PEAK CAPITAL
MANAGEMENT

D. MICHAEL BURLEIGH
Registered Investment Advisor

750 SE Indian St.
Stuart, FL 34997

772-334-9592 • 772-334-3856 fax
Mike@peakcapitalmanagement.net
www.peakcapitalmanagement.net

THE ADVISOR

MAY 2021

As Markets Pause to 'Take Stock,' So Should You

What a difference a year makes. At the start of May 2020, the stock market was struggling to crawl out of a deep crater triggered by the onset of the Covid-19 crisis. By May 1st it was only halfway back. Meanwhile, the economy was about to experience its worst quarter of economic shrinkage ever. Businesses were shutting down, unemployment was skyrocketing, and the worst was yet to come. The picture could not be more dramatically different in May 2021 — but that doesn't mean we aren't still facing challenges.

Before we talk about those challenges, let's take a moment to savor the developments of these past few weeks, both socially and in the financial markets. Socially, an estimated 100 million Americans have been vaccinated against the Covid-19 virus, as of early May.[1] As a result, more and more states are easing pandemic restrictions, allowing more businesses to get back to operating near full capacity. All this is happening just as many corporations are reporting record earnings. As of April 30th, 87% of S&P 500 companies had beaten profit expectations for the first quarter — by far more than usual.[2]

Partly in response to all this, the stock market continued climbing in the first half of April, with the Dow Jones Industrial Average topping 34,000 for the first time ever on April 15th.[3] That's good news, but remember, the markets are forward-looking. Ostensibly, they anticipate economic developments more than they react to them, which is probably why after hitting new records in mid-April, they paused for the rest of the month to consolidate. In the financial world, "consolidate" describes a period when the market realizes it's gotten ahead of itself and slows down to basically take stock of the situation (no pun intended). Of course, this market has been "ahead of itself" for almost a decade thanks to all the Fed's artificial stimulus. However, that only makes it more important than ever for big investors to slow down and consolidate when the economy shows signs of "overheating".

The Inflation Factor

In addition to record first quarter growth, remember that long-term interest rates saw a big jump from the start of the year to early April, as we discussed in last month's newsletter. From January 1st to April 1st, the yield on the 10-Year Treasury rate rose from 0.93 to 1.74%.[4] Although rates have leveled off and come down a bit since then, their rise combined with rapid growth have triggered concerns about the possibility that inflation could spike and put a drag on the recovery. Will it happen? If so, will the Fed overreact and raise short-term rates again, even after vowing early in the pandemic to keep their benchmark rate near-zero until 2023?

These are good questions, and they're why it's important to remember we're still facing challenges. As for the inflation factor: Yes, we'll probably see some inflation in the coming months, but it will most likely be transitory, not permanent. It will occur mainly from a short-term spike in demand prompted by some pretty obvious factors. The main one is that as the economy continues

Continued on page 2

Pension Plans vs. 401(k) Plans

A pension plan has become exceedingly rare, or at least that's the conventional wisdom. But that doesn't mean pensions are not still an important retirement planning tool for many people. While it's true that few private sector employers offer pension benefits for new hires, they are still common for people who work in the public sector. Many older people also have some pension benefits, perhaps from a previous employer. So, although pensions aren't available to everyone, they are still an important part of the retirement planning mix for millions of Americans.

Whether you have a pension, a 401(k) plan, or a combination of the two, you may be wondering which is better. The answer is it depends.

The Difference Between Pensions

Continued on page 3

As Markets Pause

Continued from page 1

opening, people will be eager to take advantage of it. They'll want to travel, go to parks and baseball games, and shop in stores rather than on their computers! All this, combined with the fact that many people have disposable income saved up from being in lockdown for much of the past year, will likely create a huge jump in demand.

At the same time, there are still supply shortages in some sectors of the economy due to manufacturing shutdowns during the pandemic. Remember, inflation comes from too much demand chasing too few goods and services. That drives up prices. The conditions are certainly prime for that to happen, but we think it will be only temporary. Once people get the pent-up urge to spend out of their systems, demand will level off again, the Fed will keep short-term rates where they are, and the recovery will continue at a pace that doesn't spook Wall Street.

Other Issues

Of course, in the new Age of Economic Uncertainty, forecasting even the short-term future of the markets is more challenging than it used to be. Economists and analysts can only base their forecasts on economic fundamentals and the lessons of market history. However, in the days of unchecked quantitative easing and artificial manipulation, those fundamentals have been compromised. The bottom line for income investors is to never lose sight of the reason you're invested for income in the first place: to have a strategy that helps to ensure your retirement income and attempts to minimize your risk regardless of market conditions. If the last year has taught us anything, it's that the income model not only meets these core objectives, but it also has the potential to provide even more value for some investors under certain market conditions.

As we discussed in last month's newsletter, despite the rise in long-term interest rates throughout March, many income investors actually saw their portfolio values slightly increase on their last statements thanks to diversification and active management. Even the most conservative clients may have seen their values unchanged or down only slightly — all while knowing that the drop was only a temporary paper loss and their income return was unaffected.

Keep all this in mind as you review your April 30th statements. At the same time, enjoy the progress we've made as a country in the past year, but remember there are still potential challenges ahead. As the markets have paused to take stock of these challenges, it might also be a good time for you to review your own strategy and make sure it's still aligned with your goals and right for your risk tolerance!

[1]"Number of Americans Fully Vaccinated Tops 100 Million," AP News, April 30, 2021

[2]"Wall Street Logs Early Gains Monday on Strong Earnings," AP News, May 3, 2021

[3]"Dow Ends at Record Above 34,000" MarketWatch, April 15, 2021

[4]YCharts.com

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Is Your 401(k) Plan Enough?

If you work at a company that offers a 401(k) plan, especially if the plan offers matching contributions, it may be the most important part of your retirement investment plan. But should it be the only part?

In 2021, the maximum annual 401(k) contribution is $19,500, not including employer-matching contributions. If you are at least 50 years old, you can contribute an additional $6,500 in 2021, if permitted by the plan. Your plan may impose lower limits to ensure that it complies with nondiscrimination rules.

Yet, if you're over 40 and haven't started saving for retirement, even these large annual contributions may not be enough to reach your retirement goals. Here are five questions to help you decide whether your 401(k) plan is the only plan you'll need for retirement:

- **What kind of lifestyle do you want to fund in retirement?** You'll find general rules of thumb indicating you need anywhere from 70% to over 100% of your preretirement income during retirement. How much you'll need depends on your individual circumstances. For example, if your mortgage will be paid off and you plan to stay home and watch your grandchildren during retirement, 70% of your preretirement income may be sufficient. On the other hand, if you plan to travel extensively, 100% may be a better number.
- **How much can you count on from Social Security?** Social Security benefits were never designed as the sole source of retirement income, but they still are a valuable source of income. Those with lower incomes will find that Social Security replaces a higher percentage of their preretirement income than those with higher incomes.
- **How much does your employer contribute to your 401(k) plan?** The $19,500 maximum contribution to your 401(k) plan does not include employer contributions. Employer matching contributions vary by plan, but a typical match is 50 cents for every dollar contributed, up to a maximum of 6% of your pay. However, in recent times, many employers have reduced or eliminated matching contributions. If your employer offers a match, make sure you take full advantage of it. A generous matching contribution can contribute substantially toward your retirement.
- **What are the average returns on your 401(k) investments?** You can only choose from the investments offered by your 401(k) plan. But within those parameters, select investments that match the long-term nature of your plan and will help grow your retirement funds over time.
- **What other sources of income can you count on in retirement?** If you already have other retirement assets, you might not need to rely as heavily on your 401(k) plan. Other potential sources of retirement income might include a defined-benefit pension plan, individual retirement accounts (IRAs), an inheritance, or other investments.

If you contribute the maximum possible to your 401(k) plan and still aren't sure you'll have enough for retirement, please call for a review. There are a variety of other options you can use for saving for retirement.

Pension Plans

Continued from page 1

and 401(k) Plans

What separates a pension plan from a 401(k) plan? A pension is a defined-benefit retirement plan. Your employer contributes money throughout your working years in a pot with all other employees' money. The money is then invested on behalf of you and your coworkers. When you retire, you receive a predetermined monthly benefit based on your length of service, salary, and age. Your benefit is guaranteed, but you don't have any control over how the money is invested.

With a defined-contribution plan, like a 401(k) plan, you (and your employer if they offer matching contributions) set aside money in a special account. You can then invest that money in options available in the plan. Unlike a pension, the amount you receive when you retire depends on the amount you save and the investment returns you receive.

Pros and Cons: Pensions

At first glance, pensions seem superior to defined-contribution plans. After all, you get a guaranteed benefit that lasts for the rest of your life after you stop working. A pension eliminates the risk of outliving your money or losing all your savings because of a market crash or an investing mistake. Overall, pensions also have slightly better returns over time than 401(k) plans.

But pensions have their downsides too. One of the biggest is that you can't control the investments. That means that if you're a savvy or aggressive investor, you could be missing out on possible gains. Another drawback? If you leave your employer before a certain time (called your vesting period), you lose access to all or a portion of your benefit. Finally, if your employer runs into financial distress or goes out of business, your benefit may be far less than you anticipated.

Pros and Cons: 401(k) Plans

Employers love 401(k) plans since they take the responsibility for managing employees' retirement off of the employer and put it onto the workers. Many employees like 401(k) plans too, since they can control how much they save for retirement and how it is invested. And the money you contribute is yours — you won't lose it if you change jobs (although you may lose matching contributions, depending on how long you've worked for your employer) or face the possibility of reduced benefits if your employer goes bankrupt. Finally, you can pass on any money left in your 401(k) plan to your heirs. That's not the case with a pension, where the benefits end after the pensioner or the pensioner's spouse dies.

But 401(k) plans have their disadvantages as well. First, you need to be motivated enough to set aside money from your paycheck — money you could be spending today — for retirement. Many people struggle with this, either putting off saving or not saving enough. Another problem? Many people don't take enough risk with their retirement savings. If you stick with cash or low-interest bonds, your returns likely won't be high enough to generate the income you need in retirement.

Defined benefit and defined-contribution plans each have their pros and cons. Whatever type of retirement plan you have access to, it's essential to understand how it works and what your responsibilities and options are. Please call if you'd like to discuss this in more detail.

Don't Touch Your 401(k) Plan

If you leave your employer, be careful about what you do with your 401(k) funds. Your worst option is to take a distribution, pay taxes and a penalty on it, and then spend the money on something other than retirement. By doing so, you use retirement funds and forego any further tax-deferred growth on those assets. In addition, you may incur a large tax bill, since withdrawals are subject to ordinary income taxes and a 10% federal income tax penalty if you are under age 59 ½ (55 if you are retiring).

You have three options to keep your 401(k) funds in a tax-deferred vehicle until retirement:

Leave the funds in your former employer's 401(k) plan. Generally, you can leave the funds in your former employer's plan if your balance is at least $5,000. However, most plans will not allow you to borrow from your account once you leave the company. Until you consider all your options, you might want to at least temporarily leave the funds with your former employer's plan.

Transfer your funds to your new employer's plan. Find out if your new employer's plan accepts rollovers. If so, you can typically make the rollover even before you are eligible to make contributions. However, first check out the investment options to make sure the new plan has options that will fit your investment goals. Once the funds are in your new employer's plan, you'll be able to take loans if permitted by the plan. Also, if you work past the age of 72, you won't be required to take distributions from the 401(k) plan until you retire. With traditional individual retirement accounts (IRAs), you must take withdrawals once you turn age 72, even if you are still working. If you decide to transfer the funds to your new employer's plan, get the appropriate paperwork from your new employer so the funds can be transferred directly to the new plan's trustee. Otherwise, if the funds go directly to you, your former employer will be required to withhold 20% for taxes. You must then replace the 20% with your own funds within 60 days or the 20% withholding will be considered a distribution, subject to income taxes and the 10% federal income tax penalty.

Roll the funds over to a traditional IRA. Again, you should have your former employer transfer the funds directly to the IRA trustee to avoid the 20% withholding described above. Once the funds are rolled over to an IRA, you can invest in a wide variety of investment alternatives. With a 401(k) plan, you typically have a limited number of options. If you plan on leaving part of your 401(k) balance to your heirs, an IRA usually has more flexible options than a 401(k) plan. After the funds are transferred to a traditional IRA, you can then convert the balance to a Roth IRA.

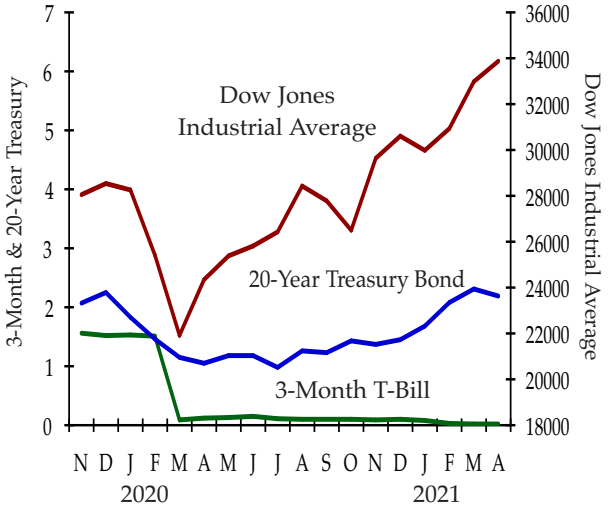
Business Data

Indicator	Month-end Feb-21	Mar-21	Apr-21	Dec-20	Arp-20
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.03	0.02	0.02	0.10	0.12
10-year T-note yield	1.44	1.74	1.65	0.93	0.64
20-year T-bond yield	2.08	2.31	2.19	1.45	1.05
Dow Jones Corp.	2.32	2.42	2.37	1.93	2.72
GDP (adj. annual rate)#	+33.40	+4.30	+6.40	+4.30	-5.00

Indicator	Month-end Feb-21	Mar-21	Apr-21	% Change YTD	12 Mon.
Dow Jones Industrials	30932.37	32981.55	33874.85	10.7%	39.1%
Standard & Poor's 500	3811.15	3972.89	4181.17	11.3%	43.6%
Nasdaq Composite	13192.35	13246.87	13962.68	8.3%	57.1%
Gold	1742.85	1691.05	1767.65	-6.4%	3.8%
Unemployment rate@	6.30	6.20	6.00	-10.4%	36.4%
Consumer price index@	261.58	263.01	264.88	1.8%	2.6%

— 3rd, 4th, 1st quarter @ — Jan, Feb, Mar Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield
November 2019 to April 2021



Everyone's Plan Is Different

Everyone's goals for retirement are different. Maybe your dream is to travel the world; maybe it's to live closer to your grandchildren. Maybe your plan is to while away the days fishing or quilting; perhaps you're planning to take up a second career. Maybe your goal is to save enough to leave a substantial sum to your beneficiaries. Whatever your dreams are, your retirement plan needs to reflect them — and because your dreams are uniquely yours, your retirement plan should be, too.

The biggest question most people have about retirement is: how much do I need? While that's not the only question, it is an important one. And while using an online retirement calculator is fine to get a very rough idea of how much you might need for retirement, those calculators don't take your dreams or particular circumstances into account; as such, the amount you'll actually need for retirement can vary greatly from the number on the online calculator.

To properly plan for retirement, you have to consider all the options, all the aspects, and all the opportunities. Please call if you'd like to discuss your retirement plan in more detail.

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