# INVESTMENT UPDATE

Saltmarsh
Financial Advisors, LLC
AN AFFILIATE OF SALTMARSH, CLEAVELAND & GUND

4th Quarter 2020

## 2020 Year-End Tax Planning Highlights


As the year-end approaches, individuals should be reviewing their situations to identify opportunities for reducing, deferring or accelerating tax obligations. These guides offer strategies and tips to help mitigate risk and to set you up for the upcoming year. [Visit our website to download the highlights.]

Did you miss our recent "Maximizing 2020 Year-End Tax Planning" webinar? [Request access to the recording on our website.]

### Inside This Issue



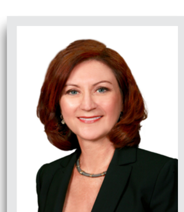
## Join us in Welcoming Mark Hemby to the Team

We are proud to announce that financial services and banking industry veteran Mark Hemby, CFA®, has joined the team in Pensacola as an investment advisor. As part of our investment advisory group, he works with clients to develop and implement investment strategies to achieve financial freedom while also ensuring their goals and objectives are aligned. Mark has over 15 years of experience in investment banking working with individuals and organizations to manage their portfolios and coordinate investment activities. In addition to his experience with fixed income trading and sales, Mark owned and operated his own business in Alabama.

## Christina Doss Featured in Bella Magazine's Resilience Issue

In the December 2020 "The Year of Resilience" issue of Bella Magazine, Managing Director of Saltmarsh Financial Advisors, LLC, Christina Doss, AAMS®, weighs in on the importance of financial planning and shares pointers on how to create financial resilience. [Visit our website for the full article.]

*"Given the current environment, for many it has become necessary to make tough financial decisions to cut expenditures as a result of reduction in income or job loss. Budgeting can help in quickly and efficiently identifying the first discretionary expenses (wants) to cut to stop the bleeding and preserve assets for critical non-discretionary needs."* – Doss



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# What Are Roth Conversions?

**by Chris Stennett, CFP® | December 17, 2020**

***WHAT IT IS:*** What it is: A Roth Conversion is a process of moving contributions held in a traditional IRA, 401k, or other qualified retirement plan, to a Roth IRA. Non-Roth contributions plus appreciation will be included in the individual's taxable income in the year of conversion.

***WHY:*** Roth IRA's are retirement savings account that feature tax-free growth and can be withdrawn without impacting taxable income, provided the Roth IRA has been open for at least 5 years and the owner is above the age of 59 ½ years old at withdrawal. For a Roth Conversion to be considered appropriate, there should be a reasonable belief that your future tax rate will be higher than the tax rate at conversion.

***WHEN ROTH CONVERSIONS MAY BE APPROPRIATE:***

1. **Temporary Decline in Taxable Income** – It is common to see taxable income decrease for periods of time just after retirement only to rise in later years. Picture the scenario of a 65-year-old recent retiree who delays Social Security until age 70 and doesn't withdraw from her pre-tax retirement account. Between ages 65 – 70 there may be a reduction in taxable income, moving her into a lower tax bracket. At 70 Social Security will begin and at age 72 Required Minimum Distributions will need to be taken moving this retiree into a higher tax bracket. To pre-pay the taxes on future IRA withdrawals during these first 5 years, an investor could convert some (or all) of their pre-tax balance to Roth and may still stay within the lower tax brackets before Required Minimum Distributions begin.

2. **Large Pre-Tax Account Balances** – There is such a thing as too much pre-tax savings. Required Minimum Distributions are mandatory taxable withdrawals from pre-tax retirement accounts. Large IRA balances will result in large Minimum Distributions requirements, which can push some retirees into a higher tax bracket. Planning ahead using one-year or multiple-year Roth conversions, an investor can reduce pre-tax balances in early retirement in order to reduce their future RMD requirements. To assist in the planning process, projecting future IRA account balances based on historical rates of return may be done by your financial advisor.

3. **Future Tax Rates Expected to Be Higher** – Other factors beyond an investors control can cause tax rates to go up. The current Tax Cuts and Jobs Act is set to end in 2025 which would cause tax rates to revert to (higher) pre-2018 figures. President-Elect Biden or future Administrations may make changes to the prevailing tax code. Additionally, investors should consider the likelihood that one spouse may pre-decease the other. Depending upon beneficiary designations and estate planning, the surviving spouse may inherit the deceased spouse's investment accounts and RMD requirements. As a Single filer, the surviving spouse's income tax bracket will likely be higher than Married Filing Joint. If there is a reasonable belief due to age or health that one spouse will pre-decease the other, it might make sense to do Roth Conversions as Roth IRAs do not have RMDs and are not added to taxable income.

4. **Beneficiary of Your IRA Is Not Your Spouse** – Pre-tax IRA assets passed to someone who is not the account owner's spouse, also inherit a tax liability. Non-spouse beneficiaries of all IRAs (including Roth IRAs) are now required to withdraw all the money from the account within 10 years of the deceased individual's passing. Consider a widow naming her adult child as the beneficiary of her $1,000,000 IRA. Her moderately successful adult son, who is making $80,000/yr. in income, must take all $1,000,000 (plus any growth) out of the account within 10 years. His taxable income went from $80,000/yr. to at least $180,000 or more ($1,000,000/10 years = $100,000/yr.). This only gets worse if the beneficiary is in high-tax bracket when they inherit the account. What if that widow were in the 12% bracket, but her son was in the 32% bracket? Using Roth Conversions, the widow could have reduced or even eliminated this future tax liability by paying taxes at her more favorable tax rate.

5. **The Stock Market Is Down** – Investors should not make a decision to convert solely based on market performance, but when markets are down resulting in lower portfolio values, the tax burden to convert will be less. You should have a reasonable expectation that the markets will recover.

A Roth Conversion is not a way to bypass paying taxes. It is a strategy where you are willingly paying the taxes today at a potentially lower rate, on funds you may not need until later in retirement or not at all. Executing this strategy properly involves understanding all the considerations of converting versus not converting and should not be done without the help of a professional. If you are interested in exploring if a Roth Conversion is right for you, reach out to your financial advisor or tax professional.

# Dividends in the Time of COVID-19

**from the Dimensional Fund Advisors "Perspectives" Newsletter | November 30, 2020**

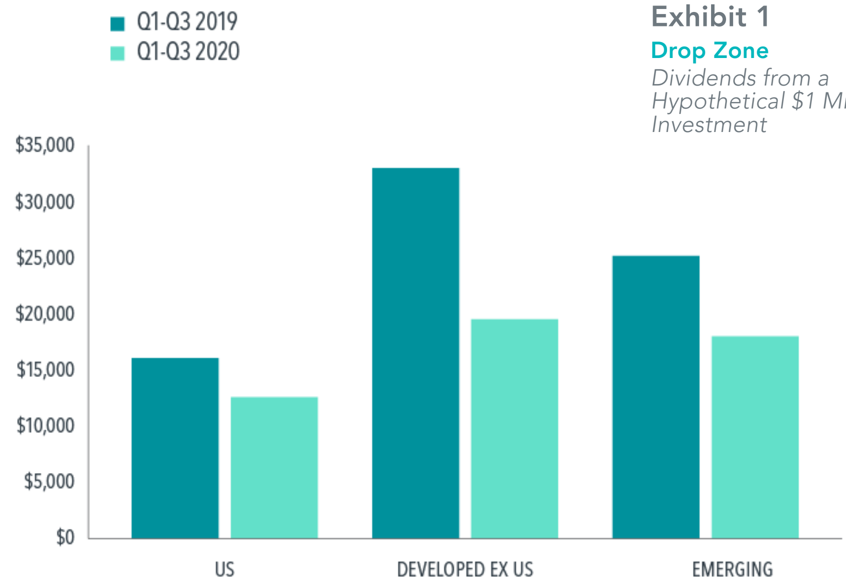
Many investors view dividend payouts as a reliable source of income. However, those expecting to receive consistent dividend income may have been surprised to see lowerthan- expected dividend payouts following the onset of the coronavirus pandemic, when both market volatility and market declines were extraordinary. In reality, recent and historical data show that changes in dividend policy are common, especially during times of higher uncertainty.

Aggregate dividend payouts fell meaningfully in the first three quarters of 2020 compared to the same period in 2019. **Exhibit 1** shows the dividends earned from a hypothetical $1 million investment in US, developed ex US, and emerging markets in both periods. Developed ex US markets showed the most drastic change with a 41% decrease. Dividend payments in emerging markets decreased by 29% and in US markets by 22%.

Globally, large firms have historically had the highest propensity to offer dividend payouts,[1] but even successful, established firms were not immune to the economic consequences of a global pandemic. A few examples help illustrate this point. Harley Davidson (HOG) has been paying dividends to shareholders since the 1990s. In April 2020, the motorcycle manufacturer slashed its dividend from $0.38 per share to just $0.02, a 95% decrease.[2] Gap Inc. (GPS) suspended its dividend payments until at least April 2021[3] after the economic downturn left the clothing brand with particularly poor revenues.

Harley Davidson and Gap were not the only firms to change their dividend policies. As shown in **Exhibit 2**, 38% of firms in global markets (2,584 companies) that were expected to pay dividends, consistent with their payout history, instead decreased, omitted, or eliminated their dividend payments

**Exhibit 1**
**Drop Zone**
*Dividends from a Hypothetical $1 Million Investment*




***Past performance, including hypothetical performance, is no guarantee of future results.*** *Source: Calculated by Dimensional from Bloomberg data. In USD. Eachhypothetical investment includes all securities in the investable equity universe in the applicable region at free-float market cap weight as determined at the beginning of each year. To be included in the investable equity universe, securities must meet certain minimum capitalization and liquidity requirements. Investment companies are excluded.*

**Exhibit 2**
**Changing Tune**
*Dividend Policy Changes in Global Markets (% of Dividend-Paying Firms), 2020*

*Source: Calculated by Dimensional from Bloomberg data. Dividend-paying firms include all firms that have paid a dividend in the preceding 12 months and were expected to pay a dividend in the current quarter.*

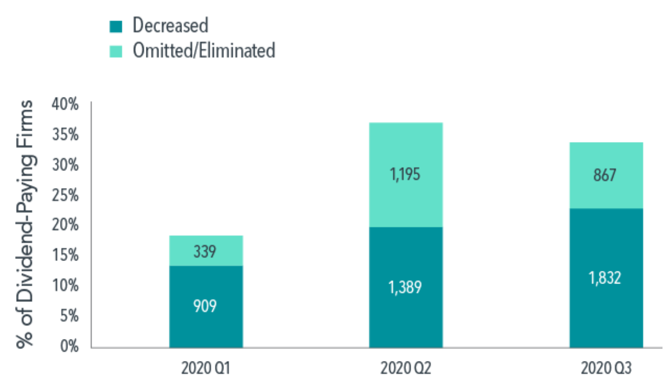
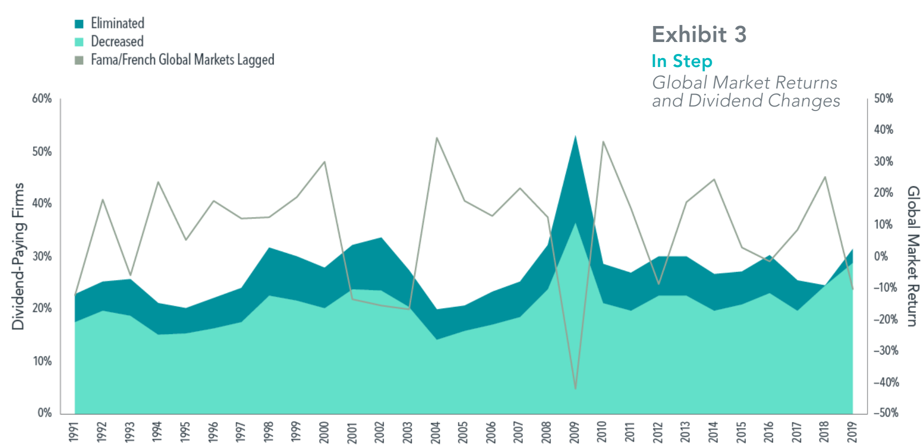



**Exhibit 3**
**In Step**
*Global Market Returns and Dividend Changes*




*Note: Global Market return is free-float market cap weighted average of Fama/French Developed Markets and Emerging Markets Indexes. See Index Descriptions in the disclosures for descriptions of Fama/French index data. Source: Calculated by Dimensional from Bloomberg data. Past performance is no guarantee of future results. Dividendpaying firms include all firms that paid a dividend in the prior calendar year.*

*(continued on page 4)*

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# Dividends in the Time of COVID-19 *(Cont.)*

**from the Dimensional Fund Advisors "Perspectives" Newsletter | November 30, 2020**

in the second quarter, more than doubling the 1,248 firms that made similar changes to their dividend policy in the first quarter of the year. The trend continued into the third quarter: 2,699 firms made such changes.

While these dividend cuts may come as a surprise to some investors, history buffs may recall that, in 2009, Harley Davidson announced it was cutting dividend payouts from $0.33 per share to $0.10, a 70% decrease.[4] In fact, during the Great Recession, significant changes to firms' dividend policies spiked throughout global markets. **Exhibit 3** displays Fama/French global market returns for 1991–2019 with a one-year lag and the proportion of dividend-paying firms that eliminated or decreased their dividend payouts. In 2008, for example, the global market was down more than 40%, and, the following year, many firms made changes to their dividend policies. The historical correlation between global market returns and dividends that are eliminated or decreased may suggest that firms are more likely to alter their dividend payouts during times of market instability.
The first three quarters of 2020 remind us that dividend payouts can be inconsistent, particularly in volatile markets Hence, investment strategies that focus on income derived from dividends may not serve investors who need a steady income stream and, moreover, might not be the most effective way to pursue long-term wealth growth. A more reliable approach is to structure equity asset allocation around the characteristics that research demonstrates drive long-term higher expected returns, namely size, relative price, and profitability, while maintaining broad diversification across names, sectors, and countries.

1. Stanley Black, "Global Dividend-Paying Stocks: A Recent History" (white paper, Dimensional Fund Advisors, March 2013). 2. Harley-Davidson, Inc., "Dividends & Stock Splits," investor.harley-davidson.com/stock-info/dividends-and-stock-split. 3. Gap Inc., "Gap Inc. Provides Update In Response To Covid-19 Outbreak," news release, March 26, 2020, investors.gapinc.com/pressreleases/news-details/2020/GAP-INC-PROVIDES-UPDATE-IN-RESPONSE-TO-COVID-19-OUTBREAK/default.aspx 4. Harley-Davidson, Inc., "Dividends & Stock Splits.

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