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Q2 2021 Economic & Market Update

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2nd Quarter 2021 Market Summary

1 Year Returns (Year over Year)

US Stock Market	Developed International	Emerging International	Global Real Estate	US Bond Market	Ex-US Bond Market
42.71%	35.31%	39.60%	34.31%	-0.68%	4.81%

Since Jan. 2001							
Avg. Quarterly Return	2.3%	1.4%	2.9%	2.8%		1.2%	1.1%
Best Quarter	28.0%	24.4%	32.3%	31.5%		4.6%	4.6%
	2020 Q2	**2009 Q2**	**2009 Q2**	**2009 Q3**		**2001 Q3**	**2008 Q4**
Worst Quarter	-22.3%	-23.2%	-27.5%	-35.4%		-3.0%	-2.7%
	2008 Q4	**2020 Q1**	**2008 Q4**	**2008 Q4**		**2016 Q4**	**2015 Q2**

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2020, all rights reserved. Bloomberg Barclays data provided by Bloomberg.

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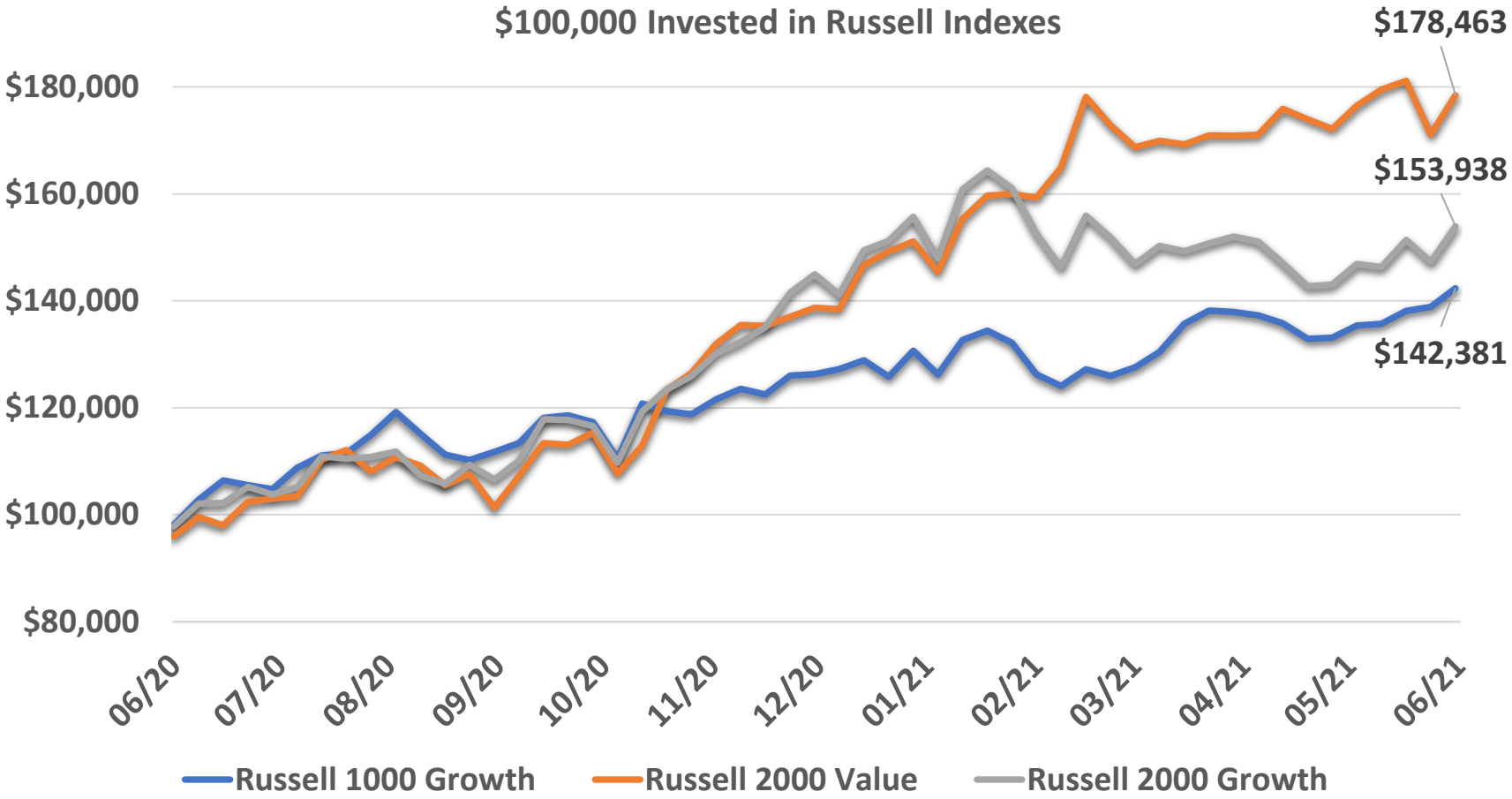
Smaller Company Stocks Outperformed

- Consistent with small caps' past strength in changes of economic cycles
- Small Cap Value index outperformed Small Cap Growth, which in turn outperformed Large Cap Growth over past year



Source is FactSet. Weekly returns from 06/25/20-06/25/21 (IWF = Russell 1000 Growth, IWO = Russell 2000 Growth, IWN = Russell 2000 Value)..

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2nd Quarter 2021 Returns

Returns from 2Q Start to Finish

US Stock Market	Developed International	Emerging International	Global Real Estate	US Bond Market	Ex-US Bond Market
6.87%	5.22%	3.63%	8.92%	1.50%	0.83%

Source is FactSet. Returns from 04/1/21-06/31/21.

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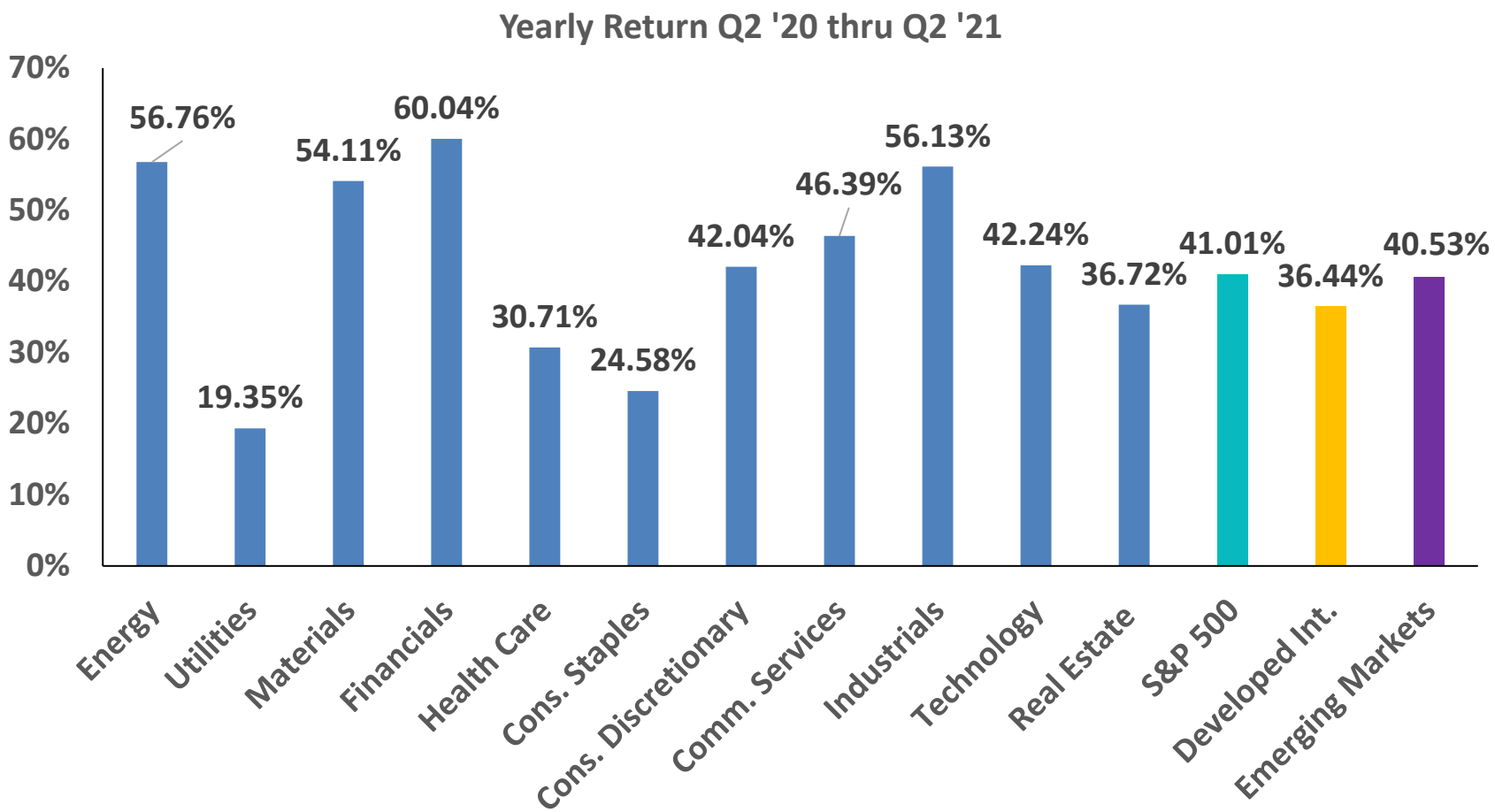
Value-Oriented Sectors Performed

- Over the past 12 months, the market experienced some rotation out of higher multiple growth areas to cheaper, more cyclical sectors



Source is FactSet. Returns from each respective sector are represented by S&P Composites. International is represented by iShares EFA and EEM. Data as of 6/25/2021.

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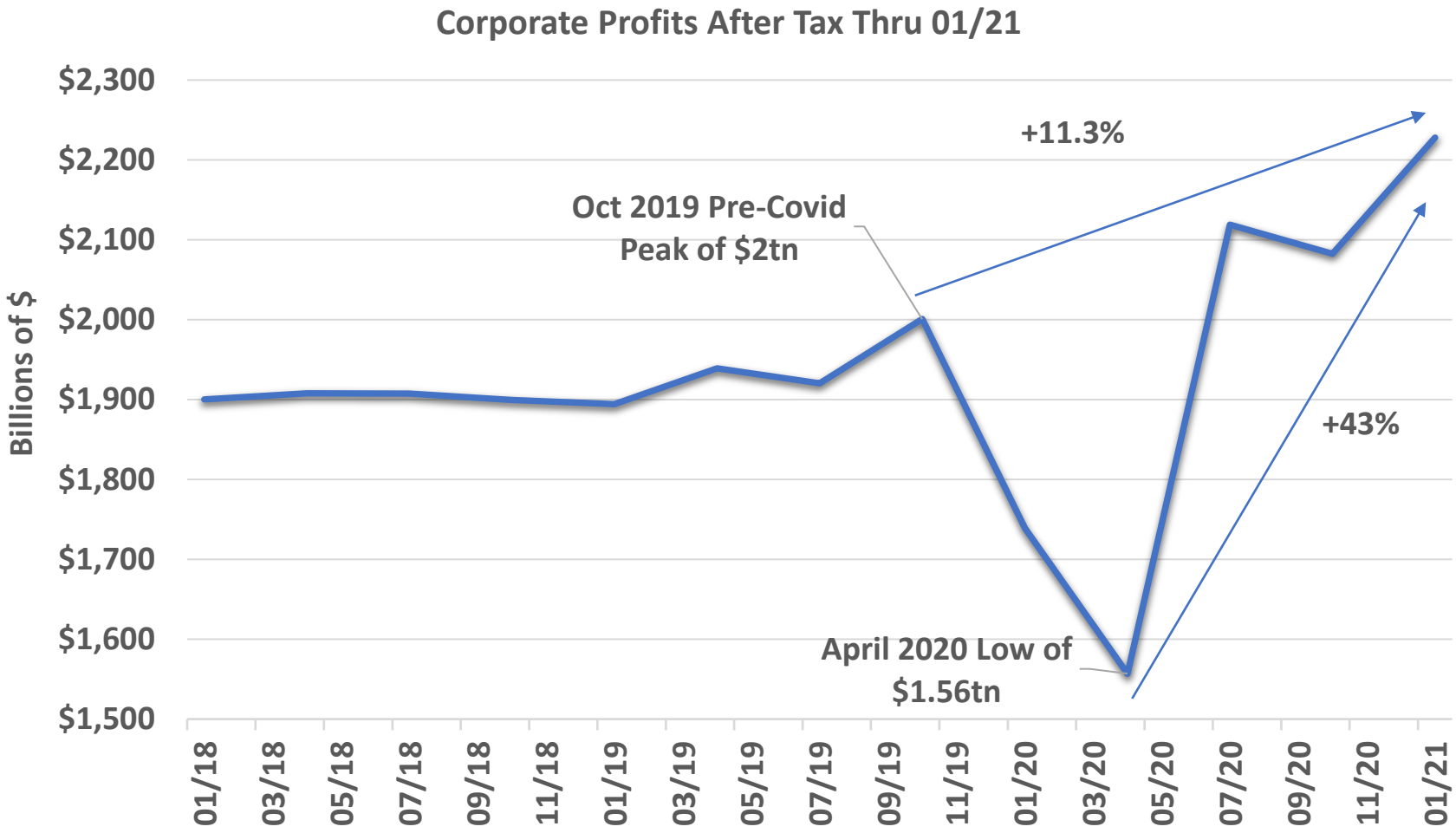
Corporate Profitability Reaches All Time High

- Aggregate company profitability has climbed to levels more than 11% above the pre-pandemic peak



Source is The Federal Reserve's series "Corporate Profits After Tax (without IVA and CCAdj).. Billions of Dollars, Seasonally Adjusted Annual Rate. Data from 01/01/2018 thru 01/01/2021.

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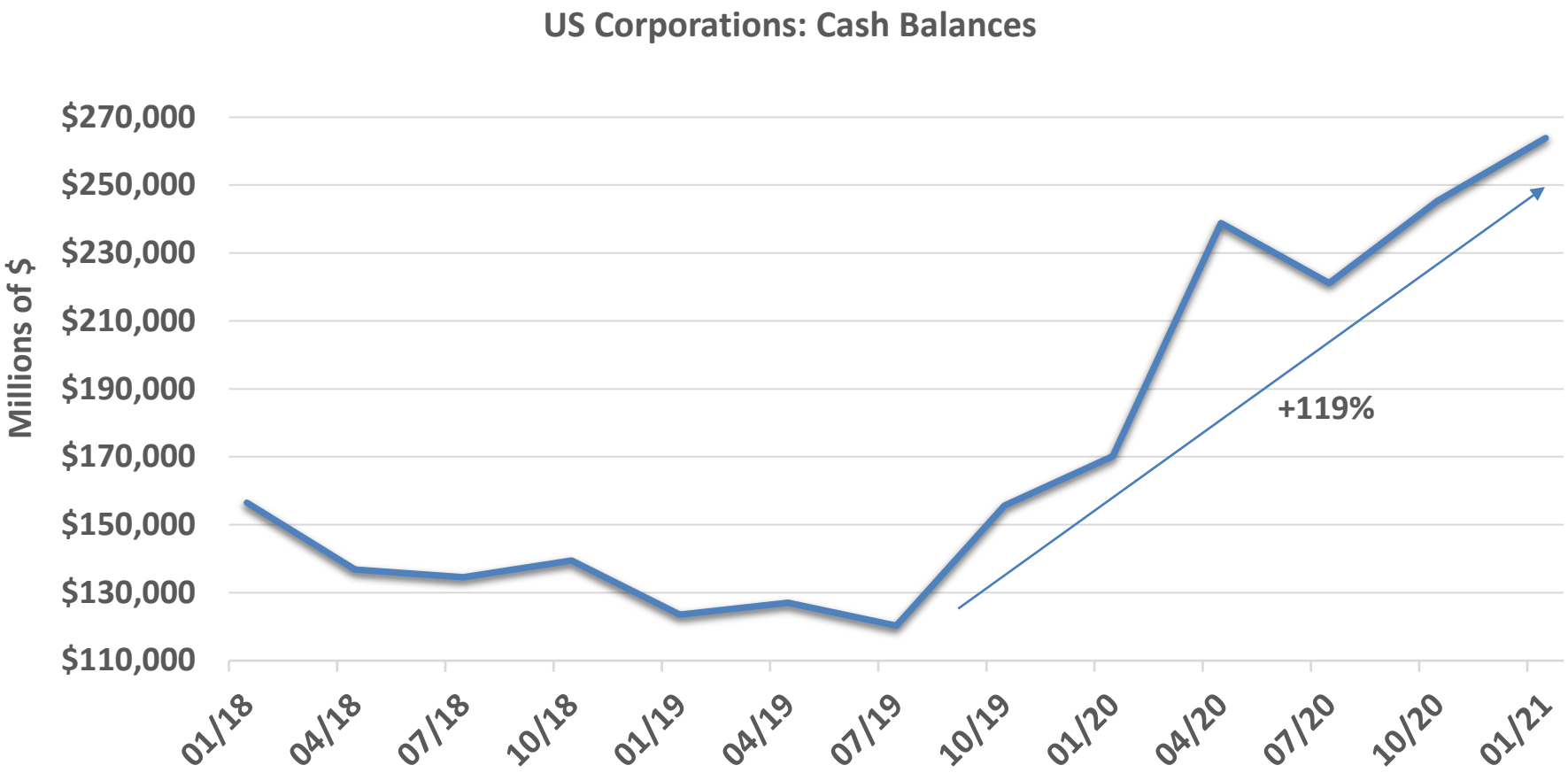
Company Liquidity Reaches All Time High

- Corporations' balance sheets have rarely been stronger; the health crisis was a very different catalyst compared to causes of prior recessions



Source is The Federal Reserve's series "US Corporations Total Cash on Hand and in US Banks'.. Millions of Dollars, Not Seasonally Adjusted. Data from 01/01/2018 thru 01/01/2021.

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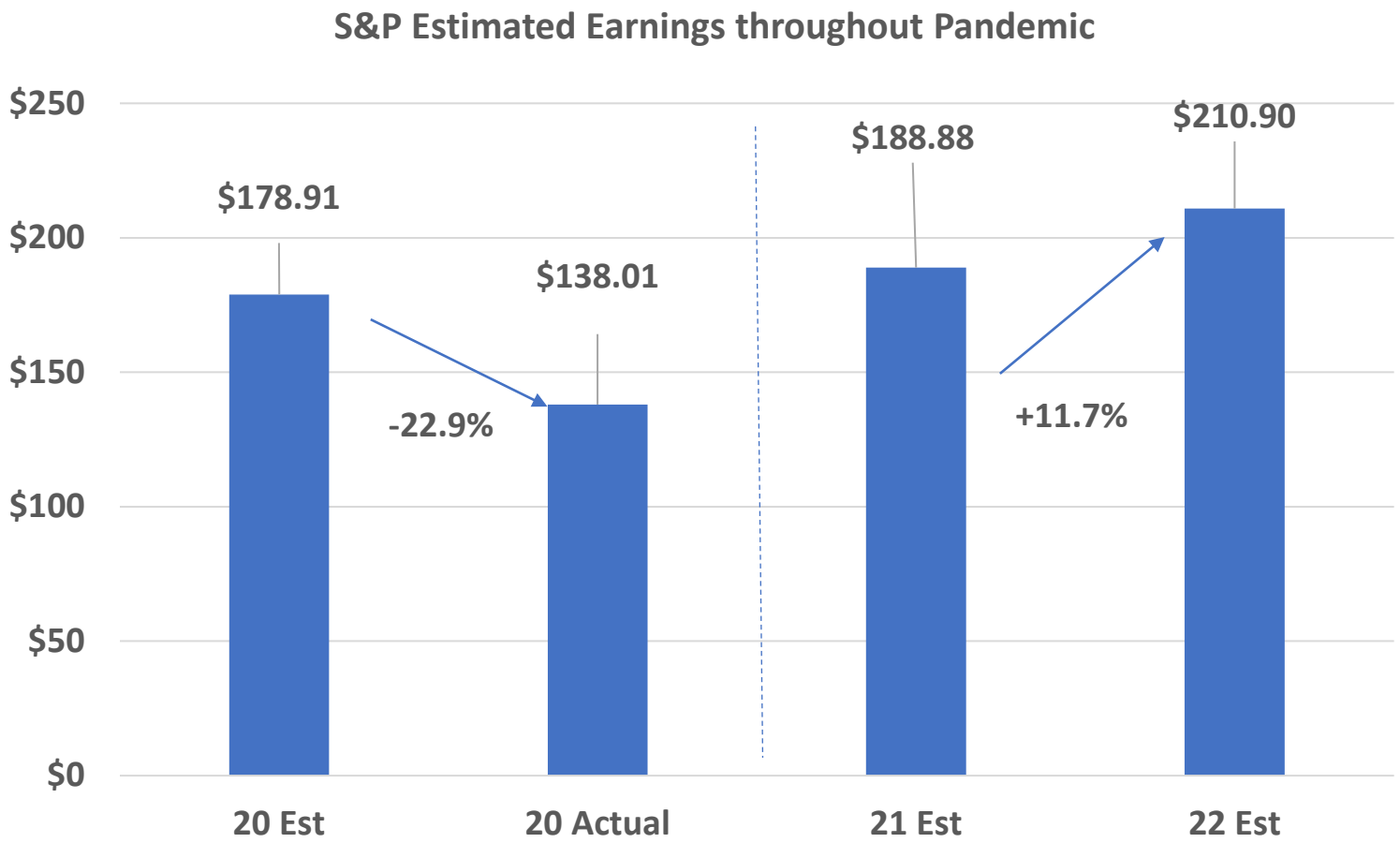
2020 S&P Earnings 23% Less Than Pre- Pandemic Estimates, 2022 Earnings Estimates Near 53% Higher



Source is FactSet. Estimate History for S&P 500 (SP50). Data as of 7/8/2021.

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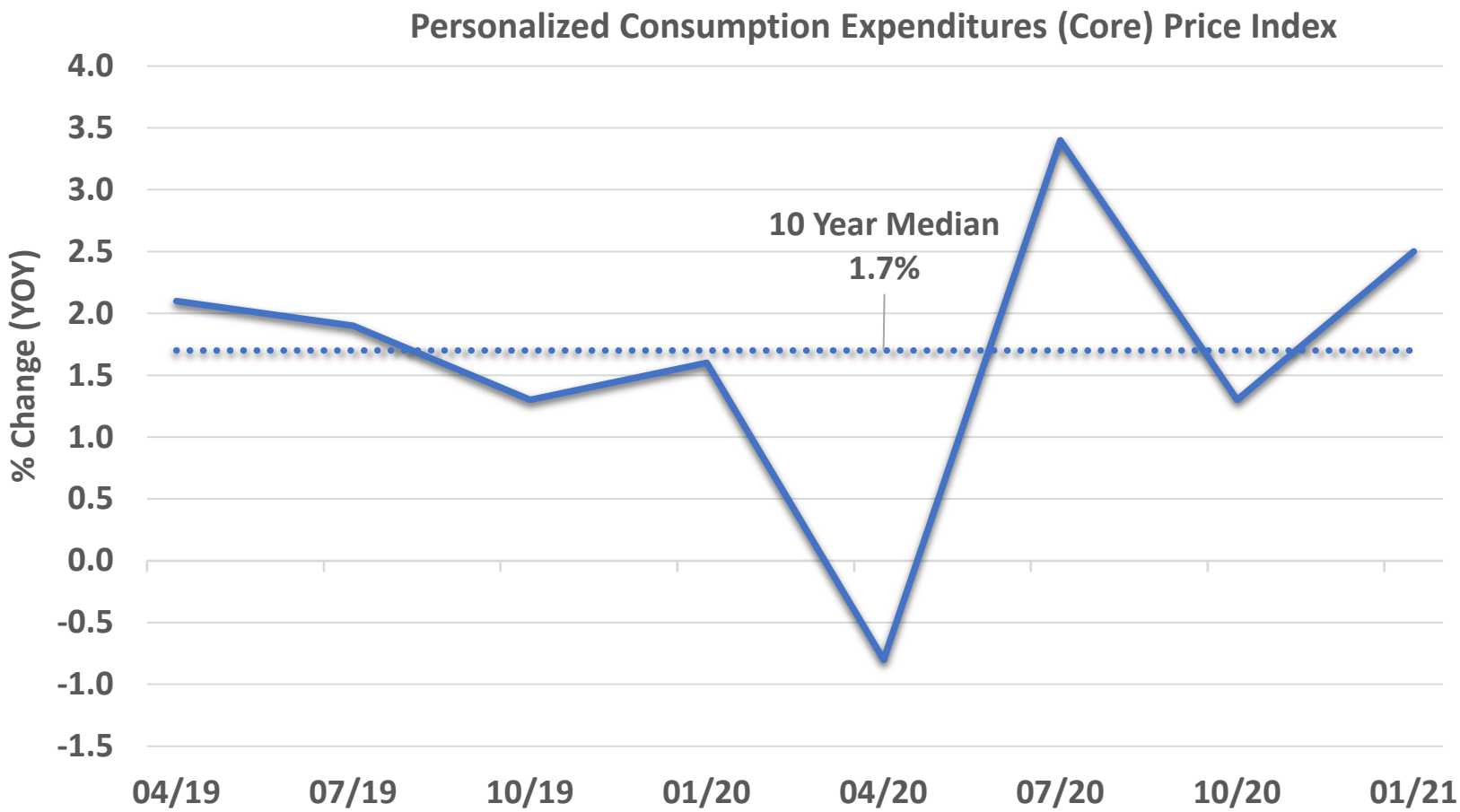
Realized Inflation Level Increases

- This commonly accepted measure of tracking inflation does not include the impact from changes in food or energy prices.



Source is The Federal Reserve's PCE (Core) Index (% Change from Preceding Period).. Quarterly data, seasonally adjusted. Data from 04/02/2019 thru 01/01/2021. Dotted reflects median from Jan '11 thru Jan '21

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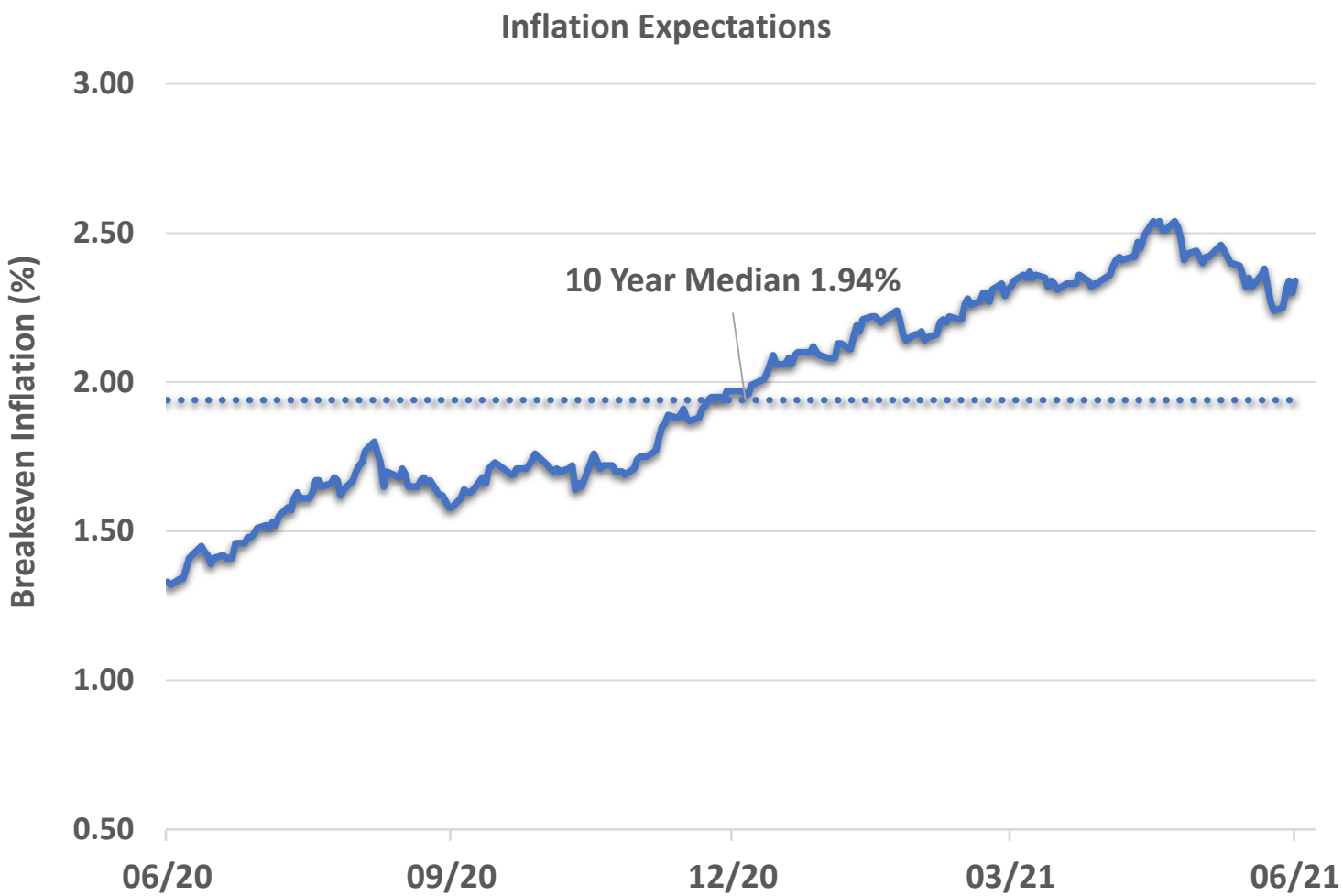
10-Year Inflation Expectations Surpassed 2.5%

- Currently stands moderately above the Fed's 2% long-term inflation goal



Source is The Federal Reserve's 10 Year Breakeven Inflation Rate % Daily, from 06/25/20 thru 06/25/21. Daily data (excl vacations/non business days).

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After Climbing .8% During Q1, The 10-Year Treasury Note Yield Has Since Dropped .2%

Source is The Federal Reserve's 10 Year Treasury Rate (% Daily, Not Seasonally Adjusted), from 06/25/20 thru 06/25/21. Daily data (excl, vacations/non business days).

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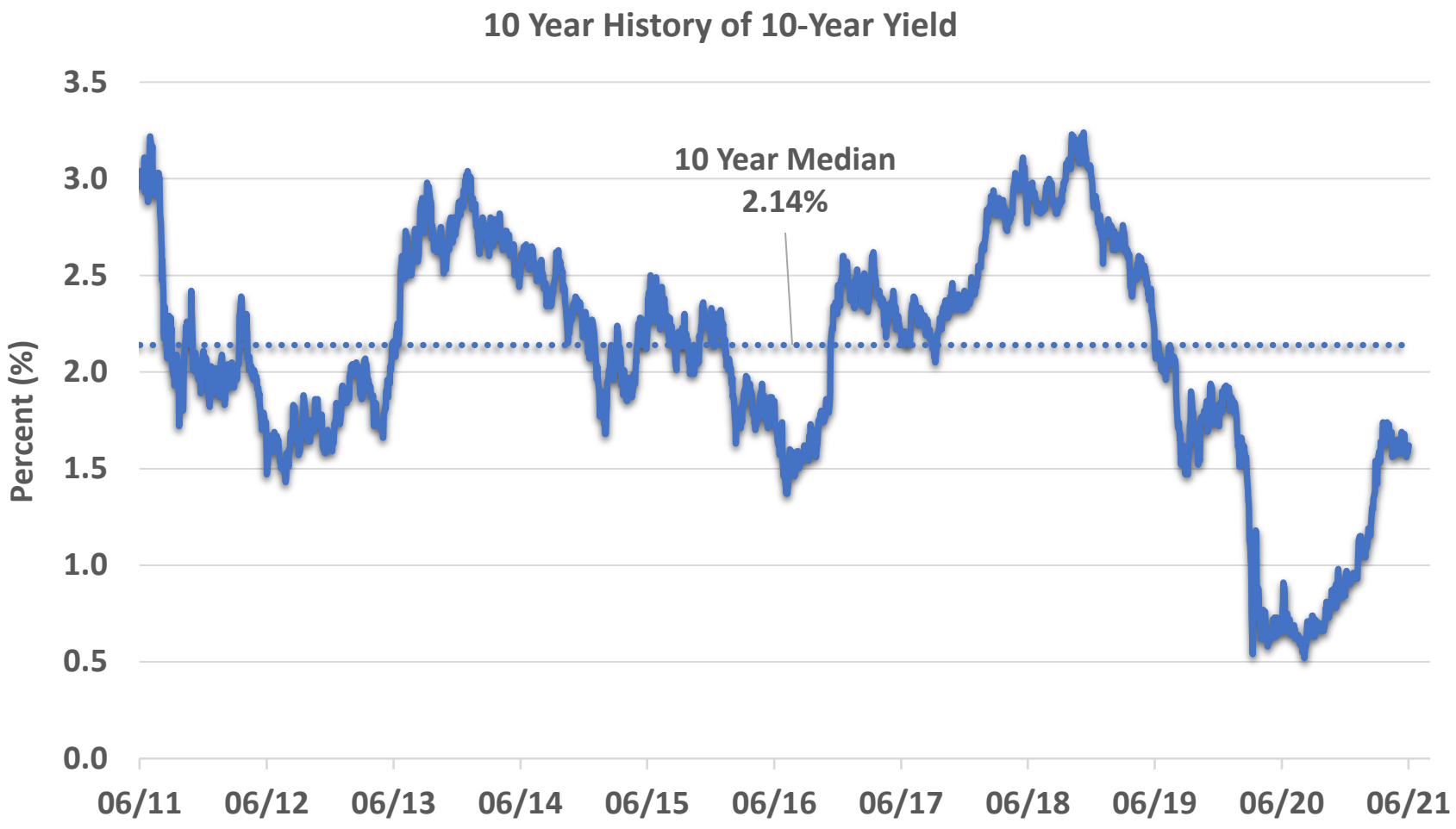
But, 10-Year Yield Is Still .6% Lower than Longer Term Median



Source is The Federal Reserve's 10 Year Treasury Rate (% Daily, Not Seasonally Adjusted), from 06/01/11 thru 06/25/21. Daily data (excl. vacations/non business days). Dotted line is the median.

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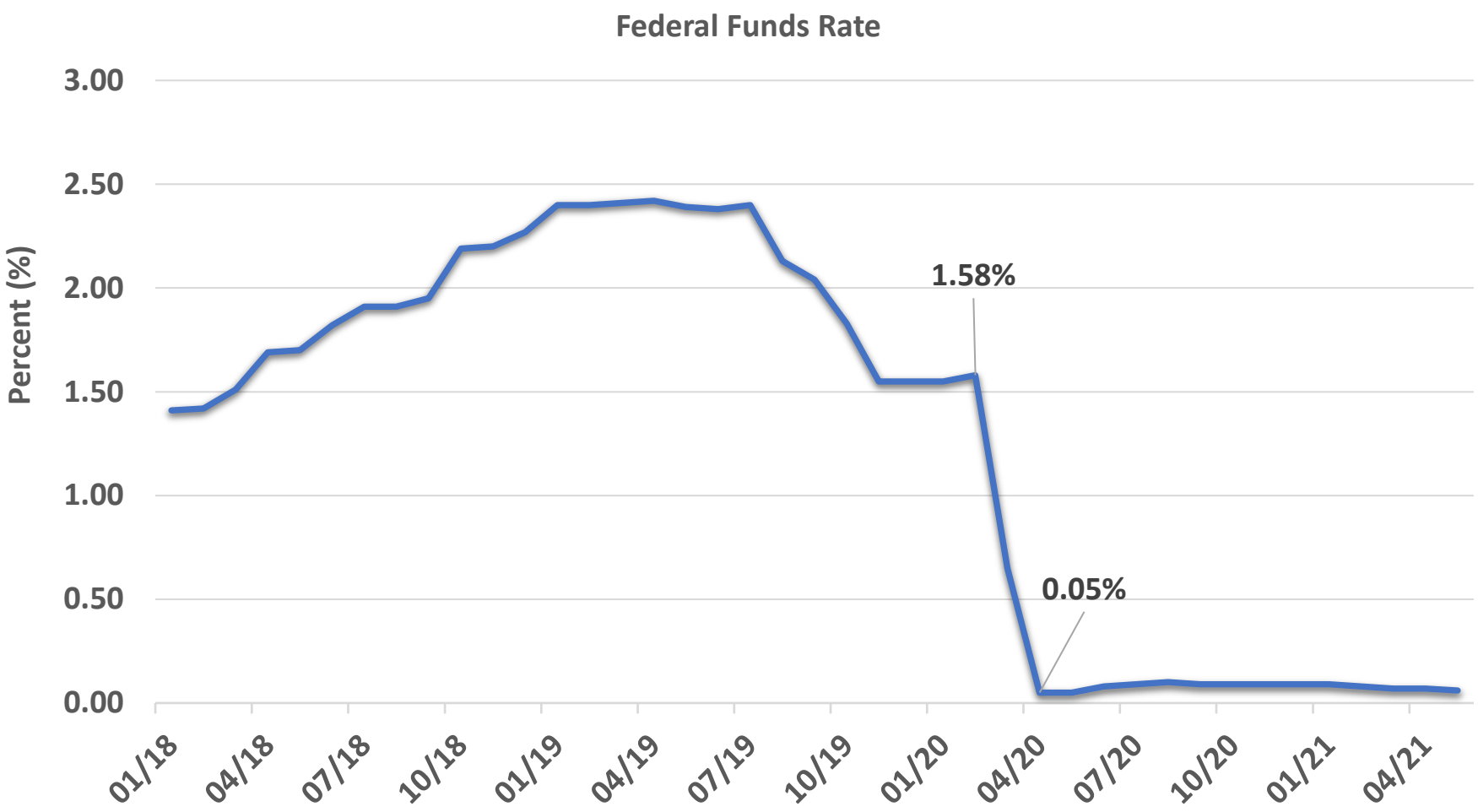
The Federal Funds Rate Stays Under .1%



Source is The Federal Reserve's Effective Federal Funds Rate % Monthly, from 01/01/18 thru 05/01/21.

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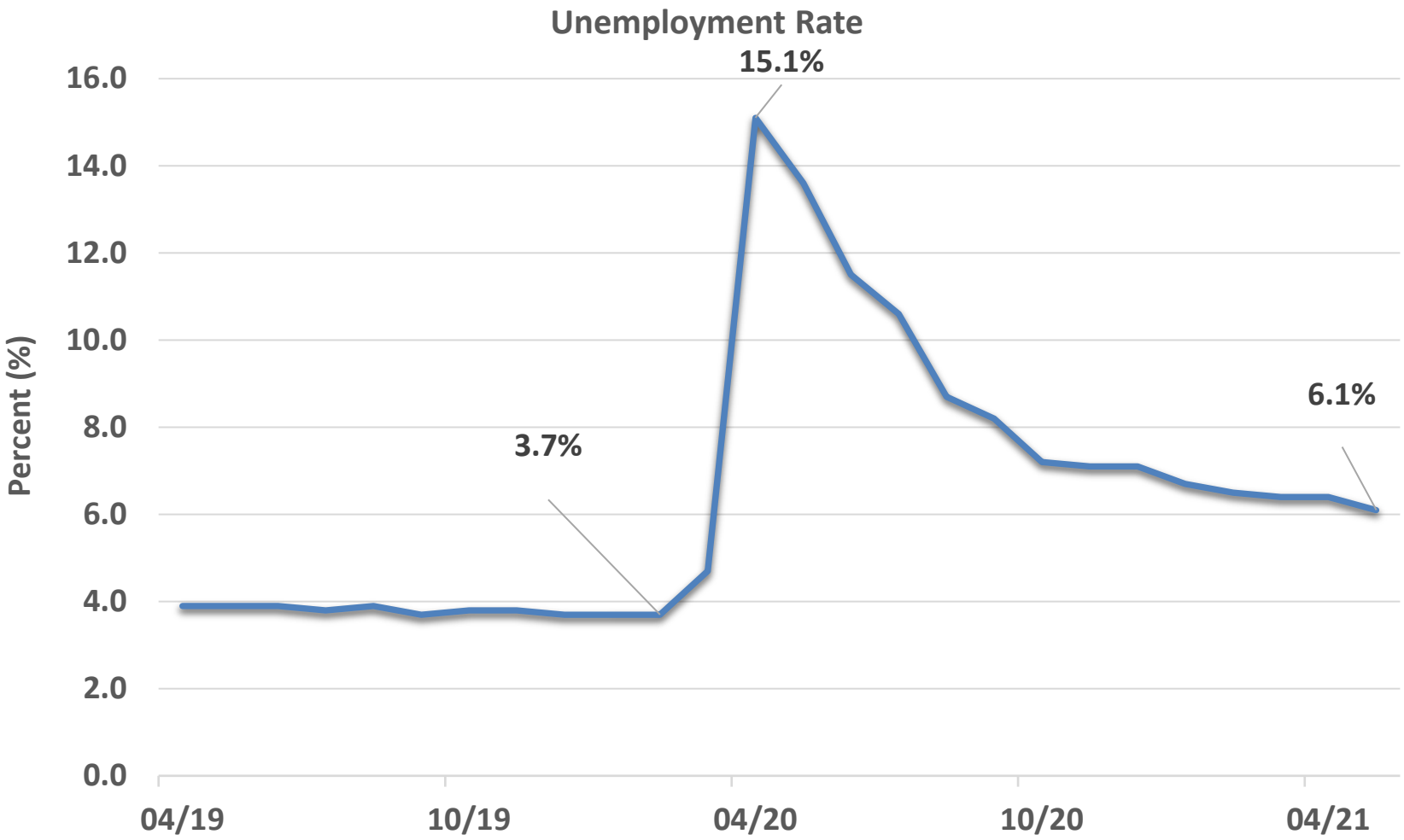
Unemployment Rate Has Declined 9% from Peak



Source is The Federal Reserve's Total Unemployed Plus Disc Workers (as a % of Labor Force Total), from 04/01/2019 thru 05/01/21. Monthly data.,

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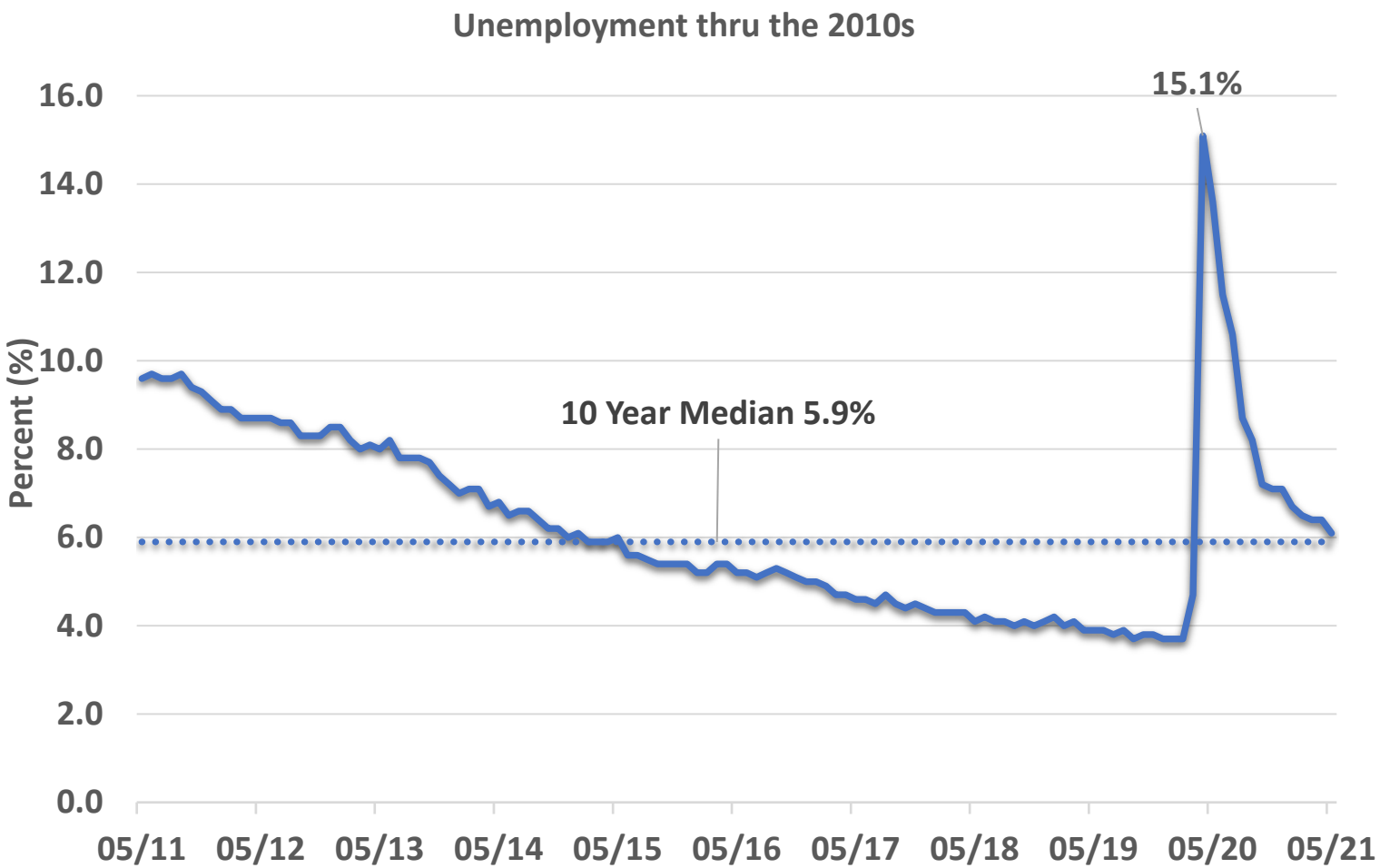
Unemployment Is Less Than 1% Higher Than 2011 thru 2021 Median



Source is The Federal Reserve's Total Unemployed Plus Disc Workers (as a % of Labor Force Total), from 05/01/11 thru 05//01/21. Monthly data., Dotted line is the median.

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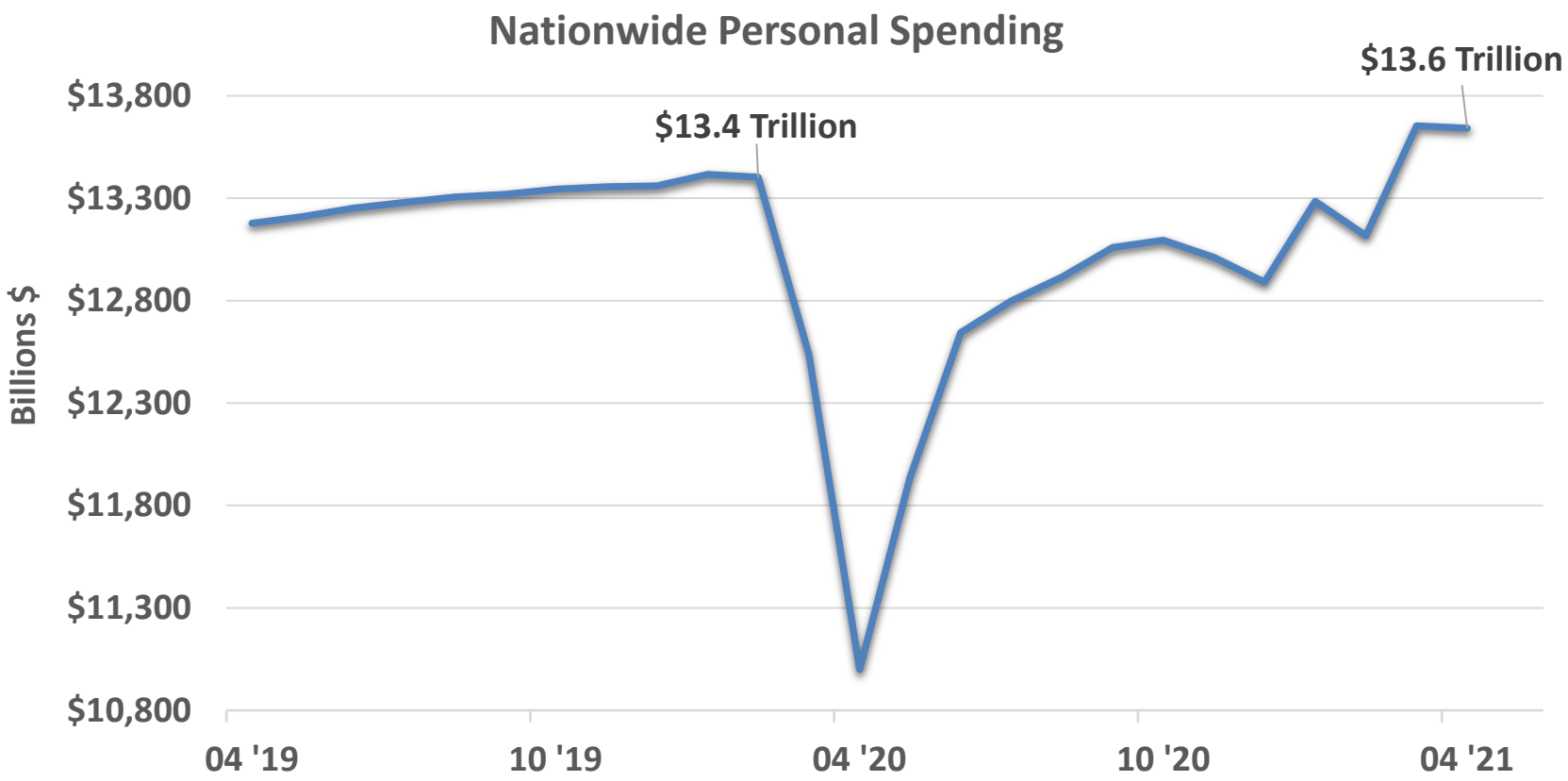
Consumer Spending Surpasses Pre-Pandemic Peak

- Excludes inflationary impact
- Spending has now fully recovered, and in fact exceeded, prior pre-pandemic peak
- A key reason for the strength of the overall economy and markets



Source is Federal Reserve Bank of St. Louis. Real Personal Consumption Expenditures (Billions of Chained 2012 Dollars).Data as of 5/28/2021.

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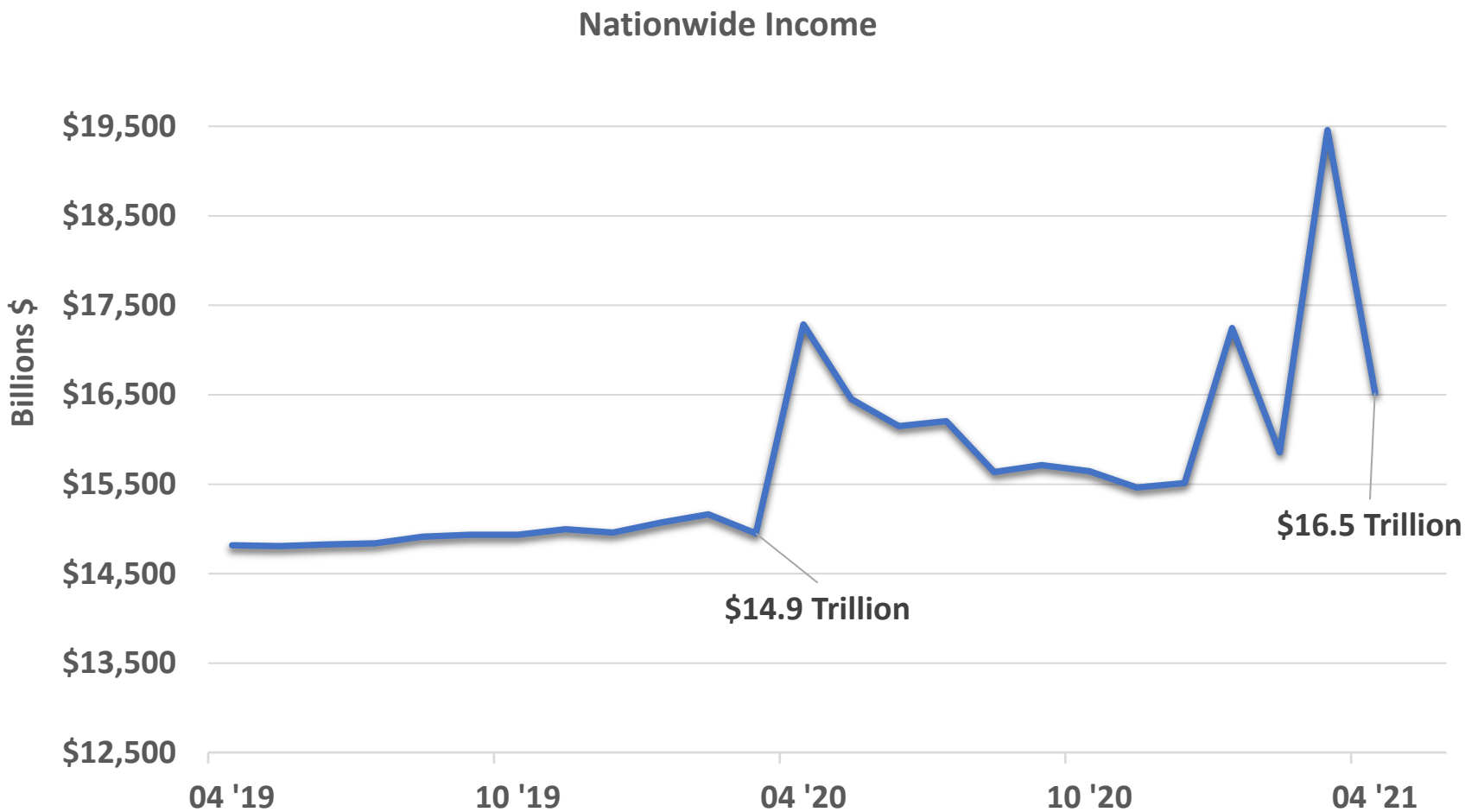
Rising Incomes Help Support That Spending

- Positive gap between incomes and spending increases near $500 Billion
- Again, omits the effect of inflation



Source is Federal Reserve Bank of St. Louis. Real Disposable Personal Income (Billions of Chained 2012 Dollars).Data as of 5/28/2021.

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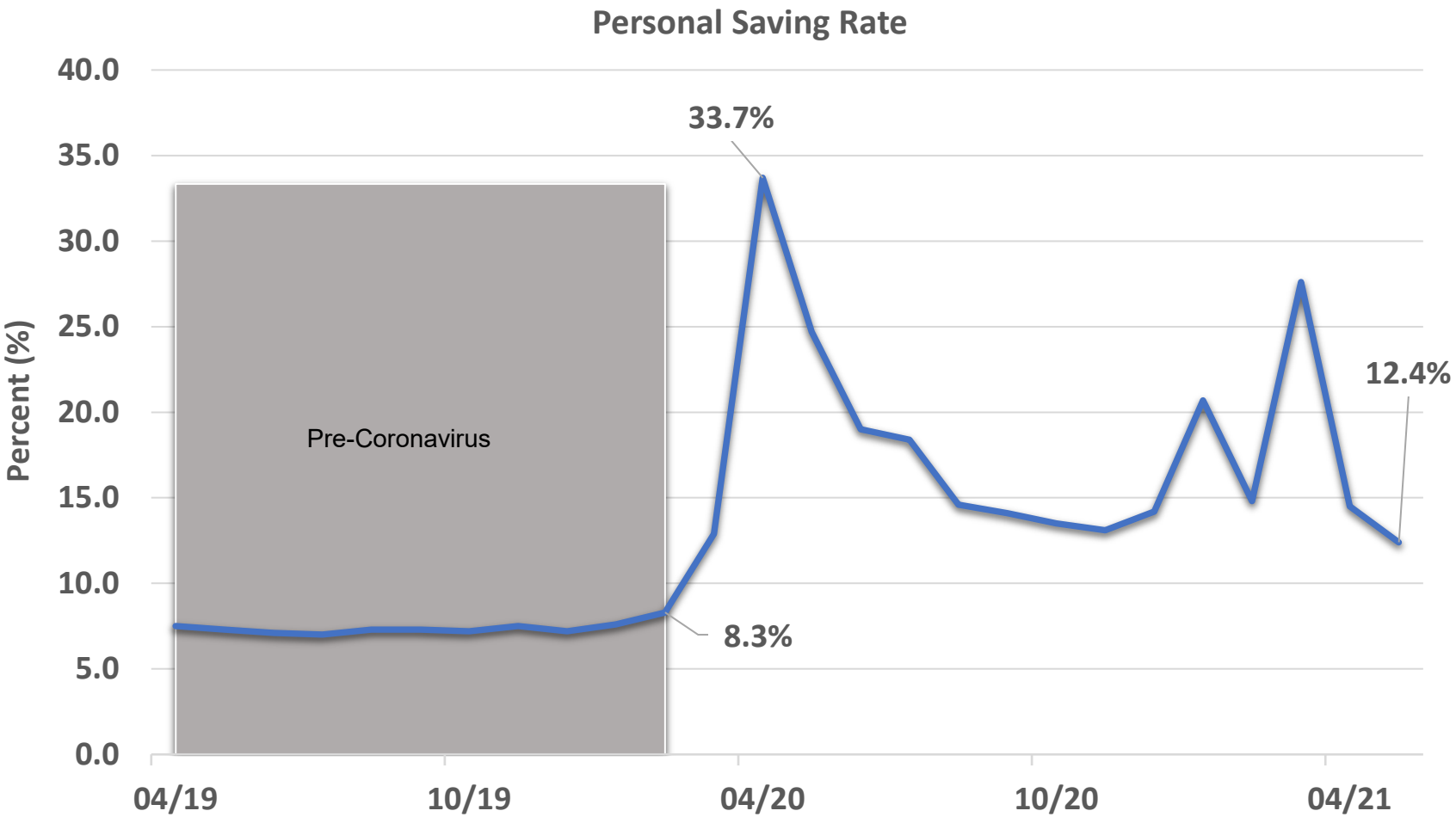
More Fuel In The Tank?
Consumers Sitting on Considerable Savings



Source is Federal Reserve Bank of St. Louis. Personal Saving Rate (% - Monthly, Seasonally Adjusted). Data spans 04/01/19 thru 05/01/21.

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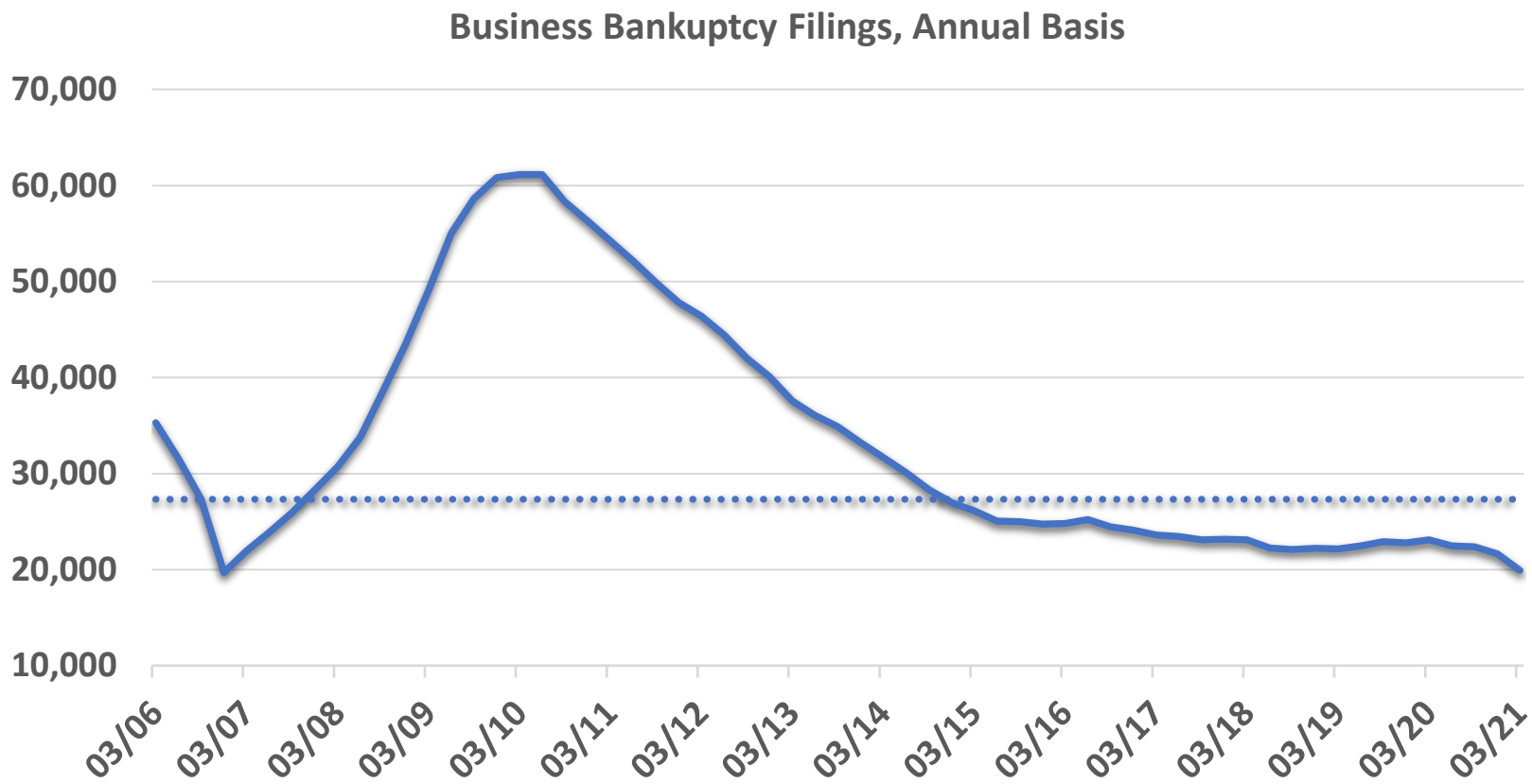
7,000 Fewer Bankruptcies

- For the year ending March 31st, 2021, the number of company bankruptcies (filing for protection under any chapter) is more than 7,000 lower than the median over the past 15 years
- Level is just over the lowest level recorded in the period (EOY 2006 – when just over 19,700 companies filed in that rolling period)



Source is FactSet. Business Bankruptcy Filings, Chapter 11 and All Others. Quarterly Data, spanning 03/31/06 thru 03/31/21.

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Equity Market Valuations Are Above Historical Levels: International To A Lesser Extent

Source is FactSet. LTM (Last Twelve Months) PE for iShares EAFE (EFA), iShares EM (EFA), and iShares Russell 3000 ETF (IWV)

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Estate and Gift Tax: Current Rules and Proposals for Change

Larry Harris, CFP®, CPA
Brad Burlingham, CPA

Tax planning for income or estate and gift tax implications is very much a consideration of various tradeoffs.

A careful discussion with your attorney and Parsec advisor is a great place to start.

2021 could be a very consequential year for estate and gift tax taxation.

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Overview of Current Rules

The three components of the Federal transfer tax are:

The Federal Gift Tax:
Imposed on lifetime transfers by gift

The Federal Estate Tax:
Imposed on transfers of property at death

The Generation Skipping Tax:
Imposed on lifetime transfers and on transfers at death to beneficiaries more than one generation below the transferor. The GST tax is in addition to any other applicable gift or estate taxes that apply to the transfer and is assessed at the highest transfer tax rate (40% for 2021).

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Tax Computation

Taxable Amount Over …	Taxable Amount Not Over …	Tax on Amount in Column 1	Rate of Tax on Excess Over Amount in Column 1
$0	$10,000	$0	18%
$10,000	$20,000	$1,800	20%
$20,000	$40,000	$3,800	22%
$40,000	$60,000	$8,200	24%
$60,000	$80,000	$13,000	26%
$80,000	$100,000	$18,200	28%
$100,000	$150,000	$23,800	30%
$150,000	$250,000	$38,800	32%
$250,000	$500,000	$70,800	34%
$500,000	$750,000	$155,800	37%
$750,000	$1,000,000	$248,300	39%
$1,000,000	----------	$345,800	40%

Applicable Credit Amount

(Formerly Unified Credit Amount)

- The *applicable credit amount* is allowable credit against estate and gift taxes.
- Determine the tentative tax on the *applicable exclusion amount*; how much can be transferred before an estate tax liability will be incurred.

The applicable exclusion amount equals the total of the following:

- The basic exclusion amount:
  - $11.58 million in 2020
  - $11.7 million in 2021
- Basic exclusion amount reverts to pre-2018 levels after 2025 under current rules.
- The Deceased Spousal Unused Exclusion (DSUE):
  - The unused applicable credit or exclusion amount of a deceased spouse whose estate did not use all its applicable credit or exclusion against gift or estate tax liability.

Value of Assets for Estate / Gift Tax Purposes and Cost Basis for Beneficiary / Donee

- Estate assets are valued at fair market value at date of death.
- Gift assets are valued at fair market value at the date of the gift.
- There is a step up in cost basis for estate assets to date of death fair market value and the step-up cost basis carries over to the beneficiary.
- There is no step-in basis for gifts and the carryover basis of the donor carries over to the donee.

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The Generation Skipping Tax (GST)

Every donor is allowed a lifetime GST exemption:

$11.58 million

2020 exemption

$11.7 million

2021 exemption

- The GST is imposed when there is a transfer from one generation to a beneficiary or donor who is more than one generation below the transferor.
- For example, a GST transfer occurs when a grandparent makes a gift to a grandchild skipping over the living child of the transferor and parent of the donee or beneficiary.

Consider Utilizing the Current Applicable Credit Amount in 2021

- The increased basic exclusion amount is temporary for the years 2018-2025, after which it is scheduled to revert to pre-2018 amount (approximately half of the current amount).

- Final regulations assure taxpayers there will be no claw back of the current high temporary exclusion. The regulations provide a special rule that allows an estate to compute its estate tax using the higher of the basic exclusion amount that applied when gifts were made during life or the basic exclusion amount on the date of death.

- Therefore, individuals taking advantage of the temporary increase of the gift and estate tax exclusion amounts in effect from 2018 to 2025 will not be adversely impacted after 2025 when the exclusion is scheduled to be reduced to pre-2018 levels.

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Proposals for Changes in Estate and Gift Tax Rules

For the 99% Act (March 2021)

This bill, introduced into the US Senate on March 25, 2021, could lay the groundwork for what's ahead with changes to estate, gift, and trust rules. If passed, the effective date would be December 31st, 2021, and would result in significant increases to federal estate and gift tax. (Senators Bernie Sanders and Senator Sheldon Whitehouse.)

Sensible Taxation and Equity Promotion Act (STEP) of 2021 (March 2021)

On March 29th the Senate's Van Hollen and House's Pascrell released proposals that would result in the realization of capital gains on the date property is transferred by gift, trust, or death.

Department of the Treasury Green Book (May 2021)

President Biden, in the recently-released Green Book, has proposed far-reaching changes to the taxation of capital gains and the treatment of property that is gifted or is transferred at death, including taxing capital gains at ordinary income rates and treating the receipt of assets because of death as a realization event. (America Families Plan)

"Green Book" – Presidential Tax Proposals

Corporate tax rates:

- Current flat rate of **21%**
- Proposed flat rate of **28%**
- Effective starting **1/1/2022**

Individual tax rates:

- Current top rate is **37%** for taxable income over **$628,300**
- Proposed top rate would be **39.6%** for taxable income **over $509,300**
- Effective starting **1/1/2022**

Change to Capital Gains Treatment

- Currently capital gains taxed at:
  - 0% (if taxable income under $80,000)
  - 15% or 20% (if taxable income over $496,600)
  - an additional 3.8% Net Investment Income Tax (NIIT) may apply if taxable income over $250,000
  - higher rates for “collectibles” and depreciation recapture
- Proposed that ordinary income rates would apply if taxable income over $1 million
- Effective “at date of announcement” (April 28, 2021)
- Would apply to transfers at gifting or death

Eliminate Like-Kind Exchanges for Real Estate Transactions:

- Currently gains from real estate sales can be deferred if the proceeds are used to purchase “replacement property” … must utilize qualified intermediary, identify replacement property, take into account decreases in debt
- Proposal would completely eliminate deferral for gains in excess of $500,000 per year for all transactions
- Effective starting 1/1/2022

S-Corp Shareholders and Self-Employment Tax

- Currently flow-through income from S-corps is not subject to self-employment tax (social security and Medicare of 15.3%)
- Proposal would apply self-employment tax to flow-through income over $400,000 from S-corps in which the shareholder materially participates.
- Effective starting 1/1/2022

Increased Funding for the IRS

- IRS budget decreased 20% (in real dollars) between 2010 and 2020
- Funding for the IRS to increase by $80 billion over the next 10 years; increase to enforcement staff of 15% per year
- Resources especially allocated to those with income greater than $400,000
- Hopefully would increase service also and reduce unprecedented delays

Congressional Tax Proposals

- **Home Office Deduction Act of 2021:**
  Would temporarily allow a deduction for home office and other unreimbursed expenses of employees

- **FAIR Act:**
  Would exclude from gross income interest paid on overpayment of tax

Q&A

Is it a good time to increase dividend stocks?

What is your perspective on future interest rates and inflation and their impact on the bond market?

Where do you see core inflation heading? How might further government stimulus affect the markets?

How should we structure our investment account types and ownership now to minimize estate and gift taxes now and in the future?

What do you think the chances are that Biden's tax proposals will be enacted as it relates to individuals, including the capital gains increase being retroactive to April 28th?

At what level of income (AGI) will the highest tax bracket kick in?

Are there some strategies to keep from reaching that bracket?

Proposed 39.6% tax bracket would apply to taxable income over:

- $509,300 for Married Filing Jointly
- $254,650 for Married Filing Separately
- $452,700 for Single
- $481,000 for Head of Household

Avoiding higher brackets?

- Lower income by deferring gains, harvesting losses, maximize retirement contributions, strategic business asset purchases
- Increase deductions by maximizing retirement contributions, strategic purchase of business assets, strategic charitable contributions

Please provide updates regarding Secure Act 2.0 … will there be changes to charitable giving and/or RMDs?

Charitable giving:

- If not itemizing, $300 “above the line” contribution deduction applies in 2021 as it did in 2020
- Cash contribution limit remains at 100% of AGI, continuing from 2020; does not apply to gifts to Donor Advised Funds (DAFs)
- Appreciated stock gifts – remain limited to 30% of AGI, 20% if to private foundation
- Qualified Charitable Contributions (QCDs) from IRAs up to $100,000 still allowed for persons over 70 ½ years old

RMDs:

- Required in 2021, unlike 2020 (no “make-up” required)
- Required to begin by April 1 of the year after you turn 72
- Non-spouse beneficiaries need to consider the 10-year rules to distribute all inherited IRA balances

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