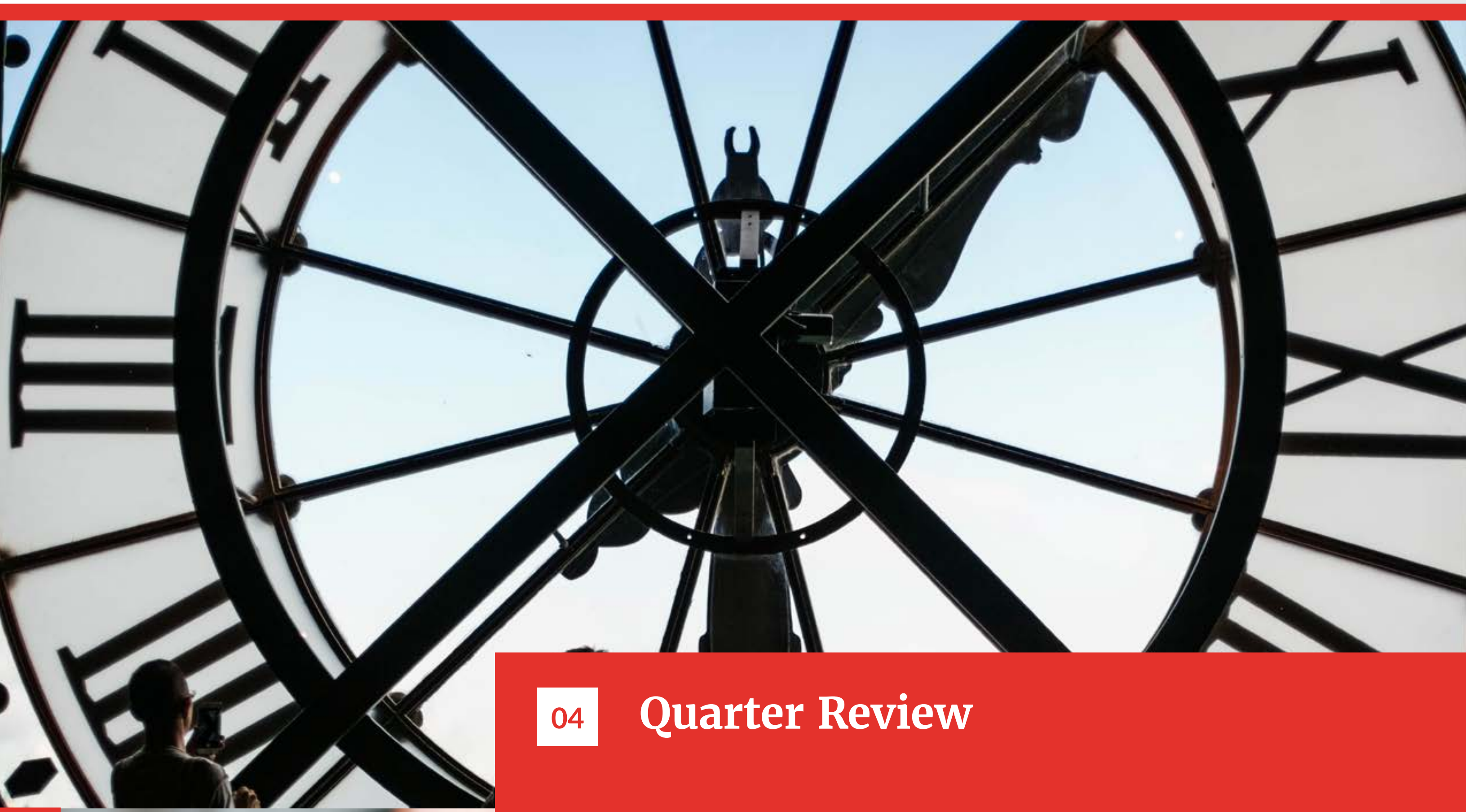
BCS Wealth Management

the BENCHMARK
Newsletter

ISSUE NO. 16 JULY 2021



04 Quarter Review

How have the markets recovered since the beginning of the COVID-19 pandemic? Nathan discusses the rebound and appraises some factors that could drive the markets from here.

02 Tax Considerations of Gifting to Loved Ones

Philip explains the tax implications associated with financial gifts.

06 Inflation: The "Silent Killer" of Savings Accounts

Nick illustrates how low inflation is impacting the value of your money.

By Philip Bachman

Tax Considerations of Gifting to Loved Ones

If you have a child, grandchild, or other loved one that you'd like to bless with a financial boost, what tax implications should you think about?

It's a big question, and the answer is multi-faceted. For specific tax advice, we recommend contacting your CPA or tax advisor. This article is just a high-level overview about gifting assets to loved ones other than a spouse. (In general, there are no tax implications for asset transfers from one spouse to another under the unlimited marital deduction, as long as both spouses are U.S. citizens.)

I find it easiest to break down the conversation into two realms: (1.) tax on the gift itself and (2.) tax on the income and/or growth the gift might produce.

Gift Tax

The IRS' philosophy is that gift tax is the responsibility of the donor, not the recipient. However, in practice, gift tax doesn't come into play often because of the annual gift tax exclusion and the lifetime exemption. The federal estate and gift tax exemption applies to the total of an individual's taxable gifts made during life and assets left at death.

For 2021, the annual gift tax exclusion is $15,000 per donor, per recipient. This means a donor can give anyone else like a relative or friend up to $15,000 in assets a year, free of federal gift taxes. A married couple making a gift to a child, for example, could transfer $30,000 per year ($15,000 x 2 givers) without incurring federal gift tax.

Gifts above $15,000 in a single year simply could be counted towards the lifetime exemption. That amount for 2021 is $11.7 million per individual and $23.4 million per couple. The gift tax only kicks in after lifetime gifts exceed these amounts. In 2017 as part of the Tax Cuts and Jobs Act (TCJA), Congress doubled the exemption starting in 2018. The amount rises with inflation through 2025. However, the increase is set to lapse after 2025 back to the much lower pre-2018 levels.

Income and/or Capital Gains Tax

Once the asset becomes the recipient's, they are responsible for any taxes owed on the income it produces and/or its growth if it's sold for a gain. Most investors with taxable accounts already are familiar with these rules. It gets more nuanced if the recipient is a minor. To that point, the next four paragraphs are a primer about the "kiddie tax."

The so-called kiddie tax is tax on a child's unearned income. It's designed to prevent parents or other relatives from shifting investment income to a child in a lower tax bracket. Since its enactment as part of the Tax Reform Act of 1986, the kiddie tax rules traditionally tied the tax on a child's unearned income to the tax rates of the child's parents.

A law change in the 2017 TCJA uncoupled the kiddie tax from the parents' rates. Instead, effective for tax years 2018 and 2019, the tax on a child's unearned income was to be figured using the tax brackets for estates and trusts (with some modifications). Since the tax rates for estates and trusts increase more steeply than the individual income tax rates, this change resulted in an increase on the kiddie tax for some families.

But then the rules changed back to the way they were. Effective beginning with the 2020 tax year, the 2019 Setting Every Community Up for Retirement Enhancement Act repealed the law change made by the TCJA. Parents who used the estate tax rate in 2018 and 2019 have the option to amend their income tax returns and use the parents' rate instead.

Other bond strategies might include Treasury Inflation Protected Securities (TIPS). TIPS are a low-risk treasury security indexed to inflation where the principal amount invested is increased by the percentage of inflation. Floating-rate bonds could also hold up to inflation better than fixed-rate bonds, all else being equal.

Under the current rules, the child's unearned income under $1,100 is not taxed; the next $1,100 is taxed at the child's tax rate; and any unearned income in excess of $2,200 is taxed at the parents' tax rate. The parent may be able to report the child's income directly on the parent's tax return for simplicity. The kiddie tax applies to a child's net unearned income if the child is under age 19 or is a full-time student under age 24, has at least one living parent, has unearned income above a threshold amount ($2,200 at this time), and doesn't file a joint return with a spouse for the year.

Lastly, rounding out the conversation is capital gains tax. Gains or losses must be figured whenever the asset is sold (unless it's tax-qualified like an IRA). Generally, the recipient's cost basis and holding period is the giver's cost basis and holding period. Note how this is different to assets received through inheritance. The cost basis for inherited assets is usually based on the value as of the date of the original owner's death. Often, although not always, this results in a favorable "stepped-up" basis for the heir.

Financial Planning Implications

Gifting assets to family members can be appealing from a financial planning standpoint. Indeed, a good example is where a donor gives low-basis appreciated stock shares to a family member in a lower tax bracket. Having said that, there can be a number of issues to think about. For example, it might be a case where a child or grandchild might apply for college financial aid and may not want as many assets in their name.

Provided it aligns with your family's objectives and keeps you on good financial footing, transferring assets to relatives is thoughtful and impactful. It helps them to have more matches in the matchbox – resources to draw upon to achieve their aspirations. Let us know if this topic prompts any questions or if we can do anything for you.

Philip Bachman,
CIMA®
Financial Advisor
Investment Management & Research

Client Ice Cream Social Highlights

We had a great time hosting our clients and friends at our ice cream social event in May. The ice cream was delicious, but after not seeing many folks for a long time, the real treat was getting to be together!

Quarter Review

By Nathan Goodwin

It's hard to believe we're starting the second half of 2021. Is it just me or is this year flying by? With everything that happened in 2020, it felt like the year that would never end. Now it feels like time won't slow down!

At this point last year, the markets were still trying to recover from the historic selloff in March sparked by the COVID-19 pandemic. Twelve months later, we find the markets not only recovered but hovering near all-time highs, well above pre-pandemic levels. Combining the first two quarters of the year gives us the second best return for the S&P 500 since 1998 (first two quarters), trailing only the first half of 2019. Let's take a look at where we are today, then let's consider some opportunities and concerns for the rest of the year.

Major Stock Indexes	2nd Quarter 2021	YTD
DJIA	4.6%	12.7%
Nasdaq Composite	9.5%	12.5%
S&P 500	8.2%	14.4%
Russell 2000	4.1%	17.0%
Global Dow	4.9%	14.7%
Japan: Nikkei 225	-1.3%	4.9%
Stoxx Europe 600	5.4%	13.5%
UK: FTSE 100	4.8%	8.9%
Major Bond Index	**2nd Quarter 2021**	**YTD**
Bloomberg Barclays US Aggregate (Total Return)	1.8%	-1.5%

Looking at the second quarter with blinders on offers a pretty nice picture. The S&P 500 was up 8.2%, adding to 5.8% in the first quarter. The DJIA was up 4.6% and the NASDAQ up 9.5%. Even better, these returns were accompanied by relatively low volatility for a change. It was a quarter we'd all like to see on repeat.

Taking the blinders off now, we know that there is a lot going on in the world. Much has been done to prime the recovery from the effects of the pandemic and economic shut-down. The vaccine appears to be a success and is readily available. Most of the economy is back up and running, and demand for products and services is high. Low interest rates continue to support borrowing and a strong housing market. Supply chain issues have created sharp price swings in several areas, such as in the home and automotive sectors, among others. Additionally, multiple stimulus payments from the federal government have injected billions into the economy, with even more coming soon for infrastructure.

All of these items lead many to believe economic growth will continue in the short term.

What could stop the recovery and further growth? Looking ahead, there are two major items that have come to the forefront. The first is inflation. For more than a decade, inflation has essentially been non-existent. However, the speedy recovery and large monetary injections have the economy running hot. Are you building a house or trying to buy a car? You know what I'm talking about.

The Consumer Price Index was up 5% year-over-year in May. What's yet to be seen is if these various price increases will pull back once supply and demand even out again. Much of the current economic debate is centered on this question. While we don't have a definite answer yet,

we are seeing some commodities start to retract from their highs of late.

The price of lumber is one area experiencing this pull back after an incredible climb. (Check out the upcoming blog post by John Brandon with more specifics on this topic.)

There is not much debate about the presence of inflation; it's mostly about what will happen from here. However, it's important to note that it's not always a bad thing for your investments. Actually, stocks generally do well during inflationary periods and arguably provide the best hedge against it. Take the last 12 months for example. Based on 5% inflation, $1,000 in cash a year ago only has $950 in purchasing power today. Another way to say it is that you need roughly $1,050 today to have the same buying power your $1,000 had a year ago. But consider that same $1,000 invested in the S&P 500 over the past 12 months would be worth $1,379 today. Stocks can help us keep up with and exceed inflation.

The second major concern is Federal Reserve policy and how they will respond to the booming economy and inflation. Tapering the bond buying program and/or increasing interest rates are not necessarily bad things. In fact, they're usually a sign of a growing economy. But the pace and timing of such changes can spook the markets if such action is not expected, or if it's initiated sooner or in larger increments than expected. We'd like to think the Fed has learned their lesson on this. Time will tell.

In conclusion, the second quarter was very positive for the major stock indices. Strong earnings, low interest rates, and extra funds for many create the possibility for continued growth. Headwinds are always present and ever-changing, but we believe your financial plan should not be.

These are interesting times, but we're here to walk beside you. Thank you for the trust you place in us. We don't take it lightly!

Nathan Goodwin, JD, CFP®
Partner & Senior Financial Advisor

Latest News from Around BCS Wealth Management

Andrew Farmer, who interned with us this past summer and winter, has joined us again for summer 2021. He will soon be returning to Belmont University in Nashville, where he will be starting his sophomore year. Andrew is a finance major and has become a valuable asset and member of our team.

The office has a new look thanks to these stunning photos by Heather Koenig. Heather is a friend, client, and a talented photographer! Check out more of her work on her website.

HEATHERKIRKPHOTOGRAPHY.COM

Inflation: The "Silent Killer" of Savings Accounts

By Nick Clay

The Federal Reserve's balance sheet continues to expand on the heels of the COVID-19 pandemic. With the government continuing to print money to jumpstart the economy – and no immediate offset on how to pay for the spending – we are starting to experience an uptick in inflation. Simply put, the U.S. money supply is being expanded, but the amount of goods available for consumption isn't rising commensurately.

A simplified, fundamental economic construct holds that if a central bank prints more money, households should have more cash to spend on goods. But if there is more money chasing the same amount of goods, lack of supply and increased demand will increase prices. Most of us have experienced a rise in costs recently if doing home improvements, purchasing real estate, filling up with gas, booking travel in the midst of pent-up demand, or even buying steaks for a weekend barbecue.

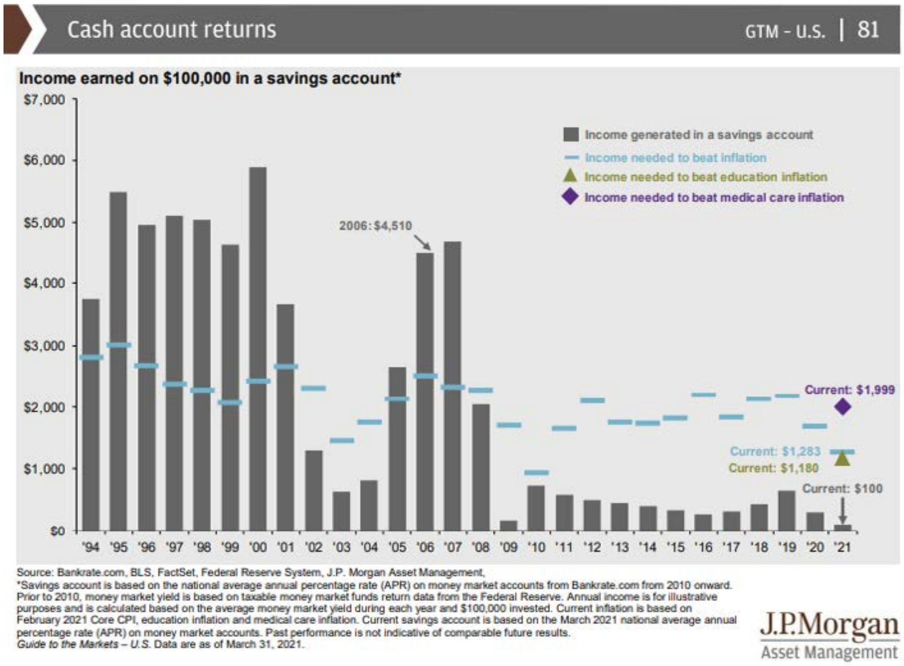
In addition to an increased money supply, many parts of the supply chain were crippled during the pandemic, which led to further supply/demand imbalances and an increase in costs. To be clear, we are still hovering at or below long-term average levels of inflation, but nonetheless inflation is something to keep an eye on. Notably, the April reading of the Consumer Price Index (CPI) saw a rise of 4.2% year-over-year. (For comparison, the average annual CPI increase was just 1.9% from 2011 through 2020.)

Interest rate policy is a key economic tool the Federal Reserve uses to encourage economic recovery and expansion. The Fed's lowering of interest rates is meant to spur borrowing, business expansion, and economic activity. Interest rate levels across the board remain near record low levels. Although this is good if you are in the market to borrow money, which the Fed hopes you do, it becomes a challenge if you are trying to earn interest on savings deposits.

What happens when inflation is around its long-term historical average, 3.1% (average annual CPI, 1913-2019), but you are earning near 0% on your savings or money market accounts? You are losing purchasing power. Stated another way, you are losing value on your money. This is why inflation is called the "silent killer." The M2 money supply as a percentage of GDP is near record highs, meaning there is higher than normal balances sitting in savings accounts, checking accounts, CDs, money market accounts, and the like. It's common these days for our clients to ask, "Is there anything I can do with extra cash that isn't earning anything for me?"

Consider this chart:

- The gray bar represents interest earned on a $100,000 savings account. You'll see in 2006 you could expect to earn $4,510 per year in interest. Fast forward to 2021, and that number has drastically dropped to $100!

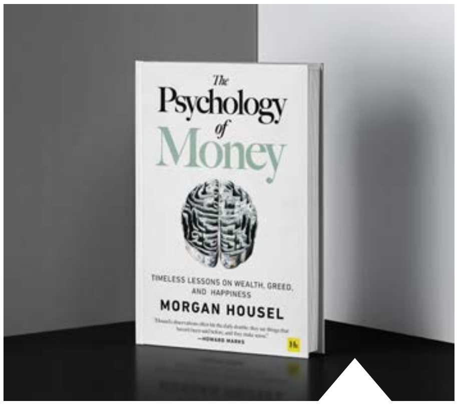


- The blue lines represent the level of income needed in order to keep up with broad inflation. When we are below this line, this means prices of goods of services are increasing, but your dollars in savings accounts are not keeping up. You are losing your ability to afford goods and services over time.
- Look at inflation on education and healthcare, which is generally even higher than broad inflation. Keep this in mind if you are saving money for a child's future education expenses or if you are saving money for healthcare expenses in retirement.

What's the moral of the story? Keeping cash set aside for emergency and short-term spending needs is important for peace of mind and financial success. However, having large or excess amounts of cash can be detrimental to long-term financial and investment goals.

How can you fix this? Invest. Investing is the key to turning savings into wealth, and investing over the long run in a well-diversified portfolio is crucial to reaching your financial goals and maintaining your purchasing power as prices increase over time. If this article resonates with you, we recommend talking with your financial professional and assessing what might make sense for any excess cash savings.

Nick Clay, CFP®, AIF®, AAMS®
Managing Partner & Senior Financial Advisor



Book Review– *The Psychology of Money*

By Myra O'Dell

I recently met my good friend from college and her family at the Outer Banks in North Carolina. As it turns out, the weather did not cooperate for spending much time at the beach, but it was perfect for catching up on some reading! One book in particular had been on my reading list. It's *The Psychology of Money* by Morgan Housel.

From early on in my career, I've found the topic of behavioral finance to be intriguing. Our society has made major advancements in science through the years. From technology to healthcare, our knowledge base is growing at a pace that seems exponential. We know, more than ever before, what behaviors either help or hurt our overall health. Likewise, we have more tools at our discretion to help us manage our finances. Despite these developments, our human nature still leads us rogue at times in both areas.

This book outlines what the author believes to be 20 of the most important flaws, biases, and causes of bad behavior when it comes to money. I'm only going to cover two of the topics in this article, but I think all 20 are worth consideration, so I encourage you to read the full book.

Confounding Compounding

If something compounds, meaning that a little growth serves as fuel for future growth, a small starting base can lead to results so extraordinary they seem to defy logic. The author uses Warren Buffett as an example. At the time that the book was written, Buffett's net worth was $84.5 billion. Of that amount, $84.2 billion was accumulated after his 50th birthday and $81.5 billion after 65th birthday!

Buffett began investing when he was 10 years old. At age 30, he had a net worth of $1 million. He's been able to generate an average annual return of 22%. That's an extraordinary average return! However, let's say that he didn't start investing until his 30's because he spent his teens and 20's spending on other things. If his net worth had only been $25,000 at age 30 because of his spending habits, and he decided to retire at age 60, his net worth would have been $11.9 million instead of $84.5 billion! While Buffett has proven to be a phenomenal investor, much of his wealth can be attributed to compounding and time.

When measured by average annual return, Jim Simons, head of the hedge fund Renaissance Technologies, holds the record at 66% annually since 1988. In comparison, his net worth is $21 billion. Despite the fact that his average return is 3 times as high as Buffett's, he is 75% less rich simply because he has had half as many years to compound. Although, I'll go on record saying that $21 billion is not too shabby!

So what's the take away from this story? The best time to plant a tree was 20 years ago. The second best time is today. That's a quote that I learned from my coworker, Tommy Greer. No matter when we started saving, most of us still wish we would have started sooner. We can't change the past, but we can start now in order to affect the future!

Freedom

Controlling your time is the highest dividend money pays. In general, people seek more wealth to bring happiness. While happiness is a complicated subject because every single person is different, the author notes that there seems to be one common denominator in happiness when it comes to your finances: The ability to do what you want, when you want, with who you want, for as long as you want.

When we think about the value of money, we tend to think about the things we can buy, from must haves like food and clothing to luxuries like vacations and sports cars. But money's greatest intrinsic value is its ability to give you control over your time.

A small amount of wealth means the ability to take a few days off work when you're sick without financial disaster. A bit more wealth means being able to wait for a good job to come around after you have been laid off, instead of having to take any job you can find. Having an adequate emergency fund means not losing sleep over the unknown happening. Even more means being able to retire when you want to instead of when you need to.

Using money to buy time and options has a lifestyle benefit that few luxury goods can compete with. I'm a bit of a control freak, so this is a concept that I caught onto a long time ago. When making purchases, whether it is a series of small purchases or one big purchase, I always weigh the value of the purchase(s) against what the money could provide in terms of financial freedom/flexibility for the future. Sometimes I decide the purchase is worth it and sometimes I don't. Sometimes I make the wrong choice and regret it later! I think you owe it to yourself to look at purchases from this perspective.

CONTINUED ON PAGE 8 >>

BCS Wealth Management

801 F Sunset Drive, Suite 1
Johnson City, TN 37604
423.283.9821

PRSRT STD
US POSTAGE
PAID
JOHNSON
CITY, TN
PERMIT NO. 26

BCS Wealth Management is an independent financial planning firm in Johnson City, TN. We help individuals, families, and businesses reach goals important to their financial wellbeing. We provide investments and financial planning, insurance, and group benefits.

bcswealth.com

Accounting Today is a leading provider of print and online business news for the tax and accounting community. Accounting Today's "The Top 150 Firms by AUM (2021)" ranking was assembled using data from Audit Analytics. Submissions were received from almost 200 firms. In most cases, firm names are those of the financial planning/advisory subsidiary, not the CPA Firm. Firms were ranked by their total assets under management ("AUM"). The AUM figures were for a variety of dates, but none earlier than year-end 2020. Rankings are not indicative of a firm's future performance nor do they evaluate the quality of services provided to clients. BCS Wealth Management did not pay a fee to participate in this ranking.

CONTINUED FROM PAGE 7 >>

Even though it's not listed in the book, I can't write about this topic and not mention that I think money also provides the ability to give generously to people or organizations that you feel compelled to give to. While this concept falls under the general definition of control that the author mentions, I feel like it is a concept that is important enough to be mentioned specifically.

In summary, we think about and are taught about money in ways that are much like physics (with rules and laws) and not enough like psychology (with emotions and nuance). However, finance is largely guided by people's behaviors. To understand why people bury themselves in debt, you don't need to study interest rates. You need to study the history of greed, insecurity, and optimism. To identify why investors sell out at the bottom of the bear market, you don't need to study the math of expected returns. You need to think about the agony of looking at your family and wondering if your investments are imperiling their future.

As financial advisors, we can guide you through the mathematics and help educate in good decision making, but only you can truly control your behavior. I hope this summary helps you think about decision making in a new light. If you find these two topics interesting, I think you will thoroughly enjoy reading the whole book.

Myra O'Dell,
CFP®, MBA
Partner & Senior Financial Advisor

Your Team of Wealth Magnets

BCS Wealth Management has been acknowledged in *Accounting Today* magazine for a seventh consecutive year. The 2021 *Accounting Today* "Wealth Magnets" article ranks the top 150 wealth management firms which are affiliated with CPA firms. We are proud to be recognized as third in Tennessee and 72nd in the country based on assets under management.