2021 | Q3 Newsletter

Q3 Market Update

Q3 started off with a bang bolstered from an exceptional Q2 earnings season. However, September capped the enthusiasm by delivering losses for the month across all the major sectors, except energy. There are a number of catalysts behind the late quarter decline including a potential government shutdown, a looming debt ceiling, the Delta variant, inflation fears, and the Fed tapering.

Taking these in turn, the potential government shutdown was averted with a last-minute approval to keep the doors open through December 3rd. However, the damage was done as the headlines had the entire month of September to instill the fear into investors. In addition to the potential shutdown, Janet Yellen pressed the nerves of the market with her words of caution around the debt ceiling limit. The debt ceiling is definitely a more dire conversation and Yellen is absolutely correct in her efforts to draw attention to the matter.

The ramifications of the US missing any of their debt payments will have a devastating and long felt impact to the market and overall economy. The last time the US came close to defaulting was the summer of 2011 which included a downgrade of the US Government by Standard and Poor's. Despite the US not actually defaulting, the S&P500 index still saw a decline of almost 19% within a 1-week timeframe. If 2011 is any indication of a potential default, this time round will be even more magnified with the increase in media attention and perceived elevated market values.

While the above government actions have a finite time frame, the Delta Variant and inflation concerns pose a bigger risk as it relates to investor confidence. The Delta Variant does not appear to have an end date in view and is a direct cause for our current supply-side inflation. The thought of a "transitory inflation" environment is wearing thin on investors as the supply chain continues to struggle on making meaningful progress. As mentioned in prior writings, the duration of the supply chain disruption is at the core of the short-term health of the economy. Inflation fears have sunk into the minds of investors and will pose the more serious long term negative effects if not corrected within the near term.

In all, the economy continues to improve and we expect a solid year-end rally. However, October may test the nerves of investors as the Government deals with the debt ceiling. We agree with the Fed that the current inflationary environment is a ripple effect of the COVID shutdowns. But the question remains, just how long will the economy take to get back to full production and settle on the "true" costs for goods that are not inflated because of short-term supply chain disruptions?

As always, timing the market is not a prudent investment strategy, but instead, time in the market is the key to success. There has been, and will be, a lot of noise in the headlines which undoubtedly will raise fears and concerns around the market. We continue to monitor and adjust our portfolios to weather the storms in an effort to achieve long-term success. If you have any questions or would like to discuss your portfolio, please reach out to us at ria@findec.com or 209-957-7413.

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House Tax Proposal

On September 15, 2021, the House Ways and Means Committee approved tax increase and tax relief proposals that are to be included in the "Build Back Better" reconciliation legislation. We are expecting the Senate's tax proposals to be released in the coming weeks which will then kick off the highly anticipated rounds of debates to determine what will be included in the final legislation. The recent release of the House's proposal provides a sense of relief to many taxpayers as it contains, in large part, more muted changes than Biden's initial proposal. However, the House's proposal does contain some interesting concepts as it pertains to retirement accounts. The following provides a high-level overview of some of the key considerations in the House's current proposal as they pertain to investors.

Corporate Tax Rates

The proposal also expands the corporate tax rate and introduces a new tax rate structure as follows: corporation's taxable income at $400,000 and below will be taxed at 18%, between $400,00 and $5 million would be taxed at 21% and income above $5 million would be taxed at 26.5%. There is also a supplemental tax owed for income over $10 million. This new graduated tax structure will not apply to qualified personal service corporations. Instead, those corporations will be subject to a flat 26.5% tax rate.

TOP MARGINAL INDIVIDUAL TAX RATES

Starting with the 2022 tax year, the proposal increases the top marginal tax rate from 37% to 39.6% on income as follows: married filing jointly with income over $450,000, heads of households over $425,000, single filers over $400,000, married filing separately over $225,000 and estates and trusts with income over $12,500.

CAPITAL GAINS AND QUALIFIED DIVIDEND RATES

The current proposal would increase the top rate applied to capital gains and qualified dividends up from 20% to 25%. The House's proposal to increase the top capital gains and qualified dividends rate to 25% is unique in that the new rate would apply to gains recognized after September 13, 2021, the date the proposal was introduced, as opposed to starting prospectively on January 1, 2022. It is important to note that this increase is a substantial reduction in Biden's original proposal which proposed a rate change to 39.6%.

It is important to note that no measures in the House's proposal have been finalized and the Senate is still pending their proposal. We are still very much in the discussion period and no action is recommended at this stage of negotiations between the House and the Senate. More information will come in the weeks and months following and we will continue to provide updates as material information is released.