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Investors Managers Advisors

REPORT & COMMENTARY

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TO: CUSTOMERS & FRIENDS
FROM: CHRISTOPHER WEIL & COMPANY, INC.

Latin – once a mandatory language for the educated classes, at least in the Western world – has long since fallen out of favor. But one Latin phrase might well be the mantra (whether in the East, West, North or South) for the era of COVID-19: *Homo proponit, sed Deus disponit.*

Even if you speak no Latin, you can probably figure out the translation: "Man proposes, but God disposes."

This is obviously not new news. "The best laid plans of mice and men often go awry," said Robert Burns. "These are the times to try men's souls," said Tom Paine. (He was talking about the American Revolution but he might just as well have added that there has never been a time when people's souls weren't being tried, somewhere, and, get ready for it, there never will be.) Parenthetically, you will note that all of the quotes refer to "man/men." I can understand why at some point, women stood up and said enough is enough.

Murphy's Law ("If something can go wrong, it will go wrong") is meant to be funny – but it's not only not funny, it's all too true. As is Weil's Corollary: "Murphy was an optimist."

If you think about it, so much of how we live our lives and so much of how we build and operate our institutions is motivated by the knowledge we all have that the exigencies, the risks, the pitfalls of life are many (some expected as a fact of life: auto accidents for example; some arising suddenly and unexpectedly: the pandemic for example). I haven't a clue as to how much of our resources, particularly time and money, are spent on "threat defense" (the military, the Public Health Service, Social Security, the FAA, rodent control services, winterizing homes, mosquito abatement, insurance of every kind, medical research, anti-lock brakes ... the list is endless) but it would not surprise me, assuming the answer were somehow quantifiable, if it turned out to be a surprisingly large number.

Fifty years ago, before financial planning was a recognized practice, I wrote an article for a trade publication (long defunct) of which I was the "financial columnist" about the fundamentals of "personal economics." My article was a primitive attempt to sketch out for readers a model of what a comprehensive personal financial plan would look like, identifying as best I could all necessary financial services and the functions they served in the life of individuals and families.

I thought I had come up with a clever way of presenting the model. I divided it into two parts: what instruments are required for that part of your life where you are economically on the defensive and what instruments for that part of your life where you go on the economic offensive. In the defensive section, I put such things as adequate cash reserves, life insurance, health insurance, property and casualty insurance and so on. In the offensive section, I put the various investment choices that people make as they build and preserve wealth: ownership of liquid equity (stocks, mutual funds, options) and illiquid equity (real estate, proprietary business ownership), and ownership of debt instruments (bonds and loans of one sort or another).

Well, it was pretty primitive, not least because I avoided discussing the critical issue of selection, which really means I avoided discussing the experience and education needed to assess the merits of each possible choice (how, that is, to know not just the *what* but the *which* as well - and in what amounts, at what prices, with what critical terms and conditions included and/or excluded and with whose help/advice).

I also made what I now view as a conceptual mistake. What I then called "going on the economic offensive" turns out to be motivated, at least in many cases, by defensive considerations. In fact, in most people's lives, even in the lives of the very well-to-do, the motivation for building and maintaining wealth can more usually be described as defensive.

Which brings me to the subject that I really want to talk about: Why, in many cases, it makes good sense to keep growing wealth – even when, by conventional standards, you have "enough."

Why? To *defend* (or prepare to defend) against the many ways in which personal wealth can be diminished and/or to *compensate for loss* (or prepare to compensate) as and when "events of diminishment" arise.

The list of "risks" that can lead to wealth diminishment is long. In no particular order, here is a representative sampling.

1. Inflation. "Really," you say? "None now, none on the horizon." Well, we will see. In the economic literature there is a growing concern (not shared by all, it is true) that the country is setting the stage for a major and enduring inflationary period in the out years. In matters of this kind, my position is simple: hope for the best, expect the worst (and plan accordingly). The moral to this story? Grow assets.

2. Cost of children's and grandchildren's education (a "risk" you may take on voluntarily). The cost of a four-year private college is running at $60,000 a year or more (before grant or scholarship offset). The cost of a graduate degree or medical school or law school? Don't even ask. The student debt problem is a national scandal and a huge debit to what might otherwise be a booming GDP. Parents and grandparents of means are often motivated to solve this problem, at least in their own families, but wealth diminishment (think five grandchildren whose education costs you have elected to fund) is often a consequence. The moral to this story? Grow assets.

3. Cost of supporting elderly parents or other relatives, including ourselves. This "risk" is particularly material when you consider the cost of such specialized services as memory care. (I have a friend who is paying $10,000 monthly for her husband's care facility and $15,000 monthly for the

additional twenty-four-hour care her husband's condition requires. An exceptional case, but still…). The moral to this story? Grow assets.

4. Risk that Social Security and/or other fixed sources of retirement income (defined benefit pension plans, for example) will be "re-worked" downward or otherwise adjusted in unfavorable ways (not a big risk for persons of means unless the "means" are comprised of illiquid non- or low-income-producing assets, and/or where fixed sources of income contribute a significant portion of needed cash flow). Where there are underfunded obligations, as is the case with the promises of Social Security and many defined benefit pension plans, it is only a matter of time. The moral to this story? Grow assets.

5. The risk of (investment and other) losses. Murphy's Law always obtains. Things go wrong. Investments go wrong. You are faced with a significant uninsured liability claim. That planned inheritance doesn't materialize. (Don't laugh. I know someone who "knew" that she was an heir to a ton of wealth from the estate of her 92-year-old aunt. In anticipation of her inheritance, she bought a home that she normally could not afford. You can guess the rest of the story. The aunt died but the inheritance was a small fraction of what was expected. The home had to be sold quickly and at a significant loss.) The moral to this story? Grow assets.

6. The risk (very real, very significant) that contemplated changes in various tax "charges" will materially impact both income and capital. You can be sure that income tax brackets will rise, especially for high earners. You can be sure that the estate tax exclusion will go down, probably sooner than 2026 and probably to $5,000,000 per person. Estimating the effect of a reduced estate tax exclusion is tricky. If you and your spouse have an estate of less than $10,000,000 today, what will it be at the time of the second death? You can try to keep your estate below $10,000,000 by gifting. But, as most of you know, annual gifts in excess of the annual exclusion reduce your ultimate estate tax exclusion dollar for dollar. So long as your combined gifts in excess of your annual exclusions and your net estate do not exceed $10,000,000, then no estate tax is due (assuming the above exclusion). But should there be any growth in your estate such that gifts plus net estate exceeds $10,000,000, the excess will be estate taxed at somewhere in the range of $50%. The moral to this story? Grow assets.

7. In the above example, most people would agree that $10,000,000 is a pretty substantial estate - and it is. But consider the case of the family with this net worth who would like to leave their estate in full to their five children. Assume the estate consists of a large home ($2,000,000), an IRA ($6,000,000) and miscellaneous other assets ($2,000,000). The parents may think they are leaving $2,000,000 to each of their children but they are wrong. The IRA carries with it a deferred income tax liability which could, depending on the states in which the heirs live and their other incomes, range upwards of 50% of the IRA's balance. So the potential for IRA value diminishment (based on today's values) could be near $3,000,000 as IRA distributions are taken by heirs. Worse, there is much talk of eliminating (or at least modifying) the step up in basis at death. I happen to believe that it is only a question of time before the step up is eliminated. If I am right – and assuming the basis in the home in this example is, say $500,000 – then if/when the home is sold by the heirs, they will be faced with a capital gains tax (who knows what rates will be at the time?) on the gain of $1,500,000 (plus gains, if any, from date of death). The moral to this story? Grow assets.

And of course there are motivations to increase wealth that are not risk-based (and not driven by a sense, which some have, that "there is no such thing as enough"). I am thinking, for example, of those who want to increase their philanthropic commitments as and when possible.

Estate values come in all shapes and sizes and yearly cash flows come in all shapes and sizes, which means there is no way to generalize about what constitutes a suitable allocation to philanthropy for the philanthropically inclined. But it is obvious that if you enjoy a comfortable income and have a sizeable net worth, then any growth in either would enable you to increase your charitable gifting. For donors and donees this would be a blessing and is a simple way to avoid estate taxation on the amount gifted. (For those who want to pursue the many questions and issues surrounding personal philanthropy, I invite you to call our in-house philanthropy specialist and financial advisor, Tyler Hewes, CFP®.)

Maybe your circumstances are such that you can weather any "risk" or "diminishment" event without pain. But if you are among the vast majority of investors, even the vast majority of well-to-do investors, who are subject to life's vagaries and for whom wealth diminishment *would* be painful, then a continuous course of wealth enhancement is the best medicine.

P.S.: Fine, you might say. But "grow assets" is only an abstraction until we know something more about the "critical issue of selection" I referred to above. The subject deserves a book, not a paragraph. But here is a paragraph.

"Growth" (as I am using it here) does not mean the sorts of "opportunities" where there are (ostensibly) big rewards and usually even bigger risks (not SPAC's, not cryptocurrency, not early-stage pharma). Such opportunities may be perfectly appropriate *speculations*, but the kind of growth I am talking about involves investments with a reasonable probability of success: mainstream investments in the best sense of the word (quality corporate and real estate equity, adequately diversified, with a responsible party minding the store). In fact, just the kind of assets that comprise a typical investor's core holdings. So, for most prudent investors, just more of the same.

~ Chris Weil