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THE ADVISOR

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Will the Second Half of 2021 Be 'Better' in Every Way?

We're halfway through the year already, and in some ways the second half of 2021 is poised to be dramatically different than the first. That's because the "return to normal" that began at the start of this year is now well underway and will continue to expand in the next six months. Most mask-wearing mandates have already been lifted and most Covid-19 restrictions have been greatly relaxed. Socially, things should keep getting better, but what about financially? Will the second half of 2021 be better, about the same, or worse for your investments than the first half?

Naturally, no one knows for sure, but some recent developments might help give us an answer. Let's talk briefly about where the economy and financial markets have been so far this year, and what it's meant for income-based investors.

Even before Covid-19 infection numbers began dropping with the help of the three vaccines, the US economy came into 2021 going strong. To some extent, the economy has been in steady recovery mode ever since it first got sucker-punched by the pandemic in the second quarter of last year. That's when the U.S. GDP shrank by a historic 31.4%. However, that was followed in the third quarter by an also-historic rebound of 33.4% growth. Growth continued at a strong 4.3% in the fourth quarter and an even stronger 6.4%in the first quarter of 2021.[1]

Shift to Overdrive

Like the economy overall, the stock market has been in recovery mode ever since feeling the initial impact of the coronavirus, although its rebound has been much more dramatic. After investor panic caused the market to fall by about 40% last winter, it came roaring back. In fact, two out of the three major market indexes had already hit new peak highs again by late summer. Naturally, a lot of that had to do with the historic relief measures approved by Congress and the Fed, since Wall Street has been more focused on artificial stimulus than on economic fundamentals for over a decade now. With yet another relief package in the works heading into this year, the stock market shifted into overdrive and rose steadily from January to early May, with all three major indexes hitting multiple new peaks.

At the same time, long-term interest rates also rose steadily in the first quarter. The yield on the 10-Year Treasury rate jumped from 0.93% to 1.74% between New Years and late-March.[2] Rates have leveled off and even dropped some since, with the 10-Year ending June at 1.48%. However, that big jump of more than 50% did create some challenges for income investors due to the inverse relationship between interest rates and bond values. The good news is that the soaring stock market and other factors also created conditions and opportunities for portfolio managers to help minimize those challenges. In fact, even our most conservative clients saw their portfolio values increase over the first half of the year despite the interest rate headwind. Those with a higher risk tolerance saw even greater increases thanks to strong performing value stocks, BDCs, ETFs, and other higher-risk income strategies.

So, while we can be reasonably sure the second half of the year will be better from a social standpoint, what about economically and in terms of the markets? Well, after making that steady climb from January to May, the

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Tax Planning and Retirement

Whether you're newly retired, about to retire, or thinking ahead, there are numerous benefits to tax planning in your golden years. Taxes are often the furthest thing from people's minds when it comes to retirement, but the truth is, even when you're no longer accountable

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Second Half

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hot stock market suddenly cooled off a bit and volatility returned. That was mainly blamed on fears about inflation, and those fears have continued to some degree. June saw quite a bit of volatility, in fact. The Dow Jones Industrial Average sank below 34,000 for the first time since April,[3] and ended June slightly down for the month.

Despite these recent bouts of nervousness, we don't believe inflation fears will have a major impact on the markets in the second half of the year. We think the inflation spike we're seeing now is transitory and caused mainly by pent-up consumer demand combined with some supply chain disruptions. As life continues returning to normal, that demand will outpace the availability of many goods and services, creating inflation. Once consumers get that pent-up urge to spend out of their systems, we believe prices will stabilize again sometime in 2022.

A 'Good' Picture

Also, remember that long-term interest rates have remained stable since that early year spike, and we believe that trend will continue. In addition, the Fed has renewed its commitment to keeping short-term rates near zero at least through the end of 2022. All these factors should help minimize the risk of another major market pullback. At the same time, it's likely the market growth we do see from now through December will be more gradual and less dramatic than it was in the second half of last year or the first half of this year. For the most part, Wall Street has probably priced most of this year's earnings into the market already, and now it's time for corporations to catch up. In short, we believe the economic picture will continue to be good for investors overall in the second half of the year, but not dramatically "better" like the social picture.

Of course, in the Age of Economic Uncertainty, anything is possible. There is a chance the economic recovery could strengthen beyond expectations and keep pushing Wall Street to lofty new heights. On the other hand, if second quarter earnings disappoint, if inflation turns out to be permanent, if long-term interest rates start climbing again, or if a vaccine-resistant Covid-19 variant emerges…any one of these factors could quickly undercut the recovery and make the outlook for the second half of 2021 worse.

The bottom line is that, if the coronavirus has taught us anything, it's the importance of having a financial strategy that expects the unexpected and is flexible enough to adapt to sudden changes.

[1]Bureau of Economic Analysis, BEA.gov

[2]YCharts.com

[3]"Dow Falls More than 500 Points," CNBC, June 17, 2021

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What Is Tax-Loss Harvesting?

Tax-loss harvesting is choosing to sell some investments at a loss to reduce taxes on realized capital gains from other investments. The key to successful tax-loss harvesting is to identify investments that have lost value and then determine which to sell, while staying true to your target investment mix and diversification strategy. Following are things to consider to see if tax-loss harvesting can help you lower your tax bill.

Assess Your Capital Gains

Thoroughly review your investments to determine a rough estimate of your capital gains. If you frequently buy and sell, you most likely have both short-term and long-term gains and losses. Long-term capital gains are those on investments you've held longer than one year, while short-term capital gains are those held for one year or less.

Estimate Your Tax Liability

After figuring out the potential amount of your capital gains, you will want to estimate your potential taxes from realized gains based on the type of gain it is and your income.

In taxable accounts, the long-term capital gains tax rate is 15% to 20% (0% for taxpayers under certain income limits), while short-term capital gains are taxed at ordinary income tax rates (10%, 12%, 22%, 24%, 32%, 35%, or 37%). Dividend income received by individual taxpayers from a domestic or qualified foreign corporation is also taxed at the same rate as long-term capital gains.

Harvesting Losses

Once you have an understanding of what you will owe in capital gains taxes, you can start looking for investments you want to sell. You may first want to consider investments that no longer fit into your strategy or those that have poor prospects for growth in the future.

To increase your potential tax savings, try to apply as much of your capital loss to short-term gains, because they are taxed at a higher rate. The tax code states that short-term and long-term losses have to first be used to offset gains of the same type. If you have losses of one type that exceeds what you have gained, you can then apply the excess to the other type of capital gains. For example, let's say you sell a long-term investment at a $16,000 loss but only had $5,000 in long-term gains for the year. You could then apply the excess of $11,000 to any short-term gains.

Additionally, if you don't have any gains in a given year, the tax code allows you to apply up to $3,000 in capital losses to reduce your ordinary income, which is the same rate as short-term capital gains.

Watch out for the Wash-Sale Rule

After you've sold the investments with losses, you will most likely start looking for new investments. Even though you took a loss on an investment to reduce your capital gain taxes, you may decide that it is still an attractive investment because it has good potential and still fits within your investment strategy. Be careful when you buy it because the wash-sale rule will disallow your tax write-off if you buy the same security, an option to buy the security, or a substantially identical security within 30 days before or after the date you sold the security with the loss.

Please call if you'd like to discuss this in more detail.

Retirement

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to a boss or clients, you still have to answer to the IRS. Payroll taxes may be a thing of the past, but the money you plan to support yourself with, such as retirement and investment accounts, savings accounts, pension payouts, and potentially even Social Security benefits, could be taxed.

In fact, depending on how much you've saved and how much you withdraw annually, you could be in a higher tax bracket than you anticipated. Couple that with the possibility of higher future tax rates, and you could find yourself with less retirement income than you had planned.

However, with sound tax planning, you can protect your golden years from becoming tarnished by unnecessary taxes, regardless of whether you're planning to retire 30 years from now or you've already done so.

If You're Thinking Ahead to Retirement…

Consider Investing in a Roth IRA/Roth 401(k)

When it comes to taxes and retirement, if you want to maximize what you've worked so hard to save throughout the years, it's critical to strategize how you invest your money. Anticipating how much you need to save is just the first step; planning on where you will allocate these savings is a critical component if you want to make the most of your retirement funds. Many people assume that contributing solely to a tax-deferred employer-sponsored plan translates to a comfortable retirement. After all, what could be better than sheltering a portion of your pre-retirement income from taxes while taking advantage of employer-matching incentives?

However, when many people retire, they're surprised to learn that their tax-deferred account withdrawals are not only taxed, but quite possibly at a higher rate than they may have anticipated. Diversifying your retirement-savings plan by contributing to a Roth IRA or Roth 401(k) could give you more flexibility when it comes to tax savings during retirement.

While you can't take advantage of tax-savings benefits now, withdrawals from Roth accounts are tax free, allowing for more latitude in retirement. In addition to future tax-savings benefits, Roth IRA accounts also provide the flexibility of penalty-free withdrawals of your contributions should you need access to monies for an unexpected situation prior to retirement.

Don't Forget about Other Taxable Investments

Unless you have funds that aren't tax deferred, safeguarding your retirement money from taxes could prove challenging. Like a Roth IRA or Roth 401(k), brokerage and/or mutual fund accounts can be valuable tax-free income sources in retirement.

Unless you want to pay taxes on every withdrawal you make during your retirement years, you'll likely want income sources that aren't subject to taxes down the road. A diversified plan that includes non-retirement accounts can protect you from higher tax brackets and maximize your income throughout your retirement years.

At Retirement Age…

Have a Withdrawal Strategy

Just as you had a retirement savings plan, you'll now need a strategic withdrawal plan to shelter as much of your retirement income as possible from taxes. The good news is, the more diversified your investments are, the more options you'll have available when it comes to tax savings. Both the timing and sequence of the accounts you draw from can significantly impact what you owe the IRS each year. For example, if you have taxable investments you've held for longer than a year, it may be more prudent to tap into these first, since the maximum 20% long-term capital gains tax could be less than the income tax rate you'll pay once you begin withdrawing from your tax-deferred retirement accounts. In fact, you might not pay capital gains tax at all, depending on your income bracket.

If you're over 72, don't forget about your minimum required distributions; though there are exceptions, failure to take these distributions can invoke a penalty as high as half of the amount you neglected to withdraw.

Plan Ahead: Targeted Tax Brackets.

You might also consider meeting with your financial and/or tax advisor to plan ahead for the following tax year with a specific marginal tax rate in mind. You can precalculate taxable income, living expenses, and deductions before deciding how much you'll need to withdraw from your investment accounts in order to stay within your targeted marginal tax rate.

Consider Delaying Social Security Benefits

This strategy actually provides you with multiple money-saving options. By delaying your Social Security benefits, you'll avoid a higher tax bracket while beefing up your distributions. This isn't just applicable to younger retirees: anyone who reaches his/her full-benefit age receives an annual 8% increase for each year distributions are delayed until age 70. While not everyone can afford to postpone Social Security benefits, you may decide that delaying these benefits as long as possible is financially advantageous in the long run.

Move to an Income-Tax-Free State

Many retirees don't just move to states like Arizona for the scenery. The tax-saving incentives can be just as appealing, particularly if you currently reside in a high-tax state. Willing to embrace the cold? Alaska has no state income or sales tax, and once you establish permanent residency, you'll even receive an annual dividend check from the state's oil wealth savings account. If you had plans involving temperatures of a warmer sort, consider moving to an income-tax-free state such as Nevada and Florida. You might also consider states that offer tax immunity solely to retirees, exempting Social Security benefits and even qualified retirement accounts from state income tax.

Please call if you'd like to discuss these strategies in more detail.

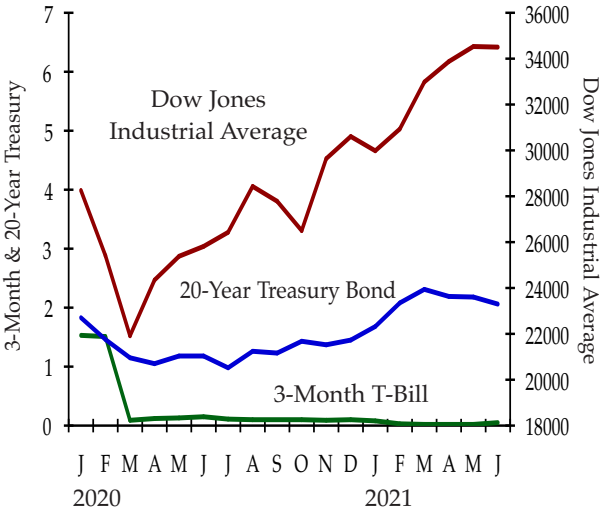
Business Data

Indicator	Month-end Apr-21	May-21	Jun-21	Dec-20	Jun-20
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.02	0.02	0.05	0.10	0.15
10-year T-note yield	1.65	1.58	1.45	0.93	0.66
20-year T-bond yield	2.19	2.18	2.06	1.45	1.18
Dow Jones Corp.	2.37	2.33	2.29	1.93	2.50
GDP (adj. annual rate)#	+33.40	+4.30	+6.40	+4.30	-5.00

Indicator	Month-end Apr-21	May-21	Jun-21	% Change YTD	12 Mon.
Dow Jones Industrials	33874.85	34529.45	34502.51	12.7%	33.7%
Standard & Poor's 500	4181.17	4204.11	4297.50	14.4%	38.6%
Nasdaq Composite	13962.68	13748.74	14503.95	12.5%	44.2%
Gold	1767.65	1899.95	1763.15	-6.6%	-0.3%
Unemployment rate@	6.00	6.10	5.80	-13.4%	-56.4%
Consumer price index@	264.88	267.05	269.20	3.4%	5.0%

— 3rd, 4th, 1st quarter @ — Mar, Apr, May 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
January 2020 to June 2021



Calculating Your Investment Basis

Your capital gain or loss on the sale of an investment equals the proceeds from the sale less your basis. When you purchase an investment, your basis equals the price you paid plus any fees or commissions. While the calculation is fairly straightforward, other factors can affect your basis calculations:

- Reinvested dividends are added to your basis at full market value plus any fees or commissions.
- The basis of any investment received as a gift is the donor's original basis plus any gift tax paid by the donor. However, if you then sell the investment at a loss, your basis is equal to the lesser of the donor's basis or the investment's fair market value on the date of the gift.
- For inherited investments, the basis is the market value on the date you inherited the investment, typically the date of the donor's death.
- Your basis in stock that has been split is the same as your basis before the stock split. Your per-share basis, however, will now equal your total basis divided by the number of shares you own after the split.
- When you exercise a stock option, your basis equals the price you paid for the shares plus any fees or commissions, which may be lower than market value. Shares must be retained for at least one year after purchase and for two years after receipt of the option, or any gains will be taxed as ordinary income.

Please call if you'd like help calculating your basis in an investment. FR2021-0310-0004

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