July 2020

Q3 SMART MONEY

INVESTMENT INSIGHTS

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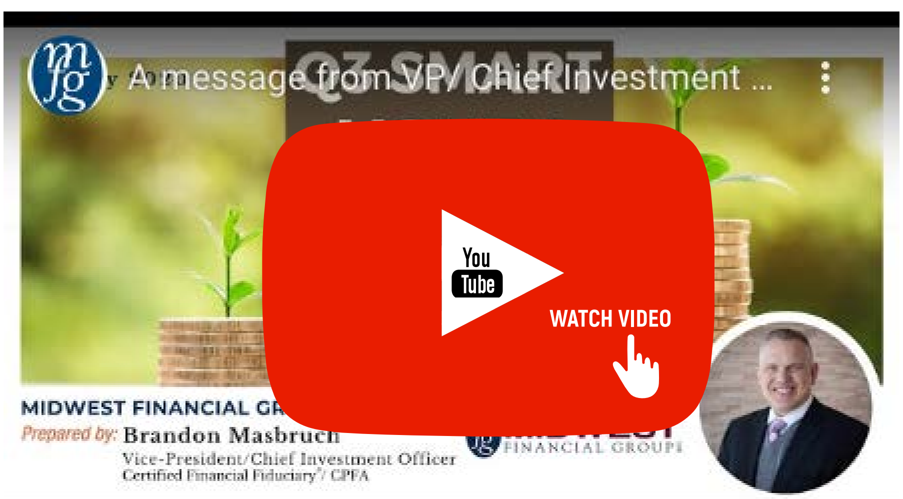
WHAT DIRECTION DO WE GO FROM HERE?

Generally, if I had an opportunity to sit down and send you a note following one of the best quarters the US markets has experienced in over two decades, that would be an easy and enjoyable letter to write. But as I sit here trying to lay out my message to you, I struggle with what the right tone should be. As it relates to your investments, we are in a better plane than we were three months ago, but what direction do we take from here? Regarding the virus, the case count continues to rise, but the death rate has plunged, meaning more and more people that contract the virus are surviving. But while we could talk about all the positives that have happened over the last quarter, there are still significant headwinds that need to be given their proper attention as well.



Just as I wrote to you 3 months ago about the speed of the drop in the markets, the recovery has been equally as fast. The S&P 500 has gain approximately 25% in the quarter leaving the index still down about 4.5% for the year so far and not quite 10% down from its February highs. So, while we have seen a strong recovery to this point, we still have a way to go to put the drop in the markets behind us. The question is, when will that happen.

Over the next 6 months we should continue to see high levels of volatility, days of good and bad performance. With the level of uncertainty as to the path of the virus, the time to a vaccine or improvement in therapeutics, the reopening of the economy and the consumers ability to take part, the return to work of those that have been displaced, and what a return looks like for those that have been working remotely for the last couple of months. If we stretch that timeline out further and look 12-18 months down the road it is likely that volatility remains but with better direction as to the path of the recovery and what our new normal looks like. Keep in mind, and I am sure the media will not let you forget, that we will be having an election this fall that could drastically change the path of the markets as well.

WHAT IS THERE TO LOOK FORWARD TO?

With all that information, what is there to look forward to and how do you remain comfortable with the plan that we have helped you put in place? You can start with the fact that you have taken the time to put a formal financial plan in place. With your plan in place, and your follow through on taking our review meetings, we can continue to ensure that you are properly positioned for whichever stage of life you find yourself in. Your investment changes and decisions should continue to be driven by that plan, not by the noise going on around us. No one can determine the track of the stock or bond markets and missing out the best days of the market does significantly more damage to your account than missing out on the worst days provides support. Time in the market continues to be your best long-term driver of return.

"As a fiduciary we continue to work in your best interest and to deliver what we feel is the best collection of investments to meet your needs and goals in accordance with your financial plan.

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In the second quarter the investment committee met and moved forward with a mid-quarter portfolio adjustment. In almost all portfolios we added a growth focused fund to our US small-cap position. This adjustment was a hedge against the chance that value is not able to lead the market coming out of the market downturn that we are in. As always there are no transaction charges, nor any compensation derived from investment changes in our models. As a fiduciary we continue to work in your best interest and to deliver what we feel is the best collection of investments to meet your needs and goals in accordance with your financial plan.

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As we move forward there are two certainties though that need to be dealt with. First, in 2026 the individual tax rate decline that was a part of the Tax Cut and Jobs Act will sunset and all rates move back to their 2017 levels. This is the written tax law as we know it today, and it will take a new law change to alter it. With the level of government stimulus used over the last couple of months, and the additional spending that is being proposed, it is highly likely that we will see taxes increased further and potentially sooner than it is written right now. For that reason, continued, and proactive planning regarding the amount and timing of the taxation of your assets needs to be a driving force in your financial planning. Remember that when you move into retirement it is not as important to focus on how much you have, you need to focus on what you get to keep. Tax drag on a portfolio is going to be a detractor of return moving forward if you do not take a proactive approach to you plan.

The other certainty that we need to be aware of is that bank and money market assets will not have the ability to keep up with inflation. So, while the number of dollars and cents that you have may be protected, their value and your ability to purchase goods and services with those same dollars and cents will decrease. In April bank deposits grew by $685 billion, which is more than has ever occurred in a full year. While it is great that people have taken to improving their savings during this period of uncertainty, this will be a significant negative to your financial future if not addressed. The old 60/40 model is dead, general bonds will struggle to offer actual return as we again move off a near 0% federal funds rate to something that is higher than that in the future. We need to ensure that the data of the past, high amounts of bond holdings, and using CDs and retirement income, do not overshadow the realities of the present and possibilities of the future. Income planning as it was done 20 years ago is not wrong in general, but it is wrong, and will not work in this interest rate environment. Just as we work to continually mold and shape the investments that we use, we need to continue to mold and shape our approach to income planning as the tools of the past will block your path to a successful retirement.

As always if you have questions, if you want to take this broad, general letter, and talk about how it specifically impacts you and your financial plan, or if your family or friends would like to find out how they can also take control of their financial future, please reach out to either your primary advisor here at Midwest Financial Group, or me specifically, and we'll be happy to discuss. We are committed to keeping all lines of communication open and can meet in person as needed, set up a digital meeting via Zoom, or a phone call. Whichever you prefer we will be able to accommodate, as it is you that we are here to work for. So, as we move through the summer, stay safe, stay healthy, and stay in touch.

Take care,
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