Norman J. Politziner's
Financial Planning

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What's The Risk Of A Market Melt-Up?

The Standard & Poor's 500 stock index repeatedly broke records for months and the risk of a market melt-up should be considered. Are stocks fairly priced? For the answer, we turn to Jerome Powell, the U.S. Federal Reserve Bank chairman.

Fed chairmen generally avoid talking the stock market up or down. However, at a press conference in December 2020, Mr. Powell was asked specifically about the fact that stocks are highly priced by traditional valuation standards, like price-to-earnings (P/E) ratios. Mr. Powell's answer is important to investors, though it did not get much press.

That day, the East Coast faced the worst winter storm in years and a lot of things were going on, as always. But here's what Mr. Powell said: "Admittedly, P/Es (price/earnings ratios) are high, but maybe that's not as relevant in a world where we think the 10-year Treasury is going to be lower than it's been historically."

The Fed chair is saying stocks are not overpriced compared to bond yields, which are going to be low for a sustained period. The Fed is saying, pay no attention to the market's P/E ratio; it's more relevant in the current conditions to value the market's P/E ratio relative to bond yields. On that basis, stocks aren't expensive.

Mr. Powell was saying that the traditional valuation measures, including P/E ratios, may not be so relevant right now because of the low-interest rate situation worldwide. He's saying that what's most important in the current financial economic conditions, is the comparison of the P/E ratio to bond yields.

Just as you would not use a sledgehammer to drive a nail, the valuation method commonly used to measure current stock prices – P/E ratios – is the best tool for this situation. The current situation is uncommon, and it makes sense to use a tool to measure

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The Thoughts That Count

The year is more than half over—so far, so good.

Despite Covid-19 and the variants, the economy is rebounding at an astounding rate. About nine million jobs are yet to be filled, and people are spending money on things put off for too long.

Yet, there is a feeling of uncertainty in the country. Aside from the sharp political divide, there is growing mistrust of the edicts coming from federal and state officials. People see officials mandating behavior that they themselves don't follow. There is a growing fear that schools may not reopen, that the economy will tank, and that institutions such as the CDC may not be up to the task.

Yet, in spite of this, the economy is on a long and steady climb. The American entrepreneurial spirit is alive and well; its people are strong and resilient. They know a good storyline when they see it and have bought into its ending: We will survive this pandemic and come out of it better, stronger, and with more appreciation of what is important.

We try not to pay attention to the noise and to concentrate on the long-term trends. We pay attention to the things we can do to make things better and pay more attention to our families. Stay well and be positive.

Norm

Tax Alert For High Income And High Net Worth Individuals

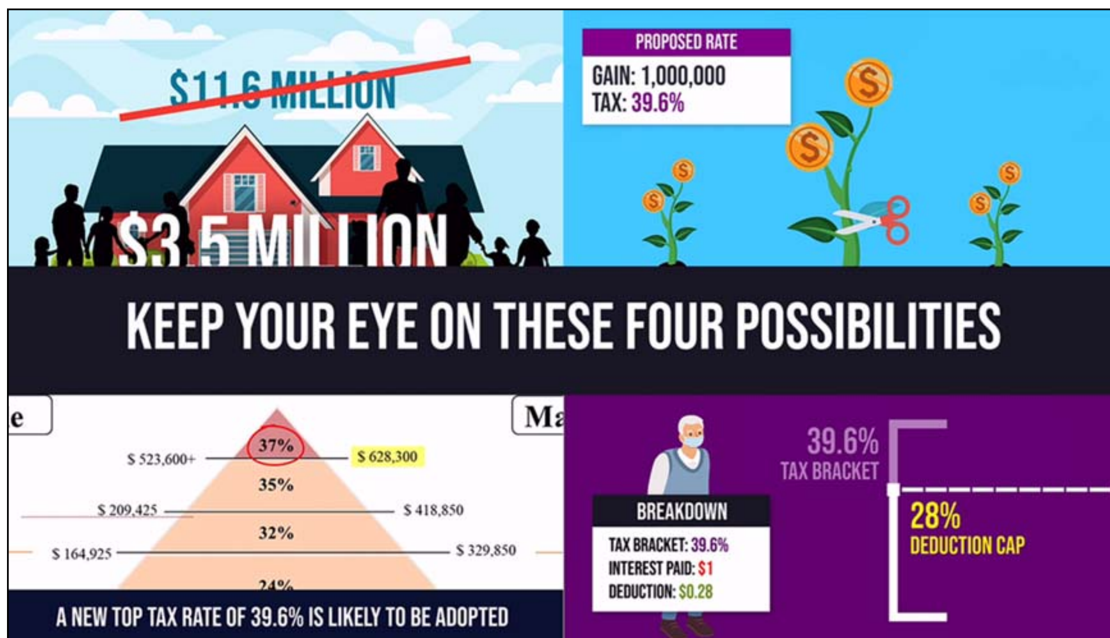
The political standoff in Washington, D.C., has complicated tax planning enormously. No one knows exactly how it will shake out but what we do know is that there are four possibilities to be prepared for.

1. The estate tax exemption is expected to be slashed dramatically, from $11.6 million, to $3.5 million per person, most likely. In addition, the estate tax rate could be stiffened.

2. Capital gain taxes could be hiked in a couple of ways. The current favorable capital gains tax rate of 20% could be eliminated if your taxable income is more than $1 million. In addition, the "step-up" in the basis accorded capital gains on inherited investments may be eliminated on gains of more than $1 million. If your current estate plan hinges on leaving highly appreciated assets, like stocks, business interests, real estate, and other investments, this would slash what your heirs inherit after paying taxes.

3. President Biden has proposed raising the top tax rate. In 2021, the top tax rate is 37% and that applies to income of more than $628,300 for joint filers. A new 39.6% income tax bracket is very possibly going to be adopted. Not only would the top tax rate rise to 39.6%, but the 35% tax bracket could be eliminated, which greatly expands the number of taxpayers subject to the 39.6%.

4. The value of itemized deductions could be capped at 28% for those in the new top tax bracket. To be clear, a high-income professional or business owner in the proposed 39.6% tax bracket, who deducts mortgage interest, would be entitled to a deduction of only 28 cents for each dollar paid in mortgage interest, instead of 39.6 cents on the dollar. Itemized deductions would lose 30% of their power in lowering your tax bill annually.

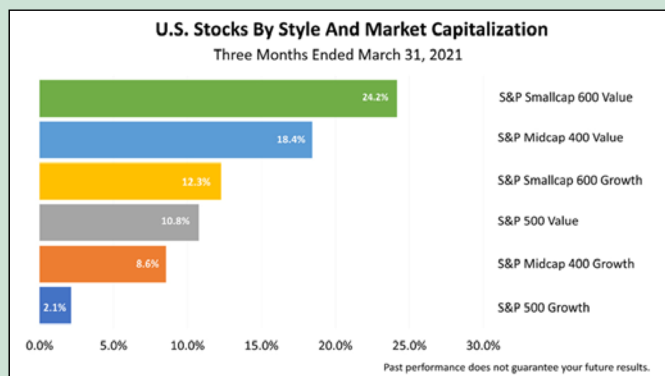


The matrix of variables is complex but keeping these four possible changes top of mind could significantly help minimize your federal income and estate taxes as tax-hike possibilities turn into certainties in the weeks ahead. ●

Stock Market Trend Report

While a single quarter of data is usually not elucidating – it's just not enough time and data to make a sweeping conclusion – sometimes a single quarter tips you off to a shift in investor preferences. That's true in this three-month snapshot. It shows the stock market investments classifying companies by market capitalization and style.

The fact that small-cap value led the market last quarter marked a reversal of the pandemic boom in which the super-cap growth stocks, like Amazon, Apple, Facebook, Microsoft, Netflix, and Google, dominated returns and temporarily distorted the performance of the S&P 500 index.



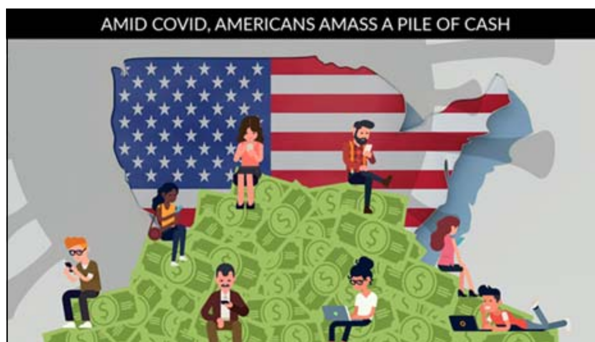
Many stocks in the blue-chip Standard & Poor's 500 index were weak relative to the tech giants earlier in the pandemic. The tech giants grew stronger during the pandemic because their solutions were used more than expected, triggering larger than expected profits in a handful of super-large cap stocks.

Since the S&P 500 index is market-weighted, the price surge in the super-large tech companies became more influential in the S&P 500 index. That trend was reversed last quarter and again in the first quarter of 2021 ended March 31, 2021.

Since the election, the bull

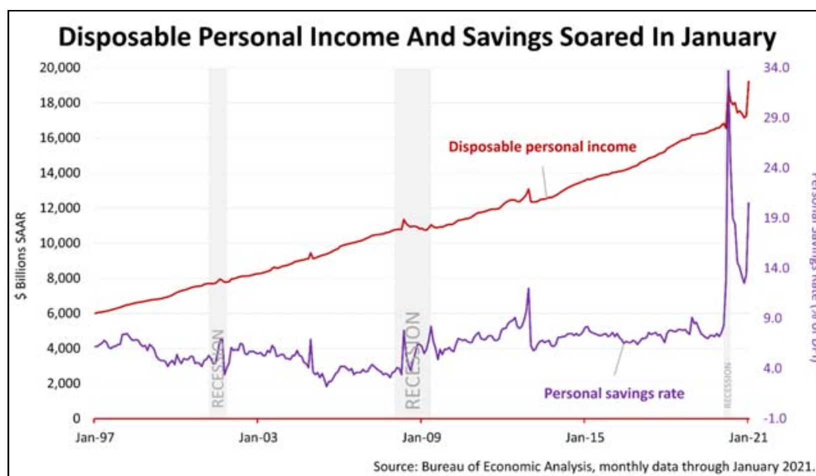
The Cost Of Not Having A Financial Plan Is Surging

With the cloud of the Covid pandemic still hanging heavy across the nation, Americans are sitting on an unprecedented mountain of cash while income, estate and gift tax rates are changing. Financial planning in the current environment of accelerated change is suddenly much more important.



If ever there were a silver lining, it's that staying at home has enabled Americans to amass a cash reserve as never before. However, the speed of change has accelerated rapidly, driving up the cost of failing to update a personal financial plan. What's going on?

The pandemic has spawned federal payments to Americans at a level never seen before. Here's the latest snapshot of the unprecedented change in disposable income and savings under way, according to the latest data from the U. S. Bureau of Economic Analysis.



While the chart only goes back to 1997, the dual surges in these two important factors driving growth of the economy are without precedent in modern U.S. history. The surges resulted from Covid relief cash payments made by the government in April and May 2020 and again in January 2021. Cash from the 2020 payments accumulated in savings accounts and was being spent down when January's Covid aid payments hit. The $1.9 trillion aid and stimulus package is going to cause another surge in disposable income and savings.

The fundamentals driving this economy are confounding and totally unexpected. In 2020 and early 2021, as the nation endured its worst public health crisis ever, stock prices repeatedly broke new all-time record-highs! The proximate cause of the stock price gains amid a pandemic was an explosion in savings held by Americans, financed by a series of cash payments from the Government.

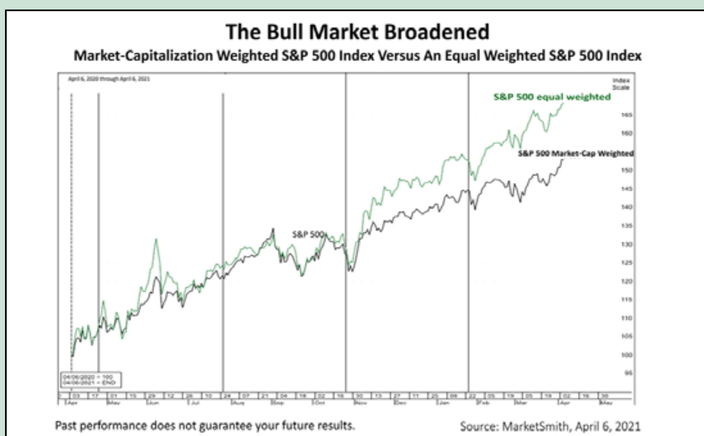
With interest rates low and the Fed reiterating in March that it does not plan to raise rates for the foreseeable future, bonds are not an attractive investment. So, consumers sitting on this mountain of cash that has been mounting for many months now may spend it or invest it for the long run. Both outcomes would be good for asset prices on stocks and housing.

Central bankers and economists will be debating the long-term effects of the growing influence of government in the U.S. economy and the risk it poses, but the financial outlook for now is unexpectedly bright, even as the dark cloud of the pandemic casts a long shadow over the nation. Financial assets are being revalued, as the relative value of stocks versus bonds has changed.

Meanwhile, taxes are about to be hiked by another new Covid aid legislation package, the American Rescue Plan, and another round of legislation that will hike taxes further is expected to be adopted after the economy has recovered but before the end of 2021.

When the pace of change in the world was slower, the cost of not having a strategic financial plan was not so dear. This is not the time to sit on your hands. This is the time to act. ●

market broadened out. Value and small-cap stocks have surged. In this chart, the equal-weighted Standard & Poor's 500 stock index is outperforming the market-capitalization weighted S&P 500 index, which is commonly quoted and the main benchmark of U.S. stock performance.



Investors have viewed the election of President Biden in very positive terms, undoubtedly because of the enormous fiscal stimulus the new administration is pursuing. The larger role played by the government in responding to the Covid economic crisis will be subject to political debate. No matter your politics, however, the broadening of the bull market is a good trend for stock market investors. ●

Asset allocation cannot eliminate the risk of fluctuating prices or uncertain returns. Diversification does not assure a profit or guarantee against loss.

A Tax And Financial Planning Opportunity Is Closing

From the perspective of a financial professional, the window of opportunity to act before taxes are hiked is about to close. The plan to end the step-up in basis on inheritances is perhaps the most significant change.

Other tax proposals President Biden campaigned on include a sharp reduction in the favorable treatment on profits from investments, a new top tax rate of 39.6%, and an expansion of the 12.4% Social Security tax on tax-filers who earn more than $400,000 in adjusted gross income annually.

At the time this was written, the details of the new taxes were still unknown. The elimination of the step-up in basis was still an open question but politics were dictating the timeline and dimensions of the tax changes.

It's possible the tax hikes about to be negotiated in Congress could be retroactive, which would render defensive planning measures fruitless. That's unlikely, but the window of opportunity to act is closing.

If your annual income is higher than $400,000 or your family has an estate worth more than $3.5 million, please let us know if you have questions. ●

The Risk Of A Market Melt-Up?

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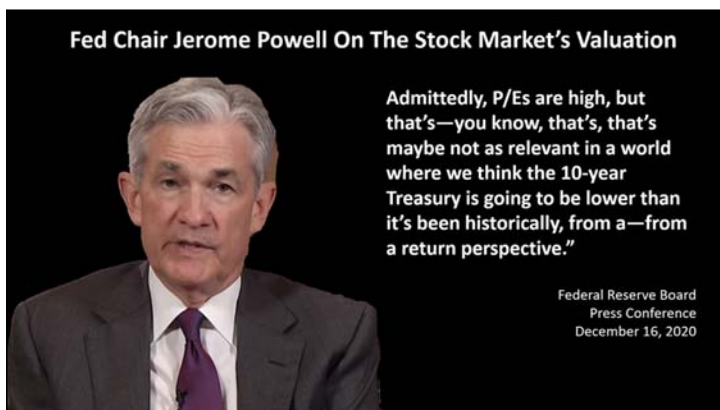
valuations in the context of the currently low interest rates.

It's important because, to the extent that the Fed chair believes that current conditions, which are unprecedented in history, then he's going to remain accommodative and keep aiding and abetting the Treasury in creating money. This would continue to support stocks, as well as the economy, for the foreseeable future.

In contrast to former Fed chair Alan Greenspan, who warned stock investors were growing irrationally exuberant in 1996 – four years before the peak of the great bull market, remembered in history as the tech stock boom – Chairman Powell is saying: pay no attention to P/E ratios, the traditional valuation benchmark of stocks; what matters more is the P/E ratio compared to the 10-year bond yield, and, that bond yields are expected to remain low for the foreseeable future because of population trends in developed and developing nations, improvements in technology, and other fundamentals.

If the Fed thinks high price-to-earnings ratios are less relevant and that bond yields relative to stock prices are the important measuring instrument under current economic conditions, then that leaves leeway for stocks to rise without Fed action to quell an exuberant stock market. Thus, the risk of a market melt-up is a real thing.



If you fear missing out on a market melt-up or worry about being overexposed to stock risk, the right tool is a core portfolio diversified across low expense assets and professionally managed. ●

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