POLARIS ADVISORS, LLC.

THE Retirement Report

Retirement Transition Planning

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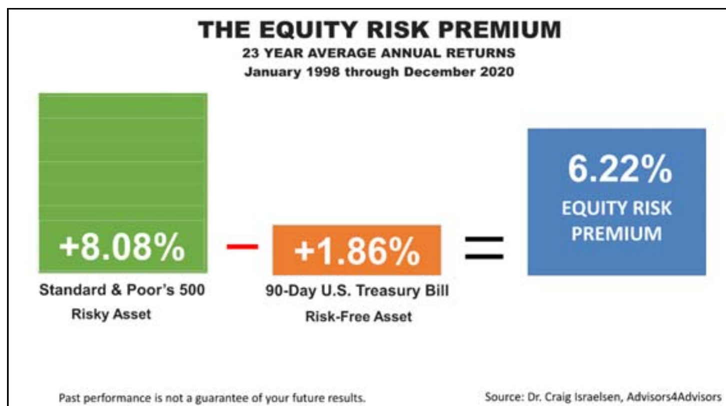
Equity Risk Premium Grew Wider And More Important

Modern portfolio theory (MPT) holds that investors get paid extra return for taking risk. The concept is simple but can be hard to implement without coaching and education, and it grew more important lately: Investors who take equity risk expect to earn extra return.



To quantify the risk premium of stocks – the amount you get paid for owning a risky asset, according to modern investment theory – here are the numbers: Over the 23 years ended December 31, 2020, the risk-free 90-day U.S. Treasury bill averaged an annual return of 1.86%, compared to the 8.08% annualized return on the Standard & Poor's (S&P 500) stock index. By subtracting the 1.86% return of the risk-free asset from the 8.08%, the resulting 6.22% annually earned on stocks over the boom-and-bust cycles since 1998 represents the equity risk premium.

To be clear, owning stocks through the tech bubble in 2000, the financial crisis in 2008 and 2009, and the Covid bear market rewarded investors with a premium of 622 basis points over what they would have earned by investing in a risk-free 90-day Treasury.

The equity risk premium flattened considerably in the last quarter, moving from 5.75% to 6.22%, as the return on stocks improved while the 90-day Treasury bill remained incredibly low. Low Treasury bill rates and the $900 million federal economic stimulus and relief aid enacted in December have created a mountain of cash, driving up stock prices.

The following chart better illustrates the risky aspect of the equity risk premium. The red data series shows the daily changes in the stock market prices, as represented by the S&P 500. Big one-day drops of between -3% and -5% are not uncommon in recent months, and, earlier in 2020, stocks plunged -12% in a single-day! So, indeed, earning the equity-risk premium is hard and scary at times. Armed with these kinds of statistics, which show that big plunges do come frequently, may make it easier to withstand the uncertain times.

As always, the current outlook is fraught with fear. New Covid variants threaten the effectiveness of vaccines;

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The Risk In The Equity Risk Premium

Last quarter, our newsletter addressed the concept of the "equity risk premium." (That's the average earnings that stocks return over what bonds return.) It does so again this quarter, about one year removed from the COVID-19-related market drop last spring. Since then, markets are substantially up again.

The return of our most common benchmark (moderately conservative) for the year ending March 24, 2021, is 26¼%. Many of our clients' accounts actually exceeded that. As dramatic as this seems, it's always good to remember that markets can go both ways. Our 26+% gain comes shortly after stock indexes lost 12% in one day.

At times like these, when the prices of stocks and houses are rising and speculators are rampant in the markets (as evidenced by the "GameStock" debacle), it's good to keep a long-term perspective. A twelve-month period with highs and lows ranging from negative 12% to positive 26% clearly indicates why the term "equity risk premium" contains the word "risk." On the other hand, that swing hardly affected the long-term returns of approximately 6% to 7% earned by most clients who've been with us since 2003.

We manage this risk with a mix of stocks and bonds, plus holdings of cash, all designed to carry us through market downturns. There's no doubt that price volatility in the markets has recently increased, but that doesn't mean we need to give up our equity risk premium of approximately 6% going forward.

Stay well,

Ric and Trang

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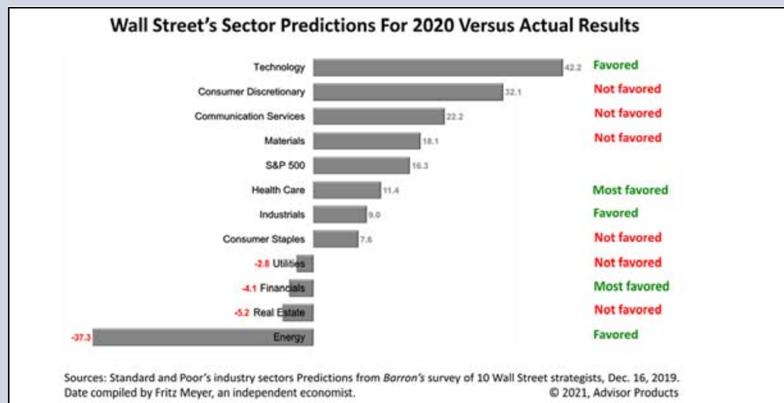
An Important Investment Idea To Remember In 2021

Just before the beginning of every year, 10 top Wall Street investment strategists are asked by *Barron's*, the century-old financial magazine, to predict which industry sectors will outperform and underperform the Standard & Poor's 500 stock index for the year ahead.



Fritz Meyer, an independent economist, whose content is licensed by this firm, has tracked the results of Wall Street's predictions in *Barron's* every year since 2007, based on the Barron's survey of Wall Street's top strategists. The accompanying infographics show Wall Street's inconsistent results for the 12 months ended Dec. 31, 2020.

In Dec. 2019, nine of the 10 strategists said financials would outperform. Sounds like a sure thing? Nope! Financial stocks lost 4% in 2020. That's a major miss, considering the S&P 500 – which is comprised of the 10 industry sectors, shot up by 16.3% in 2020.

Similarly, stocks benefiting from increased discretionary spending by consumers were picked to outperform the S&P 500 by three strategists, while four predicted they would underperform. Although consumer discretionary was panned by more strategists than those who favored it, it was the second-best performing sector of 2020, with a spectacular 32.1% gain.

Technology stocks, a perpetual favorite with Wall Street, were a good pick for 2020, as was health care. However, another favored sector, energy, lost a stinging -37.3% in 2020.

Based on the data compiled annually since 2007 by Fritz Meyer (an independent economist widely praised by independent financial professionals for many years), Wall Street's best minds are shown to be chronically inconsistent in predicting which industry stock sectors will be the best or worst performing during a particular calendar year.

An important investment idea to remember in 2021 is this: Strategic investing is not preoccupied with predicting what happens tomorrow or in the next 12 months.

Wall Street pundit's predictions make great magazine covers but have nothing to do with investing strategically over the long run. ●

Wall Street's Sector Predictions For 2020 Versus Actual Results

	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Communications Services	Utilities	REITs
RBC Capital Markets	-			+		+		-	-	+	
Yardeni Research		-	+	+	+					-	
T. Rowe Price	-			+	+						
Nuveen				+	+	-		-			
State Street	-			+	+		+			-	-
J. P. Morgan		-	+		+	+		+	+	-	-
Citi	+	-	+	+	+	+	+		-	-	
Morgan Stanley	-	+		+			-			+	
Blackrock	+		-	+	+		+	-			+
BofA Securities	+	-		+		+		-		+	-
Net (+/-)	-1	-3	+2	+9	+7	+3	+2	-3	-1	-1	-2
Actual 2020	+32%	+8%	-37%	-4%	+11%	+9%	+42%	+18%	+22%	-3%	-5%

Sources: Standard and Poor's industry sectors Predictions from *Barron's* survey of 10 Wall Street strategists, Dec. 16, 2019.
Date compiled by Fritz Meyer, an independent economist.

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An Investor Insurrection, The GameStop Incident Could Result In Jailtime For Its Leaders

Like lemmings going over a cliff, small investors a have been buying shares of GameStop and a few other stocks that hedge funds had bet against, causing a short squeeze that is captivating media attention.

Don't fall for it!

The financial fight is widely depicted in the media as a battle of small investors against giant Wall Street hedge funds, and everyone loves an underdog – but it's not that simple.

Although an army of small investors successfully united to sock Wall Street hedge funds with staggering losses estimated at more than $20 billion, they are alleged to have succeeded only by using illegal tactics and, of course, naive investors ultimately suffered huge losses.

The drama began after a group of individual investors came together on an online forum on Reddit, a social networking site controlled by the owners of Conde Nast, an ailing publishing giant. A group of users on its "WallStreetBets" forum bid up the stock price of GameStop to irrational valuations, along with some other out-of-favor companies.

Almost immediately, the U.S. Securities and Exchange Commission announced an investigation. Civil, criminal, and financial penalties could follow and some individuals that started the hype could go to jail.

Moreover, once small investors were no longer willing to speculate on the absurdly priced stocks, the game stopped. Some investors were stuck with big losses.

In the real world of financial news that matters to sensible investors, the 60 economists surveyed in mid-February by *The Wall Street Journal* were forecasting a V-shaped recovery over the seven quarters ahead. While the GameStop story captured attention, don't fall for it. ●

Act Before Hitting The Crossroad Of Fiscal And Tax Reality

The United States Government's Covid aid to individuals and businesses is expected to raise the nation's debt to about $28 trillion. For high-earning and high-net worth individuals now is your last chance to act before higher taxes are expected to be enacted in 2021. Here's what you need to know:

The $6 trillion in Covid aid and stimulus adds to the $22 trillion federal debt outstanding, incurred to pay for Social Security, Medicare, Medicaid, and other programs, and years of widening annual federal budget deficits. The nation's debt is about equal to current annual gross domestic product (GDP) but expected to swell to 127% of GDP, according to the Committee For A Responsible Federal Budget, a bipartisan think tank.

The U.S. has a low tax burden relative to other major world economies and it is the world's largest developed economy. It possesses the financial strength to pay the suddenly larger-than-expected debt due to the Covid crisis. However, fiscal reality means taxes are going to rise in 2021.

With the U.S. approaching a major shift in fiscal and tax policy, high-income earners and high-net worth individuals are all but certain to be targets for tax hikes in 2021. Acting now – before the shift in tax policy is enacted into law – could result in significant tax savings in 2021 and subsequent years.

Precisely which taxes will rise and by how much is yet to be decided. Some of the tax hikes will be retroactive to the beginning of 2021 and although no amount of planning will change that, professional tax planning advice could nonetheless result in significant tax savings for high-income and high-net worth individuals.

President Biden campaigned on a plan for increasing the payroll tax on select employees by adding a new 12.4% tax on those with wages of more than $400,000. Also planned is a hike in the top income tax rate, from the current 37% rate to 39.6%. Doctors, dentists, senior managers, business owners and other high-earning professionals will be affected if these tax two income tax hikes are enacted.

Meanwhile, the exemption from estate tax of $11.7 million – $23.4 million for a married couple – is almost certain to be slashed to $3.5 million – $7 million for a couple, under Mr. Biden's tax plan. If this change is enacted, the estate tax will be expanded to hit millions of families.

In addition to targeting high income earning and high net worth individuals, tax compliance by the IRS is expected to toughen. It's a way the Government can raise taxes without going to Congress.

You may not be able to avoid higher taxes under the new tax rules expected to be enacted. Tax planning is highly personal because everyone's timing, assets, income, and family situation is unique, and the precise law changes are not yet known. But enough is known about what's ahead to recommend being proactive about tax planning right now. ●

New Identity Fraud Tactic Targets Amazon Prime Users

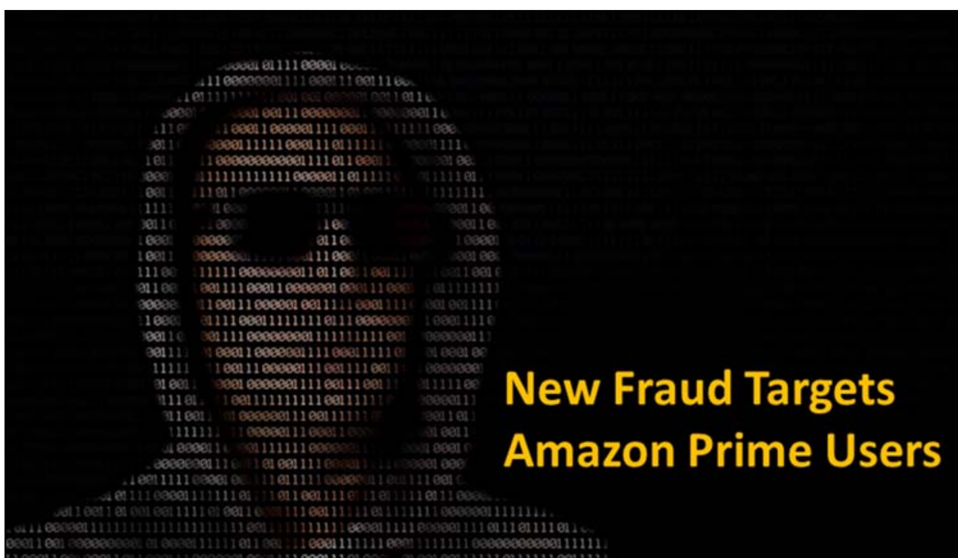
If you receive an email update on an order from Amazon that you did not place, beware; it's likely an attempt to steal your credit card information.

Unlike emails from Nigerian royalty and other obvious scams, this fraudulent email contains none of the telltale spelling or grammatical mistakes. It's not yet filtered by Microsoft and spam protection software. It is a new and sophisticated financial fraud threat.

The fake Amazon Prime email order is billed to you but shipped to a strange name and address unfamiliar to you. A toll-free number is provided.

"Thank you for calling Amazon," says the person who answers and gives you his name. "How may I help you today?"

This is where the sophistication of the fraudsters is most frightening. With the din of a call center in the background, the fake Amazon representative never asks you for your account password after you explain why you are calling.



Adding credibility, the fake rep tells you to check your email because he is sending you a one-time password. Even a skeptic now is likely to believe this is a real Amazon representative!

The fake Amazon rep is careful to never ask for your full credit card numbers but eventually connects you to another department to cancel the fake order. To be clear, the fake email and fake representative was all a setup. The final stage of the fraud is still yet to come.

To generate the one-time password, the fake Amazon rep simply used your email address to request a new password for your Amazon account. That generates an email to you, but makes it seem legitimately sent by the fake Amazon rep you are talking to.

In this case, the bad guys hung up the phone after questions about their location and verifying their identity, but it's easy to see how many consumers could fall victim to this scam. ●

Equity Risk Premium Grew Wider

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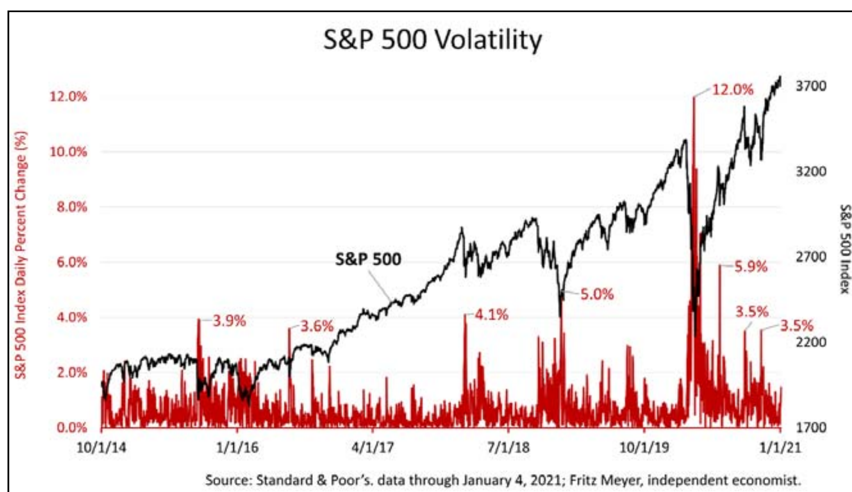
rising inflation suddenly poses risk for the first time in years; and the economy has recovered only four million of 14 million jobs lost in the pandemic. The risk of a stock market plunge should be expected, but retirement investors – permanent investors who plan to own stocks for the rest of their lives – would be wise to view volatility as a friend. That's a different way of looking at the world, but it absolutely is valid.



Choosing to expose a portion of your portfolio to price volatility, also known as risk, enables you to earn a better return over the long run. You wouldn't earn the six-percentage-point equity risk premium in stocks if you weren't exposed to lots of volatility. It just goes with the territory. It's part of owning a risk asset.

With bonds out of favor, the inflation rate remaining low despite persistent signs of stronger than expected economic growth, and consumers flush with cash payments from the federal American Rescue Plan, 2021 could be a good year for the equity risk premium once again. As always, however, you'll have to earn it by putting up with some risk! ●

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