QUARTERLY NEWSLETTER • **1ST QUARTER 2020**

PRAETORIAN GUARD℠

QUARTERLY NEWSLETTER
1ST QUARTER 2020

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2019 MARKET COMMENTARY

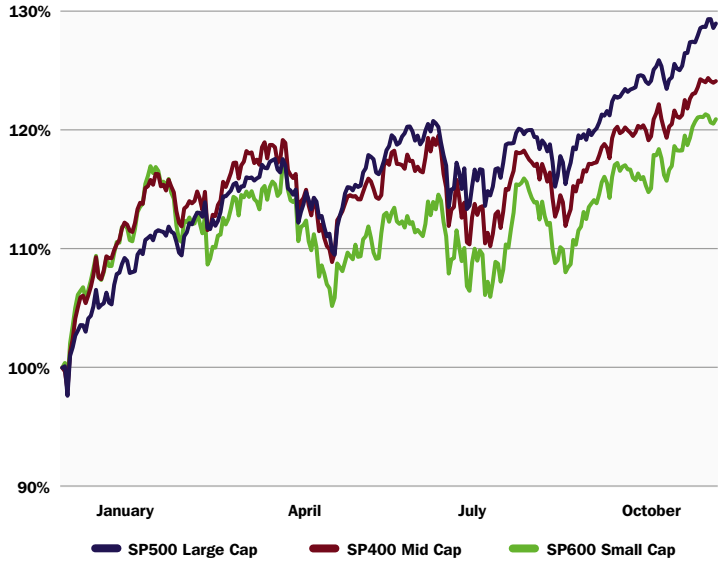
By **Richard A. Hewitt**

U.S. equity markets were all up strongly for the year with the S&P 500 returning 28.8%, mid-caps returning 24.0% and small caps coming in with a 20.8% return. International indices were also positive for the year but lagged the U.S. by a significant degree with developed markets returning 18.4% and emerging markets 15.4%.

The performance of all U.S. stock market indices was positive but as expected throughout the year there were some short-term negative dips. Those negative times stress your ability to focus on the underlying fundamentals that drive market returns and extrapolate a long-term "trend". The 2019 highlights of the U.S. economy include unemployment remaining at historically low levels, positive job growth, and wages increasing at rates well above the past decade. All these factors combined to contribute to consumer spending levels being strong (which is the greatest driver of the U.S. economic engine). Additional information on the state of the U.S. economy is contained in Marc Wehmeyer's article.

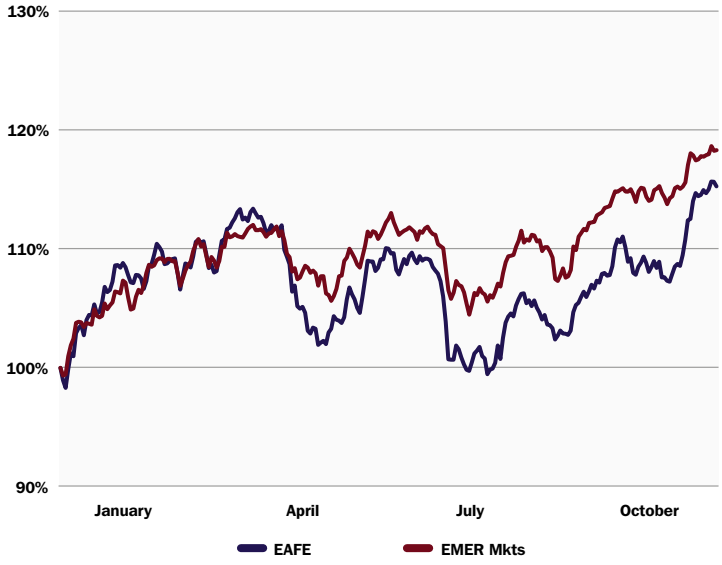
Looking ahead to 2020—it appears a "Phase 1" trade agreement between the U.S. and China will be formally signed in January and the U.S. Mexico Canada Agreement (USMCA) will be ratified—both of those will remove some economic uncertainty and help business investment rebound.

U.S. Equity Market Performance 2019



Source: Yahoo! Finance

International Equity Market Performance 2019



Source: Yahoo! Finance

STRATEGIC METHODS FOR GIFTING

By **Joseph P. Clark**

While many popular gifting strategies involve charities, gifting to family members can be equally rewarding. Here are a couple of strategies that you can use depending on the type of charitable goals you have in mind:

Annual Gift Tax Exclusion – In 2020, $15,000 can be gifted to any individual (without reporting or paperwork) and there is also no reduction in the federal estate and gift exemption amount (currently $11.58 million per person). You can still gift more than $15,000 to one person by filing an IRS Form 709 – the Gift Tax Return. Amounts given over $15,000 begin to reduce the amount you can leave tax-free at death unless you split gifts with your spouse. In this case, you can together give $30,000 (in 2020) without tax, but an IRS Form 709 is required. You can also make unlimited payments directly to medical providers or educational institutions on behalf of others for qualified expenses without incurring a taxable gift or affecting your $15,000 gift exclusion. This method is a great way to assist a loved one with large medical bills from an illness or help pay for a family member's education. This strategy reduces your taxable estate and helps preserve your lifetime exemption.

529 Plan Contributions – Most people are aware of 529 plans that are tax-advantaged savings plans designed to encourage saving for future education costs. However, most people are probably not aware of the 5-year gift tax averaging, where each contributor to a 529 college savings plan can make a lump sum contribution of up to five times the annual gift tax exclusion. A couple can jointly give double this amount. The contributions are treated as though they were spread evenly over a five-year period starting with the current calendar year. The lump sum contribution will use all or part of the annual gift tax exclusion for the beneficiary during the five-year period. Use of the five-year averaging of annual gift tax exclusions for 529 front loading plus gift splitting with a spouse allows a maximum total of $150,000 ($15,000 x 5 years x 2) at one time.

Donor-Advised Funds - The Tax Cuts and Jobs Act of 2017 brought significant changes to the United States tax code. For instance, in 2019 the standard deduction nearly doubled to $12,200 for individuals and $24,400 for married couples. This increase combined with capping the federal deductions of state, local, and property taxes at $10,000 led to nearly a 50% decrease in the number of households opting to itemize deductions. A technique called "bunching" involves consolidating tax-deductible charitable contributions that would normally be made over multiple years into a single tax year. In the consolidated year, the donor contributes to a charitable giving vehicle, such as a donor-advised fund (DAF), and receives an immediate tax deduction through itemizing deductions on his or her federal tax return. The donor would then recommend grants from the donor-advised fund to qualified charities over several years, allowing the donor to utilize the now higher standard deduction in those years. Should this technique interest you, Praetorian Guard has been working with a DAF called American Endowment Foundation since 2006 to help clients receive the maximum tax deduction for their charitable gifts.

Qualified Charitable Contributions (QCDs) – As mentioned in previous newsletters, individuals who are at least 70 ½ years old and subject to Required Minimum Distributions (RMDs) from their Individual Retirement Arrangements (IRAs) can make a distribution directly from their IRA to a qualified charitable organization. The QCD age did not change with the SECURE Act even though the RMD age changed from age 70 ½ to 72. QCDs are tax-free distributions and therefore are not included in the owner's income so they provide the same benefit as an itemized deduction (even if you are not itemizing deductions on your tax return).

One thing to remember about the assets you gift is that your cost basis will transfer over to the recipient. So, if the asset has appreciated in value significantly prior to the gift, the recipient could incur the substantial taxable gain when selling that asset. However, highly appreciated assets received as part of an estate, on the other hand, generally get a "step up" in basis, which means a taxable gain could be avoided if the asset is sold soon after being received.

PRESIDENT'S COMMENTARY

Some amazing events to observe from the past decade: the iPhone 3 to the iPhone 11, U.S. Oil production increasing from 5.5 MBD (Million Barrels Per Day) to 12.9 MBD, the Cubs winning the 2016 World Series, and the S&P 500 nearly tripling from 1,123.58 on Jan 1, 2010 to its close this year at 3,230.78.

The important point to recognize is that technology, applied science, ingenuity and entrepreneurial markets did not stand still for the last 10 years and the pace of change will only accelerate in the decade to come. While the news headlines often frame our challenges as insurmountable and unsolvable, the history of the human race provides a very different track record—we don't lack the ability to address our challenges; instead what we need is a healthy dose of confidence grounded in history that the best way to solve a problem is allowing many creative geniuses and a few "pluggers" to try to develop a solution. History teaches us that at least one will succeed.

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THE POLITICAL AND ECONOMIC OUTLOOK FOR 2020

By **Marc A. Wehmeyer**

"It's the economy, stupid." Although we like to believe that the issues surrounding presidential elections are more complicated than a slogan, Bill Clinton's successful campaign in 1992 demonstrates the power of simple, in-your-face messaging. President Trump has joined Bill Clinton as an "impeached" president and (like him) will almost certainly avoid removal by the Senate. Unlike Clinton, Trump will be running for re-election after being impeached and both the Republicans and the Democrats can be expected to try to spin the situation to their advantage. The factors determining which candidate will ultimately prevail in 2020 are uncertain, but the state of the U.S. economy will once again likely dominate all other considerations, including impeachment.

The U.S. economy continues to motor along as we enter 2020, although at a slower pace than the 2.9% growth rate for 2018. Although official 2019 numbers won't be released until January 30th, the Wall Street Journal Economic Forecasting Survey estimates full year 2019 real Gross Domestic Product (GDP) growth at 2.2% and 2020 real GDP growth at 1.8%. GDP measures the value of all goods and services produced in the economy. Other key indicators continue to show the underlying strength of the economy. The unemployment rate is 3.5%; inflation was 2.1% over the last 12 months; non-farm labor productivity growth – a measure of output per hour – rose 1.5% from the 3rd quarter of 2018 to 2019; and personal consumption expenditures (PCE) rose 1.5% over the last 12 months.

Entering 2019 there was widespread concern the economy could slip into a recession and interest rates fell dramatically, with the yield on the 10-year treasury note falling from 2.69% at the beginning of the year to a low of 1.47% in late summer. Moreover, long-term rates fell below short-term rates resulting in an inverted yield curve, a condition which often precedes recession. In response, the Federal Reserve lowered the target on the federal funds rate – the rate banks charge each other for overnight loans – three times in 2019 from a range of 2.25% – 2.5% down to 1.5% – 1.75%. Since bottoming in late August/early September the yield curve has normalized with the yield on the 10-year Treasury note rising to 1.92% in late December. The open question is whether the U.S economy will experience a "soft landing" of slower economic growth without dipping into a recession.

External factors are the biggest threat to continued short-term growth of the U.S. economy and the usual suspects will be front and center. Despite the promise of an initial trade deal with China and the approval by the House of Representatives of a revised trade agreement with Canada and Mexico, a resumption of trade hostilities would certainly hurt the U.S. economy and President Trump's prospects for re-election. Additionally, the election season will likely be full of twists and turns, and stakeholders in the economy will attempt to handicap the outcome of not only the Presidential race, but control of Congress as well. Regardless of whether the eventual Democratic nominee for President is from the moderate or liberal wing of the party, the general election is likely to be close again. The Democrats should retain control of the House and Republicans should retain control of the Senate. The worst-case scenario for the U.S. economy would be a sweep of the presidency and both houses of Congress by either party.

"IT'S THE ECONOMY, STUPID." ALTHOUGH WE LIKE TO BELIEVE THAT THE ISSUES SURROUNDING PRESIDENTIAL ELECTIONS ARE MORE COMPLICATED THAN A SLOGAN, BILL CLINTON'S SUCCESSFUL CAMPAIGN IN 1992 DEMONSTRATES THE POWER OF SIMPLE, IN-YOUR-FACE MESSAGING.

2020 promises to be another eventful year. With financial markets at or near all-time highs and the economy continuing its record run of economic growth, it is tempting to try to anticipate future events which might derail the bull market and the growth of your investment portfolio. Historically, trying to outsmart the collective markets is hazardous to your financial health. Continuing to make progress towards achieving your financial goals requires exposure to some degree of risk. Feel free to reach out to us if you would like to discuss any aspects of your investment plan and whether we need to make any adjustments for your current situation.

IMPLICATIONS OF THE SECURE ACT'S PASSAGE

By **Richard A. Hewitt**

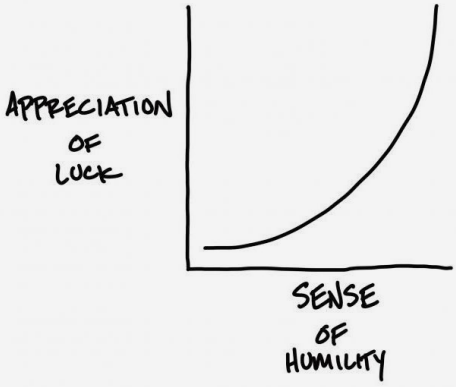
On December 20th, the President signed the SECURE Act, which is the largest change in retirement account laws since 2006. The key points are highlighted here [positives marked by "+" and negatives by "–"]:

+ The age a Traditional IRA account owner must start taking Required Minimum Distributions (RMDs) changed from age 70 ½ to age 72, which impacts account owners who reach age 70 ½ in 2020—they can now delay their first RMD. Account owners who have started RMDs in 2019 or earlier are not impacted.

+ IRA accounts owners who have employment income can contribute to their Traditional IRA regardless of age—it previously was not permitted after age 70 ½. This will also include Spousal IRAs (where one spouse is working and has sufficient income to allow both to contribute). This presents the opportunity for Roth IRA conversions for higher income workers.

– The "Stretch" IRA is dead for IRAs (Traditional and Roth) where the account owner dies after 12/31/2019. Non-Spouse beneficiaries who inherit a Traditional or a Roth IRA no longer can take distributions over their life expectancy. Instead the inherited account must be fully distributed by the 10th year. There is no requirement to make any distributions prior to that, however, it could cause a significant tax liability for a large account. We are still evaluating the various planning recommendations to consider how to adjust to this new law and will have more to say in future newsletters. Spouse beneficiaries can continue to take the account as their own just like the prior law.

LUCK AND HUMILITY



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CLOSING THOUGHT

"What you see depends on what you thought before you looked."

—Eugene Taurman

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