BKMWM Newsletter April 2021

Topics:

1. Pandemic Markets
2. Inflation
3. Housing Market
4. 2020 Retirement Contribution Reminders

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BKM WEALTH MANAGEMENT

1) Pandemic Markets – Lessons Learned

About a year ago the stock market (as measured by the S&P 500 Index) dropped roughly 34% in just over a month. 30 days later it was up 32% from the low point, and now nearly 12 months later it's up over 76% from that same low point. The rally didn't start when the vaccines were announced. Instead, it started while grocery store shelves were empty and city streets were eerily quiet. For investors we believe that there are lessons to be learned from the past year.

Lesson 1: Timing the market is a fool's errand

Investors who sold stocks in mid-March of last year missed out on potential recovery of 76%[1]. In fact, missing just five days last year could have cost investors 30%.[2] Time in the market matters more than timing the market. Have an investment plan with a target allocation and the discipline to stick to it. If stocks drop and pull your allocation below your target, consider buying more. If stocks rise and push your allocation above your target, consider trimming.

Lesson 2: The stock market is forward looking

Stock prices don't typically reflect what's currently happening with a company or in the economy. Instead, they reflect investors' collective predictions of what will happen in the future. When stocks crashed last spring they eventually got down to the point where forward looking investors started buying. In late March, stock prices began to rise. It wasn't a reflection of what was happening in that moment. It was a forward looking indication of what might happen months later.

Lesson 3: Diversify

When the future looks uncertain it can be tempting to hide out in your favorite sector such as cash, commodities, real estate, utility stocks, bonds, etc. However, a diversified allocation remains prudent and 2020 helped reinforce it. "Safe havens" such as commodities and utilities were down 3.1% and up just 0.52% respectively last year. Meanwhile, it would have been difficult to stomach the volatility of a portfolio of small cap stocks, but they were up 20%. Instead of concentrating, we encourage investors to diversify. A blend of stocks, bonds, real estate, commodities and cash might have returned 8-16% last year.[3]

Sources: 1) S&P 500 Global Market Intelligence. 2) Bloomberg, "Hazards of Ill-Timing". 07/03/2020. 3) Wells Fargo Investment Institute CAR 0121-01567

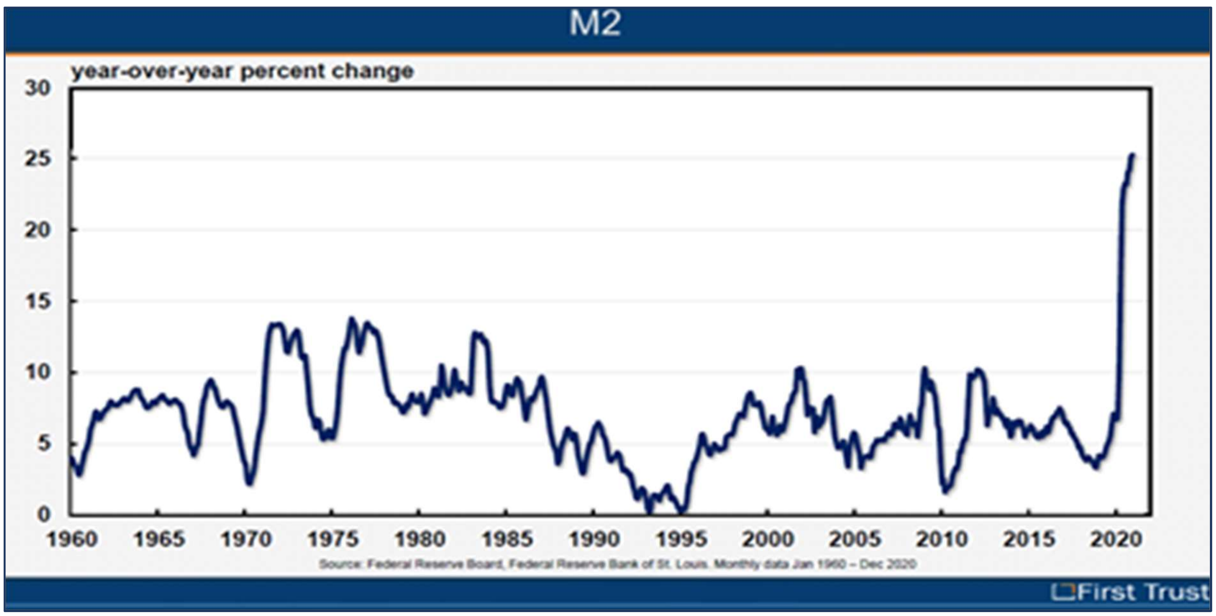
2) Inflation

One of the concerns on the minds of investors, economists and even the Federal Reserve these days is inflation. Inflation is the rate at which the price of goods and services goes up as the value of currency goes down. It is considered a natural consequence of economic growth over time, and many economists consider a “healthy” inflation rate to be around 2% per year. Inflation can occur as the result of a multitude of factors, but most often stems from an abundance of money in circulation.

The trepidation at hand for some stems from a potentially looming consonance of inflation-driving circumstances. Sharply rising interest rates, the levee breaking of pent up consumer spending as the world emerges from the pandemic, and the virtually unprecedented injection of money into the economy are each inflationary catalysts that could come together to drive acute inflation.

The likelihood of persistently high inflation has become a contentious issue between economists who vary in how they view the glut of money supply. Adherents of traditional Milton Friedman economics suggest that inflation is closely linked to monetary supply. While more modern leaning economists – supported by Federal Reserve (Fed) Chairman Powell – suggest that the relationship between money supply and inflation is broken, and high money supply is not necessarily correlated to inflation.

The following chart displays just how extreme the recent increase in money has been. M2 is a measure of the amount of money “out there,” inclusive of currency, checkable deposits, and savings or money market accounts and funds.



The disagreement among economists essentially started during the financial crisis. Central banks (like our Fed) in many countries began a level of monetary manipulation that had never been seen before, with extensive quantitative easing and other endeavors aimed at stimulating growth. The result has been a 15 year experiment testing Modern Monetary Theory (MMT). MMT suggests that governments and central banks can safely control economies through money creation (i.e.-stimulus and quantitative easing), while carrying much higher debt balances than would be traditionally palatable. The potential risk to freely printing and disseminating money is inflation.

Perpetual stimulus can work as long as the Fed has tools to control it. The two levers in the Fed’s toolbox are their control of interest rates and their control of the money supply through the issuance or repurchasing of government Treasuries. What currently has eyebrows raised is the thought that the Fed could actually run out of tools, getting caught between interest rates having nowhere lower to go on the one side, and being unable to raise interest rates quickly enough to head off inflation on the other, all the while being handcuffed in their ability to pump new money into the economy following more than a decade of unprecedented stimulus and spending.

Looking ahead, this will be something to keep an eye on given the recent spikes in interest rates. The Fed is now charged with the difficult task of prognosticating the economic trends of the coming months and carefully walking in lock step with interest rates and other market trends. While we believe it remains unlikely that we will see a damaging level of persistent inflation, we will remain diligent.

3) Housing Market

Many clients who own their homes have seen their house values increase significantly over the past decade. While these values help increase your net worth, they do not improve your retirement income unless you plan to one day downsize to convert this increase in value into spendable cash. This is why we often inquire about your estimated home value but do not incorporate the value into the planning process other than to estimate your net worth or for estate purposes.

Lately, home price appreciation and home upgrades have been a topic of interest among clients. The fact is, since 1891, U.S. home prices have increased just 3.2% per year before inflation (nominal) and 0.3% after inflation (real).

U.S. National Home Price Changes (1891- 2019)

Year	Nominal	Real	Year	Nominal	Real	Year	Nominal	Real	Year	Nominal	Real	Year	Nominal	Real
1891	-10%	-12%	1917	2%	-16%	1943	11%	8%	1969	7%	1%	1995	2%	-1%
1892	2%	8%	1918	6%	-14%	1944	17%	14%	1970	8%	3%	1996	2%	-1%
1893	4%	-4%	1919	10%	-5%	1945	12%	10%	1971	4%	1%	1997	4%	2%
1894	17%	30%	1920	10%	7%	1946	24%	6%	1972	3%	0%	1998	6%	5%
1895	-9%	-5%	1921	-2%	9%	1947	21%	12%	1973	3%	-6%	1999	8%	5%
1896	-13%	-15%	1922	1%	4%	1948	2%	-1%	1974	10%	-2%	2000	9%	6%
1897	3%	6%	1923	1%	-1%	1949	0%	2%	1975	7%	0%	2001	7%	5%
1898	6%	4%	1924	0%	0%	1950	4%	-2%	1976	8%	3%	2002	10%	7%
1899	-4%	-6%	1925	5%	2%	1951	6%	0%	1977	15%	8%	2003	10%	8%
1900	14%	-3%	1926	-4%	-3%	1952	4%	3%	1978	16%	7%	2004	14%	10%
1901	-16%	-14%	1927	-4%	-1%	1953	12%	11%	1979	14%	0%	2005	14%	10%
1902	18%	15%	1928	1%	3%	1954	1%	1%	1980	7%	-5%	2006	2%	-1%
1903	2%	-8%	1929	-2%	-3%	1955	0%	0%	1981	5%	-4%	2007	-5%	-10%
1904	5%	9%	1930	-4%	2%	1956	1%	-2%	1982	1%	-3%	2008	-12%	-12%
1905	-12%	-15%	1931	-8%	1%	1957	3%	0%	1983	5%	1%	2009	-4%	-7%
1906	19%	19%	1932	-10%	0%	1958	1%	-1%	1984	5%	1%	2010	-4%	-6%
1907	10%	6%	1933	-4%	-5%	1959	0%	-1%	1985	7%	4%	2011	-4%	-7%
1908	-10%	-8%	1934	3%	1%	1960	1%	-1%	1986	10%	8%	2012	6%	5%
1909	-2%	-6%	1935	10%	7%	1961	1%	0%	1987	8%	4%	2013	11%	9%
1910	8%	-3%	1936	3%	2%	1962	0%	-1%	1988	7%	3%	2014	5%	4%
1911	-2%	4%	1937	3%	0%	1963	2%	0%	1989	4%	0%	2015	5%	5%
1912	4%	5%	1938	-1%	2%	1964	1%	0%	1990	-1%	-7%	2016	5%	3%
1913	0%	-7%	1939	-1%	-1%	1965	2%	0%	1991	0%	-3%	2017	6%	4%
1914	4%	3%	1940	3%	3%	1966	1%	-2%	1992	1%	-2%	2018	5%	3%
1915	-8%	-10%	1941	-8%	-18%	1967	2%	-1%	1993	2%	-1%	2019	4%	1%
1916	9%	-3%	1942	3%	-6%	1968	4%	-1%	1994	3%	0%	**Ann.**	**3.2%**	**0.3%**

COMPOUND **Data Sources: S&P/Case-Shiller, BLS** @CharlieBilello

Over long periods of time, there is a correlation between inflation and home prices. However, we need to remember that there are periods of time where home prices can also fall. Those who claim their homes have been their best investment often fail to factor in the many carrying costs associated with home ownership (mortgage interest, taxes, repairs, maintenance, etc.). Consumer spending tends to rise when home prices rise. This can lead to illogical spending and ill-advised home upgrades. It may feel good that your home price has appreciated, but it is important to keep it in perspective. Please call us to discuss how your home value factors into your retirement plan.

4) 2020 Retirement Contribution Reminders:

- May 17th is the last day to establish and/or make contributions for 2020 in a Traditional IRA, Roth IRA, Coverdell Education Savings Account, or Wisconsin 529 Savings Plan.

- Employer contributions to SEP IRAs, SIMPLE IRAs and Profit Sharing Plans can be made until the tax filing deadline including extensions.

- Traditional IRA deductibility limits:
  - If neither individual nor spouse is a participant in another plan: $6,000* maximum deduction
  - If the individual is an active participant in another plan:

Married/joint MAGI	Single MAGI	Deduction
Up to $105,000	Up to $66,000	$6,000
$105,000-$125,000	$66,000-$76,000	Phased out
Over $125,000	Over $76,000	$0

-If a spouse (working or nonworking) is not covered by a retirement plan but his or her spouse is covered, the spouse who is not covered is allowed full deductibility up to $198,000 joint MAGI, phased out at $208,000 joint modified adjusted gross income (MAGI).
-Maximum deduction is $7,000 if age 50 or older.
-Note: Phase-out for married filing separately is $0–$10,000.

- Roth IRA contribution income limits:

Married/joint MAGI	Single MAGI	Max. Contribution
Up to $198,000	Up to $125,000	$6,000
$198,000-$208,000	$125,000-$140,000	Limited
Over $208,000	Over $140,000	Cannot Contribute

-Contributions to Roth IRAs are not tax deductible; however, qualified distributions may be tax-free.

- Catch-up contributions to both Traditional and Roth IRAs for those age 50 and over is an additional $1,000.

Source: https://www.irs.gov/publications/p590a

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