THE BIRCH LANE PERSPECTIVE

Preserving and Growing Wealth
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"Never put off till tomorrow what may be done the day after tomorrow just as well."
– Mark Twain

How Long Can You Defer Taxes?

Although Benjamin Franklin was correct to say "Don't put off until tomorrow what you can do today" when it comes to accomplishing great goals, the same logic does not apply to paying taxes. Deferring taxes can lead to substantial benefits that compound over time. And in some cases, you may be able to defer taxes forever.

Consider the difference between a short-term trading strategy and a long-term strategy. Suppose you invested in a hedge fund that earned 8% annualized returns.

Hedge funds typically employ short-term trading strategies. If you're in a high tax state, your marginal tax rate is probably around 50%. That means your 8% pre-tax return would be more like 4% after tax. Barely above inflation.

Consider the compounding differences between an 8% return and a 4% return. If you invested $1 million at a 4% average return, you'd have a little over $3 million in 30 years. However, if you invested at an 8% average return, you'd have a little over $10 million in 30 years. That difference of $7 million is what you lost due to taxes.

So what are your options?

Of course, you want to maximize tax deferred accounts when available. These would include things like 401Ks, IRAs, Roth IRAs, Defined Benefit Plans, etc.

However, if you're selling a business or realizing a large executive compensation package, most likely you're going to have a lot of money in taxable accounts. But even there, you have good tax management options.

Suppose you built a diversified portfolio of individual stocks. For wealthy individuals, individual stocks have a significant tax advantage compared to owning funds. The 30-year return of the S&P 500 has been around 10%. If you bought a fund that invested in S&P 500 stocks, you would have had a large gain over time. However, you also would have had a large tax liability.

If instead, you bought a diversified portfolio of individual stocks, some of those stocks would do well and some wouldn't. Even if the total return were the same, market returns tend to be driven by a small number of big winners. A portfolio of individual stocks gives you the flexibility to sell the losers or mediocre performers to fund your needs rather than sell across the board. Even if there is a gain, you could choose investments that have long-term gains, which is taxed at a lower rate. This minimizes your tax liability.

If you've been tax managing an account for a while, eventually you'll sell your losers and mediocre performers and will be left with positions that have large unrealized gains. However, even there you have options to minimize tax impact and reduce concentration risk.

For example, you could use securities based lines of credit to tap a portion of your equity. This is how many billionaires fund their lifestyle without selling their stock. You could take out a line of credit secured by the stock, letting it continue its potential growth. This could make sense if it were a small portion of your equity and you believe the return potential and tax deferral is greater than the interest rate on the line of credit.

You could also do a variable prepaid forward. This could also good for reducing concentration risk. A variable prepaid forward allows you to take out an amount of cash now in exchange for a commitment to deliver shares or cash in the future. If it meets the requirements, the cash upfront would not be taxed and the tax can be deferred until the shares are actually sold. And if you pay it back in cash rather than shares, then there is no tax either since there is no sale. You may also have the option to either extend the old contract or do a new contract when the previous one is due, effectively further deferring the tax.

Finally, whether you ultimately pay tax depends on whether you use the money for yourself or pass it on to children or charities. If you ultimately spend your wealth, you can defer taxes and thereby maximize growth, but you cannot avoid them altogether. However, if you pass on your assets, then your heirs get a stepped up basis and you've avoided capital gains taxes altogether. For example, you could have held a stock for 30 years, had a massive gain, and owe no capital gains tax as it gets a stepped up basis on death. Likewise, donating appreciated positions to charity also avoids taxes.

Not everything is about taxes though. If you think a company's fortune has changed and its investment value is going to be impaired, it's better to pay the taxes and sell at the high value. If you plan to use all your assets for your own enjoyment, then some taxes are unavoidable. It is your money, after all, and using it for your own enjoyment is perfectly reasonable.

Finally, capital gains tax management is a small part of your overall estate planning, tax planning, and financial planning strategy. You will want to make sure everything is aligned to accomplish your goals, concerns, liquidity needs, and risk exposure.

Key Wealth Principles

- A foundation of good habits is more important than fancy techniques
- Invest in quality businesses at an attractive price
- Build a portfolio of good businesses in different industries
- Maintain appropriate reserves and income sources
- Consider your financial circumstances, liquidity and timing needs, goals, tax considerations, and risk exposure

Building Your Resource Network

Steve Jobs wrote an email to himself a year before he died to remind himself that he did not create many of the things that he relied on to innovate and grow. Things like the food supply, a legal system to protect his rights, medicine, technologies, math, etc. The fact is we all succeed by building on the efforts of others.

We can help directly with tax planning, estate planning, financial planning, asset allocation, and investment management.

To further help our clients, we have built a network of resources both internally and externally. These resources include M&A advisors, M&A attorneys, SBA lenders, fractional CFOs, CPAs, bookkeepers, business consultants, estate attorneys, mortgage lending, high yield savings, and more.

If you are looking to grow your business, considering a business exit in the next five years, or just want to preserve and grow your wealth, we are happy to talk. The conversation is no obligation and we may be able to help you, either directly or by introducing you to someone in our network.

To learn more, please visit my calendar online at Calendly or email me at Randall.Watsek@RaymondJames.com for a no obligation consultation. The earlier you start planning, the better prepared you'll be.

Last Month's Winners and Losers

Winners	**Losers**
Growth	Value
Momentum	Profitability
Crypto-currency	Capital efficiency
Oil	Risk
Gold	Stocks
Argentinian stocks	Long-term bonds

Last month saw a rise in long-term interest rates, which hurt the value of long-term bonds as well as stocks. Commodity-like assets such as oil, gold, and crypto were positive while growth and momentum did better than other styles within the realm of stocks. Overall, this would suggest fears of persistent inflation.

Stocks

	S&P 500	Dow Jones U.S. Select Dividend	Russell 2000	Bloomberg US Long Treasury
1mo Return	-0.9%	-0.2%	-1.4%	-5.2%
YTD Return	21.0%	18.6%	9.6%	-2.9%
10yr Return	13.0%	9.8%	7.9%	0.3%
20yr Return	10.6%	8.6%	8.3%	3.5%
30yr Return	10.7%	11.2%	8.9%	5.6%

Source: FactSet as of 11/1/2024. We use the S&P 500 index as an illustration of the performance of large cap stocks, the Dow Jones U.S. Select Dividend index as an illustration of the performance of high dividend stocks, the Russell 2000 index as an illustration of the performance of small cap stocks, and the Bloomberg US Long Treasury index to illustrate the performance of treasury bonds with maturities greater than 10 years out.

Despite all the worries over the last couple years, the stock market has been well above the long-term average return of 8-10% this year, at least among the large U.S. companies that dominate the S&P 500. Small cap stocks have been more in line with the historical averages. Stocks have done notably better than long-term bonds due to the rise in long-term interest rates hurting the value of bonds.

Going forward, returns depend on a combination of economic growth, corporate profitability, and valuation. Valuation is reasonable for most stocks, but in bubble territory for large cap growth stocks. It would be prudent to take that into account in your allocations between different classes of stocks.

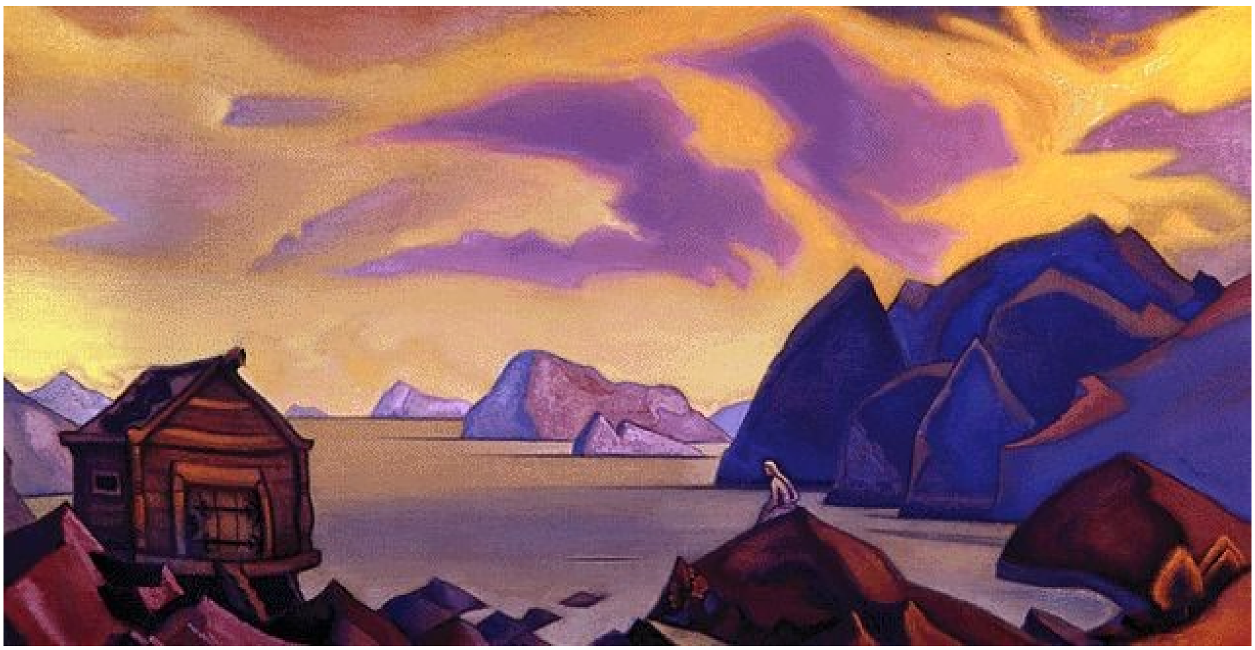
It's hard to know what, if any, effect the elections will have on long-term results, despite the vast quantity of noise generated during political seasons. Looking to the past, it seems that there is no clear lasting market impact, regardless of the winner. The big risks tend to be things beyond the control of the president, such as pandemics, the global financial crisis, the Dot.com bust, etc.

Rather than trying to jump around political events beyond our control, asset allocation should be a balance of benefiting from long-term growth potential, meeting liquidity needs for the next several years, providing resilience to major and minor recessions that periodically come along, and having a risk profile that lets you stick with your strategy no matter what happens in the market.

	Large Cap Stocks	Dividend Stocks	Small Cap Stocks
Dividend Yield	1.3%	3.1%	1.6%
Earnings Yield	4.9%	5.8%	5.8%
Earnings Growth	10.3%	8.0%	15.6%
Return on Equity	17.6%	12.5%	10.2%
% Losing Money	5.6%	6.9%	38.2%

Source: FactSet as of 11/1/2024. Dividend Yield is an estimate based on the weighted average of all companies in the category (by market cap). Earnings Yield, Earnings Growth, and Return on Equity are estimates based on the median profitable company. The % Losing Money statistic represents the percent of stocks with negative earnings in the preceding 12-month period. Large Cap stocks are defined here as the stocks in the S&P 500, according to FactSet. Dividend Stocks are defined here as the stocks within the S&P 500 that pay an above-median dividend yield, according to FactSet. Small Cap stocks are defined here as U.S. stocks ranked 1,001 to 3,000 in market capitalization, according to FactSet.

Artwork



"Waiting" by Nicholas Roerich (1941). Source: WikiArt.org.

Income Investing

Interest Rates	
1yr Treasuries	4.3%
10yr Treasuries	4.3%
10yr TIPS	1.9%
Municipal Bonds (5yr AAA)	2.7%
Corporate Bonds (5yr A)	4.6%
30yr Fixed Rate Mortgages	7.4%

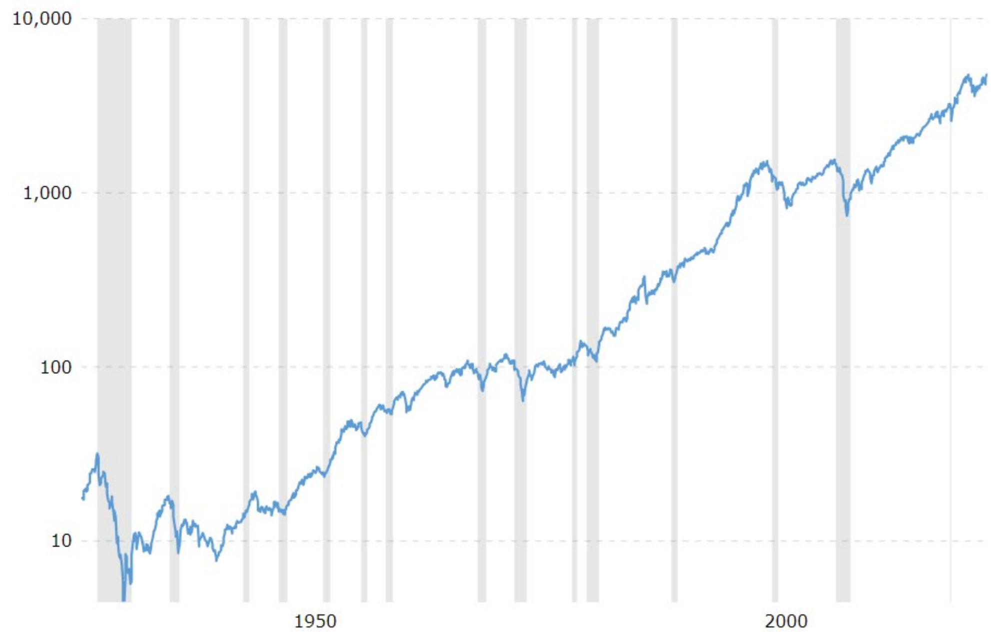
Dividend Yields	
Common Stocks	1.3%
—Top 25%	4.0%
—Next 25%	2.3%
Preferred Stocks	5.9%
Utilities	3.3%
Real Estate (REITs)	3.6%

Source: Interest rates from Raymond James' Weekly Interest Rate Monitor as of 10/28/2024 and The Wall Street Journal as of 11/1/2024. Source for the Dividend Yields is from FactSet as of 11/1/2024. Common Stocks uses the estimated weighted average dividend yield for the S&P 500. The top 25% yield is the median yield of the top quartile of dividend-paying stocks out of the largest 1,000 stocks. The next 25% yield is the median of *the second quartile. Preferred Stocks is the median dividend yield of the 100 largest traded preferred stocks (by dollar volume, per FactSet). REIT and Utilities dividend yields are the median of those sector stocks included in the 1,000 largest common stocks.*

Long-term interest rates have risen on rising inflation concerns. While there has been improvement this year, further improvement will be difficult given ongoing government deficits. I have not yet seen a realistic plan to rein these in, so I would expect ongoing pressure for elevated interest rates. While we've gotten used to low interest rates over the last 20 years, the average long-term rate over the last 100 years has been in the 5-6% range, so we're still somewhat low compared to history.

The Long View

S&P 500, Jan. 1928 to Dec. 2023



Source: MacroTrends.net

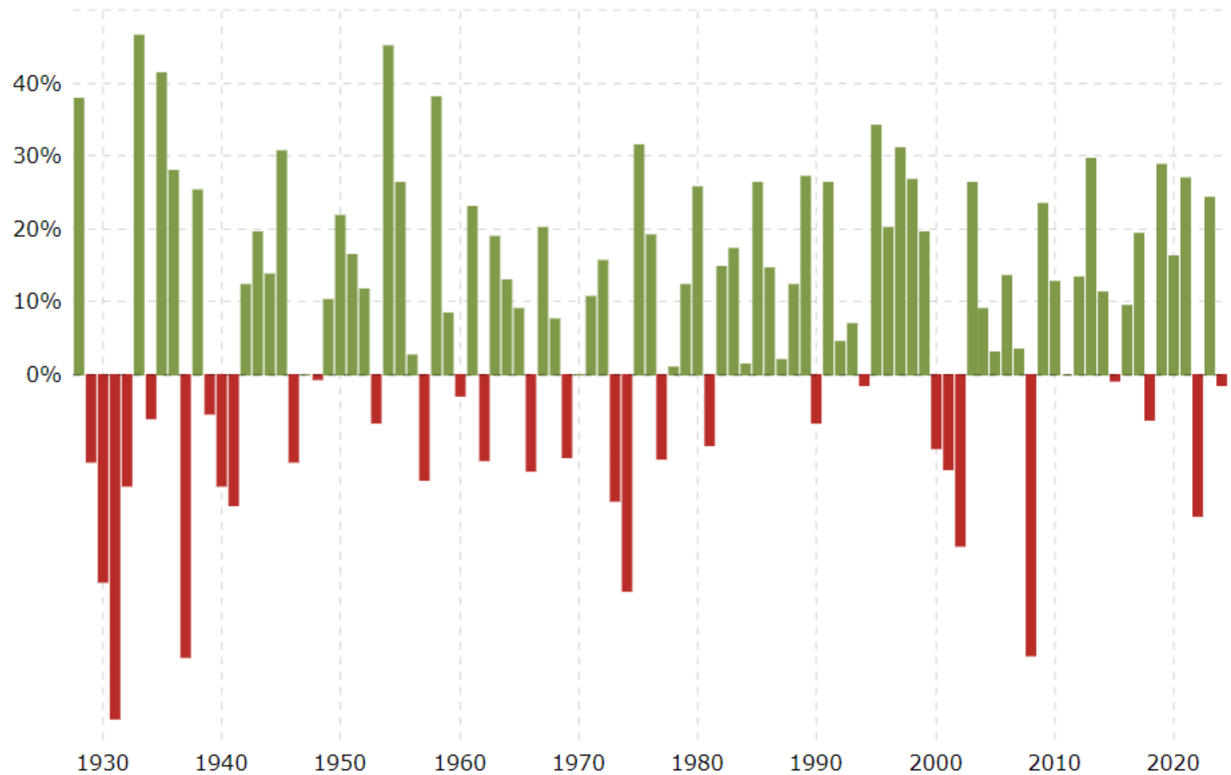
For the last 20, 30, and 100 years, stocks have averaged around an 8-10% annual return, driven by dividend yield, reinvestment of earnings, and earnings growth. Long-term bonds have yielded about 5% on average over the last century while inflation has been about 3%.

Throughout this period, there have been major upheavals, such as the Great Depression, World War II, The Korean War, The Vietnam War, dropping the gold standard, 1970s high inflation, 1987's Black Monday Crash, the Dot.com bust, the 9/11 terror attacks, the Global Financial Crisis, and the Covid Crash, among others.

These events led to severe market downturns about once every decade, with a median price decline of 33% and a median time to recover back to the previous high of 3.5 years. If we were to include dividends, the recovery to previous highs is actually a little faster. *

Meanwhile, a 3% inflation rate results in a 59% decline in the value of a dollar over 30 years. Meaning that people who retire at 60 years old on a fixed income face a high risk of a lower quality of life as they get further into retirement. *

The Price of Market Returns: Significant Volatility



S&P 500 Yearly Returns, 1928 to 2024. Source: MacroTrends.net

** Source: Morningstar Direct via cfainstitute.org, FactSet. Past performance is not necessarily indicative of future performance. Depreciation of the dollar: $1 / (1 + 3%)^30 = $0.41 real value 30 years later.*

Market Outlook

Now I'll put on my "Nostradamus Hat" and make some predictions, for whatever they're worth:

- Inflation will average 2-5% over the next 10 years.
- Interest rates will fall in the 3-6% range for 10yr Treasuries over the next several years, in line with inflation and historical experience.
- The economy will grow 2-3% in real terms over the next several years.
- Stocks will average an 8-10% return over the next 10+ years. After subtracting inflation, this will translate into about a 5% real return, in line with the estimated earnings yield on the S&P 500. There is likely to be at least one big decline every decade or so.

From the standpoint of where you and your family will be in 30 years, none of this matters. What matters is finding good quality investments that are likely to grow over the decades. For this reason, I largely ignore my own general market forecast and invest whenever I find a business that I am confident in and that trades at an attractive valuation.

Help Secure Your Golden Years

I first began managing money in the late 1990s, right when the Dot.com boom was taking off. People who didn't know anything about business were making money buying whatever stock was hyped on TV. Wall Street firms were overflowing with profits by selling stocks to the public they knew were worthless. One notorious analyst earned $12 million a year, while privately putting down the stocks he was promoting.

Then it all came crashing down.

Most of the Internet stocks of that era went bankrupt or lost most of their value. The market went down for three straight years from 2000 to 2002. Millions of investors lost a huge chunk of their retirement savings.

Did people learn the right lessons? Only a few years later, we had the Great Financial Crisis from 2007 to 2009. Again, Wall Street was selling worthless financial instruments. This time it took down the real estate market too. Again, millions of investors lost a large portion of their retirement savings.

We want our clients to hold positions of real value, so we **personally research** all the positions in our strategies and review them regularly.

While it may surprise you, we believe this commitment to personal research and investment management sets us apart from other advisors. The vast majority of advisors outsource research to fund managers or their firm's cookie cutter options.

Instead, we personally research each position to develop the confidence that it is right for you. This commitment to research develops the trust, for us, that all the strategies we recommend are the right ones for our clients, in line with their risk tolerance, time horizon, and future goals. **Your finances are too important for a cookie cutter solution.**

At The Birch Lane Group of Raymond James, we work as a team to provide our clients with personal service, custom financial planning, and investment management tailored to your needs. I specialize in working with business owners, executive compensation issues, retirement planning, and investment management. Donna Colucci also does extensive financial planning, with expertise in life transitions, divorce planning, estate planning, and long-term care insurance. Tricia Jones works tirelessly on client service, trading, and account management.

We are dedicated to helping you achieve financial independence and a comfortable, stress-free retirement.

What Can a Comprehensive Financial Plan Do for You?

Having a well-designed financial plan and investment strategy is important for your financial future. It can help improve your security, confidence, and comfort. It can answer questions like:

- How much will you need to be financially independent?
- Are your assets structured in a tax-efficient manner?
- Does your estate planning protect you and your family from liability, the consequences of unexpected death or illness, and excessive death taxes?
- How will you handle unique circumstances, such as executive compensation, kids' college education, elderly parents, special needs children, and the other elements of life?
- Should you change any savings or investing habits?
- Could you improve your asset allocation or current investment choices?
- What are the odds that you will run out of money if market conditions are poor?
- Do you have a comprehensive risk mitigation strategy to incorporate business and career risk, concentrated wealth risk, market and economic risk, personal and family liability, liquidity needs, debt service, intergenerational risk, and unexpected death or illness?

If you have never had a financial plan run for you or have not reviewed yours recently, we would be happy to create a financial plan and investment strategy for you.

To set up a time, please visit my calendar online at Calendly or email me at Randall.Watsek@RaymondJames.com.

Sincerely,
Randy Watsek

P.S. If you know anyone who might benefit from the information in this letter, please pass it along.

Biography

Randall Watsek and the Birch Lane Group currently maintain or advise on over $250 million in client assets. He has managed money for over 25 years, first as a credit portfolio manager at City National Bank and then as an equity research analyst, sector portfolio manager, and quantitative researcher at DGHM, a quality value boutique managing money for pension funds, endowments, businesses, and high net worth individuals. He leveraged this experience to join Raymond James and advise business owners and executives.

Watsek earned an MBA from the University of Chicago in Analytical Finance and Accounting, and a BA from Claremont McKenna College in Economics and History. He also earned the CHARTERED FINANCIAL ANALYST (CFA®) and CERTIFIED FINANCIAL PLANNER (CFP®) designations.

Watsek has been quoted in a variety of publications on investing and personal finance topics, including *MarketWatch*, the *Wall Street Journal*, *Investor's Business Daily*, *Money Magazine*, the *Arizona Republic*, *ThinkAdvisor*, *The Business Journals*, and *ReThinking65*.

Watsek is the father of two young children and lives in Westchester County, New York.

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The Birch Lane Group of Raymond James

Raymond James held approximately $1.5 trillion in client assets as of 9/30/24, has been profitable for 147 consecutive quarters (since 1988), has equity research coverage of over 1,200 companies, and maintains investment grade credit ratings by Moody's and S&P.

The Birch Lane Group advises clients collectively holding over $250 million in assets. The team consists of:

Donna Colucci, CFP®, Associate Vice President
Tricia Jones, AAMS®, Registered Client Service Associate
Randall Watsek, CFA®, CFP®, CEPA®, Financial Advisor

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If bonds are sold prior to maturity, you may receive more or less than your initial investment. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise. Treasury Inflation-Protected Securities (TIPS) provide protection against inflation by adjusting their principal amount annually based on the Consumer Price Index (CPI) and then paying interest on that new amount. The principal amount is readjusted every year based on the prior year's CPI, meaning it can go down as well as up. There are special risks associated with investing with bonds such as interest rate risk, market risk, call risk, prepayment risk, credit risk, reinvestment risk, and unique tax consequences. To learn more about these risks and the suitability of these bonds for you, please contact our office. 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