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

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Sources: https://www.wsj.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.

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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.

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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.

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