Market Insights & Planning Highlights

Q2-2022

MARKET OUTLOOK

Buying Back Into Risk: When, Why and How

by Robert Koscik

If you've been working with me long enough, you've no doubt heard me quote the great Warren Buffet. Perhaps my favorite saying from the Oracle of Omaha is this one: ***Be fearful when others are greedy and greedy when others are fearful***. But despite being a wise mantra, individual investors almost never follow it when in control of their own portfolio; it's a value that is typically acquired only when working with an advisor who stays true to the principle. Why is that? Because when left to their own devices, individual investors find it extremely difficult to remove their emotions from the decision-making process.

As humans, we tend to feel more pain from losing money than joy when watching the profits roll in. Let's put it this way: when the market is going gangbusters, it is extremely rare for me to receive a phone call from a client asking "you know, Rob… maybe I'm taking too much risk given all this money I'm making. Should we pull back?" Likewise, it's infrequent (but I won't say never) that a client picks up the phone during a plunge to ask if we should be taking advantage of the fact that risk is on sale.

So today we'll set emotion aside and discuss the nature of risk and reward in two parts. First, how I use simple math to approach it and, second, how I use that math as a guide to when to buy back into a falling market…

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MARKET OUTLOOK

Buying Back Into Risk: When, Why and How [cont.]

Risk Calculated

It's no secret that the continuing volatility of the market is something I had anticipated for a while, sparking significant advance changes in Q3 of last year. The factors that led to making a market call (for the first time in a long time) were first and foremost valuations. The second was that the market had gotten to where it was because of excess liquidity injected into the economy at both the fiscal and monetary level. The Federal Reserve has been unwilling to admit that they are behind the curve—and if we shouldn't fight the Fed when their policy is loose, we should probably embrace the same concept when they start to get tight. In essence, they've been walking a tightrope over the Grand Canyon. And as they teeter in the wind, the market participants below are losing trust that they'll make it safely to the other side. But let's get to the math:

- We have a market trading at 25 times earnings (the price of the market divided by its earnings-per-share).
- If earnings growth going forward is 7% per year (matching the last six decades) and if in 20 years the market trades at 15 times earnings (historic average)…
- Your investment performance from growth is 4.25% per year. With a hypothetical 1% dividend, that is 5.25% per year for 20 years.
- But what if the market valuation today was 25% lower, and all other variables were the same? Your 20-year return would be 6.75% per year (5.75% from growth and 1% from dividends).

Conclusion: That 25% correction creates an extra 1.5% per year return for 20 years. How much I believe one should allocate to a market with valuations at one level versus another should vary. The concept is known as risk versus opportunity. Here goes…

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MARKET OUTLOOK

Buying Back Into Risk: When, Why and How [cont.]

- At future prospects of making 5.25% from risk assets (extra risky taking into account valuations and market conditions) when ultra-low risk assets are yielding > 3%: I may believe it is prudent to focus on living to fight another day.
- At future prospects of making 6.75% from risk assets when ultra-low risk assets are yielding > 3%: I may be willing to do a bit more than just dip my toes back in the water. If you do everything right preparing for the downside, you always need to embrace that no one has a crystal ball.

Based on those numbers, I'll say that adding risk back to a portfolio should be done in a gradual manner. The first buys will likely need to be done before the market fully resets its valuations; if the market reverses while you are still in a defensive posture, being right wasn't worth the risk of being wrong.

As Always, Look to History

Of course, my ultimate guide is history. So I'll leave with you with this: over the past 32 years, the S&P 500 has seen 15 drops of 15% or more. ***In every case but one the market was higher 10 years later.*** In other words, staying the course and engaging some risk would have beaten holding your money in cash in 14 of 15 instances.

What was the average 10-year return after those 15 drops? **+134.63%.** Not bad 😉.

Source: https://www.cnbc.com/2022/01/25/long-term-investors-shouldnt-worry-too-much-about-stocks-being-10percent-off-their-highs.html
Source: https://www.wsj.com/

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FISCAL POLICY

How Much Will Raising Rates Help? – by Matt Ringle

Here's something to think about…

With the recent raising of interest rates by the Federal Reserve, many Americans are asking if it will help stem rampant inflation. After all, raising rates has traditionally been the Fed's main tool to fight inflationary trends. But it might not help this time around. Why?

It's About Supply and Demand

The problem is that raising rates won't fix the problem that has caused inflation. When Congress decided to cut check after check to Americans during the pandemic it increased demand while doing nothing to increase supply.

Raising rates will in fact only limit that supply further, as companies who would increase supply will now be reluctant to borrow money at higher rates.

To say the policy is counterproductive is an understatement.

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FISCAL POLICY

What a Rising Dollars Means for the Economy and You

by Matt Ringle

There's no doubt that when the U.S. dollar rises in value, Americans benefit in a number of ways. However, a rising dollar also comes with its fair share of poor consequences. What are the positives? What are the negatives?

Below we explore just a few of these impacts and how they can affect you and your money.

Business & The Buck

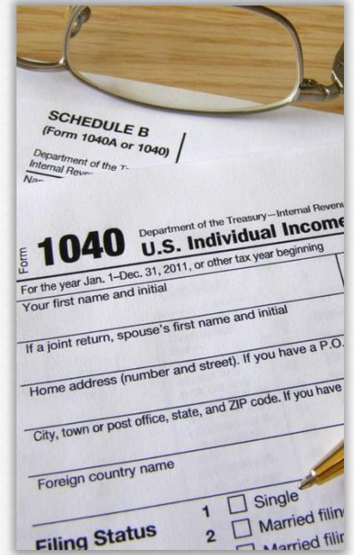
A rising U.S. dollar first has a major impact on the prices of domestic goods and services--which affects the ability of American companies to export goods abroad. A decrease in exports usually produces a subsequent earnings decline for multinational corporations. Rising dollar values can ultimately be a headwind to the domestic economy overall.

Unlike multinational organizations, smaller companies generally sell their products and services to American consumers. However, many of these companies might depend on raw material imports from China, Brazil, Hong Kong and other Asian countries. A strengthening dollar makes imports cheaper, presenting an opportunity to expand profit margins. Even though this is applicable for large companies as well, the caveat is that a high percentage of their sales come from outside the U.S., thereby offsetting the benefits of low raw material costs.

TAX MATTERS

Special Tax Scenarios Q&A - by Matt Ringle

As we've pointed out before, we at DLAK are not tax accountants (nor did we stay at a Holiday Inn Express) but taxes are very much a part of our world. That being said, we wanted to share several unique tax situations that can arise over one's lifetime.



Do I always have to file a tax return?

For the 2021 tax year, if you are married and file a joint return with a spouse who is also 65 or older, you must file a return if your combined gross income is $27,800 or more. If your spouse is under 65 years old, then the threshold amount decreases to $26,450. Bear in mind that these income thresholds only apply to the 2021 tax year, and generally increase slightly each year.

When a spouse passes, are you still allowed to file Married Filing Jointly?

For the two years after the year of your spouse's death, you can use the Qualifying Widow(er) filing status if all five of the following statements are true:

1. For the year in which your spouse died, you filed (or could have filed) a joint return with your spouse.
2. You did not remarry (in the two years after the year of your spouse's death). E.g., your spouse died in 2021 and you do not remarry before January 1, 2024.
3. You have a child or stepchild (not a foster child) you claim as a dependent.
4. The child lived with you in your home all year, except for temporary absences.
5. You paid more than half the total cost of keeping up the home in which you and the child lived for the year. The total cost of keeping up a home includes things like: food expenses, rent, mortgage interest, home insurance, real estate taxes, utilities, repairs, maintenance, and other household expenses.

Special Tax Scenarios Q&A [cont.]

When a last remaining parent passes away, does a tax return need to be filed?

The answer is most often YES. The responsibility for filing a deceased person's tax return usually falls to the executor or administrator of the estate. If you're filing taxes as an executor, administrator or legal representative, include Form 56 along with the completed 1040 or 1040-SR to show the IRS you have the right to file the tax return.

When is the return do? Tax returns are due on the tax filing deadline of the year following the person's death. For example, a person who passed away in 2021 would have a final tax return due by April 18, 2022.

Need help completing the return? You'll use the same tax forms the deceased person would have used if they were alive. If you weren't involved in the person's finances before, you can use a prior year's return as a guide or use the IRS' guide to getting information for a deceased person to get a transcript of their past tax return.

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RETIREMENT PLANNING

Are Your Overpaying for Medicare Part B? – *by Robert Koscik*

If you're paying more than $170.10 in Medicare premiums, then keep reading. Retirees are seeing an increase of $21.60 per month or 14.5% in 2022 for Medicare Part B. Although the standard premium for Medicare Part B (which covers doctor visits and outpatient services) is $170.10, seniors hit with the surcharge will pay from $238.10 to $578.30, depending on their income. So how do you calculate the surcharge and how do you know if it affects you?

Driven By Life Events

The Medicare surcharge is based on your modified adjusted gross income from two years ago. For 2022, for example, the surcharge is based on your MAGI in 2020. For purposes of calculating the surcharge, MAGI consist of your adjusted gross income plus interest from tax-exempt municipal bonds. Well, many different things can have a significant impact on your income in two years and one major one is retirement. That said, if you worked in 2020 and have since retired, you may qualify to appeal a Medicare premium surcharge. Some other life changing events to consider may be the death of a spouse or a divorce.

Unfortunately, if the surcharge was triggered by a one-time income spike like a large IRA distribution or realizing high capital gains in a taxable account, you may be out of luck. When faced with this surcharge, you'll receive an Initial Income-related Monthly Adjustment Amount (IRMAA) Determination Notice from the Social Security Administration. The first step in having this reviewed is filling out Form SSA-44 and providing any supporting documents, or scheduling an interview with your local Social Security office (1-800-772-1213). Even if you're married, file jointly, and only one spouse experienced the precipitating event, both spouses should submit an appeal. If this request is denied, there are three different avenues of appeal. You can go to the Office of Medicare Hearings and Appeals, to the Medicare Appeals Council or to the federal district court where you live.

Guardian and its subsidiaries do not issue or advise with regard to Medicare

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PERSONAL FINANCE

What Should I Shred? What Should I Keep?

By Jenny Cyrus

Clients often ask: *When it comes to government-issued documents or those sent by DLAK, which should I keep and which should I shred/discard?* Below is a helpful guide:

Tax Forms

Generally, the IRS has three years from the date you file to audit your return. You also have three years to file an amended return. Although your chances of being audited are slim (the IRS singles out less than 1% of all individual returns) you may need these documents to file an amended return. So keep your documents for at least four years from the current filing date. (Ex: keep 2021 documents until 2025).

Homeowner Documents

In short…KEEP EVERYTHING. When you sell a primary residence, you are exempt from paying taxes on the first $250K (filing single) or $500K (Married Filing Jointly). With recent housing prices soaring, you might find yourself selling a long-held home way above the price you thought you could. To avoid paying taxes on a gain, you may be able to raise your basis, if you made home improvements. However, this can only be done if you have documented proof. For example: you have owned your home for 30 years. You purchased it at $100K. You now go to sell the home for $400K. If you're a single filer, you'll pay capital gains tax on $50K. However, if you have documentation that you updated the bathrooms, remodeled the kitchen, and put on a new roof (all for $100K) you can increase your basis to $200K and pay zero in taxes.

Investments

It's advisable to keep your quarterly or annual account statements dating back at least 5-7 years. Keeping Roth IRA statements is especially important; if you are ever questioned by the IRS on taxability, you'll want to be able to prove you already paid.

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TAX MATTERS

Help Potentially Reduce Your Taxes With QCDs – by Jenny Cyrus

If you are 72 years old and taking the standard deduction on your tax return, you should strongly consider upping your charitable giving. Why? Because when you turn 72, you're required to take taxable distributions from your IRA. But what many taxpayers don't know is that you can use that required minimum distribution (RMD) to donate to charities without it counting as taxable income. This is called a Qualified Charitable Deduction (QCD) and you can donate up to $100K annually.

What are the Tax Advantages?

- The QCD amounts will be excluded from your adjusted gross income (AGI), resulting in tax savings on that amount. A lower AGI could then:
- Decrease the amount of Social Security that is subject to tax.
- Potentially lower your Medicare premiums.

If you do take advantage of this, remember to inform your tax preparer. The QCD amount must be correctly listed on the tax return in order to get the tax break.

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HEALTHCARE

Spousal Assets & Medicaid Eligibility – by Jenny Cyrus

When a spouse goes on Medicaid, and if the other spouse is not on Medicaid, is the spouse's IRA a countable asset?

If the spouse is not RMD age (under 72):

- If the IRA is not in payout status, the IRA is a non-exempt asset, which means the total amount in the IRA will be counted as an asset, affecting your Medicaid eligibility.

  In order to qualify for Medicaid, you will need to cash out your IRA and spend down the assets.

If the spouse is RMD age (72 or older):

- When an IRA is in payout status (RMDs), the IRA will not count as an available asset in terms of eligibility for Medicaid and the owner can keep the IRA.

  However, and unfortunately, the payments that are received will count as income.

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NEWS TO USE

Did You Know?

Medicare Will Pay for At-Home Covid Tests

People with Medicare Part B (outpatient care coverage)—including Advantage Plan enrollees—will be able to obtain up to eight free over-the-counter tests per month from participating pharmacies and health-care providers.

Few People Buy Homes With Cash, Most Have a Monthly Mortgage Payment

Unless you live under a rock, you know the cost of homes have been increasing. Can prices keep up forever? Certainly not. With interest rates up too, the percentage of a family's income needed for mortgages is eating into disposable income beyond what we even saw in 2008. Something eventually will have to give. Either home prices will need to come down or maybe the government will forgive all mortgage loans. Ha!

Americans Have Run Out of Free Money

U.S. personal savings have plummeted from their pandemic highs. In April 2020, the rate stood at 33.8% of disposable income. As of January 2022, it has dropped to just 6.4%--the lowest level since 2013. Source: https://tradingeconomics.com/united-states/personal-savings

Your Homeowners Insurance May Not Cover Your Collectibles

When it comes to collectibles, most homeowners insurance policies either don't cover them or impose a low dollar amount limit. If you own items like jewelry, memorabilia, etc., a specific rider may be needed on your policy.

Watch Your Step

Approximately 30% of all people ages 35 to 65 will suffer a disability for at least 90 days, and about one in seven can expect to become disabled for five years or more!

Source: https://www.affordableinsuranceprotection.com

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