philosophy behind these requirements? There really is no such thing as a good or bad stock. Instead, think of stocks as either cheap or expensive.

## **Adopting the Intelligent Investor Mind-Set**

*“There will continue to be wide discrepancies between price and value in the marketplace, and those who read their Graham . . . will continue to prosper.”* – Warren Buffett, appendix of *The Intelligent Investor*

Investing can be difficult. It involves uncertainty and risk, two things most of us aren't naturally comfortable with. But with some guidance supplied by the rules and best practices advocated by Graham, and (of course) your financial advisor, you can become an intelligent investor and achieve your investment goals.

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*or investment product. Please contact your financial professional for more information specific to your situation.*

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# **Year-End Financial Planning Checklist: 10 Suggestions to Help You Stay on Track**

Although 2020 has been a year of unexpected changes, one routine has remained consistent: the fourth quarter means it's time to begin organizing your finances for the new year. To help you get started, here's a checklist of key topics to think about, including new tax and retirement considerations related to the COVID-19 pandemic.

## **1) Max out retirement contributions.**

Are you taking full advantage of your employer's match to your workplace retirement account? If not, it's a great time to consider increasing your contribution. If you're already maxing out your match or your employer doesn't offer one, boosting your contribution to an IRA could still offer tax advantages. Keep in mind that the SECURE Act repealed the maximum age for contributions to a traditional IRA, effective January 1, 2020. As long as you've earned income in 2020, you can contribute to a traditional IRA after age 70½—and, depending on your modified adjusted gross income (MAGI), you may be able to deduct the contribution.

## **2) Refocus on your goals.**

Did you set savings goals for 2020? Evaluate how you did and set realistic goals for next year. If you're off track, we'd be happy to help you develop a financial plan.

## **3) Spend flexible spending account (FSA) dollars.**

If you have an FSA, note that the Internal Revenue Service (IRS) relaxed certain "use or lose" rules this year because of the pandemic. Employers can modify plans through the end of this year to allow employees to "spend down" unused FSA funds on any health care expense incurred in 2020—and let you carry over \$550 to the 2021 plan year. If you don't have an FSA, you may want to calculate your qualifying health care costs to see if establishing one for 2021 makes sense.

## **4) Manage your marginal tax rate.**

If you're on the threshold of a tax bracket, you may be able to put yourself in the lower bracket by deferring some of your income to 2021. Accelerating deductions such as medical expenses or charitable donations into 2020 (rather than paying for deductible items in 2021) may have the same effect.

Here are a few key 2020 tax thresholds to keep in mind:

- **The 37 percent marginal tax rate** affects those with taxable incomes in excess of \$518,400 (individual), \$622,050 (married filing jointly), \$518,400 (head of household), and \$311,025 (married filing separately).
- **The 20 percent capital gains tax rate** applies to those with taxable incomes in excess of \$441,450 (individual), \$496,600 (married filing jointly), \$469,050 (head of household), and \$248,300 (married filing separately).
- **The 3.8 percent surtax on investment income** applies to the lesser of net investment income or the excess of MAGI

greater than \$200,000 (individual), \$250,000 (married filing jointly), \$200,000 (head of household), and \$125,000 (married filing separately).

## **5) Rebalance your portfolio.**

Reviewing your capital gains and losses may reveal tax planning opportunities; for example, you may be able to harvest losses to offset capital gains.

## **6) Make charitable gifts.**

Donating to charity is another good strategy worth exploring to reduce taxable income—and help a worthy cause. Take a look at various gifting alternatives, including donor-advised funds.

## **7) Form a strategy for stock options.**

If you hold stock options, be sure to develop a strategy for managing current and future income. Consider the timing of a nonqualified stock option exercise based on your estimated tax picture. Does it make sense to avoid accelerating income into the current tax year or to defer income to future years? If you're considering exercising incentive stock options before year-end, don't forget to have your tax advisor prepare an alternative minimum tax projection to see if there's any tax benefit to waiting until January.

## **8) Plan for estimated taxes and required minimum distributions (RMDs).**

Both the SECURE and CARES acts affect 2020 tax planning and RMDs. Under the SECURE Act, if you reached age 70½ after January 1, 2020, you can now wait until you turn 72 to start taking RMDs—and the CARES Act waived RMDs for 2020. If you took a coronavirus-related distribution (CRD) from a retirement plan in 2020, you'll need to elect on your 2020 income tax return how



you plan to pay taxes associated with the CRD. You can choose to repay the CRD, pay income tax related to the CRD in 2020, or pay the tax liability over a three-year period. But remember: once you elect a strategy, you can't change it. Also, if you took a 401(k) loan after March 27, 2020, you'll need to establish a repayment plan and confirm the amount of accrued interest.

## **9) Adjust your withholding.**

If you think you may be subject to an estimated tax penalty, consider asking your employer (via Form W-4) to increase your withholding for the remainder of the year to cover the shortfall. The biggest advantage of this is that withholding is considered to be paid evenly throughout the year instead of when the dollars are actually taken from your paycheck. You can also use this strategy to make up for low or missing quarterly estimated tax payments. If you collected unemployment in 2020, remember that any benefits you received are subject to federal income tax. Taxes at the state level vary, and not all states tax unemployment benefits. If you received unemployment benefits and did not have taxes withheld, you may need to plan for owing taxes when you file your 2020 return.

## **10) Review your estate documents.**

Review and update your estate plan on an ongoing basis to make sure it stays in tune with your goals and accounts for any life changes or other circumstances. Take time to:

- Check trust funding
- Update beneficiary designations
- Take a fresh look at trustee and agent appointments
- Review provisions of powers of attorney and health care directives
- Ensure that you fully understand all of your documents

## **Be Proactive and Get Professional Advice**

Remember to get a jump on planning now so you don't find yourself scrambling at year-end. Although this list offers a good starting point, you may have unique planning concerns. As you get ready for the year ahead, please feel free to reach out to us to talk through the issues and deadlines that are most relevant to you.

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## **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.

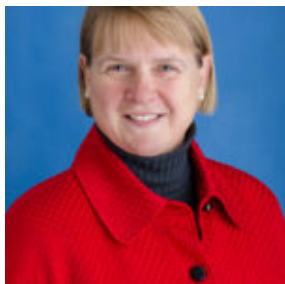
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# Managing Risk Through Diversification...Now, More Than Ever

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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 20.80%	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 15.61%	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 7.06%	High-Yield 7.48%	Large-Cap Value -8.27%	Emerging Markets 18.90%
	International 7.75%	Mid-Cap Bond -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.

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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.

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**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®.

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## 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.*

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# 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 apply—for example, if you were separated or divorced, if your spouse passed away, or if you were a service member—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.

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## Test Your Knowledge of COVID-19 Mortgage Relief

In response to the pandemic, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law on March 27, 2020. Included in the CARES Act are provisions that allow homeowners to delay mortgage payments through forbearance for federally owned or backed mortgage loans.



## True or False?

Under the CARES Act, when a mortgage payment forbearance period ends, a lump-sum balloon payment is immediately required to catch up on missed payments.

**Answer: False**

Although you can choose to repay all the missed payments at one time in a balloon payment, doing so is not required under the CARES Act. After the suspension ends, a variety of repayment options may be available depending on your lender and mortgage type. Repayment options may include setting up a repayment plan, modifying the payment, or increasing the length of your loan to account for the missed payments.

Once a mortgage is placed in forbearance, the loan payments will be temporarily suspended, but this does not mean the loan is forgiven or removed. The good news is that while the mortgage is in forbearance, late fees will not apply. Interest will continue to accrue on the mortgage during forbearance, however.

The following information can help you determine if you qualify for mortgage payment forbearance:

- **Eligibility:** Eligible homeowners include those who have (1) experienced a COVID-19 hardship, such as a loss of a job, reduction of income, or sickness, and (2) have a federally owned or backed mortgage. Federally backed mortgages may include those backed by the U.S. Department of Housing and Urban Development, Federal Housing Administration, U.S. Department of Veterans Affairs, U.S. Department of Agriculture, Fannie Mae, or Freddie Mac.
  - The Consumer Financial Protection Bureau has [tools](#) to help you look up which organization owns your mortgage. You can also contact your

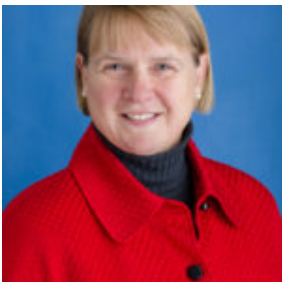
mortgage lender to confirm which organization owns your mortgage.

- **Duration of relief:** Payment relief is available for 180 days. In addition, you can apply for an extension for another 180 days.
- **How to access relief:** Reach out to your loan servicer to discuss solutions available.

Some states have provided temporary relief from certain foreclosures or evictions as well. Many companies are also providing a range of mortgage relief options as needed. For mortgages not backed by the federal government, contact your mortgage servicer to see how it can help.

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## Doing Well by Doing Good – Socially Responsible Investing in 2020



By Sarah Ruef-Lindquist, JD, CTFA

The world of investing is increasingly focusing attention on ways in which capital can be invested to support businesses that are promoting social or environmental welfare, and/or govern themselves in a way that promotes diversity and inclusion of those historically marginalized in corporate leadership, either by virtue of gender, race or other suspect criteria.

For many investors, this approach aligns with their desire to support business that are “doing good” in the world either in terms of what social or environmental issues they are addressing, and perhaps in terms of how they govern themselves and treat the employees within their companies.

What has come to be known as Socially Responsible Investing (“SRI”) or Environmental Social Governance investing (“ESG”) involves using criteria like environmental, social, governance and employment practices to choose what investments will be held in a portfolio. According to Commonwealth Financial Network’s website:

Sometimes referred to as environmental, social, and corporate governance (ESG) investing, [Socially Responsible](#) (SRI) is a broad-based strategy in which **corporate responsibility** and **societal concerns** are factored into investment decisions. In short, an SRI strategy seeks to **maximize both financial return and social good**.

Companies that deal in tobacco, gambling, fossil fuels, weapons, or involve child labor, employee discrimination, or lack board diversity are the kinds that get attention in SRI/ESG screening. Mutual funds will screen out companies that don’t measure up in those areas.

This has broad appeal for many investors, but for some time there have been concerns that one could sacrifice market performance for social benefit. Over time, the index that

measures the performance of mutual funds that screen for SRI companies has shown that the gap has narrowed significantly between the general mutual and exchange-traded fund world and SRI-screened funds.

Most recently, during the first quarter of 2020, some saw better performance from their ESG exchange traded fund (ETF) than the S&P 500 delivered. A June 2020 article “ESG Funds Shine During Pandemic” in *Wealthmanagement.com* by Lawrence Carrel noted historically high inflows into mutual and exchange-traded funds while the overall fund universe posted higher outflows.

Favorable performance in the SRI and ESG space is not new. According to a US News and World Reports June 7, 2018 blog post entitled *Socially Responsible Investing Delivers*:

Research and performance history imply that socially responsible investors receive superior absolute returns and risk-adjusted performance, while also addressing sustainability concerns. Dollars invested in sustainable and socially responsible strategies provide companies with better ESG metrics easier access to capital, which reduces the cost of equity and supports higher stock prices.

<https://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/articles/2018-06-07/socially-responsible-investing-delivers-for-investors>

The author, Kate Stalter, regular contributor to *The Smarter Investor* noted “Since 1990, the socially conscious Morgan Stanley Capital International KLD 400 index ([DSI](#)) of U.S. stocks outperformed the S&P 500 in almost every time frame, and had better returns than the market cap-weighted index in both bull and bear markets.”

The Covid-19 pandemic may have magnified the appeal of SRI and

ESG investing. The Carrel article quoted a senior product specialist at Swiss-based Pictet Asset Management, Marc-Oliver Buffle: “A lot of people have noticed that not having as many airplanes in the sky and cars on the road leads to cleaner air...leading to a global realization...directly playing into the hand of those businesses that we invest in, ones providing solutions to those issues.”

Perhaps as compelling for some investors, the article also quoted Martin Jarzebowski, director of responsible investing at Federated Hermes, as noting ...”a new consistency of quality factors among ESG leaders, such as lower volatility and a higher profitability of their business models...taking structural ESG considerations into a normal investing framework is a new form of risk management.” He concluded, after noting the outperformance of ESG in the 4<sup>th</sup> quarter of 2018 “...ESG has more semblance of being the new quality factor.”

While the positive social and environmental perspective of SRI/ESG investing may be compelling, the quality dimension of these investments may be equally – if not more -compelling for some.

Consider whether a more socially responsible approach to investing makes sense for you. Would knowing that your investments were supporting companies working to improve the environment, or address social causes, or include women and minorities in executive leadership add value to your experience as an investor? As with all investment choices, you should consult with your financial advisors before making any changes to your portfolio or investment strategy.