HEMSLEY EST. 1993 ADVISORS

The Advisor

QUARTERLY NEWSLETTER

2021 Q3 REVIEW:

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GENERAL MARKET COMMENTARY

The third quarter began with businesses being optimistic, stock market averages up approximately 15% YTD, and continuous speculation about interest rates and inflation.

It ended with increasing concerns about government spending, potential tax increases, stock market volatility, rising interest rates, and visible signs of inflation. These factors contributed to the markets giving back some of their earlier gains in the quarter. Despite this, the Dow Jones Industrial Average, the Standard & Poor's 500 Stock Index, and the NASDAQ Composite Index still ended with YTD gains of 10.6%, 14.7%, and 12.1%, respectively.

Calendar year corporations' second quarter earnings reports ended by early August and as was expected, were solid and mostly exceeded expectations. One could easily detect cautious business optimism looking out for several additional quarters and into 2022. Supply constraints such as parts, materials, and shipments of key components will continue but should begin to ease up towards year end, although likely remaining tight well into 2022.

Inflation, or cost increases, are a concern in many industries as profit margins will be pressured. Ultimately, earnings growth will be affected. Companies are looking for creative ways to reduce their increased costs, but ultimately some may have to be passed on to consumers.

As we enter the last quarter of the year, the major concerns continue to be inflation, the availability of workers, supply shortages, and when the Fed will raise interest rates. The Fed strongly implied that they would begin to cut back or taper their bond purchases in November or December of this year. This is just a very small reduction, but it signals to the market that interest rates could begin increasing by mid to late 2022. Already we have seen small rate increases in the bond market with the yield on the 5-year and 10-year Treasury Notes increasing to 1% and 1.5%, respectively.

The general public may or may not pay too much attention to economic data or what the Fed may do, but they do pay attention to what affects them now or may affect them in the future. Already they are feeling the effects of rising prices in goods and services, including in the grocery store, as well as gas and other energy costs.

The public also knows that government spending, which is partially paid for through tax increases on corporations, can affect ordinary Americans through lower wages and benefits or reduced wage increases. In addition, companies may spend less on capital items or new projects that will affect jobs. A tax increase tends to produce what we call a "hunkering down effect" and frequently leads to slower economic growth going forward. Slower economic growth coupled with higher inflation is called stagflation that benefits no one! Real incomes will shrink due to the higher prices and weak economic growth.

Patience will be required by investors as we transition through these economic challenges, the trend towards higher interest rates, and additional government spending.

The stock markets may be volatile into early next year due to increased investor frustration, but this does not mean one should stop investing. Down markets provide one with the opportunity to lock in higher effective dividend yields that increase cash flow. This results in the potential for attractive total returns over the following 2-3 year period.

Recently there have been double digit dividend increases from The Procter & Gamble Company, Deere & Company, and Microsoft Corporation. Given the strong earnings growth over the last several quarters and despite the measured optimism for future growth, we expect the increases to continue.

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We continue adding money to fundamentally attractive dividend income stocks with growth potential. These include names such as AbbVie Inc., Cisco Systems, Inc., Duke Energy Corporation, Intel Corporation, and many more. We have also been adding to previously out of favor energy stocks such as Exxon Mobil Corporation, with a current 5.8% dividend yield, or The Williams Companies, Inc. a natural gas pipeline company, with a 6.2% dividend yield. With interest rates still near 0%, a dividend yield of even 1.8% from a growth company such as Starbucks becomes very interesting.

A buzz word that investors often hear or read about is asset allocation. This means what percentage of one's portfolio should be invested in assets such as equities, bonds, or cash. Often you will see pie charts with different percentages at various ages. We believe that no matter your age, there is no standard percentage allocation of stocks, bonds, or cash that should be held in one's portfolio.

Each person or household is different, and the correct allocation is based on what is appropriate for them. Some of these differences, or "moving parts" as we call them, include: the client's age, goals, proximity to retirement (time horizon when will they be withdrawing money from the account), their risk tolerance level, the cash flow they will need in retirement or for major outflows, the general level of interest rates, the amount of retirement assets available, and many other factors, including taxes.

In years past, when an investor could obtain a 4% return on a 1-year CD, we were generally 25% - 35% in fixed income (bonds and cash) for individuals nearing or in retirement. Bond purchases were laddered so, upon maturity, cash would be available for required distributions or general living expenses.

> Consumers' one year inflation expectations have risen to 5.2%, according to the New York Federal Reserve in its August survey. That's up from 3.0% just one year ago.

In addition, the interest rate provided a nice return.

Today, however, given the appreciation in stock prices, many portfolios are now around a 15% fixed income allocation. We would like this percentage to be larger as we always try to have at least 3 years' worth of cash flow in a safe and predictable place (cash, bonds, and annual investment income) as the client approaches retirement or is in retirement.

At present, there are limited fixed income opportunities available with attractive yields. As interest rates begin to move higher, we can increase the fixed income allocation by either selectively selling some securities or using the portfolio cash flow to invest in bonds instead of adding to one's stocks.

An interesting observation we have made over the years is the amount of dividend income that credits to one's account due to the steady dividend increases. This is a great situation for an investor to be in! The reinvestment of these dividends back into the portfolio can effectively double your portfolio income in 7-10 years. If one is distributing the dividends and using them for living expenses, they will help you maintain your purchasing power by keeping up with inflation. Dividends or dividend increases are not guaranteed, but they certainly have been attractive. And, given the strong earnings growth of the last several quarters, will likely continue to be increased.

FINANCIAL PLANNING – NEW IRA LIFE EXPECTANCY TABLES AND OTHER CHANGES TO RETIREMENT PLANS

Beginning in January of 2022, new life expectancy tables will be in effect for individuals required to withdraw money from their IRAs or company retirement plans.

These changes will reduce required annual distributions, allowing one to defer taxes a little longer and provide more retirement income in future years to account for slightly longer life spans. The amount of the reduction will vary by age, but in general, one can expect the required distribution to be approximately 6% - 8% less under the new tables.

Of course, these are just minimum requirements for individuals turning 72 beginning in 2022 or later. Remember that a retiree can always withdraw more than the required amount to meet living expenses and cash flow needs. In addition, since the bulk of most individuals' liquid assets are in retirement accounts, individuals younger than age 72 can take distributions for annual living expenses if needed.

You will see from the chart to the right that the required distribution at age 72 is 3.65% of the owner's account balance as of December 31st of the preceding year. This percentage then increases to 6.94% at 87 years of age. Under normal conditions and with a diversified portfolio, these percentages allow the owner's account value to continue increasing well into their 80s. At that point, the account will likely level off and begin to decline as the owner reaches the age of 90 and beyond.

Given that young retirees under the age of 80 will typically have higher expenses than older retirees, one may consider taking a slightly higher distribution rate than required by the IRS tables. This plan can provide a comfortable lifestyle for the young retiree(s) and still provide adequate amounts of income at age 80 and beyond.

We are mindful of two common fears a retiree has: 1) outliving their money and 2) the potential of flat or declining account values for several years caused by poor market returns or severe corrections. A comfortable percentage withdrawal rate can be established to meet the needs of the active young retiree, minimize the potential of outliving their savings, and provide for future financial planning needs or objectives, such as leaving money to children or grandchildren, planning for long-term care, and gifts to charity.

If one continues to work beyond the age of 72, they can contribute to the employer sponsored 401(k) plan. A distribution from this retirement plan, if one does not have a 5% or greater ownership interest in the company, is not required until the year the participant terminates employment. This is a great tax benefit to individuals who continue to work since the money can continue to grow tax deferred and they can elect to continue making tax deductible or Roth contributions. Similar benefits are now allowed for IRA owners that continue to work.

Even though the required minimum distribution (RMD) now commences at 72 years of age, charitable giving of up to $100,000 per year from an IRA is still allowed for individuals age 70 ½ and older. This procedure is called a Qualified Charitable Distribution (QCD) and has gained in popularity as more individuals become aware of it. The amount directed to charity is used to reduce one's RMD. For instance, if one has an RMD of $25,000 and directs the IRA custodian to send $7,000 to a charity, the taxpayer's gross income is reported as $18,000. The account owner meets the RMD requirements, benefits the charity, and saves income taxes!

IRA Required Minimum Distribution Percentages Effective January 1, 2022

At Age	Percent
72	3.65%
77	4.37%
82	5.40%
87	6.94%
92	9.26%
100	15.6%

FINANCIAL PLANNING - PUTTING PORTFOLIO GROWTH TO GOOD USE

As investment portfolio values have increased over the last couple of years, it has created several opportunities for account owners. For example, individuals now have more flexibility to retire earlier from full-time employment, make a real estate investment, fund education expenses, remodel a home or purchase a car, or perhaps even help a family member with medical or dental expenses. Another way that some of this portfolio appreciation and good fortune can be put to very beneficial use is to consider making a charitable contribution.

Nearly everyone contributes annually to charity frequently with cash, gifts of clothing, furniture, volunteer work, etc. However, given the growth of capital that most investors have experienced, we urge you to now consider gifting some shares of one of your appreciated securities. An example would be to gift 25 or 50 shares of Microsoft. You won't miss it, your dividend income will hardly be affected, there will be no capital gain, the asset is removed from your estate, and the value transferred is tax deductible.

This gifting can be done as a transfer of the shares directly to the charity or via a Donor Advised Fund (DAF). The DAF is an account managed by a custodian such as Schwab Charitable. It is a private charitable account used for charitable gifting named after you, e.g., Bill and Jane Doe Charitable Donation Fund. In our example, the Microsoft shares are transferred to the DAF, then sold by Schwab Charitable and invested in one of their managed product funds.

Once the gift is made, it is irrevocable and you receive a tax deduction for the value transferred. You can now recommend that the charity make gifts (called grants) to any approved charitable organization. These grants can be made for as little as $50 and are very easily requested electronically via the computer.

The money in the account can be donated over a short period of time or left in the account to grow for future grants. Also, additional contributions can be made to the DAF at any time with a corresponding tax deduction. It is entirely up to you. And most importantly, apart from the tax deductions, you would be sharing a small amount of your good fortune with less fortunate individuals.

Lastly, with the USPS announcing that mail delivery will be taking longer, we would like to remind you of the option to receive your quarterly portfolio statements and newsletter electronically. Please contact Nick Martin at nmartin@hemsleyadvisors.com to set up this arrangement.

As always, contact us with any questions. Enjoy the beautiful fall weather and upcoming holidays. How quickly 2021 has passed!

George [illegible] Nick Joanne

In 2020, Americans donated a record amount of $471 billion to charities. This was surprising as charitable giving typically declines during an economic downturn.

NEWSLETTER DISCLOSURES:

1. This newsletter may include forward-looking statements. All statements other than statements of historical fact are forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," and "expect"). Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements.

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