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Back to the Investment Basics

Part 1: Remembering Summers Past

There are so many big events competing for our attention this summer. . . said nearly every investor, almost every summer, ever.

We're not making light of this summer's uncertainties. Inflation is real, and needs to be managed, and we can't rule out the possibility we'll see a recession. Heightened levels of market volatility across stock and bond markets alike may have left you once again wondering whether this time is different. Wider worries prey on our minds as well, such as the war in Ukraine, ongoing discord closer to home, climate change, and the rise of artificial intelligence.

But it's also important to remember, we're inherently biased to pay more attention to recent alarms than long-ago news. In the right context, this form of recency bias makes perfect sense. As we go about our lives, it's often best to prioritize our most immediate concerns—or else. No wonder we've gotten so good at it.

However, as an investor, if you overemphasize the news that looms the largest, you're far more likely to damage your investments than do them any favors. You'll end up chasing hot trends, only to watch them combust or fizzle away. Or you'll jump out during the downturns, without knowing when to jump back in.

Yesterday's News

How do we defend against recency bias? It can help to place current events in historical context. Do you remember what investors were worrying about a year, several years, or several decades ago? If you experienced some or all of these events first-hand, you might recall how you felt at the time, before we had today's hindsight to inform our next steps.

Some past news events include:

- **2021:** The Taliban takes control in Afghanistan, while a "ragtag army" of online traders led by Roaring Kitty storms Wall Street.
- **2020:** COVID-19 shuts down economies worldwide. Civil unrest rides high across a gamut of socioeconomic concerns, and a divisive U.S. presidential election looms large.
- **2018:** Two U.S. government shutdowns occur—in January and again at year-end, with the latter lasting more than a month.
- **2017:** The year-end Tax Cuts and Jobs Act (TCJA) upends U.S. tax codes.
- **2016:** The Brexit referendum and U.S. presidential election deliver surprising outcomes.
- **2015:** A long-simmering Greek debt crisis erupts.
- **2013:** A 16-day U.S. government shutdown occurs in the fall.
- **2012:** The U.S. narrowly averts plummeting over a fiscal cliff.
- **2011:** For the first time, the U.S. federal government credit rating is downgraded by one of the major rating agencies from AAA to AA+, and the Occupy Wallstreet movement is born.
- **2008:** Wall Street broker and former NASDAQ chair Bernie Madoff is arrested for fraud.
- **2007:** The Great Recession and global financial crisis begins.
- **2001:** The 9/11 terrorist attacks send global markets reeling. An accounting scandal at Enron culminates in the energy giant's bankruptcy.
- **1999:** The dot-com bubble bursts; the Y2K bug spurs massive, worldwide computer reprogramming.
- **1990:** Iraq invades Kuwait.
- **1980:** U.S. inflation peaks at 14.8%; Americans are marching in the streets over the price of groceries. Also, the U.S. Savings and Loan crisis begins, ultimately costing taxpayers an estimated $124 billion.
- **1973:** An OPEC oil embargo "fueled bedlam in America."

Investment Mainstays

These are just a few examples. They don't include the market's endless stream of lesser alarms that are easy to dismiss in hindsight, but often generated as much real-time storm and fury as the more memorable events.

The point is, there's always something going on. And even as global markets persist, we forget or rewrite our memories, until they're no longer available to inform our current resolve.

In the face of today's challenges and tomorrow's unknowns, we advise looking past recent trends, and focusing instead on a handful of investment basics that have stood the test of time. They may seem unremarkable compared to the breaking news. But when has "buy low, sell high," or "a penny saved is a penny earned" become a bad idea once all the excitement is over?

Next up, we'll review some of these investment basics, and how they apply to you and your personal wealth.

Until next time, no regrets!

Eric Hutchens
President & Chief Investment Officer

FINANCIAL PLANNING TIP

How "Equalizing Your Estates" Can Help

"Equalizing the taxable estates refers to methods of arranging the estates of spouses in a way that will result in the least total amount of estate tax liability. Federal estate tax rates are progressive (i.e., the tax rate increases with the size of the estate). Thus, two estates of equal value pay less total estate tax than one estate valued at $0 and the other estate valued at all the assets. The spouses' goal is to avoid, or even totally eliminate, potential estate taxes."[1]

The current federal estate tax exemption is $12.92 million in assets per person, $25.84 million per couple. This exemption is portable from one spouse to the other, so if the first-to-die did not use his or her full exemption, the remaining exemption can be used at the survivor's death. Most combined estates are under $26 million and will pass on to heirs free of federal estate tax at this time.

If you are married, live in Minnesota and your combined estate is likely to be more than $3,000,000, the current state estate tax exemption, then you may be a good candidate for equalization. Minnesota's exemption is not portable like the federal exemption.

In order to shelter the most assets from estate taxes, whether federal or state or both, two elements must be in place: 1) assets must be in the decedent's name alone, and 2) a credit shelter trust must be created at the first death.[2] The credit shelter trust moves assets that were applied to the decedent's estate exemption into a trust at the first death, and these assets are not included in the estate of the surviving spouse (and therefore not subject to estate tax) at the second death. Both elements are needed together because the only assets that will be available to go into a credit shelter trust are those owned by the decedent alone. If you have a will or revocable trust that creates a credit shelter trust (aka family trust or disclaimer trust), but you own everything jointly with rights of survivorship (JTWROS) with your spouse, then there are no assets available. JTWROS ownership vests in the survivor at the first death. It should be noted that JTWROS assets can be disclaimed into a credit shelter trust in certain circumstances, but for most situations we should assume this is not the case.

Let's go through a simple example where the Minnesota exemption applies. William and Mary are spouses who are now in their 80s. Most of their assets are in their IRAs, say $2 million each. They named each other as the primary beneficiary with their adult children as contingent beneficiaries in equal shares. Their bank accounts, brokerage accounts and their home are owned as joint with right of survivorship, altogether worth another $2 million. If William dies first, there are no assets to go into a credit shelter trust as everything will be in Mary's name as the surviving owner and primary beneficiary. William can use his $3 million Minnesota exemption, and if there were any assets in excess of that, they would go to Mary tax free due to the unlimited marital deduction at first death. So, no estate tax at William's death. Now when Mary dies, her estate will be worth at least $6 million. Mary's estate will owe Minnesota estate tax on the remaining $3 million after her exemption is applied. A rough calculation at a 13% estate tax rate puts the state estate tax bill at $390,000.

What if William and Mary had split the ownership of the $2 million in joint assets between them, and set up a credit shelter trust at the first death (the two main requirements for estate tax avoidance mentioned previously)? Putting assets in each spouse's name is the way to "equalize." At William's death, the $1 million of assets in his name alone would go into the credit shelter trust with Mary as trustee and would be removed from Mary's future estate. Mary will have access to the income and principal of the trust should she need it. Just like before, there are no taxes owed at William's death. This time, however, Mary's estate is $5 million rather than $6 million. After her $3 million state estate tax exemption is applied, her estate will owe taxes on $2 million at a 13% rate, or $260,000. This represents a potential tax savings of $130,000. By simply equalizing the spouse's estates, significant dollars can be saved for heirs. There are many ways to reduce potential estate taxes and each person's situation will be different.

1. The Retirement Group. (December 29, 2020). *What is equalizing the taxable estates?* https://www.theretirementgroup.com/blog equalizing-the-taxable-estates
2. Ibid.

Upcoming Webinar Introduction to Investing

Do you have questions about investing? We often get asked by our clients to introduce their children and other family members to the concepts of investing. In response, Allodium is pleased to present *Introduction to Investing* featuring Saul Baumann and Derek Van Calligan. Whether you are new to investing or a seasoned investor looking for a refresher in the basics, this webinar is for you.

Join us for this webinar as Saul and Derek cover investing basics on June 22, 2023 at 2:00 p.m. In case you can't make it, the presentation will be on our website and YouTube channel. To register click on the link:

https://tinyurl.com/2tfuzve3

Headlines

- David Bromelkamp, Derek Van Calligan and Saul Baumann went to Omaha for the Berkshire Hathaway Annual Meeting. Warren Buffett and Charlie Munger shared their views .
- Congratulate Eric Hutchens for becoming a CFA Charterholder!
- Eric Hutchens will be a speaker at the 5th Annual Private Wealth Great Plains Forum on July 26, 2023. His panel topic: "The Future of Wealth Management."
- Allodium welcomed seven new clients in the first quarter of 2023.
- Our office will be closed June 19 and July 4 for company holidays.

To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

Steward is published quarterly by Allodium Investment Consultants. Please contact iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.