WIGAND

INTEGRATED WEALTH

September 2020 Client Update

TEAM MEMBER SPOTLIGHT

We would like to take this opportunity to formally introduce to you our Client Service Associate, Rob Forest. While Rob has already had the pleasure of speaking with many of you and trading emails with many others, he looks forward to getting to know each of you on an individual level.

Rob came to us highly recommended as an industry veteran with over 20 years of experience—having served wealth management clients at Smith Barney, UBS, and Resolute Independent Advisors. Rob's experience in helping clients transition from brokerage to advisory firms has proved invaluable in our recent transition to Wigand Integrated Wealth. As our transition period comes to a close, his passion for developing relationships and providing individualized support for our clients will remain a crucial component of the value he provides to our Team. We have already come to know Rob well as a person committed to his work and dedicated to his family.

Outside of the office, Rob enjoys spending time with his daughter, Casey, and wild adventures through the Rocky-Mountain terrain in his Jeep (pictured below enjoying his favorite pastime, 4-wheeling through ice cold rivers and other treacherous conditions). We are very fortunate to have him on our team and he is excited to get to know and work with all of you.

YEAR-END TAX PLANNING OPPORTUNITIES

Two acts that became law in 2020 brought changes to retirement plan rules that have important tax-planning implications for many taxpayers. The SECURE Act, enacted January 1, 2020, changed several rules related to retirement plans, including IRA's, 401k's, and similar plans. One of the changes made in that act was an increase in the required minimum distribution (RMD) age from 70 1/2 to 72 for those not turning 70 1/2 before the end of 2019. That's good news, of course, for those affected by the rule who don't need the income from their plan, as it allows them to defer taxable income for an additional number of years --1 or 2, depending on their birthdate.

The CARES Act, passed in March, brought numerous provisions that extend well beyond tax planning, of course, to provide relief from the devastating effects of COVID-19. That act included another significant change to retirement plan RMD's -- namely, waiving them for 2020. The RMD delay from the SECURE Act and waiver from the CARES Act, separately and in combination, could create the opportunity to pull other income forward into 2020 to minimize future taxes. By the same token, pushing back deductions where possible could also prove beneficial.

Roth Conversions

One way to pull income forward is by making a Roth conversion -- a taxable conversion from your traditional IRA to a Roth. If this can be done in a lower tax bracket than you'll be in when RMD's start or resume in the future, you could save more tax in the future than the conversion costs you this year. If the IRA you're converting includes any nondeductible contributions, you'll benefit even more.

Gain Harvesting

Another way to pull income forward is to realize capital gains beyond the amount you normally would, a concept commonly referred to as "gain harvesting." Gain harvesting at the right time could lower your short and/or long term capital gains rate, a consideration that could have a meaningful effect on your future wealth.

Charitable Contributions

Just as pulling income forward could benefit you, delaying deductions could have a similar effect. If you might be in a lower tax bracket in 2020 due to the current RMD rules, charitable deductions and other itemized deductions may benefit you more in future years.* Through a Donor Advised Fund, or simply by consolidating contributions in future years, you can still give as much over time to the organizations you support while maximizing your tax benefits at the same time. In fact, the increase in the standard deduction that took effect in 2018 as part of the Tax Cuts and Jobs Act (TCJA) can make these gifting strategies beneficial for taxpayers even without the recent RMD rule changes.

**Many charities have non-calendar fiscal years, so a gift made in January of 2021 might still meet an organization's budgeting needs. If you're concerned about the effect of delaying your gift(s), we'd be happy to host a conference call with you and your donee organization(s) to discuss the idea.*

Elections and Asset Markets

Election years seem to bring uncertainty. I can't remember an election year when I wasn't asked about repositioning portfolios based on the expected outcome of the presidential election. It's certainly a question worth asking. However, we don't believe positive results can be achieved reliably by significant repositioning based on the forecasted outcomes of elections or other near-term events. Our own experience and substantial amounts of research indicate that investors most often reduce their wealth by attempting to time their investments. In fact, during my career, I have witnessed many attempts at timing and don't recall any of them producing a positive result. Likewise, we are aware of no other asset managers that use event-based timing as a part of their investment process.

Why is this (or any) type of timing so hard? The simple answer is "math." The law of probability works against timing successfully. When it comes to an election, for example, to translate a forecast into investment profits would require being right about four things: 1) which candidate will be elected, 2) what effect that result will have on our investments (let's assume for our example that we think they'll decline.), 3) when to sell our investments before the election (i.e., before other market participants see what we see and sell before us), and 4) when to buy back in (i.e., exactly how large the decline will be so we can time our buy-back). Let's say we have a strong conviction about our forecasts for each of these outcomes and assign each a 70% probability. What are our chances at getting them all right? Only 24% -- 70%*70%*70%*70*%. Certainly, we could be wrong about one or more outcome and still achieve a profitable result. However, even our over-simplified illustration (in addition to our experience) is enough to satisfy us that correctly forecasting a series of events – political or otherwise -- is too improbable to make up for the lost returns likely to occur from being uninvested (or substantially under-invested) over any given time period. As noted in the last section of this report, we are willing to make some smaller adjustments under compelling circumstances.

As a timely aside, for those interested in how party control has affected returns historically, this Forbes article gives the topic a pretty thorough look (how the stock market has performed before during and after presidential elections).

FINANCIAL CLIMATE CONTINUED

Two final points about timing: one is that history offers plenty of examples of events or possible events that greatly alarmed investors but that seemed to have little eventual effect on asset markets, either because the effect was less than expected or the event did not occur at all. Recent examples include Y2K, Fiscal Cliff fears in 2012, the Brexit vote in 2016, and pending US government shutdowns in both 2013 and 2019. The second point about timing is the most critical. We don't need to engage in it to achieve your objectives. The allocation we have chosen together gives you a high probability of meeting your objectives despite the declines likely to occur from time to time. In other words, we have built those declines into our planning. If we believed we could successfully avoid them, we would attempt to do so, but, for the reasons given above, we don't believe we or anyone can do that reliably (although we'll always keep looking for reliable ways to improve investments results).

So, if we don't base investment decisions on specific event outcomes, how do we make those decisions? In short, we manage portfolios according to financial principles and historical evidence. Financial principles dictate that the value of an investment should equal the present value of all future cash flows produced by that investment. Historical evidence shows that certain indicators have been reliably predictive of returns, especially over long periods of time. More below.

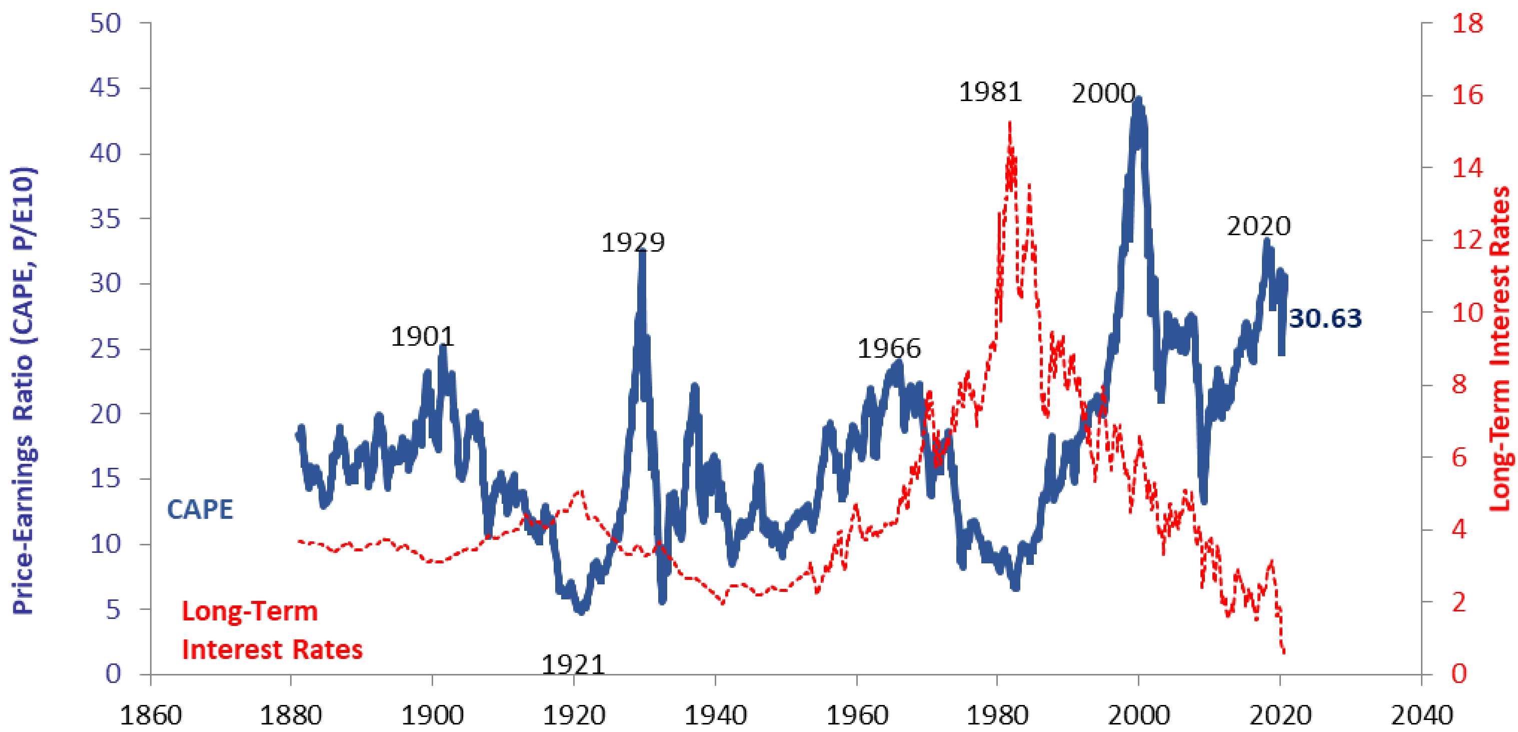
"FAR MORE MONEY HAS BEEN LOST BY INVESTORS PREPARING FOR CORRECTIONS, OR TRYING TO ANTICIPATE CORRECTIONS, THAN HAS BEEN LOST IN CORRECTIONS THEMSELVES." -PETER LYNCH

Current Outlook and Investment Positioning

What do our indicators currently reveal? Well, despite the implication in the election timing discussion above, our indicators do in fact leave us cautious on the broad US markets. However, we see reason for optimism about certain segments of the US market and about foreign markets in general.

While valuations are not good timing measures, some of them have proven highly predictive of long term returns. Cyclically Adjusted Price to Earnings (CAPE) and Price-to-Book Value are two such measures. We won't define these measures here for the sake of brevity, but the following links give an indication of their current levels and possible range of long term outcomes for the US and other major equity markets.

The first link, from the web page of renowned Yale professor Robert Shiller (Shiller Data-- image shown below) shows that the US CAPE, recently at 30.63, is higher than any level between 1881 and 2019 except for two time periods. Those two periods were the Roaring 20's and the Technology Bubble, both of which were characterized by low returns in the 10-15 subsequent years, which included major declines in both instances.



FINANCIAL CLIMATE CONTINUED

The second link, courtesy of StarCapital (Stock Market Expectations 15 yr.) shows 15-year returns for equity markets worldwide after historical periods in which their respective CAPE and Price-to-Book ratios were at levels comparable to current levels (as of 7/31/2020). Median US returns were 2.7% and 2.0% based on CAPE and Price-to-Book, respectively, while world markets overall (including the US), were at 5.0% and 5.9%. (Please access the link for important disclaimers and for the full report – a quick and informative read for those interested.)

Which distribution of returns followed on comparable valuations over 15 years

		Subsequent returns using CAPE						Subsequent returns using PB				
Country	**CAPE**	**Max**	**75%**	**Med**	**25%**	**Min**	**PB**	**Max**	**75%**	**Med**	**25%**	**Min**
Singapore	**11.2**	18.30%	12.90%	10.40%	7.90%	2.90%	**0.8**	19.80%	14.40%	12.40%	11.00%	6.20%
Spain	**11.1**	18.30%	12.90%	10.40%	7.90%	2.90%	**1.1**	18.20%	12.30%	10.00%	8.40%	3.40%
Hong Kong	**12.8**	22.00%	10.90%	8.30%	6.50%	1.20%	**1.7**	18.20%	8.60%	6.80%	5.20%	-2.10%
United Kingdom	**12.5**	22.00%	10.90%	8.30%	6.50%	1.20%	**1.5**	22.10%	10.00%	7.80%	6.40%	0.30%
Norway	**13.8**	22.10%	9.80%	7.70%	6.00%	0.30%	**1.7**	18.20%	8.60%	6.80%	5.20%	-2.10%
Germany	**16.5**	20.20%	8.50%	6.70%	5.40%	-0.30%	**1.5**	22.10%	10.00%	7.80%	6.40%	0.30%
Emerging Markets	**15.5**	20.20%	8.50%	6.70%	5.40%	-0.30%	**1.6**	19.00%	9.50%	7.30%	5.70%	-0.90%
Developed Europe	**16.3**	20.20%	8.50%	6.70%	5.40%	-0.30%	**1.6**	19.00%	9.50%	7.30%	5.70%	-0.90%
Australia	**17.1**	18.20%	7.90%	6.40%	4.80%	-1.50%	**1.9**	15.80%	8.10%	6.40%	5.00%	-3.20%
Italy	**16.8**	18.20%	7.90%	6.40%	4.80%	-1.50%	**1.1**	18.20%	12.30%	10.00%	8.40%	3.40%
Belgium	**18.3**	17.50%	7.70%	6.10%	4.40%	-2.10%	**1.3**	22.10%	10.40%	8.90%	7.40%	1.20%
France	**17.8**	17.50%	7.70%	6.10%	4.40%	-2.10%	**1.6**	19.00%	9.50%	7.30%	5.70%	-0.90%
Japan	**18.1**	17.50%	7.70%	6.10%	4.40%	-2.10%	**1.2**	22.00%	11.60%	9.40%	8.00%	1.20%
Canada	**20.2**	15.00%	7.40%	5.40%	3.20%	-2.10%	**1.8**	16.60%	8.30%	6.60%	5.20%	-2.60%
Sweden	**20.8**	14.50%	7.10%	5.40%	3.00%	-2.10%	**2.3**	14.10%	7.60%	5.00%	2.90%	-3.80%
World AC	**22.4**	14.40%	6.80%	5.00%	2.50%	-2.00%	**2.1**	15.00%	8.00%	5.90%	4.20%	-3.80%
Netherlands	**23.9**	13.80%	6.40%	4.30%	2.30%	-2.00%	**2.1**	15.00%	8.00%	5.90%	4.20%	-3.80%
Developed Markets	**23.6**	13.80%	6.40%	4.30%	2.30%	-2.00%	**2.2**	14.40%	7.70%	5.40%	3.30%	-3.80%
Switzerland	**24.8**	12.50%	6.40%	4.30%	2.40%	-1.50%	**2.7**	10.60%	5.90%	4.10%	2.40%	-2.30%
United States	**30.1**	10.40%	4.10%	2.70%	1.00%	-2.10%	**3.8**	10.20%	3.10%	2.00%	0.40%	-6.40%
Denmark	**35.7**	7.20%	2.70%	1.90%	-0.20%	-3.80%	**3.5**	10.20%	3.10%	2.00%	0.40%	-6.40%

Based on comparable valuations, the table shows the subsequent real returns over 15 years in local currency and incl. dividends based on current CAPE and PB. The analysis is based on the maximum available data sample (S&P 500 from 1881-2015 and 16 country indexes from 1979-2015). The underlying methodolgy and data is based on our research paper "Predicting Stock Market Returns Using the Shiller-CAPE: An Improvement Towards Traditional Value Indicators?" [2016]. Source: StarCapital as of 07/31/2020.

That said, we should be cautious about assuming future returns will always follow historical patterns, because circumstances can never be identical over different time periods. The current period, to be sure, involves some unprecedented circumstances, leaving us little evidence on which to base forecasts. In addition, we still see US business in aggregate as a (if not "the") world leader in driving innovation and advancement. Therefore, even though we are underweighting the US and overweighting foreign equities relative to our long-term targets at the moment, we still maintain considerable US exposure in all of our investment models and will likely continue to do so.

An example of a US sector we are overweighting is Midstream Energy, the segment of the energy industry that processes and transports oil and natural gas, among other activities. Even given what we see as conservative assumptions for future earnings and cash distributions, the current prices of many of the individual Midstream companies could result in future returns that provide attractive returns for the sector in general. We also feel that certain attributes of the midstream sector -- namely fixed-fee contracts, the importance of natural gas in domestic power generation, and the lower carbon emissions of gas relative to other fossil fuels -- make the sector lower-risk relative to other segments of the energy industry.

A final note relates to hedging. We make some use of hedging but limit that use strictly. The reason we limit its use is that, unlike stocks and bonds (in the absence of the negative yields experienced in some countries), which have positive expected returns over time, hedging stock and bond exposure, put simply, carries a negative expected return. Regular hedging over time periods during which stocks and bonds have positive returns (which historically has been <u>all</u> long periods of time), would have produced negative returns, as a hedge is designed to move opposite the asset being hedged to one degree or another. Our practice is to invest in assets with positive expected returns, of course.
That said, the evidence shows that September and October are historically volatile months. That evidence, together with the fact that US valuations are historically high and the possibility of growing election uncertainty in the weeks ahead, have prompted us to replace temporarily some of our market-neutral investments with volatility hedges in several of our investment models. These hedges are in the form of exchange-traded notes designed to rise in price if volatility increases sharply.

Please keep in mind that there are always many factors involved in assessing financial considerations – far too many to address in a single report. In this update, we've attempted to cover a few of the considerations we see as most timely and relevant.

As always, we welcome discussions about the above topics or any others you'd like to explore and look forward to talking with each of you soon.

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