FINANCIAL DESIGN STUDIO

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WILL GOOD NEWS IN 2021 BE BAD NEWS FOR THE MARKET?

BY: ROBERT STOLL, CFP® CFA

The risk of upside economic surprises in 2021 is building. COVID-19 vaccines are being rolled out quickly, which raises the prospect of the economy opening up soon. Meanwhile, Democrats won the final two Senate races of the 2020 election cycle, increasing the chances of more aggressive fiscal spending to prop up the economy.

There's an old Wall Street adage for the stock market that goes something like this: "Bad (economic) news is good news (for the market)". We saw this dynamic play out in spades in 2020, which gave us everything from a pandemic to dysfunctional elections to murder hornets. Despite these worries, the S&P 500 closed at an all-time high on December 31st!

This brings up an interesting question for investors as we head into 2021: Will stronger economic numbers propel the stock market even higher? Or are we facing a risk that "good economic news is bad news" for the market?

Do Consumers Have Pent-up Demand to Spend?

At the end of 2020, Congress finally passed a stimulus bill that included another round of checks being sent to consumers. While they were half the size ($600) of what was sent last Spring, many people received this money by the end of the year.

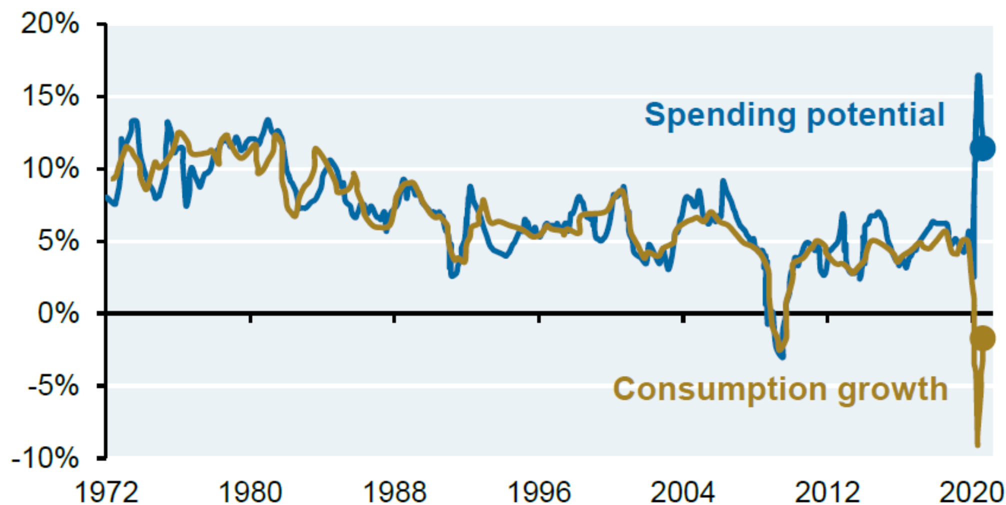
When consumers received their $1,200 checks last April, many people used that money to pay off debt. Total credit card debt outstanding is $100 billion lower than it was pre-pandemic, representing about 1/3 of the total stimulus money that was sent out. The rest was used to sustain living expenses for those that lost jobs, or to work on home projects for those fortunate enough to keep working.

Since then, the economy has stabilized and recouped about half of what it lost in the Spring. As fresh $600 checks hit bank accounts the last week of December, a quote from CEO Ray Blanchette of TGI Friday's caught our eye:

"We're actually doing much, much better for the last couple of days," Blanchette said in an interview. He said the company noticed the increase "as soon as those stimulus checks hit — talk about pent-up demand."

Later in the article, Mr. Blanchette noted that TGI Friday's sales increased by 20% the week after consumers received stimulus payments. Talk about pent-up demand!

A chart we recently saw illustrates this pent-up demand nicely. It shows that consumption spending growth has lagged "spending potential" significantly in the last year.



Given that COVID-19 vaccines are being rolled out, the "risk" is for the economy to open up more quickly than what's currently expected. As that happens, we may see consumer spending surge given how badly many people want to get back to normal.

How Will Democratic Control of the Senate Affect the Economy?

Two Senate seats were left undecided after the November elections, resulting in a run-off the first week of 2021. At stake: which party would control the Senate.

With President-elect Biden set to take office and the Democrats keeping control of the House, these races were big. Would Congress be split, resulting in more gridlock? Or would the Democrats take control, opening up the prospect of more spending?

With the Democrats winning both seats in Georgia, we now have one party in control of the White House and Congress, which historically means that big legislation gets passed. Here, Democrats have promised to send out yet another round of stimulus checks, this time $2,000 each.

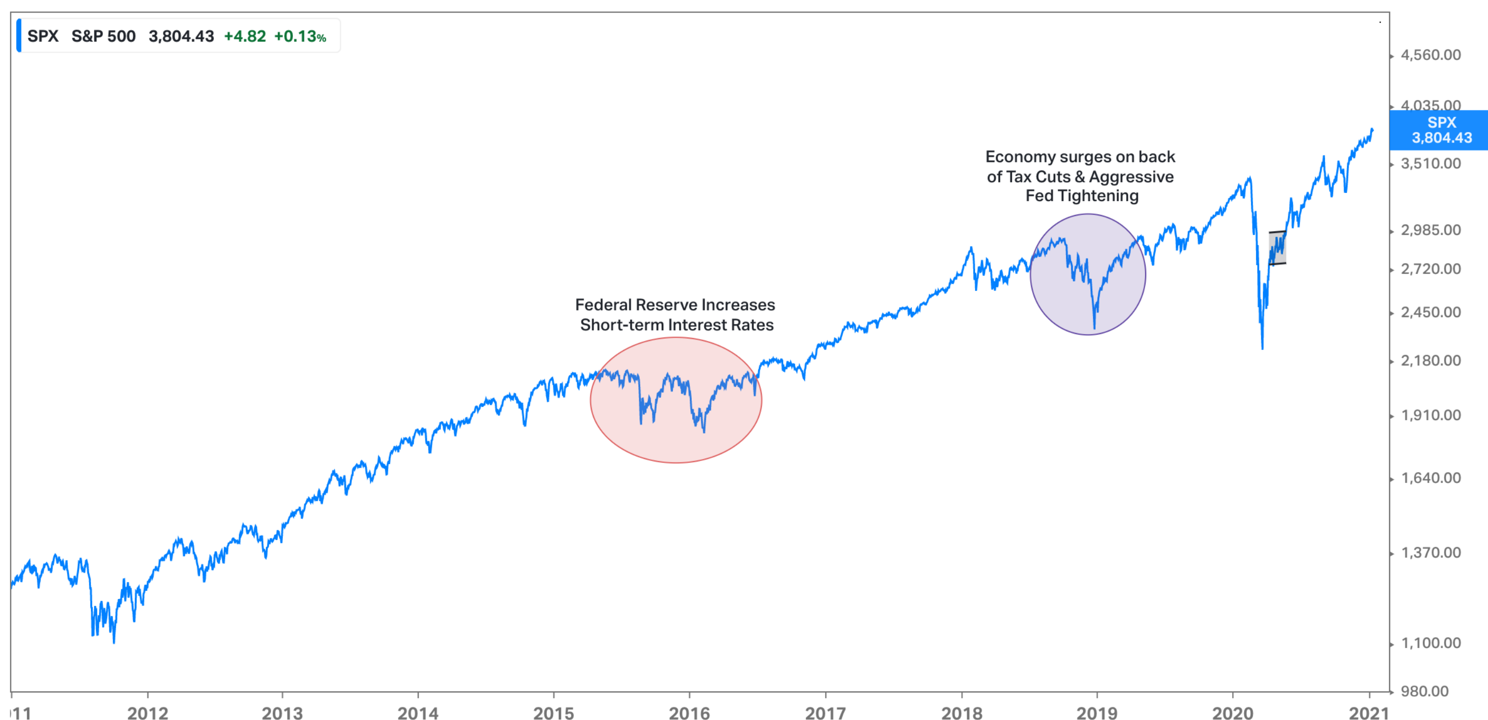
To put the potential impact of these checks into perspective, the median family income in the United States is about $70,000, or $5,800 per month. If this new round of stimulus passes, a married couple with two young children would receive $8,000, much more than they'd normally make in a month!

Given the long nine months everyone has been trapped in their homes, it wouldn't surprise us to see a consumer spending surge if this new round of stimulus is passed. The combination of people emerging from hibernation and having a fistful of "free" money would likely lead to a surge of economic optimism.

Will Good News Be Bad News for the Market?

One of the hardest aspects of investing is that the stock market moves less on the news of *today* and more on what it expects the news to be in the next 6-12 months. Last April, as the severity of the economic damage was becoming apparent, we saw several commentators say, "Why on earth is the stock market going up — the economy just declined by 33%?!?!"

It's a perfect example of why making buy/sell decisions based on news you're hearing today is rarely a good idea. The stock market already discounted that news weeks ago.



What drove the stock market to fresh highs in 2020 despite the economic turmoil? Answer: It was the promise and delivery of exceptionally easy monetary policy from the Federal Reserve. As I've talked about in previous newsletters, the stock market is very sensitive to where Federal Reserve policy is going, not where it's been.

There have been two examples in the last several years of the stock market suffering corrections despite better economic times. In late 2015 and 2016, as the Federal Reserve was preparing to tighten monetary policy for the first time in years, the stock market suffered two 15% declines in 12 months.

Then, in late 2018, the stock market declined by over 20% as investors worried that the economy was in danger of overheating. Tax rates had been lowered for business and consumers alike, and the Fed was increasing the pace of short-term interest rate hikes.

Wayne Gretzky is famous for saying, "go to where the puck is going to be, not where it has been." With that in mind, let's imagine what mid-2021 might look like if the COVID vaccines are rolled out aggressively. Small businesses will be allowed to reopen. Restaurants, live music events, and travel will be open for business for the first time in almost a year. Do you think consumers are going to be itching to get out and enjoy these things again? What if they have an extra $2,000 in their pockets for each family member? Heck yeah, we might see a feeding frenzy come Summer!

When Will the Federal Reserve Tighten?

If the economy gets "hot" in the summer, we have to think ahead to what the Fed might then be thinking. They've been clear for the last year that they expect rates to stay very low for several years. But if the economy surges, the prospect of higher inflation also rises.

Anyone that's done a home project the last nine months know that construction materials and labor costs have gone way up. And for good reason; if we're trapped at home, we might as well improve what we have to look at every day! Higher demand for something almost always results in higher inflation.

The Federal Reserve has been clear they want to see higher inflation, which is why we expect them to keep short-term interest rates low throughout 2021. But frankly, they're trying to achieve a Goldilocks situation where inflation goes up, but not by too much.

We believe the Fed overestimates their ability to fine-tune the economy with that much precision. As we learned in the 1970s and early 80s, inflation isn't something that can be easily turned on and off. Given

the massive potential pent-up spending impulse in the economy right now, we can envision a scenario where the mid-2021 economy is booming so much that investors worry about tightening Fed policy. And if that happens, history suggests the stock market could struggle as that new "risk" is priced into the market.

Separating the Real Economy from the Stock Market

Too often, I think the Fed and many investors view the health of the economy through the lens of what the stock market is doing. But we can't ignore the fact that the Top 10% of all earners in the U.S. own 87% of the stock market wealth. There's a significant percentage of society that could not care less what stocks are doing since they don't own any stocks. Their concern is jobs and making ends meet every month.

While the Fed hasn't admitted any part in driving wealth inequality, they have said that the Goldilocks level of unemployment – the point at which the labor market is so tight that drives wage inflation - is lower than what they previously believed.

This leads to one of two potential scenarios:

One, the Fed leaves the punch bowl out longer so it drives the unemployment rate to a very low level. This is great for workers, obviously, but also raises the prospect of inflation.

Alternatively, the Fed may go back to its old playbook of tightening monetary policy – either explicitly or implicitly – at the first sign that the economy is overheating, short circuiting jobs growth.

Regardless of which of these scenarios plays out, we see increased risk of a "good news is bad news" scenario playing out for the market in 2021. As always, we don't make portfolio decisions based on our guess of where the market is going to go. But we think it's important to "know where the puck is going" so we're on alert for potential investment opportunities down the road.

SCHEDULE YOUR TAX RETURN

BY: MICHELLE SMALENBERGER, CFP®

Have you ever thought to schedule your tax return? Let me explain what I am talking about and the advantages to this. We know that once January 1st comes we start getting tax documents in the mail. But after these documents have all arrived people often procrastinate and time just slips by until suddenly April 15th is here! April 15th is the deadline to have your tax return filed and your payments made, if you owe money.

What does it mean to schedule your tax return?

Scheduling your tax return means once you get all of your documents that you meet with your accountant as soon as possible. It might be early February when you are ready to meet with your accountant. You can go ahead and get your tax return done! Give all of your records to your accountant so they can complete your return for you. There might even be some planning you can do to change your tax results.

The Benefits

With your return complete if you owe more money the great thing is that now you have additional time to save for that. So if you were surprised and don't have money set aside already, now you have a couple of months before the April 15th deadline. You don't need to panic but rather plan out how to make those funds available.

Ultimately what I mean by scheduling your tax return is to get your return done as soon as you are able, so you know the result. Don't procrastinate until April 10th to find out what the result is.

You can stop any anxiety by giving yourself time to prepare for the due date. Or if you should receive a refund now you can get that back sooner too! Perhaps you need to file a tax extension because there are forms you won't receive even before April 15th.

Get your return filed by your accountant early. You will also be helping your accountant by getting it done earlier. They just might thank you!

CONSOLIDATING RETIREMENT ACCOUNTS

BY: MICHELLE SMALENBERGER, CFP®

Do you have accounts with past employers you need to do something with? Should you roll these over or should you just leave it where it's at? We will discuss some things to consider when you are making these decisions. There are really two main types of accounts available with your employers: tax-deferred like a 401(k) and tax-free, like a Roth 401(k).

What to consider when Consolidating Retirement Accounts:

Investment Options: When we talk about investment options these are the choices you can invest your funds in. These are typically going to be limited to a list that your employer has made available to you. Some allow for a self-directed brokerage account where you can choose from any investment, but for the most part you are limited to a number of choices given to you. Now in an IRA there are unlimited choices and the account can be held at any custodian. The Roth 401(k) is the same regarding investment choices. You can see quickly just from this first consideration why it's important to research these factors when consolidating retirement accounts.

Access to Funds: At some point you will need to start using the funds you've saved. What is the process to do that? From your 401(k) you need to contact your plan administrator or old employer. Then you will likely need to complete paperwork or link your account to your bank account. Every employer is different so you will have to inquire about the process you need to abide by. Accessing funds from an IRA can be set up easily by linking direct to your bank account. Again, the Roth 401(k) is similar in this area. You just need to understand that the process to access funds does not need to be overly complicated. There are custodians that make it simple.

Fees: This is one of the more important things that people aren't aware of. With each of these accounts fees will vary. You can research to see the fees charged for each fund. They will be different depending on the investments available to you. But we are specifically talking about the expense ratio of a fund. You need to understand the total fees you are being charged so you can compare options equally. Very often an investment professional can cost you less by choosing lower cost funds. And you receive more value because they provide financial and tax planning in addition. This is important to know so you can choose the professional advice you receive.

Required Minimum Distributions (RMDs): This is one of the biggest differences between these accounts. Required Minimum Distributions are required from an IRA and from a 401(k) when you stop working. These start at varying ages between 70 ½ and 72 depending on when your date of birth is. Even a Roth 401(k) requires an RMD if you are no longer working. Now remember with a Roth type of account you won't pay tax but you do have to take a certain percentage out each year. But if you roll your Roth 401(k) over to a Roth IRA then there is not a RMD required. This is the biggest item in this list where there are differences between the accounts.

What to watch out for when consolidating retirement accounts

So now let's consider where we can move these accounts to. To move funds out of the current retirement account you typically want to complete a "rollover." To avoid a taxable event the 401(k) gets rolled over to an IRA. This rollover does not cause any taxes to be paid. Likewise, a Roth 401(k) gets rolled into a Roth IRA.

Another catch you need to be aware of is a direct vs indirect rollover. This has to do with where the check will be sent to complete the rollover. When you are rolling funds over you are literally removing them from your 401(k) and sending the funds to your IRA. Ideally you want it to go directly from your employers account to your IRA. It is not uncommon that they mail the check directly to you, which is known as an indirect rollover. It indirectly goes through you, to your IRA. If this is your employer's process you need to make sure that check gets deposited into your IRA that you have opened in a timely manner.

The important 60 calendar days you can't pass

Something that is really important is the 60-day rule. These are 60 calendar days, NOT business days. You have 60 calendar days to get those funds from when they were sent to you into your IRA account. If you pass the 60-day window all of the funds will be taxable. This can be a very large amount given some people's retirement account balances.

If we can help you to think through all of these choices or the timing we would be happy to. We specialize in managing the many decisions so you take action properly and completely. Even managing when to start taking distributions can become complex. We will help make it simple for you.

WHEN DO I NEED TO ISSUE A 1099?

BY: STEVE SMALENBERGER, EA

When do I need to issue a 1099 is a very common question by business owners. A 1099 states the payment you've made throughout the year to non-employees. It is a tax document that tells the IRS what you paid to the individual. This includes individuals such as contractors or subcontractors. A 1099 is simply a summary of payments. Once your total payments to an individual get over a certain threshold the IRS requires you to issue a 1099. Once it is over $600 for the year you need to issue a 1099. So, this is the dollar amount to answer the question of when do I need to issue a 1099?

When do I need to issue a 1099 by?

Once you exceed that $600 amount you need to issue the 1099 by January 31st after year-end. So you get through the end of December and add up all the payments for that year, then create a 1099 and send that to your contractors. You have 30 days. If you can't get that done there needs to be an extension requested by the IRS. This is just one piece of your tax preparation that's needed to help you get your tax return completed in a timely manner!

What will I need to issue a 1099?

You need to have a W-9 on file. A W-9 is simply the name, address, and social security number of the individual working for you. It's best to get that sooner than later, like when you hire the individual. Having that W-9 to begin with will allow you to quickly and easily send their 1099. Filing your tax forms and returns timely helps everyone!

How do I issue a 1099?

Another common question is how do we do this? You can always print out a form, handwrite it, then send it or mail it into the IRS and to your contractor. Even easier is that you can also do it online either at www.irs.gov or through online bookkeeping softwares or apps. If you don't have any of these systems in place we can help you with that so next year is easier.

Once payments have exceeded $600 you'll issue the 1099 to individuals and it will be a deductible expense to you. You do need to issue 1099s each year as required. If you were ever audited the IRS is going to look at your expenses and if one of these hasn't been issued you will have penalties and fines.

If you have any questions or need help with any of these forms please feel free to reach out to us.

PENSION OPTION ANALYSIS

BY: TREVORE MEYER, CFP®, CKA®

Pension Option analysis decisions can be difficult to evaluate alone. Although we are beginning to see them less pensions are still a critical source of retirement planning for many people. Making the right decision with your pension can save you and your family thousands of dollars over time. Today we discuss things you should consider as you evaluate which option would be best to take your pension. When you consider these you will be able to stick with your plan for the long-term.

Pension Option Analysis Choice

Lump-sum Pension: If your employer allows you the ability to take the lump sum option we would like you to consider it. While it may not be your final choice you want to compare it with other annuity options available. A lump sum rollover doesn't force you to take an income stream over time. Instead it provides more flexibility of when to take a distribution from that account.

It's also important to consider the growth rate of your pension. You instead get to invest those funds as you would in an IRA or 401(k) you have with your employer.

Other payment options: The default option will be for you to have a payment come to you on a monthly basis based on your life expectancy, but there are typically a lot of other options available to you. One choice we often encourage clients to review is called a joint and survivor option. This option is based on your life expectancy and your spouse's life expectancy as well. The reason you would want to do this is to receive the most out of your pension.

If something catastrophic were to happen to you while you were taking your pension based only on your life then your payment would stop. Your spouse would be left with no further pension payments coming in. By electing the joint and survivor option at a 50% or 100% option you would receive a reduced benefit but the expected advantage is a monthly benefit received for both of your lives. You make sure you have that income for you and your spouse throughout your entire retirement. These types of decisions make up the decisions needed in a pension option analysis.

When do pension payments start?

Most pension payments start paying out funds at age 65. Let's call it a normal retirement age. Now some plans allow you to defer that date to a certain period, like age 67 or 68 but that is subject to a number of conditions. Sometimes you even have the option to take it early, before age 65.

Now if you do take it early you have what is called a reduced benefit. That reduced benefit is the same way with Social Security. If you take your benefits early you haven't had as much time to let them grow and build as much of a cash value. So you receive a reduced amount.

If you have a longer life expectancy this reduced benefit might actually still make sense because you are collecting for a longer period of time. It's important to coordinate your life expectancy with your payment options because even if you have a shorter life expectancy maybe your spouse doesn't. And that's when the joint survivor option may come into play and be the best option.

Because of all the possibilities with a pension option analysis like start dates and life expectancy the variables can get overwhelming. You want to be sure you make the right decision for you and your family. If you have questions about your pension and you are not sure which option makes the most sense, reach out so we can get started helping you.

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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