Private Wealth perspectives

VERSION 20.2

INVESTMENT MANAGEMENT • FINANCIAL AND ESTATE PLANNING • PRIVATE BANKING • FIDUCIARY ADMINISTRATION • RETIREMENT PLAN SERVICES

In these unusual times, normal behaviors and routines can provide needed solace from the uncertainty. I hope you have come to see Private Wealth Perspectives as part of your welcome and normal routines as our team strives to share timely and valuable insights into financial matters affecting your plan. In this current edition you will read about the CARES Act and more specifically the Paycheck Protection Program. Our Director of Private Banking, Nancy Leming, will draw relevant corollaries from Newton's laws of motion to today's banking and economic situation. Travis McEowen from our Investment Management team will remind you of important tenets for investment success and we will provide a primer on what you should expect from your relationship with First Merchants Private Wealth Advisors. Today more than ever, we are reminded of how much we value the connectivity we enjoy with all of you as clients. We look forward to our next opportunity to see you and wish health and safety to you and your loved ones.

Michael Joyce

President, Private Wealth Advisors

INVESTMENT MANAGEMENT

The Year Without a Santa Claus

The Year Without a Santa Claus is one of those stop motion animated TV Christmas specials produced by Rankin/Bass in the 1970's. Though not nearly as popular as Rudolph or Santa Claus Is Comin' to Town, the special has its share of fans, not to mention a terrific horn line in The Snow Miser/Heat Miser Song. In the show, Santa has come down with some sort of illness and his doctor tells him to switch up his routine by staying home for Christmas. Santa becomes depressed because he can't get out and do what he normally does. Sound familiar? As I thought about how the COVID-19 pandemic has affected our lives, this will no doubt go down in history as The Year Without _______. The Year Without School, Concerts, March Madness, The Stanley Cup, Easter in church, Graduations, Wimbledon, Vacations, the Kentucky Derby, Dining out, the NBA Finals, Family Reunions, The Olympics, Flying, and…. Toilet Paper. It isn't World Wars that have stopped most of these things from happening, but rather a virus .00012 millimeters in diameter. This pandemic has taught us, or perhaps reminded us, of many things: the importance of teachers, the sound of voices raised together in song, the freedom to hop in the car and go, the hum of a crowded restaurant, and the warmth of an embrace. It has also been a good reminder that life, and investing, are not without risks.

For more than 10 years, we had enjoyed a bull market run. We had entered the 11th year of an economic expansion, the longest on record. But most investors suffer from a phenomenon called recency bias. Recency bias is simply a person remembering things that have happened recently, instead of remembering something that may have occurred further in the past. When we have a string of very successful years in the markets, investors tend to be "lulled to sleep" by a market that seems to always be moving up. Dramatic, market moving events like Black Monday in 1987, the bursting of the Dot Com bubble in 2000, and the Financial Crisis of 2008-2009, gradually fade from people's minds. But the risk is always there, and it eventually catches up and fulfills its promise to the law of averages. You see, the average economic expansion lasts 5.5 years—we had gone 11 years. On average, the stock market experiences a 20% correction every 2 years—we had gone 10. The numbers suggested we were due, even overdue, for a reversion to the mean, but the cause and speed of the event we could not have predicted.

We teach and preach that stocks are for the long run. You buy stocks because they have higher returns than (safer) bonds, if held long enough to reward investors for the extra risk they're taking. Sometimes that risk rises to the surface, and this is one of those times. The tendency of stocks to beat bonds over time is called the "equity risk premium," and it has proven to hold true over time. Since 1900, global stocks have returned 3.2% per year more than bonds, with income reinvested. In theory, that outperformance is the reward for the volatility of stocks and the danger of unexpected events, including pandemics. Without a higher reward than bonds, the predictable returns of fixed income securities would be far more appealing than the gyrating swings of stock prices. Stock investors should demand a premium future return to cover the uncertainty about what the shares will be worth when it comes time to sell them. Part of that premium return is determined by what price is paid for the shares. We already mentioned the outperformance of global stocks vs. treasury bonds since 1900, but that gap is even wider when looking at just U.S. stocks, which have beaten Treasuries by an average of 4.4% per year since 1900. In fact, U.S. stocks outpaced bonds in every decade since 1900 except one, the 2000s. The reason for this is the 2000s started at the peak of the dot-com bubble, with stock valuations at historically high levels. So, to earn the equity risk premium, the keys are to, first, avoid buying stocks when they are historically overpriced, and, second, accept that the reason stocks beat bonds is because they are riskier.

At FMPWA, we start with the second premise—it's why all of our accounts have an Investment Policy Statement or Investment Objective. We never want to take more risk in your account than you are comfortable with. If you can accept that stocks are riskier than fixed income investments, and the volatility that comes along with stocks, we will invest accordingly. If stock market volatility makes you uncomfortable, we shouldn't be investing in stocks. It's also the reason why the first question on our Investment Policy Statement asks about any expected upcoming withdrawals or ongoing cash needs. If we're doing our job, any funds that we know will be disbursed in the near term will not be subjected to stock market risk. That should give you some comfort during times like this when equity risk rears its head. The first key to earning the equity risk premium was to avoid buying stocks when they are overpriced. One way to help determine if it makes sense to buy stocks is to compare their prospective returns to their main alternative, bonds. U.S. Treasury bonds currently offer some of the lowest returns in history, a guaranteed 0.75% for 10 years. Stocks are significantly cheaper than they were just two months ago, having lost a quarter of their value from the February peak. The Price/Earnings ratio for the S&P 500 has fallen from nearly 20x on 12/31/19 to 16x as of 3/31/20. The implied annualized total return for stocks over the next 5 years from these levels is close to 10%, while at of the end of the year it was closer to 5%. Relative to bonds, stocks certainly look attractively priced right now. But it's important to remember that the equity risk premium is there because the future is uncertain, and uncertainty has rarely been higher than it is now.

Oh, I never told you how the TV show ends! You see, Mrs. Claus sends some elves out to find proof that Santa is still important to people—and find it they do. In fact, Santa is so touched by the outpouring of generosity and appreciation he receives, that he starts feeling better and decides to make his annual journey after all. As the special ends, Mrs. Claus reminds us that "yearly, newly, faithfully and truly" Santa always comes. It's a fitting phrase for the situation we face right now. It seems that yearly there are new challenges for us to face. Throughout history, the human race has adapted, survived, and thrived in the face of challenges. In the midst of this pandemic, we're again seeing the best in humanity. People are making homemade masks for medical workers, CEOs are taking pay cuts to keep employees on the payroll, messages of hope are being shared on social media, technology is allowing us to connect with friends and family in ways past generations could have never imagined. From the American Revolution to the Civil War, The Great Depression to World War II to 9/11, this country has faced challenges, and "newly, faithfully and truly" we have emerged stronger. That will be the case this time as well, and we will be here to help get you through it.

Travis McEowen

Travis McEowen

WEALTH MANAGEMENT

The Full Picture

If you are a regular reader, you may have noticed the title of this section has changed from Personal Trust to Wealth Management. Although past subject matter included topics beyond trusts, we believe this heading is emblematic of the comprehensive financial advice and solutions you should expect from your First Merchants Private Wealth Advisors team.

So what exactly is comprehensive financial advice? Why is it important to achieving your goals? What should it include? How can you be sure the advice you receive from one expert does not undermine or conflict with that of others? These are just a few of the questions that may cross your mind when considering this topic.

Given the headlines of the day, a medical analogy seems in order. While you may have a specialist who focuses on a specific area of your health, your primary care physician is responsible for ensuring your overall well-being. Very often, it is your primary care physician who identifies conditions which require the skill of a specialist or team of specialists. Further, the treatments prescribed by your specialists should work together in support of your overall health to avoid adverse interactions. For example, it is up to the specialist and primary care physician together to determine if your overall health can endure a procedure or if you need to focus on strengthening another area first. Without a coordinated plan for your care, you may encounter unintended consequences or diminish well-intended efforts to improve other areas of your health. In the same way, advice relating to all aspects of your financial goals should be considered together to achieve success. This is especially true for longer term goals, but shorter term goals share this principle as well.

The primary categories to address when developing a comprehensive plan are investing, retirement plans and savings, along with risk mitigation and management. The latter is primarily accomplished through insurance and may overlap with tax strategies and, trust and estate planning, which will also determine how your assets will be transferred after death. Another key consideration is credit use. It may be advantageous to make use of loans to fund certain purchases or ventures. You should expect your advisor to understand both sides of your balance sheet. Comprehensive advice and planning will anticipate cash flow and liquidity needs to support your goals as well.

There is an overriding risk to your financial goals if these areas are addressed independently rather than collectively. Each has a direct impact on the others. As portrayed in the medical analogy, well-intended advice and solutions could produce unintended consequences in the absence of a coordinated plan. Enlisting the guidance of an advisor skilled to listen and understand the interactions of your financial goals is crucial to achieving them. It is unlikely any one advisor has the expertise to offer in-depth guidance in all areas. But, a competent and engaged advisor will have the ability to assemble the team of experts needed to deliver a suite of solutions designed to accomplish your overall goals.

To illustrate, an advisor working with a business owner on his/her trust needs, may need to include an insurance specialist to design solutions which could provide for care in later years and liquidity to facilitate succession planning. Further, this advisor may work with a retirement plan specialist to address retention of new leadership in the company and minimize or defer taxes on distributions. These distributions may find their way into the aforementioned trust which would be strategically designed in collaboration with attorneys and CPAs to minimize or defer taxes and ensure flexible disposition of assets beyond what could be accomplished through a will. The strategic use of credit may be advantageous at any point in this scenario as well. A more common example is the use of multiple investment managers, along with a 401(k) or two, in the case of a married couple, to save for retirement. Your advisor should ensure there is a clear understanding of your overall risk/return expectations. When combined into a single portfolio, are you taking on more risk than you are willing? A comprehensive approach will highlight areas in need of attention. Maintaining an up-to-date plan is essential to staying on a path to successfully achieve your goals.

So what should you expect from your Private Wealth Advisors team or for that matter, any advisor? How can you be sure your overall financial picture and goals are understood? It starts with an advisor who listens and asks the right questions. It is impossible to provide solutions that work together without understanding your priorities, aspirations and areas of concern along with life changes. You should expect your advisor to engage with other experts as well. First Merchants Private Wealth Advisors offers clients a team of experts who provide guidance in all areas of planning. We work alongside you, attorneys and accountants to provide solutions which are truly comprehensive. You should expect your advisor to approach each interaction with an objective to understand your life goals and how they connect to your financial goals. Virtually every life event connects to a financial decision, even if the outcome is to confirm your plan should remain on course. Recent events have certainly reminded us of this fact. All of our lives have changed over the last several months. When considering your financial health, are all areas of your plan still working together to ultimately reach your goals? Whether the answer is yes, no or I don't know, our advisors are focused on proactive outreach to listen, ask good questions, understand and offer solutions that can keep you moving you toward your goals, no matter what life events take place.

Audrey Mistor

PRIVATE BANKING

Banking Physics

In physics, invisible and powerful forces are always at work which are awe inspiring and often mind bending. Great scientific minds have solved complex theorems and challenged the applications and relationship of matter and energy. Categorized into 11 different branches of physics, scientists have discovered so much, yet, have infinitely more to achieve.

With these particular thoughts in mind, I couldn't help but also correlate to today's world crisis that is COVID-19. This thorny looking virus, invisible to the eye, has put into place powerful forces with enormous human and financial impact. No one person or company is immune to either impact. Every household and business is managing to what we know right now, offering support to others and a human touch in ways that are not physical, and anticipating and planning for a return to "normal".

Stay with me… I would like to suggest that these forces of nature apply to the forces of banking, à la Banking Physics. The most infamous and influential scientist/individual in modern times is Sir Isaac Newton. Amongst his countless contributions as a scientist, theologian and author, his most well-known concept is Newton's Three Laws of Motion. As I have thought about our current personal and business environments during the COVID-19, I keep coming back to Newton and these Laws.

Every object in a state of uniform motion will remain in that state of motion unless an external force acts on it. This reminds me of the past several years, those without crisis—what is, hopefully, around the corner again—and the feeling of business as usual, enjoying the steady times, and managing through the inevitable but controllable "blips". Certainly, "business as usual" will have a different look and feel post COVID-19, of which we will all ultimately enjoy and value.

Force equals mass times acceleration. In comparison to today's complicated algorithms and Excel spreadsheets, this 5 word equation is a walloper! Consider these word substitutions: Shelter-In-Place = The World times 60 Days. For First Merchants, this translates to dramatic changes in methods to deliver service to our clients in an immediate fashion, without precedent. Within short order, we were able to shift delivery models across all facets to 80% remote and not miss a beat along the way.

For every action there is an equal and opposite reaction. Shelter-In-Place. Limited, or in some cases, Paused Business Operations. Market Volatility. Human Concern. On their own, impactful. Together, never yet experienced and impact unfolding daily. As your community bank, we were prepared to respond in an impressive manner. Increased digital limits to access funds, heightened online logins, and customer service accessibility were implemented and executed. Payment deferrals for business and consumer loans were processed in recognition of financial impact by our clients. Paycheck Protection Program (PPP) applications were received, which represents 3,600 business clients over a four day period. As of this writing, 1,970 applications were accepted by the SBA before the PPP funds were exhausted, accounting for $750 million in much needed funding. We are prepared to forward the remaining applications to the SBA immediately, upon further funding approval by our United States Government. Daily contact is made to our clients just to say hello and make sure you are OK. All without interruption to what you expect from us on a day to day basis – assist in financing a new home, remodel your current home, open new deposit accounts, financing your dream project, and planning for the future.

We are in the people business and all look forward to connecting with you with a warm, personal greeting. Perhaps meeting over a meal or indulging in a favorite beverage. One day soon, our houses will transition from a shelter to a home. Please know that as we move forward together, First Merchants can, has, and will be there for you.

Thank you, be safe, and be well.

Nancy Leming

Nancy Leming

RETIREMENT PLAN

Cares Act memo

On Friday, March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), a massive relief bill for those suffering as a result of the Coronavirus pandemic was passed by the House and signed by the President. This legislation is aimed at providing relief for individuals and businesses that have been negatively impacted by the coronavirus outbreak. For some of the below key provisions that apply to IRAs and/or Retirement Plans, certain qualifications have to be met to be considered a qualified individual. Qualified individuals are defined as:

- Someone diagnosed with the virus by a test approved by the Centers for Disease Control and Prevention.
- Someone whose spouse or dependent is diagnosed with the virus by a test approved by the Centers for Disease Control and Prevention.
- Someone who experiences adverse financial consequences due to the virus as a result of one or more of the following:
    - Being quarantined, furloughed, laid off, or having work hours reduced due to the virus
    - Being unable to work due to lack of child care due to the virus
    - Business owners unable to work due to the closing or reduction of hours
    - Other factors determined by the Secretary of Treasury

For the following key provisions, you must be a qualified individual:

- IRA and Retirement Plan distributions of up to $100,000 that is exempt from the 10% early distribution penalty. Effective through December 31, 2020.
    - Although the penalty is waived the distribution will be taxable, the option of spreading the federal taxes over a 3 year time frame is also included along with a 3 year rollover (repayment) provision.
    - Not subject to the Retirement Plan 20% mandatory federal withholding.
- For the next 180 days, a qualified individual in a plan may take a loan of 100% of his/her vested account up to $100,000. Furthermore,

any loan payment due on an outstanding loan between the date of enactment and December 31, 2020, is delayed up to one year. The five-year repayment period is also extended for one year. Interest accrues on the loan during the delay period.

- Because of the uncertainty about how repayment of coronavirus-related distributions will be handled, and the tax impact of such repayment, it may be advisable for participants to take loans first. As the repayments may be delayed as discussed above, the immediate effect is the same (i.e., the participant gets money in pocket), but the repayment ramifications are clear. If the participant ultimately terminates employment within the year, the loan can be converted to a distribution at that time.

Key provisions that affect IRAs and Retirement Plans in which you do not have to be a qualified individual:

- Required minimum distributions (RMD) for tax year 2020 have been suspended and do not have to be taken.
- If 2019 was the first year for you to take an RMD and you chose to delay until 2020, those RMDs have also been suspended.
- The RMDs have also been suspended for Inherited IRA and Retirement Plan beneficiaries who are not subject to the 10-Year payout rules. If the distributions were part of a 5-Year payout schedule, an additional year has been added.
- If you have already taken your 2020 RMD, you may wish to consult with a tax advisor to determine if some or all of the distributions may qualify either for conventional rollover treatment or for repayment treatment as a Coronavirus-Related Distribution.
- The deadline to make a 2019 IRA contribution has been extended until July 15, 2020.

This summary is not an all-inclusive listing of provisions pertaining to IRAs and Retirement Plans, but they are key in what First Merchants Private Wealth Advisors considers the essential provisions. The Act also includes provisions for many different sections of the economy.

Retirement savings are a crucial component of an overall financial plan and factor strongly into the comprehensive and coordinated approach First Merchants Private Wealth Advisors delivers to our clients. If you have any questions or concerns, your First Merchants Advisor is readily available to discuss them with you.

Eva Kreps

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> “As the adage goes, clients do not care how much you know until they know how much you care. And more than the reward of effective expertise, it is the strength of the relationships we have with our clients that brings us charging through the door each day.
>
> MICHAEL JOYCE
> *President*
> *Private Wealth Advisors*