Second Quarter 2021

GALECKI FINANCIAL MANAGEMENT — FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	4.38%	6.17%	6.17%
Russell Midcap Index	2.71%	8.14%	8.14%
Russell 2000 Index	1.00%	12.70%	12.70%
Dow Jones Industrial Average	3.76%	6.06%	6.06%
Morgan Stanley EAFE Index	2.30%	3.48%	3.48%
DJ US Real Estate Index	5.67%	7.70%	7.70%
S&P Commodity Index	1.58%	16.74%	16.74%
Barclays Aggregate Bond Index	-1.25%	-3.37%	-3.37%

INDEX RETURNS

Stocks rose in the first quarter as investors looked forward to an economic recovery. The S&P 500 increased 6.17% in the first quarter after a strong showing last year. Value stocks outpaced growth stocks by a wide margin. The S&P 500 Value index rose more than 10% while the S&P 500 Growth index was only up around 2%. The Russell Mid-cap index was up 8.14% in the quarter while the Russell 2000 index rose 12.7%.

International stocks also advanced in the first three months. The MSCI EAFE Index was up 3.48% in the quarter led by an 11% return in the Netherlands. Emerging Market stocks rose by 2.29% in the first quarter led by Taiwan and Chile advancing 10% and 14% respectively.

Bond markets declined aggressively from fears of potentially higher inflation sparked by historic stimulus measures in the U.S. The Barclays Aggregate Bond index dropped 3.37% in the first three months which is a major move. Global bonds declined 5.28% in the quarter on similar fears.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy increased by a 4.0% annualized rate in the fourth quarter of 2020. Early estimates for the first quarter are in the 3-4% range. Economic activity is picking up at an impressive pace both domestically and globally. Consumers are feeling more confident as vaccinations are becoming more available. It is now estimated that 55% of Americans have either been vaccinated or already exposed to COVID-19. This number will approach 75% by the end of June, which puts us in the “Herd Immunity” zone.

Consumer debit/credit transactions are up 13% from 2 years ago, which shows overall growth. The Leading Economic Index was up 0.2% in February to 110.5. This follows the 0.5% increase in January and the 0.4%

increase in December. Industrial Production fell 2.2% in February due to harsh winter conditions. The Capacity Utilization rate (which measures how much slack is in the economy) was at 73.8 percent in February which is 5.8% below the long-term average.

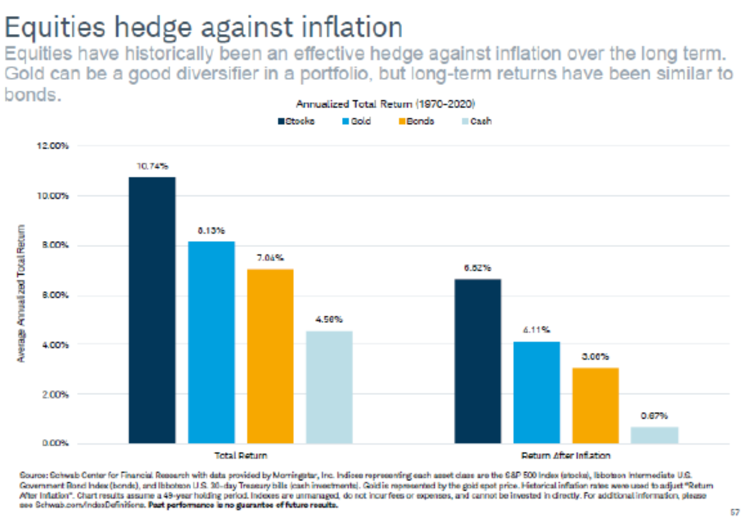
Non-farm payrolls rose by 916,000 in March. The unemployment rate declined to 6.0%. This is down 8.8% from the high in April of last year. Initial weekly unemployment claims were 744,000 for the week ending April 3, 2021. The four-week moving average was revised up by about 2,250. There were 7.4 million job openings at the end of February. This was the highest number in the last two years for the series.

Manufacturing increased to 64.7% on the ISM PMI index in March. This was an increase of 3.9% from February. The New Orders Index came in at 68% which was an increase of 3.2% from January. The ISM Services index was at 63.7% in March which was an all-time high and an 8.4% increase from February. This marks the 10th straight month of growth for the services sector. The Business Activity Index came in at 69.4%. This suggests significant economic activity will continue over the next few months as demand is strong.

Global economies also experienced stronger activity. The JPM Global Manufacturing PMI was at 54.8 in March which is up from 53.2 in February. This marks the eighth straight month of expansion and the index is at a 36-month high. The European zone saw a big improvement from 48.8 to 53.2. Germany led the surge with a 57.3 reading and the UK added a 56.4 reading. India came in at 56 and Russia was at 54.6.

EQUITY AND BOND MARKETS

Equities continued their run in the first quarter with the S&P 500 advancing more than 6%. We did see a major style shift as value outperformed growth by a wide margin. It will be interesting to see if this trend continues for the remainder of the year. Meanwhile, a new $1.9 trillion stimulus package was passed in March. This follows the $2 trillion package from April of 2020 and the $900 billion package in December of 2020. This is nearly $5 trillion of capital being infused into the economy. While the additional capital is benefitting many in the moment, there is a lingering question of whether this will trigger an inflation problem.



Most economists believe that it is too early to determine how much inflation we will see, and for how long. Many believe it will be short-lived. However, it is important to know that stocks have historically been the best hedge against inflation. Over the last 50 years (above chart), stocks have returned a 6.6% rate of return above inflation. Gold has outpaced inflation by 4.1% and bonds beat it by 3.06%. Cash historically has a difficult time outpacing inflation. So, as we think about how to invest a portfolio in an inflationary environment, it is critical to maintain proper equity exposure to retain as much buying power as possible.

Recent investor sentiment polls are showing extreme optimism according to Ned Davis Research. When this has occurred in the past, short-term equity returns have not been all that exciting. These levels have typically marked short-term tops in the market. With the P/E ratio of the S&P 500 around 22 times earnings, we could be in for a near-term correction. However, these things are difficult to time and we do not recommend trying to do so.

International equities appear extremely attractive at these levels. The ACWI ex-US index has a P/E ratio of only 16.4 times earnings which is roughly 23% cheaper than U.S. equities. The dividend yield is also above 2.7%. Domestic stocks have outperformed international stocks for the last 13 years. However, history would suggest that we will enter a period when international equities outperform for an extended period. It will be important to maintain proper international exposure to take advantage of this opportunity.

Bonds may continue to struggle over the next few years as the Federal Reserve begins to raise rates. However, bonds still play an important role in a diversified portfolio and should not be overlooked.

PORTFOLIO MANAGEMENT

The Investment Committee continues to make minor changes in the asset allocation. The Innovator buffered ETFs have been removed to accommodate bigger equity moves. We have added some American Funds balanced funds to all portfolios to increase diversification and hopefully increase returns. Many clients have significant gains that we are trying to manage around. However, if taxes on capital gains do indeed lose their favorable lower tax status with the new proposal (more on this below), then this would be a good year to take the gains.

International returns continued to drag down the portfolio in the first quarter. The Investment Committee believes that maintaining exposure to international holdings is still prudent and will be rewarded at some point. It is possible that domestic returns continue their run in 2021 followed by a shift to international returns in 2022.

The bond market experienced significant volatility in the first quarter with the Barclays Aggregate bond index dropping more than 3%. It is likely that this will continue for the remainder of the year. We believe high yield bonds, convertible bonds, and global bonds will all benefit from the current economic environment this year, so we are maintaining our allocation. We also have a nice exposure to our market neutral fund which has done quite well.

FINANCIAL PLANNING

Dominating the financial planning landscape so far in 2021 has been the possibility of changes to tax laws. At this time, no definitive plans to increase taxes on individuals have been introduced. President Biden recently unveiled an infrastructure and climate proposal that included an increase in tax rates on corporations. The plan calls to raise the corporate tax rate from 21% to 28%. In 2017, the corporate tax rate was 35%.

Even though everything is still speculative at this time, we did want to review the individual tax changes that are getting significant media attention and were a focus during President Biden’s campaign.

- **Estate Tax Laws –** Currently, individuals can pass $11.7 million to the next generation without paying estate taxes out-of-pocket. This doubles to $23.4 million for married couples. There has been talk of this threshold being lowered. In 2017, the limit was $5.49 million per individual, $10.98 million per couple.

- **Capital Gains Taxes –** The top capital gains tax rate is 20% for individuals with income above $445,850 and married couples with income above $501,600. There is some support in Washington to change the capital gains rate to ordinary income tax rates for taxpayers making more than $1.0 million per year. The top ordinary income tax rate is currently 37%.

- **Cost Basis Step-Up at Death –** Upon a taxpayer's death, assets held outside of a tax-deferred investment vehicle receive an update in the cost basis based on the value of the asset on the date of death. For example: an 85-year-old has held shares of XYZ company for 50 years. The cost basis is $0 as it was gifted from an employer. The heirs receive the XYZ stock with the basis adjusted to the stock price on the date of death. The heirs sell the stock with minimal income tax consequences. Another common scenario is a primary residence purchased years ago in an area of the country that has seen rapid real estate appreciation.

  Instead of adjusting the estate law as we discussed above, changing the cost basis step-up rules could generate additional revenue for the government and has gained ground in recent months. However, this is becoming less likely as administratively it would become much more difficult and time consuming to settle estates.

If you have questions on how potential tax law changes may impact your financial situation, please reach out to your Fee-Only Financial Planner or accounting professional.

Company News

Greg Galecki started the business that became Galecki Financial Management in August 1990. Over the last 30+ years, Greg became a leader in the financial planning industry, a radio personality (on a show that lends our newsletter its name!), and grew GFM into the Fee-Only Wealth Management firm it is today.

Greg was one of the first advisors in the State of Indiana to adopt the Fee-Only approach as opposed to commission-based compensation. That mentality of always putting the best interests of our clients ahead of our own, has been ingrained into every advisor, employee, and intern that has walked through our doors over the years. Under Greg's leadership, GFM has grown to have the strong reputation it has today.

With that we announce that Greg will be retiring at the end of 2021.

Throughout Greg's time growing GFM, he always made the succession of GFM a priority. He brought on a team of other Financial Planners to not only help grow the firm, but ensure that his clients would be taken care of well after his retirement.

Today GFM has grown to include six other Financial Planners and Shareholders aside from Greg: AT Kohout, Brady McArdle, Melanie Colwell, Kevin Chandler, Andy Young, and Chloe Blythe. AT became a shareholder in 2006, Brady and Melanie in 2011, and Kevin, Andy, and Chloe in 2019. As of January 1, 2022, the remaining six shareholders will be taking the reigns as full owners of the business.

There is no one quite like Greg Galecki. His leadership, knowledge, humor, and world-class metaphors are one-of-kind. We are thrilled for Greg as he transitions to this next stage of his life but will of course miss his quick wit around the office.

AT, Brady, Melanie, Kevin, Andy, and Chloe are all looking forward to carrying the mission and core values that Greg instilled in us for years to come. We will continue growing the legacy and story of Galecki Financial Management for another 30+ years.

- Galecki Financial Management Investment Committee

Special Note: If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com