HEMSLEY ADVISORS, LTD. (847) 381-7314

311 S. WACKER DRIVE
SUITE 1525
CHICAGO, IL 60606

432 N. HOUGH STREET
BARRINGTON, IL 60010

September 30, 2020 Quarterly Newsletter

General Market Commentary

We hope this newsletter continues to find you, your family, and friends healthy. We have all had to adjust to a new way of life these past six months. It is difficult to recall a period in recent memory where so many different issues are occurring at once that have a bearing on the financial markets. The issues the market had to contend with include the COVID-19 pandemic and its effects on people, travel, and businesses, over 9 million people still unemployed, social issues, the upcoming elections, a weakening dollar, and recently, fears about inflation. Concurrently, the initial public offering market is very active, and many social media, large cap technology stocks, and growth stocks have been bid up significantly in price. Apple and Tesla's stock price appreciated to such a degree that the board of directors of each company decided to split their shares. However, toward quarter's end these momentum stocks have pulled back. The housing market including home renovations, which has a significant effect on economic growth, is very strong. Auto sales continued to improve in August, and manufacturing, material, and industrial sectors of the economy also continued to grow. In spite of segments of the economy being adversely affected by the pandemic, the markets have recovered significantly from the March lows and ended the quarter with the Dow Jones Industrial Average, the Standard & Poor's 500 Stock Index, and the NASDAQ Composite Index having YTD changes of -2.7%, 4.1%, and 24.5%, respectively.

As Q2 earnings reports and associated conference calls came in from mid-July to mid-August, one common theme emerged. Companies are adjusting to the pandemic, taking decisive action in controlling costs to preserve financial strength, and making operational adjustments to exit the pandemic stronger. Forward looking forecasts were cautious but one could discern that business conditions were improving as we entered Q3. It wasn't surprising to see the markets continue to appreciate through July and August. Seeing the momentum stocks pull back between 10-15% in September was a positive because it reduced excess speculation. We can't predict what is going to happen in the short term, but we do know that after a large run up in stock prices earnings have to catch up to the valuations. Markets lead the economy in both expansions and contractions. With the appreciation we have experienced since March, a period of stock prices trading in a narrow range is likely warranted.

One of our objectives in managing your portfolio is maintaining and increasing investment income or cash flow which is integral to portfolio and personal financial planning success. This continues to be a challenge. As mentioned in our last newsletter, <u>the biggest disruption to cash flow is coming from the near-zero interest rate environment that we are operating in</u>. This unfortunate environment doesn't appear to be changing until at least 2023. We continue trying to be creative and invest some of the maturing bond proceeds into dividend-yielding stocks such as Duke Energy, Pfizer, Verizon, and others. Such stocks are examples of quality securities with 3% or greater dividend yields with the potential for annual dividend increases and stock appreciation.

The objective is to maintain the total cash flow received from the maturing bond proceeds at around 2%. We always like to see current year portfolio cash flows continuously increasing and higher than the previous year. This has not been too difficult to obtain in recent years but given the current environment, we will just have to be patient and hopefully see cash flows this year at least equal to last year. A steady, predictable, and increasing source of cash mitigates stock market volatility and helps offset inflation. It also creates a comfort feeling and gives clients choices without having to sell stocks at an inopportune time.

Throughout the quarter, with few exceptions, we tended to avoid the momentum stocks but did find value in many of the basic economy stocks. We looked for stocks that will benefit from a strong housing industry, an improving auto industry, and an expanding economy. Companies like Corning Inc. are well positioned to benefit from the change in our lifestyle and society's needs. They produce glass products that are used in flat screen TVs and other consumer electronics (more people are staying at home), vials to deliver a COVID-19 vaccine, 5G technology, and data centers. Other stocks that we think will appreciate in this new economy include DuPont de Nemours, Inc., Dow, Inc., 3M Company, and Honeywell International Inc.

We also find companies like Starbucks Corporation and Walmart Inc attractive. Both have dividend yields of 1.6% to 1.9% and attractive growth potential. Starbucks, like all restaurants, has been negatively affected by the coronavirus pandemic. But, over the long term office workers will return, airport traffic will increase, and same store sales growth will resume. Walmart, with its growing e-commerce business among other initiatives, could become a formidable competitor to Amazon.com. This will take some time but is clearly a developing trend.

The strong increase in personal savings continues. While down from May it is still more than double the rate from previous years. As mentioned last quarter, we encourage using this unexpected savings to increase your 401(k) contributions, fund an IRA, add to the kids' college education savings, pay down debt, or simply invest the money for other long term goals. This is beneficial to all but particularly mid-career individuals. You no longer have the advantage of time similar to a person in their 20s or early 30s. Invest some of this increased savings on a monthly basis. Someday you will be happy you did!

Now is a good time to be thinking about year-end tax planning and next year's cash needs. As usual, we will be harvesting any tax losses. A $3,000 capital loss will save most people about $800 in federal and possibly state income taxes. If you have self-employment income, you may consider setting up an individual 401(k) plan. This is a fantastic tax savings vehicle for self-employed individuals but must be set up prior to December 31st. If one of your young adult children has earned income this year, consider setting up a Roth IRA for him or her. A small contribution can increase significantly over the next 40 years and it will all be tax free at retirement. The account just has to be set up and funded by April 15th of 2021 for the 2020 tax return. Even though Congress suspended the RMDs from retirement accounts in 2020, qualified charitable distributions (QCDs) can still be made from IRAs. Charities benefit and the amount withdrawn is not included in your gross income for tax purposes. Unless Congress makes a change, RMDs will be required once again in 2021. Last, if you have projects planned for the house, education bills, weddings, etc., now is the time to be thinking of raising the money. Don't wait until the last minute and be at the mercy of the market fluctuations.

Financial Planning

Social Security Claiming Strategies

As the population ages, more individuals are becoming eligible for Social Security benefits yet more people are continuing to work beyond conventional retirement age. The question then becomes: when is the best time to commence benefits? Should I commence receiving Social Security benefits at the age of 62, should I elect to receive benefits at my full retirement age (FRA), or should I defer benefits until I turn 70 years of age?

Social Security is a complex program and there is no one right answer. The commencement of benefits depends both on your present financial situation and employment status and what is appropriate for you now and throughout retirement. Below are some of the salient points that one should consider when electing a particular Social Security claiming strategy.

- When one is first eligible for SS upon turning 62 years of age, the allure of added income can be very tempting. However, if you commence receiving benefits at 62 and your full retirement age is 66, you will incur a 25% reduction in your monthly payment. As FRA gradually increases to 67 years of age for individuals born after 1954, commencing benefits at

62 will incur a 30% reduction in the monthly payment. This reduction stays with you for life.

- More importantly, and often overlooked by most people, is the long-term effect of this percentage reduction. This percentage reduction also causes fewer benefit dollars to be received by your non-working spouse via the spousal benefit. When the non-working spouse reaches FRA, they are entitled to one half of the higher-earning spouse's benefit. Today one half of the spousal benefit could be approximately up to $1,500 per month. But, since the higher earning working spouse commenced receiving benefits at 62, the spousal benefit would be reduced to $1,125, a 25% reduction for life assuming a FRA of 66 years.

- Last, if your plans include working while drawing Social Security benefits prior to FRA, you will have to give back to the Social Security Administration $1 for every $2 you earn above $18,240. For instance, if you are eligible to receive $1,000 a month from Social Security and have $36,000 of earned income (wages, salaries, tips, bonuses, fees, etc.) you will lose $8,880 of your benefit ($36,000 - $18,240 = $17,760 divided by 2 = $8,880). This benefit is not permanently lost but it is instead postponed. Upon reaching full retirement age, Social Security will adjust your monthly benefit based on the benefits that were withheld.

In 2020 when one turns 66 years of age (FRA) there are now additional decisions to make. You can commence receiving benefits today, which could be up to $3,000 per month, or elect to defer the receipt of benefits. Deferral can be done up until the month one turns 70 years of age. Doing so results in an 8% annual increase in the base amount of benefits at FRA. Conventional wisdom and advice today is that if you don't need the benefits due to continued employment or your general financial strength, then you are better off deferring receipt. In terms of total dollars received the breakpoint is approximately 80 years of age. In other words, those who anticipate living longer than 80 years will receive more total dollars in their lifetime by electing to delay claiming benefits.

The other alternative to consider is to elect a claim and invest strategy. This is where one continues to work and at the same time elects to receive SS benefits at full retirement age. The monthly benefit is then invested with an objective of growth, income, and stability. Depending on the investment return, the breakpoint will then be stretched out beyond 80 years of age to 84 or 85. This strategy allows for some creativity on where to invest. If your employer's plan allows it, after-tax contributions to the 401(k) plan should be considered. Another option is to fund an IRA for you and your spouse. If your extended work life includes self-employment income, then an individual 401(k) plan would be an excellent choice for your SS income. A monthly investment into a no load mutual fund or a 529 Plan for the grandchildren could also be appropriate options.

Conventional wisdom says that you should defer claiming benefits if you continue to work in your 60s. Knowing that there is no set answer for any individual or couple, we tend to recommend a claim and invest strategy. The reason for this recommendation is that, as you may know, current estimates are that the Social Security trust fund reserves are set to be depleted in 2034. Again, this is just the reserves. It does not take into account the current income from wages and self-employment earnings that also provide income for the trust funds. Starting in 2021, Social Security is projected to begin dipping into the reserves to pay benefits to retirees. When the reserves are scheduled to be depleted in 2034, there will only be enough revenue to pay 79% of promised benefits.

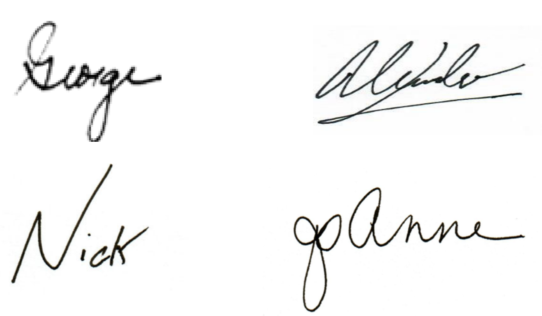
Given the COVID crisis we suspect that there is a high probability that the trust fund reserves will be wiped out prior to 2034. Congress will be forced to act and ultimately changes will be implemented. These can include increasing the wage base on which SS taxes are computed, currently at $137,700 (and annually adjusted for inflation), raising the retirement age beyond 67, payroll tax increases, or means testing. Means testing is already being done on the Supplemental Medical Insurance plans of Medicare Part B and Part D and, because of this they are in good financial condition for many years into the future. We suspect in the future that means testing will be implemented for retirees above certain income levels in an effort to maintain SS funding levels. What the threshold amount would be is anyone's guess at this time. Looked at a different way, an individual today with Social Security income of $36,000 per year or a married couple with Social Security income of $72,000 could potentially have those benefits reduced by some percentage. Therefore for some individuals' financial situation and to hedge against the potential for means testing, it doesn't make sense to defer the receipt of SS benefits until 70 years of age. Yes, you will be projected to have more monthly SS income but the claim and invest strategy may be more beneficial in the long run.

Since Franklin D. Roosevelt signed the Social Security Act into law in 1935 it has been an excellent program of providing retirement income and a basic level of general welfare to older Americans. We know some believe that this program will not be there for them in the future. We don't agree with this. Social Security is a tremendous social benefit that will always be available. There will be adjustments and amendments along the way but Congress will not eliminate a social program. It may perhaps be at an increased cost but SS is definitely here to stay. Don't hesitate to contact us with any questions regarding your personal situation.

Exciting Changes Ahead!

The team at Hemsley Advisors has been working on a project over the past few months that will enhance our firm. We will be revealing the outcome of this project to all of our clients after the end of the year in our next mailing. Stay tuned!

Happy autumn,



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