PRAETORIAN GUARD℠

QUARTERLY NEWSLETTER
3RD QUARTER 2020

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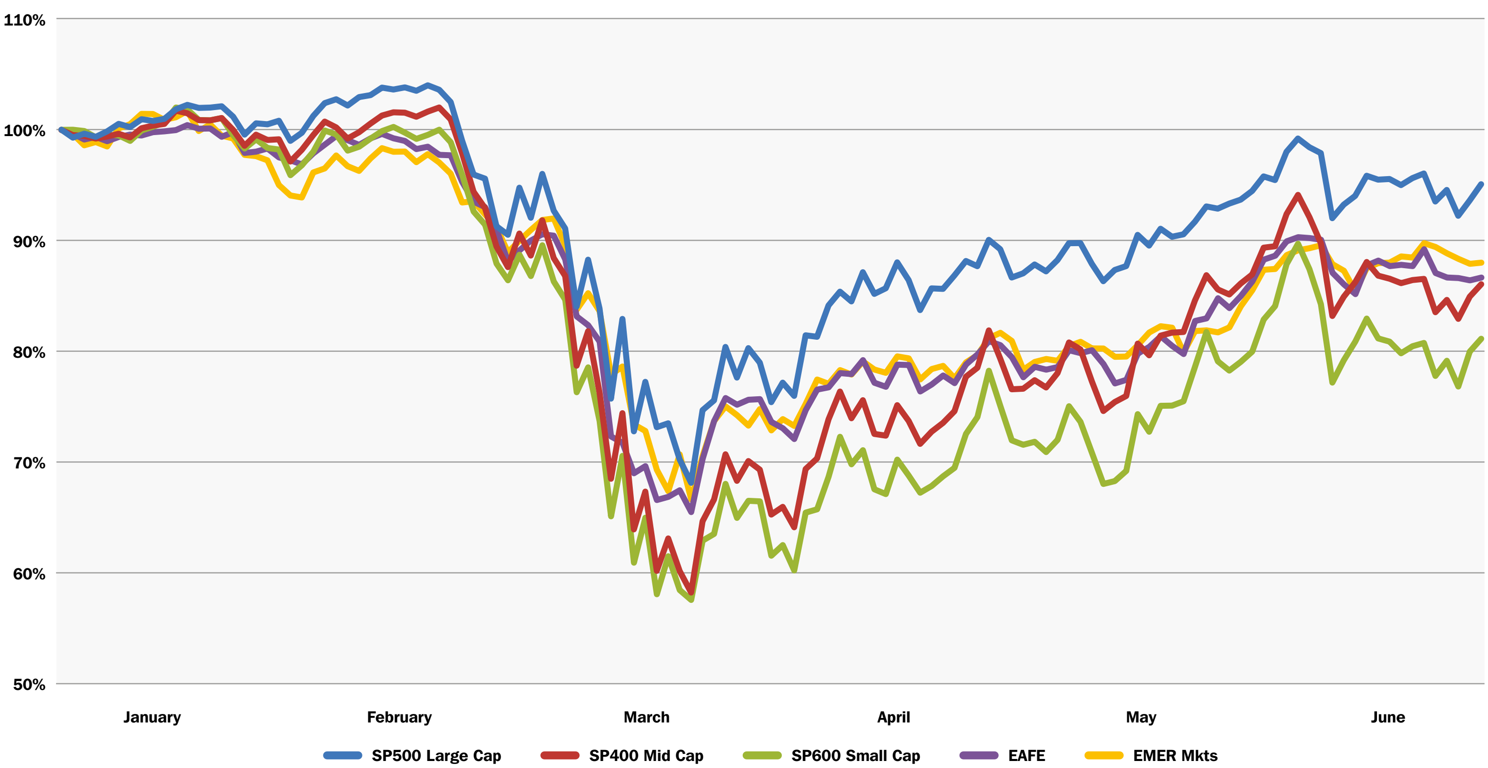
SECOND QUARTER MARKET COMMENTARY

By **Richard A. Hewitt**

From the market lows of March 23rd, we have witnessed a strong rebound in U.S. markets and a recovery in International Markets. U.S. large cap stocks (especially growth stocks such as Amazon and Facebook) have led the charge. While most families with a majority of stock exposure will still be negative for the year to date, the carnage of February and March appears to have been overblown.

Is this "normal"? The more accurate question: is this kind of market fluctuation "not normal"? The answer is that we should never expect to receive the long-term average return *in any single year.* Vanguard updated a study covering the period 1926-2019 and found that in only 6 years (out of 94) was a given annual return within +/- 2% of the average return over that entire period.

2020 U.S. & International Equity Market Performance



Source: Yahoo! Finance

SIGNIFICANT TAX CHANGES FOR 2020

By **Joseph P. Clark**

The government funding bills that passed in December 2019 and the economic stimulus packages enacted in March 2020 have produced a long list of changes to 2020 tax provisions. Many of those changes are minor to include annual inflation adjustments. Other changes are more significant. We wanted to highlight those to improve your understanding and possibly even save you some money next year in April when you file your 2020 return.

1. ***Recovery rebates.*** Most of our clients will not qualify for this rebate, but it is important that you understand it as you may have parents, children, or friends who qualify. Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, most Americans received direct economic recovery rebate payments of $1,200 ($2,400 for couples filing jointly), plus $500 more for each child under age 17. The payments phased out for joint filers with adjusted gross incomes (AGIs) above $150,000 and single filers with AGIs above $75,000. The rebate is an advance payment of a special 2020 tax credit that will be reconciled on the 2020 tax return (i.e. some may get more rebates and some may or may not have to return them).

2. ***Retirement plans.*** There are a lot of changes in 2020 for retirement plans. Most of the changes come from the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which was signed into law late in 2019. We covered many of these changes in our Q1 newsletter, however some of these changes are worth highlighting again since the CARES Act includes a few provisions affecting retirement accounts as well. Both acts significantly impact required minimum distributions (RMDs) from IRA accounts. For example, under the SECURE Act, the beginning age for taking RMDs rises from 70½ to 72. However, the CARES Act allows all seniors (regardless of age) to skip their RMDs in 2020 without penalty. The latter change results in a lower 2020 tax bill and potentially lower 2022 Medicare premiums for those seniors.

3. ***Sick and Family Leave Credits for Self-Employed.*** The Families First Coronavirus Response Act includes tax relief for self-employed people who can't work because of the coronavirus. The law forces many employers to provide paid sick and family leave for workers affected by the virus. However, tax credits against the self-employment tax are also allowed for self-employed people who can't work for a reason that would entitle them to coronavirus-related sick or family leave if he or she was an employee. Employers also get tax credits to help them pay for the paid leave they are required to give their employees.

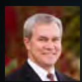
4. ***Student Loan Payments by Employers.*** The CARES Act allows employers to pay down up to $5,250 in workers' college loans in 2020. The payments are excluded from the workers' wages for federal tax purposes. The $5,250 cap applies to both student loan repayment benefits and other educational assistance (e.g., tuition, fees, books, etc.) offered by an employer under current law.

5. ***Medical Expenses.*** The 2020 threshold for deducting medical expenses on Schedule A is 7.5% of AGI. The AGI threshold was slated to jump from 7.5% to 10% after 2018, but the 2019 government funding law revived the 7.5% figure for 2019 and 2020.

6. ***Energy Credits.*** The residential solar credit falls to 26% for 2020, which is down from 30% in 2019. It drops again to 22% next year and ends after 2021. If you were considering utilizing this credit, be aware that the window is closing.

7. ***Alimony deduction.*** The deduction for alimony payments was repealed under the Tax Cuts & Jobs Act of 2017, however the IRS issued clarifying guidance in May 2020. There is no change in it since Jan. 1, 2019. Alimony or separate maintenance payments are not deductible from the income of the payer spouse (or includable in the income of the receiving spouse) if made under a divorce or separation agreement executed after Dec. 31, 2018. The clarification is that generally alimony payments are deductible from the income of the payer spouse and includable in the income of the receiving spouse, if made under a divorce or separation agreement executed on or before Dec. 31, 2018 (even if the agreement was modified after December 31, 2018, unless the modification changes the terms of the alimony or states that alimony payments are not deductible by the payer spouse or includable in the income of the receiving spouse).

THE ECONOMIC LESSONS FROM THE SHUTDOWN OF 2020 & SIGNS OF INCREASING ECONOMIC ACTIVITY



By **Richard A. Hewitt**

It is time for us to pause and look back at what we've learned over the past few months. First, Washington DC can still move quickly if needed to address problems facing the country. Nothing focuses a politician's mind so much as the fear of being blamed for something, especially in an election year. That said, politics has returned to the forefront at the speed of light.

Second, economic incentives matter. Policy and incentives are inseparably intertwined and when legislation is rushed (see above), analysis of incentives is left on the cutting room floor. An example is the additional $600 per week in unemployment benefits from the CARES Act. It made financial and political sense when passed but expires on July 31st. The issue is that for *some* it made not working temporarily more beneficial than returning to work. If extended it should be a *deferred* lump sum payment contingent on returning to work and then paid out.

Lastly, in a nation as large and diverse in terms of population density (from the use of public transportation to a myriad of other factors), any "One Size Fits All" solution will be sub-optimal — governors did a solid job of figuring out what worked. Granted it was by trial and error and imperfect, but no one had prior training on this since even the long-time politicians were not in office during the Spanish Flu of 1918 (although it seems like it).

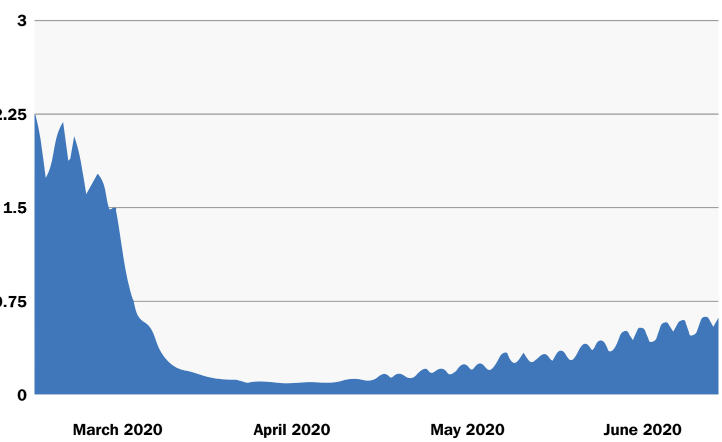
There are several economic statistics confirming greater economic activity than the March 2020 shutdown lows. The first is the amount of Transportation Security Administration (TSA) security checks and the second is U.S. gasoline demand. TSA shows how many of us have started flying again and while we have a *long* way to get back to late February levels, the U.S. traveler is once again taking to the skies.

Second, U.S. gasoline demand confirms what all of us already knew — there are more people venturing out on the roads than three months ago. Gasoline demand has not yet recovered to late February levels but has significantly rebounded. Both indicate that we are less fearful to venture out and spend money. This will only improve as summer turns to fall.

In closing, the best course of action for the next few months is to continue to reopen, protect the most vulnerable (we know who they are now), and handle hot spot outbreaks where they occur (and accept that many of us may ultimately be exposed). Legislatively, an infrastructure bill is being discussed which could be marginally beneficial. However, the closer the election comes, the less likely anything new gets signed into law.

TSA Passenger Throughput

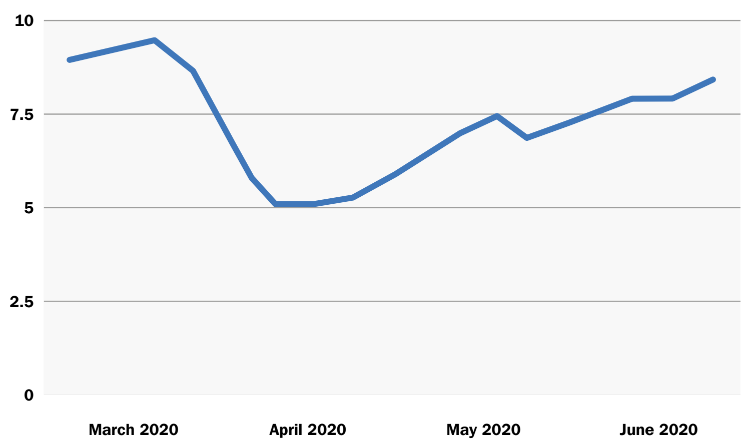
(in millions)



Source: U.S. TSA

Million Barrels Gasoline Per Day

(in millions)



Source: U.S. Energy Information Administration

PRESIDENT'S COMMENTARY

The reopening of the U.S. economy is underway. It is difficult to remember the original task when you are in a swamp (and up to your neck in alligators)—to find the drain plug. Curiously, this applies today. The shutdown was to "flatten the curve" (the drain plug) and not stop the COVID-19 virus from spreading at all (the alligators). As a country, we did that.

Now we are engaged in a new test—our ability to live with uncertainty while at the same time carrying on… because we must. We are not in the throes of a "second wave" but still part of the first. There is a race on between vaccine/treatment development and achieving herd immunity. As I have communicated in the past, the key statistic to focus on is deaths—the one number with the least subjective interpretation, although there is a distinction between dying "of" COVID-19 and dying "with" COVID-19.

Vaccine testing for several candidates has entered or will soon enter Phase 3 testing (and we learn more each week). We will not see another nationwide lockdown if there is a second wave—it would do more economic damage than public health benefit.

LONG-TERM CARE CONSIDERATIONS

By **Marc A. Wehmeyer**

Risk is inherent in all aspects of life. The COVID-19 pandemic has highlighted numerous ones—the medical risk of contracting the virus, economic risk of losing your job, or market risk of a decline in your investment assets. Preparing for the unexpected is part of any financial plan.

We all face the possibility that we may no longer be able to function independently as we get older. According to the U.S. Department of Health and Human Services, approximately 70% of individuals turning 65 today will need some form of long-term care services, which is defined as assistance with one or more of the activities of daily living (ADLs): bathing, dressing, toileting, transferring (to or from a chair or bed), eating, and maintaining continence. The risk is higher for women than men on average because they tend to live longer. Additionally, the risk is higher for individuals living alone.

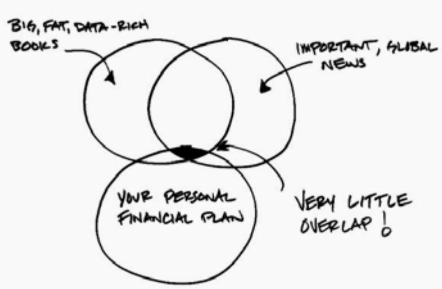
Unfortunately, long-term care is expensive. The nationwide annual median cost for nursing home care in a private room was $102,200 in 2019. You can look up the cost of care where you live using Genworth's Cost of Care Survey tool at www.genworth.com/aging-and-you/finances/cost-of-care.html. Complicating things further, it is impossible to know in advance how long you might need long-term care services.

There are four basic ways we can treat any risk—avoid, reduce, retain, or transfer it. The risk of needing long-term care is effectively unavoidable. You could possibly reduce your exposure by staying active, keeping up with your preventative medical care, eating well, and building and maintaining a strong network of family and friends. Even with taking steps to reduce the risk, you will retain some amount of long-term care risk. The primary way we decrease the retained risk is to transfer some of it to an insurance company.

There are four basic options for protecting against the costs of a long-term care event—self-insurance, a dedicated long-term care policy, hybrid insurance, and life insurance with a long-term care rider. The default option is to self-insure, retain the risk, and pay for any needed long-term care costs out of existing assets. Any long-term care costs would be partially offset by lower expenses in other spending categories such as travel, transportation, dining out, and entertainment. Traditional long-term care policies are less common now than they were in the past. Most policies provide benefits if the insured needs help with two of the six ADLs or has cognitive impairment, typically after a waiting period. Many insurers have stopped issuing policies as the cost of servicing claims have exceeded insurer expectations. A significant downside of traditional long-term care insurance is that policyholders may face premium increases prior to experiencing a long-term care event and policies can be cancelled if you can't keep up with the payments. Hybrid insurance was developed in part to overcome the possibility of rate hikes. Hybrid policies are normally part of a life-insurance policy that provides extra coverage for long-term care, potentially exceeding the value of the death benefit. One of the benefits of a hybrid policy is that the premiums do not increase. They also provide a death benefit if you don't end up needing long-term care (unlike traditional long-term care policies). Separately, some life insurance policies can also be purchased with a long-term care rider that allows you to access a portion of the death benefit early if you need long-term care.

There is no one right answer for protecting yourself against the possibility of a long-term care event and the associated costs. Everyone's situation and circumstances are different, as are all the competing protection options. One thing you can do to reduce the uncertainty surrounding long-term care is to discuss the topic with your loved ones to share your expectations and concerns. You could potentially avoid a crisis by building consensus and developing a plan ahead of time. If you would like to discuss the details of how a long-term care event might impact you and how you can plan for the risk, we would be happy to discuss your options.

IT DOESN'T MATTER



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CLOSING THOUGHT

"The greatest good we can do our country is to heal its party divisions and make them one people."

— ***Thomas Jefferson***

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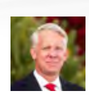

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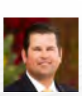

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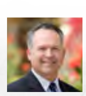

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