May 2020 Newsletter – Looking across the Valley

We hope all is going well with you, especially in light of the ever-changing coronavirus situation! Normally we do not send out newsletters as often as this, but we thought some observations might be useful. The past two months have been a time of uncertainty, fear, suffering, and great opportunity. We know that in the long term this too will pass, but it may be difficult holding that long-term vision while in the midst of turmoil and ambiguity.

Looking across the Valley

We do not know when this recession will end, but over the last 80 years, stocks have turned up on average 107 days *before* a recession has ended* – an average of 3.5 months ahead of time! Furthermore, in practice, we don't get confirmation that a recession has ended until long after that. For example, in the financial crisis of 2008-09, the S&P 500 bottomed on March 9th 2009 at 677, but the National Bureau of Economic Research did not confirm the recession had ended until Sept 21,* by which time the S&P 500 was at 1055 – up 57%. And even then, nobody believed it! So waiting until there's confirmation the recession has ended misses much of the market recovery.

Of course, no one can consistently time the market bottom. No one. And emotional decisions usually do not work well in the long term. **At times like these we need to stay disciplined and keep looking across the valley.** The shape of the recovery (be it V-shaped, U-shaped, W-shaped or even the illusory L-shaped) is both unknowable and irrelevant to the long-termed investor focused on goals and retirement planning. What matters is the inevitable fact of the eventual recovery.

Personal opinion

The character of this recession is also different from most. In essence, it was not triggered by a *debt* crisis, but by a medical *science* crisis. A major personal and corporate debt deleveraging event like we experienced in the 2000s usually takes the better part of a decade or more to resolve, slowly growing our way out of the excessive accumulated debt. Debt resolution takes time, a lot of it. In contrast, scientific medical problems have the potential for significantly faster solutions, especially now.

Looking even further across the valley, this crisis may also have unintended benefits, such as forcing the trial of technological innovations like telecommuting and productive connectivity by businesses who have until now resisted. Other silver linings are coming, but that's a discussion for another time.

Opportunities – Further observations on tax savings

In our last newsletter, we listed some great tax-saving strategies available in a down market. However, the tax rules are complex and so these have to be carried out with forethought. Two examples are noteworthy:

- <u>Tax-loss Harvesting</u>

  To avoid triggering the wash sale rule and remain invested in the market, we sell down positions and **buy a similar investment at the same time**. The wash sale rule applies to the *combination* of retirement accounts and taxable accounts. To do this right takes detailed portfolio planning and trade timing.

- <u>Roth Conversions</u>

  401ks and IRAs are useful retirement vehicles for deferring taxes in our high tax years. However, the taxes you've deferred in the past will have to be paid *sometime*. At age 72 the onerous *required minimum distributions* (RMDs) start. RMDs greatly **shorten the <u>time</u> and <u>amount</u> of tax-free compounding of earnings in these accounts,** perhaps the greatest cost of holding IRAs throughout retirement.

  Enter the tax-free Roth -- one of the best retirement vehicles ever invented. It pays to *convert* traditional IRAs to Roth IRAs when your tax rates are lower of course. However, not usually recognized, it pays to convert particularly when the market is low. **Reduced share values in a downturn allow us to convert more shares for the same tax cost**. Patient execution of a long-term conversion plan to top-up tax brackets year-by-year, coupled with market downturns, can accumulate considerable lifetime tax savings – typically more than your present portfolio value!

Bottom Line

The point is that we are *prepared* and welcome whatever comes in the short term. In the long term, we know where we are headed – a disciplined approach to keep on track to achieve our long-term goals and fund our retirements.

If your tax bill is becoming considerable and you'd like to reduce it, learn more by [scheduling a free conversation].

We truly appreciate our clients. *All* have been prepared, both financially and psychologically for this, and their response and relative calm throughout this downturn have been genuinely gratifying.

With heartfelt best wishes that you and your families stay healthy and safe!

Lisa and Jack

"Those who invest only when commentators are upbeat
end up paying a heavy price for meaningless reassurance."

-- Warren Buffett

*Sources: Legg Mason Global Asset Management, Michael LaBella; www.nber.org