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TAGStone CAPITAL INC

Third Quarter 2021

THIRD QUARTER MARKET OVERVIEW

The torrid recovery in stocks following the 2020 pandemic selloff paused in Third Quarter 2021, with stocks both at home and abroad finishing either flat or modestly down.

The broader S&P 500 large-cap index eked out a 0.58% gain for the quarter. Small stocks saw steeper downturns during the period, with the Russell 2000 small-cap index down 4.36%.

Foreign stocks were generally flat during the quarter. The MSCI EAFE index of large stocks in Europe, Australasia, and the Far East finished the period down 0.45%.

Alternative asset classes were mixed during the third quarter. Emerging markets suffered the most profound drop of all the major asset classes for the period, falling 8.09%.

Bonds mainly were flat during the quarter. The Bloomberg U.S. Aggregate bond index gained 0.05%.

The financial media is handwringing these days about the recent downward trend in stocks and about the ability of the global economy to continue its recovery. The reality is that no one knows which way the stock market or the economy is heading in the short term.

Bull markets often run years longer than conventional wisdom expects and changing our long-term investment strategies based on that conventional wisdom historically costs investors dearly. It's essential to keep in mind that, even if the stock recovery does run out of steam for an extended period in the future, these downturns have been temporary setbacks on the stock market's long, upward climb.

Tax Planning in Turbulent Times: An In-Depth Report

Whether you're saving, investing, spending, bequeathing or receiving wealth, there's scarcely a move you can make without considering how taxes might influence the outcome. But how do we plan when we cannot know?

The particulars may evolve, but it seems there are always an array of tax breaks to encourage us to save toward our major life goals. However, it remains up to us to make the best use of these "tools of the trade." Today, let's cover what those tools are, as well as how to integrate them into your investing and financial planning.

PART 1: THE TOOLS OF THE TAX-PLANNING TRADE

Saving for Retirement

The good and bad news about saving for retirement is how many tax-favored savings accounts exist for this purpose. There are a number of ***employer-sponsored plans***, like the 401(k), 403(b), and SIMPLE IRA. There also are ***individual IRAs*** you establish outside of work. For both, there are traditional and Roth structures available.

In any of these types of retirement accounts, your dollars have the opportunity to grow tax-free ***while they remain in the account***. This helps your retirement assets accumulate more quickly than if they were subject to the ongoing taxes that taxable accounts incur annually along the way (such as realized capital gains, dividends, or interest paid).

SELECTED 2021 EQUITY INDICES

	Sept. '21	3rd Qtr.	YTD
S&P 500 Total Return (Large-Cap Stocks)	-4.65%	0.58%	15.92%
Russell 2000 Total Return (Small-Cap Stocks)	-2.95%	-4.36%	12.41%
MSCI EAFE (Developed International Stocks)	-2.90%	-0.45%	8.35%
MSCI Emerging Markets (International Emerging Stocks)	-3.97%	-8.09%	-1.25%

SELECTED 2021 FIXED INCOME INDICES

	Sept. '21	3rd Qtr.	YTD
Barclays U.S. Aggregate (Broad Domestic Bonds)	-0.87%	0.05%	-1.55%
Barclays 1-5 Yr. Credit (Short-Term Domestic Bonds)	-0.21%	0.09%	0.13%
Barclays 5-10 Yr. Credit (Intermediate-Term Domestic Bonds)	-0.94%	0.02%	-1.20%
Barclays U.S. TIPS (Treasury Inflation Protected Securities)	-0.71%	1.75%	3.51%
FTSE World Gov't 1-5 Yr. Hedg'd (Short-Term Global Bonds)	-0.25%	0.02%	-0.28%

Tax treatments for different types of retirement accounts can differ dramatically from there. You can make pre-tax contributions for some, but ***withdrawals*** are taxed at ordinary income rates in the year you take them. For others, you contribute after-tax dollars, but withdrawals are tax-free—again, with some caveats. Each account type has varying rules about when, how, and how much money you can contribute and withdraw without incurring burdensome penalties or unexpected taxes owed.

Saving for Healthcare Costs (HSAs)

The Healthcare Savings Account (HSA) offers a rare, triple-tax-free treatment to help families save for current ***or future*** healthcare costs. You contribute to your HSA with pre-tax dollars, HSA investments then grow tax-free, and you can spend the money tax-free on qualified healthcare costs. That's a good deal. Plus, you can invest unspent HSA dollars and still spend them tax-free years later, as long as it's on qualified healthcare costs. But again, there are some catches. Most notably, HSAs are only available as a complement to a high-deductible healthcare plan to help cover higher expected out-of-pocket expenses.

Employers also can offer Flexible Spending Accounts (FSAs), into which you and they can add pre-tax dollars to spend on out-of-pocket healthcare costs. However, FSA funds must be spent relatively quickly, so investment and tax-saving opportunities are limited.

Saving for Education (529 Plans)

529 plans are among the most familiar tools for catching a tax break on educational costs. You fund your 529 plan(s) with after-tax dollars. Those dollars can then grow tax-free, and the beneficiary (usually, your kids or grandkids) can spend them tax-free on qualified educational expenses.

Saving for Giving (DAFs)

The **Donor-Advised Fund (DAF)** is among the simplest but still relatively effective tools for pursuing tax breaks for your charitable giving. Instead of giving smaller amounts annually, you can establish a DAF and fund it with a larger, lump-sum contribution in one year. You then recommend DAF distributions to your charities of choice over future years. Combined with other deductibles, you might be able to take a sizeable tax write-off the year you contribute to your DAF—beyond the currently higher standard deduction. There also are many other resources for higher-end planned giving. For these, you'd typically collaborate with a team of tax, legal, and financial professionals to pursue your tax-efficient philanthropic interests.

Saving for Emergencies

There are also various tax-friendly incentives to facilitate general "rainy day fund" saving and offset crisis spending. These include state, federal, and municipal savings vehicles, along with targeted tax credits and tax deductions.

Saving for Heirs

Last but not least, a bounty of trusts, insurance policies and other estate planning structures help families leverage existing tax breaks to tax-efficiently transfer their wealth to future generations.

With ongoing negotiations over the tax treatment on inherited assets, families may well need to revisit their estate planning in the years ahead. Come what may, there's always an array of best practices we can aim at reducing your lifetime tax bills by leveraging available investment tools to maximum effect. We'll cover those next.

Part 2: Tax-Wise Investing

Leading with Tax-Wise Investing

It's one thing to have the tools just described. It's another to make the best use of them.

We view effective tax planning as a way to reduce your lifetime tax bill—or beyond if you're preparing for a tax-efficient wealth transfer to your heirs.

In short, tax planning is an ongoing campaign staged on multiple fronts. One of the most powerful ways to ward off excess taxes is to be tax-wise about your investing. And yet, few investors take full advantage of the many opportunities available at every level. These levels include how you manage your investment accounts, select individual holdings, and buy and sell those holdings along the way.

As you manage your investment accounts …
Are you doing all you can to build, manage, and spend down your taxable and tax-sheltered accounts for maximum lifetime tax efficiency?

- **Building:** Are you maxing out your contributions to appropriate tax-sheltered accounts? The more money you hold in various tax-sheltered structures, the more flexibility you'll have to delete or at least defer taxes otherwise inherent in building capital wealth.

- **Managing:** Are you deliberate about your ***asset location***, dividing your various assets among your taxable vs. tax-sheltered accounts for overall tax efficiency? Ideally, you use your tax-sheltered accounts to hold your *least* tax-efficient holdings while locating your *most* tax-efficient holdings in your taxable accounts.

- **Spending:** When the time comes to spend your wealth, have you planned for how to tap your taxable, tax-deferred, and tax-free accounts? There is no universal answer to this critical query. Cash-flow planning calls for deep familiarity with the particular accounts and assets you've got, the particular rules involved in deploying each, and your particular spending goals. All that while keeping a close eye on any changes that may alter your plans.

As you select individual holdings …
Are you being deliberate about selecting tax-efficient vehicles? Even when different funds share identical investment objectives, some may be considerably better than others at managing their underlying holdings. Seek out fund managers with solid tax-management practices, including:

- **Patient Investing:** Many fund managers try to "beat" the market by actively picking individual stocks or timing their market exposures. We suggest using managers who instead patiently participate in their target market's long-term expected growth. A patient investment strategy not only makes overall sense, but it's also typically more tax-efficient as it involves less, potentially taxable action.

- **Tax-Managed Investing:** Some fund managers offer funds that are deliberately tilted toward tax-friendly trading techniques for your taxable accounts. Such methods include avoiding short-term (more costly) capital gains and aggressively realizing capital losses to offset gains.

As you buy and sell holdings …
Like the fund managers you choose, are you also being patient and deliberate about your trading? Do you avoid excessive trading and short-term capital gains (currently taxed at higher rates)? Are you guided by a personalized investment plan? Bottom line, the fewer trades required to stick to your investment plan, the better off you're likely to be when taxes come due.

Harvesting Capital Gains and Losses
An investment plan also facilitates your or your advisor's ability to identify and make the best use of tax-loss and tax-gain harvesting opportunities when appropriate.

Tax-loss harvesting typically involves:

1. Selling all or part of a position in your portfolio when it is worth less than you paid for it.
2. Reinvesting the proceeds in a similar (not "substantially identical") position.
3. Optionally returning the proceeds to the original position after at least 31 days have passed (to avoid the IRS "wash-sale rule").

Without significantly altering your portfolio mix, you can then use any realized capital losses to offset current or future capital gains.

It's worth noting, tax-loss harvesting typically lowers a harvested holding's cost basis. So contrary to popular belief, you're usually ***postponing*** rather than ***eliminating*** taxable gains. Why bother? More time gives you more control over when, how, or even if you'll realize the gains. For example, you could wait until tax rates are more favorable or reduce embedded gains over time through gifting, charitable giving, or estate planning tactics.

Tax-gain harvesting involves selling appreciated holdings to generate taxable income deliberately. Why would you do that? Remember, your goal is to minimize ***lifetime*** taxes paid. So, especially once you're tapping your portfolio in retirement, you may intentionally generate taxable income in years when your tax rates are more favorable. You're sacrificing a tax return battle or two, hoping to win the tax-planning "war."

Part 3: Tax-Wise Financial Planning

Weaving Tax Planning Into the Fabric of Your Life
Managing for tax-efficient investing is just one way we help families reduce their lifetime taxes. We also help integrate all of the above into your broad financial interests. Following are just a few life events that can pose potential tax-planning challenges and opportunities:

Events	**Tax-Planning Possibilities**
You get a job.	Enroll in and max out contributions to any tax-sheltered accounts such as a 401(k) or Health Savings Account (HSA).
You buy a home and start a family.	Score extra tax deductions; use the savings to pay down college debt, contribute to an IRA, or establish a 529 plan account for your child.
You receive an executive compensation package.	Work with a financial planner or tax professional to determine how and when to exercise your options for maximum tax efficiency.
You receive a financial windfall, such as an inheritance.	Allocate a significant portion of any new wealth to tax-sheltered retirement accounts. (Ditto for those executive compensation benefits.) Seek to offset taxable gains with any available losses.
You sell your first home and buy a bigger one.	Keep an eye on any gains from the sale. With some caveats, the Taxpayer Relief Act of 1997 says you can exclude up to $500,000 of the gain as a joint filer ($250,000 for single filers).

Events	Tax-Planning Possibilities
You transition to a new, lower-paying career, take a leave of absence from work or incur a financial setback.	If your annual income is taking a temporary hit, consider leveraging the lower tax bracket to reduce your lifetime taxes by harvesting capital gains or performing a Roth conversion.
You buy a business.	Engage a tax-wise professional financial planner to facilitate the acquisition.
You send your 18-year-old to college.	Time to tap their tax-sheltered 529 plan. Adjusting your income levels through practical tax planning may also help secure a more favorable student aid package.
Your 18-year-old decides against college after all.	Consider redirecting their 529 savings to a different beneficiary or withdrawing the assets and paying tax + 10% penalty (which may not be so bad if the assets have grown tax-free for years).
You sell a business.	Ideally, your succession plan has been in place for years before positioning your business for a tax-efficient transfer. Targeted insurance may also help cover taxes without placing an undue burden on you, your partners, or successors.
You retire.	Plan how and when to take Social Security and any pension benefits available, as well as how and when to tap your taxable and tax-sheltered accounts. Once again, during low-income years, you may also plan to engage in some tax-gain harvesting to reduce your overall tax basis.
You downsize to a smaller home.	Again, mind your capital gains, as described above. If you've lived in the home for at least two years, you should be able to exclude gains of up to $250,000/$500,000 per single/joint filer.
You decide to work part-time in retirement.	Good for you! But do some tax projections to determine how the extra income may impact your tax rates, benefits, and bottom line.
You are charitably inclined.	Even with the 2017 Tax Cuts and Jobs Act tax code changes, tax breaks remain for the philanthropically minded. For example, you can use well-timed giving to offset unusual taxable events, such as setting up a Donor-Advised Fund in the same year you exercise a taxable stock option, sell a highly appreciated asset, or incur other significant deductible expenses.

Events	Tax-Planning Possibilities
You incur high healthcare costs.	Speaking of deductible expenses, you may be able to bundle high-priced elective procedures into a single year to take more than your standard deduction that year (especially if you pair it with bundled charitable giving). Or, if you're ***not*** seeking a higher deduction, this may be an excellent time to tap tax-free assets in your HSA.
You prepare to pass your wealth on to heirs or other beneficiaries.	The taxable implications of estate planning are extensive and best addressed with a financial planner *and* estate planning attorney. Especially since the 2020 SECURE Act eliminated the stretch IRA, you may also want to assess whether you'd rather prioritize reducing your own lifetime taxes or those of your heirs and proceed accordingly.

The Big Picture

The above scenarios represent only a handful of the tax-planning events you might encounter throughout your life. Whether you're building, preserving, or spending your wealth, tax planning remains integral every step of the way. Each financial move you make can and should be leveraged for tax efficiencies as described. Better still, a seasoned tax-planning professional can combine these parts into an integrated whole as you pursue lifelong tax efficiency.

Put another way, ideal tax planning integrates seamlessly with all your greater financial plans. This can get complicated—like a juggling act, in which we must keep an eye on each item as well as the big-picture results.

Could you use an experienced hand to keep your total wealth at play? We're here to help!