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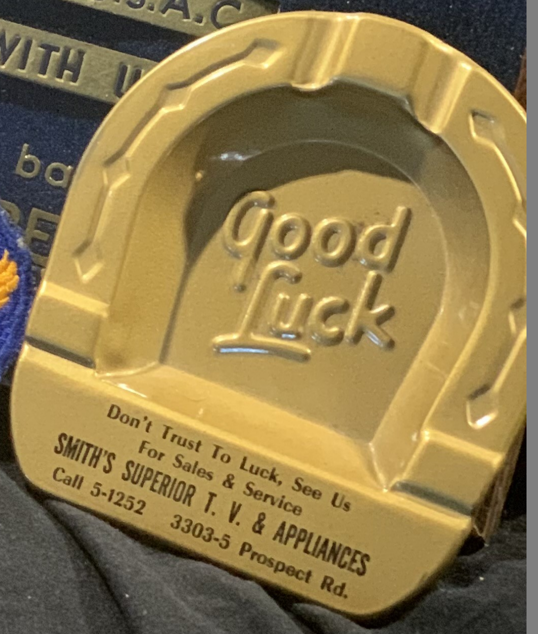

REDUCE YOUR TAXES

Q4 2021 Newsletter

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Gerald "Jerry" Smith served in WWII as a Radio Tech in the Army Air Corps, the precursor to the United States Air Force. During those days, allowing the enemy to obtain your radio or frequencies would create a major security compromise. To mitigate this risk, small grenades were placed in the dashboard of those aircraft and were detonated to destroy the radio if a pilot ever had to eject.

During a routine radio removal procedure one of those bombs exploded in Jerry's right hand. He lost an eye, several fingers and was filled with shrapnel from the blast, but he survived. Coming home, he opened the first television store in his home town of Peoria, Illinois, raised a family and enjoyed life. He had picked up a staph infection in a hospital, suffered from severe arthritis and occasionally a piece of that old shrapnel would work its way back to the surface. He ended up spending several of his final years getting around in an electric wheelchair but he never complained. In those days, you just didn't. Back then, everyone knew…somebody else has it worse. Grit your teeth and get through it.

Jerry was one of the funniest human beings I ever met and he was my grandfather. He always had a great joke; most of them were even appropriate to share in mixed company.

As the weather would break in the Spring he would usually pull out one of his favorites and announce in a loud voice ***"Would you look at this beautiful day! All the birds are chirping and eating the dirty worms."*** I suspect this was a quote or phrase he picked up from a TV show or movie at some point but I have no idea from whence it came. I only know it made me laugh whenever he said it.

It is usually on one of those beautiful Spring days each year when I get a call with this question; "Tyson, this is crazy, you know how much I'm paying in taxes this year? What can I do? How can I fix this?" In many cases, there are actions we can take to reduce the tax burden, as long as taxes hadn't yet been filed. However, in many other cases, we find out that it is too late and the caller missed their opportunity for the best possible outcome.

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How to Reduce Your Taxes

Let me first state that each individual, family or company face a different set of challenges. Some of the suggestions on this list will be significant game-changers for many readers. Other ideas, maybe not. The most important thing I can recommend is to call your financial advisor as soon as possible and go through these topics.

1. If you are covered under a company retirement plan, increase your contribution amount.
    - A. Traditional retirement plan contributions are deposited pre-tax and reduce your tax burden this year. They compound tax-deferred and income tax is typically paid as it is withdrawn during retirement when savers are potentially in a much lower tax bracket.
    - B. ROTH contributions are deposited after-tax. You still pay income tax on those earned dollars this year. The contributions then also grow tax-deferred but then they come out Tax-Free, when withdrawn after age 59 ½.

2. If your Employer Sponsored retirement plan limits the amount you are allowed to contribute to a dollar amount below the maximum allowed by the IRS, you probably have a defective plan that is failing the IRS tests. Please introduce us to your Human Resources Team or Business Owner so we can help them solve this issue.
    - A. $19,500 is the maximum 401(k) contribution for anyone under age 50 in 2021
    - B. $20,500 is the maximum 401(k) contribution for anyone under age 50 in 2022
    - C. $26,000 is the maximum 401(k) contribution for anyone 50 or older in 2021
    - D. $27,000 is the maximum 401(k) contribution for anyone 50 or older in 2022

3. If you turn 50 during 2022, review the numbers above and adjust your percentage to maximize your amount.

4. If you cannot afford to maximize your contribution amount, at least increase your amount to capture all of your employers matching dollars. That is free money being left on the table.

5. SIMPLE IRA Employee Contribution Limits are $13,500 in 2021 and $14,000 in 2022.

6. SEP IRA Contribution Limits are $58,000 or 25% in 2021 and $61,000 or 25% (whichever is lower) in 2022.

7. Defined contribution limits from all sources are capped at $58,000 in 2021 and $61,000 in 2022.

8. The Employee compensation limit for calculating contributions is moving from $290,000 to $305,000 in 2022.

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9. The Highly Compensated Employees threshold for nondiscrimination testing is also moving up from $130,000 in 2021 to $135,000 in 2022.

10. Profit Sharing distribution deadlines coincide with tax filing deadlines plus extensions. You may have more time than you thought to reduce those taxes.

11. Contact your CPA to review if possible tax credits, deductions or charitable contributions might be applicable or helpful.

12. IRA & Roth Contribution Limits for 2021 & 2022 remain the same at $6,000 under 50 or $7,000 for those who are 50 or older.
    - A. IRA & Roth IRA contribution phase outs apply, depending on income.
    - B. IRA Phase out on IRS web site: https://www.irs.gov/retirement-plans/ira-deduction-limits
    - C. Roth IRA Phase out on IRS web site: https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2021
    - D. Changes for 2022: https://www.irs.gov/newsroom/irs-announces-changes-to-retirement-plans-for-2022

13. Review all your holdings for possible tax loss sales. You have until December 31st to take advantage of them.

14. If you need to sell an asset with a tax consequence, can you defer the sale until it is a long -term gain, instead of a short term gain?

15. Do you need to sell the asset at all? Could it be used as collateral instead? Is that appropriate for your situation?

16. If you need to sell an asset with a tax consequence, can you borrow against that asset to defer the sale into the next calendar year? This may not eliminate the tax but it may provide an opportunity to find an offsetting transaction over the next calendar year and the cost of the short term leverage might be relatively de minimis.

17. If you own a business and have not reviewed at least all of these options – call us.

18. If you don't own a business. Have you considered starting one?

19. Consider utilizing the HSA savings deduction.

20. Consider tax-advantaged investments in your taxable accounts.

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Government Debt

To help my readers understand government debt, I first want to illustrate using a concept we can all understand; The Household Budget. Now, you may not think that you have a budget but I have found that most people have a pretty good idea of how much money they bring home each paycheck and how much money they spend each month. Those two things equal a basic budget. Subtract how much you spend from how much you make each month and you will get a numeric result. That resulting number is either positive or negative.
Below, I illustrate the difference using two fictitious couples.

In our first example, let's say **"Jim & Pam"** are very fiscally responsible and bring home $5,000 each month after taxes. If their household expenses then cost them $4,500 (mortgage, insurance, electric, water, cell phone, food, gas, haircuts, etc.) they have a surplus of $500. $5,000 - $4,500 = $500 this extra $500 can then go into savings, donations or a rainy day fund. These two have a **Budget Surplus**, an excess of income. By the end of 10 years, they would have saved $60,000. If invested at a 10% annual rate of return, this would grow to over $95,000.

In another example, let's say **"Marge and Homer"** are less responsible and have a **Budget Deficit**. They bring home the same $5,000 but spend $6,000 each month. How could that happen? They didn't have the money, how could they have spent an extra $1,000? Unfortunately, in our society, it is way too easy to find a way to borrow extra funds by simply obtaining a high interest rate credit card. The next month, this couple would then either need to pay off the $1,000 or just the interest on the original $1,000 at the prevailing (outrageous) rate. If they out-spent their income by $1,000 in the second month, they would then have a total of $2,000 in debt, plus the interest. Making just the interest payments is a whole lot cheaper than paying off the principal so the pattern could continue. Eventually, without an increase in income or a reduction of spending, the compounding deficit and debt servicing (interest charges) could put them into bankruptcy.

So now we can talk about our favorite uncle…Uncle Sam. The U.S. Government, if thought of like a household, also has regular expenses that have to be paid. Unlike you and me, the government does not have a traditional mortgage, instead it funds the military. The U.S. Government does not have real estate taxes, it funds the CIA. The U.S. Government does not have a water bill, it pays for Government programs. The list of budgeted government expenditures is very long and the final outlay is an impressive number. In Fiscal Year 2021, the US. Government spent $6.82 trillion dollars. That is ($6,821,000,000,000). During Fiscal Year 2021, the federal government collected $4.05 trillion dollars; $4,050,000,000,000. The shortfall of roughly $2.77 trillion dollars was borrowed money. So where does the U.S. Government borrow money?

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Obviously, the U.S Government cannot simply go online and apply for a credit card with a $100 trillion dollar limit. Those do not exist. At least, I've never heard of one. As an alternative, the U.S. simply issues IOU's with a fixed interest rate on them. Since the U.S. Government is one of the safest and most financially stable countries on the planet, loaning money to her is a very low-risk investment. Since it is very low-risk, it is also very low-reward; the interest she pays on her IOU's (Treasury Bonds) are exceptionally low.

So who buys them? Let's pick on another fictitious person…**Mr. Wayne**…and let's say Mr. Wayne has One Billion Dollars.

When you have one billion dollars, what is your biggest worry? Maximizing your return? No. The biggest concern of the truly wealthy is making sure they stay wealthy! Ergo, Mr. Wayne would want to keep his money in a very safe place, like a bank. Unfortunately, banks can only protect deposits through the FDIC Insurance coverage up to $250,000 at present. In order to protect $1,000,000,000 with FDIC Insurance, Mr. Wayne would need to have his funds spread across 4,000 FDIC insured institutions. In reality, not only would this be very difficult to achieve and track, there are a limited number of FDIC institutions available. As of September 30, 2021, FDIC.gov listed the total number of FDIC Insured Institutions at 4,914. (Source Data Link: https://www.fdic.gov/analysis/quarterly-banking-profile/statistics-at-a-glance/2021sep/industry.pdf) …what if he had $2 Billion? Or 3 Billion? Or what if he was super-wealthy because he founded an online retailer, a software company or the most prolific electric vehicle in history? Those types of people have a typical net-worth in the hundreds of billions of dollars.

Those super-wealthy individuals, companies, institutions and even other countries with cash will spread their funds among other nations debt issues….those IOU's I mentioned earlier. In the United States, those are called Treasury Bonds. Other countries issue them as well. When making decisions on where to park all that cash, a quick look around the globe will show where the highest rates can be earned.
Today, here are some of the current 10-year Government Bond Yields being offered (as of 12/1/2021)

Australia	1.75%
US	1.42%
Canada	1.57%
United Kingdom	0.72%
Japan	0.07%

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The natural instinct when perusing this list of 10-year offerings, might be to buy the highest yielding Australian bonds. That may not be the wisest decision because other factors will come into play. Is Australia as stable as the United States? What will their economy look like in 10 years? Is there any economic instability that might impact their ability to make their regular interest payments and ultimately pay back the funds in 10 years? Will interest rates move against us and cause the secondary market value of these bonds to fall at any point in the next 10 years? If so, is it possible that I might be forced to cash some of them in during that time or at a low point? Please understand, I'm not picking on Australia. Those same questions all apply to the US Treasury bonds as well. …and Canada…and the United Kingdom …and Japan.

Let's go back to Marge & Homer. Those two were outspending their income every month and were at risk of running out of borrowing power by hitting their credit limits on their cards. The U.S. Government also has a credit limit called the Debt Ceiling. This Debt Ceiling is a self-imposed budgetary restriction on how much money the government can borrow through the issuance of bonds. They keep raising it so they can borrow more money.

Is it possible the U.S. Government could become so buried in debt that it could never dig itself out? In a word…yes…but it is highly unlikely. Unlike Marge & Homer, the income paid into the U.S. Government increases over time. Inflation is one of those causes. Remember signs on gas station doors 3 years ago? At that time, they were advertising starting wages of $8.00 to $10.00 per hour. Today, those same signs say $15.00 to $20.00 per hour. If those employees are in the 10% income tax bracket, they have increased their hourly tax payment by upwards of 50%. That's a big pay raise for the Government.

State and Local Governments also benefit from inflationary pressures. Now that the price of cars has spiked, how much more sales tax gets collected at the time of purchase? Increase in home value? That's fantastic – but real estate taxes can now go up. Pick up a new computer over the weekend? How much was the tax?

Our system is layered and complex but it works. The focus tends to be on the dollar amounts because they are so large and attention getting. In my opinion it is a much clearer picture when government spending is illustrated as a percentage of total GDP, Gross Domestic Product. This chart can be found on USGovernmentSpending.com and was originally pulled from the sources sited below. We, as a nation, have had times in our history when spending needed to temporarily spike in order to combat a major threat…the U.S. officially entered WWI on April 6, 1917 – see the red spike. The U.S. entered WWII in December 1941 – see the red spike. Since then, there has been a gradual increase in spending until the next big

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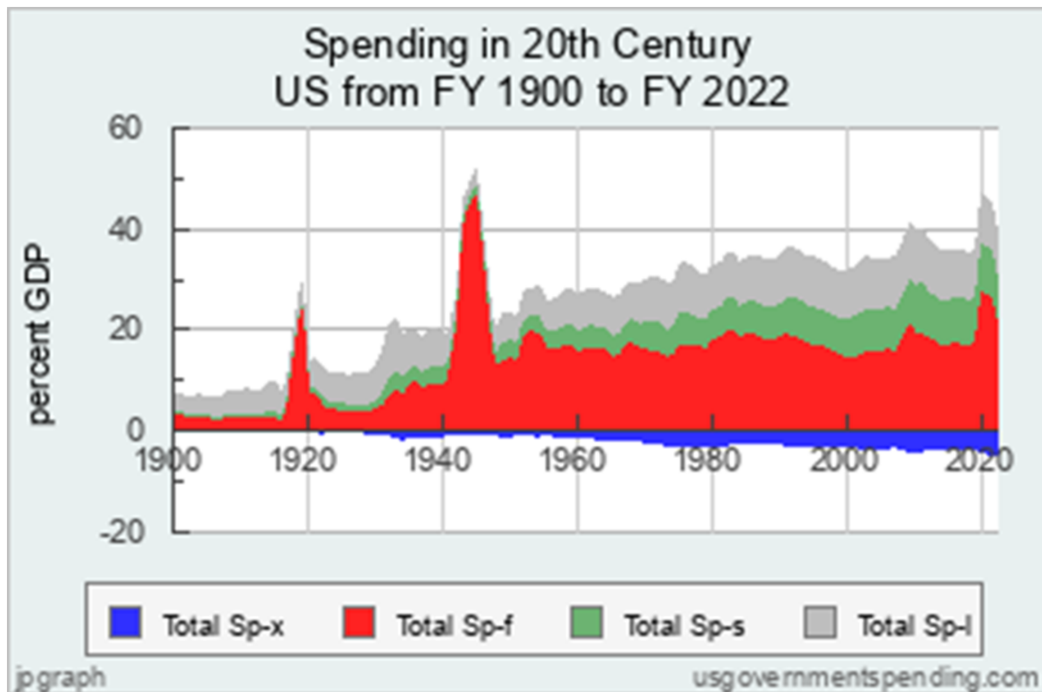

Chart Key:

- Local direct spending
- State direct spending
- Federal direct spending
- Transfer to state and local

Two solutions are typically brought up when discussing the national debt and how best to reduce it.

1. **Increasing revenue** received by the U.S. Government through
   A. GDP Growth
   B. Increasing Taxes

2. **Cutting Government Spending** to create a budget Surplus like our friends Jim & Pam. Both ideas have merit and would theoretically work but our government leaders tend to garner favor by funding pet projects and tap any surplus they can find. This chart from USASpending.gov shows the massive deficit increase we have recently incurred through our fighting of the COVID Pandemic. Interestingly, it also shows the last time we have an annual government surplus was 2001.

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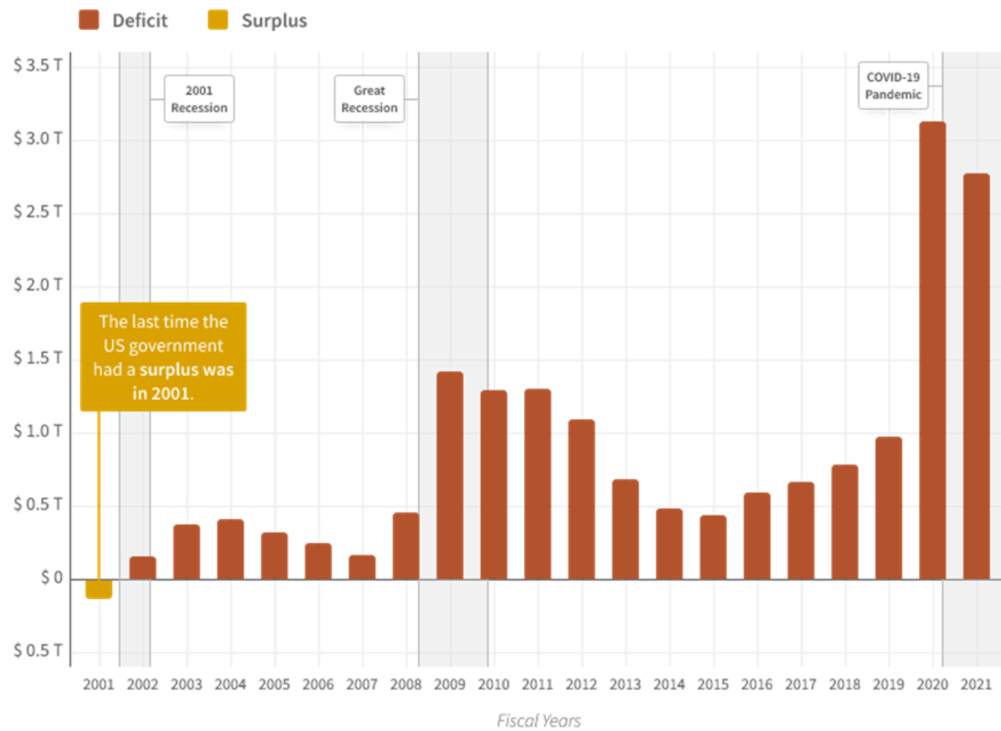

What is Tapering?

Tapering is primarily used in 3 places: the barber shop, the athletic training field and in the Federal Reserve Bank.

Tapering is a technique used by barbers to reduce the length of hair from longer to shorter beginning higher on head. For example, one might ask a barber to "Please taper my sideburns and stop them *here*", while pointing with a finger.

In sports, it is typical for an endurance athlete to reduce the length of a workout for a few days prior to a competition. We used to taper our workouts as we got close to a meet when I was on the swim team in high school, for example.

When hearing the term kicked around in the financial media, it can be very confusing to most listeners. Is the Federal Reserve Bank gearing up for some competition? Is Jay Powell talking about a new fashion statement he plans to make? Answer: None of the above.

I pause here to ask you, the reader, if you read the previous article on Government Debt in this issue. If not, please do so before continuing as some of the concepts I discuss below will pivot from those previous explanations…………………………..good. Thank you.

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The United States Government currently operates in a constant state of deficit; they spend more than the tax revenues collected each year. This makes it necessary to borrow money to cover expenses. They borrow from the investing public, super-wealthy individuals, companies and other countries by issuing Treasury Bonds of various maturities. I.O.U.'s with a promise to pay back the borrowed money at a specific date and interest until those funds come due.

The Federal Deficit in 2021 was $2.77 Trillion which was borrowed through this method. There are also old bonds coming due that must be redeemed and new bonds are issued to new buyers to replace them. This compounding is why our National Debt continues to climb. Buyers come to the table and purchase this debt because it is a safe place to park their cash. They receive a little interest along the way but the primary benefit of U.S. Treasuries is the safety they provide.

The Federal Reserve Bank is an institution that is separate from the Federal Government. Although there is a symbiotic relationship between the two, they are still very different entities. The Federal Reserve regulates the banking industry, conducts national monetary policy and maintains financial stability. In addition to their regulatory authority, The Fed can set the overnight interest rates that member banks charge when borrowing money from each other. This is referred to as the Fed Funds Rate. The other tool that the Fed has is the ability to be a buyer of Treasury Bonds when the U.S. Government issues them.

The U.S. Government must borrow money to cover expenses or else they would have to cut services or default on previous debts. Either scenario would be devastating to our credit rating, reputation and the confidence of Treasury Bond buyers in the future. Neither scenario is something the U.S. Government would allow. As such, if there are not enough buyers to buy all the bonds being issued, then the U.S. Government must increase the interest rate they are paying in order to attract another buyer.

The Federal Reserve Bank has a lot of cash. That cash can be used to buy Treasury Bonds. If the Fed comes to the table as a buyer with deep pockets of cash to spend, it negates the need for the U.S. Treasury to raise rates on their new bonds. A new buyer does not need to be attracted, the Federal Reserve Bank is gobbling up all they need to issue. Until they stop.

Today, the Fed spends roughly $120 Billion each month buying Treasury and Agency issues. When they talk about "Tapering", it means they are looking at reducing the amount of money they spend each month. When that happens, it is reasonable to expect that the U.S. Government will need to attract a replacement buyer by offering a more attractive interest rate.

The general expectation is that rates will increase when the Fed reduces/tapers their buying. The chart below is from Brookings.Edu and shows the current balance sheet of the Federal Reserve. As you see, there are $8 Trillion of Government issues on the Fed balance sheet.

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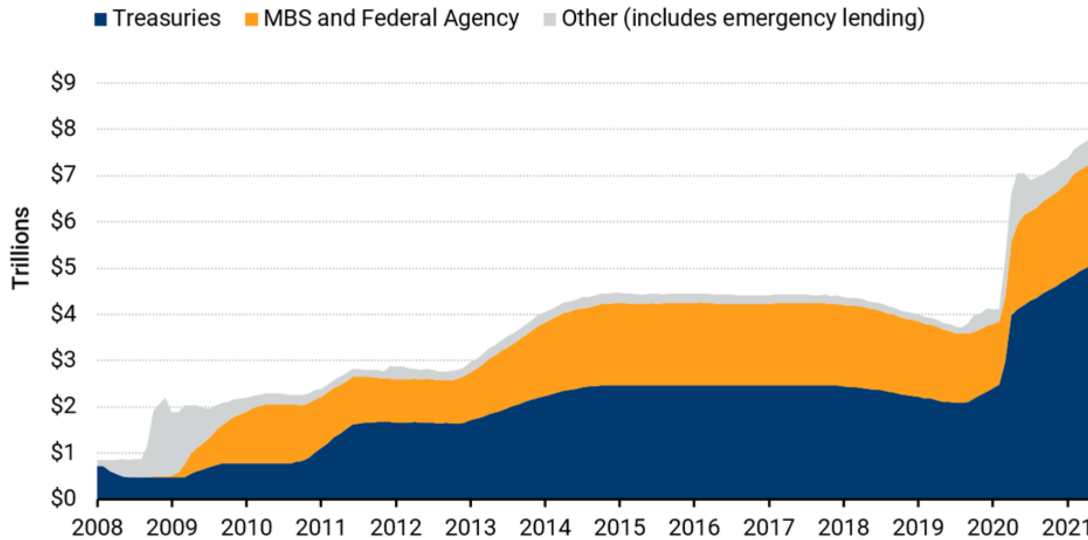

Source Link: https://www.brookings.edu/wp-content/uploads/2021/07/fig1_assets.png

Omicron

The first case of the Omicron variant entering the United States was identified in California on December 1st, 2021. The patient had returned from South Africa on November 22nd and had been previously vaccinated but had not yet received a booster shot. This variant was initially discovered in South Africa. Many reports are indicating the Omicron variant will have a higher infection rate but a much lower medical impact when compared to COVID-19. Dr. Fauci recommended that people continue to get the booster and not wait for a possible Omicron variant of the vaccine. He said it may not be necessary and that there isn't enough information to make a definitive determination yet. This will change over time as more information is discovered from studies.

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The day after Thanksgiving, the U.S. Equity Markets initially fell on the news of the new variant which, at that time, had not yet reached U.S. shores. That initial market drop was on Black Friday but the markets rallied on the following Monday, just two days later. This market bounce was telling in that it was in contradiction of the "typical" market pattern over a big news weekend and it meant a lot of investors were discounting the expected impact of the new Omicron variant. That changed by Tuesday and the markets once again began to adjust. At present, we are closely monitoring the situation and taking action where appropriate.

Market Analysis and Expectations

Equities have rewarded us in 2021 and, barring any major pullbacks, should remain in positive territory by year end. The Omicron Effect remains the current wildcard. Through December 1st, the S&P 500 was up 20.15% YTD and the DJIA was up 11.16%. AGG, the Core US Aggregate Bond ETF is down for the year at (3.012%) Gold also posted a weak year, down (6%).

Oil remains inflated at $65.79 / bbl but currently trading well off of the October 25th high of $85.41 / bbl. A recent publication on CNBC.com indicated Oil could continue to $150 in response to current international conditions. This chart shows oil price changes over the past two years and I have drawn in the technical channel to help illustrate Oil's recent breakout to the downside. Oil is generally more difficult to predict as it is influenced by so many factors that impact supply conditions. The use of the U.S. Oil Reserves and our international political relationships stand prominent among those influences.

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International investors underperformed with EFA, the MSCI EAFE ETF posting just shy of 4% through December 1st. International Core MSCI Emerging Market ETF, IEMG was in negative territory at (3.92%) over the same time period.
Interest Rates were on a fairly steady rise before the Omicron variant raised its ugly head. Since then, rates have stabilized and reversed course with the 10 year treasury now back below 1.5%. The Fed indicated they will likely continue to Taper so the rate climb may continue once the Omicron data is absorbed in the economic forecasts.

Tyson's Commentary

The Tyson Smith Group methodology of Asset Management and Financial Planning is unique to our group. The details of our Model Development Processes are proprietary and not available to the general public or other financial advisors. Our work is Forward-Looking, driven by quantitative analysis, projected performance expectations and our own personal experiences & studies. I have stated many times that one of the most dangerous things in the financial industry is an asset manager who entered the business after 2008. Since then, with the exception of a very brief pullback in 2020 as COVID hit, many managers have not had to navigate a true Bear Market or an extended period of economic weakness.

I am often asked how we manage to find success so often and I typically respond "I just get lucky a lot." …and that is true. We may be conducting our analysis, rebalancing our models and putting forth our best efforts for our clients but there are times when we may not accomplish the outcomes to which we aspire. I have also stated many times that No One knows where the capital markets will be in 6, 12 or 18 months from now. No One can definitively and consistently predict the markets with absolute certainty. And No One has a crystal ball to see the future. Our methodology simply takes as much information as we can glean at any given point in time, analyze, evaluate and then take action. So far it has worked well for our clients but "past performance is not a guarantee of future results". I can always be wrong.

The greatest risks I currently see on a forward looking basis remain 3-fold.

1. Omicron and future Covid variants are a wild card. We do not yet have enough data to definitively make a determination about this latest variant. Most reports currently indicate that Omicron is much easier to catch but has a much weaker impact on those who are infected but these are very preliminary indicators. More to come.

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2. Our International Political Relationships are strained. Russia is massing their military on the Ukrainian border. Embassies are being emptied and talks between Putin and Biden do not initially appear to be effectual. Remember from my previous writings…when oil prices are higher, our traditional enemy states have more income and revenue to take military action. When oil prices were lower, we did not hear much from them. Side Note: Ukraine is not a NATO Member Nation, which means the U.S. is not obligated to intervene. We also have not been successful at persuading the OPEC nations to increase production so oil prices come back down. The recent pullback in oil has been attributed to Omicron and an expected release of strategic reserves from the U.S. and China.
3. Our departure from Afghanistan may have created a terrorist incubation location. If those formerly-suppressed enemies return to recruiting and rallying followers, there could develop a real risk of terrorist attacks again. If we begin to see activity or smaller attacks throughout Europe or on within our allies borders, it would indicate a need for increased vigilance here.

In spite of those risks, at present, my 2022 Outlook remains very strong for **Equities**, cautious for **International** and warry of intermediate to longer-term traditional **Fixed Income** holdings. We have made adjustments to stabilize our fixed income exposure during rate volatility and continue to overweight where we expect equity strength. I caution investors against **Gold** allocations during rising rate environments as it has an inverse relationship to the U.S. Dollar movement and the U.S. Dollar tends to benefit from those same rate increases. There are also equity market sectors that benefit greatly from higher rates and others from higher government spending.

Dividends are important when considering the total return of a portfolio and when planning for future income. Current fixed income yields are historically low so the use of less-traditional income sources has become more important…and very effective, so far. Dividends come from company stocks and those same shares are subject to price fluctuations in the open market so reviewing your Asset Allocation Model is important right now.

In conclusion, I strongly recommend that my readers take a copy of this publication to their next review with their financial advisor and use it as a guide for the meeting. We covered a lot of topics to close out 2021 which should benefit most investors.

If you have questions, comments or need clarification on any of these pieces, please reach out to us directly: TysonSmithGroup@RaymondJames.com or 407-648-4488. We're happy to help.

Tyson Smith, AAMS, AIF, CRPC, CRPS, WMS

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The Tyson Smith Group of Raymond James

Rene A. Naranjo, AAMS®, Financial Advisor
FINRA Series 7 & 66 and Insurance 2-15; Life, Disability, Long Term Care, Health and Annuity

Born in Miami, FL to a family of Cuban refugees, Rene is driven by his unshakable belief in the American Dream and that *anything* is possible through hard work and perseverance. Bringing his spirit of discipline and focus, Rene's goal is to help his clients navigate the various financial challenges they'll face throughout their lives. Rene understands that achieving success requires passion, tenacity, and sacrifice in order to overcome the challenges and adversities that inevitably surface along the journey. By planning for the best and planning for the worst, Rene helps all of his clients grow, achieve, and protect their financial accomplishments that they have worked so hard to achieve. Rene is an Accredited Asset Management Specialist® and services both the South and Central Florida communities, where he attended Bishop Moore Catholic High School, Rollins College, and the University of Central Florida for his Masters in Mass Communications. He is fluent in both English and Spanish and spends his spare time watching movies or cheering for his Miami sports teams along with the Orlando City Lions and UCF Knights with friends and family.

Ashlee Palmer
Practice Business Coordinator

Ashlee is a Florida native but has spent the last 20 years in Augusta, GA. She is excited to be back home after so many years. She has been with Raymond James for almost 13 years and started with Morgan Keegan.

Ashlee enjoys reading, walking and playing with her dog Murphy, and of course watching the UCF Knights!

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Tyson Smith, AAMS®, AIF®, CRPC®, CRPS®, WMS, First Vice President – Investments
FINRA Series 7, 9, 10, 63, 65 and Insurance 2-15; Life, Disability, Long Term Care, Health and Annuity

The Tyson Smith Group was founded in 1998 in Peoria, Illinois. Tyson relocated the practice to Orlando, Florida in 2003 where he still resides with his wife and two children. When not in the office or at a speaking engagement, Tyson can usually be found road-cycling, on a softball field or playing golf.

The Tyson Smith Group was recently selected to serve on the Raymond James Retirement Plan & Institutional Advisory Council (RIAC) in recognition of our commitment to Retirement Plans.*

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Balanced Equity Model
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