The Barrister Quarterly

BARRISTER

PLANNING | INVESTMENTS | INSURANCE

Issue: 2Q2021

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Barrister was founded with the sole mission of offering clients an opportunity to meet their financial objectives through independent, ethical, unbiased, and competent professional guidance.

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Dear Friends,

At Barrister we practice evidence-based financial planning and investing, while striving to remain rational in our decision making. The latter can be difficult at times, especially when there is a sense of euphoria in the markets and certain asset classes. As mentioned in our last Quarterly, this approach allows us to help clients avoid large drawdowns in their portfolios. At that time, Bitcoin was hovering around $60,000, a little below its all-time high. We were fielding questions from clients and prospective clients interested in our views on crypto. We felt then – and continue to feel – the jury is out on the sustainability of crypto as an investible asset class. Today, Bitcoin trades at less than $34,000, down more than 45% from its peak.

All major equity indexes (Dow, S&P 500, Nasdaq, Russell 2000) are currently trading close to all-time highs. Volatility, measured by the VIX, has been trending lower for the past year. This is against the backdrop of the largest government stimulus programs in our history (over 26% of GDP!) and skyrocketing home values. On the other hand, there is persistent talk of increased taxes on capital and corporations, labor and supply shortages, and a Fed seemingly more aware of the risks in an overheating economy. With these disparate forces at play, what is an investor to do? Nothing.

According to data from Macrotrends, the S&P 500 had only 28 negative return years since 1927. Nineteen of those years were double-digit negative returns. The S&P 500 is already up 14.29% this year, so we are on track for 66 years of positive returns. If this year's performance holds, equity markets will have been positive 70% of the time. Evidence-based thinking tells us we should go with the odds and not invest based on what occurs less than one-third of the time.

Best,

PLANNING NOTES

Shock & Awe: Peter Thiel's Roth IRA

Since a trove of IRS data was leaked to investigative journalist site ProPublica, details of the wealth and taxes of a number of high-profile Americans have been drip fed to the public. None of these has been as incredible as the revelation last week that legendary Silicon Valley investor, Peter Thiel, holds a Roth IRA with a $5bn balance.

We'll leave the hand-wringing and ideology to the likes of ProPublica – you can read their take on this situation here. What we're interested in answering is why one would want that much money in a Roth IRA and, if this is a preferred outcome, how to go about doing it.

For the uninitiated, the Roth retirement account was established in 1997 by the eponymous Senator to allow savers to accumulate *after-tax* retirement dollars. Those dollars are then protected for life from all forms of taxation. The distinction with traditional retirement accounts is that these accounts store *pre-tax* dollars which are taxed at ordinary income rates in retirement. The traditional retirement account therefore bears two risks the saver should be aware of: 1) an unknown future income tax rate in retirement and 2) required minimum distributions (you can't leave your funds in a traditional retirement account untouched forever). The Roth eliminates both (1) and (2) in exchange for a known income tax borne today.

Broadly speaking, if the cost of income taxes (and foregone cashflow) today is less than the benefit of tax-free income (via account withdrawals) in the future, then it's probably safe to say having as much money in a Roth account as you can is a preferred outcome. For arguments sake, let's address why you might not want to put money into a Roth. The first is if you have such high income that you're being taxed at rates which makes any income reduction more beneficial today than tax-free income in the future. Think of high earners in high tax states like California and New York where all-in marginal tax rates exceed 50%. The other risk with the Roth, which is a bit harder to pin down, is what if they change the rules? If you read the ProPublica article linked above it's pretty evident in its tilt that they would like to see this "tax dodge" eliminated for the wealthy. In that case you may have been better off just putting money into a taxable brokerage or trust account instead. It's hard to see this happening and applying retroactively but in today's political/tax environment, who knows.

Now let's discuss how to get money into a Roth. The Peter Thiel story is a good place to start because while it's application is simple, the logic behind it is not a widely discussed planning technique. Thiel made a standalone Roth IRA contribution which was subject to an annual limit ($2,000 at the time, $6,000 today) and income phaseout (earn too much and you can't contribute). He contributed about $1,700 worth of "founders" PayPal stock, valued at 0.1 cents per share (that's about 1.7mm shares). Notwithstanding the debate about that valuation, contributing highly undervalued or underappreciated property (shares, bonds, etc.) into a Roth account is a smart strategy. Peter later repeated this trick with shares in Facebook. The article ignores the fact that the vast appreciation of these interests was not a given. To be sure, who's ever heard of the losers Peter Thiel invested in? It's worth mentioning had they been in the Roth account and depreciated to $0, the loss could not offset other capital gains or income.

Beyond the standalone contribution there are three other ways to make Roth contributions. First is through an employer sponsored retirement plan. Since the limits for these are higher than for IRAs, this is a way to build more Roth savings. The next method is called a Roth conversion. With the conversion you are converting traditional retirement dollars into the Roth account. The amount withdrawn in the conversion is reported to the IRS and taxed as ordinary income in that year. This might be a good idea in a year when income is lower. People that have highly variable income might consider this technique or retirees who need to diversify their savings vehicles. The final technique is known as a "back door" Roth contribution. This is for individuals who are phased out from standalone contributions due to their income. Instead, they make a traditional IRA contribution, which is not subject to income limits, and choose not to deduct the contribution on their tax return. A month or more later (a good rule of thumb) they convert the traditional IRA into a Roth IRA. Note, this is only recommended to individuals who have no other IRA assets.

When asked by our clients about how to save on taxes, Roth savings inevitably floats up there near the top of the discussion. The trick is getting money into and growing the money in the account. Smart strategies like converting traditional dollars (in low-income years) or contributing depreciated assets (in bear market years) can add a nice "tail wind" to any Roth account. Moreover, everyone should be evaluating their employer plans for the Roth option against their marginal income tax rate. Finally, the "back door" Roth option, while it lasts, is open to everyone. While we all won't have the means or luck to create a $5bn Roth IRA, with thoughtful planning, the same opportunities to build a tax-free nest egg that exist for the wealthy are right there for the rest of us. It's up to us to take advantage.

MARKET & ECONOMIC INDICATORS

Indicator	*Note [change vs prior quarter]*
Investor Sentiment AAII	48.6% Bullish [+2.6%] | 29.2% Neutral [-1.8%] | 22.2% Bearish [-.80%]
Investor Sentiment CNN	45 Neutral [-13]
Leisure and Entertainment (PEJ)	YTD up 30.93% [+14.72%], beating the S&P 500 by 15.05% [+6.34%]
Technology (XLK)	YTD up 14.21% [+9.79%], trailing the S&P 500 by 1.67% [+1.41%]
SemiConductors (SMH)	YTD up 18.29% [+2.49%], beating the S&P 500 by 2.41% [-5.89%]
Financials (XLF)	YTD up 26.50% [+9.05%], beating the S&P 500 by 10.62% [+.67%]
Staples (VDC)	YTD up 5.72% [+2.98%], trailing the S&P 500 by 10.16% [-5.4%]
Healthcare (XLV)	YTD up 12.84% [+9.88%], trailing the S&P 500 by 3.04% [+1.5%]
Utilities (XLU)	YTD up 3.5% [+.7%], trailing the S&P 500 by 12.38% [-7.68%]
Commodities (GSG)	YTD up 31.47% [+16.79%], beating the S&P 500 by 15.59% [+8.41%]
20yr+ Treasury (TLT)	YTD down 7.99% [+4.5%], trailing the Barclays Bond Index by 6.14% [+3.16%]
2yr/10yr Government Bond Spread	Spread is positive at 1.23% [-.29 bps]
High Yield Bonds (HYG)	YTD up 2.47% [+2.01%], beating the Barclays Bond Index by 4.32% [+.67%]
HYG spread vs 10yr Treasury	+304 bps [-32 bps]
YOY Corporate Earnings	For Q2 2021, estimated earnings growth rate for the S&P 500 is 61%
Central Bank Activity	Fed will likely begin tapering soon and has indicated a rate rise in 2022
Average Hourly Earnings	YOY decrease of 2.8% for the period ending May 2021
Fund Flows	Outflows of $1 Billion for Equity Funds and Inflows of $6 Billion for Bond Funds
Advanced/Decline Line S&P 500	At its highest point YTD
Merger & Acquisition Activity	U.S. M&A activity decreased with a decrease in spendingn on deals as well

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