TCV

TRUST & WEALTH MANAGEMENT

MANAGING YOUR ASSETS IN TURBULENT TIMES™

FINANCIAL PLANNING IDEAS

STEADY HANDS

"This time it's different."

That's a phrase we usually associate with market tops. Just before the Internet investment bubble burst, we heard rosy economic forecasts and excellent rationalizations for inflated stock values. As we know, markets will right themselves; bubbles will burst.

Now we are in a very different situation, with economic distress unseen in generations. It really is different for the financial markets. We've seen breathtaking global short-term stock market drops. Unprecedented government reactions.

"Don't panic" may sound soothing, but it is not an investment plan. We can't offer you a panacea for these circumstances, and you should beware of anyone who says that they can. Events are forcing fundamental changes in our global financial infrastructure. They will take time to unfold. In the meantime, we invite you to work with us to ride out this financial storm.

We ***do*** have faith that the markets will, ultimately, right themselves again. We don't know how long that will take. This brochure offers context for the current situation, with informed observations on how we may help you to respond to it.

Whether you already have an account or trust with us, or that relationship is still in our future, we invite you to talk with us about your concerns. ***We are here for you.***

THE **CARES ACT** AND YOUR RETIREMENT

You can't take anything for granted anymore.

The current financial markets crisis is a double blow for those who are looking to retire in the next few years. Not only have retirement savings balances been hammered by the stock market's losses, but real estate markets also have been affected by the orders to shelter in place. The traditional plan of selling the family home at retirement to capture $250,000 ($500,000 for married couples) in tax-free appreciation is very much in doubt for many.

What's more, we are in an environment of historically low interest rates. That makes it doubly difficult to wring an adequate income from any portfolio.

What can you do?

Realistic assessment

The first step on the road to recovery is to take stock—no pun intended—in a serious way of your resources and your expectations for retirement. A wide variety of retirement calculators are available on the Internet for just this purpose. You will need to project your income needs, your savings growth until retirement, and how much income your retirement capital can produce.

Don't use the traditional, overly optimistic rates of return, such as 10% for stocks and 8% for bonds. For the near term, average rates of return for all asset classes are expected to be lower.

With this data in hand, you'll probably see that you need a much bigger capital cushion for retirement. That's going to affect your retirement start date, and it may have other implications for post-retirement employment.

Tax-sensible savings

It's always been important to save all that you can, and now more than ever. If you are covered by an employer's retirement plan, you should save at least as much as needed to trigger the maximum employer match. Employer-sponsored retirement savings programs have the advantage of payroll deduction, making the savings habit easier to fulfill. Your savings dollars go further when stock prices are low.

But don't put all your eggs in the tax-deferred basket. Remember, most distributions from 401(k)s and IRAs are taxed at ordinary income rates, even if the gains come from stock investments.

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RMDs suspended for one year

When the stock market collapsed during the 2008 great recession, Congress created a one-year suspension of the rule that requires minimum distributions (RMDs) from IRAs and qualified retirement plans. The purpose of the suspension was to avoid forcing withdrawals when values were low, which could dramatically deplete account balances.

Essentially the same rule has been enacted for 2020, for the same reason. Retirees who have already been on a program of RMDs won't have to take one for the 2020 tax year. The same rule applies to beneficiaries of inherited IRAs. Of course, they are allowed withdraw money if they wish to.

Someone who turned 70½ in 2019 was required to take an RMD for the 2019 tax year but was allowed to defer that distribution until April 1, 2020. If the distribution was taken in 2019 (to avoid having two RMDs in the same tax year) it must be retained. If the distribution was not taken, it is now waived. The IRS provided transitional guidance, under which RMDs taken after February 1, 2020, may be rolled back into an IRA until July 15, 2020. RMDs taken in January 2020, are not eligible, but the stock prices were much higher then anyway. Many people who took withdrawals during that month are happy that they did so, locking in higher values.

These changes apply to all taxpayers, not only those who have been directly affected by the pandemic.

Beginning this year, RMDs are not required until reaching age 72. That change was enacted last year.

Thus, the more tax-efficient approach may be to choose fixed-income options in your tax-deferred accounts and to have a taxable portfolio that emphasizes stocks. This approach secures the advantage of the 15% or 20% tax rate on qualified dividends and long-term capital gains.

Don't be too conservative

If you converted your savings to cash before the market slide began, congratulations! If you didn't, you are in the same boat with the majority. But you can't stay in cash forever. Some experts expect more inflation in the future as a consequence of the government's economic stabilization efforts. Only stock investments have been able to keep up with inflation in the past.

The problem always is identifying the market bottom. Once the bottom is reached, gains can happen very quickly. In the first year after the 1974 bear market, for example, large company stocks returned 37.2%. Small company stocks jumped 52.8%! If you sit on the sidelines for too long, you may miss important opportunities.

We provide retirees with professional portfolio management

Some retirees enjoy managing their investments. Many prefer to enjoy their retirement. For this latter group, we offer a range of portfolio management services to simplify their financial lives. Our advice is objective, geared to the unique profiles of each of our clients. If you have substantial assets that could use professional supervision, we are here to assist you.

Possible changes to employer retirement plans

In March, Congress responded to the ongoing pandemic with the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The new law has many facets, but here we focus on the effects on qualified retirement plans and changes that plan sponsors may adopt.

Plan loans

The normal rule for a loan from a 401(k) plan or qualified retirement plan is that one may borrow up to 50% of the vested balance, to a maximum of $50,000. These caps are doubled for certain loans made from March 27, 2020, to September 23, 2020, to a maximum of $100,000 or 100% of the vested balance. Repayment of the loan may be deferred until January 1, 2021, when a five-year amortization must begin.

The expanded loan rule is available to any taxpayer who tests positive for COVID-19 or whose spouse tests positive. The larger loan may also be permitted for someone:

- who was quarantined, furloughed, laid off, or had reduced hours because of the disease;
- was unable to work because of lack of childcare;
- who had closed or reduced hours of a business owned by the taxpayer because of the disease; or
- other factors that may be identified by the Treasury Department.

Loans are not permitted from IRAs or Roth IRAs.

Coronavirus-related distributions

An alternative to the loan is a distribution, which is permitted for the same "qualified individuals" as the expanded loan provision. Up to $100,000 may be distributed. The distribution will be subject to income tax, but there will be no 10% penalty on premature distributions if the account owner is younger than 59½. The income tax may be paid in full for the 2020 tax year (could be the best choice if the taxpayer has fallen into a low tax bracket). Alternatively the distribution may be treated and taxed as if it were received 1/3 in 2020, 1/3 in 2021, and 1/3 in 2022. Deferring the tax bill is tempting, but one may be in a higher tax bracket in two years. Also, the state income tax treatment of the distribution may not match the federal rules.

However, there is an alternative that involves no income taxation at all. The taxpayer may elect to repay the Coronavirus-Related Distribution over three years. Such repayments will be treated as if they were trustee-to-trustee transfers. What's more, the repayments will not affect the taxpayer's right to make future normal retirement plan contributions.

Although these "relief valves" for affected taxpayers are welcome, invading retirement resources should be considered a last resort, especially when stock prices have fallen substantially. Taking a distribution when values are low may amount to locking in a loss.

WHEN ARE STOCKS SAFE?

Like dynamite, equity investments can be powerful, but they must be handled with care.

In October 2007 the Dow Jones Industrial Average and the S&P 500 touched their all-time highs. One year later the indices had collapsed by 30% or more. An estimated $8 trillion evaporated over the course of just 12 months.

Stock market declines of this magnitude have happened before, in percentage terms if not in dollar value. That's why the first rule always has been, don't invest in stocks for the short term. Money that you will need in a year, perhaps in three years, perhaps even in five years, should be parked in a very safe place.

The question for all investors will be, when will stocks be good investments again? Actually, some stocks are good investments right now, because not all firms have been hurt equally by the financial market meltdown. But more people are looking at the stock market as a whole to gauge financial health.

One important measure of investor sentiment is what they are willing to pay for a stream of company earnings. This is commonly referred to as the price/earnings ratio. The graph below charts from 1920 to April 2020, an aggregate modified P/E of the large companies represented by the Standard & Poor's 500-stock index (the CAPE ratio developed by Professor Robert Shiller). Over the long term, the average P/E has been 15.5.

How low can it go?

In the early 1980s, when stocks were extremely unpopular, the P/E ratio fell to single digits. But it wasn't just the riskiness of stocks that drove investors away, it was the alternatives. Long-term interest rates on safe government bonds rose to an unprecedented 15% in 1981. Why take a chance on stocks when guaranteed double-digit returns are available?

But we know the rest of the story. Fiscal and monetary policies were used to break the back of the 1970s-era "stagflation"; interest rates fell; and a great bull market for stocks began.

Then came a severe bear market (popping the "internet bubble"), followed by a recovery which ended with the Great Recession in 2008. The sequel to that was the longest bull market in history and a series of new index records.

The graph suggests that stocks are no longer severely overvalued, but there may be more to the story. We don't yet know how the coronavirus pandemic will end.

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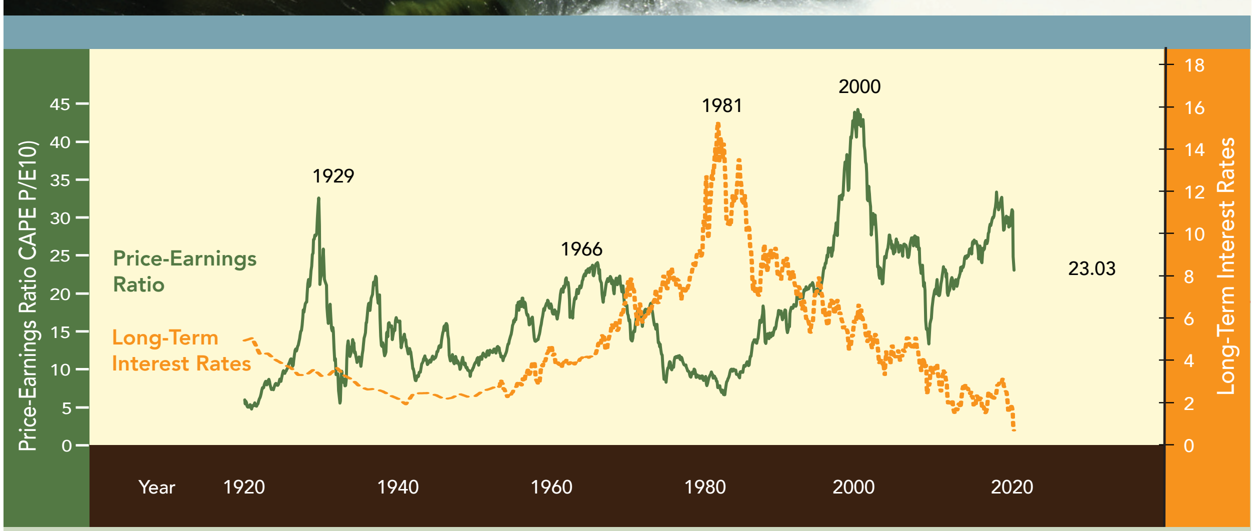
P/E ratios from 1920



Sources: http://www.econ.yale.edu/~shiller/data/chapt26.html; M.A. Co.

Don't miss out on the upside

To say that the market has reached a bottom would be very premature. Government programs put into place to mitigate a recession and restore the economy require more time to have an effect.

Still, when markets do recover, as they eventually will, they tend to recover in very short bursts, over periods that are very difficult for investors to time accurately.

One major study of price movements over 160,000 trading days in foreign and domestic markets determined that missing just the 10 best days in each market—that is 0.1% of the total number of days—resulted in a loss of over 50% of the total return, compared to staying in the market passively throughout the period.

If you avoid stocks altogether, you are unlikely to outperform inflation, and you still are not guaranteed of avoiding a loss. But choosing the right stocks, and the right time to invest, can be daunting.

The longer-term perspective

Sometimes, when the financial markets seem especially challenging, it's good to take a deep breath and remember the long-term perspective.

Stocks are riskier than bonds, with higher highs and lower lows. In the 94 years since 1926, as reported in Ibbotson® SBBI® 2020 Yearbook indices, large company, one-year stock returns have ranged from plus 53.99% to minus 43.34%. During that time, there were 69 up years and 25 down years. Small company stocks were even more volatile, ranging from plus 142.87% to minus 58.01%. Long-term government bond returns have ranged from a gain of 40.36% to a loss of 14.90%. Bondholders lost money in only 24 years.*

Inflation raises the stakes. The potential loss of purchasing power is serious. For example, $1,000 invested in 1926 in the large company stocks represented by the S&P 500-stock index nominally would have grown to $9,243,386 by the end of 2019, but after accounting for inflation, would be worth just $644,803.*

Long-term investors have less to fear. Over longer time periods, market volatility recedes. For rolling ten-year periods, large company stock returns ranged from plus 20.06% to minus 1.38%, and long-term government bonds fell in a range of plus 15.56% to minus 0.07%. Only once have government bonds had a negative 10-year return.

**References to stock and bond market indices are for illustration only. You cannot invest in an index.*

Why choose a fiduciary?

Today's investors have more choices than ever for managing their investments—including doing it themselves. Access to extensive information and sophisticated tools can make everyone feel like an expert.

But not everyone really is an expert.

We are fiduciaries, which makes us different from other investment managers. That status does not make us infallible, nor does it come with a crystal ball for seeing into the future. But it does mean these things:

- We are subject to special legal duties of fidelity and loyalty to our clients. When it comes to trust management, we are required by law to put the interests of trust beneficiaries ahead of our own.
- We are subject to audit and regulatory supervision.
- Our fees are linked to the size of the accounts that we manage, not to the number of transactions we generate. That means our investment advice can be truly unbiased.
- In managing trust assets, we must take into account the interests of both present and future beneficiaries, which is an unusual investment perspective. This approach is not risk free, but it tends to be risk averse.
- Because investment management is a core part of our business, we are professionally staffed and equipped for the job.

If you would like to learn more about "fiduciary duties," we will be pleased to meet with you at your convenience.

BONDS FOR BALLAST

Adding fixed-income elements to the portfolio can mean steadier sailing.

In the days of sailing ships, reckless skippers who opted for "all sail, no ballast" often came to grief. This year investors might keep that nautical metaphor in mind as they review their portfolios.

Too much sail, i.e., stocks?

Too little ballast, i.e., bonds?

In determining your optimum sail-to-ballast ratio, the key factor is likely to be your time horizon. How long before you'll need to turn your investments into cash?

If the answer is "five years or less," it is prudent to carry more ballast than sail. That is, invest primarily in intermediate bonds or bond funds.

On the other hand, if your answer is "20 years or more," historical studies suggest that you can carry just about as much sail as you wish—provided that you don't panic when market storms buffet your stocks.

If you decide to add ballast to your investment program, you have many types from which to choose.

Treasury bonds. Investors who buy bonds and notes issued by Uncle Sam know that they'll receive interest twice a year and face value at maturity. Also, interest paid on Treasury issues is exempt from state and local (but not federal) income taxes. Like any other bonds, Treasuries may fetch more or less than face value when sold before maturity.

Corporate bonds. To obtain significantly higher yields, investors may turn to corporate bonds. The value of such bonds will shift with the economic success of the issuer. Interest payments are fully taxable at ordinary income rates by federal, state, and local governments.

Foreign bonds. Yields on bonds issued by foreign countries and businesses may look appealing when compared to U.S. yields. But to enjoy the higher income, American investors must accept an added risk. If the dollar strengthens against the currency of the country issuing the bond, they could end up with fewer dollars than they invested—even though the foreign bond maintained its value as measured by the currency of the country that issued it. Of course, there's a flip side. If the dollar weakens in relation to the other country's currency, U.S. investors could profit.

Tax-exempt bonds. Bonds issued by U.S. cities, states, and other governmental units pay interest that is generally exempt from federal income tax. Yields are lower than yields from taxable bonds of comparable quality, but after taxes many investors find that they come out ahead.

Treasury Inflation-Protected Securities (TIPS). The bond investor's great enemy is inflation, which erodes the purchasing power of even the best-performing bond portfolio. TIPS provide one answer. The value of the principal and income payments of these bonds is adjusted for changes in the consumer price index. However, the changes are taxed at ordinary income rates when made, so these bonds may be best suited for tax-deferred retirement accounts.

Portfolio management

In addition to choosing the type of bond, the bond investor has a variety of risks that will need to be assessed and managed. Although bonds are, as a class, safer investments than stocks, that doesn't make them simple to own.

Credit risk refers to the financial soundness of the issuer. Will they be able to make interest payments and return principal on schedule? That concern becomes more acute during periods of economic downturn. Credit risk varies from issuer to issuer, with U.S. Treasury securities at the top end of the scale and high-yield corporate "junk" bonds at the bottom. The more speculative the bond, the higher the yield required to attract investors.

Interest-rate, or market, risk refers to the sensitivity of bond prices to changing economic conditions.

Bond values move in the opposite direction from interest rates. To illustrate, let's say that you own a 3% T-bond with a face value of $100,000 and 10 years remaining to maturity. Suppose that the government issued new 10-year bonds paying 4%.

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What if you then needed to sell your bond?

Who would pay $100,000 to receive $1,500 every six months when $2,000 is offered? You would have to accept less—specifically, the amount that will make your $1,500 coupon payment equal to a 4% yield to maturity.

Conversely, when interest rates fall, bondholders may reap extra rewards.

Note that a change for the better or worse in the credit quality of the issuer will have similar effects on the price and yield of a bond.

Term risk. When interest rates change, the effect on short-term bonds is slight. This is because the eventual return of the principal is close at hand. The change in the yield of a few coupons is not terribly significant in comparison.

On a long-term bond, however, coupon payments and the interest that they earn on reinvestment can be the largest component of the bond's total return. So a change in interest rates or credit quality will have a greater effect. To compensate for the increased risk of long-term bonds, investors generally demand higher yields.

Before diving into bond investing, one needs to determine whether current yields meet projected income needs, or if the stock market's volatility makes the comparative safety of bonds more important than their yield.

Balanced portfolios

An investment portfolio needn't be all stocks or all bonds, of course. Historical studies reveal that blends of stocks and bonds may remove much of the downside risk of a portfolio, at a relatively small cost in upside potential.

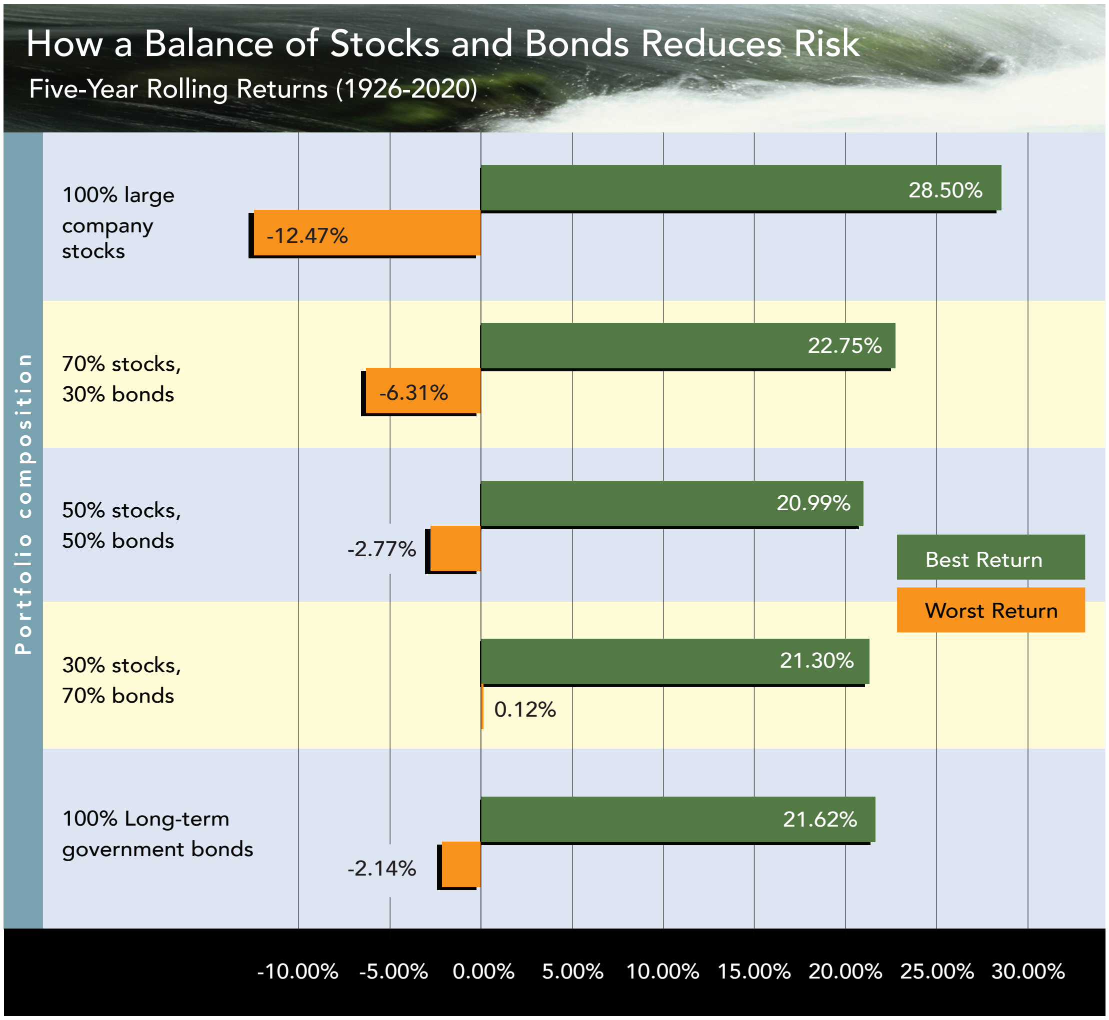
During the period from 1926 through 2019, large company stocks enjoyed a compound annual return of 10.2%, according to the Ibbotson® SBBI® 2020 Yearbook, while bonds returned 5.5% (assuming interest and dividends are reinvested). During those 94 years, a 100% stock portfolio beat a 100% bond portfolio 58 times. One might have thought that stocks always outperform, but, of course, stocks have had many bad years over the decades.

The difference between average long-term stock and bond yields may not sound large, but over a long time period, the effect on portfolio performance is extraordinary. The table below compares the growth of $1,000 invested in large company stocks, and in long-term government bonds, with inflation from 1926 through 2019. Dividends and interest payments are reinvested in this analysis, but taxes and transaction costs are ignored.

Stocks, Bonds, and Inflation, 1926-2020
(Year-end 1925 = $1,000)

	1926	1951	1976	2001	2020
Inflation	$1,000.00	$1,417.00	$3,104.00	$9,768.00	$14,336.00
Long-term government bonds	$1,000.00	$2,709.00	$4,707.00	$48,882.00	$159,173.00
Large company stocks	$1,000.00	$6,765.00	$59,989.00	$2,683,578.00	$9,243,896.00

Source: Ibbotson® SBBI® 2020 Yearbook, M.A. Co



Source: Ibbotson® SBBI® 2020 Yearbook, M.A. Co

The table on the previous page shows that the cost of living is more than 14 times higher now than it was in 1926, but a $1,000 portfolio invested in long-term bonds in 1926 would have grown to over $159,000 today. Meanwhile, $1,000 invested in stocks would have grown to over $9 million (without regard to inflation).

Is there a way to capture some of that exceptional upside potential while shedding the very real downside risk?

Let's say that the portfolio is held for five years, and that a blend of stocks and bonds is chosen. The graph above shows the maximum and minimum return experience over all five-year periods from 1926 through 2019. A blend of 30% stocks and 70% bonds never experienced a negative five-year period, while all-stock and all-bond portfolios did.

The best five-year period for the 30% stocks/70% bonds portfolio was 1982-1986, while the worst was 1965-1969.

Take the long-term view

These examples, though derived from real investment experience data, are simplified for the sake of illustration and cannot be relied upon for future results of any particular investment program. Still, they show that investors do have choices, even in down markets, and that a longer-term time horizon may enlarge the chances for success.

ESTATE PLANNING CHECKUP

Significant asset value changes create problems and opportunities in estate planning.

Here are some points to take into consideration before your next consultation with your estate planning advisors:

■ ***Trust allocations and specific gifts.*** Some wills use formula allocations to divide an estate among two or more trusts. The expectation of the effect of such provisions may be thwarted when asset values suffer a major decline. Some beneficiaries could be disinherited inadvertently.

Similarly, when a will includes specific bequests ("all my XYZ stock to my son, my home to my daughter," for example), changes in asset values may cause provisions that once looked equal to become very unequal.

A bequest of a specific dollar amount also can be problematic. Specific bequests normally take precedence over residuary bequests, but, typically, the residuary language is used to fund trusts. A severe decline in asset values may cause such trusts to be underfunded.

■ ***Death tax planning.*** When stocks fall in value by trillions of dollars, estate tax collections fall as well. Many fewer estates will be large enough to owe federal estate tax. What's more, the amount exempt from federal estate tax temporarily doubled in 2017. For those who die in 2020, the exemption will be $11,580,000.

Current law calls for the exemption to fall in 2026. Some in Congress would like to accelerate that process. Many estate planners have recommended that wealthy clients "lock in" the higher exemptions by making large taxable gifts before 2026. Such gifts could be even more tax-efficient if they are made when asset prices are low. Subsequent appreciation in value passes to beneficiaries without estate or gift tax.

The tax savings may look great on paper, but in a period of such uncertainty as we have today, even the wealthiest people may hesitate before making an irrevocable commitment to transferring wealth. Still, it is a subject worth exploring with your estate planning advisors.

■ ***Annual exclusion gifts***. Everyone may give up to $15,000 to each of as many donees as one wishes. A grandfather with two children and four grandchildren, for example, may give a total of $90,000 without owing a penny of federal gift tax or using any portion of the $11.58 million federal gift tax exemption. Should grandmother join in splitting the gifts, the gift-tax-free transfer may go to $180,000. Even larger amounts can be gifted if spouses of the children are included.

When asset values decline, more shares of stock, for example, may be given without gift tax, providing a larger capital base for the next generation.

■ ***Grantor Retained Annuity Trusts.*** Today's low interest rates reduce the tax costs of establishing a Grantor Retained Annuity Trust (GRAT). The idea of a GRAT is that the grantor funds a trust for a specific number of years. During that time the trust pays the grantor an annuity, and at the end of the term, the assets pass to other beneficiaries, typically the grantor's children. A gift tax is due when the trust is funded, but the amount of tax is reduced to reflect the passage of time until the transfer to the remainder beneficiaries takes effect. The trust is usually funded with assets expected to appreciate at a rate that is more than enough to cover the annuity payments. Any appreciation in the value of the trust assets passes to the beneficiaries without additional gift tax.

A special type of GRAT is funded with the grantor's home and is called the Qualified Personal Residence Trust (QPRT). Here the grantor retains the right to live in the home for a specified number of years. Gift taxes due on this strategy will be reduced both by low interest rates and the decline in home values.

■ ***Charitable IRA rollover.*** Those who are older than 70½ are permitted to make direct transfers to charity of up to $100,000 from their IRAs. Charitable transfers from IRAs will count as required minimum distributions, but they won't be included in taxable income. For retirees who are in a top tax bracket, direct charitable transfers from their IRAs will be more tax efficient than taking a taxable distribution and then a deduction for the charitable gift.

Married couples may arrange for up to $200,000 in direct transfers if both spouses are older than 70½ and each has an IRA.

THE NEXT STEP IS UP TO YOU

When it comes to wealth management, we bring our experience of investing in up and down markets as well as perspective on the full range of issues that impact family financial security. We are able to tailor strategies individually for each of our clients.

Would you like to learn more about what we can offer you and your family? Call us soon to arrange for a meeting with one of our officers at your convenience.

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