Fee Only Financial Planning & Investment Management

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Resolute Connections

In this month's newsletter *The Depth of the Recession* covers the effects of the pandemic on the economy with evidence of some positive trends. W*hat's Taxable? What's Not?* reviews the tax implications of the various types of aid some people are receiving – hint, not much is free from the grasp of Uncle Sam even when one has been forced out of the labor force due to a pandemic.

And while our esteemed leaders in the capital waffle, bicker, and dither, the article *Stimulus Spending* reviews a study showing how critical a lifeline the CAREs act provided to many families. Perhaps this should be required reading in Washington, DC.

Some more positive news can be found in *Falling Fund Fees* which concerns something most investors never see - the expense ratios of their mutual funds and ETFs.

Please be safe and we wish you continued health. If you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

The Depth of the Recession

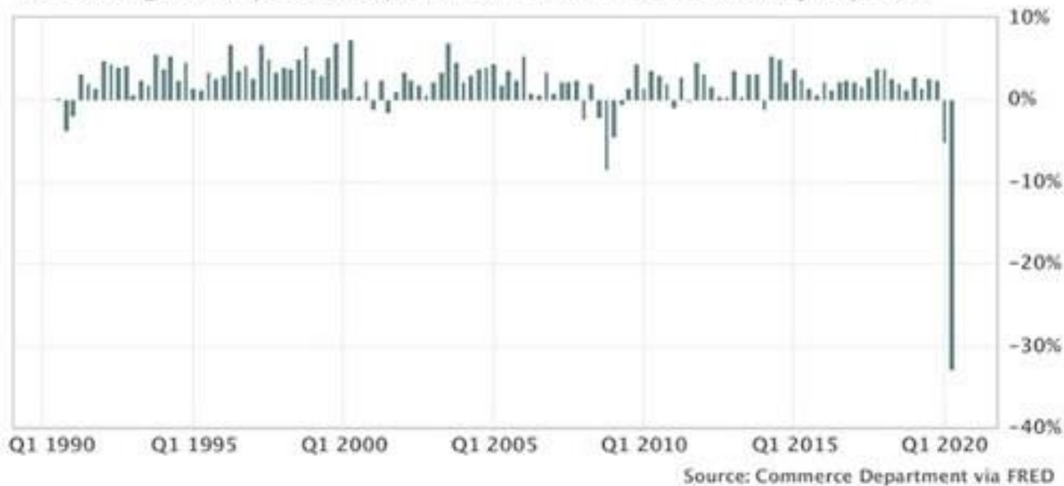
The current recession officially started in the first quarter, with a 5% decline before the country was slammed by the COVID-19 pandemic. But the pandemic has definitely made itself felt in the economy. Most of us, by now, saw that the U.S. economy's second quarter lost (according to the headlines) 32.9% of economic activity—the worst single-quarter drop since World War II. By way of perspective, the

previous record was a 10% drop in 1958, and the worst of the Great Recession saw an 8.4% annualized GDP drop in the fourth quarter of 2008.

What was NOT widely reported is that this is an annualized figure, meaning that the economy would actually lose roughly 33% of its total only if all four quarters declined at that same rate. The actual economic shrinkage was 9.5%; that is, the overall economy in the second quarter was 9.5% smaller than during the previous quarter.

And you probably didn't see it reported that economic activity actually began to rebound in May and June, after a disastrous March and April. Factory production and construction appear to be rebounding, although travel and leisure, including airline travel and visits to amusement parks, continue to struggle. The unemployment rate has also fallen, from nearly 15% in April to 11.1% currently. However, it should be noted that today's unemployment rate is higher than it was at any time during the Great Recession. The last week in July marked the 19th consecutive week in which initial jobless claims totaled at least 1 million.

This is not an attempt to sugar coat the current recessionary environment; the chart below speaks for itself. We have experienced slow economic growth in the years since the Great Recession, and now growth has turned decisively negative as the country deals with shutdowns, social distancing and increased hospitalizations. States like Florida, Texas, California and Arizona have had to reimpose some lockdown measures to stem recent outbreaks, and some other states that have largely escaped the worst impact could suddenly become coronavirus hotspots.



But we should not ignore the positive data in the midst of the downturn. Congress is debating another bailout package for families at risk, and the Bureau of Economic Analysis reported that disposable personal income and the savings rate both jumped in the second quarter. In fact, the personal savings rate has risen from 9.5% in the first quarter (already an unusually high number for Americans) to 25.7% in the second quarter. This suggests that the CARES Act relief worked as intended.

While at the same time other figures have nowhere to go but up. Consumer spending contracted at almost exactly the same rate as the economy (down 34.6% annualized) over the second quarter, and investment in new housing dropped 38.7%. Both are now rising again; housing starts in July were 23% higher than in June and about the same increase was evident when compared to July 2019. This is a huge increase which may reflect a growing trend resulting from the pandemic: some workers can live anywhere and still do their jobs. The inflation rate dropped 1.9% in the second quarter as companies cut prices to boost sales.

It is impossible to predict whether the worst of the economic devastation caused by the pandemic is behind us. There seems no question that other countries have done a better job of containing the virus than we have in America, and we all know that economic recovery will depend on getting people safely back to work. This downturn will leave a permanent scar on many businesses and workers, and nobody expects the economy to get back fully on its feet until we find a vaccine that provides herd immunity. But it also seems unlikely that the rest of the year will be as downright

depressing as what we experienced in March and April. Reports of U.S. economic demise are almost certainly premature.

What's Taxable? What's Not?

People are receiving money from all sorts of sources these days: unemployment compensation because they're out of work, government stimulus checks, bartered services with other service providers—and how do you know what is taxable, and what is not? A recent article outlines different types of compensation and whether or not you should include them on your tax return.

The first: unemployment compensation. You may be surprised to learn that unemployment insurance payments, even if they stem from the pandemic fund, have to be reported as taxable income. Future legislation may change that, but for now: taxable.

The value of free services you received, even if you bartered for them, is also taxable. So is jury duty pay, taxable as ordinary income. Prizes received must be reported as ordinary income using the fair market value of the item received—a surprise to contestants on game shows. Alimony is a mixed bag. For divorce decrees prior to 2019, the money is taxable to the person who receives it, and deductible to the person who pays it. For divorces taking place after January 2019, alimony is neither deductible by the person who paid it nor deemed additional income by the person receiving it.

Not taxable: the stimulus checks themselves, child support payments and life insurance proceeds. The article also notes that any income you might have received from illegal activities—including the fair market value of anything you stole on the date you stole it, should also be included on your tax form. We're going to go out on a limb and assume that provision doesn't apply to you.

Stimulus Spending

You've probably seen the debate over the second round of stimulus checks that are being delayed now due to a certain amount of squabbling in Congress. Some economists say that this next payment will be an important lifeline to many families, and that the checks will stimulate the economy. Others have said that the money is simply put in the bank and never gets to the economy at all.

Who's right?

It turns out the U.S. Census Bureau's Household Pulse Survey for June 11-16 includes actual data on how the CARES Act $1,200 ($2,400 to married couples; an extra $500 per child) checks were spent, collecting 73,472 total responses and extrapolating across the entire population of 160 million recipients. The government agency estimates that 59.35% of households used the stimulus check to pay expenses, and another 13.32% used it to pay off debt. Only 11.98% said they have or would use the money to add to their savings. So, the first thing that tells us is that the stimulus checks were, to at least some extent, a lifeline to 88% of households, and superfluous to about 10% of wealthier recipients.

Of those 127.8 million households (projected) who used the check mostly for expenses, 52.3 million spent at least a portion on rent, and another 40.6 million spent a portion on a mortgage payment. 91.3 million spent at least part of their check on utilities. 23.3 million spent some of their stimulus funds to pay down credit card or other debt, including student loans. The conclusion: many Americans used the government money simply to keep a roof over their heads.

When asked about other expenditures that might have stimulated the economy, the survey found that 55.72% of households spent some of the payment on food, 14.16% on clothing, 39.5% on household supplies or personal care products, and just 5.52% on household items.

The survey found that, in aggregate, 70.81% of households that make less than $75,000 a year spent their check mostly on expenses.

Another survey, conducted by economic professors at the Columbia Business School and the University of Chicago's Booth School of Business, looked at real-time spending data from a nonprofit that helps people create budgets via an app. They found that those in the lowest income group, who earned less than $1,000 per month, spent about 40% of their checks in the first ten days. Those who earned more than $5,000 a month, meanwhile, spent closer to 20% of the check in that brief period.

The group's report found that most of the money was spent on food, household items, bill payments and rent—but interestingly, compared with past stimulus payments, recipients spent about three times as much on food, including restaurant takeout delivery. Meanwhile, people receiving stimulus checks were much less likely to spend on durable goods like electronics, furniture or cars. The conclusion is the same: the "stimulus" appears to have been more of a lifeline than a boost to U.S. consumer expenditures. The researchers concluded that the increase in unemployment insurance might have had a larger effect on consumer spending per dollar than the stimulus.

Falling Fund Fees

Most investors never see the expense ratios of their mutual funds and ETFs, but financial planners know that those costs add up, and typically seek the thriftiest share classes for their clients. That job is getting somewhat easier.

A recent industrywide review by the Morningstar fund research organization found that, on an equal-weighted basis (meaning that funds with more assets were weighted proportionately more heavily), investors pay an average fee of 1.10% a year in actively-managed U.S. equity funds, down from 1.21% in 2015. Investors in passively-managed U.S. equity funds (including ETFs) paid an average of 0.49% a year, down from 0.62% in 2015. Actively-managed international stock fund costs came down from 1.39% to 1.22% over the same time period; for passively-managed funds, the drop was from 0.60% to 0.49%. Overall, for all funds—including taxable and municipal bond funds, commodities and alternative funds—the weighted average for

active managers came to 1.08% a year (down from 1.20% in 2015) compared with 0.61% (down from 0.72%) for passive funds.

Morningstar predicts that fund fees in both active and passive categories will continue to drift lower, as consumers and advisors put their money into increasingly less expensive funds. And it notes that there are now a handful of zero-fee index mutual funds and ETFs. Is it possible that 50 years from now, some funds will pay investors to put money in their hands?

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For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.

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