Market Insights & Planning Highlights

Q3-2022

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MARKET OUTLOOK

On Recessions, Recoveries, and the Road Ahead

by Robert Koscik

Even a casual observer of the market is likely aware that we're witnessing one of the worst six-month cycles in recent history. Stocks have seen such a precipitous decline that fears of a recession are spreading. I believe, as I've shared previously, that we're right in the middle of that recession now. After all, a recession is defined as two consecutive quarters of GDP decline. That was the case in each of the 13 post World War II recessions, including those of the 21st century (2001, 2008 and 2020), according to the National Bureau of Economic Research.

Experts appear to agree. As Moody's Analytics chief economist Mark Zandi says "historically, when inflation is high and the Federal Reserve is working hard to quell it, recessions happen more often than not" (as rate-hiking campaigns often precede economic downturns).

So, we know that stocks plummet before a recession. But how do they perform in the teeth of a recession? You might be surprised to learn that the S&P 500 rose an average of 1% across all recession periods since 1945. Why? Because markets usually top out before the start of recessions and bottom out before their conclusion. In other words, the worst is over for stocks before it's over for the rest of the economy.

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MARKET OUTLOOK

On Recessions, Recoveries, and the Road Ahead (cont.)

In nearly every case, the S&P 500 has bottomed out roughly four months before the end of a recession. The index typically hits a high seven months before the start of a recession.

The market is a predictor of the future. Declining stocks are therefore the traditional indication that most investors believe we are headed for a recession. “When we do finally fall into a recession,” Zandi adds, “that’s usually a good time to get back into the market.”

Searching For The Light

If things weren’t uncertain enough, there’s another factor to consider: the upcoming midterm elections in November. The second year of a presidential cycle tends to have weaker stock market returns overall. In particular, the second and third quarters of midterm years each have seen declines throughout history, with more volatility than at any other times during the presidential cycle. Investors are certainly seeing such volatility now. And with inflation at a 40-year high, I believe the volatility will persist through the remainder of the calendar year.

That begs the question of where I currently stand on taking risks. First off, I’m looking for a light at the end of the tunnel as it pertains to inflation. Novice investors almost always talk about how they will be more willing to take on risk when things feel a little better. My experience tells me I need to be earlier than that. By the time ***you*** feel better, it will likely be when the market is much higher, if not ***because*** the market is much higher. That said, I can’t just sit and wait for a light at the end of the tunnel. I have to anticipate it—particularly when it comes to the two circumstances that are causing inflation: the supply chain slowdown and the ultra-tight labor market…

On Recessions, Recoveries, and the Road Ahead (cont.)

Everyone knows this country can no longer function, if even exist, in a high interest rate environment over extended periods of time due to the share of the budget the debt payments would take up. Getting it right is critical. My business has nothing to do with supply chains, so I am anything but an expert. However, I do spend a great deal of time listening to CEOs and CFOs of impacted companies. The good news is that they're expressing much more optimism than I would have expected. The consensus is that we could be just months away from normalization on the supply chain front (barring a major Covid reoccurrence).

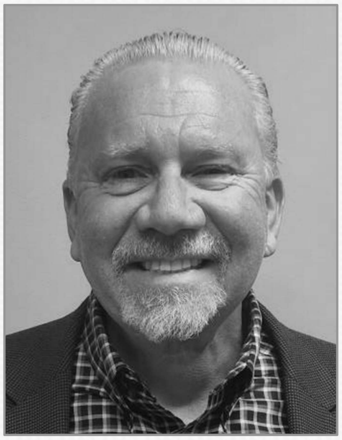
As for the labor market, it's clear that wage inflation will not subside until we see a reversal of the dynamic wherein job openings exceed job applicants. I personally believe we will need 6-7% unemployment to turn this around—but I will not be waiting for that 6-7%.

Where Do We Go From Here?

As per the earlier points, my opinion is that it's time to move on from an over-allocation to defensive categories. However, it's not the time to be "risk-on" either—as the baby hasn't been thrown out with the bath water just yet. The path forward, over the next few months, will be a transition from low beta/defensive to more neutral. As always, I'll be watching closely to see if the market (or categories, more likely) get historically cheap. And I'll be looking for the light, of course.

TAX MATTERS

Take Advantage of Investment Losses at Tax Time



by Brett Roth

There's no doubt that it's been a tough year for markets. Whether you're invested in stocks, bonds, mutual funds or ETFs, most every sector is awash in red ink. But there's a silver lining to investment losses: **tax-loss harvesting**.

The tax code's rules on losses for individual investors are generous when it comes to assets held in taxable accounts (as opposed to tax-sheltered IRAs and 401(k) plans). Investors can sell their losers and book a capital loss, typically for the difference between a holding's purchase price and its sale price. Then they can use these losses to offset taxable capital gains from selling winners, either right away or in the future.

Shelter From The Storm

Such losses can shelter gains from a broad range of assets, so losses from the sale of a bond fund, for example, can offset taxable capital gains from the sale of an index fund, cryptocurrency or real estate.

And if an investor doesn't have enough taxable capital gains, then he or she can deduct up to $3,000 of losses per year against ordinary income such as wages or interest; a strategy can be to take up to $3,000 each year in capital losses to offset income/interest. Unused losses above that carry forward indefinitely for future use, although individual investors can't carry losses back to offset gains on prior-year asset sales.

Here's a simplified hypothetical example: John bought 200 Microsoft shares for $16,000 in Spring 2020. Then he paid $45,000 for Bitcoin in Spring 2021. Both holdings are in taxable accounts, and John wants some cash…

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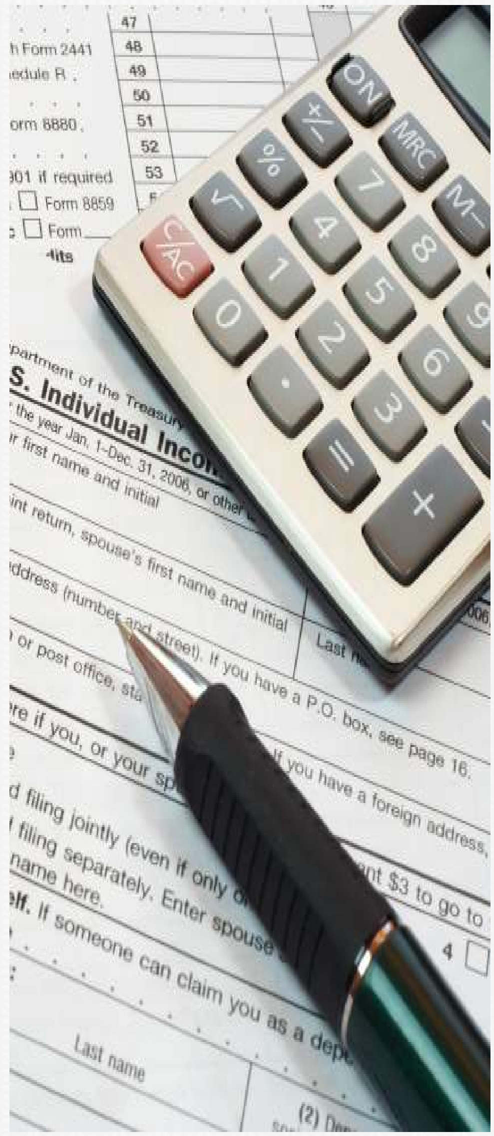
TAX MATTERS

Take Advantage of Investment Losses at Tax Time (cont.)

At recent prices, John's Microsoft stock had a capital gain of about $14,000 and his Bitcoin incurred a loss of about $15,000. If he sells both holdings at those prices, then his Bitcoin loss can shelter his gain from selling Microsoft shares and John won't owe tax on it. The remaining $1,000 loss can offset other taxable gains or, if he doesn't have them, $1,000 of ordinary income.



That's not all: Many investors use the tax code's rules systematically to sell losers and bank losses for use against future gains while staying invested in the market.

As with many investing strategies, the devil is in the details, so here's an important reminder: For those of you that were clients in March 2020, with after tax accounts, you will remember that even though the drop was short, it was so significant that the attention to detail that we place at DLAK allowed us to implement the strategy above for your benefit.

Staying Vigilant

At DLAK, we consistently monitor the financial markets and your specific accounts for opportunities to lower tax burden to you and your family. We will continue to do so in these volatile times.

Consult your tax, legal, or accounting professional regarding your individual situation. The information provided is based on our general understanding of the subject matter discussed and is for informational purposes only.

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INVESTMENT STRATEGIES

How DLAK Protects You From Interest Rate Risk

by Matt Ringle

As is always our goal with this newsletter, we want to bring you timely information that not only benefits your everyday household finances but also increases your knowledge of the financial world.

You may recall an article written by Robert Koscik in our Q4 2021 newsletter discussing various ways to generate “lifetime income.” Within that piece, Rob shared his analysis on one of the more widely used methods to do so: bond funds. He specifically discussed the significant risk a rising interest rate environment poses to these investments.

With the recent volatility in the market, I wanted to take a moment to reflect upon the impact rising rates have had on bond funds and how that has validated the defensive strategy we have been utilizing for you here at DLAK.

On The Mark

Since the beginning of 2022, the Federal Funds rate (which impacts short term interest rates) was at 0.25%. In recent months, the Fed has raised rates all the way to 1.75%. That 1.5% increase has caused bond yields to rise and simultaneously bond prices to plummet. If you held the U.S. Bond Index (a proxy to reflect corporate bond funds) starting at the beginning of this year, you would have lost almost -10% in total return (principal and interest).

Compare that to our suggested strategy of using Fixed Annuities. Over this same time period (a 2.5% or 3% fixed annuity) average return is somewhere between a positive 1.25% and 2%. **That is an out-performance of at least 11% on average.**

Sources: https://tradingeconomics.com/united-states/interest-rate, https://www.wsj.com/market-data/bonds/benchmarks

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ESTATE PLANNING

Easing the Tax Burden on Your Heirs - by Matt Ringle

As the old saying goes, the only certainties in life are death and taxes. But just because they're unpleasant topics doesn't mean we can't enjoy discussing strategies to lessen tax burdens after your passing! One such strategy to consider is an uneven inheritance split among your heirs.

Wage Levels Are Key

With the changing of the tax law in 2019 with regard to how inherited IRAs or 401(k)s must be distributed, it may behoove you to revisit how your heirs receive their inheritance. For example, if you have a higher wage-earning heir versus a lower wage-earning heir, you may consider leaving your after-tax money (brokerage accounts, house, bank accounts, life insurance proceeds, etc.) to the higher wage-earner and the pre-tax money (IRAs, 401(k)s, pre-tax annuities, etc.) to the lower wage-earner.

Why you might ask? Dividing the inheritance up in this fashion will ensure the most tax-efficient transfer of wealth for all parties involved and keep your hard money out of Uncle Sam's pockets. Let's break it down in the chart that follows on the next page…

ESTATE PLANNING

Easing the Tax Burden on Your Heirs *(continued)*

Scenario 1 demonstrates what the tax consequences would be if you did NOT pay attention to taxes and split the inheritance evenly between your heirs. Both heirs would receive $100,000 of after-tax money. But for the pre-tax portion, the heir in the lower marginal tax bracket would receive $99,999.99 while the heir in the higher marginal tax bracket would only receive $83,333.25 after they pay higher taxes of 35%. Total taxes paid to the government would be $114,000.

Total Inheritance	**$**	**456,410**
Pre-Tax Portion of Inheritance	$	256,410
After-Tax Portion of Inheritance	$	200,000
Scenario 1: No Tax Consideration (Assets Split Evenly)		
	Lower Wage Earning Heir	**Higher Wage Earning Heir**
Marginal Tax Bracket	22%	35%
Net Inheritance After Tax	$ 200,000	$ 183,333
*Total taxes paid = $114,000		
Scenario 2: Taxes Considered (Pre-Tax Assets to Lower Wage Earning Heir & After-Tax Assets to Higher Wage Earning Heir)		
	Lower Wage Earning Heir	**Higher Wage Earning Heir**
Marginal Tax Bracket	22%	35%
Net Inheritance After Tax	$ 200,000	$ 200,000
*Total taxes paid = $56,410		

Scenario 2 demonstrates what the tax consequences would be if we instead paid close attention to tax treatment. In this example you would allocate all of the pre-tax assets to the beneficiary in the lower 22% marginal tax bracket and allocate the after-tax assets to the beneficiary in the higher 35% marginal tax bracket. The heir in the 22% marginal bracket would receive $199,999.99 in inheritance after paying 22% taxes. The heir in the 35% marginal tax bracket would receive all $200,000.00 of the after-tax inheritance and pay $0 in taxes. Both heirs would receive the same total inheritance, but taxes paid to the government are reduced to $56,410. **That is a total tax savings of $57,590 just by paying attention to which heir receives your specific assets!**

For those who plan to leave money to both heirs and charities, you should consider designating the after-tax funds to your heirs and the pre-tax ones to the charities. The latter will receive a tax break and your heirs will inherit the money tax-free. It's a win-win!

Consult your tax, legal, or accounting professional regarding your individual situation. The information provided is based on our general understanding of the subject matter discussed and is for informational purposes only.

TAX MATTERS

The Tax Advantages of "Bundled" Giving – *by Brett Roth*

Are you getting the biggest (or any) tax advantage for your charitable contributions? It's been five years since the Tax Cuts and Jobs Act of 2017 nearly doubled the standard deduction to $25,900 for a married couple and $12,950 for a single person. As a result, many taxpayers who were itemizing are now taking the standard deduction.

Charitable individuals who are on the fence between itemizing and the standard could be enjoying the best of both worlds by using a technique known as "bundling" via Donor Advised Funds. Through bundling, individuals condense two or more years' worth of giving into a single year and itemize to gain the maximum tax benefit. They then take the standard deduction during the other years.

For example, Jane and Bob currently give $12,000 to their church each year. The couple has $18,000 in other itemized deductions ($10K in real estate taxes, $8K in state income taxes, and zero in mortgage interest). If they continue to donate $12,000, their annual itemized deductions of $30,000 do not exceed the $25,900 standard deduction for couples filing jointly. Of the $12K gifted they would get less than a $5K deduction. If Jane and Bob have the financial means to put 3 years' worth of giving into one year, by bundling those gifts ($36,000 for three years), **they can gain almost $12,000 (or $24,000) of additional tax deductions over a two- or three-year period!** They get a $54K itemized deduction in year one, and $29,500 in each of the next two years by just taking a standard deduction. That's $113K worth of deduction over a three-year period versus $90K by gifting yearly. In a 24% tax bracket, that's approximately $6K in your pocket and your church gets the same.

Below are just a few of the firms that specialize in donor advised funds in which you can direct how much and when each of your charities is gifted. But as always, review your specific situation with your DLAK financial advisor and/or your tax, legal, or accounting professional regarding your individual situation. The information provided is based on our general understanding of the subject matter discussed and is for informational purposes only.

- Christian Financial Resource
- Dayton Foundation
- Greater Cincinnati Foundation
- American Endowment Foundation
- Fidelity Charitable Gift Fund

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FAMILY AFFAIRS

Caring For Your Aging Loved Ones

By Jenny Cyrus

It's a challenge most everyone eventually has to face…caring for our aging parents. If you're among the many Americans dealing with the issue right now, you know that the responsibilities can be overwhelming both physically and emotionally. You may even be approaching your own golden years and hoping to ease future burdens on your children.

Whenever the time of need may arrive, you might consider hiring a Geriatric Care Manager. A GCM is typically a licensed nurse or social worker who specializes in geriatrics and can help explore options for you or your loved one's care.

Planning Ahead

- After identifying needs, wishes and limitations, a GCM will develop both a short and long term plan and suggest services and resources to execute each.

- Costs can range on average from $100-250 an hour. While that may sound pricey, it's money well spent for the knowledge and resource of a trained professional. For example, 20 hours @ $150/hour would equal $3,000—which is less than one month's cost at an assisted living care center.

- Below are some resources to connect with a GCM:
    - https://www.caring.com/senior-care/geriatric-care-managers/
    - https://www.aginglifecare.org//ALCAWEB/What_is_Aging_Life_Care/Search/Find_an_Expert.aspx
    - https://eldercare.acl.gov/Public/Index.aspx

NEWS TO USE

Did You Know?

Owning a Home is Getting More Costly

The cost of owning own home is 31.50% of monthly income—up from 23.9% in the 2nd quarter of 2021.

DLAK feels strongly that you should not pay more than 16% of your income for your monthly mortgage. If you're doing so, it will be difficult (if not impossible) to save as much as the average family needs to save.

Source: https://www.thebalance.com/costs-of-owning-a-new-home-31-5-percent-of-your-monthly-income-5509576

The Rule of 72. What is it?

The rule of 72 is a simple formula that shows how quick your money will double at a given return rate. Essentially, you can divide 72 by your annual compound interest rate and see how many years it will take for your investment to double. Here's a breakdown of how it works:

- 72 ÷ 9% annual average return = 8 years to double your money
- 72 ÷ 3% annual average return = 24 years to double your money
- 72 ÷ 11% annual average return = 6 ½ years to double your money

The S&P 500 Dips in Midterm Election Years

Looking back at the performance of the S&P 500® Index during midterm election years since 1946 shows that in the five months leading up to the election, in every single mid-term year, the S&P 500® Index has suffered a decline from its peak. The average of those declines is 17.59%.

Source: Bloomberg and Strategas, 2.28.2022

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