KORBITZ FINANCIAL PLANNING
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April 2020 Newsletter

Korbitz Financial Planning

Introduction

The COVID-19 pandemic is like nothing I have seen in my lifetime. It is a human tragedy on a global scale. The words I write in this newsletter are not meant to diminish this at all. That said, my job is to help my clients with their finances, in good times and in bad. This is one of those bad times, and like it or not, bad times can present opportunities to some. Below are a series of articles, all with some connection to the COVID-19 crisis. Please let me know if you have any questions on any of the issues discussed. I wish you and your loved ones good health.

Eric
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Rebalancing 101

It has become apparent to me, based on several conversations with clients during the recent market turmoil that I have not adequately explained what portfolio rebalancing means.

At the most basic level, portfolio rebalancing means returning your portfolio to the target asset allocation that you had previously set.

For the 11 years from March 2009 through February 2020, this meant selling stocks and buying bonds. Why? Think of it this way. If you start with a portfolio that is $50 in bonds and $50 and stocks, you have total value of $100. If stocks rise 20%, you now own $50 of bonds and $60 of stocks, and you have a total value of $110. Your asset allocation has now shifted to 45% bonds ($50/$110) and 55% stocks ($55/$110). To rebalance you need to sell $5 of your winners (stocks) and move them to the relative losers (bonds.) You then end up with $55 in bonds and $55 in stocks, so that you are back to your 50%-50% target.

When stocks are falling, rather than rising, the opposite occurs. If you start with a portfolio that is $50 in bonds and $50 and stocks, you have total value of $100. If stocks FALL 20%, you now own $50 of bonds and $40 of stocks, and you have a total value of $90. Your asset allocation has now shifted to 55% bonds ($50/$90) and 45% stocks ($40/$90). To rebalance you need to sell $5 of your winners (bonds) and move them to the relative losers (stocks.) You then end up with $45 in bonds and $45 in stocks, so you are back to your 50%-50% target.

Human nature is such that people often want to do the OPPOSITE of rebalancing. That is, they want to BUY stocks when they have risen, and want to SELL stocks when they have fallen. That is not the way to increase the size of your portfolio. The way to do that is to BUY stocks when they have fallen and SELL stocks when they have risen. As Warren Buffet puts it: "Be fearful when others are greedy, and greedy when others are fearful."

I hope this helps you to understand the rebalancing process. Please let me know if you have any questions.

Making Lemonade out of Financial Lemons

I don't need to tell you that the stock market has been down lately. Down, a lot. But what can you do to help yourself in this depressed stock market? There are several things.

1. Rebalancing: As discussed in the previous article, when stocks are down, rebalancing involves buying some of those depressed stocks with your relatively stronger bonds and cash. If you are due for an annual update in the next month or two, we will address this at that time. If you are not due for a rebalancing until late summer, fall or even next winter, you may want to act sooner.
2. Roth Conversions: If you are able to convert IRA assets to Roth IRAs, this is a good time to do that. Why? Well, a stock fund that may have been worth $30,000 at the end of January, is likely worth about $20-22,000 today. If you converted that fund to a Roth IRA, would you rather pay tax on $30,000, or on $20-22,000? If you normally do Roth conversions later in the year, it makes sense to accelerate that process.
3. Required Minimum Distributions (RMDs): I have had several clients express concern about taking RMDs from stock funds when prices are depressed. That is understandable. Although Congress has waived the need to take RMDs in 2020, some clients need to take money from their retirement accounts for living expenses. An easy solution to this is to switch your RMD withdrawal from a stock fund to a money market or bond fund. That way you are taking your money out of a fund that has done relatively well (bonds or money market) and NOT out of your stock funds, which are worth less today than they were several months ago.
4. Roth Conversion instead of an RMD: If you do not need your RMD for living expenses but would be comfortable with the same taxable income as in 2019, consider doing a Roth conversion in the amount of your RMD. Your IRA balance goes down, your Roth IRA balance goes up, and your stay in the same tax position you were in last year.
5. Tax Loss Harvesting: I do not think there are many clients in the position to benefit from this, but tax loss harvesting is something to consider. If you bought a stock or mutual fund and it is now in a loss position, or "under water" you might consider selling the loss security in order to take the tax loss now, and then purchasing a similar, though different stock or mutual fund. There are some complications to this strategy, such as avoiding the "wash sale" rule which could disqualify your loss, so get some advice before doing this.
6. Mortgage Refinancing: If you have a mortgage interest rate of 4% or higher, you should be keeping an eye on mortgage rates. This is likely to be a good time to consider refinancing and reducing your interest expense on your mortgage.
7. Re-Fund Your Children's 529 Plan: My daughter had to leave her dorm early, in March rather than May, due to the COVID Crisis. The University that she attends has indicated that they plan to refund a portion of her room and board. Since I paid for that expense with money from her 529 plan, that is where the refund will go. Back into her 529 plan, to be used at a later date. If you receive a similar refund, you should put the money back into the 529 plan. Make clear to the custodian that this is NOT a contribution, but rather a re-deposit of refunded money. That way the re-deposit will not count against your contribution limit.

If you are interested in exploring any of these options, please let me know.

Break Glass in Case of Impending Higher Tax Rates

I had been preparing an article in January, before COVID-19, to discuss the (then) current state of the Federal budget. I'll give you the short version: The last two tax bills (2017 and 2019) had the Federal government borrowing money from your children and mine, in order to give large tax decreases to you and me. The Federal budget deficit (the amount we spend each year that exceeds the amount we collect each year) was forecast to balloon from slightly under $1 Trillion in 2019 to $1.7 Trillion in 2030. And that was BEFORE COVID-19!

The $2 Trillion spending bill which passed Congress in March, and which I have no issue with since it is responding to a genuine crisis, will make all these budget problems worse. Far worse. I fully expect the 2020-2021 Federal budget deficit to be the largest in history, likely in the range of $3-5 Trillion.

I will show my age here, but I have been a student of taxation and Federal budget policy since the early 1980s. Tax rates ebb and flow. Tax simplification comes and goes. There was a brief period during the late 1980s and early 1990s when we had two tax rates—15 and 28%. That did not last long. We currently have the lowest individual and corporate tax rates in the last several decades. Tax rates were as high as 50% as late as 1986 and as high as 70% as recently as 1981!

Now is the time to "break glass in case of emergency", and for most of you, to shift your 401k or 403B contributions from pre-tax (meaning you get a deduction now, at lower tax rates, but will pay taxes later, at likely higher tax rates) to Roth (where you will get no tax deduction now, but all your withdrawals will be tax-free down the road.) An exception to this would be taxpayers currently in the highest tax bracket who will retire and KNOW their income will put them in a much lower tax bracket in retirement. This change, from pre-tax contributions to Roth contributions, WILL cause your tax bill to go up in the near term. But it will make your tax bill go down in the long term, and possibly by quite a bit.

In the next few years, we will see the Federal budget deficit and the national debt skyrocket to levels never seen before. Ultimately those in Washington will HAVE to increase taxes to keep that debt from overtaking the entire economy. Mark my words, tax rates will go up.

Hopes

I will close with my hopes for a post-COVID-19 world:

1. That everyone will take hand washing and personal hygiene more seriously!
2. That people will telecommute more.
3. That people will commute less.
4. That the planet will get cleaner.
5. That more people will learn to cook, and continue to cook.
6. That we all clear out the clutter in our homes and keep it that way.
7. That people will appreciate social interaction more. Personal, social interaction. Not on a device.
8. That people will learn and keep up new hobbies.
9. That everyone will appreciate our public health workers, our emergency responders and our public service employees. It seems they get forgotten until there is a national or international tragedy.
10. That those with the capacity to do so will donate more, whether time or money, to those organizations that help others.
11. Please add your hopes here!

This has been an unprecedented several weeks, and we are not even to the worst of it yet. Our country, and our world, have been through bad times before. Think World War II. Think Great Depression. Think World War I. Think “Spanish” Flu pandemic. We will get through this. You will get through this. What is required now is patience, and rational thinking. Be well, stay healthy.