Comprehensive Investment Management, LLC
Fee Only Personal Financial Planning
Spring 2024

A NEW HIGH AND A ROUND NUMBER

Just as we go to press the DOW has hit a new all time high topping 40,000. Round numbers always get special attention even though in this case 40,000 is just one digit higher than 39,999. We do the same thing with birthdays.

Spring is the time of year when temperatures swing so much you're not sure when you go out whether you should wear a coat, a sweater, both or neither. The markets are always fickle and Spring is no exception. On January 19th the S&P set its first new high in two years. If you need a reminder, the markets had a very rough year in 2022. This year over the 46 business days from January 19th to March 28th the S&P set 19 new highs. That's a trend. The next business day, April Fools Day would you believe, prices made a U-turn. By mid April the S&P was down 5.5%. On May 1st the direction again changed and now we find the S&P at yet another new high and the DOW over 40,000. During that down time did bonds offer any refuge? No. In April stocks fell 4.2%, bonds 2.4%.

The economy continues to grow but inflation is still very much a worry. Investors have continued to anticipate in the near future a reduction in interest rates by the Federal Reserve. It hasn't happened. Consumer prices are 3.5% higher than a year ago. Federal Reserve policy makers are shooting for 2%. If inflation shows even a slight inclination to go up, the Reserve may even raise rates. That would disappoint a lot of people and 40,000 would be a distant memory. From a historic perspective, interest rates are not high, so this is an example of: *what have you done for me lately?* After almost 15 years the punch bowl of ultra low interest rates has been taken away and the party-goers have yet to accept that.

The markets will continue to perk up at any sign that inflation may be slowing. For example, a recent slow down in hiring and small uptick in unemployment calmed some investors' nerves. What a paradox that a rise in unemployment is seen as good news. The economic outlook of most consumers is reported to be dark and most economic observers expect inflation to stick around. The reason for the consumer gloom is that inflation is accumulative. It doesn't reset to 0% every January 1st, although it's often reported that way. In the last two and a half years the cumulative price increase has been 15.3%. Over eight years 2012 to 2020 the cumulative change was just 12.7%. An annual average of 1.5%. People want those days back.

Stock prices are driven by company profits. In the first quarter 73% of public companies exceeding analysts' expectations. Don't expect bond prices to improve much until inflation is clearly corralled.

Average Annual Returns of Select Mutual Funds

As of May 15, 2024	YTD	1 Year	3 Years	5 Years	10 Years	15 Years
US Stocks	7.8	20.6	5.3	10.5	10.7	13.9
Foreign Stocks	8.7	13.7	-3.9	7.1	6.2	10.3
Intermediate Bonds	-.2	2.5	-2.0	1.3	1.8	3.4
High-Yield Bonds	1.3	9.3	1.8	3.7	4.1	6.8
Balanced Fund 65/35 stocks/bonds	7.2	17.0	4.9	9.1	8.3	10.2
Balanced Fund 35/65 stocks/bonds	2.8	8.8	1.3	5.0	5.3	7.6

Over the past 15 years $10,000 in the 65/35 fund would have grown to $46,000 vs $31,000 in the 35/65 fund.

Bonds: You Can't Live With Them and You Can't Live Without Them

Stop me if you already heard this. The returns on bonds, especially since the financial crisis, has not been good, and yet investors need them in their portfolios to reduce volatility. You have probably also heard that investors should ignore volatility, that is, the "noise" that accompanies the ups and downs of the financial markets.

A question then could be asked: If I'm to ignore the ups and downs in stock prices why not own just stocks? It is after all well accepted that an all stock allocation has a higher expected return than one that includes some percentage of bonds.

You are probably familiar with the phrase attributed to ancient Greeks: "Moderation is best in all things." Well, all things includes portfolio allocations. The great majority of financial practitioners recommend diversified portfolios because historically they have had higher returns after taking into consideration the amount of risk taken. For most people the primary goal in investing is not to have the investment grow as much as possible but for the investments to be available to fund withdrawals for a long time. And if there is something left over for heirs that's fine, too.

What would a higher stock allocation get you? Historically a 50/50 stock/bond allocation has provided an annual return of 8.7%. With inflation averaging 2.8% since 1985 most investors would be very happy with a real return of 5.9% (8.7 minus 2.8). A stock/bond allocation of 60/40 has provided a higher return of 9.1%, but with a 10% increase in the number of years with a loss, as well as in the amount of the average loss. When stocks are at 100%, the annual return goes to 10.3% with one in four years experiencing a loss. The worst loss was 43% almost double the worst loss for a 50/50 allocation. If after a 50/50 allocation takes its worst loss, it grows back to its original amount in three years. That assumes it returned to its average performance over those three years. Using the same scenario it would take a 100% stock allocation six years to get back to where it was.

The often sighted safe portfolio withdrawal rate of 4% comes from the original study in 1998 that was based on actual market returns over 75 years. The study defined safe as the ability of a portfolio to successfully cover withdrawals for a certain range of years at variable rates of withdrawals. The results of the study showed that for a 100% stock allocation a 4% draw started to falter at the twenty year mark. In other words the portfolio ran out of money. The 50/50 allocation still had 100% success at a 5% draw at 30 years.

The conclusion of the study was that an allocation heavy in bonds was the least successful. No real surprise there. But the study's author went on to say: "Because of the benefits of diversification, the presence of some bonds in the portfolio increases the success rate for low to mid level withdrawal rates. For example, for withdrawal rates of 7% and lower, the 50/50 allocation has a higher success rate than the portfolios with greater stock allocation for all payout periods." His conclusion: a portfolio with a bond allocation has been more successful than one with just stocks.

Since it is unlikely most investors will choose to go all one way or the other, another way to consider the stock vs bond paradigm is to compare the returns of two balanced funds with varied allocations. Vanguard's Wellesley fund is 35/65 stocks/bonds and the Wellington fund is the opposite 65/35. As you can see in the chart on page one the difference between the two that favors Wellington is quite significant over all the time periods shown. It hasn't always been that way, but now it really should be no surprise. We have been reporting in this newsletter for some time about the poor performance of bonds. The thirty year bull market for bonds that started in the 80's had to end sometime. The Federal Reserve left bonds out of the picture in its efforts to have the economy recover from the 2008 financial crisis. Covid slowed everything down and has been a big factor contributing to high inflation which is the number one nemesis of bonds. The number two nemesis is rising interest rates which is the primary tool the Federal Reserve uses to fight inflation. Market watchers were making some optimistic prediction for bonds in late 2023 and early in 2024. Obviously they were ahead of themselves, but maybe what they saw is still on its way.

CIM

TAX COST BASIS VERSUS PERFORMANCE

Right now you are probably asking yourself why is it that the cost basis of my investment when subtracted from the market value does not accurately reflect my return? Actually you may first have asked yourself: what is cost basis?

First thing to remember is that the cost basis of an investment in a tax deferred account such as a traditional IRA means nothing. For taxable accounts cost basis is used to determine the taxable gain or deductible loss when the investment is sold. For IRA's the taxable income is the amount distributed. There are exceptions. Qualified charitable distributions available to those at least 70.5 years of age are not taxed. Neither are management fees paid directly from the custodian to an adviser. Another is if an IRA balance includes contributions which were not tax deductible. When applicable a calculation is made to reduce the taxable income on a percentage basis.

If you invest $10,000 in a taxable account that is your cost basis. If you were to then sell the investment for $10,500 you have a taxable capital gain of $500. Where it gets complicated is if you reinvest dividends and capital gains in the case of mutual funds. Before the end of a calendar year mutual funds are required to distribute all the dividends and gains it has collected to its shareholders.

Shareholders can take income in cash or they may reinvest it. Either way there is taxable income to be reported. When reinvested, the income amounts are added to the cost basis simply to reflect that the additional shares were purchased rather than a result of growth in value. If not added to the cost basis the reinvested shares would be taxed a second time when the investment was sold. As an example, if you paid $10,000, then reinvested $500 of income, your cost basis is now $10,500. If the investment value rises to $11,000 you are ahead $1,000. But when sold the taxable gain be $500. You don't have to sell an investment to determine its cost basis. The amount of unrealized gains and losses is available on your statements and/or on your account at the custodian's web site. But be aware that it is accurate only for tax purposes and does not reflect what your return was on that particular investment.

NEW VANGUARD CEO APPOINTMENT BREAKS THE MOLD

For the first time in its 50 year history Vanguard will be led by someone who never worked directly for its founder, the late John Bogle. Those leaders were John Brennan who served from 1996-2008, William McNabb, 2008-2017 and the current Tim Buckley who took over in 2018. Each CEO also served as chairman of the Board, so in effect they reported to themselves. That's also changing. The new CEO, Salim Raji, will report to a Board led by incoming chairman Mark Loughridge a former executive at IBM. Not announced as such, of course, but it certainly appears to be a shake up. It's unusual for a company like Vanguard to announce the retirement of its CEO and not at the same time introduce the new one. Buckley's departure was announced in February to be effective by year end. Now its set for July, when the new chairman takes the reins.

Jack Bogle
1929-2019

The recent announcements indicate that Vanguard's future is about further growth. I was hoping to hear something about a return to the good old days when individual investment success and customer service were paramount at Vanguard. For years it staffed the phones on Saturdays for the convenience of customers who worked during the week. Even before he died Bogle was known to his many fans as Saint Jack. When he was in charge (1974-1995) there were no brokerage accounts for customers to buy non-Vanguard funds. He was concerned they would encourage frequent trading. He figured customers who want to do that could have another account elsewhere for those trades. That's not a growth attitude. He stepped aside from his CEO role for a heart transplant and upon his return was surprised to be blocked from returning to a management position. Until his death in 2019 he maintained an office at Vanguard and spent his time lecturing and writing a dozen books selling over 1.1 million copies.

Salim Ramji / Tim Buckley

What Is An EA?

Q. I see Mercedes now has an additional abbreviation after her name. What is an EA? According to Google it is an IRS designation that dates back to 1884 and stands for Enrolled Agent. So Mercedes works for the IRS?

A. An Enrolled Agent (EA) is a tax professional who earns their credentials from the IRS. However, EAs are independent practitioners and do *not* work for the IRS. EAs advise, represent, and prepare tax returns for individuals, businesses, estates, and trusts. They offer services such as tax preparation, tax planning, and representing clients during IRS appeals.

Mercedes earned the EA designation in February having completed the last section of the three-part Special Enrollment Examination and the application process which includes extensive suitability and background checks administered by the IRS.

To maintain the designation, every three years EA's must complete 72 hours of approved continuing education programs. Tax laws are constantly influx, so it's important EA's stay current with the changes, effective dates, etc. They also have the additional goal of minimizing their clients' tax liabilities.

Mercedes goal in achieving EA status was to align her knowledge and skills with the standard set by the company CIM's founder, a CPA, when serving the tax needs of CIM clients. Both CPAs and EAs are highly qualified professionals in the field of taxation.

Despite the absolute and irrefutable connection between investing and taxes, this is a note you will see on the brochures and web sites of the great majority of RIA's. "*We cannot provide tax advice, and nothing herein should be considered tax advice. You should consult your own tax advisor regarding your specific situation including if you're uncertain about the interpretation of a specific tax regulation."* That is intended to be a disclosure, but it should also be considered a warning.

Comprehensive Investment Management, LLC is a Registered Investment Adviser (RIA) registered with Pennsylvania Department of Banking and Securities. As the company name indicates its services go beyond investment management to include the wide range of services generally described as financial planning. Important elements of those services are tax advice, planning, and preparation.

Comprehensive Investment Management, LLC

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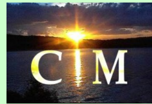

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The CIM investment strategy:
Control risk yet outperform the market by using well managed, no commission, low cost mutual funds. Maintain appropriate asset allocation and diversification. Minimize taxes.

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