

THOUGHTS FOR THE WEEK

FEELING 'BOUT HALF PAST DEAD

July 8, 2022

**"I pulled into Nazareth
Was feeling 'bout half past dead"****- The Band**

Many US equity investors are feeling *'bout half past dead* as they pull into the third quarter of 2022. Bond holders are in pain, too. Cryptocurrency investors might be pinching their digital decentralized pennies before too long. And gold bugs are in the red as of this writing. It feels like there's no place to hide.

Of course, your brilliant neighbors, co-workers, and in-laws who eschewed the prudent advice of owning a diversified basket of high-quality cash flowing investments, in favor of buying crude oil futures earlier this year, are sitting pretty. Well done, folks!

Investment*	YTD Return
Crude Oil	53%
Gold	-1%
Investment Grade Bonds	-14%
S&P 500	-20%
Bitcoin	-55%

*Source: FactSet; 6/24/22

Are we kicking ourselves for not "seeing this coming?" No. We appreciate the extreme difficulty and low odds of success of stringing together a series of short-term investment ideas. Not to mention the onerous costs and potential high taxes.

Are we surprised? No. We appreciate that markets regularly experience large intra-year drawdowns. The average intra-year price decline for the S&P 500, going back to 1980, is ~(14%) (Source: The Bloomberg).

The investing year has been a slog. For professionals and amateurs alike. But as Epictetus say...

"It's not what happens to you, but how you react to what happens that matters."

Periods of market volatility, high inflation, and recession are inevitable. Their occurrence is not all that important in the long run – markets tend to recover over time. But how we react to their occurrence is important.

We often say, “Don’t just do something. Sit there!” A well-designed portfolio should be able to weather myriad market scenarios, and with time, achieve a long-term goal without many – if any – short term tactical changes.

To the contrary, “Doing Something” – aggressively doubling down, panic selling, etc. – can create unintended risks, especially if the decisions don’t align with the strategy you established in advance of a market selloff.

But there *are* exceptions. And investors have the option to “Do Some Things” without effecting the unintended risks accompanied with “Doing Something”.

Tax Loss Harvesting

The US Tax Code allows investors to participate in something called tax loss harvesting. This involves selling one investment at a loss and buying a similar, but not identical, security to replace it. For example, an investor may sell the Vanguard US large cap ETF at a loss and buy the Vanguard S&P 500 ETF to replace it, capturing the loss but preserving the investment. Think about it this way – in California the top capital gains tax rate is 37.1%, so every \$100 of capital loss captured by an investor in this tax bracket has \$37.10 of real value. Capital losses offset capital gains dollar for dollar. Harvesting losses can significantly increase your future after tax rate of return.

Roth Conversion (link to a recent WSJ article below)

Retirement accounts come in two broad flavors: *Traditional* and *Roth*.

- A *Traditional IRA* is funded with **pre-tax** dollars, and investors are taxed when they withdraw money during retirement.
- A *Roth IRA* is funded with **after tax** dollars, and investors are **not** taxed when they withdraw money during retirement.

The US Tax Code allows investors to “convert” all or a portion of a *Traditional IRA* to a *Roth IRA* before or during retirement. The “converted dollars” are considered ordinary income for tax purposes in the year of the conversion, but it may make sense to “prepay” taxes by converting all or a large portion of a *Traditional IRA* before required withdrawals kick in*.

With asset prices down this year, the tax burden of conversion falls. If you’re considering converting from a *Traditional* to *Roth IRA* this year, the costs have decreased.

Both strategies add value in a down market, without adding risk. Tax loss harvesting builds a “bank” of losses to use in the future. Converting your *IRA* in a down market saves on taxes now.

As Epictetus said, “It’s not about what happens, it’s about how we react to what happens.” Despite feeling ‘bout half past dead, investors can still do little things to improve outcomes, while they otherwise act prudently and patiently in this rocky market.

A few things to consider, but far from a comprehensive list. We look forward to our discussions.

Mike, Cate, Scott, Willis, Suzy, and Oscar

Private Wealth Advisors

Mike Burbank, Managing Director Wealth Management

Scott Hafeli, CFA, Executive Director

Willis Davis, CFA, First Vice President

Morgan Stanley Private Wealth Management

555 California Street, 14th Floor | San Francisco, CA 94104

Office: 415 576 3131

If you would like to unsubscribe to this email, please contact Oscar Castillo at Oscar.Castillo@morganstanleypwm.com

Sources: <https://www.wsi.com/articles/fight-the-bear-market-blues-with-a-roth-ira-conversion-11656063003>

*Both Tax Loss Harvesting and Roth Conversions have intricate tax related nuance. We recommend working with a tax professional before engaging in either.

Please note that the URL(s) or hyperlink(s) in this material is not to a Morgan Stanley Smith Barney LLC website. It was created, operated, and maintained by a different entity. Morgan Stanley Smith Barney LLC is not implying an affiliation, sponsorship, endorsement with/of the third party or that any monitoring is being done by Morgan Stanley of any information contained within the linked site; nor do we guarantee its accuracy or completeness. Morgan Stanley is not responsible for the information contained on the third-party web site or the use of or inability to use such site.

The information and data contained in this piece are from sources considered reliable, but their accuracy and completeness are not guaranteed.

This illustration in this piece is hypothetical and shown for illustrative purposes only. The illustration is not intended to predict the returns of any particular investment, which will fluctuate with market conditions. Actual results may differ from those depicted in the illustration. The Burbank Hafeli Group at Morgan Stanley Private Wealth Management is focused on serving the investment and financial planning needs of the founders of food, beverage, and consumer products companies and private equity and investment banking professionals.

Mike Burbank was recognized as one of the Top 400 Advisors in the United States by the Financial Times in 2013 and 2014. Scott was also recognized as one of the Top 400 Advisors in the United States by the Financial Times in 2015.

<http://www.morganstanley.com/disclosures/awards-disclosure.html>

A Roth Conversion may not be right for everyone. There are a number of factors taxpayers should consider before converting, including (but not limited to) whether or not the cost of paying taxes today outweighs the benefit of income tax-free Qualified Distributions in the future. Before converting, taxpayers should consult their tax and legal advisors based on their specific facts and circumstances.

Morgan Stanley Smith Barney LLC ("Morgan Stanley"), its affiliates and Morgan Stanley Financial Advisors or Private Wealth Advisors do not provide tax or legal advice. Clients should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trust and estate planning and other legal matters.

Asset allocation, diversification and rebalancing do not assure a profit or protect against loss. There may be a potential tax implication with a rebalancing strategy. Please consult your tax advisor before implementing such a strategy.

The views expressed herein are those of the author and do not necessarily reflect the views of Morgan Stanley Wealth Management or its affiliates. All opinions are subject to change without notice. Neither the information provided, nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance is no guarantee of future results.

This material does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The strategies and/or investments discussed in this material may not be appropriate for all investors. Morgan Stanley Wealth Management recommends that investors independently evaluate particular investments and strategies and encourages investors to seek the advice of a Financial Advisor. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives.

Any type of continuous or periodic investment plan does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low-price levels.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives, and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer.

Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Morgan Stanley Private Wealth Management, a division of Morgan Stanley Smith Barney LLC. Member SIPC.

CRC 4826450 dtd 07/08/2022