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Gift Tax Exemptions Could Become Much Less Available

If we learned one thing from the 2016 presidential election, it is that the only poll that matters is the one taken on Election Day. The outcome of presidential elections often has a dramatic impact on our financial planning and so an unpredictable election can make important financial decisions difficult.

Many experts now predict that the currently attractive environment for Tax, Gift and Estate Planning will change for the worse, regardless of which party wins the upcoming election. The logic here is straightforward: the recent rapid expansion of government borrowing as a result of the COVID-19 pandemic has placed enormous pressure on the government to maintain or increase tax revenues. This makes it unlikely that either party will do anything that may have the short-term effect of reducing tax revenue.

The window is likely to close quickly. An effective way to reduce the estate tax bill for your family, is to transfer wealth to your beneficiaries while you are alive. However, when you transfer wealth, you use up part of your lifetime gift and estate tax exemption. Right now, that gift exemption stands at an all-time high of $11.58 million ($23.16 million for married couples). This high exemption amount was a direct result of the Tax Cuts and Jobs Act, which took effect on January 1, 2018. Prior to that the lifetime gift and estate tax exemption amount was $5.49 million per individual so the exemption was effectively doubled! Unfortunately, this legislation "sunsets" by the end of 2025 which means that unless Congress acts, the exemption will go back to $5.49 million per individual.

You may lose your large exemption opportunity. In the case where Congress does decide to act before 2025, it may reduce this exemption even sooner, possibly acting to reduce the exemption amount retroactively to Jan of 2021. Those not taking advantage of the high exemption amount while it is in place, risk permanently losing their opportunity, making it a "use it, or lose it" period between now and the end of this year.

What can you do? With the Federal Reserve Bank lowering interest rates in response to the Pandemic-induced economic slowdown, it turns out that these low rates favor a type of estate planning strategy called a Grantor Retained Annuity Trust, or GRAT for short. A typical GRAT strategy may do a good job at tax-free wealth transfer if you use an illiquid, cash generating asset like commercial real estate, a closely held business or a highly concentrated stock position. A more flexible version, called a Structured GRAT, allows you to take advantage of this wealth transfer strategy even if your wealth is primarily in liquid investments like cash or short-term investments.

Even though the upcoming election and a low interest rate environment make this a good time for Estate Planning, these issues can be complex and should only be addressed with the help of professionals. Families with a desire for transferring wealth to heirs to lower the future burden of estate taxes should seek professional advice. We are here to help and work with your Trust & Estate Attorney and/or Tax Accountant.

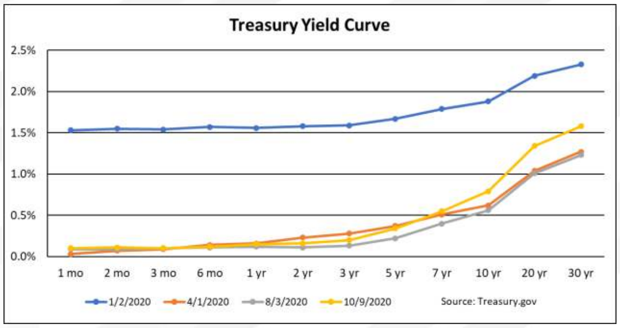
Markets are Fixated on Stimulus

If there were any remaining questions as to what is driving markets, this week we appeared to get a definitive answer. The week went something like this:

Optimism for a stimulus deal is growing – Market up 1%-2%
Somebody says stimulus talks are stalled – Market down 1%-2%
Mnuchin and Pelosi are still talking – Market up 1%-2%
Trump says no stimulus deal until after election – Market Down 1%-2%
Trump proposes deals for airlines, individuals and small business – Market up 1%-2%
etc., etc.

Monetary and fiscal stimulus is like a drug for the stock market. The more it gets, the more it wants, producing a Pavlovian response to stimulus headlines. **Despite the back and forth during the week, the market is betting that more stimulus is on the way (eventually) and stocks had a very strong week.**

The bond market is looking at things a bit differently, but is also laser-focused on a stimulus package and that is apparent in the Treasury Yield curve.



The chart at right shows the treasury rates at various maturities at four different dates, which we identify as follows:

- January 2 – Pre-pandemic;
- April 1 – Peak Panic;
- August 3 – Peak Fiscal Ease
- October 7 – Anticipating More

The January line (blue) reflects an economy rolling along with relative ease. Longer term yields had begun to rise due to relatively strong economic performance. By April (orange line), the pandemic was in full swing and everything had changed with all rates sharply lower in response to extraordinary actions taken by the Federal Reserve (FED) to ease market and economic conditions. Those FED actions were eventually followed by Fiscal stimulus (CARES Act), which began to push stimulus onto Main St. and not just financial markets. By August (gray line), the yield curve had not changed much, but the initial stimulus was beginning to unwind and although economic growth was restored, we were (and still are) a long way from a full recovery. The yellow line is the yield curve at the close on Friday, after another jump in long term rates despite FED intentions to keep rates low, as Trump re-started stimulus negotiations with a deal that moves closer to the Democrats proposal.

The Bond Market is Sending a Message?

Like the stock market, we believe the bond market is looking past the on-again, off-again stimulus talks and projecting that at some point, there will be more stimulus. That means more money pumped into the economy; growing Treasury debt issuance, and more monetization of debt. The difference is that the bond market is not nearly as excited as stocks. **The bond market is saying that it will take higher yields to sell all that new debt.**

Here is a look at Bank of America's take on post-election stimulus scenarios:

Table 1: Post election stimulus scenarios

	Stimulus Size ($bn)	UI Benefit	State and Local Aid ($bn)	One Time Checks ($bn)	Two Month Deficit Impact ($bn) Lower Bound	Two Month Deficit Impact ($bn) Upper Bound
"Supersized"	$3,500	$600/week	$1,000	Y ($400)	$1,000	$1,200
Baseline	$1,500	100% wage replacement*	$500	Y ($290)	$850	$1,000
"Skinny"	$500	$300/week	$0	N	$50	$75

Source: BofA Global Research

We think the fairly sudden rise in long term interest rates is discounting the growing Biden lead in the polls and a greater probability of a 'Blue Wave' on election day. The rationale is that a Blue Wave would open the door not only to the 'supersized' plan above, but also to additional fiscal measures to spur growth, such as infrastructure improvements. There is no question our infrastructure is in need of an update, at a minimum. However, the bond market is focused on massive new debt issuance and it appears it has begun to react with higher rate demands. Below is how Goldman Sachs estimates rate changes on the 10 year note under various scenarios.

Exhibit 3: 10y US yield outcomes in various US election scenarios, all else being equal

	Expected Rates Market Outcome	Cumulative impact on 10y nominals relative to pre-election levels		
		1-day	1-week	1-month
Delayed Results/ Contested Election	- Poor risk environment, accompanied by declining yields - Flattening of yield curve, as risk aversion fuels hedging demand for longer maturity USTs	-5bp	-10bp	-15 to -20bp
Unified Democratic Control	- Higher nominal yields resulting from higher fiscal expenditures, somewhat tempered by higher corporate tax rates and potentially more stringent regulatory environment - Increase in real yields as well, though initial increases in front end (up to 5y) could prove temporary and reverse over time - Steepening of both real and nominal curves on both increased upside to future growth/inflation and supply	+15bp	+25bp	+30 to +40bp
Divided Control	- Modestly higher yields as election outcome uncertainty resolves, along with drop in chances of reversal on tax cuts - Low likelihood of further meaningful fiscal stimulus means little follow-through of move higher. Further changes will depend mostly on trajectory of the underlying economy	+5bp	+5bp	+5bp
Unified Republican Control	- Possibility of more action on taxes, further deregulation could reduce UST demand and create upside pressure on yields, but more modest, and with limited follow-through than under unified democratic control - Some curve steepening on potential additional (but smaller) fiscal measures, with economic trajectory again playing a more dominant role	+10bp	+15bp	+15bp

Source: Goldman Sachs Global Investment Research

Our conclusions:

1) **The bond market is attempting to impose some limits on our long-standing fiscal imprudence.** All this stimulus gives the appearance of being free, but it also comes with a long term-price, which should not be ignored.
2) If you think you know what is going to happen, you're not thinking. **No one knows how this will all end and that is why we stick to the plan and keep portfolio risks balanced as best we can.**

PWM in the News

Philip Palumbo, Chief Investment Officer, discusses how COVID may affect your municipal bond portfolio.

What We're Reading

The Spiraling Environmental Cost of our Lithium Battery Addiction

Nuveen's Robert Doll on Markets Post Election (video, 4 min.)

U.S. troops in Afghanistan should be 'home by Christmas': Trump

The Plastic Pandemic

Unfavorable Views of China Reach Historic Highs in Many Countries

Milton Friedman on Capitalism vs. Socialism (Phil Donahue – 1979)

Goldman's Cohen Warns Over 'Considerable' Market Downside

The Most Dovish Fed in History is on a Mission to Spur Inflation

FED warns that delaying stimulus will have 'enormous consequences'

U.S. could have enough coronavirus vaccine for every American by March

Now the CDC says Covid-19 is airborne — here's what that means for you

U.S. weekly jobless claims inch lower, but remain stubbornly high

The above headlines are from multiple sources, including, Reuters, The Wall Street Journal, The NY Times, Bloomberg, Barron's, and CNBC.

Markets This Week

The stock market appeared to get comfortable with a Biden win, although we caution that this race is far from over. Despite an on-again, off-again stimulus deal, and gyrations around each announcement of progress or a lack thereof, markets appear to content to believe not only that that stimulus will come eventually, but with a Biden win, it will come big. Stocks were up solidly across the board with Small Caps, Energy and Materials leading the way. Bonds, however, are not cheering bigger stimulus, as rates rose in the face of ever larger treasury bond offerings to come.

US Equities	1 week	YTD	Fixed Income	1 week	YTD	Sector Breakdown	1 week	YTD
S&P 500 (SPY)	3.90%	8.87%	20+ Yr. Treasuries (TLT)	-1.63%	19.15%	Consumer Disc. (XLY)	3.45%	23.19%
Dow (DIA)	3.30%	1.54%	Barclays US Aggregate (AGG)	-0.15%	6.03%	Info. Technology (XLK)	4.56%	32.15%
NASDAQ (QQQ)	4.18%	34.90%	Intermediate Municipal (MUB)	-0.37%	2.34%	Financials (XLF)	3.83%	-16.82%
Russell 1000 Growth (IWF)	4.17%	28.06%	US Corporate Bonds (LQD)	0.09%	7.04%	Health Care (XLV)	4.03%	7.35%
Russell 1000 Value (IWD)	3.81%	-8.34%	Barclays US High Yield (HYG)	1.34%	-0.82%	Utilities (XLU)	4.60%	0.05%
Vanguard Mid-Cap (VO)	4.18%	5.10%				Industrials (XLI)	3.99%	0.27%
Vanguard Small-Cap (VB)	5.74%	0.67%				Energy (XLE)	5.05%	-46.90%
						Materials (XLB)	5.07%	9.61%
International Equities	1 week	YTD	Commodities	1 week	YTD	Consumer Staples (XLP)	2.56%	5.79%
MSCI EAFE (EFA)	2.80%	-4.07%	Commodities (PDBC)	4.85%	-15.76%	Comm. Services (XLC)	2.15%	13.04%
MSCI Emerging (EEM)	4.18%	2.73%	Gold (GLD)	1.42%	26.72%	REITS (VNQ)	1.33%	-8.94%
						Homebuilders (XHB)	3.34%	25.95%

The table above is an analysis of the weekly and year to date returns of various markets/sectors that we follow (More RED = worse performing markets/sectors; More GREEN = best performing markets/sectors). Source: PWM Research

Retirement Planning:

How to Create Cash Flow in Retirement

In the face of very low yields, retirement "income" deserves a fundamental rethinking.

Tax & Estate Planning:

Rich Americans Are Protecting Their Fortunes From a Possible Biden Win

Advisers are urging clients to transfer wealth to the next generation to take advantage of the Trump administration's generous estate tax rules.

Health:

Older adults using cannabis to treat common health conditions

Data indicates 61 percent of patients who used cannabis began after age 60

Entrepreneur:

7 Legit Methods to Teaching Yourself Any Skill

You have the ability to teach yourself anything. And we mean anything.