FINANCIAL DESIGN STUDIO

DESIGNED FOR LIFE

NOVEMBER 2020 NEWSLETTER

OPPORTUNITIES TO GIVE

Our team believes that Teamwork Makes Dreams Work! We strive to be a team helping our clients because you benefit when we pool together our experience, resources, and energy. That's why we are teaming with you, our community, to have a bigger impact together making others' dreams possible.

Here are two ways we invite you to get involved with us! We will match one gift or box per family that you donate to ANY nonprofit organization before 12/31/2020. Simply send us a picture of you dropping off, buying, or preparing your gift so we can match your gift donation!

Here are the deadlines to join in each of the opportunities:

- Gingerbread houses can be bought until December 1st
- Operation Christmas Child Boxes need to be filled & returned by November 27th

MORE OF THE SAME

BY: ROBERT STOLL, CFP® CFA

Election 2020 has delivered a divided government. While Biden appears to be winning the Presidency, the GOP has kept the Senate and picked up a few seats in the House. In short, no one came out of the election a clear winner.

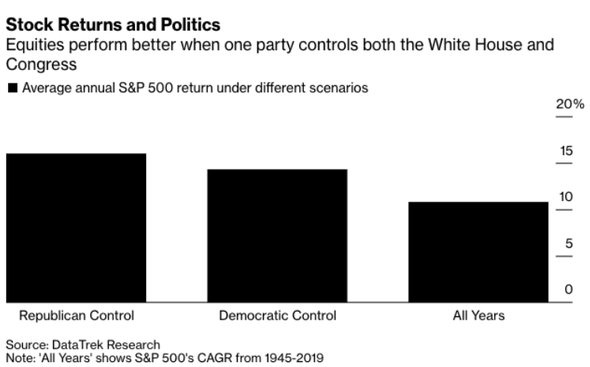
The investment environment for much of the last 10 years has seen a surge in growth-oriented tech stocks and a steady decline in bond yields. The initial reaction to Election 2020 is a continuation of this theme: big tech stocks like Facebook and Amazon are surging, while government bond yields have fallen back to where they were a few months ago.

Now that we have a result from this historic election, it's time to turn our attention towards the future and look at what this means for the economy and the stock market. The policy outlook may be uncertain, but the outlook for the stock market might be less so.

Divided We Fall?

Over the course of my career I've heard a lot of market pundits say, "stock markets love gridlock." The theory is that a divided government means there's less chance of one side or the other pushing through agendas that are unfriendly to the economy and market.

Yet the data on stock market performance during divided and united governments suggests otherwise. Since 1945, average annual returns for the stock market were better when either Democrats or Republicans controlled the presidency and Congress.



For the economy, a split government this time around is likely to be more negative. The president and Congress were unable to deliver a second round of Coronavirus stimulus before the election. States and small businesses remain under severe pressure from closures. If further stimulus continues to be held up after the election, the impact on the real economy will certainly be bad. Economists have already been slashing their forecasts for economic recovery in the fourth quarter of 2020 (source: New York Federal Reserve NowCast).

Don't Fight the Fed (Again!)

When it comes to the stock market, we continue to point towards the Federal Reserve as the key driver. In our May 2020 newsletter, we wrote a piece entitled "Don't Fight the Fed" which detailed how the stock market has become almost completely dependent on the course of Fed "stimulus." If the Fed is easing policy, stocks go up. If there's a threat of tighter policy, stocks suffer.

A divided US government means the chances of the economy getting a boost from fiscal policy

Clinton	
US Stocks	17.2%
Int'l Stocks	10.6%
Gov't Bonds	9.5%
Corporate Bonds	7.6%
High Yield Bonds	6.9%
Gold	-2.4%

Bush	
Gold	15.5%
Gov't Bonds	9.3%
Corporate Bonds	7.6%
High Yield Bonds	3.2%
Int'l Stocks	-0.1%
US Stocks	-2.9%

Obama	
US Stocks	14.5%
High Yield Bonds	13.4%
Corporate Bonds	7.2%
Int'l Stocks	7.0%
Gov't Bonds	3.9%
Gold	3.5%

Trump	
Gold	17.2%
US Stocks	13.8%
Corporate Bonds	9.9%
Gov't Bonds	9.9%
High Yield Bonds	8.0%
Int'l Stocks	-3.4%

Sources: Ibbotson; FDS Estimates

is lower than it would've been had there been a Blue or Red wave. A lot of investors were counting on one side or the other to win decisively, which would've unleashed trillions of dollars of fiscal stimulus.

Without fiscal stimulus, the onus will fall to the Fed to keep interest rates near zero for an extended period of time. Furthermore, it's likely they will continue to support the bond market by buying corporate and high yield bonds, which bodes well for stocks.

If the last 12 months of Coronavirus has taught us anything, it's the power of Federal Reserve stimulus on the stock market. While the economy collapsed, stocks quickly recovered due to the Fed's actions to support the market.

There's a chance that the inability of a divided Congress and President Biden to pass stimulus is so overwhelmingly negative that stocks start to suffer as a result. But the evidence over the last 12 years has taught us that downside could be limited if the market believes the Fed will become more "unconventional" in supporting markets.

Staying Diversified

While we expect the overall investment environment to be similar to what we've seen in the last decade, different asset classes will do better than others. History bears this out, as each asset class has its day in the sun, followed by periods where it lags. A look at the annualized returns of six key asset classes over the last 4 presidential terms bears this out.

There are two main goals with having a well-diversified portfolio. First, it takes the guesswork out of where to invest. It's impossible to consistently predict which parts of the market will outperform from year-to-year and getting it "wrong" can be costly. When you're well-diversified, you have a toe in the water in each asset class, meaning you'll participate in those that do well and those that lag.

Secondly, a well-diversified portfolio is less volatile, particularly when you look at multi-year periods. In our FDS Winter 2020 event, I shared a chart of how the returns of a diversified stock portfolio compared to investing only in the S&P 500 index. While the cumulative returns from 1990 to 2019 were very similar, there was less chance of experiencing a bad multi-year outcome from being diversified.

Above, you can see there have been several cases since 1990 of the S&P 500 index delivering negative returns over various 3, 5, and 10 year periods. But the diversified portfolio hasn't experienced a single 5 or 10 year negative return performance period. That can change, of course. But the point here is that have a diversified portfolio has well-served investors over the last 30 years.

Your Plan; Your Future

Regardless of how you feel about the results of the 2020 election, please keep in mind that your life story is not built around election cycles. The career you enjoy, the kids you send to college, and the retirement date you choose are driven by your family's personal needs. Politics may inform your choices around some of these things – such as tax strategies – but your financial decisions are largely driven by what's happening in your life. A life that's unique to you.

As we stressed in last month's newsletter, it's important to keep your eyes on your personal goals.

Why Is a Diversified Portfolio Better?

Reducing the risk downside scenarios

	3-Year Rolling Returns		5-Year Rolling Returns		10-Year Rolling Returns	
	# of Periods With a Loss	Worst Cumulative Performance	# of Periods With a Loss	Worst Cumulative Performance	# of Periods With a Loss	Worst Cumulative Performance
Diversified Portfolio	4	-25.5%	0	1.7%	0	32.4%
S&P 500 Index	6	-37.6%	5	-11.0%	2	-13.0%

That's what we're here to help you do. We're here to remind you of all the "whys" behind the goals you set when you first started working with us. To bring you back to those tangible goals and desires that can make a positive impact in your life, your family, and your community.

One of my favorite song lyrics is from a very old Grateful Dead tune, Betty and Dupree: "Wake up Betty, see what tomorrow brings....it might bring sunshine, and then it might bring rain."

It's a reminder that every day is a new day. Some of those days are going to stink. But many others are going to be great. Being able to adjust to these changing days on the fly is what makes life rich. Having a partner like FDS at your side helping you along the way helps keep your emotions in check and eyes on the thing that matters: your life story.

HIGH INCOME EARNERS 401K MISTAKE

BY: MICHELLE SMALENBERGER, CFP®

We all know each year in our 401(k) we have a maximum amount we can save. This year that maximum amount is $26,000. And let's assume you get paid once per month giving you twelve pay periods for the year. You save an equal amount each pay period. So you know that when you get to the end of the year you will fully fund this $26,000 that you can contribute. You start at the beginning of the year and begin to fill it up. But what most people may not be aware of is if you make too much money, too soon, you cannot put in the full $26,000.

You could get stuck if you make too much, too soon! Once you've earned $285,000 (Salary and bonus combined) you actually have to stop contributing to your 401(k). You've made too much to keep contributing. Once you make more than $285,000 not only can you not put your employee contributions into the 401(k) but your employer cannot continue to contribute for you either.

So if you are a high income earner it's very important that you max out your employee contributions before you earn this $285,000. You essentially need to front-load contributions in the beginning of the year to put in the full $26,000, if that's the annual maximum contribution. But you need to know you will fully fund your 401(k) before you get to this income amount.

We want to be sure you're thoughtful of these things, because this can be a surprise if you're not aware. This is something you may not know until the first year you have to stop contributing. But let's not learn the hard way! Contributing to a 401(k) is a great way for you to lower your taxable income so we want to make sure you are maximizing your benefits where you can.

UPDATE YOUR MONTHLY CONTRIBUTIONS

BY: STEPHEN SMALENBERGER, EA

Did you know the maximum amount that can be contributed to retirement accounts can change from year to year? It's true. And taking advantage of these contribution limits increases can make a big impact over your working career. Today, I want to walk through this with you to make sure you are indeed maxing out these accounts when able!

For the year 2020, the maximum amount that can be contributed to a 401(k) is $19,500. If you're over age 50, you get to contribute an additional $6,500 for a total of $26,000. If we are just looking at the $19,500 that works out to $1,625 per month.

What can you do if you're not on-track to maximize your 401(k)?

Start by taking a look at your paystub, the most recent would be the most helpful. There should be a line on there that indicates how much you are contributing both for the current period and another for the year-to-date. Find the year-to-date number and write it down.

For our purposes, let's use the example of $12,000. Next, take the annual limit of $19,500 and subtract the $12,000. This results in $7,500 which represents how much we'd need to add or before year-end. Let's also say that in our example that there's only 5 more pay periods remaining for the year. Dividing the $7,500 now by these 5 remaining pay periods, results in $1,500. This means that our payroll deferrals need to be at least $1,500 a pay period to stay on-track and hit our target of $19,500. If you notice the current period's amount is less than this, you'll want to make an adjustment soon. Keep in mind that the changes may not be immediate, so be sure to work with your payroll department to determine the appropriate amount to elect to meet your goal. For the year 2020, the maximum amount that can be contributed to Traditional and/or Roth IRAs is $6,000 or if over the age of 50 an additional $1,000 for a total of $7,000.

What can you do if you're not on-track to maximize your IRA?

Following the same process, we'd take the amount already contributed year-to-date and subtract that from the contribution limit. This amount is then divided by the number of months remaining before the end of the year to determine how much is needed on a monthly basis.

While contributions to IRAs can technically be made up until April 15th after year-end, many of our clients like to complete their contributions during the calendar year. Not only do we find that this is easier to conceptualize but it also helps with cashflow and budget planning.

Unlike employer plans like the 401(k), both the Traditional & Roth IRAs are subject to income phase-outs. That means that as your income increases, you may make too much or exceed thresholds disallowing you from receiving a tax deduction for contributions in the case of Traditional IRAs or even being able to make a contribution at all in the case of Roth IRAs. For this reason, it's important to know where you fall on the phase-outs. Contributions after you've met threshold limits would be considered "in excess" and would need to be subsequently taken back out or else you could incur penalties & interest.

We understand that there's a lot of detailed information here. The point of this is to help you determine if you're on-track to maximize your retirement contributions in any particular year.

If you need help to figure out what makes the most sense for you and to max out your 401(k), Traditional IRA or Roth IRA, please reach out to us. We would be happy to help you!

WHAT NEEDS TO HAPPEN BY 12/31/2020?

BY: STEPHEN SMALENBERGER, EA

As we approach the end of the year what things do we need to be thinking about? What HAS to happen before 12/31? We've created a list of these items that you can download at our website, but right now we are going to talk through each of these items.

Tax Planning: Create your tax return ahead of time. Do an analysis so there are no surprises.
Retirement Accounts: Contribute enough to get your free employer match or the maximum amount you can each year of $18,000 or $24,000, if you're over age 50.

IRA Contributions: This can actually be done after year-end. But if you can contribute sooner the funds can be invested sooner.

Adjust Tax Withholdings: If you find after analyzing your return that you have under-withheld this is a great time to get caught up so you don't incur a penalty when you file your return.

Charitable Donations: These can be cash, non-cash, stock, or household items

RMDs: For those over age 70 ½, or those who have inherited accounts from someone. There is a 50% penalty on the amount not taken by year-end.

Roth Conversions: This is moving money from a traditional IRA to a Roth IRA. You could do a partial amount, full amount, or none. But how much room is available in your tax bracket before you go over into the next bracket? An analysis can help see if this is an option.

Gain/Loss Harvesting: Balancing how much we have in gains or losses and equalizing it for tax strategy purposes. So if you have large gains, maybe you have positions at losses you can sell to neutralize the tax effect.

Medical Expenses: Have you met your deductible? Things that you might be doing in January, maybe bump ahead to December to increase the expenses you can deduct for taxes.

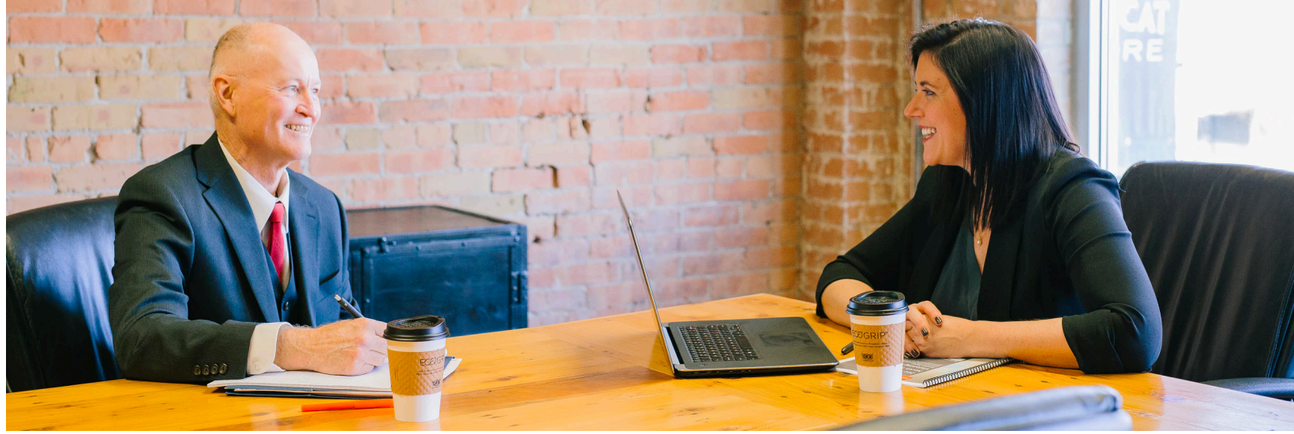
HSA Contributions: If you have a high-deductible health care plan and an HSA, this is a way to contribute money to pre-tax. Similar to the IRA you have until the following year to make this contribution.

Gifting: These are gifts to people rather than to charitable organizations. You can gift up to $14,000 per person per year. With your spouse you could do gift-splitting. This means that you can each give $14,000 per person, for a total of $28,000 per person per year.

FSA: "Use it or lose it." These are funds that you have set aside to pay for a medical expense this year. If you don't spend the money you lose it. Some plans have a grace period or an amount that you can carry over. Be sure your know the rules for your plan.

529 Plans: Whether you're a parent or grandparent, you can use 529s to contribute for college expenses in the future.

On our website there is a list of year-end tax planning items to review to make sure you have checked everything! Be sure to download your copy!



ASSET LOCATION

BY: ROBERT STOLL, CFP® CFA

Today we are going to talk about one of the silent killers of investment performance, taxes. Taxes are a fact of life and we can't avoid them forever. However, we can be strategic about when incurred so that it doesn't negatively affect our finances any more than necessary.

One thing I see a lot when reviewing investment statements is that people like to own mutual funds. While they may be good mutual funds that perform well, they are not tax-efficient but are rather tax-inefficient. What I mean by that is many mutual funds pay out "capital gains distributions" at the end of the year. These are proceeds from the sale of stock and other assets by the fund's managers that are passed on to you the investment owner. The gains are reported on a 1099 and picked up on your Tax Return as income, which you pay tax on. It doesn't matter whether you bought or sold it during the year, that tax burden is going to come to you whether you like it or not.

Here's an example: imagine a married couple who makes $150,000 a year and they also have a $250,000 portfolio. Due to the investments they hold within their portfolio, it's not uncommon for them to receive $10,000 capital gains distributions from the underlying mutual funds in any given year. The taxes they have to pay on the distribution is $1,500. Now that may not sound like a lot of money, but when compounded year after year, it adds up!

This example highlights the importance of a tax planning strategy called "Asset Location." What that means is you want to make sure your tax-inefficient investments (ex. mutual funds) are held inside accounts like IRAs. If that same mutual fund was instead owned within an IRA, the couple would be able to defer any income generated from their investments until funds are later withdrawn from the account in the future. Therefore, the $1,500 capital gain distribution in our example wouldn't be taxable when received.

Conversely, any tax-efficient investments (ex. index funds) should be held within individual, joint or trusts which are considered taxable accounts. Index funds, sometimes called passive funds, try to match indexes like S&P 500 or Dow Jones Industrial Average. Since they don't trade a lot, they also don't generate a lot of capital gains, if ever.

By being strategic about where your investments are held can end up saving you a lot of money over time. This is what we do for our clients and the portfolios that they entrust us to manage. We make sure their investments are not only appropriate to own, but are also located in the right kind of account. If you need help with your investments and you're not really sure how to do this asset location strategy, then please call us. We would be sure to help you with your investments.

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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FINANCIAL DESIGN STUDIO
DESIGNED FOR LIFE
21660 W. Field Parkway
Suite 118
Deer Park, IL 60010