RESOLUTE FINANCIAL

Fee Only Financial Planning & Investment Management

October. 2020

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Resolute Connections

In this month's newsletter our first couple of articles, *Day Trading with Robinhood* and *Pandemic Saving,* discuss two important developments that have arisen from the Coronavirus shutdown of the economy; whether these two trends are long-term or a flash in the pan remains to be seen.

Preparing in Advance delineates the differences in tax policy between Presidential candidates Donald Trump and Joe Biden as the differences are pretty significant for a small portion of taxpayers. And our final article*, Advice or Sales,* touches on the new water down regulation regime the Securities and Exchange Commission is implementing to protect consumers from unsavory brokers and advisors: as always live by the creed - buyer beware.

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.

Day Trading with Robinhood

If you do any investment searches online, you have probably noticed the "Two Top Robinhood Stocks to Buy in September," or "Top 5 Penny Stocks on Robinhood to Watch for September". Or you can find actual pages of listings of 'top' stock touts and tips from the popular trading app. Robinhood, with its free trading, now has 13 million users who are actively buying and selling, sometimes daily, an estimated $20 billion of personal assets. The site has been described as a large collection of amateur investors who are using their quarantine time to explore day trading, which for many has replaced gambling in casinos and on sporting events.

There is some evidence that these traders are moving the markets, not necessarily because of their order flows, but because popular stocks on Robinhood are listed in the headlines. In addition, momentum algorithms at large brokerage firms amplify any small shifts in the popularity of individual stocks, so when smaller investors buy, and buy again, others follow the trend.

Most discount brokerage firms have now matched Robinhood's $0 trading fee for stocks and ETFs. Robinhood receives almost half of its revenue from payment for order flow—that is, selling its trading business to whatever clearing firm is willing to pay the most. Regulators have fined the company more than $1 million for failing to ensure that its customers receive the best price for orders.

It matters whom a company like Robinhood sells its trading data to. Companies like Virtu and Citadel, clearing firms that Robinhood sends its clients' orders through, can use this information to decide how to invest for their own accounts, essentially interposing their own trading interests between the retail customer and the order they have purchased. There is evidence that Robinhood exacts a higher price for its trading data than other, more conventional firms, because the company is willing to embrace that significant conflict on behalf of its investors.

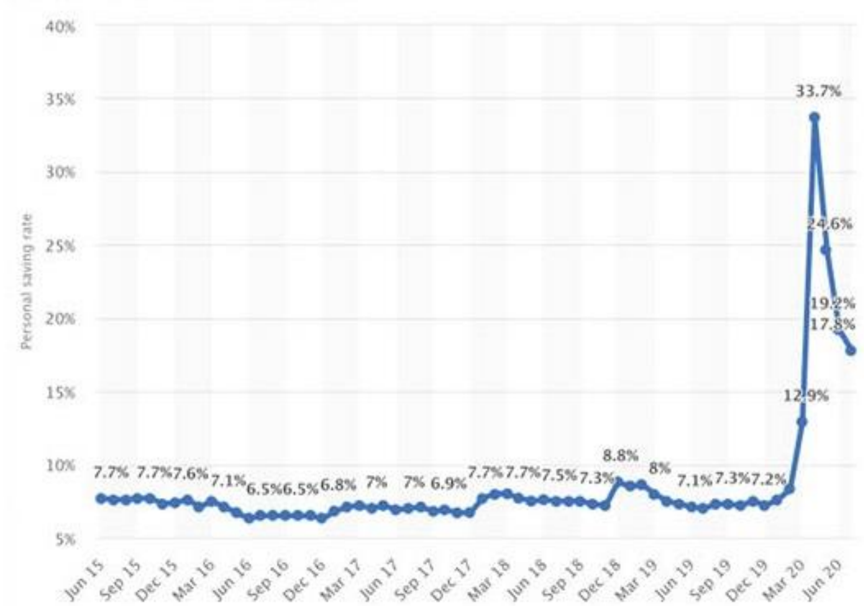
Viewed over time, day trading by amateur investors—popular in the late 1990s—has seldom ended well. Back then, unsophisticated traders kept buying and buying until just about every professional was warning that the markets were becoming seriously uncoupled from their underlying valuations—right up until the so-called Tech Wreck of the early 2000s, when the markets plunged dramatically, wiping out the day traders and many others as well.

Today, with Robinhood's unprecedented popularity, professionals are once again warning that the markets have become seriously uncoupled from their underlying valuations. Are we in for a repeat of history? Does anyone want to wager we aren't?

Pandemic Saving

One of the strangest statistics during the current pandemic is the remarkable change in the U.S. savings rate. Americans—and perhaps people everywhere—tend to save more when they feel like the future is uncertain. As you can see from the chart, the U.S. personal savings rate (the aggregate ratio of personal saving to personal income) was well within normal bounds, running somewhere between 6.5% and 8% from June 2015 right up until COVID-19 started ramping up in March of this year. According to the U.S. Bureau of Economic Analysis, Americans responded to the threat by saving a remarkable 33.7% of their income in April, and the savings rate has remained above 17% since then.

U,S. Savings Rage since 2015



A second chart, showing longer-term data, makes the recent spike even more dramatic—basically like nothing the U.S. has ever seen before. As you might expect, during the spike, consumer spending fell 12.6%, and a Harvard-based research group found that higher-income Americans were responsible for most of this decline. Interestingly, past spending cuts during past recessions tended to impact costly items like cars and homes. Today, spending has fallen most on services that require in-person interaction, like restaurants and hair salons.

Not everybody thinks a higher savings rate is good news. Consumer spending accounts for almost 70% of the U.S. economy, so any decline in consumption could pose a risk to the U.S. economy's recovery.

Preparing in Advance

The differences in tax policy between Presidential candidates Donald Trump and Joe Biden are pretty significant. Current polls show the Democratic candidate with a substantial lead, which suggests that all of us should prepare for the possibility of a different tax regime in 2021. But what, specifically, should we consider doing as the elections approach?

The Biden tax proposal would raise taxes on individuals with yearly incomes above $400,000, from the current 37% to 39.6%. Social Security taxes would stay the same for most Americans: 6.2% assessed on the first $137,700 of income. But the plan would then impose a 6.2% Social Security tax on any income above $400,000.

The lesson here is that if you aren't earning more than $400,000 a year, it may not be necessary to do any advance preparation. But people who fall into that income category might consider moving some of their expected income that would normally fall into the 2021 tax year back into 2020—potentially saving tens of thousands of dollars in taxes. For example, workers whose bonuses would throw their income above $400,000 could ask that the bonus to be paid out before the new year. Executives with non-qualified stock options that produce ordinary income taxes should sell in 2020 rather than 2021.

The Biden plan would also raise capital gains taxes on taxpayers with more than $1 million in income—so when a person sells stocks and ETFs for a profit, the gains would be taxed at a 39.6% rate, even if they were held for more than a year. It would make sense for those individuals to time their gains and losses, selling assets in 2020 to take advantage of the lower (20%) rate now.

Finally, a President Biden would push for a reduction in the estate tax exemption of $11.58 million per person, down to $5.49 million, adjusted each subsequent year for inflation. For people who would be affected, it might be time to get assets out of their estate before the laws are changed. They could accelerate their gifting programs—and, because the proposal would also eliminate the step-up in basis at death, the best assets to gift would be highly-appreciated stock or closely-held shares.

As you can see, most Americans won't be affected by these proposals, which means that the higher taxes won't carry a lot of weight with a majority of voters. However, when one factors in state taxes, some in states like California and New York will be paying top tax rates exceeding 60%. How much of an impact on the economy this type of tax regime will have will always be debated; but what is not likely up for debate is the exodus of high-income tax payers from the above states to low tax states like Texas and Florida, and even New Hampshire, will continue and accelerate. For those who would be impacted, it always helps to have a contingency plan.

Advice or Sales?

You should be glad you don't work as a financial planner who believes in a fiduciary standard—who has pledged to work for the best interests of clients rather than yourself or the company you work for. Why? Because the big sales organizations on Wall Street control the organizations that make our rules.

Case in point is the Securities and Exchange Commission's new Reg BI—aka Regulation Best Interest. The regulation was supposed to clean up unsavory sales activities and help consumers recognize who is on their side—and, most importantly, who is an insurance or annuity salesperson masquerading as a professional, or somebody who is there to collect assets for an expensive Wall Street investment program.

Alas, Reg BI actually did almost nothing to stop salespeople from calling themselves professional advisors, and even recharacterized their asset gathering and sales activities, on behalf of their brokerage employers, as "best interest." The result is that consumers have to be extra careful that they aren't being sold under the guise of advice.

Surely this is too harsh, right? Recently, the state regulators, the North American Securities Administrators Association (NASAA), came out with some data that was designed to help them figure out how to regulate fiduciary advisors, on the one hand, and brokers, on the other, under the SEC's new rules. The state regulators know a lot more about how brokers conduct themselves than most consumers, and for that reason their report is enlightening.

The NASAA organization sent out questionnaires to brokerage firm reps and advisors, and found that in 2018, brokerage firms were far more likely to sell complex and high-commission products than independent advisory firms—and one suspects that the small number of advisors (3-7 percent) who were selling such products were registered both with the SEC and also with the broker-dealer sales regulator known as FINRA.

The new Reg BI initiative prohibited what were once widespread product-specific sales contests at brokerage firms, but still allowed sales contests, quotas or bonuses for overall sales activity—and the report found that 15% of brokerage firms utilized these contests. Fully 18% of the brokerage firms accepted third-party compensation from another financial institution to push products on their behalf. NASAA found that these sales activities were extremely rare among independent advisory firms.

Perhaps the most important thing to know is that the Reg BI initiative prohibited brokers and salespeople from calling themselves "advisors" or "advisers." The report found that well over half of brokerage firms allowed their representatives to call themselves "advisors," and others simply described themselves as "wealth managers" or "financial consultants."

The report concluded that “investors seeking the highest standard of care will need to continue exercising caution in taking any securities professional title at face value, and may avoid confusion by simply asking their investment professionals whether or not they are receiving a fiduciary standard of care.”

Source:
Bob Veres Inside Edition Newsletter

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