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QUARTERLY NEWSLETTER
4TH QUARTER 2021

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3RD QUARTER 2021 MARKETS & ECONOMY DISCUSSION

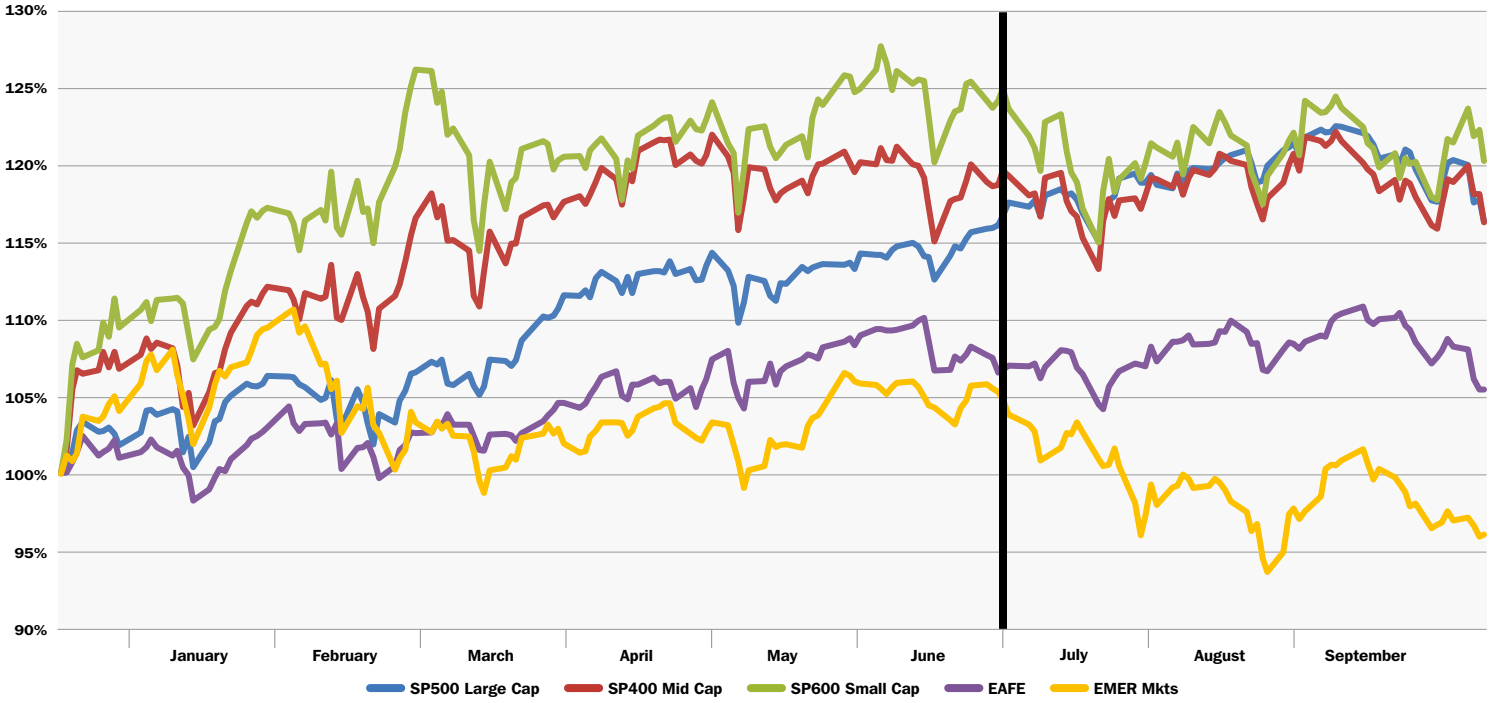
By **Richard A. Hewitt**

Markets in the United States were generally flat to slightly negative for this quarter. Only the S&P 500 Large Cap had positive returns while both Mid and Small Cap indices were down slightly. We believe this is a function of the impact of the Delta variant of COVID-19—which slowed down the recovery that was well under way in June. It is clear by the graph below that the recovery took a pause during Q3. We believe the worst of the Delta variant is behind us.

There are many headwinds impacting markets in the near-term. Most worrisome is the unknown status of legislation in Congress that will impact both personal and corporate tax rates. As stock prices are an estimate of discounted future earnings, until we know the tax rates, brackets and related phaseouts, the future is not as clear as anyone would prefer. The second big hurdle is inflation—after more than a decade when the U.S. Federal Reserve could not hit its target of 2% annual inflation, we are now experiencing price increases in almost every sector of the economy.

There is discussion that some of this inflation will be "transitory" but most of it will not be. The Federal Reserve needs to raise interest rates sooner rather than later; remember, we are starting from a Fed Funds Target rate of 0.25%. *(continued on pg. 4)*

2021 U.S. & International Equity Market Performance



Source: Yahoo! Finance

INTRODUCTION TO 72(t) DISTRIBUTIONS

By **Marc A. Wehmeyer**

59 ½. That's the age when you can start withdrawing funds from an Individual Retirement Arrangement (IRA) (sometimes referred to as Individual Retirement Accounts) without having to pay a 10% early distribution penalty. In most circumstances it doesn't make sense to tap your IRAs prior to turning 59 ½, especially if you are still working. In addition to the 10% penalty, the full amount of the distribution will be taxed as ordinary income if taken from Traditional IRA funded completely with pre-tax dollars.

However, you may find yourself in a situation where you are less than 59 ½ and the assets you have accumulated in your Traditional IRA could make a meaningful difference in your life. Maybe you are retiring earlier than planned. If only you could access them and avoid the 10% penalty.

There is a provision of the Internal Revenue Code called Section 72(t) that covers an exception to the 10% penalty for Substantially Equal Periodic Payments (SEPP) based on life expectancy. When you start a SEPP program, you must withdraw money from your Traditional IRA for a minimum of five years, or until you reach 59 ½, whichever is later. The only exceptions to the 5-years/age 59 ½ rule are death, disability, and depletion of the account. There is no minimum age to initiate SEPP payments. The IRS provides three approved methods for determining your SEPP payment amounts. All are based on life expectancy.

The first method is called the Required Minimum Distribution (RMD) method and the annual payment for each year is determined by your life expectancy based on your current age and the account balance. The annual payment will vary from year to year. The RMD method produces the smallest annual payment to start out.

The second method is called the fixed amortization method. In this method the annual payment is calculated using your life expectancy, the account balance, and an acceptable interest rate. Once the annual payment is determined for the first distribution, the payment for subsequent years is the same.

The third method is called the fixed annuitization method. In this method the annual payment is calculated using an annuity factor that is determined by your life expectancy, the account balance, and an acceptable interest rate. Like the fixed amortization method, the payments remain the same for subsequent years once the annual payment is determined for the first year.

If you start with the fixed amortization or fixed annuitization method, you can make a one-time irrevocable change to the RMD method. You can also separate your IRA assets into multiple accounts and then calculate and take SEPP distributions from just one IRA that is a subset of your overall IRA assets.

If you are thinking this all sounds complicated, you are right and the penalties for making a mistake are substantial. If you fail to take one of your scheduled 72(t) distributions or modify the payment amounts, you no longer qualify for the exception to the 10% penalty and all your distributions since you started the plan would be subject to the 10% tax plus interest. *(continued on pg. 4)*

POLITICAL AND ECONOMIC ENVIRONMENT

By **Richard A. Hewitt**

It is clear from my commentary that politicians are once again on my "other" list. As I write, the Congress is considering a reconciliation package stated to be a "mere" $3.5 Trillion dollars—but that number is artificially low by at least 50% based on a 10-year budgeting window and inside the beltway math (which is fuzzier than Enron math). Included in this proposed package are a host of non-budget items best described as shooting at a few but hitting us all. An example is the backdoor Roth IRA. It is currently a legal means for higher income savers to make after-tax contributions to a traditional IRA and then convert to a Roth. Because Peter Thiel (Paypal co-founder) used the legal rules in the late 1990s, savers who are clearly not billionaires will have a great saving option taken away from them. The Alternative Minimum Tax was signed into law in 1969 and was largely due to 155 households not paying taxes. If you want to fix the Peter Thiel issue, a one sentence statement in the legislation could read: "Pre-IPO shares will be valued at cost for the owner and all beneficiaries."

Diatribe finished. What can we expect from the reconciliation? First, it is likely but not assured that it will take place. Right now the two most powerful politicians in the nation may be SEN Joe Manchin of WV and SEN Kyrsten Sinema of AZ. What they decide to accept is what will happen. Thus, the exemption equivalent for the estate tax will be reduced to at most $5.5 million per person, twice that for married taxpayers and portability will remain. Marginal tax rates at the upper end will return to the 2016 levels of 39.6% and capital gains tax rates will stay below 30%. Corporate tax rates (for C Corps) rise from 21% to 26-28% but not above that level.

Many of the social programs desired by the Democrat Party will get started so we predict a reprise of the wars over the Affordable Care Act that will go on and on. So called green energy programs will be harmful to those on the lower end of the income scale as prices rise (see California or Germany for a preview of coming attractions) as lower income individuals pay a much larger percentage of their income on energy. Sadly, this effort won't do much for reducing carbon emissions.

The immediate threat of a Government shutdown has passed as Congress has passed funding until December 3rd. We expect a shutdown at that time has a low probability of happening as Congress does not like to star in the role of the Grinch. However, there will be some inside the Beltway posturing and then it will get addressed as it always does for a period likely past the 2022 midterm elections. It is an artificial drama that has all the excitement of Elizabeth Taylor's 8th wedding night.

KEY STEPS TO BUILDING A SOLID ESTATE PLAN

By **Joseph P. Clark**

Your estate plan is much more likely to be successful when you avoid the most common mistakes and implement some essential elements. You already know a complete plan is needed and it should be reviewed periodically, especially when there are major changes in your situation. You also know the plan should include: a will, durable power of attorney for health care, durable power of attorney for finance, and an advance medical directive. However, here are some additional steps that you should also take:

1. Simplify and organize the plan. Not making the plan easy for your executor can result in extra time and money to settle the estate. Ensure that the executor knows the details of the estate's assets and liabilities and where to find the necessary documents. We also should be simplifying and streamlining our estates as we age, which makes the estate settlement process faster and less expensive.

2. Understand the plan. Few people really understand the major components of their estate plans, and that can lead to failure. Estate planners are able and willing to explain a plan so the basics are understood. Clients should not hesitate to ask the planner questions or explain things in more detail and should also take notes for review later. Often people understand an explanation of the components of the plan but don't retain that knowledge later when they must implement the plan.

3. Communicate with your heirs. A major reason some estate plans aren't successful is that the next generation isn't prepared, which often results in waste or mismanagement of the assets. One option to reduce that risk is to leave the estate in trusts, where trustees manage the wealth and control distributions. An even better solution is to ensure the children have a basic knowledge of and are comfortable with how much money they're likely to inherit. Children also benefit from knowing their parents' philosophy about managing, accumulating, spending, and giving money. Heirs must understand the property, your intentions for it, and how to manage it.

4. Prepare for potential family conflicts. Family conflicts are often contained while the parents are alive, but they can surface once one or both parents pass. Often the details of the estate plan itself cause or worsen family conflicts. Some clients create conflicts by committing the mistake of having siblings with different personalities or philosophies jointly inherit property. Your estate plan can help bring your family together or cause major family unrest so it is important to plan ahead for conflict that may arise.

5. Make strategic gifts. Gifts are a key ingredient of an estate plan, and they can be a great way for the next generation to become comfortable handling wealth. Rather than simply gifting cash, develop a strategy that will maximize the impact of your gifts. Cash gifts tend to be spent quickly, while property gifts are more likely to be kept and held for the future. Consider tax efficiency when deciding which property to gift as that is key to maximizing the family's after-tax wealth.

6. Fund living trusts. A common estate planning mistake is failing to fund a revocable living trust. The trust is created to avoid the process of going through probate and establish a process under which assets will be managed in case of disability or death. However, a living trust is ineffective if it isn't given legal title to assets. A critical step is transferring legal ownership of assets to the trust, and many people overlook it. Real estate is transferred to the trust by changing the deed. Financial accounts need their titles changed, and each financial institution has its own process. People spend a lot of money having living trusts created but not enough time transferring assets to the trusts, and most assets that aren't in the living trust must go through the probate process.

7. Be specific in naming beneficiaries. Don't assume your primary beneficiary will be around by the time your estate plan takes effect. Name contingent beneficiaries to receive your assets. Consider selecting "per stirpes" which will allow assets to pass to the next generation as desired. This is on many beneficiary forms. Per stirpes means that in the event the beneficiary you name predeceases you, the share he or she would have received goes to his or her heirs. This is a great way to keep those assets in that branch of the family if that is your intent.

8. Establish a business succession plan. Few businesses survive the second generation of owners because most business owners don't have an adequate succession plan. The value of a small business declines rapidly when the owner departs without a firm succession plan in place. A succession plan specifies who will run the business, who will own it, and when the transitions will occur. If no one in your family wants to run the business, the succession plan should lay out a plan for the business to be sold when you retire or pass away. Either way, the business must be managed (and structured) so it is ready for a sale or inheritance.

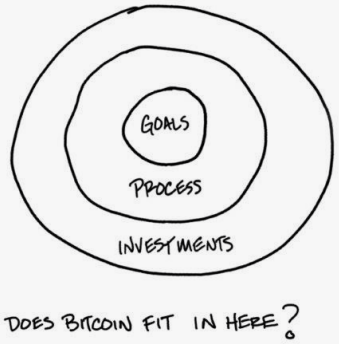
If you take these key steps and avoid the common pitfalls of estate planning, your estate plan is much more likely to be successful in distributing the assets in the time and manner you intend.

PRESIDENT'S COMMENTARY

"WE AS A NATION SHOULD DEMAND BETTER FROM OUR ELECTED AND APPOINTED LEADERSHIP."

To be frank, this past quarter was a train wreck. From the Delta variant of COVID-19 rearing its ugly head to the debacle in Afghanistan, I am reminded of Casey Stengel's 1962 question regarding the inaugural NY Mets' season: Can't anybody here play this game? We as a nation should demand better from our elected and appointed leadership. I'm an optimist but unless both sides of the electorate hold politicians accountable, we are in for a rough period until the innate goodness of the American people take on the task of cleaning up the mess. It is past time to reroute the political rivers through Washington—the professionals have made a mess of it so let's find some people who have started a business, met payroll, dealt with Government regulations and survived.

GOALS PROCESS INVESTMENTS



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3RD QUARTER 2021 MARKETS & ECONOMY DISCUSSION (CONTINUED FROM PAGE 1)

The Fed has two mandates: full employment and price stability. Markets would like to see a clear signal from the Fed that the latter is more important as we continue to navigate our way back to normality.

As we head into the 4th Quarter, some of the legislation issues will become known along with the timing of when different tax aspects become binding. We expect markets will continue to be more volatile in the last quarter of 2021 and after the initial reaction to any bill passing, we can return to the larger driving force of renewed economic activity. Johns Hopkins data shows weekly case levels appear to have peaked on September 5th and are trending down to some 800K cases/week. This is positive and among the most important harbingers of future economic recovery.

INTRODUCTION TO 72(t) DISTRIBUTIONS (CONTINUED FROM PAGE 1)

Modifications include adding new funds to the account either through rollovers or contributions, or by taking extra withdrawals beyond the annual SEPP payments.

There are additional details and caveats to SEPP payments that go beyond the scope of this article. If you are interested in finding out more about SEPP payments and whether they might make sense in your situation, please reach out to us to initiate a discussion which would include consulting your tax professional as part of the conversation.

CLOSING THOUGHT

"Life is short, and you don't have time to figure everything out on your own. The wisdom of the past was hard-earned, and your dead ancestors may have something useful to tell you."

—Jordan Peterson

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