FINANCIAL DESIGN STUDIO
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OCTOBER 2020 NEWSLETTER

WHO'S READY FOR THE ELECTION?

BY: ROBERT STOLL, CFP® CFA

If the first presidential debate between Donald Trump and Joe Biden is any indication, we're in for a heckuva election in November. Investors have their views about what the election of one or the other will mean for the stock market. Oftentimes, the worst fears of these investors never came to pass.

History can be a good guide to keep investors grounded heading into an uncertain period. We've noted in the past that emotions are Enemy #1 of successful investing. To help avoid that trap, let's see how previous election cycles turned out and how that knowledge can help us stick to our investment plans.

First Year After an Election

We'll start by looking at annual returns of the S&P 500 Index in the year after a presidential election. To put these returns into historical context, the annualized total return of the S&P 500 index for all years from 1926 to 2019 is +10.2%.

The average return in the year following the last 16 presidential elections is very close to this long-term average at +10.9%.

S&P 500 Total Returns Year After Election Cycle

Election Cycle & Result			Returns the Following Year
1956	Re-election	Eisenhower	-10.8%
1960	New president	Kennedy	26.9%
1964	Re-election	Johnson*	12.5%
1968	New president	Nixon	-8.5%
1972	Re-election	Nixon	-14.7%
1976	New president	Carter	-7.2%
1980	New president	Reagan	-4.9%
1984	Re-election	Reagan	31.7%
1988	New president	Bush	31.7%
1992	New president	Clinton	10.1%
1996	Re-election	Clinton	33.4%
2000	New president	Bush	-11.9%
2004	Re-election	Bush	4.9%
2008	New president	Obama	26.5%
2012	Re-election	Obama	32.4%
2016	New president	Trump	21.8%
		Average All Elections	**10.9%**
		Re-elections	**12.8%**
		New presidents	**9.4%**

Stock market returns in the years following the re-election of an incumbent proved better than when a new president was elected. We can only speculate as to why. Maybe investors favored certainty over the uncertainty of change? Still, average returns when a new president was elected aren't far off the long-term average (+9.4% vs. +10.2%).

Surprisingly, we've only had two incumbents defeated since the 1950's: Carter in 1980 and Bush Senior in 1992. In the wake of those elections, Reagan's first year as president saw negative returns of -4.9% while Clinton enjoyed returns of +10.2%. Given the stark policy differences between Trump and Biden, many investors worry about what how 2021 will turn out if Biden is elected. While a small sample size, history suggests it won't make a huge difference.

Contested Election?

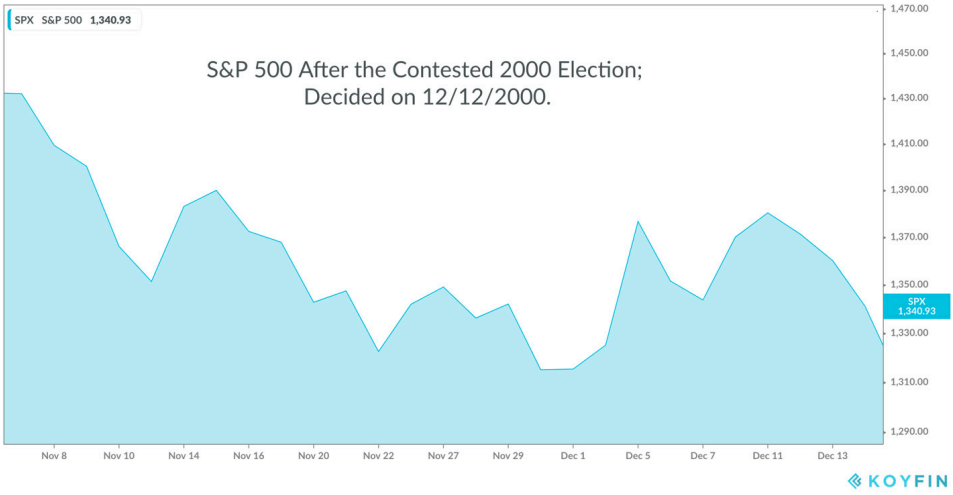
On Election Night 2000, I went out with group of guys from work to the Saloon Steakhouse in Chicago to enjoy some filet mignon and watch the election results. After 4 hours we finally had to call it a night. Little did we know it would take over a month until that election was decided!

Prognosticators are preparing the public for much of the same in 2020. With mail-in ballots figuring prominently, the prospects for a contested election are clearly higher. How did the stock market handle the Bush v Gore battle 20 years ago?

There was an initial drop in the stock market by 5% in the week after Election night 2000 (November 7, 2000). After that, stocks treaded water for a few weeks until the election was finally decided on December 12.

The year following produced negative returns as seen in the table above (-11.9%). However it's important to remember that the Tech Bubble started to burst in mid-2000 and the 9/11 attacks happened in late 2001.

No one expected a contested election in 2000, whereas almost everyone is expecting one this year. We've always found that the stock market discounts (i.e. prices in) events well-before investors start talking about them. As such, we believe this view (contested election) is already built into stock prices. (Famous last words?)



1st Term vs 2nd Term

The last item we'll look at is average stock market returns in a president's first term vs. their second term. The results, we'll find, are remarkably consistent.

First terms in office tended to be better, which makes some sense. New face in town. New ideas, and a renewed sense of confidence. What's remarkable is that each change in president flipped between Republican and Democrat, except Bush in 1988. Despite these changes in party power and the obvious policy implications of those changes, the stock market performed well. That's a good reminder.

President	Term	Total Return S&P 500
Eisenhower	2nd Term	43.9%
Kennedy	1st Term	65.7%
Johnson*	2nd Term	39.3%
Nixon	1st Term	29.4%
Nixon	2nd Term	6.6%
Carter	1st Term	55.1%
Reagan	1st Term	50.5%
Reagan	2nd Term	91.9%
Bush	1st Term	79.2%
Clinton	1st Term	88.7%
Clinton	2nd Term	88.7%
Bush	1st Term	-2.1%
Bush	2nd Term	-19.3%
Obama	1st Term	72.3%
Obama	2nd Term	70.8%
Trump	1st Term	58.6%
	Average 1st Term	55.3%
	Average 2nd Term	46.0%

Do Presidents and Elections Even Matter?

Presidents and elections obviously do matter for the country in terms of political philosophy and tangible policy. However, after looking at all the data here, it's hard to find any stock market pattern at all. Regardless of whether the incumbent kept his seat or not - or which party was in power or not – the stock market has basically produced returns close to long-term averages through all of it.

What's important to point out is that during these years, there were major events going on that created uncertainty for investors. Vietnam War. Kennedy assassination. Civil Rights Movement. Great Society. Nixon resignation. Stagflation of the 70's. Iran-Contra. First Gulf War. 9/11. Second Gulf War. Great Financial Crisis. COVID-19. You get the idea. Through all of that – and through all the changes in party politics – America has continued to power forward.

Our message to clients as we head into the 2020 election season is to stay calm and stick to your plan. If Biden wins, sure, we'll have plenty of debate about future fiscal policy and tax changes. Just like previous changes in power, Americans adjust and move on. If Trump is re-elected, the big question is whether the tax cuts enacted in 2017 are made permanent. Currently, the tax cuts for individuals is set to expire or "sunset" at the end of 2025.

History has favored the patient investor. Let the timing of your financial goals – not politics – dictate what you do with your investments.

SAVING STRATEGIES FOR HIGH INCOME EARNERS

BY: ROBERT STOLL, CFP® CFA

One of the biggest questions we get from high earning business owners and corporate executives is: how can I be saving more money? If you look at the 401(k) limits for 2020 you can put $19,500 ($26,000 if you're over 50) into your 401(k) pre-tax. While that is a good amount, depending on your expected retirement lifestyle, that may not be enough for you to be able to live in retirement comfortably. The question is how can you be saving more?

We have a couple of options and I will preface all this by saying you have to be very careful, so please work with a financial professional or tax accountant before you do any of these things. Here are some options to think about:

1. HSA

The first option is a Health Savings Account (HSA). Given the cost of healthcare and retirement these days, it's really important to think about your healthcare costs in retirement as a separate expense, apart from your normal living expenses. The great thing is that when you take money out of the HSA for medical purposes, the distributions are not taxable. To the extent you have an HSA available to you, we recommend maxing out contributions so when you're in retirement you will have a dedicated pool of money to be able to pay those medical expenses.

2. Backdoor Roth

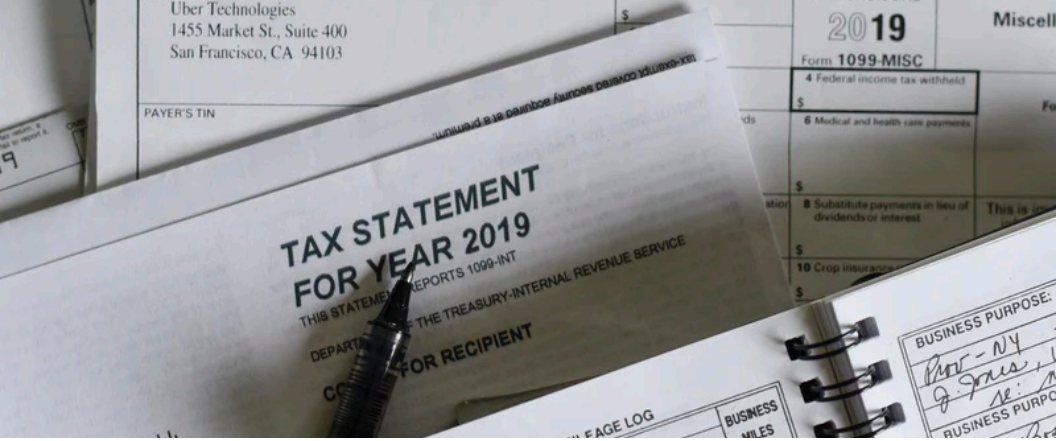
Another strategy that we consider is called a "Backdoor Roth". High income earners are likely going to exceed the limits where you can get a tax deduction for making an IRA contribution. However, that doesn't mean you can't contribute to your IRA. Any contribution(s) are classified as non-deductible. A Backdoor Roth takes that non-deductible contribution from your IRA and converts it to a Roth IRA. The benefit is that the Roth IRA grows tax-free and when you take money out of a Roth IRA you don't have to pay taxes on it like you do out of a Traditional IRA.

3. Mega Backdoor Roth

Another strategy, similar to a backdoor Roth, is called a "Mega backdoor Roth" conversion. In this case, you are putting after-tax money into your 401(k) plan. We know that for 2020 the limit for pre-tax contributions to a 401(k) is $19,500 ($26,000 if you're over 50), but you can actually put up to $57,000 into that 401(k) plan between your pre-tax contributions, your company match, and after tax contributions. The strategy depends on whether your plan allows it. To the extent you contribute after-tax money, you can roll these funds directly into a Roth IRA once you leave the company or while still employed, if in-service rollovers are permitted This can be a great way to save a lot of extra money and additionally benefit from the money being a Roth account!

4. Taxable Account

The last thing we look at is the good old taxable account. This is a brokerage investment account that you can open up at a custodian like Schwab. The key here though is while there are no contribution limits, you want to make sure it's invested in a tax-efficient manner. Investing in passive index funds that don't pay out year-end capital gains distributions, owning municipal bond funds and other asset location strategies will help make sure that you are not paying a lot of taxes while you are investing as well.



BE PROACTIVE: TAX ANALYSIS

BY: STEPHEN SMALENBERGER, EA

One question we hear a lot from those who are self-employed and doing some type of payroll is: "How do I balance my taxes and save for the future?" For this let's discuss your tax analysis...

Let's go through an example so I can show you some of the mechanics of how a tax analysis works.

If you pay yourself $1,000, you will receive a net check of $923.50 after all mandatory taxes have been taken out such as Social Security (6.2%) and Medicare (1.45%). This means that if you want to save for the future, reduce your taxable wages or make payments towards your tax bill, you have $923.50 left to allocate.

The payroll deductions can be any of the following:

- Pre-Tax Deductions
  - Traditional 401(k)
  - Health insurance
  - Dental Insurance
  - Health Savings Account (HSA)
  - Disability Insurance
  - Childcare
- Federal Tax Withholdings
- State Tax Withholdings
- After-Tax Deductions
  - Roth 401(k)
  - Disability Insurance

The payroll deductions going towards any of the items listed above can be either as a percentage of earnings or as a fixed dollar amount per paycheck.

If you elect to defer $100 from your wages into your Traditional 401(k), this will reduce your Taxable Wages to $900. You are receiving the benefit now since you are taxed on less income and the funds in your retirement are growing tax-deferred which means there are no tax implications until you start making withdrawals.

You may also elect to have a certain dollar amount or a percentage of each paycheck to go towards your Federal and/or State income tax. For example, if your State tax bill is $1,200 and you get paid twice a month... you could choose to have either 5.0% of your wages withheld towards this or $50 per paycheck.

As a business owner, you have a lot of options in how much you pay yourself, when, how much is withheld and how much is set aside for the future. The flexibility is all in your hands to choose the best and most efficient way to do it!

DID YOU FINISH YOUR ESTATE PLANNING DOCUMENTS?

BY: MICHELLE SMALENBERGER, CFP®

Recently I heard a statistic about number of estate planning documents that never get completed or finished.

This percentage was a shocking 86%! That could be a will, trust, or power of attorney when you are naming someone to take control when you pass away or become incompacitated. Each of these documents are important in those situations.

What does it mean to not finish? Simply, they never actually sign them.

You can have them beautifully drafted and they say what you want, but if you never sign them, then they actually aren't enforced.

With this being such a high statistic it reminded me of when I was at a business strategy workshop for a week. One of the other speakers who was there brought up this great list of strategies and options and help their business move forward to help them succeed. Their concern was actually that they wouldn't follow through with everything they were planning.

They were concerned that they would go home with good intentions to finish, but they wouldn't actually do it.

Instead of allowing yourself to be part of this statistic, decide to do something that's still undone. We want to help you move forward with your goals and make a plan that you can put into action. You can accomplish what you set out to do, and we can help you do it!

FAFSA SEASON IS HERE!

BY: ROBERT STOLL, CFP® CFA

FAFSA season is here for parents sending their child to college next year! FAFSA stands for "Free Application for Federal Student Aid" and is just as important as filling out college applications.

Many parents and students don't bother filling FAFSA out because they think they make too much money or have too many assets to qualify for aid. That may be true. But filling out FAFSA allows some students to receive grants that are offered on a first come first serve basis. Plus, if your student is going to take out Federal student loans, they must fill out FAFSA in order to receive them.

Quick Note on the CSS Profile

In getting ready for college, you may come across another form called the CSS Profile. CSS stands for "College Scholarship Service." I'm not going to go through the process of filling out a CSS Profile here, but want you to be aware of it.

The CSS Profile is basically a more in-depth version of the FAFSA form that digs further into your financial situation. If your student wants to apply to a school that requires a CSS Profile, they will have to fill out both a FAFSA form AND a CSS Profile.

What schools require a CSS Profile? If your child plans on applying to any of the schools on this list, then they will also have to fill out a CSS Profile. Check with each school to see what their specific rules are.

Getting Started With The 2021-2022 FAFSA

The 2021-2022 FAFSA season begins on October 1, 2020. I suggest getting this done as soon as possible (i.e. in October) so your student can focus on filling out college applications. By filling out the FAFSA early, you may also become eligible for school-specific grants that are made on a first come, first serve basis.

Here is a general list of what you will need when you fill out the FAFSA. Given it can take upwards of one hour to complete the form, I suggest gathering all this data before you start the FAFSA process.

- Student & Parent Social Security Numbers
- Student & Parent's 2019 Federal Tax Returns (see below...can electronically import as well)
- Bank statements for parents & students (checking, savings, and CD accounts)
- Investment account statements for parents & students (mutual funds, stocks, and bonds)
- Value of any real estate owned, other than your primary home
- Value of UGMA & UTMA accounts
- Value of 529 Savings accounts
- FSA ID of parent & student
- A list of the schools your student wants to apply to

Note what financial information is NOT needed:

- Retirement accounts (IRAs, Roth IRAs, 401k, 403b, etc)
- Cash value life insurance
- Equity in your primary home

Where to Apply

Visit our website for a full walk-through about completing the FAFSA form.

FREQUENTLY ASKED QUESTIONS

Are you a Fiduciary?
Yes, we are! This means we have a duty to act in your best interest. A person acting in a fiduciary capacity is held to a high standard of honesty and full disclosure in regard to the client and must not obtain a personal benefit at the expense of the client.

You're Fee-Only: What does that mean?
We have chosen to be a fee-only advisory firm. This means we do not accept any fees or compensation based on product sales. While we know our clients need products like insurance we do not receive any benefit from any source when you buy a product.

How does Financial Planning Work Virtually?
With advances in technology, it is amazing how much we can accomplish virtually! We are able to share everything we do in person, virtually. We simply use screen sharing and video software so we can see you and look at the same documents, together. Most forms can also be electronically signed.

Are you taking on new clients?
Yes! We are happy to work with friends or relatives that you think would benefit from a Financial Advisor relationship. A quick phone call is all it takes to see if they are a great fit.

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