7 COVID-19 Inspired Investment Strategies

STRONGBOX WEALTH

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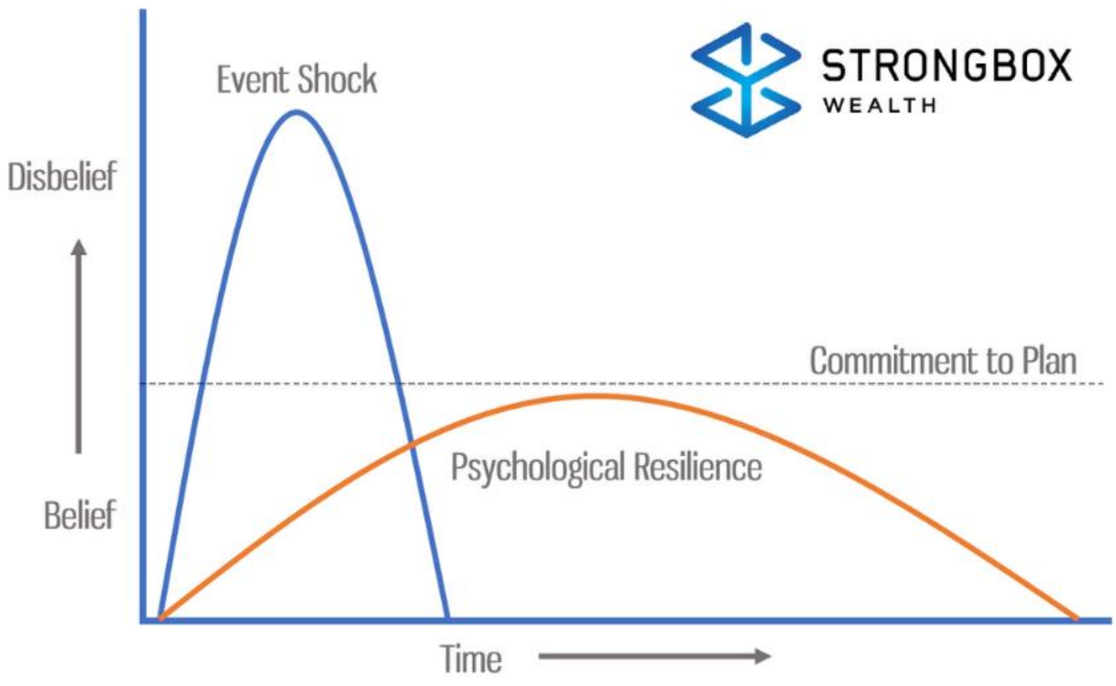
From one of the strongest economies the U.S. has ever seen to shuttered doors across the country resulting in the fastest recession on record, the COVID-19 global pandemic has changed our way of life in a few short months. Commerce essentially stopped as people across the country "sheltered in place" to "flatten the curve". Unemployment levels hit record highs with an estimated thirty million out of work in just a few short weeks. On the other hand, rapid advances in vaccination trials and treatment protocols for this novel disease and unprecedented stimulus from the Federal Reserve Bank, U.S. Treasury Department, and Congress totaling near $7 trillion have seemingly stabilized the financial markets for now. The event shock is mostly behind us at this point, COVID-19 is real, and it is going to be here for many more months. Thus, many investor worries are starting to mount with looming concerns of a second virus wave, unemployment rising again, a transition of power following the election, trade relations, civil unrest, and the scale of our remaining post-pandemic small and medium sized business. For these reasons, we offer seven strategies you should consider implementing with your investments in response to COVID-19.



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1. Focus on quality

Owning high quality cannot be overstated, in our opinion, but what does that mean? First, we want to ensure the investments of our clients' hard earned money into profitable companies. That may sound obvious, but there are many publicly traded companies yet to turn a profit and there are many more operating at a loss, having been amplified by the detrimental effect of the recent national work slowdown. Beyond profits, we are highly focused on corporate debt levels. Many companies have drawn on lines of credit during this pandemic to ensure adequate capital needed to weather the storm. Many more went one step further by raising billions in cash through new debt obligations issuance. With the Fed dropping short term interest rates to zero, bond market participants are starving for yield. When a north of inflation rate of return cannot be found in the U.S. Treasury market, many consider increasing risk by forgoing credit quality with lower grade or high yield corporate bonds. Accordingly, low borrowing rates may provide an environment prime for companies to raise capital by issuing more debt. Though that may be prudent for some, inevitably many companies have become overleveraged. With more business revenues paying interest expenses and debt, while less is deployed to growth drivers like innovation, a cycle of further debt issuance may eventually facilitate a spike in bankruptcies. We actively seek to avoid client asset exposure in poor quality balance sheets.

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There are many quality metrics that we consider such as liquidity ratios, earnings variability, cash on hand, dividend growth history, dividend coverage, and industry leadership. Yet, while all of us are embroiled in this global health and economic crisis, we feel investment decisions should be made by giving primary attention to a company's profit and debt as most important indicators of quality. We encourage investors to avoid the temptation to speculate on investing in stocks and bonds of down and out companies. Though some will hopefully recover over time, many may not. In our view, that added risk is not worth the potential return, as there are profitable companies otherwise poised to both survive and grow through this historic period.

2. Understand the time horizon for various assets and account types

By nature, investing is positioning your current assets in vehicles designed to generate positive returns over time. Understanding that capital markets do not always go up, the question centers on the time frame in which you intend to use (spend or repurpose) the asset. In our view, any common stock investment should be made with capital commitment of a three-year minimum time frame, preferably five years. Of course, there are less volatile investments for a shorter time horizon such as short duration bonds, FDIC insured CDs, and money market funds that can be used to complement stock investments built into a carefully crafted asset allocation.

Account types matter a great deal as well. Retirement accounts such as 401(k)s, IRAs, and Roth IRAs are generally intended to provide cash flow as replacement income through the post-retirement years. Downturns in portfolio values should be expected as stock allocations are ultimately owned for income growth over long periods of time. We recognize that is easier said than done, especially during pronounced market declines. It should be noted that if you are currently and consistently funding one of these account types while markets are down, you are also buying at lower prices that should ultimately be beneficial over time. Two of the hardest investor actions are avoiding the temptation to sell when prices are down and being bold enough to buy into that weakness. Professional advice can set you on the right path and potentially save you from major financial mistakes during periods of volatility.

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3. Examine cash reserves for potential liquidity needs over the next 12 months

We engage in thorough conversations with our clients to determine liquidity needs for each investment and account type. Any asset or income expected to be used inside a year should be in cash, money market, FDIC insured CDs, or an ultra-short maturity high-quality bond holding. If you are retired, make sure you have enough in these low to no volatility holdings at a minimum equal to your expected expenses over the next 6-12 months. Markets have always been and will always be volatile so we encourage clients to focus on what they will need over the near term from their investments. We suggest building out layers of liquidity for known expenses, unknown expenses such as home or auto repair, and potential life changing circumstance such as job loss or serious health issue. There is no one-size-fits-all approach to time horizon and liquidity, but there is considerable risk in being under allocated to liquid assets. We encourage clients to have a thorough discussion with us about all financial aspects of their life in order for us to best propose a planning course of action.

> “ We suggest building layers of liquidity

4. Consider tax loss harvesting and portfolio rebalancing in taxable accounts

It may feel unwise to sell a stock at a loss, but often this is a prudent action to take, especially when a similar company in the same industry that is also down in price. We call this proactive step “tax loss harvesting” or making a “lateral move.” In this COVID fueled market there are several industries impaired in price such as energy, financials, materials, and industrials. However, there are many quality stocks within those sectors that we feel have high probably to recover. This could be a prime time to take a loss and increase the quality at the same time.

There are also some companies in technology, healthcare, and consumer sectors that have significantly grown through the pandemic. Many “stay at home” company stocks appear bulletproof, yet history suggests taking gains as a prudent decision when position size becomes larger than you would comfortably buy today with fresh cash. Especially in tax deferred accounts, this is an opportune time to prune positions that are up big and rebalance to prescribed allocation. It is typically wise to pare gains with losses in taxable accounts as well. Remember that portfolio efficiency is an important determinant of consistent portfolio returns over time. We encourage proper balance, high quality, periodic rebalancing, and staying true to your long-term risk tolerance. We are ready to serve as your guide should you have questions related to tax implications of your portfolio.

5. Consider Roth conversions with Traditional IRA assets

Tax rates were cut in 2018 and, if no action is taken otherwise by Congress, will revert to those higher rates after 2025. This leaves us with a current Roth conversion window of opportunity that should be examined. Additionally, we know Democratic leaders are voicing their opinion that tax rates should be higher and would move to do so if enabled through the upcoming November election. Taxes for business, higher earners, capital gains and dividends, as well as marginal bracket rates and thresholds are all on the table. Thus, the current window could close sooner than later. We know that distributions from deferred accounts such as 401(k)s, 403(b)s, and Traditional IRAs will be taxed at future prevailing rates. Why not

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consider paying this one-time tax now at lower rates by converting a portion of Traditional IRA to a Roth IRA? There are several aspects of the planning discussion that should be had when considering a Roth conversion. First, you should speak with your tax advisor who understands your entire tax circumstance. Second, you should pay the tax owed from non-IRA sources rather than the Traditional IRA conversion proceeds. Third, it is likely necessary to make a quarterly estimated tax payment after a conversion to avoid penalties. Fourth, if there is an IRA investment that you have conviction in and the price is depressed, consider converting that position in kind (as-is) instead of cash.

6. Consider frontloading your charitable giving with appreciated stock

One of the most overlooked planning vehicles is a donor advised fund. For the investor owning a concentrated or low-cost basis stock and having charitable inclinations now or down the road, a donor advised fund is a great consideration. A tax deduction is received the year in which you make an irrevocable contribution to a donor advised fund. You possess the ability to sell the positions inside the fund for no reportable capital gain and reinvest proceeds to most anything. Grants from a donor advised fund are made to any 501(c)(3) to support your values based charitable organizations. When paired with a Roth conversion and an itemized tax return, you can offset the tax owed by establishing and funding a DAF in often similar proportion.

7. Review your plan

How are you invested and why? When will you use this money and at what intervals? Are you on track to meet your future plans? Is your current portfolio aligned with your target allocation design? Is risk properly and efficiently addressed? These and many more questions should be explored on a regular basis. We know markets ebb and flow over time, but financial objectives tend to be relatively consistent. Have written goals, review your plan, be purposeful in your portfolio allocation, and know your risk tolerance. Along with ongoing professional advice, you should consistently rebalance your investments in abidance with that disciplined strategy.

> " Financial objectives tend to be relatively consistent

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