Financial Alternatives
integrated wealth management

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Introduction

In our April and October quarterly newsletters, we typically focus on financial planning topics while our January and July newsletters focus on investment topics. Due to the COVID-19 market correction that we are currently experiencing, we decided to include some investment information in this quarter's planning newsletter.

The planning section of the newsletter covers high profile changes to retirement plans in 2020 that we will be reviewing for our clients. We then discuss Vanguard's short-term economic forecast before taking a quick look at historical investment returns following sharp market downturns - like the one we are currently experiencing. Finally, we discuss the folly of trying to time the ups and downs of the investment markets. We try to keep things brief and leave you with a few valuable takeaways.

The CARES Act Effect on Retirement Plans & Planning Considerations

The Deadline to Make an IRA Contribution is Now July 15

Although not a part of the CARES Act, it's important to note that IRS Notice 2020-18 extended the deadline to file 2019 tax returns from April 15th to July 15th. They later clarified that the deadline for making regular IRA, Roth IRA, and HSA (Health Savings Account) contributions is July 15th as well. This extension will give you extra time to decide if you want to make an IRA contribution if you have not already done so.

There Are No Required Minimum Distributions (RMDs) for 2020 (including inherited IRAs)

While the Act waives the RMD requirement for IRAs in 2020, we do not think you should automatically suspend your RMDs this year. We will be looking at this on a case by case basis for each of our clients. In general, we believe no change should be made if you need your distributions to meet current expenses. If you don't need your RMDs and they are being withdrawn in a lower tax bracket, consider converting the distribution to a Roth IRA. If you do not need your RMD, and the added income pushes you into a higher tax bracket, you would be a good candidate to suspend your distributions for 2020. Another important note is that the recently signed SECURE Act extended the starting age for RMDs to age 72 (from age 70 ½).

Executive Summary

- In light of the newly passed CARES Act, consider reviewing your retirement account planning.
- Required Minimum Distributions (RMDs) are not required in 2020.
- Vanguard is forecasting a sharp contraction in Gross Domestic Product (GDP) in the coming quarter of nearly 17% on an annualized basis followed by a sharp upswing.
- Historically, US equity returns following sharp downturns have been positive.
- There is no proven way to successfully time the market. Missing only a few days of strong returns can drastically impact overall performance.

The economic support being provided to individuals and corporations during these unprecedented times is going to be expensive and will have to be paid for at some point which could very well result in higher taxes down the road.

Waiver of the 72(t) 10% Early Withdrawal Penalty for Coronavirus-Related Distributions (CRD) In 2020

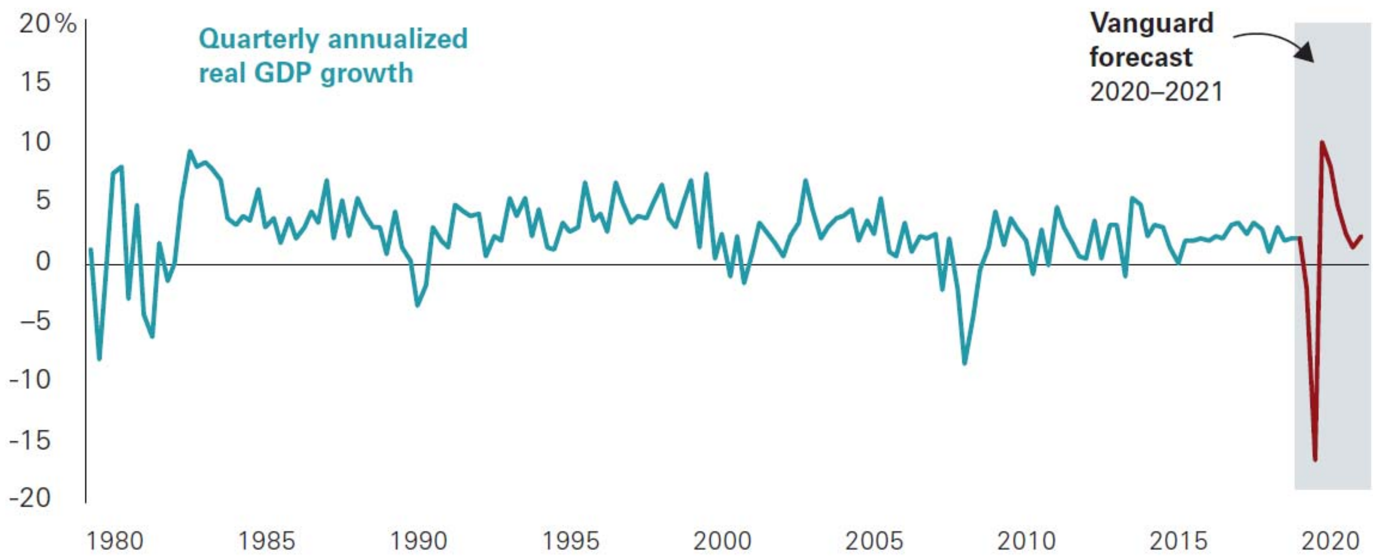
The early withdrawal penalty of 10% on withdrawals before age 59 ½ is waived for 2020. Qualifying individuals can withdraw up to $100,000 from an IRA, 401(k), 403(b), or government 457(b) plan. Withdrawals will still be subject to taxes, but qualifying individuals will have the option to spread the tax over three years. In addition, distributed amounts can avoid taxation if they are paid back over the next three years. We anticipate that if distributions are paid back, an amended return will need to be filed to claim a tax refund.

Typically we would only suggest workers take a withdrawal from their retirement plan in very limited situations. For example, if a person expects to end up with much lower 2020 income due to unemployment, it may make sense to withdraw funds from their 401(k) or IRA, since the taxes on the withdrawals would likely be at much lower tax rates. Here again it may make sense for this individual to make a Roth conversion.

To qualify for a Coronavirus-Related Distribution (CRD) you'd need to meet any of the following:

- COVID-19 diagnosis
- Spouse or dependent has a COVID-19 diagnosis
- Experienced adverse financial consequences due to COVID-19

A sharp but short contraction



Source: Vanguard, U.S. Bureau of Economic Analysis

401(k) Loan Limits Increased from $50,000 or 50% of Vested Account Balance to $100,000 or 100% of Vested Account Balance

In order to qualify for the higher retirement plan loan limits, a loan has to be taken within 180 days of the March 27, 2020 enactment of the CARES Act. Another provision in the bill allows that, if you have a current 401(k) loan, you can delay your loan repayments for up to one year. Just like with the above Coronavirus-Related Distribution (CRD) you have to show that you have been adversely affected by COVID-19 to qualify.

Vanguard's Forecast – A Sharp Contraction, then an Upswing

Due to the COVID-19 economic shutdown we know that Gross Domestic Product (GDP) is going to contract. In Vanguard's forecast (https://advisors.vanguard.com/insights/article/asharpcontractionthenanupswing) they expect consumer spending declined in March and will decline in the months ahead at the sharpest pace since at least World War II - with clear impacts to employment.

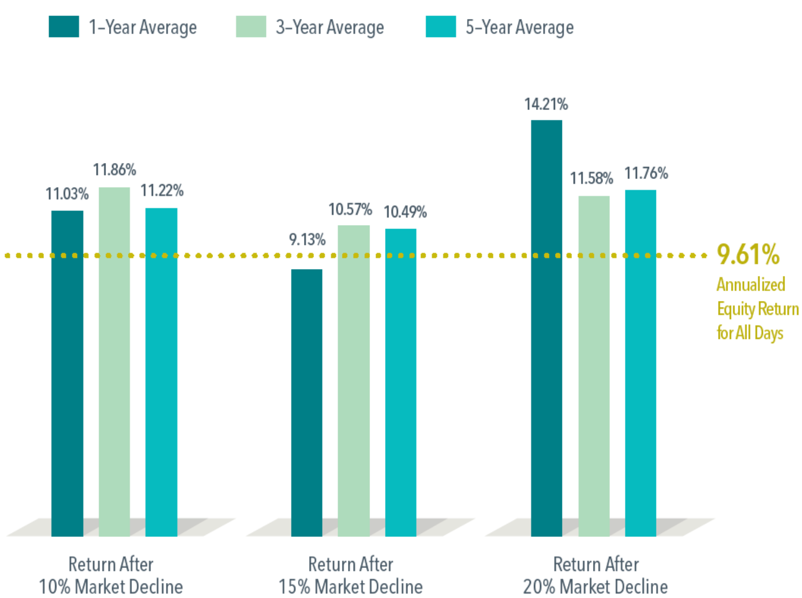
As shown in the illustration above, Vanguard is forecasting that real GDP is likely to decline in the coming quarter by nearly 17% on an annualized basis. This would mark the deepest decline since at least the 1950s. They also predict that this could turn out to be among the shortest recessions in our history, and foresee a rebound in growth in the third quarter to mark the end of this sharp, yet short, recession.

We have seen more pessimistic and more optimistic forecasts than Vanguard's. Time will tell whether their forecast turns out to be accurate, but we feel it is a reasonable one.

US Equity Returns Following Sharp Downturns

Sudden market downturns can be unsettling. Yet, US equity returns following sharp downturns have been positive when taking a historical perspective. Note the following using the graph below which illustrates the performance of a US market index after declines of 10%, 15%, and 20%, since 1926:

US Market Returns July 1926 - December 2019



Source: Dimensional Fund Advisors, Fama/French Total US Market Index

- Stocks have generally delivered strong returns over one, three, and five-year periods following steep declines.
- Just one year from a decline of 10% or 20%, returns were higher than the long-term average of 9.6%. The return after a 15% decline was within half a percentage point of the average.
- Looking three and five years later shows that annualized returns were higher than the long-term average.
- Sticking with your plan and your portfolio allocation helps put you in the best position to capture the market recovery.

The Cost of Trying To Time the Market

The impact of missing just a few of the market's best days can be profound. The graph to the right shows just how profound this is in dollar terms with a hypothetical investment in the S&P 500 stock index.

A hypothetical $1,000 invested January 1, 1970 turns into $121,353 through March 17, 2020.

If you miss the S&P 500's five best days, the return dwindles to $77,056. Miss the 25 best days and the initial $1,000 invested only becomes $26,989 (a missed opportunity of $94,364).

There's no proven way to reliably time the market by investing on the best days or moving to the sidelines to avoid the worst. History argues for staying put through good times and bad.

Staying invested and focused on the long term helps to ensure that you're in the position to capture what the market has to offer. Missing only a few days of strong returns can drastically impact overall performance.

Summary

We will review each of our clients circumstances to determine if it makes sense to change the RMD schedule that is already in place.

The COVID-19 economic contraction and likely recession we are currently experiencing will be pronounced; but with the aggressive fiscal and monetary policy measures already enacted, there is a chance it could be shorter than many expect.

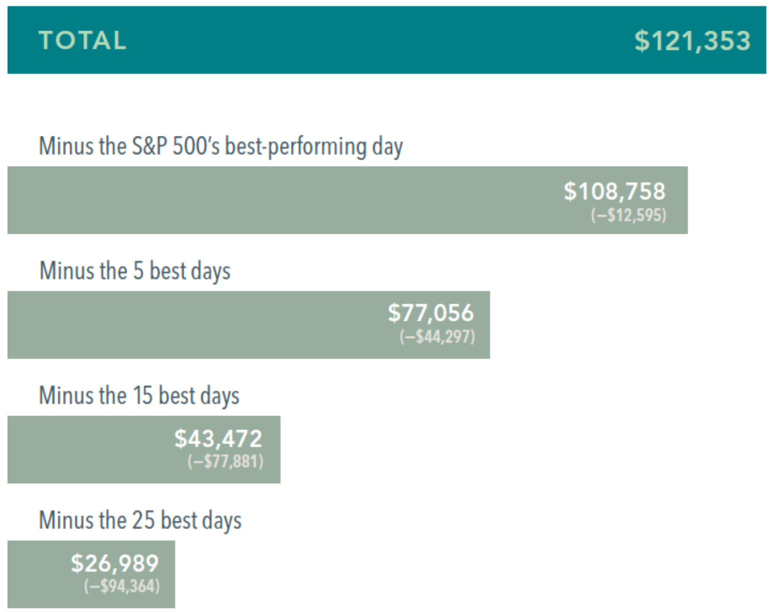
US stock returns following sharp downturns have been positive and now is not the time to panic and sell. Investors are normally rewarded for hanging onto their stock positions and even adding to them during down markets.

At times of crisis there is a strong temptation to "get out", and then move back into the market once the perceived danger has passed. Yet, there is no proven way to successfully get the timing right, and such attempts often increase emotional stress as ones agonizes over when to sell and when to buy.

We advise you to stick with the long-term investment plan and allocation that you have. This is one of the best ways to relieve stress and participate in the eventual recovery.

We hope you and your family are well. Please contact us if you'd like to discuss your investments or any other aspect of your financial life in greater detail.

Hypothetical Growth of $1,000 Invested in US Stocks since 1970



Based on the total return of the S&P 500 from 1/1/1970 to 3/17/2020.

Source: Dimensional Fund Advisors

Past performance is no guarantee of future results. All content in this newsletter is intended as general information, not specific advice. Performance data listed is for illustrative purposes only. Portfolios are personalized and often consider many variables, including investment objectives, age, time horizon, risk tolerance, and tax variables. Information contained herein has been obtained from sources believed reliable, but not guaranteed

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