Schneider
WEALTH STRATEGIES

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(212) 924-2290 | David A. Schneider, CFP®

WEALTH MANAGEMENT REPORT

Capturing The Equity Risk Premium

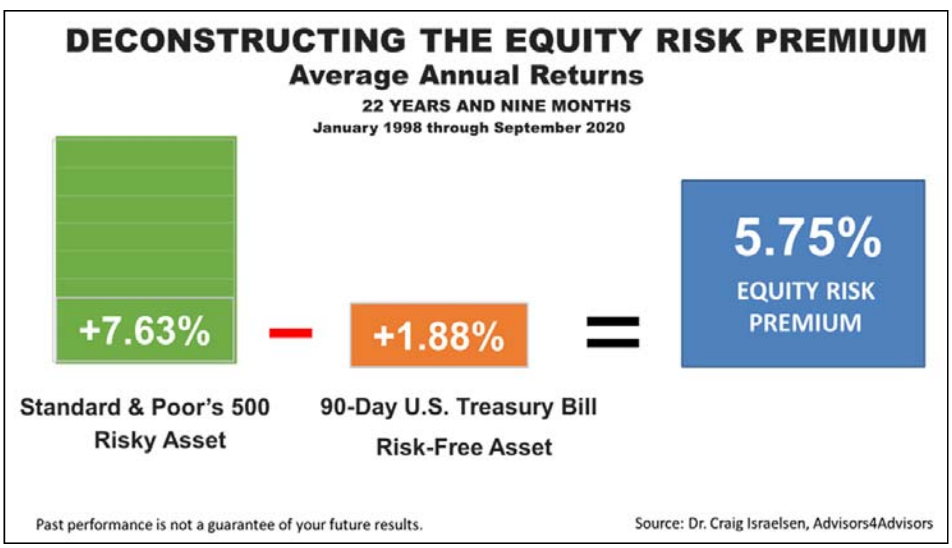
During the Covid pandemic, one day drops in stocks of between -3% and -5% have not been uncommon. And then there was March 12, 2020, a one-day plunge of -12%.

Times of painful stock market losses are when investors earn the equity risk premium. The equity risk premium is financial jargon for the extra return investors were paid for taking a risk. Successful investing requires an understanding of the risk premium on stocks. So here's a look at it over the last decades on the Standard & Poor's 500 index, a period that includes the outbreak of the Covid pandemic in the U.S.

To quantify the post-Covid equity risk premium, look at the equation in the graphic: Over the 22 years and nine months ended on September 30, 2020, the risk-free 90-day U.S. Treasury bill averaged an annual return of +1.88%, compared to a +7.63% annualized return on the S&P 500 stock index.

Subtracting the 1.88% from the 7.63%, resulting +5.75% represents the premium stock investors have been paid annually over the boom and bust cycles since 1998. Put another way, owning stocks through the tech bubble in 2000, financial crisis in 2008-2009, and COVID outbreak bear-market rewarded investors with a premium of 575-basis points over what they would have earned by investing in risk-free 90-day Treasury bills.

The chart on the last page does a better job of illustrating the scary parts of the equity risk premium. The red data series shows the daily changes in the stock market, as represented by the price of a share of the S&P 500. Enduring a loss of one-third of your portfolio's value, for some investors, was a stomach-wrenching experience. Sometimes, earning the equity risk premium is hard.



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Beware Of "Choice Architecture" When Making Decisions About Health, Wealth And Happiness

Simply by rearranging the placement of foods, cafeteria managers can increase or decrease our consumption by as much as 25%! To be clear, workers at cafeterias and restaurants wield enormous influence over what people eat.

In the groundbreaking 2008 bestseller, "Nudge," Richard Thaler, winner of the 2017 Nobel Prize for Economics, and Cass Sunstein, founder of Harvard Law School's Program on Behavioral Economics and Public Policy, reveal the hidden role choice architecture plays in our decisions about health, wealth, and happiness – how we can be "nudged" to make certain choices.

Choice architecture determines what's placed at the front of department-store entrances, what's at the top of fast-food restaurant menus, and whether batteries, hand sanitizer, or *The Enquirer* are showcased on a retail checkout line. In addition, choice architecture tracks every click you make on Amazon and across the Web. To be sure, data science is booming online, powering tech giants like Facebook, Apple, as well as your smartphone.

It's important for financial consumers to be aware of whether or not they are being nudged in the best direction. There is no law requiring Las Vegas casinos must place games with the best odds for gamblers in front of the entrance, or for brokerage apps or financial marketing to nudge you to choose the best financial solutions.

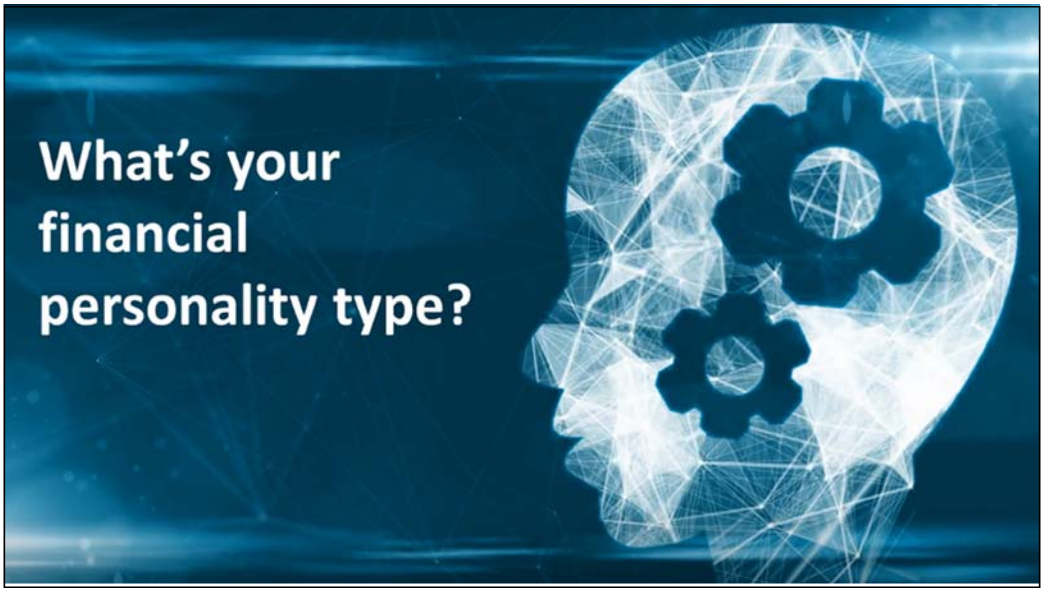
Three Easy Ways To Increase Your Chance Of Financial Success

Making small changes to your financial behavior can be an important step in determining your long-term financial success. Here are three simple activities that can help.

Automate. Infrequent interventions, such as budgeting once a year, are less likely to bring success than more automatic actions that occur quarterly or monthly. Enrolling in a salary reduction plan which takes money from each paycheck and goes into your 401(k) plan illustrates the difference between decisions that require your recurring action versus those that are automated. What else might you automate to increase your savings or make sure you pay your bills? You could automatically pay a bit extra each month towards your mortgage and have it paid off several years early.

Write it up. Whenever you make a major financial decision, write yourself a note about your decision.
By jotting down your analysis at the time you make a decision, you'll create an introspective record that, over the years, will help reveal what is working for you.

Increase self-awareness. Your financial personality can help or hinder your financial success and you may be entirely unaware of it. Increasing self-awareness can help you avoid sabotaging yourself. The burgeoning social science of behavioral finance can help you learn about your financial personality traits. For example, would you rather receive $160 today or $246 in 12 months? How about $160 today or $180 in 12 months? Your answer to a series of questions like this can reveal your predisposition toward deferring rewards now in favor of reaping financial benefits from a long-term plan. Similar questions can guide you in determining how likely you are to tolerate losses in bear markets, whether you are overconfident about your financial decision-making abilities, and offer hints of the types of investments that might work best in a long-term portfolio designed to help you accomplish your financial goals.



If you would like to talk about other steps you can take to ensure healthy financial behavior, please do not hesitate to contact us. ●

SEC Is Struggling Amid Covid Pandemic

Since it's probably not on your reading list, here are highlights investors may want to know from the 2020 annual report of the Enforcement Division of the U.S. Securities and Exchange Commission.

Policing Securities During Covid. "By mid-March, the entire Division had transitioned to mandatory telework and essentially all of our operations were conducted remotely," says Stephanie Avakian, director of the division.

An Epidemic Of Fraud. Covid inspired a wave of investment fraud. In March and April alone, the Commission suspended trading in the securities of two dozen issuers where there were questions regarding the accuracy and adequacy of information related to COVID-19 that those issuers injected into the marketplace, including claims about potential COVID-19 treatments, the manufacture and sale of personal protection equipment, and disaster-response capabilities. All told, from mid-March through the end of the fiscal year on Sept. 30, 2020, the Division's Office of Market Intelligence triaged approximately 16,000 tips, complaints, and referrals -- a roughly 71% increase over the same time period last year -- and the Division opened more than 150 COVID-related inquiries and investigations and recommended several COVID-related fraud actions to the Commission.

A Decline In Total Actions. Understandably, total enforcement actions declined, during this initial period of the Covid pandemic. A total of 715 enforcement actions were filed in the 12 months ended September 2020. Taking depositions, getting sworn statements, and related legal procedures were moved online, disrupting investigations and prosecutions of securities crimes. Although total enforcement actions declined, stiffer penalties were assessed. "While the number of cases the Commission filed was down as compared to last year, the financial remedies ordered set a new high," according to Ms. Avakian's public letter, accompanying the report.

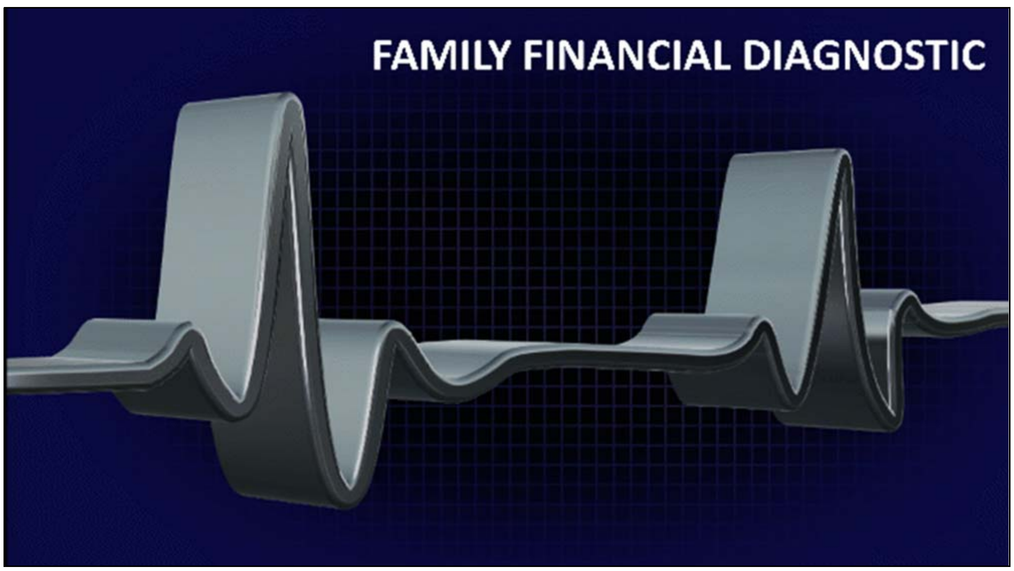
The Bad News For Financial

A Five-Point Covid Diagnostic For Family Wealth Management

A terrible truth of the Covid pandemic is that families are at greater risk of losing a matriarch or patriarch. Whether you're a beneficiary or grantor, here's a five-point diagnostic for managing family wealth; issues to consider that might require urgent action due to the unusual times we are living through:

When did you last update your will? Wills should be reviewed periodically.

Do you need a revocable trust to avoid probate? State laws vary, so there are no hard and fast rules, but the Covid crisis has made the use of revocable trusts a more popular estate planning vehicle. Courts were recently shuttered across the country. It's prudent to continue expecting delays in the probate court process. If a family member is intubated and can no longer manage family financial matters, a revocable trust facilitates the transition in the management of family assets. Whoever is named as successor Trustee may present the trust document to the asset custodian (which may have a copy of it already) and the management of assets can then be assumed by the successor.



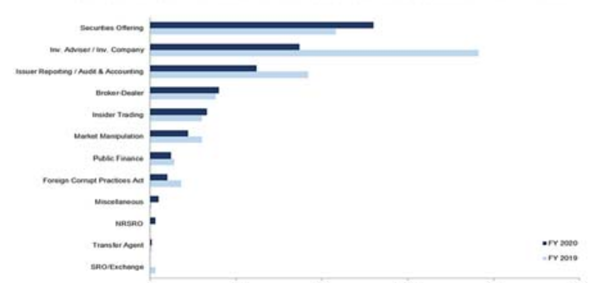
GRATS and other trusts should be reviewed, and they are expected to be recommended more often in managing family assets in the months ahead. Grantor retained annuity trusts (GRATS) are a way to freeze the value of an estate, to reduce estate taxes. For many years, GRATs have been set up based on the IRS's mid-term Applicable Federal Rate (AFR). However, with the AFR dropping in mid-August to 40-basis points (0.40%), trusts may need to be updated to use the long-term IRS AFR. With higher taxes expected, due to the weakening U.S. balance sheet, locking in the long-term AFR on a GRAT is worth considering. To be clear, higher taxes on inheritances are a likely target for generating new revenue, which makes it wise to consider 10-year GRATs instead of the traditional two-year GRAT.

Intrafamily loans are also pegged off the IRS's AFR, and this may also be a way of transferring wealth. While direct loans to children might expose assets to divorce settlements or claims by business creditors, loans made through trusts are more compelling tax-wise. They allow you to loan some money to the trust at a 40-basis-point interest rate for a mid-term loan of up to nine years, or you can even go out 20 years, with the rate at 1.2% here in August 2020. Any earnings beyond that 40 basis-point hurdle rate is shifted over to the trust tax-free.

Don't wait to do any of this. Estate and trust lawyers are already overwhelmed with work. And it's not simply a matter of just drafting a trust or will. You also must get the Grantor and the Trustee to execute it. Or, if you have an institutional trustee, you must determine, "OK, what am I going to transfer to the trust? Am I going to need appraisals?" All of these decisions take time. It's therefore best to start now, just in case you run into challenges along the way. ●

Consumers. A breakdown of the number and percentage of the types of actions brought in Fiscal Year 2020 is bad news for investors. The agency took enforcement actions against half as many investment advisers and mutual funds as in FY2019. SEC data combines investment advisors serving individuals with companies managing mutual funds. These are two key sources of financial advice and the plunge in enforcement actions when complaints, tips and referrals from other agencies soared by 71%, is cause for concern. If you're saving for a child's college education, your retirement, or for the benefit of your heirs, the sudden plunge in policing by regulators puts a bigger burden on you to be wary of financial sales pitches. It's more important than ever to work with a professional you know you can trust bigger burden on you to be wary of financial sales pitches. It's more important than ever to work with a professional you know you can trust. ●

Investment Adviser And Mutual Fund Enforcement Actions Slashed In Half In 2020



Source: U.S. Securities and Exchange Commission, 2020 Division of Enforcement Annual Report; released Nov. 2, 2020.

Starting A Business? Plan To Succeed

In America's capitalist system, an economic cycle entails destruction of businesses and their replacement with newer businesses. It's survival-of-the-fittest, a process in which the ranks of businesses are periodically thinned by recessions.

The Covid recession, early evidence suggests, is leading to a boom in entrepreneurialism. "The pandemic has had all sorts of unexpected consequences, from a boom in sourdough-bread baking to more people listening to nostalgic music on Spotify," according to The Economist on October 10, 2020. "Less noticed is a once-in-a-generation surge in startups."

So here's an important strategic tax tip for anyone who just started a business or who's about to do so: Plan now to transfer your ownership to your family.

To be clear, your new business may succeed! Capitalism is dynamic. which keeps the American dream alive. Businesses that failed in the Covid crisis are going to spawn the launch of new businesses that will succeed and ride the wave of growth in the next economic cycle. If you plan to succeed, and, if your business does indeed boom in the new expansion cycle, it is wise to plan now to transfer assets to your children, charities, and what's important to you. You can set up your company tax-efficiently right now to minimize taxes many years from now for your heirs.

Under President Biden, the amount exempt from estate tax may change from $11.58 million to a lower number. By forming the company and managing the selection of shareholders with this in mind from the time of initial formation of your company, you will have more control over the tax-efficient transfer of your business.

The U.S. debt has skyrocketed due to the Covid crisis and estate taxes may head higher in the years ahead. Planning now for the success of a new business by minimizing taxes on its transfer to the next generation could result in considerable tax savings.


The Economist

United States

Oct 10th 2020 edition ›

The number of new businesses in America is booming

No other rich-world country is experiencing the same rise in entrepreneurship

In the excitement of starting a new venture, it is rare to plan an exit strategy. However, the entrepreneurial eruption currently under way, in combination with the expected expansion of the estate tax to millions of more families, may make a little planning today an extremely shrewd tax saving tactic years from now. ●

The Equity Risk Premium

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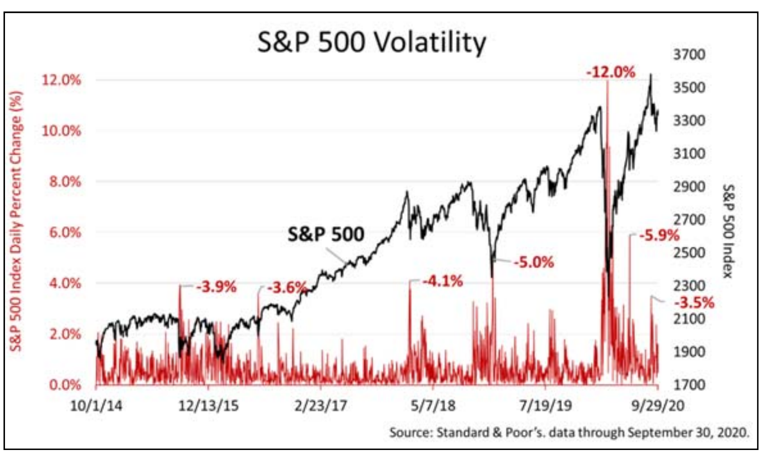
Armed with these kinds of statistics, however, knowing that big daily down days reliably do come, it is easier to withstand the uncertainty.

The risk of a stock market plunge looms larger. However, permanent investors who plan to own stocks for the rest of their lives would be wise to view volatility as a friend.

That may be counterintuitive, but it absolutely is valid. Choosing to expose a portion of your portfolio to price volatility, also known as risk, justifies a better return. You wouldn't earn the equity risk premium on stocks, if you weren't exposed to lots of volatility. It just goes with the territory. ●



David A. Schneider, CFP® | Schneider Wealth Strategies | 41 Madison Avenue, 31st Floor | New York, NY 10010
Phone: (212) 924-2290 | Toll Free: (800) 461-3283 | Fax: (800) 291-3742 | david@schneiderwealthstrategies.com | www.schneiderwealthstrategies.com