



PERSONAL
INVESTMENT
MANAGEMENT, INC.

Quarterly News Release

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In this edition, we: 1) Defer comment related to ongoing legislative processes, 2) Offer comprehensive analysis of the current state of inflation throughout the global economy, 3) Deliver important commentary on the topic of estate planning.

Current Events

We have included this brief section simply to convey that we are not spending time on political current events in this issue. Headline reporting on negotiations within the Democratic party, as well as reporting on special measures to keep the government funded temporarily, on the debt ceiling and on a variety of other topics is plentiful. We are reluctant to devote too much time to any of these for fear that developments may render our reporting outdated before it reaches you. We will cover the outcomes of these processes in due time and as appropriate.

Economic Commentary

Brian C. Fahey, MA, CFA & Christopher J. Reedy, MBA, CFP®, CIMA®

Introduction

Commensurate with the sharp downturn in equity markets in March of 2020 due to early panic about COVID-19, we started producing and distributing monthly market commentary. Prior to this, our commentary was distributed quarterly. There are advantages and disadvantages to such frequent markets/ economics-based communications. The primary advantage to PIM clients is that given the great many primarily profit-driven media sources of financial commentary, we hope to be at least one source of purely objective information, perhaps the only one.

The potential disadvantage is that our commentary is based upon information available at the time and therefore, may have a limited shelf life. Economic data shifts constantly, often daily. While we are not suggesting that our monthly market commentaries be marginalized, we do wish to call attention to the rather transient nature of economic data and therefore, of our views. Plainly stated, the views expressed in our commentaries are only as durable as the data supporting those views. And the data is constantly changing. The most significant recent example of a change in our view based upon a change in data is the commentary that follows on inflation.

Inflation

Inflation is one of the most hotly contested topics in economics today. The facts and assumptions around this issue have changed a great deal in the past few months.

Our earlier assumption was that the development of vaccines would allow businesses, the job market, supply chains and consumer demand to return to something resembling normal over the course of the year. If general economic life returned to normal, then by the end of this year inflation would fall to something close to the sub 2% rate that prevailed over the past decade. The economic forces that have kept overall inflation low, such as aging demographics, technology, wealth inequality, and rising debt levels have not gone away. In fact, those forces are stronger today than in March of 2020. Yet inflation is currently above 5% and seems set to remain elevated for a while.

Unfortunately, the arguments for transient inflation have been delayed by the Delta variant and slow vaccine distribution in the developing world, as well as whatever viewpoint you prefer for vaccine skeptics in the US. Inflation is now a global concern. Even Western Europe, the land of perennial deflation, is seeing pricing pressure at 15-year highs.

Why is this?

The Delta variant and the policies put in place to stem its health impact have exacerbated the strain on global supply chains, generating disruptions that have manifested into higher prices. China closed the 3rd busiest shipping port in the world for three weeks to contain a COVID outbreak earlier this summer. Malaysia, a key country in computer chip packaging and testing, has the most stringent COVID-inspired mobility rules in the world, according to the University of Oxford. These production bottlenecks combined with record level consumer demand for goods are generating inflation at a time when analysts were expecting the opposite. Supply chains remain under incredible pressure. The cost of moving a 40-foot shipping container out of China to the US has increased from \$2,000 to \$10,000 in the past eighteen months. Delivery times of manufactured goods globally have never been longer (data to '98). Logistics remain such an existential challenge to US businesses that Costco has chartered cargo ships and rented shipping containers to ensure that they have goods to sell this holiday season. So much for getting back to normal.

The fingerprints of the Delta variant are also apparent in the labor market, the single most important predictor of inflation. Certain pockets of the economy seem to be unable to attract and maintain employees. Healthcare, retail, and leisure/hospitality appear to be the most impacted. While salary growth in the economy overall is at a similar level today as pre-pandemic, that wage growth is happening with 5.4 million fewer employed workers. This suggests that many people are still unwilling or unable to return to work due to health and childcare concerns, forcing employers to increase wages. The best example of this in the data is for women aged 18-29 working in leisure and hospitality. This cohort likely has a high level of childcare responsibilities while also working in areas with direct customer contact. Wages for this group have risen 9% this year (~3x times faster than the headline rate) and the industry is still struggling to find workers.

For the broader economy, recent inflation data isn't all bad. Productivity is increasing faster than wages, suggesting that firms can afford to give employees raises while maintaining profit margins, though this varies depending on the industry. Schools opening and increased vaccine distribution should ease labor concerns into the fall. Other business costs that impact the inflation rate, such as commodities, have turned markedly lower. Lumber prices are down 65% from their May peak. The story is similar for industrial commodities such as iron, silver, and copper. Commodities were one of the first areas in the global economy to see COVID-induced price surges. These prices are now quickly abating.

The most encouraging news is that COVID-related hospitalization and death rates are beginning decline in the hardest hit areas of the US (AL, AK, FL, GA, KY, SC, TN, WV and WY). Overall mortality rates in those states are currently the highest in the developed world, and it will take time for those numbers to moderate. Asia is also seeing a similar decline in their COVID mortality rates, though their economies still have much more stringent

mobility rules in place. Until the public health situation improves, logistics bottlenecks and resulting inflation will remain.

Implications: The Fed

The Fed has stated for months, and reiterated as recently as August, that they expected inflation to be short-lived. The most significant implication of shifting inflation expectations is that the Fed recently conveyed its intention to scale back accommodative economic support programs faster than anticipated. This may seem counterintuitive. So let us pause and explain. Inflation, as a data point, reflects an over-heating economy. An over-heating economy is too many dollars chasing too few goods. Fed policy related to inflation control is intended to keep these things in balance. By first reducing quantitative easing in November (purchasing treasury securities and mortgage-backed securities in the open market), then raising interest rates in 2022, the Fed seeks to moderate the trajectory of the economy and thus keep inflation in check. Typically, the Fed doesn't take the stimulus "punchbowl" away until employment levels exceed their previous peak. The US economy is about 5 million jobs short of that figure today, and analysts anticipate it will take another 10-15 months to get back to where we were pre-pandemic. The Fed is willing to move much faster than they have historically.

Built into the Fed's inflation concern is the assumption that the US economy will rebound sharply in the 4th quarter of this year (7% growth) as Delta and its economic impacts wane. The Fed's 2022 GDP growth estimate is 3.8%. That level of growth has only been experienced once in the past twenty years, not including 2021, and would put pressure on the inflation rate even if the economy were free of COVID concerns. The rate of growth expected by private sector economists is half of the Fed's 3.8% estimate, a rather curious development as the two are generally very close to each other. The growth rate "potential" for the US economy is estimated to be 2%. Anything higher should generate inflation, with demand outstripping supply. The Fed seems willing to ignore its full employment mandate in favor of its stable prices mandate.

Implications: The Markets

The bond market believes that the Fed will follow through with earlier than expected rate hikes. The 10-year Treasury has spent the past six months between 1.20-1.35%, only to move up to 1.55% the week after the Fed's most recent meeting. If the market comes to expect higher rates in the future due to Fed policy, then bonds will sell off, which is exactly what happened. Economically sensitive equities in value sectors (financials, energy, industrial, materials, consumer discretionary) have performed well on the news while growth sectors such as technology have struggled.

We've made the argument that the equity market is dependent on low interest rates to maintain high valuations. The facts and assumptions around that conclusion have not changed. Other than a brief trip higher to 1.7% in March, the bond market has played along, with the 10-year Treasury spending much of the year below 1.35%. It now appears that the market expects rates to move higher, which should benefit value stocks in the sectors listed above. The equity market should be able to digest this change in leadership if interest rates do not move too high too quickly and the upcoming earnings season goes according to expectations.

To date, only a handful of companies have reported earnings for the most recent quarter. FedEx, Nike and Bed Bath & Beyond all reported early and missed analysts' profit estimates due to supply chain issues, labor costs and declining consumer demand for home goods. This is a small sample, but it does evince a more challenging operating environment. The "Goldilocks" market that has prevailed since November of 2020, commensurate with initial Covid-19 vaccine announcements, seems set to face challenges as government support ebbs and the virus continues to impact economic activity globally.

Preparing for the Ultimate Eventuality

Christopher J. Reedy, MBA, CFP®, CIMA®

“It was a mess.” “Paperwork everywhere.” “We couldn’t find anything.” These are common refrains from our clients who have found themselves in a position of responsibility for settling an estate. Grieving the loss of a spouse, parent, grandparent, sibling, or anyone is so very difficult. Navigating significant administrative confusion at the same time can become overwhelming.

What follows is our advice for preparing for the ultimate eventuality in a manner that makes the process as administratively easy for your loved ones as possible. We are not estate attorneys. We are not qualified tax professionals. Therefore, the provision of specific legal or tax advice is inappropriate and prohibited, according to the Securities and Exchange Commission, the Certified Financial Planner Board of Standards and more generally as fiduciaries. Our counsel on these matters is intended to be a framework within which you may consider your own unique situation and consult a qualified professional if there is work to be done.

Have A Basic Estate Plan

A basic estate plan is comprised of the following documents: Will, Financial Power of Attorney, Power of Attorney for Health Care, Living Will, and often a Community Property Agreement. For the disposition of items of personal property, often a “Gift List”, is recommended. Beneficiary Designations are also very important. In certain situations, the use of Trusts may be appropriate.

At a high level, think of your total assets as being able to be segregated into two categories: Probate Assets and Non-Probate Assets. Non-probate assets have a beneficiary designation and pass to heirs outside of the probate process: insurance products (life insurance and annuities), retirement accounts (IRA, Roth IRA, 403(b), 401(k), etc.), and sometimes regular investment accounts and bank accounts via the use of the “transfer on death” and “payable on death” designations. Schwab calls this a “Designated Beneficiary Plan”, which some of you have implemented. Everything else is a probate asset (houses, cars, other personal property). The Will document should specify a Personal Representative (executor/ executrix), in charge of the estate settlement process. Think of the Will document as a set of instructions to the probate court and Personal Representative for the disposition of probate assets.

A Financial Power of Attorney designates the person who will make financial decisions on your behalf when you are no longer able. The Healthcare Power of Attorney will make healthcare decisions on your behalf when you are no longer able. The Living Will makes clear your views on life support. And a Community Property Agreement makes clear what is to be included in a marital estate.

Now pause for a moment and consider what may occur should you experience significant cognitive decline, experience a life-threatening illness, or pass away unexpectedly without a basic estate plan in place. Imagine the confusion. Having at least a basic estate plan in place serves the following purposes: 1) ensures that you are cared for properly if you suffer a health event, 2) ensures that your assets are distributed per your wishes, 3) relieves your loved ones of the stress and confusion that the absence of an estate plan will certainly cause.

Trust Planning

Very generally, a trust is used for one of three reasons: 1) estate tax optimization/ avoidance (not evasion), 2) asset protection from creditors, 3) establishing conditions/ requirements for the use of Trust assets following your death.

If you are at risk of paying state or federal estate tax, then trust planning can be effective in making sure your estate pays no more than absolutely required. Creditors may have a more difficult time gaining access to trust assets. There are legitimate reasons that you may wish to control the disposition of your assets after your passing. Some common examples are: 1) beneficiary is a minor, 2) beneficiary has special needs, 3) beneficiary lacks relevant investment management or general money management experience, 4) you wish to provide for more than one generation of beneficiary.

Beneficiary Designations

For many, our two most valuable assets are our primary residence and our retirement account(s). Retirement accounts have beneficiary designations and generally bypass the probate process. Often beneficiaries are people, family members, etc. Sometimes beneficiaries are charities. Sometimes, with more complex trust planning, the beneficiary might be a testamentary trust (a trust created by instruction within the Will document), or trust already in existence. It is very important to periodically review your beneficiary designations.

Lifetime Gifting

Our primary concern is our own financial security. There may come a time however, when this is no longer in question. When assets and income exceed anticipated cash needs by enough, then gifting in the present to eventual beneficiaries becomes a consideration.

The federal annual gift tax exclusion amount is \$15,000. This means that any person may gift to an unlimited number of people, \$15,000 per recipient, per year, without having to report the gift. However, larger gifts are allowable and can benefit the giver as well as the recipient.

A gift of greater than \$15,000 to any one person, in any one calendar year, requires filing IRS Form 709. However, the gift itself is not a taxable event to the giver or the receiver. The IRS wants a record of the gift so that the amount can be added back into your estate at your passing to determine if your estate owes federal estate tax. The Federal Estate Tax Exemption Amount is currently \$11.7MM, per person, portable between spouses. Therefore, a marital estate valued at less than \$23.4MM will likely not pay federal estate tax.

Most PIM clients need not be concerned about paying federal estate tax and therefore, may gift amounts larger than the annual exclusion amount of \$15,000 without worry.

While few will pay federal estate tax, Washington residents may be subject to Washington State estate tax. The current Washington estate tax exemption amount is \$2,193,000, not portable between spouses. Whether you have total assets approximating \$2,193,000 or double that for a marital estate, you should be thinking about how to avoid paying estate tax in Washington.

One way to reduce the size of your estate, and thereby avoid Washington estate tax, is by making large gifts while you are alive. Unlike the federal government, which adds back the value of large gifts for determining the applicability of federal estate tax, the State of Washington does not add back the value of large gifts.

Another reason to consider larger gifts during your lifetime is the enjoyment you may experience watching the objects of your generosity put your gifts to use. Maybe your gift is the down payment on a new home, or maybe your gift pays off a mortgage. Maybe your gift supports the opening of a new small business or pays off a student loan. Maybe your gift is saved/ invested for retirement.

Get Organized

Sounds simple enough, but we aren't always as organized as we should be. This is really a filing task. Keep original copies of the following documents in a safe place: 1) estate planning documents, 2) insurance documents (life insurance, annuities, long-term care), 3) bank and brokerage account information (financial institutions, account numbers etc.), 4) a list of all professional service providers (tax professional, estate attorney, insurance professional, investment professional), including names, company names, telephone s, physical and email addresses, 5) anything else you know to be relevant to your loved ones in the event of your incapacitation or death.

Hold a Family Meeting

Once you have a valid estate plan and have consolidated and safely stored all relevant documents, consider inviting your loved ones together for the purpose of discussing the nature of your estate. What you choose to disclose during this meeting is up to you. But at minimum, consider informing attendees of two things: 1) that you have a valid estate plan and the location where this and other relevant documents are safely stored, 2) inform the group of who has been assigned important roles, such as financial or health care power of attorney, personal representative of your estate, or trustee.

You may certainly go beyond these minimum requirements and inform your heirs of the size and composition of your estate. And you might consider sharing what the estate plan documents specify regarding the ultimate distribution/ disposition of financial assets, real estate, and other personal property. In other words, who gets what.

It is the absence of such a meeting that causes tremendous stress for heirs in the estate settlement process.

Conclusion

If you have ever been involved in settling an estate, then you know how stressful it is dealing with administrative complexity while grieving. If you have not, we assume that you know someone who has. We have been on the periphery of many of these processes, involved only to the extent appropriate. Our experience has been what you might assume. Families who have followed the advice recommended in this article generally get through the process as easily as the circumstances allow.

If we can be of any assistance, please reach out to your PIM Financial Adviser.

Closing Remarks

Please accept our most sincere gratitude for your trust in PIM. It is our pleasure and our privilege to serve you, our valued clients.

With summer in the rearview mirror and as we settle into the last quarter of the year, please be in touch with your PIM Financial Adviser if you would like to schedule a review meeting or have any specific questions or areas of interest for discussion.

In the meantime, we hope that you enjoy the lovely autumn season.