

THE Retirement Report

Retirement Transition Planning

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Fourth Quarter 2021

A Crucial Investment Lesson From A Difficult 20 Years

The commemoration of 9/11 and pullout of U.S. troops from Afghanistan marked the passing of 20 difficult years. Historians will debate the lessons to be drawn from this tumultuous time for decades to come. For investors, however, a crucial investment lesson to be drawn is clear: In the past 20 years, amid the tumult and difficulties, broadly diversifying paid off, and quite convincingly at that!

These are the chief findings of a study of the 12 asset classes for which risk and return data are available for at least 20 years. The author of the study, Craig Israelsen, Ph.D., is a professor of finance for over three decades and an expert on portfolio design.

According to Dr. Israelsen, the Standard & Poor's 500 stock index averaged a 7.5% return annually for the 20-year period ended December 31, 2020 and had a standard deviation – a measure of its risk – of 17.8%. In

contrast, a broadly diversified portfolio comprised of 12 assets equally weighted delivered 91% of the return of stocks but with only 69% of the risk.

A portfolio with 12 equal weightings of different investments had a standard deviation of 12.3 and a return of 6.8%. That's a good tradeoff for investors: accepting about 10% less return with a 30% reduction in volatility.

It's clear evidence that, even over a 20-year period of world-shaking events, a strategic approach of broad diversification worked.

A one-asset portfolio having 100% in a high-risk, high-reward investment, like stocks, averaged a strong 7.5% annualized return, but you would have had to endure wild swings in the value of your portfolio that annually averaged 17.8%. For example, in the five-week Covid bear market of February-March 2020, instead of

All Invested All Balanced All The Time

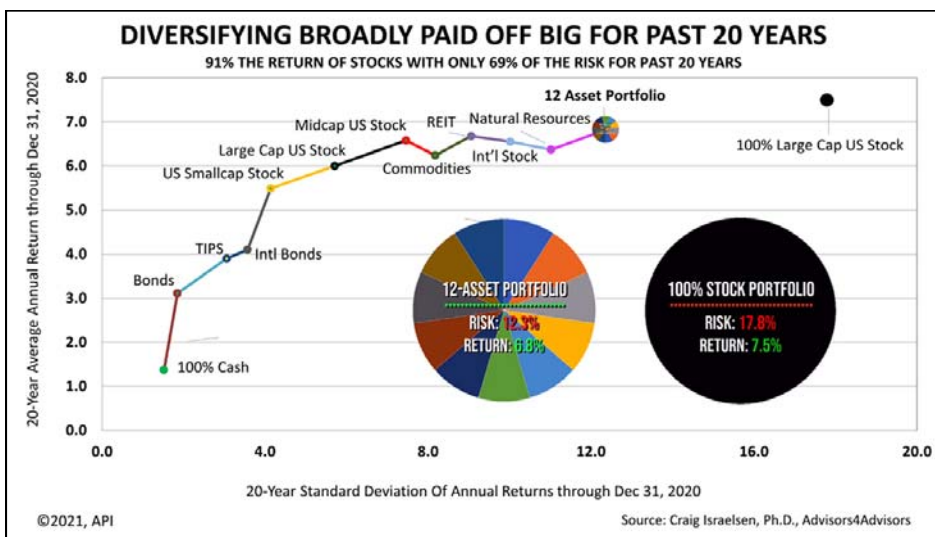
In our front-page article this quarter, Professor Israelsen of Brigham Young University once again demonstrates the benefits of investment diversification. His study shows how the 20-year return for the S&P 500 stock index is moderated by balancing it with dissimilar investments like bonds, real estate, and commodities. A one-asset portfolio of all high-risk-and-return stocks averaged a strong 7.5% return over the 20 years ended December 31, 2020. It also subjected investors to some wild negative swings along the way, such as 37.6% in 2008, and 33.9% at the onset of Covid-19 in early 2020. If investors were to panic and sell out at those scary times, almost all their long-term earnings would have been lost.

Properly balanced, those losses were limited to approximately 21% in each case, for a 60/40 portfolio. Dr. Israelsen's conclusion is that through balanced diversification, we can achieve 90% of stocks' return with only 70% of their risk. Getting a third less risk while losing only a tenth of our earnings is a great deal for an investment strategy designed to last our lifetimes. If you would like to review your risk-return profile, please give us a call.

Hope your holidays were great, and we look forward to working with you in 2022.

Stay well,

Ric and Trang



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Why Now's A Great Time For A Financial Crisis Plan

For the five years through June 30, U.S. stocks were the No. 1 performing investment of major securities indexes! The S&P 500 index more than doubled in value, despite the pandemic! Remarkably, U.S. stocks were No. 1, not only for this five-year period through June 30, 2021, but for the past five five-year periods ended June 30! And, as the end of the third quarter neared, the S&P 500 kept breaking records.

This is precisely the right time to ask yourself: What could go wrong?

The stock market has been treating American investors to outsized gains year after year, and the party could continue - - the good times could roll for another five years or get even better! As professionals, however, we believe it's wise to plan for a stock market slump, to plan what you would do if things go

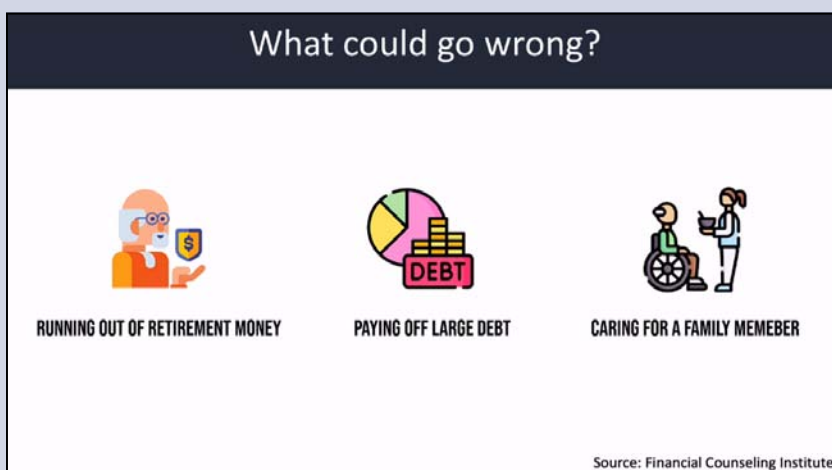


wrong with your business, your job, or God-forbid, your health.

With the stock market and housing values sharply higher than a year ago,

based on your experiences and personality characteristics. So everyone has their own very personal reaction to life's risks. Even if your

financial future is looking bright at this moment, writing your crisis plan now, rather than in the throes of a crisis, can help ensure you will continue to sleep soundly even if your worst financial nightmare were to come true. That's why now is the right time for financial crisis planning. ●



A Framework For Investing For Life

Modern Portfolio Theory, or MPT, is a framework for investing. It provides part of the intellectual underpinning of our firm's approach to managing investments. So, it is important to explain it periodically.

Just as constructing the framework for a home is strategically designed by connecting one piece of wood with another, MPT provides a system for constructing a portfolio based on measurable dimensions of investments – history and quantitative characteristics.

Owning different kinds of investments is less risky than owning only one type of asset, and MPT is a system for diversifying across a wide

range of assets based on their statistical characteristics.

Classifying investments based on their distinct characteristics – such as the aggregate value of a company's shares outstanding, profit growth, and share-price variance – imposes a quantitative discipline for selecting combinations of investments based on historical data.

Investments revolve around a world that is always changing, however, and not enough statistical history of different kinds of investments exists to make investment predictions about the future with certainty. MPT is a way of managing that uncertainty.

Just as every stud and joist in a home

has its own mathematical dimensions, investments have their own unique shape and characteristics. MPT organizes statistics that measure the characteristics of different kinds of investments used to construct a portfolio. It's a way of building a portfolio so that the return you expect over the long run is maximized for a given level of risk.

Just as a home can be built to your personal needs and preferences, so, too, can a portfolio be custom-built to suit your personal risk tolerance specifications. To be clear, cookie cutter portfolios is not what we do. Each portfolio can be tailored to an investor's preferences.

2021 Year End Tax Planning: Higher Stakes And More Confusing Than Ever

Year-end tax planning is more important than usual because it occurs concurrently with a turning point in U.S. tax policy. For the first time in 40 years, taxes on income and wealth transfers are headed higher.

Exactly what's about to happen – which provisions of the estate and income tax laws will be revised and the financial impact on high income and high net worth individuals – is uncertain. It depends on Congress, politics, the economy and financial markets, thus making it impossible to predict.

President Joseph R. Biden, Jr., was elected running on a platform that included a proposal to slash the estate tax exemption accorded individuals from \$11.7 million to \$3.5 million. By early September, however, fears of an imminent hike in estate taxes dissipated. Congress was expected to do nothing to change current estate tax law. Why?

Doing nothing is politically expedient. Neither party would be faulted for letting current lapse. The “sunset” of

Economist Harry Markowitz introduced MPT in a 1952 essay. He was awarded a Nobel Memorial Prize in Economic Sciences in 1990. Thus, it took from 1952 to 1990 – 38 years – for Markowitz to be recognized by the Nobel committee. This provides insight into the how long it takes for knowledge to be accepted.

Over the last 70 years, the power of Modern Portfolio Theory has grown to be understood. It is now the framework for investing embraced by most institutional investors worldwide and it is now a foundational



current estate tax rules would mean the 2021 individual exemption of \$11.7 million would continue to rise with inflation annually until December 31, 2025. Starting January 1, 2026, however, the individual exemption from estate tax would revert to about

\$6 million (assuming inflation does not sharply escalate).

The \$11.7 million exemption currently accorded individuals \$23.4 million for couples – would be slashed by more than 50% – if Congress does not act. For estate planning purposes,

individuals with taxable estates can relax a bit but need to stay informed through the end of 2021, just in case the situation changes.

Meanwhile, federal income tax hikes on high

income individuals – specifically, tax-filers with more than \$400,000 of income, are expected to be enacted by the end of 2021. President Biden campaigned on a proposal to raise income taxes on individuals with more than \$400,000 of annual income. This makes income-tax planning more important while complicating the right moves to make now, in preparation.

This is a timely warning that year-end tax planning in 2021 will be a cliffhanger. It requires the attention of high-income/high-net worth individuals now. While details of the coming tax hikes are impossible to predict, one thing is certain: planning for the complex matrix of possible changes to the Tax Code, starting right now, would be smart. ●

EARLY WARNING: YEAR-END TAX PLANNING 2021



element in teaching finance at the world's best colleges and universities.

MPT is a starting point for constructing a quantitatively driven portfolio based on fundamental economics. Just as the laws of physics are relied upon for building a home, fundamental factors of economics are relied upon in constructing a portfolio using MPT. To receive a report on investment performance and current financial economic conditions, please contact us. ●

Making A Life-Changing Financial Difference To A Spouse And Needy Loved Ones

Tax law and estate planning might bore you to death, but this brief tip could make a life-changing financial difference to your surviving spouse, and other loved ones, including disabled and chronically ill family or friends, as well as any minor children in your life.

These individuals are among the five exceptions to the usual distribution rules on the inheritance of assets in IRA, 401(k), or other federally qualified retirement plans.

New rules, that went into effect on January 1st, 2020, with the enactment of The Secure Act, require the beneficiary of inherited IRA or 401(k) accounts to deplete the money in those accounts within 10 years. It was a technical change that many overlooked in the rush of tax law changes that occurred in 2020 during the pandemic. But it made a big difference in tax planning.

To be clear, until 2020, beneficiaries of an inherited IRA or 401(k) were not required to liquidate an inherited account within 10 years, as is now

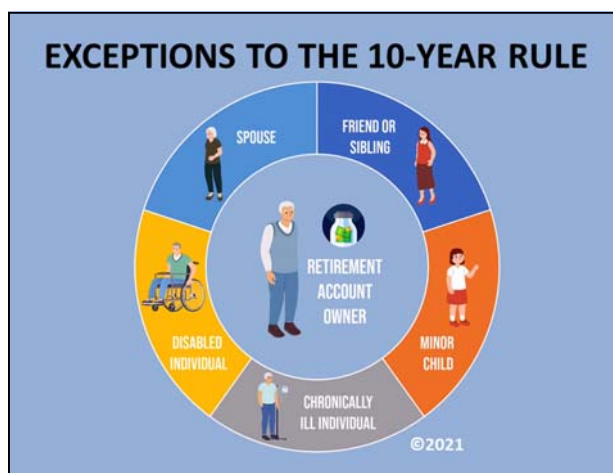
required, which had left open a major tax break: They had the option to stretch out distributions over their actuarial life expectancy, thus, leaving the assets to compound tax-free for a much longer period. The 10-year mandatory distribution rules carved out some key exceptions for certain individuals that now require attention, if you intend to pass on your retirement plan, IRA, or other qualified plan assets to a spouse, chronically ill or disabled individual or minor child.

For a disabled individual, who

inherits federally qualified retirement assets, for instance, stretching out distributions over decades could transform the inheritance into an income stream for life. The same is true for a widower, chronically ill individual, or minor child that inherits your retirement account.

In addition, a fifth exception to the usual distribution rules applies to a beneficiary that is less than 11 years younger than the retirement account owner. A sibling or friend who is 10 years or less your junior, who inherits qualified retirement account assets, also may use their life expectancy -- instead of taking required distributions over 10 years.

If you own a sizable IRA, 401(k) or other qualified account, and your beneficiary is your spouse, a friend or sibling 10 years or less younger, an individual with a disability, chronic illness, or a minor child, the five exceptions to the 10-year rule pose complicated tax planning as well as legal and investment issues requiring personal advice from a professional that is beyond the scope of this article. ●



A Crucial Investment Lesson

(Continued from page 1)

suffering the 33.9% drop in value on the all-stock portfolio, the 12-asset portfolio suffered a much more tolerable 21% loss. Wild ups and downs make investors more prone to selling at market bottoms.

To better understand this concept so crucial to investor success, the multicolored line charts the standard deviation and return of each of the 12 asset classes for the 20 years ended December 31, 2020. Each dot plots the risk and return annually averaged for an asset class.

The risk and return statistics all are based on indexes that track the 12 assets. The 12 assets are tracked by Dr. Israelsen because they form a

broadly diversified portfolio, meaning they have different characteristics that can be measured statistically. In addition, they are indexed and, thus, enable a low-expense investment management approach.

Starting with the least volatile of the 12 assets, the multicolored line shows what each of the 12 assets added to the portfolio. Adding each of the 12 assets in equal amounts for the 20-year period created the very favorable risk/return curve in this chart. The combination of all 12 asset classes yielded the most efficient portfolio, compared to any combination of one or more assets.

Strategically investing in a broad set of assets worked even during one of the most difficult 20 years of the modern era. ●

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