The Advisor

QUARTERLY NEWSLETTER

2022 Q2 REVIEW:

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GENERAL MARKET COMMENTARY

The trends of increasing inflation, rising oil and commodity prices, rising interest rates, high housing and rental costs, and stock market volatility continued this quarter, but at an accelerating rate.

The uncertainty regarding economic growth and the increasing possibility of a recession proved stressful to most investors. While Americans are continuing to spend, most recently on services, they are definitely concerned about the future. The hardship of higher prices is adversely affecting all individuals worldwide, but particularly the lower income segments of societies. Middle and upper-income individuals, however, with adjustments to their lifestyle, will likely be able to adapt more easily to higher prices. They will tend to spend less on discretionary items, eat more at-home meals, and save more as interest-earning investments become more attractive.

Transitions such as changes in price levels, whether due to inflation or supply constraints, are painful and disruptive. For instance, we can live with higher gas prices, but the move to the higher levels is what hurts. Ultimately, the price of gas and other products or services will stabilize, wages and prices will adjust over the next 12–18 months, household cash flows will normalize, and corporations will rebuild their profit margins. Also, the Federal Reserve will stop raising interest rates, financial markets will improve, people will begin to spend more, and the economy will move from recovery into expansion.

By quarter's end, the Dow Jones Industrial Average, the Standard & Poor's 500 Stock Index, and the NASDAQ had declined year to date 15.3%, 20.6%, and 29.5%, respectively. For the most part, our portfolios, which were helped by value stocks in industries such as consumer staples, drug and healthcare, energy, defense, and utilities, outperformed the averages, declining by approximately 9 - 13%. Yes, not as much as the averages, but nevertheless frustrating and stressful. This quarter also saw numerous mid-to-high single digit dividend increases from The Bank of America, Deere & Company, General Mills, Inc., Johnson & Johnson, The Procter & Gamble Company, Wells Fargo & Co., among others. Nobody likes to see their invested assets decline, but the increasing cash flow the portfolio is generating, mostly through dividends and dividend increases, certainly helps to mitigate the despair. One has to love the dividends and dividend increases when they occur as it is integral to your financial planning and investment success.

Regardless of where in the economic life cycle a person finds themselves—new investor, mid-career investor, nearing retirement, or already retired, it is very painful to see one's hopes, dreams, and optimism diminish due to a declining portfolio value when that portfolio must get one to retirement and work for them throughout retirement. The main thing to remember is that earnings and stock market movements are more cyclical than stable. In declining markets, it feels like the sky is falling and that you will have to work forever, but just as the pain is the greatest, things turn around. For those who have lived through the stock market crash of 1987, the dot-com bust of 2000-2002, and the sub-prime mortgage crisis of 2007-2009, they know that bear markets ultimately end and reverse course.

The downturn in the market has been compounded by one noticeable strategy: the concentration in high growth stocks by individuals and institutions. If you looked at the top ten holdings of most mutual funds, they were very similar even though the names were not always identical: high growth, high P/E ratios, and little or no dividends. As the markets declined, individuals and portfolio managers began liquidating these concentrated positions. This in turn caused the market decline to accelerate. Selling begets selling as everyone runs to the exits!

As a reminder, once a portfolio declines 20% it takes a 25% gain to return or appreciate back to the previous level. For instance, if a $100,000 portfolio declines 20% to $80,000, it will take a 25% gain on the $80,000 to reach the previous level of $100,000. This gain does not happen overnight. Rather it takes time, usually 2 to 3 years—or longer. A diversified portfolio made up of growth and value stocks, with a focus on cash flow generation through dividends, and short-term bonds or cash will typically decline less. If a portfolio with this allocation declines from $100,000 to $90,000, or a 10% decline, it now only requires an 11% return to appreciate back to $100,000. The point is: by not concentrating in "hot stocks," your portfolio won't decline as much as the market. Your investments may not perform quite as well in booming growth markets, but you are more likely to limit losses in the down markets and create consistent long-term results (not to mention you will have less stress, too.)

The individual investor should not be thinking of selling stocks during periods such as we are experiencing. Our clients' portfolios are built with a focus on high-quality assets that are diversified, produce income, and are fundamentally attractive. As mentioned above, this strategy minimizes losses in market declines and provides growth once stability and optimism return. Remember there is no perfect allocation. Instead, each client's portfolio allocation is unique. The allocation is based on that specific client's needs, both present and future, and cash flow requirements. Today, as difficult as it may be, one needs to look through the recessionary fears, frustration, and the daily headlines, and instead determine what investments will enhance their financial position in two years and what is most important in the long term.

NOW FOR SOME POSITIVE NEWS!

First, with the market decline, valuations are now more reasonable compared to a year ago. This decline has also increased the effective dividend yields to very attractive levels. Remember, dividend payments are fixed at a certain dollar amount. As the stock price of the dividend payor declines, *the yield on new money invested increases*. Today, one can obtain 2.5% to 4% dividend yields on high quality stocks in addition to potential future capital appreciation. In the current market, one may question the merits of adding new money to a portfolio or reinvesting existing cash given the economic uncertainty and realizing that asset prices could decline further. But in a few years, we think you will see some nice appreciation on your investments, and likely a dividend increase or two. Investing in the stock market has proven to be an efficient way to hedge against inflation over the long term.

Second, in addition to attractive stock prices and dividend yields, interest rates on short-term bonds have continued to increase. By early to mid-June, one could obtain nearly 3.5% on 2-year Treasury Notes. This yield has now declined and rates may have peaked for the year; however, very attractive yields still remain on 3, 6, or 12-month T-Bills or 2–3 year Treasury Notes. A laddered portfolio of Treasury Bills or short-term notes provides for a higher yield and is a great substitute for cash currently stored in a money market fund that is still paying a dismal interest rate. As many of you know, one of our goals has been to see increasing annual cash flows in a portfolio. In the 0% interest rate environment of the last several years, we have had to rely on dividend increases alone. Now, a 3% yield on $100,000 of bonds in a portfolio equals $3,000. This money can help with a retiree's distributions or reinvested back into one's portfolio to take advantage of attractive investment opportunities.

Last, we are very proud of all our clients during this turbulent period! Other than a few phone calls inquiring about the market volatility, we didn't see any panic. In fact, most clients were happy to add the accumulating dividend credits back into the market. We encourage you to remain optimistic. Remember to keep us in the loop regarding any cash outflow requirements, both short and long term. We will continue to look for value in stocks and bonds and, as always, provide you with personal financial planning and quality fundamental investment advice.

FINANCIAL PLANNING

PARENTS AND GRANDPARENTS – START SAVING NOW FOR A CHILD'S EDUCATION

Last quarter, Alexander wrote about the high cost of education and how it's never too early to start saving via a 529 plan. When these plans were first introduced, the funds could only be used for college tuition. Over the last few years, however, more consumer-friendly features have been added to 529 plans. The funds can now be used to pay up to $10,000 in tuition expenses for private, public, or religious elementary and secondary schools. Money can also be used to pay off student loans or to cover the cost of an apprenticeship program. Therefore, we again encourage both parents and grandparents to set up 529 education saving accounts for their children and grandchildren when the couple is first married, even prior to the birth of a child. Contributions are not deductible on a federal level, but the earnings grow tax-free and will not be taxed when the money is withdrawn to pay for educational expenses—a great way to save.

We know of one couple that contributes $1,500 annually to each of their 5 grandchildren's 529 accounts. Not only are they helping their children, who are the parents, they are also receiving $370 in Illinois tax savings. Numerous states with a state income tax provide tax savings for residents contributing to the home state 529 plan. With a time limit of 18 years to save once the child is born, assuming the funds are only used for college, a group effort is required to save the needed funds. Contact us with any questions.

Another strategy to consider that will aid your high school or college student in the future, if they have earned income, is to establish a Roth IRA for them. You, the parents or grandparents, can open the account and fund it with a gift of money. The amount of the gift can't exceed the lesser of $6,000 or the earned income of the student. The money will grow tax free inside the account for many years and someday, even an annual deposit of $1,000 will grow into a significant sum of money.

ESTATE PLANNING FOR YOUR DIGITAL ASSETS

Not too long ago, many of one's special moments and life events were documented by a physical photograph that was stored in an album and important documents and receipts were stored in files. For many today, our special moments and events memories are amassed on our phones and social media pages stored in some cloud environment. In addition, our important documents and receipts are saved on our computers and e-mail accounts. But what happens to all those photos and documents that have been saved once either you, your parents, or your spouse can no longer access the account due to incapacitation or death?

One of the least considered and discussed area when working on one's estate plan is their digital estate and how to access it upon death. A person's digital estate can include your Facebook page, Instagram account, Twitter account, e-mail account, phone text messages and photos, as well as any documents or photos saved in Google Drive, iCloud or on your computer, phone, or iPad. In addition, subscriptions such as Spotify, Netflix, e-commerce sites such as Ebay or Amazon, and financial services like Venmo and Paypal are all considered digital assets.

Companies like Google, Facebook, Microsoft, Apple, and others that function as the internet's landlords understand this, and over the past few years have come up with various solutions. Detailed below is their digital legacy and "next of kin" services that we recommend you consider using. This list is not exhaustive, but we hope it gets you thinking about your digital legacy so anything you have saved won't be lost forever.

GOOGLE

gMail, Google Drive, Photos, Drive, Calendar, and YouTube

Google has a feature called "Inactive Account Manager" that enables one to share their account data or notify someone if the account has been inactive for a certain period. This feature can be accessed via your Google account. Click on Data & privacy then scroll down to the heading More Options and click on Make a plan for your digital legacy. Here you can designate a "trusted contact" with whom you have given Google permission to share your data after your account has been inactive. Once the account has been inactive for the time you designated, Google will send them an e-mail saying that they have access to your account, what information you chose to share with them, such as files you used and saved, and will give them the ability to download this data. You can also create a Google Document with passwords to your other accounts so your trusted contact can access those accounts.

MICROSOFT

Outlook and other e-mail services, LinkedIn

Currently, Microsoft does not have a similar service to Google. They do, however, have a "Next of Kin" service that allows for the release of all Outlook.com contents, address book, and Messenger contact list after the submission of a lot of documentation. This service requires a message be sent to the Microsoft Custodian of Records via e-mail at msrecord@microsoft.com and with a request that the deceased's account be closed as well as the release of all contents. Microsoft will require a death certificate or, in the case if one is incapacitated, a notarized note from the doctor, a signed court document that states you have power of attorney or executorship of a trust. In addition, you will need to submit a document showing you are next of kin such as a marriage certificate or birth certificate, as well as information about the account holder's e-mail address such as about when the account was created (does not need to be specific) and about when was the last time the account was accessed. It is important that this information is accessible to the next of kin/trusted contact. Once all this documentation is reviewed and approved, Microsoft will send you the data.

For Linked-In accounts, if you are authorized to act on behalf of the deceased person, the account can either be memorialized or closed after appropriate documentation is submitted. If you do not have authority, then the account can only be closed.

FACEBOOK

Facebook and WhatApp only
Instagram is separate

Facebook has a service like Google's that allows you to select a next of kin to either memorialize your profile or delete your account. This service can be found under the Settings > General Settings > Memorialization settings. Once you are there, you can pick someone from your friends list to add as your "legacy contact." If this isn't done before someone passes, the next of kin can contact Facebook directly and, after proof confirming you are an immediate family member or executor of the estate, Facebook will memorialize the profile. A memorialized account allows people to post messages on the account such as memories, funeral arrangements, or memorial services.

INSTAGRAM

Instagram accounts cannot be sent to next of kin. They can only be memorialized. No legacy contact can be designated prior to death. Only a verified person, upon furnishing proof of death, can request your account be memorialized or deleted. This can be done via Reports on their app, or by visiting the help.instagram.com website.

APPLE

In December 2021, Apple released a Digital Legacy Program like Google's. On Macs, click on System Preferences or Settings > Apple ID > Password and Security > Legacy Contact. Then follow instructions. On iPhones and iPads, go to the home screen > Settings > Name, Apple ID, iCloud, Media & Purchases > Password and Security > Legacy Contact and then follow instructions.

Once you start to take inventory of your digital assets, it is amazing how long the list can be. Keeping all your passwords on a legal pad and including it with your will may seem like the perfect solution but the list may not be up to date. We recommend using a password manager/digital vault, such as Keeper Security, to keep all your passwords in one place. Then only one password—the master password—must be included with your will or given to your trusted contact. By having all your log-in information, your next of kin or trusted contact or executor can access all your accounts and download or print out important documents and pictures. Having this information makes closing or deleting accounts easier rather than having to send information to each company. Feel free to contact us with any questions.

We are here to answer any questions and help. Do not hesitate to call. Enjoy the rest of your summer!