THE CLIENT LETTER
FREE
MONTHLY NEWSLETTER

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FAQ's

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Why hasn't the market fallen yet? Will higher taxes stall the recovery?
Is inflation going to be a problem? What the hell is bitcoin and do I need to own some?

These are some of the questions we have fielded on a regular basis lately. I thought it might be helpful to use this forum to address them at large.

1. Why hasn't the market fallen yet?

Much to the surprise of many, the overall stock markets as measured by major indices have set a series of new highs so far this year. This has left a lot of investors scratching their heads with cash on the sidelines. I also hear a lot of analysis attempting to explain the markets behavior using arcane and elaborate theories. In my opinion it boils down to a much more simple cause-and-effect: *Too much cash looking for a home.*

The average yield on a money market account is near zero and the average one year CD rate was recently .25% (one quarter of one percent!). This means dollars held in cash or CDs are technically losing ground to inflation every year. This money has been looking for a home and much of it has found it in stocks and real estate. I get calls every week from people looking for alternatives for their cash. And as long as interest rates stay reasonably low, I don't see much change to this dynamic. After all, money has a way of going where it is treated the best. Some investors are calling for higher rates but with interest rates and bond yields much lower in many parts of the world, I don't see how interest rate could rise significantly here without a corresponding rise in other foreign yields. And I believe rates would have to rise to a level where fixed income investment are perceived as more attractive than stocks before derailing the bull market.

Does that mean stocks will keep going up? Certainly not in a straight line. In fact, the market feels a little bit overheated to me personally and I would not be surprised to see a normal and customary pullback of perhaps 5-10% at any moment. After all, the market has a way of weeding out the people who shouldn't be there on a regular basis. But declines of 5-10% are "normal and to be expected". On average the market has a drawdown of -14% at least once per year going back 75 years. But I also think any decline like that might be used as a buying opportunity rather than a reason to panic.

And to those naysayers who believe the market is going to collapse from these levels, I would remind you of an old Wall Street saw: "***The market can stay irrational longer than you can stay patient".***

2. Will higher taxes kill the economic recovery?

In a nutshell, I don't think so. The main reason I feel this way is that many experts on both sides of the aisle do not believe the final outcome will be the full brunt of Biden's initial proposal. Biden has proposed raising the corporate tax rate from 21% to 28%. This would restore it back to the level under the Obama administration. While I am not a fan of raising corporate taxes, many experts believe any increase will be a compromise, perhaps in the 25% range. At this level, yes it would put some downward pressure on margins, but I do not think it would derail the economic recovery. And on the personal income tax side, Biden is proposing to increase the top tax bracket back to 39.6%, where it was in the Obama administration. Again, I'm not a fan but I also don't think it will be enough to rail the recovery.

The two most interesting and perhaps damaging tax proposals that Biden has put forth have to do with capital gains.

Currently, capital gains are capped at a 20% tax rate. Biden's proposal would tax capital gains as ordinary income (39.6%) on anyone earning over $1 million. This effectively doubles the capital gains rate for these individuals. And before you dismiss this proposal as simply a tax on the super-rich, there is evidence that the actual capital gain will count towards the $1 million threshold. Therefore, a large asset sale such as a commercial building or a large residence, could generate enough capital gain by itself to be over the $1 million level and thus that portion be taxed at nearly 40% rather than 20%.

Most analysts inside the beltway feel like any tax proposal that gets passed will be a watered down version of what has been initially proposed. I tend to agree with this assessment and am not ready to hit the panic button just yet.

3. **Is inflation going to be a problem?**

The short answer: Could be, but probably not. The recent consumer price index (CPI) rose 4.2% in April, the highest reading in 13 years. I would also anticipate further high readings in the coming months as prices for many items have increased rapidly. In addition, business owners are having difficulty finding workers to fill jobs, thus putting upward pressure on wages.

But there are several reasons to believe such upward price pressure could be transient. First there were severe weather related shutdowns at many ports from the winter. These bottlenecks are still having an impact on the supply of goods.

Also, the onetime stimulus packages put significant amounts of cash in consumer's hands which are chasing fewer goods. And while this is inflationary, once the stimulus checks are spent, perhaps supply and demand will equalize.

Regarding workers, the reason cited for the difficulty in filling jobs is that many wage earners are still getting unemployment checks. When someone gets paid to stay home, it's highly unlikely they show up to a help-wanted ad. This reduces the pool of available workers and we know from Economics 101 that leads to higher wages and inflation. Once these unemployment benefits run out, I would expect the labor markets to stabilize a bit.

Lastly, my good friend and colleague, Topper Mathews made a great observation about bonds and inflation. Many would consider the bond market the best indicator of future economic activity and at the moment it does not seem overly concerned. At the time of this writing the 10 year Treasury note is yielding 1.6%. If inflation were indeed a significant concern, we would expect to see this yield moving higher.

4. **What the hell is bitcoin and should I own it?**

It is perhaps the single most asked topic in finance these days. I don't think anyone can say for sure what the future holds for cryptocurrencies. There are some who believe it will change the way commerce is conducted forever and there are others who think it is a passing fad and it is only a matter of time before people notice the emperor is wearing no clothes.

I personally do not own bitcoin - not because I don't think it can rise in value. Rather, I struggle to understand its purpose. With volatility of 10% daily, you would be hard-pressed to convince me it is a stable ***store of value***.

Some claim that cryptocurrency is a decentralized method of trade that cannot be manipulated by sovereigns and Federal governments - who can simply print more dollars to pay off debt. But as crypto gains more popularity, I would not be surprised to see government officials step in and seek to regulate this sector at least in some capacity.

Of course, if crypto is to be considered an asset class like real estate or commodities, then perhaps it may eventually have a place in portfolios. But until then, I see at least a half-naked emperor.

Edie's Corner

Just a reminder, it is always important that we have updated personal information for your accounts. Consider things such as beneficiaries, phone numbers, address changes, etc. If any of these have recently changed, please let us know. You can always email me at edie.reeves@raymondjames.com. Thanks!

Cole Ellet, CFP

Edie and I would like to tell you of an exciting announcement. We are pleased to welcome Cole Ellet, CFP as part of our Raymond James and Pinnacle Asset Management team.

Cole is a graduate of Ole Miss and holds the distinguished title of CERTIFIED FINANCIAL PLANNER professional. He has six years industry experience and specializes in financial planning as well as investment selection. Cole also brings a unique skill set of utilizing computer software to run various financial planning assumptions, something we believe is a valuable asset to clients.

Cole and his wife Ainslie have three boys and we are excited to have them as part of our family - we hope you will be as well. In the coming weeks/months, Edie and I look forward to introducing him to clients, we think he will be a valuable member of our team.

As always, we thank you for your business, your friendship and the trust you place in us. Feel free to share this letter with anyone you feel may benefit. Edie and I are in the office daily and happy to answer any questions you may have. Until then, wishing you health and happiness.

Regards,

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"2017 RJFS Chairman's Council Member"
"2019 Forbes Best-in-State Wealth Advisor Tennessee"
"2019 Bank Investment Consultant Top 100 Bank Advisors"

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Bitcoin issuers are not registered with the SEC, and the bitcoin marketplace is currently unregulated. Bitcoin and other cryptocurrencies are a very speculative investment and involves a high degree of risk. Securities that have been classified as Bitcoin-related cannot be purchased or deposited in Raymond James client accounts.

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