

# The FINANCIAL UPDATE

**D** DAY & ENNIS, LLC  
FEE-ONLY FINANCIAL PLANNING



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## Earning The Equity Risk Premium Return Of 5.75%

**D**uring the Covid pandemic, one day drops in stocks of between -3% and -5% have not been uncommon. And then there was March 12, 2020, a one-day plunge of -12%!

Times of painful stock market losses are when investors earn the equity risk premium. The equity risk premium is financial jargon for “the vig,” the extra return investors were paid for taking a risk. Successful investing requires an understanding of the risk premium on stocks. So here’s a look at the vig in recent months on the Standard & Poor’s 500 index, a period that includes the outbreak of the Covid pandemic in the U.S.

To quantify the post-Covid equity

subtracting the 1.88% from the 7.63%, resulting +5.75% represents the premium stock investors have been paid annually over the boom and bust cycles since 1998. Put another way, owning stocks through the tech bubble in 2000, financial crisis in 2008-2009, and COVID outbreak bear-market rewarded investors with a premium of 575-basis points over what they would have earned by investing in risk-free 90-day Treasury bills.

The chart on the last page does a better job of illustrating the scary parts of the equity risk premium. The red data series shows the daily changes in the stock market, as represented by the price of a share of the S&P 500. Enduring a

### *Beware Of “Choice Architecture” When Making Decisions About Health, Wealth And Happiness*

**S**imply by rearranging the placement of foods, cafeteria managers can increase or decrease their consumption by as much as 25%! To be clear, workers at cafeterias and restaurants wield enormous influence over what people eat.

In the groundbreaking 2008 bestseller, “Nudge,” Richard Thaler, winner of the 2017 Nobel Prize for Economics, and Cass Sunstein, founder of Harvard Law School’s Program on Behavioral Economics and Public Policy, reveal the hidden role choice architecture plays in our decisions about health, wealth, and happiness – how we can be “nudged” to make certain choices.

Choice architecture determines what’s placed at the front of department-store entrances, what’s at the top of fast-food restaurant menus, and whether batteries, hand sanitizer, or *The Enquirer* are showcased on a retail checkout line. In addition, choice architecture tracks every click you make on Amazon and across the Web. To be sure, data science is booming online, powering tech giants like Facebook, Apple, as well as your smartphone.

It’s important for financial consumers to be aware of when they are being nudged in the best direction. There is no law requiring Las Vegas casinos must place games with the best odds for gamblers in front of the entrance, or for brokerage apps to nudge you to choose the best financial solutions.

As a fiduciary, you can count on us to present choices for achieving financial goals that are in your best interest.

Sincerely,  
Day & Ennis, LLC

### DECONSTRUCTING THE EQUITY RISK PREMIUM

#### Average Annual Returns

22 YEARS AND NINE MONTHS

January 1998 through September 2020



risk premium, look at the equation in the graphic: Over the 22 years and nine months ended on September 30, 2020, the risk-free 90-day U.S. Treasury bill averaged an annual return of +1.88%, compared to a +7.63% annualized return on the S&P 500 stock index.

loss of one-third of your portfolio’s value, for some investors, was a stomach-wrenching experience. Sometimes, earning the equity risk premium is hard.

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## Three Easy Ways To Increase Your Chance Of Financial Success

**C**hanging your financial behavior can be an important step in determining your long-term financial success. Here are three simple activities that can help.

**Automate.** Infrequent interventions, such as budgeting once a year, are less likely to bring success than more automatic actions that occur quarterly or monthly. Enrolling in a salary reduction plan which takes money from each paycheck and goes into your qualified retirement plan illustrates the difference between decisions that require your recurring action versus those that are automated. What else might you automate to

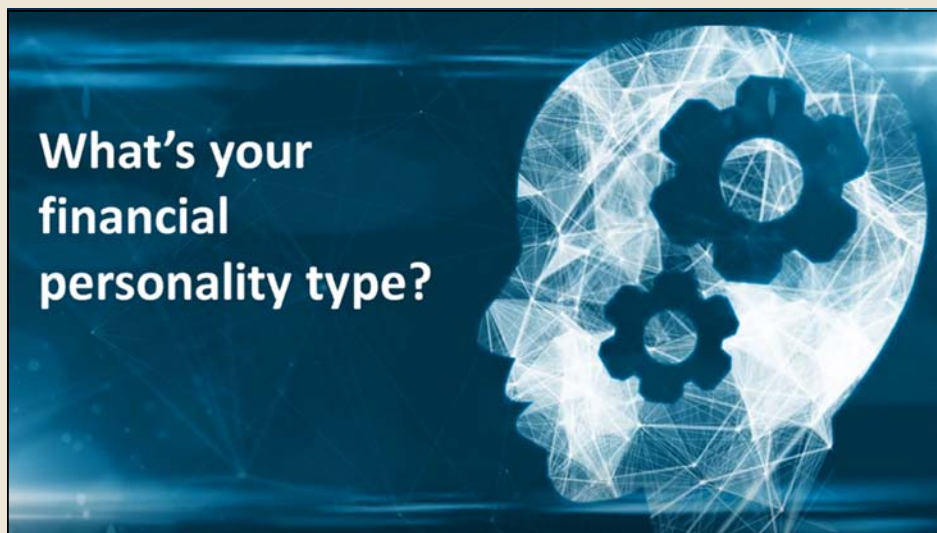
increase your savings or make sure you pay your bills? Examples include signing up for a newsletter, webinar series, or class about tax and investment planning. The easier you make it to become educated about a topic you might not otherwise research regularly on your own, the more likely you are to seek out the knowledge you need to be more fully engaged in learning and find answers to the important questions.

**Write it up.** Whenever you make a major financial decision, write yourself a note about your decision. By jotting down your analysis at the time you make a decision, you'll

create an introspective record that, over the years, will help reveal successes and failures.

**Increase self-awareness.** Your financial personality can help or hinder your financial success and you may be entirely unaware of it. Increasing self-awareness can help you avoid sabotaging yourself. The burgeoning social science of behavioral finance can help you learn about your financial personality traits. For example, would you rather receive \$160 today or \$246 in 12 months? How about \$160 today or \$180 in 12 months? Your answer to a series of questions like this can reveal your predisposition toward deferring rewards now in favor of reaping financial benefits from a long-term plan. Similar questions can guide you in determining how likely you are to tolerate losses in bear markets, whether you are overconfident about your financial decision-making abilities, and offer hints of the types of investments that might work best in a long-term portfolio designed to help you accomplish your financial goals.

If you would like to talk about other steps you can take to ensure healthy financial behavior, please do not hesitate to contact us. ●



## Private Wealth's Perfect Storm

**A**mid the Covid pandemic, changes in tax, financial, and economic arenas have created a deluge of added complexity for advisors managing private wealth. Here's an overview of the abrupt change in conditions now battering private wealth, which, when taken together, amounts to a "perfect storm:"

**Tax Policy.** Budget shortfalls across the states as well as at the federal level are expected to result in steep hikes to state and federal income and transfer taxes.

**Taxable Estates.** For individuals with taxable estates, the current exemption of \$11.58 million from estate and gift tax will be cut in half

January 1, 2026. However, the exemption amount could be cut much sooner, depending on the outcome of the November 3 election. Changes in tax policy increase the downside risks of failing to plan. While 2026 may sound a long way off, preparing now to maximize annual gift-tax exclusions, charitable donations, and appropriately tailored trusts to accomplish your goals can ensure a lasting legacy.

**Lowest Rates In Decades.** Every month the IRS releases the minimum interest rates you





# Education Tax Credits Primer

**T**he American Opportunity Credit (for college students) and the Lifetime Learning Credit — for undergrad, graduate and vocational students — are the two education tax credits available from the federal government. Students can claim either of the two credits for schooling costs, or their parents can — provided they don't opt for married filing separately.

Even if you paid education costs with a student loan, you are eligible to take these credits. You can claim both benefits on the same return but not for the same student or the same expenses.

The benefits aren't huge, but a tax credit reduces your tax bill dollar for dollar, making it much more valuable than a mere deduction. Some key details about the two credits:

## **American Opportunity Tax Credit (AOTC)**

Worth up to \$2,500, you can take the AOTC credit if you paid at least that much in undergrad education expenses in 2019: tuition, fees, books and equipment. Expenses not included in the qualifying formula: transportation, living and

medical expenses.

With a credit, should you owe \$4,000 in taxes, then you need to pay just \$1,500 to Uncle Sam.

What's more, this benefit is better for college students than the lifetime credit because it is refundable. Meaning, if the amount of the AOTC exceeds the tax you owe, then up to 40% of the credit (to a maximum of \$1,000) will be refunded to you.

You can claim the credit for up to four years. Parents take the credit if they ponied up for a student's education costs and the student is listed on their tax return as a dependent.

It does have income limits: To get

the full credit, your modified adjusted gross income (MAGI) must be \$80,000 or less, and \$160,000 if you're married filing jointly. You get a reduced benefit if the MAGI is up to \$90,000, or \$180,000. Above those top levels, you get zilch.

MAGI is the total of your household's adjusted gross income — income minus deductions — with any tax-exempt interest income added back.

## **Lifetime Learning Credit (LLC)**

This one is worth a little less, \$2,000, and there's no ceiling on the number of years you can take the LLC. That's why it makes great sense

for a grad student, who faces years of course work. Ditto for someone who goes back to school to develop new aptitudes, even if the person took the AOTC in previous years.

Like the AOTC, the LLC also doesn't cover living expenses,

medical care or transit, but does allow you to claim supplies and books that the school requires.

The MAGI ceilings are a little lower than with the AOTC. Namely, \$57,000 for singles and \$114,000 for marrieds for the full benefit, and \$67,000 and \$134,000 for the reduced credit. Another downside: The LLC doesn't have a refundable feature.

The real cost of education has risen for decades, and these two federal tax credits are a single instrument in a strategy to pay for private school or college costs. For information about other tax breaks and advice on strategically planning to finance education, call our office, as financial and tax planning are highly dependent on your personal situation. ●



are permitted to charge on loans to family members, trusts and other related entities. With this “applicable federal rate” currently at less than 1%, loaning assets may be a savvy way to transfer wealth to the next generation for buying a home, starting a business, or making charitable bequests. The loans are sometimes part of a plan to transfer a family business, or support children with special needs. With the pandemic potentially lowering the value of real estate and business assets, and causing frequent stock market volatility, optimizing low interest rates to make intrafamily loans is suddenly a more viable solution to reducing taxes and enhancing legacy planning.

**Liability Explosion.** With tenants

more often unable to pay rent, and small businesses facing financial difficulty, landlords and business owners are suddenly facing an explosion in their liability exposure. Asset protection strategies to mitigate personal liability exposure in the event of a setback requires preparation before a problem arises or facing a legal challenge.

The Covid pandemic abruptly changed tax and financial conditions affecting estate tax and asset protection drastically, and this perfect storm requires proactive engagement of family members as well as advice from tax, legal and financial professionals. Please contact us with questions about your personal situation. ●

# Confronting Mortality's Details

The Covid pandemic is causing families unimaginable suffering, worry, and grief. It is forcing many individuals to confront mortality, to consider, in very real terms, perhaps for the first time, what will happen when their life comes to an end. Here, in less than 300 words, are key facts about documents that govern what happens to you at the end of your life.

A health care proxy and living will name someone to make medical decisions if you're unable to express your wishes and contain instructions about end-of-life care. This is understandably top-of-mind for a lot of people now.

A durable power of attorney (POA) permits someone else to manage financial and other matters while you're alive. The POA empowers someone you appoint to pay bills, write checks, or sell and purchase assets on your behalf should you become incapacitated.

Your last will and testament

provides the details which take effect at your death for distributing your property. It should be reviewed annually so that the trustee, executor, and guardians of minor children you have appointed still conform to your current wishes. It's best to speak with whomever you're appointing about your wishes so that they're aware of your intentions.



A revocable trust can also provide for the disposition of your property after you die while avoiding the probate court process. Because courts across the country were shuttered for a time, they must now deal with a surge

in filings due to the pandemic. In times like these, it's advantageous to have a revocable trust to avoid probate court delays. Setting up a revocable trust requires changing the titling of bank and brokerage accounts, real estate, and other assets, and may require signing documents with a witness or notary present, which is now complicated due to social distancing.

Fortunately, remote signings can be properly executed via online meeting such as Zoom.

Finally, and most importantly, you will want to be certain that the beneficiary designations on both your retirement plans and your life insurance policies are up to date, as circumstances change over time. As a financial advisor, creating legal documents is

beyond the scope of our work, but we can refer you to experienced professionals who can create these documents so they can be properly integrated into a comprehensive financial planning strategy. ●

## The Equity Risk Premium

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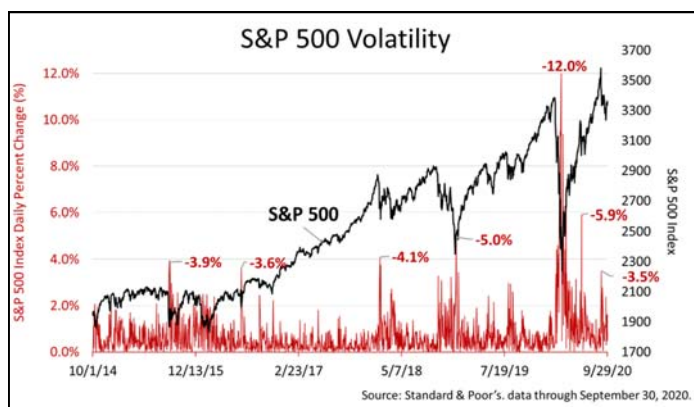
Armed with these kinds of statistics, however, knowing that big daily down days reliably do come, it is easier to withstand the uncertainty.

With the COVID outbreak tragically surpassing 1,000-deaths in a day and the changes in all three branches of the U.S. Government, the risk of a stock market plunge looms larger. However, permanent investors who plan to own stocks for the rest of their lives would be wise to view

volatility as a friend.

That may be counterintuitive, but it absolutely is valid. Choosing to expose a portion of your portfolio to price volatility, also known as risk, justifies a better return. You wouldn't earn the six percentage-point equity risk premium on stocks, if you weren't exposed to lots of

volatility. It just goes with the territory. It's part of owning a risk asset. ●



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