ANDERSON
FINANCIAL STRATEGIES

Quarterly Playbook

1st Quarter 2021

Current Financial Planning and Investment Themes

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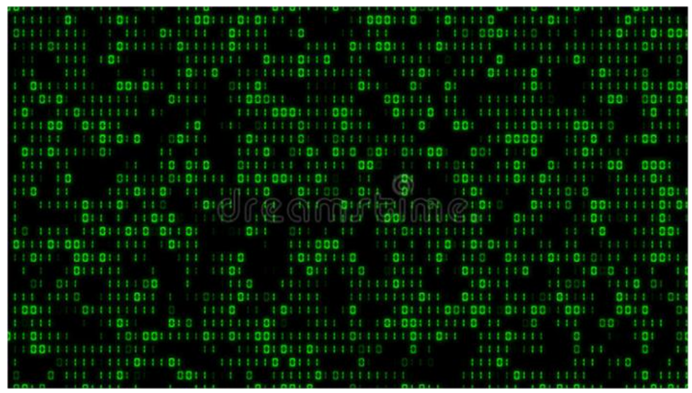
"2021: A transition year"



2020 was a year like no other and felt a bit like we were in The Matrix. While there were some silver linings, it is one year that we are glad is over. In 2021, we will be transitioning in many ways, with politics, with economics, with COVID, and even with our personal lives. Hopefully the changeover goes smoothly but it's likely that there are some bumps along the way. We expect the first part of the year to be a period where the world is finding its way back closer to normal. However, our view is that we end 2021 in a mostly positive fashion…

"Ever have that feeling where you're not sure if you're awake or dreaming?" —Neo from the Matrix

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US Economics

The US economy has not made its way out of the matrix yet, but we expect the transition to be heavily underway by the end of this quarter. After the rollercoaster year of 2020, what could have been an economic disaster is turning out to be not as bad as initially thought. The latest GDP estimate for the 4th quarter 2020 from the Atlanta Fed's GDPNow is 8.5%. If this estimate holds, the full year 2020 decline in GDP is ~2.0%. For 2021, the current Fed range of projections are 0.5-5.5% which is really a SWAG (Scientific Wild Ass Guess). Frankly, it's really too early to tell, but there are many indications that the strong economic momentum we experienced in the second half of 2020 can continue into 2021. That's the big question, how much does the rate or recovery taper off? According to Moody's Analytics, U.S. real GDP is forecasted to grow by 4.0% in 2021 and 4.5% in 2022, driven by continued accommodative monetary and fiscal policies, pent-up consumer demand, and rising corporate investment. Further momentum can be seen with unemployment data. The latest U-3 (official) unemployment reading at 6.7%, falling from 7.9% back in September. Additionally, the U-6 (broader definition including part-time) unemployment rate also fell to 11.7% from the September read of 12.8%. However, December posted the first job losses in eight months, losing 140,000 jobs. If this seems odd, remember that unemployment is calculated by the number of people looking for a job divided by the total number of people in the job market. So, if there are more people leaving the job market than the number of jobs lost, then the unemployment rate can still decline. There is an estimated 4 Million people that have left the job market since the beginning of the pandemic. Thus, the labor force participation rate is currently at 61.5%, compared to 63.4% in January of 2020. Despite this, average household net worth hit yet another all-time high, boosted by market gains, and the Personal Savings Rate remains elevated at 12.9% up from 7.6% in January. Household debt service did however inch up coming off all-time lows. To be sure, the combination of economic data is mixed, but we believe on balance things are still trending in a positive direction. It will be interesting to witness the transition over the year….

US Equity Markets

Continuing with the Matrix theme, the US stock market is facing a choice between taking the red or blue pill this year. A choice between revealing an unpleasant or otherwise life-changing truth, represented by the red pill, and remaining in blissful ignorance, represented by the blue pill. We have been saying for a while that the broad market of US stocks is looking a bit expensive, but the Federal Reserve and US Legislature have become big-time dealers of blue pills. We think that will continue while the underlying fundamentals continue to improve. This means price levels should hold up even though we expect some mild volatility here in the first quarter while things transition back to normal.

Current P/E as % of 20-year avg. P/E

	Value	Blend	Growth
Large	130.6%	144.8%	168.5%
Mid	127.1%	139.4%	194.6%
Small	107.2%	143.6%	198.5%

However, that does not mean we expect another 15%+ drop, but rather some choppiness as we move out of COVID rules to more traditional value metrics for stocks as a whole. When we look a little deeper, we believe that Small Caps still have more room to run as well as the dominant technology players commonly referred to as FAANG+ which is Facebook, Amazon, Apple, Netflix, Google, Tesla, Twitter, Nvidia, Alibaba, and Baidu. FAANG+ stocks have developed an almost unstoppable growth momentum it seems.

US Fixed Income

Bonds are deep inside the Matrix right now. Extremely low yields make even the slightest uptick in interest rates a difficult environment for traditional fixed income like Government and Investment Grade corporate bonds. However, the low-rate environment is expected to continue for at least the next year or more. Although, even though rates are expected to remain low relative to history, they should start floating up as economic recovery lengthens. That all adds up to volatility and the need to move out the risk continuum to seek more opportunity for return. We believe fixed income sectors such as Convertible Bonds, High Yield and Preferred Stocks will fair the best in 2021.

International Markets

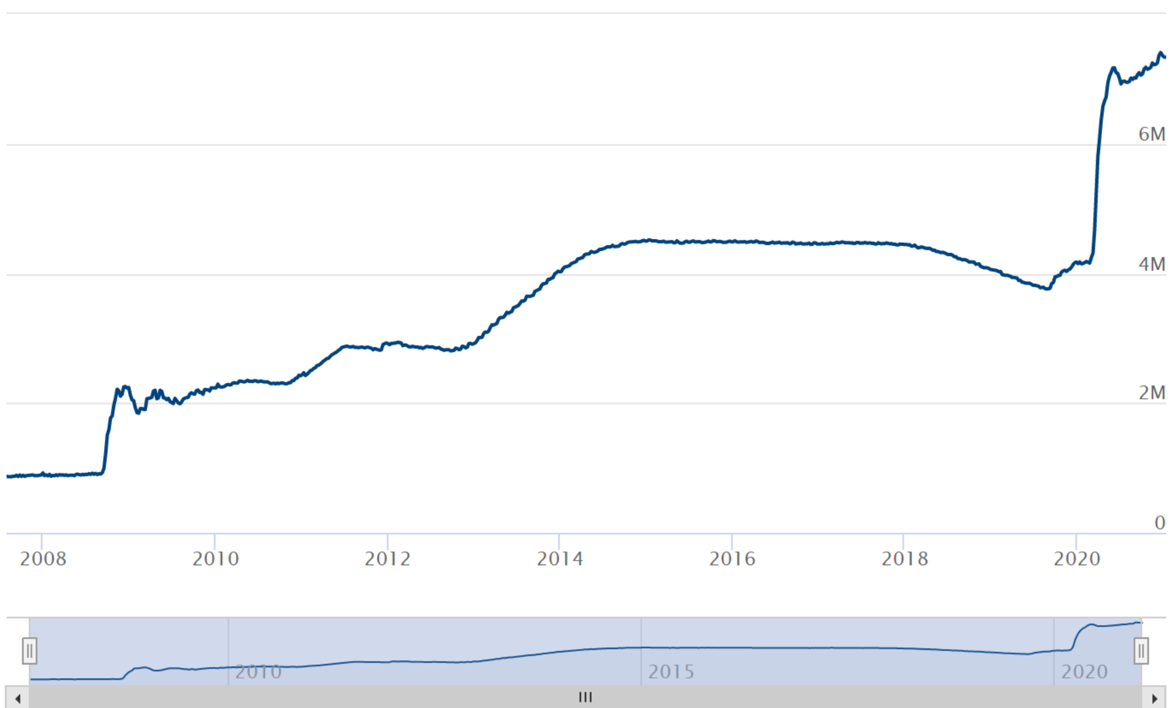
Outside of the US, the recovery has gone much slower. This leads to opportunity, relatively speaking. Valuations for global stocks outside of the US are more attractive with the MSCI All Country World Index ex-US projecting a 16.7 P/E ratio vs 22.3 for the S&P 500. That said, international investments have been lagging for many years due to relatively poor economic growth compared to the US and have been expected to outperform. Is 2021 finally the year? We will see….

Real Estate

We view Real Estate as an alternative investment asset class between stocks and bonds. It has parallels to bonds because property-owners collect contractual rents as current income. On the other hand, it also has resemblances of stocks because property-owners can increase rents under better economic conditions. Though many headlines have focused on properties severely affected by the shutdown, other sectors have benefited from the acceleration of e-commerce and remote computing. Rent collections have remained above 90% in most REIT sectors, and earnings have been far more resilient than those of the broader market. In the meantime, while a dramatic rise in inflation is not a likely scenario, the risk of moderate inflation over the medium term has increased. As such, "income with growth" should be an important given accelerating economic growth and a potential reflation environment. REITs have historically delivered their best returns in the early stages of economic recovery and have only experienced a modest recovery so far….

Interest Rates & the Fed

The Federal Reserve is hard at work dealing blue pills that let the markets remain in blissful ignorance. The majority of Fed Governors still see Fed funds rates at 0.0%-0.25% through 2023, despite GDP performance being better than their expectations. The most recent median projections for 2020 GDP improved further from -3.7% in September to -2.4% for December. Unemployment expectations dropped as well from 7.6% in September to 6.7% as of December. However, Fed Governor Brainard did note recently that the unemployment rate for the lowest paid workers is likely over 20%. The Fed believes that the economy is in a K-shaped recovery, meaning that some segments are doing well while others continue to struggle. Keep in mind, despite what they say, every economic problem is a nail and they are the hammer with extremely low interest rates. In order to keep interest rates very low, in addition to holding the Fed Funds rate near zero, they have also had to buy an enormous amount of bonds in the open market at premium prices (higher bond process equal lower yields). This has had the effect of increasing their balance sheet to over 7.3 TRILLION!



The Fed Balance Sheet since 2008

Legislative Affairs

Washington looks a lot different now than it did over the last four years and we are trying to anticipate what policies may be on the horizon. The conventional wisdom is that there will be more stability and less disruption, however our view is that the political division will become even worse. We hope we're wrong. The biggest policy question is around tax increases and their timing. Our early read is that 2021 will see more spending and stimulus from the Biden administration which will benefit markets and the economy in the short run. This may come in the form of infrastructure spending and increased government unemployment and welfare benefits. We feel it is unlikely that tax hikes will be passed in 2021, even though it was a campaign item. Same goes for any other major structural economic changes such as healthcare. Rather, these items (tax hikes and healthcare) will likely be pushed through in 2022 prior to the mid-term elections. Other slightly minor policy changes expected are the relaxation of trade restrictions with China, easing of illegal immigration enforcement, and more restrictive regulation especially around CO_2 emissions. Lastly, the bipartisan "Consolidated Appropriations Act of 2021" was passed on 12/21/2020. Here are 9 highlights from the Act:

Second Stimulus Payments – $600 per eligible taxpayer and dependent under the age of 17 is in the process of being distributed. The stimulus payment is reduced (potentially to $0) when taxpayer Adjusted Gross Income (based on 2019 tax return) is above $75,000 for Single and $150,000 for Joint filers.

Employee Retention Tax Credit – numerous changes were made to this tax credit for businesses making it very beneficial for tax purposes to keep employees on payroll. Small businesses especially (which now covers those with up to 500 employees rather than the original 100) benefit from being able to use all employee wages towards the credit calculation. The amount of the maximum wages allowed per employee to calculate the credit quadrupled from $10,000/year to $10,000/quarter. The refundable credit rate went from 50% to 70%, meaning an employer can receive 70% of $10,000 in wages per quarter ($7,000) as refundable Payroll tax credit.

Payroll Protection Program Round 1 Clarifications and Round 2 Opening – the Act provided more guidance on the requirements of the original PPP loan program. Additionally, any businesses who did not take a loan in round 1 will have an opportunity in the future, as the round 1 loan applications will be reopened. For those businesses who did take a loan, and now need more financial support, a round 2 will be opened up for applications, but the requirements look to be more stringent. Most notably, to be eligible for round 2, a business must have already received and spent their round 1 loan. One important outcome is that Congress clarified that not only are forgiven PPP loans excluded from the business's gross income, the expenses paid for with PPP loan funds will remain tax deductible as business expenses.

<u>Extension of charitable contribution tax benefits</u> – Congress made charitable giving more tax beneficial again by extending the $300 above-the-line deduction allowed in 2020 (anyone giving cash to charity can deduct that nominal amount regardless of taking the standard deduction), to allowing $300 again in 2021 and Joint filers can do up to $600. Additionally, charitable cash donations are deductible up to 100% of your Adjusted Gross Income, rather than capped at 60%.

<u>Carry Forward Unused Flexible Spending Account Balances</u> – the Act permits employers to allow employees to roll forward any unused Dependent Care and Health FSA balances from 2020 into 2021, and also 2021 into 2022. Congress recognized many were left with unused balances in those accounts because of unplanned COVID changes, and they would normally lose that money. Now, they're allowing employers to permit this without disqualifying the FSA from qualifying for a tax deduction. It is up to each employer as to whether they allow employees to carry forward their balances.

<u>Medical Deduction Floor Permanently 7.5%</u> -- for those who itemize their deductions and typically have higher medical expenses to deduct, a permanent change was made to keep that "floor" at 7.5% rather than 10% going forward. That's a beneficial change, as any medical expenses above 7.5% of your Adjusted Gross Income are deductible, rather than 10%.

<u>100% Deduction for Business Meals at Restaurants</u> – the allowed deduction for business meals went from 50% to 100% for 2021-2022. The meal must be "provided by a restaurant". One would assume this includes dining in and takeout, but further guidance will likely be coming.

<u>RMDs in effect for 2021</u> – those 72 and older with IRAs and 401ks with pretax balances should prepare for RMDs as usual in 2021.

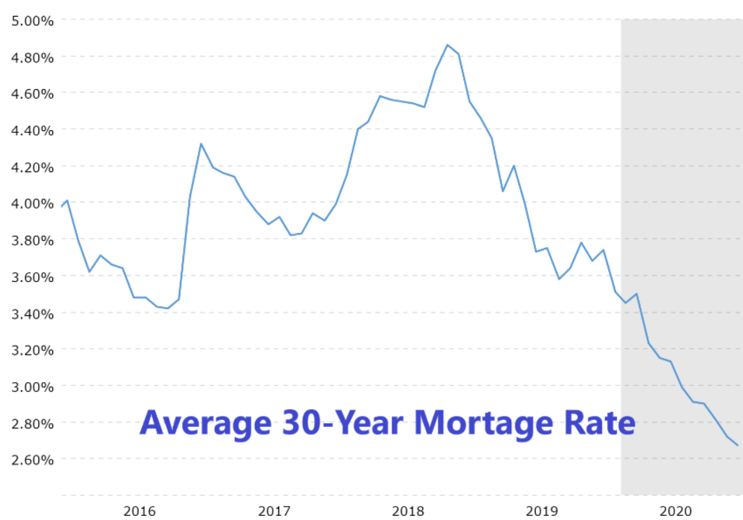
<u>Federal Student Loans Payments Back, with Interest</u> – the relief of forbearance with no interest being charged is set to expire on 1/31/21. Those with federal student loans should be prepared to resume monthly payments, with interest, in February.

Financial Planning Corner

Should I Refinance My Mortgage?

We have been fielding this question routinely for going on a year now. Interest rates have continued to drop as monetary policy has made a strong effort to keep interest rates low in order to boost the economy.

So, when do we think it makes sense to investigate refinancing? If we think about what we're trying to accomplish, which is take your current mortgage principal balance, and get a new, lower interest rate on that balance going forward, then a refinance should easily lower your monthly payment (as long as the new refinanced loan does not have a much shorter term than your current remaining loan term).



<u>The question of whether you should talk to a mortgage officer really comes down to 3 elements:</u>

1. What is your current mortgage interest rate?
2. What rate could you qualify for today?
3. Do you expect to stay in your home for at least another 5 years?

- If your current rate is 3.75% or higher, we think it's absolutely worth the time to talk to a mortgage officer.
- If your rate is 3.25% - 3.75%, we still think it's worth exploring, but the closing costs and overall savings will require a bit more analysis to determine if it's worth it in the end.

- If your rate is less than 3.25%, you're in a pretty good place and we feel you're ok staying with the mortgage you have.

- If your credit score or financial situation has changed negatively since acquiring your first mortgage, be aware this could affect what you can qualify for today. However, we're currently seeing and hearing of anything from 2.5-3.0% rates on 30-year mortgages, as long as your credit is relatively good.

- If you're planning to move within 5 years, it makes a refinance less attractive because it's much more unlikely you'll recoup your up-front costs to pay for closing.

<u>How do you analyze if refinancing is worth it after you know what your new monthly payment and interest rate would be?</u>

We like to see a "break-even" period of no more than about 3 years, with the shorter the better. For example, if refinancing drops your monthly payment by $200, and closing costs are $4,000, it would take you 20 months to recoup that up-front cost (without factoring interest you could have earned).

We feel that as long as that recoup period is 36 months or less, it's typically well worth it. Even if your plans change, and a house you intended to stay in for 20 years turns into 5 years, you would've come out slightly ahead by refinancing. And over a 15 or 30-year mortgage, after a 3 years or less break-even period, you're coming out ahead for all the remaining years.

We don't see interest rates going much lower than they are currently, but we also don't see them rising quickly in the short-term either. We expect to be in this type of environment at least through most of 2021.

If you'd like to discuss your refinance situation personally, or are looking for a lender recommendation, don't hesitate to reach out to us!

We're here to help. If you have questions about these or any other topics, don't hesitate to call us at (855) AFS-4545.