# Perspectives

**Newsletter** I Quarter Ending September 30, 2021

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## Inside This Issue



## Market Recap

In our last Perspectives, we noted that U.S. equities had a great first half in 2021 – with the S&P 500[1] up +14.4%. In the 3rd quarter, the equity rally continued – right up until the last three days of the quarter. Oh, what it might have been! The sharp sell-off in equities those last three days reduced equity returns for the quarter from +3.4% to just +0.3%. As a result, the S&P 500 is just about where it was at the end of Q2 - albeit still having a terrific year.

One of the reasons for the stock market sell-off was a sudden uptick in interest rates. Yields on the 10-year U.S. Treasury bond rose from a paltry 1.32% to a still very low 1.55% in just a matter of days. As is often the case, it is not so much the increase in rates that worries investors, it is it is how fast it occurs. In this case, the rate moved a bit too far, too fast.

In addition, the partisan dysfunction in Congress unnerved markets. The combination of Congress not being able to approve funding to keep the government open until two hours before it was to shut down, and, their inability to increase the country's borrowing limit when they know they absolutely have to do so in order to avoid defaulting on our country's obligations, is disappointing to investors – to say the least. Nevertheless, these issues will be resolved and the focus of investors will return to earnings.

The good news is that we seem to now be gettng a handle on the Delta variant of Covid. Cases and deaths are declining. Businesses continue to sucessfully adjust to new ways of operating, and customers are adjusting too. Everyone is deciding on what level of risk they are willing to accept. It is a process, and we have a long way to go – but we are making progress. Vaccine booster shots and anit-viral pills are on the horizon and both should help move us down the road toward normalization and a full re-opening of our economy.

After a tough first half due to rising interest rates, fixed income markets started the quarter by taking a breather as interest rates fell the first half of the 3rd quarter and bond prices recovered somewhat. Unfortunately for bond investors, that all reversed in the second half of the quarter and the rate on the 10-year U.S. Treasury note ended the quarter with a yield of 1.52%.

International developed equity markets have had a good year (if you live outside of the U.S.), however the strength in the U.S. dollar has reduced those returns for U.S.

investors. For example, investors in developed international markets[2] are up +6.2% year-to-date. Great absoute returns, but not great in light of the terrific returns of the S&P 500 this year. Another casualty of a stronger dollar was gold with the price of gold falling -7.5% year-to-date.

We are expecting a stronger 4th quarter. There are signs that the economy is re-accelerating as Covid cases decline. It is likely that we will see tremendous new job creation in the months ahead and declining unemployment claims. We are now entering the seasonally strongest part of the year for equities (having just made it through the seasonally weakest part of the year reasonably well). Happy and prosperous holidays to all!

- **Patrick Powers, CFA®, CPA, CFP®**
  **Partner/Managing Principal**

## Forecast

The Federal Reserve (the "Fed") knows that there is too much liquidity in the system but has mixed feelings about reducing it. My sense is that the Fed will need to see that the following five factors are in place before they do anything:

- An unemployment rate in the neighborhood of 3.8%;
- Prime-age (25-54) labor force participation close to its pre-pandemic level;
- Accelerating wage growth;
- Long-dated inflation expectations at or above target levels; and
- Non-transitory inflation at or above target levels.

All of the above factors have been accelerating, which leads me to believe that the Federal Reserve will start to first taper excess liquidity, and then begin to raise interest rates by the end of 2022.

If the Fed liftoff occurs as planned and unforeseen circumstances do not occur, we expect the 10-year Treasury bond to level off around 2% to 2.25%. To us, the message is clear, in an environment of rising interest rates, new buyers of bonds need to keep their duration[3] shorter than benchmark[4] duration. If the Federal Open Market Committee ("FOMC") follows through with increases in interest rates, monetary policy will not become extremely tight until 2024. It is too soon to forecast the pace of tapering and the rise in interest rates, but the big move in financial markets should occur when interest rates rise above the equilibrium rate. We are not there yet.

If monetary policy will not be restrictive for approximately three years, we believe it is too premature to shift to a defensive position, especially if investors share our view that risk assets should perform well over the next 12 months.

- **Steven Yamshon, Ph.D.**
  **Partner/Managing Principal**

## Portfolio Management

Stocks, bonds, and housing are punch drunk from the multiple rounds of fiscal and monetary stimulus. At its last meeting,the Fed didn't give an exact timetable of when they will start "to take away the punch bowl", but it appears the program to start tapering their $120 billion monthly purchase of government securities will begin this year and finish up by mid-2022. The markets may be volatile around these policy shifts.

As the ex-Citigroup CEO, Chuck Prince, stated, *"When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance."* But we prefer the Deep Thought by Jack Handey, *"Let's be honest: Isn't a lot of what we call tap dancing really just nerves."*

While I dance with my nerves, I know by following time-tested investment strategies, keeping my emotions in check, and by having a long-term plan, the likelihood of positive returns grows even if there is forthcoming market volatility. By succumbing to short-term strategies such as market timing or performance chasing, many investors show a lack of knowledge and/or ability to exercise the necessary discipline to capture the benefits markets can provide over longer time horizons.

This lack of discipline has cost the average investor many thousands (sometimes hundreds of thousands) of dollars over a lifetime compared to other asset classes over the last 20 years. According to Dalbar Inc., the average investor has earned 2.9% annually from 2001-2020, while the average moderately conservative portfolio (60% stocks/ 40% bonds) has returned 6.4% per year on average.[5] According to Reuters, the average holding period for U.S. stocks today is around 5 ½ months. No wonder why the average investor is their own worst enemy.

Even the average homeowner gets the importance of time in the market rather than timing the market. Most homeowners tend to stay in place for at least eight years, according to DataTrek (*note - the illiquid nature of homeownership and tax benefits partly explain the longer holding period). The average eight-year period compound annual growth rate (CAGR) for a homeowner is 3.7%.[5]

Author Carl Richards states, *"We're wired to avoid pain and pursue pleasure and security. It feels right to sell when everyone around us is scared and buy when everyone feels great. It may feel right – but it's not rational."*

Market timing easily plays on our emotions in a way that overrides even the most well thought out plans. But if you stay calm, you'll find that the likelihood of a positive return grows higher the longer you stay invested. Having a long-term plan, one that can work through market volatility, is one of the best ways to pursue your long term goals and bolster your financial situation for years to come.

If you don't have a long-term plan or are feeling nervous about the markets, we recommend you first start by determining how much risk you are willing to accept. Take our risk analysis questionnaire. From there we can continue the conversation and help you create a long-term plan.

- **Michael Allbee, CFP®**
  **Partner/Senior Portfolio Manager**

## Talk With Us!

Our goal is to help our clients build and grow their wealth, and tax planning plays an important role in this process. We recommend that you mark your calendar to review your finances in the first week of October, annually. Take this time to review your income for the year from employment, businesses, investments, or any other sources. This will help you project your tax liability ahead of time and allow your financial advisor or tax accountant to find strategies to reduce your tax burden. Implementing this consistently and reducing your tax burden annually will have a compounding impact over the years and increase your retirement nest egg. Here are a few tax planning strategies to keep in mind:

**IRAs and Retirement Plans**

Take full advantage of tax-advantaged retirement accounts. By contributing to Traditional IRAs and employer-sponsored retirement plans such as 401(k) plans, you can reduce your taxable income and lower your taxes. For 2021, you can contribute up to $19,500 to a 401(k) plan ($26,000 if you're age 50 or older) and up to $6,000 to a traditional IRA ($7,000 if you're age 50 or older).

**Roth Conversions**

If you are in a lower tax bracket this year and expect your income tax rate to increase in the future, you may want to consider a Roth IRA conversion. You can convert all or part of your pre-tax retirement account into a Roth IRA and pay the taxes now at a lower rate. The funds in your Roth IRA will continue to grow tax free, and you will have more income flexibility in retirement.

**Charitable Donation**

If you are charitably inclined, you should plan your donations in advance to ensure you maximize the tax benefits. For those over age 70.5, you may want to consider Qualified Charitable Distribution (QCD), where you can transfer up to $100K from your IRA to a charity. This method not only reduces your Required Minimum Distribution (RMD), but the distribution is also excluded from your taxable income.

**Tax Bracket Management**

The IRS uses a progressive tax system which means as your income grows, it is subject to a higher tax rate. Therefore, it is important to know in which of the seven federal tax brackets you will fall into. In your high-income years, you may want to reduce your tax liability by increasing your retirement contribution or utilize a tax-loss harvesting strategy. On the other hand, in low-income years, you may want to consider Roth IRA conversions, accelerate income recognition, or postpone deductible expenses.

Tax planning should be part of every individual investor's financial and retirement plan. There are many strategies available for individuals and business owners, but it requires proper planning throughout the year. If you'd like to learn more about tax planning strategies unique to your personal circumstances, feel free to Talk With Us!

- **Arash Navi, CFP®, CPA**
  **Controller/Wealth Manager**

## BFSG – In The News

August 2, 2021 – BFSG Nationally Ranked in Financial Advisor's (FA) Magazine

September 16, 2021 – BFSG Named One of PLANADVSIER's "Top 100 Retirement Plan Advisers" for 2021

## The Score Board

| | 09/30/2021 | YTD Change |
|---|---|---|
| Dow Jones Industrial Average | 33,843.92 | 12.12% |
| S&P 500* | 4,307.54 | 14.68% |
| NASDAQ Composite* | 14,448.58 | 12.10% |
| MSCI EAFE (USD)* | 2,281.29 | 6.22% |
| Bloomberg Commodity Index | 100.76 | 29.08% |
| Barclays Aggregate Bond Index | 2,354.86 | -1.55% |
| 10 Yr U.S. Treasury Bond Yield | 1.52% | 59bps |
| 30 Yr Fixed Mortgage Rate | 3.01% | 14bps |
| Prime Rate | 3.25% | UNCH |
| Crude Oil ($ / Barrel) | $75.03 | 54.64% |
| Gold ($ / Oz.) | $1,756.95 | -7.45% |
| U.S. $ / Euro € | $1.16 | -5.20% |
| Core Inflation (excluding food / energy) | | 4.00%** |
| Inflation (including food / energy) | | 5.30%** |

**Without Dividends; **Unadjusted 12-Months ended August 2021; bps (1 Basis Point = 1/100%)**;** UNCH (Unchanged)*
*Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve*

**Sources:**

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market. Price return quoted.
2. The MSCI EAFE Index captures large and mid-cap segments in 21 developed markets around the world, excluding the US and Canada. Price return quoted (USD).
3. Duration is a measure of the sensitivity of the price of a bond to a change in interest rates. In general, the higher the duration, the more a bond's price will drop as interest rates rise (and the greater the interest rate risk).
4. The Barclays Aggregate Bond Index is a broad-based index used as a proxy for the U.S. bond market.
5. Source: JP Morgan Guide to the Markets, Dalbar, Inc. Indices used are as follows: Homes: median sale price of existing single-family homes, 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior.