Private Wealth perspectives

VERSION 20.3

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

Perspective. Merriam-Webster defines perspective as "the capacity to view things in their true relations or relative importance". Each quarter our team attempts to share our perspective through this publication to support you in your pursuit of a secure financial future. If we have learned one thing in 2020, it's that perspective truly is relative. All around us, advice is administered on a myriad of topics by individuals whose perspective should be deemed as questionable. From the talking head on cable news to your grade-school classmate on social media, it seems in the age of COVID-19, everyone is an expert. In this edition of Perspective our team sticks to topics where we know we are qualified: the economic impact of COVID-19 and the prospects for recovery, building appropriate spending plans in every phase of life and considerations for an audit of your corporate Retirement Plan.

Stay Healthy. Stay Safe. Stay Positive.

Michael Joyce

President, Private Wealth Advisors

INVESTMENT MANAGEMENT

Normal Expectations

Since the stock market lows in March, the S&P 500 has returned to pre-covid levels, while the NASDAQ has set new highs. Yet, we recognize our economy has not returned to pre-covid levels; millions of Americans are still collecting unemployment benefits, many businesses continue to struggle under governmental restrictions and our national debt has ballooned. So…Why the rapid rally in the stock markets? The short answer is that the stock markets are forward looking, where stock prices include expectations of future earnings and growth. As our states/businesses re-open, expectations are that life will return to normal and our spending will return to pre-covid levels. Are expectations overly optimistic?

For many, the hope of returning to normal life in a short period includes an effective vaccination that is widely available, otherwise we will continue to see states pause or reverse their re-opening efforts. Recent news coverage on several vaccination candidates has fueled the hope of an effective vaccination by the end of the year and helped support the rising markets.

According to the World Health Organization, there are over 100 potential COVID-19 vaccines being developed worldwide, with 23 already in human trials. While the numbers are impressive and several drug companies are making progress at record pace, on average only 7% of the potential vaccines in preclinical development will prove to be both safe and effective. None of the 23 human trials have completed Phase III, where the vaccine candidates are tested for effectiveness. A handful have completed Phases I/II and shown immune responses, but Phases I/II were testing for safety and dosage. Just because they pass the earlier phases, with immune responses, there is no guarantee vaccine candidates will be effective in preventing the contraction of the coronavirus and will pass Phase III.

When a COVID-19 vaccine does pass Phase III and receives approval, then it is a question of capacity and demand. Several of the more promising candidates are being produced "at-risk", where millions of doses are being manufactured while clinical trials continue. If the vaccine is approved, then large quantities will be available immediately; however all of the product will be destroyed, if the vaccine candidates don't receive approval.

Once a vaccine becomes commercially available, initial demand is expected to exceed supply. When appearing before the House Energy and Commerce Oversight and Investigations Subcommittee on July 21st, all of the executives from the five drug manufacturers represented said the Federal Government should be responsible for allocating and distributing the vaccines. Shortly after the hearing, the independent and nonpartisan National Academies of Science, Engineering, and Medicine announced that the current administration has asked them to develop guidance on how to distribute an eventual coronavirus vaccine. This is a momentous task that will likely include cold chain distribution (where vaccines have to remain refrigerated or frozen) and multiple-shot regimens for millions of Americans.

Eventually supplies will catchup with demand and additional individuals will need to come forward to be vaccinated. Some people are against vaccines in general, while others may be concerned about a newly approved vaccine that has been fast tracked through the government's Operation Warp Speed. Any hesitation or reluctance to be vaccinated will elongate the timeline of achieving a herd immunity and us returning to a normal life.

The current rise in COVID-19 cases has slowed our ability to return to normal in 2020. The timeline for clinical studies and production limitations means 2021 before a significant amount of an effective vaccine can be produced. In all likelihood the Federal Government will be responsible for the allocation and distribution of vaccines, so additional delays are possible. While my expectations for 2021 (at least economically) is an improvement on 2020, our return to normal is even further out.

Kevin Besoe

WEALTH MANAGEMENT

The Full Picture

"It's easy to meet expenses – everywhere we go, there they are."

- Paul Moyer

We devote much of our lives to accumulating assets - homes, businesses, savings and investments, and probably a healthy list of other "stuff". Much is said about building and growing assets but what happens when the focus shifts from accumulating to spending? Often this occurs in earnest around the time we retire and begin to tap into our investments to replace earnings from our jobs. But, strategic spending decisions will take place throughout our lifetimes too. We may want to purchase larger residences or vacation homes, fund educational expenses, expand businesses or perhaps we find ourselves faced with large medical expenses or tax bills. Aside from establishing specific savings for items such as education or health care, which is almost always advisable, taking a strategic approach to spending can enhance your purchasing power, allowing you to do more or leave more to your heirs.

A strategic spending plan is not the same as a budget. An important part of any planning conversation should include not just how much you intend to spend but which of your assets are best suited to cover the expense or purchase. Should investments be the best choice for funding, it is important to make strategic choices of which securities should be sold. There may be opportunities to offset capital gains with losses to minimize tax consequences. Additionally, it may be beneficial to reduce large or concentrated positions in a tax-smart way or realize losses to offset gains elsewhere. Depending on your taxable income, capital gains tax rates range from 0% to 20% and if your income reaches certain levels, there is potential for additional taxation. Your team of First Merchants financial experts along with your tax advisor will review your investment portfolios and other assets to determine how best to source funds for a given purpose. This assessment contributes to sound financial decisions and planning.

The strategic use of debt can be a consideration as well. Given current low interest rates, perhaps pledging assets from your taxable investment portfolio for a loan rather than selling holdings would be advantageous. This approach leaves money in the market, allowing it to grow and eliminates potential tax consequences from the sale of securities while providing liquidity for a purchase or to cover an expense.

The type of spending is an important factor to consider when determining which assets to lever. Ordinarily, it would not be prudent to leverage a portfolio to cover day to day expenses but funding the purchase of a specific asset this way may be a wise move. The type of investments in the portfolio used to secure the debt must be considered as well to minimize the potential of a significant market downturn eroding the value of the securities used as collateral. This situation could result in a need to bolster the account with additional funds to bring the collateral ratio back in line. Generally, riskier portfolios have greater volatility and would not be the best choice for this type of situation. There is always the option to use mortgages, pledge other collateral to secure the loan or seek unsecured financing, however these options generally result in higher interest rates. A First Merchants Private Banker and your tax advisor should be included in the discussion to determine if the economics of this approach fit with your comfort level and ability to assume debt.

In retirement, it is often recommended to withdraw from taxable accounts first, then tax deferred portfolios, such as IRAs, and leave tax exempt Roth IRAs for last. Aside from Required Minimum Distributions which now begin at age 72 and depending on the amount of taxable investments you hold, this approach will generally cause a spike in taxes after your taxable accounts are depleted and you begin withdrawing from tax deferred accounts. Based on your situation, you may find that proportionate withdrawals from each retirement account type ultimately results in a lower cumulative tax bill.

Other assets such as insurance related investments and policies may also provide a source of funding if they are no longer beneficial given your situation. A tax-free exchange or surrendering a policy for its value may prove to be a beneficial strategy to fund more relevant needs as your financial situation changes. Your Private Wealth Advisors team can assist with evaluating these situations and offer solutions in support of your overall financial goals.

As you partner with First Merchants Private Wealth Advisors you can expect your team of experts to work with you and your tax advisor to not only build or preserve your assets but spend strategically as well.

Audrey Mistor

PRIVATE BANKING

Banking Physics

2020. So much can be said about this year, some of which would not be appropriate to grace the pages of this fine publication. One thing that can be said – and agreed upon! – is our essential need and desire to possess comfort, safety, and security. As an individual and as a family, we obtain all of that, and often more, through one of the best 4-letter words around: HOME.

Personally speaking, pre-2020 I am a little guilty of taking home for granted. Managing a career, family, personal and civic commitments, "home" often was a "house" to keep up in between the comings and goings of an active schedule. However, seemingly overnight one day in March, HOME definitely took on a different meaning. All of those responsibilities of career, family and commitments all remained, but rather existed in a different context, centered around why you do what you do and for whom. As a result, I have made many small (and, to be honest, large) tweaks to our house and approach to life to be more of a HOME for my family for the long term. One strategy, of course, included a new mortgage with First Merchants, delivered with excellent service and terms.

I suspect that the Leming home is not alone. Over the past three months, our Private Banking team has been engaged with numerous families while they each assess what is HOME for them. Whether deciding to commit a long term stay in a current home and potentially making renovations to that home, seeking a brand new start with a fresh, new residence, or perhaps even making the investment in a vacation home, we have been individually advising our clients with sensible and smart solutions. Interest rates continue to be at historic lows, whether financing with a traditional mortgage or structuring a customized balance sheet loan. Our team is available to answer questions and provide guidance to maximize this interest rate environment for your benefit. We appreciate the trust you have placed with us and look forward to serving you and your families.

Nancy Leming

Nancy Leming

RETIREMENT PLAN

When a Retirement Plan Audit is Required

When you hear the word 'audit', do the hairs on the back of your neck stand up? Do you get an aching feeling in the pit of your stomach? No worries…not all audits are a bad thing.

Annual 401k Audit Requirements

To protect the best interests of plan participants as well as you as a plan sponsor, federal law requires that the annual audit on large 401k plans be performed by an independent, external accounting firm. The purpose of this audit is to confirm that the plan is operating in compliance with the written plan documents and federal regulations set forth by the IRS and Department of Labor. It also ensures that all plan financial information is being reported accurately.

120 is the Magic Number

If you're unsure of whether or not your plan is required to undergo an external 401k audit, there's one number to keep in mind: 120. Why? Because companies that have previously filed their 401k plan Form 5500 as a "small" plan and haven't requested an independent 401k plan audit are required to do so once they have more than 120 "eligible participants" in the plan.

The 80-120 Rule

This rule provides an exception for growing businesses. If you (a) have between 80 and 120 participants, and, (b) were considered a small plan in the previous year, you can continue to file the shortened version of the form. When you report at least 121 participants, you must file as a large plan. If you file as a large plan after employing the 80-120 exception, you must continue to file as a large plan – even if your participant count drops below 120 – as long as you have at least 100 participants in your plan. Generally, these numbers (120 for first-time annual audits, 100 for subsequent audits) apply to the number of eligible participants on the first day of the plan year.

Employees vs. "Eligible Participants"

Notice the careful wording in these 401k rules: external 401k audit requirements don't only apply to companies with 120 or more employees or even 120 or more employees who are participating in the 401k plan.

This applies to any plan with 120 or more "eligible participants" - a group that includes former employees who have a balance in their account, current employees who are eligible for the plan, but not participating in it, and others.

Kris Feldmeyer

The Retirement Specialists at First Merchants Private Wealth Advisors are here to help

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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