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DIVIDEND SCARCITY

The finance magazines and websites tell us "10 Dividend Growth Stocks You Can Count On" (Kiplinger), or "20 Dividend Growth Stocks Blasting Off" (Forbes). There's an annual "Dividend Aristocrats" list of 65 companies, and occasional articles telling retirees that they should buy stocks so they can live off of the dividend checks.

The interesting thing about these clickbait articles is that they don't provide much historical context—and recent history has not been pretty. In 1873, a basket of large-cap stocks (similar to the S&P 500) would have provided you with a 7.47% annual income—that is, you would have gotten roughly 7.5% a year back from whatever amount you invested. The dividend rate peaked at 10.15% in 1917, and has generally hovered between 3.5% and 6% since then, up until around 1990—though mostly around the low end in the 1980s.

Since then, companies, in aggregate, dividend distributions have been much stingier as a percentage of stock prices. This is partly because many companies prefer to reinvest the money they take in from operations to increase their enterprise value and, therefore, the value of their stock.

More recently, reinvesting had also become a tax-efficient strategy for shareholders. Until 2003, dividends were taxed as ordinary income, while stock returns, if the position was held for more than a year, was taxed at lower capital gains rates. But today, qualified dividends (which is most of them) are taxed at a 0% rate for taxpayers earning $40,400 or less (joint filers: $80,800), a 15% rate for individuals earning between $40,400 and $445,850 ($80,800-$501,600 for joint filers), and 20% for singles earning above $445,851 and joint filers earning more than $501,601. The bottom line is that receiving dividends today is actually more tax-efficient than a comparable increase in enterprise value.

Dividends fell into the 2% range since 1990, and, with little fanfare, dropped to a historic low of 1.28% today. Nobody should seriously suggest that a 1.28% income rate on your money is a reasonable way to fund your retirement expenses.

Today's low dividend rate is undoubtedly driven by tax considerations and the need for spare capital in this complicated economic environment—but those are not the main drivers. The low rate is a result of the rapid increase in stock prices over the last couple of years. People today are paying more for their stock shares than they were just a couple of years ago, and much more than they did in March of 2009, when the current bull market began. Buying income is more expensive in both the stock and bond markets today, which is why most financial planners recommend that instead of trying to live off of dividends, or bond yields, or any other single source of income, people create diversified portfolios and take their income from the overall gains—wherever they happen to come from.

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GOVERNMENT-APPROVED INTER-FAMILY LOAN RATES

Logic might tell you that any loans you make to family members would be a personal matter, without requiring the government to get involved. But whenever has the tax code followed logic?

The key issue to remember, with the Internal Revenue Service involvement in family loans, is that the IRS wants to be able to calculate gift taxes against the amount you would ultimately owe in estate taxes when you pass on assets to your heirs. If you were to make a no-interest loan to a son or daughter, the IRS would count the amount of interest you would be foregoing as a gift. If you DO charge interest, the amount of interest would need to be reasonable in the eyes of the government.

What's reasonable? The government monitors interest rate movements in the marketplace, and calculates minimum applicable federal rates (AFR) for loans covering different time periods, posting them on its website. (You can find this month's rates here: https://www.irs.gov/pub/irs-drop/rr-21-16.pdf). If you charge family members or heirs less than this rate, then the government would calculate the difference, and that would be counted as a gift to the family member to whom you made the loan.

These rates are pretty low: a short-term AFR (up to 3 years) in September 2021 is 0.17%; the AFR on loans of 3-9 years is 0.86%, and anything over 9 years would have a rate of 1.71% to 1.73%, depending on whether the interest is being paid back yearly, quarterly or monthly.

Note that these rules don't apply to loans of less than $10,000 that are not used to purchase income-producing property. And if you don't want to go through the hassle of charging interest, you could always calculate (or have a professional calculate) the implied interest payments, and then offset that amount with your $15,000 annual gift exemption to the borrower. But even then, it's a good idea to document the terms and stated interest rate in case the IRS ever decides to come back and do an audit.

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WILL SOCIAL SECURITY GO BUST?

You may have read that the Social Security Trust Fund is due to be depleted in 2033, a year earlier than previous projections. This sounds alarming, except for several caveats.

First, the projected date of depletion has been in the 2035 range for the past decade, so this shift is really nothing new—or particularly alarming. The immediate cause of the shortened timeline is, of course, the slowdown of economic activity due to Covid. The Social Security Trust Fund collects payments out of the wages of millions of American workers; when those workers are laid off or otherwise unable to collect paychecks, then the Trust Fund is unable to collect its share of those paychecks.

In its annual report, the Social Security Administration says that it is projecting that employment and wages will gradually rise to full recovery by 2023, but that the level of worker productivity and U.S. Gross Domestic Produce will be permanently lowered by 1%. That permanent decline is not a consensus view of economists, and should be viewed with caution. In addition, the report projects that there will be a higher mortality for persons aged 15 and older through 2023—meaning, once again, fewer workers collecting paychecks. But the Covid mortality figures are much lower for working individuals and much higher for the people who would actually be collecting old age benefits—and there is no provision in the report accounting for the death of more than 200,000 Americans who were collecting Social Security checks.

In actual fact, the report notes that the trust fund's reserves, at $2.9 trillion, were actually $11 billion *higher* this year than they had been the previous year—and the pool that pays out retirement income increased by $7.4 billion. A chart shows that the Old Age and Survivor Insurance pool took in $968.3 billion in 2020 and paid out just $961 billion. The gloomy projection reported in the press is based on "less revenue anticipated in the near term," meaning, once again, those projections of permanently lower economic activity, and the death of many more workers, due to Covid.

Of course, most people—including reporters—don't understand how the Trust Fund actually works. The Social Security system collects its revenues from those worker paychecks (and employer matches), and then turns around and pays that money out to Social Security beneficiaries. The trust fund currently, as mentioned, has $2.9 trillion in assets—much of it in government securities. That pool of money pays out any annual shortfall between the amounts collected and the benefits—and the fact that it increased this past year suggests that it didn't have to reach into its pocket, at all, for the past 12 months.

If and when the Trust Fund *does* run out of money, the Social Security Administration would simply pay out the monies collected without a supplement—and if nothing is done by 2033, that is projected to be 78% of the benefits paid out today—remembering, of course, that it was enough to pay out 100% in the past year. The important thing to note is that 78% is not zero; it's more than three-quarters of the expected benefits. And of course, once again, this is based on a lot of assumptions, including the idea that few Americans will continue working after they receive their benefits, that the economy will never fully recover from Covid, and that pandemic mortality will be evenly distributed between the young and the old.

Finally, does anybody really think that Congress would allow the cohort of voters currently receiving Social Security benefits to take a sudden 22% haircut in that portion of their retirement income? 69.1 million people currently receive benefits, and one can guess that many of them are motivated voters. Expect some age/benefit tweaks, and some higher payroll taxes, long before you see any reductions in the Social Security income received by elderly Americans.

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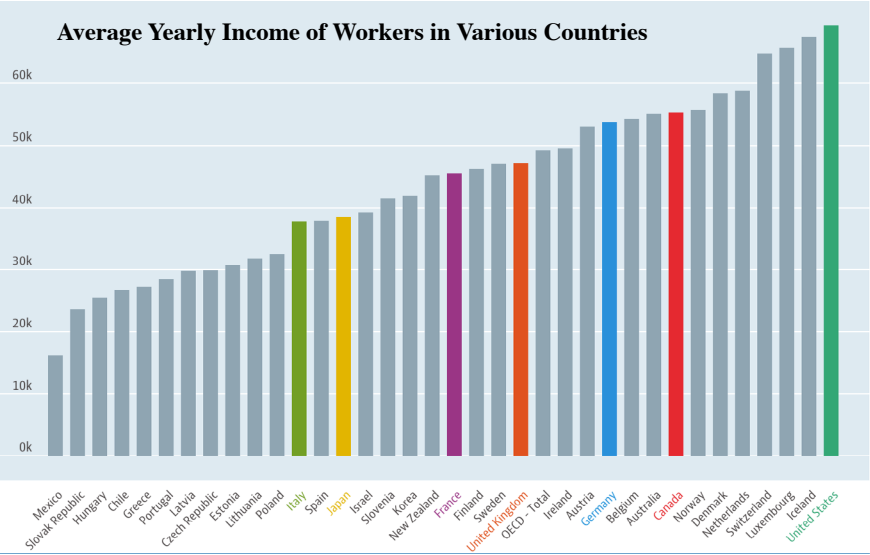
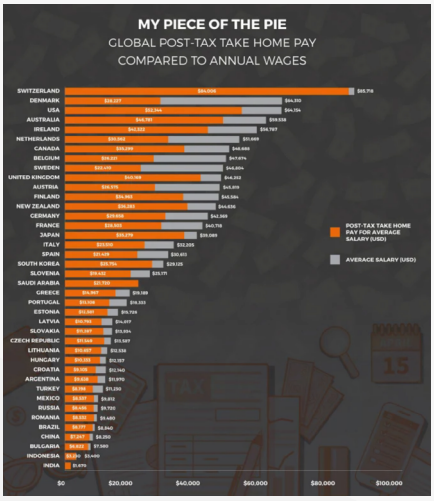
WORKER PROSPERITY IN THE U.S. AND ABROAD

Which countries have the most prosperous workers in the world? Where do companies pay the highest salaries? It depends on how you look at the numbers.

One way is to take the total wage bill in each country and divide it by the number of employees in the total economy. That gives you the attached chart, which shows that the U.S. leading the world, with average salaries in the $70,000 range.

The trouble with that statistic is that it includes minimum wage Americans who earn a few tens of thousands of dollars a year, and American CEOs, who are vastly overpaid compared with their counterparts pretty much everywhere else. (salary.com lists the median CEO salary as $777,000, and other top executives in Corporate America are similarly compensated.) America is the only country in the world where the average company's chief executive is paid 351 times as much as the typical worker.





Another way to look at comparative salaries is to calculate the average post-tax take-home pay in different countries. By this measure, Switzerland comes out on top, with an average salary of $85,718 and, because of a minuscule tax bite, an average take-home income of $84,006. The U.S. ranks second in take-home pay ($52,344), ahead of Australia ($46,781) and Ireland ($42,322). As you can see from the chart, the people in Denmark, Sweden and the Netherlands all pay half their salary in one kind of tax or another.

But once again, this is averaging in the rich and the poor, which skews the American numbers because the disparity is so high. What if, instead, we look at the median income—where, if we put everybody's annual salary in a long list, we select the wage-earner in the exact center? Wouldn't that be a fairer assessment of each country's prosperity?

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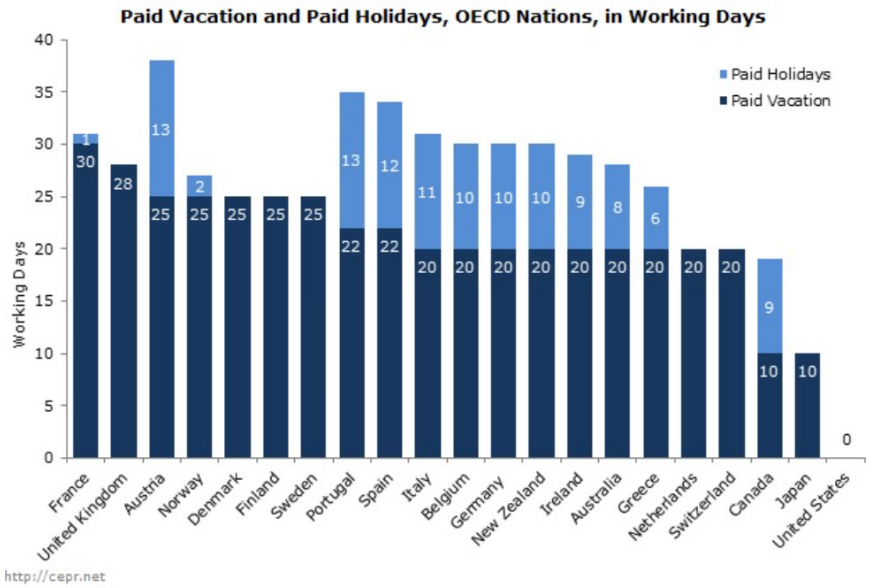
By this measure, Luxembourg leads the world, with a median income of $52,493, followed by Norway's $51,489, Sweden's $50,514 and Australia's $45,555. The United States comes in sixth in the ranking ($43,585), right behind Denmark ($44,360) and one notch above Canada ($41,280). South Korea ($40,861), Kuwait ($40,854) and the Netherlands ($39,584) round out the top ten. At the other end of the list, the median Mexican worker earns just $2,900 a year, below Lebanon, Serbia, Iran, Montenegro and Ukraine. (The average of all the global medians is $8,575 a year.)

Is there anything missing from this picture? Americans are among the highest paid workers in the world, but they also tend to work longer hours and get less time off from their jobs than workers in other nations. Based on statistics compiled by the International Labour Organization, the typical American wage earner will work 137 more hours per year than Japanese workers, 260 more hours per year than British workers, and 499 more hours per year than their French counterparts. And the U.S. remains the only industrialized country in the world that has no legally-mandated paid annual leave or paid parental leave benefits. Workers in most countries get at least 20 paid vacations (30 in France and Finland). A recent graph shows the disparity between U.S. policy toward taking paid time off vs. other developed nations.



So you could argue, with statistics to back you up, that America is the most prosperous—or at least one of the most prosperous—nations on the planet. But you also might discover that workers in other countries, despite lower median salaries, wouldn't volunteer to trade places.

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2021 THIRD QUARTER INVESTMENT MARKET REPORT

The string continues. The U.S. markets managed to eke out a sixth consecutive quarterly gain in the third quarter of the year, although most of the indices were down in the month of September. At the end of the quarter, stock investors were sitting on above-average gains and still, probably, feeling a bit uncertain about the future.

The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—eked out a 0.14% positive return in the third quarter, and is currently sitting on 15.62% gains since January 1. The comparable Russell 3000 index is up 14.99% for the first nine months of the year.

Looking at large cap stocks, the Wilshire U.S. Large Cap index gained 0.47% in value in the recent quarter, and is now up 15.52% for the first nine months of 2021. The Russell 1000 large-cap index is holding onto a 15.19% gain, while the widely-quoted S&P 500 index of large company stocks rose 0.58% in the third quarter, to post a 15.92% return so far this year.

Meanwhile, the Wilshire U.S. Mid Cap index gained 0.76% in the quarter, for a 16.52% gain so far this year. The Russell Midcap Index is up 15.17% in calendar 2021.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies experienced a 1.72% loss in the third quarter, which brings the index's total return down to a still-positive 14.65% for the year. The comparable Russell 2000 Small-Cap Index is up 15.22% in the year's first three quarters. The technology-heavy Nasdaq Composite Index lost 0.38% in the third quarter, and is still up 12.11% for the first nine months of the year.

International investors experienced mild losses over the third quarter. The broad-based EAFE index of companies in developed foreign economies was down 1.03% in the third quarter, but is still sitting on a 6.23% gain for the first nine months of the year. In aggregate, European stocks were down 1.94% for the quarter, but are still up 8.93% so far this year, while EAFE's Far East Index has returned 3.46% this year. Of the developed nations, only a small handful of countries are showing losses: New Zealand (down 7.63% in 2021), Korea (down 4.51%) and Hong Kong (down 1.81%). The strong yearly U.S. returns are beaten only by the lucky investors in the Austrian market (up 21.38%), Singapore (up 20.09%) and the Netherlands (up 24.33%).

Emerging market stocks of less developed countries, as represented by the EAFE EM index, suffered near double-digit losses in the third quarter, down 8.84% in dollar terms, but are down just 2.95% for the year. In that sector, the standout returns are coming from the Czech Republic (up 36.25% so far this year), Russia (up 32.91%), Saudi Arabia (up 37.54%) and the United Arab Emirates (up 35.89%).

Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted a 1.64% gain during the year's third quarter, and is up 24.79% since January 1. The S&P GSCI index, which measures commodities returns, gained 5.22% in the third quarter, largely due to rises in oil and energy prices, and is now up a remarkable 38.27% for the year. Gold prices are down 7.92% for the first nine months of 2021.

In the bond markets, 10-year Treasury bonds are yielding 1.48%, and there has been a small incremental yield gain in 30-year Treasuries, to a 2.06% annual yield. Overall, however, rates remain historically low; 3 month, 6-month and 12 month Treasuries are still sporting barely positive yields. Five-year municipal bonds are yielding, on average, 0.55% a year, while 30-year munis are returning just 1.73% on average.

Few are celebrating the sixth consecutive quarters of gains, perhaps because the month of September saw the first monthly decline since January, with a 4.8% downturn in the S&P 500 index. The Nasdaq market was down 5.4% as well. Of course, this has brought out a lot of gloomy forecasts from analysts who always seem to project recent market performance out into the future when, in fact, each new day, month and year brings a new surprise.

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There's a lot of noise right now for analysts to consider. Last June and July, there were inflation fears, as supply chain issues and the lingering effects of the pandemic (how many waves have we experienced now?) drove inflation to levels not seen in decades. But then, over the last couple of months, inflation has moderated, which some say has vindicated the assessments by the Federal Reserve that the recent bout of inflation was 'transitory.' We'll see.

Meanwhile, corporate earnings are showing reasonable growth during a time of economic uncertainty, and the most recent Institute for Supply Management's manufacturing index showed a greater-than-expected expansion in September despite widespread materials shortages. Personal income for American workers rose 1.1% in July and 0.2% in August, which is considered bullish for spending--and, indeed, personal spending rose 0.8% in August, which should bode well for economic growth. And, of course, there is the massive infrastructure spending bill working its way through Congress, which could have the effect, if passed, of boosting a number of economic sectors.

But at the same time, Congress is deliberating over increasing the top marginal corporate tax rate from 21% to 28% and the bill would also allow the IRS to collect taxes on U.S.-based corporations' foreign earnings, which will diminish after-tax profits by some as-yet-unmeasurable amount. And companies (and consumers) are having to deal with oil prices that are up about 80% over the past year. The market is leveraged with roughly $1 trillion in margin debt at the moment, and the federal deficit, however one might measure it, has never been higher.

The point here is that there have always been reasons to be optimistic and pessimistic about market returns, and articles that tell you to buy or sell--we call them 'clickbait'--will always be trying to grab your attention. The only thing we can know for sure is that the markets have always eventually reached new highs, through the Great Depression, through two world wars and many global skirmishes, through Presidential impeachments, political uncertainty, double-digit inflation and the most serious global pandemic in a hundred years. None of us know what's coming next in the short term, but we do know that every day, as millions of people put their efforts into their respective companies, the economy and its component corporations incrementally gain value--slowly, steadily, and with a persistent trajectory that is easy to overlook during the temporary up and down swings in the stock market indices.

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