CARLSON
CAPITAL MANAGEMENT

QUARTERLY
Newsletter

JULY 2021

# *Let's Talk About Inflation*

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Headlines are crafted with a goal of grabbing your attention. They are designed to get you to buy, click, or react. And they often do this not by focusing on topics that engage the areas of your brain responsible for logic and reason, but rather the more primal elements of greed and fear. Even armed with that knowledge, their siren song is hard to resist.

Take for example the widely discussed financial topic of the moment—inflation. Reading headlines like, "The Specter of Inflation"[1] or "Inflation: A high price to pay"[2] or "Get Ready for Inflation and Higher Interest Rates: The unprecedented expansion of the money supply could make the '70s look benign"[3] are sure to make you feel uneasy and question how you're prepared for the "inevitable."

Reading further into the story that follows the last headline, written by a prominent economist and published in *The Wall Street Journal*, we see, "It's difficult to estimate the magnitude of the inflationary and interest-rate consequences of the Fed's actions … To date what's happened is potentially far more inflationary than were the monetary policies of the 1970s, when the prime interest rate peaked at 21.5% and inflation peaked in the low double digits."[3] With such a strongly worded argument penned by an expert, how could you not raise up and want to take action to either protect yourself or try to take advantage of the impending disruption? Do your feelings change to know that the first two headlines are from 2011, and the last headline is from June 2009, and that monthly inflation numbers over the past 12 years average an annualized 1.7%[4]?

## TODAY'S INFLATION FEARS

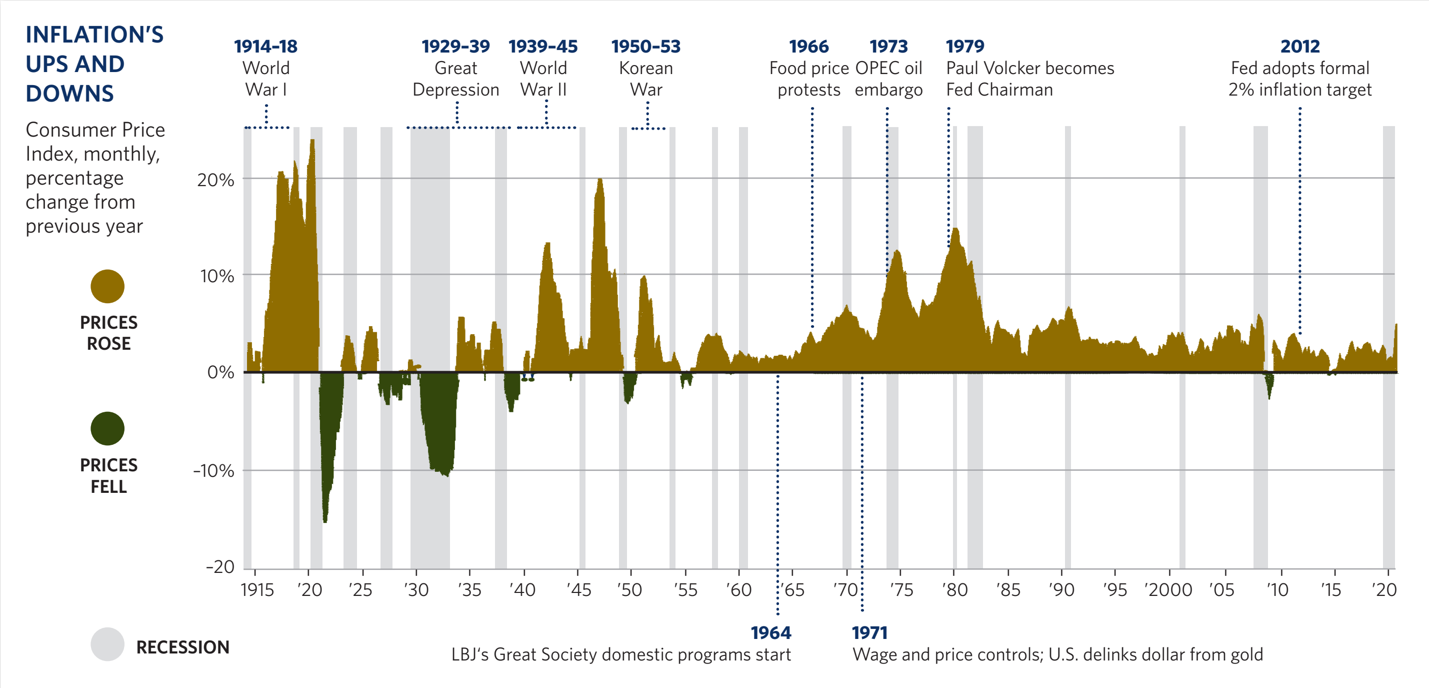
The fear of hyperinflation coming out of the global financial crisis was omnipresent for years due to the unprecedented actions taken by the government and Federal Reserve to keep the banking sector and economy from further collapse. The story of today's fear is very similar. Trillions of dollars in pandemic relief have entered the market, and the concern is that prices will have to rise. Some of these fears are being stoked by actual price increases, though it's too soon to say whether these spikes will be transitory in nature due to short term supply chain disruption and lack of production or potentially more permanently elevated prices.

So, why were the economists and inflation hawks warning us of peril in 2009 so wrong? And in that context, how should the current inflationary fears be viewed? The short answer is that accurately predicting future inflation is nearly impossible. And those lucky few who may get it right in one instance are unlikely to get it right the next time.

Even in hindsight, economists often come to different conclusions on what caused, or didn't cause, inflation to spike over time. The challenge with predicting the future is that it's always different than the past, and, therefore, building models and applying the lessons of the past to future scenarios may lead us to draw incorrect conclusions about cause and effect.

*Continued on page 2*

[1] *https://www.independent.org/news/article.asp?id=2973*
[2] *https://www.ft.com/content/f12c2178-1cef-11e0-8c86-00144feab49a*
[3] *https://www.wsj.com/articles/SB124458888993599879*
[4] FRED Economic Data – Federal Reserve Bank of St Louis




*Data represents past performance. Past performance is no guarantee of future results. Chart is for illustrative purposes only.*
*Source: U.S. Bureau of Labor Statistics; https://www.wsj.com/articles/when-americans-took-to-the-streets-over-inflation-11623412801*

## A BRIEF HISTORY OF INFLATION

When looking back over our relatively short economic history, we see wildly different experiences in inflation in the first 70 years compared to the past 35. This may lead some to conclude that we're due for an inflationary spike. It may cause others to conclude that the earlier period isn't helpful for today's globally connected world. The most dramatic inflationary spikes that we see in the chart above are related to production and supply shortages during world wars and economic growth that occurred when the dust settled on these dark periods—events that we cannot plan for in structuring investments within a long-term portfolio. The prolonged inflationary period of the 1970s and early 1980s included markets processing the delinking of the U.S. dollar from the gold standard and energy shortages stemming from the OPEC oil embargo—events that may not pose a risk to repeat in the future. Additionally, the Federal Reserve is very different today than it was in these periods. In the past 20 years, there has been a clear demonstration of an increased role of the Fed to support economic growth. Depending on your point of view, this may be a good thing or a bad thing, but we shouldn't expect a return to a hands-off Fed any time soon.

## STRATEGIES TO PROTECT FROM INFLATION

So, with all that said, what can we do about inflation if it does rear its ugly head? One of the first thoughts that people often have is to include gold in their portfolio to protect against a potential decline in the value of the U.S. dollar during inflationary periods. This conclusion is typically supported by the experience of the price of gold during the inflation of the 1970s, during which gold far outpaced the rate of inflation and other traditional hedges. However, when we play that story forward, we see that gold has not kept up with inflation since its highs of 1980, and it has had decades-long periods in which it lost value.

In a similar and more modern theme, Bitcoin and other cryptocurrencies have been referred to as "digital gold." But beware, they continue to be extremely volatile, with daily price movements that can dwarf a decade's worth of inflation. Additionally, although accessing many cryptocurrencies is becoming easier with some custodial platforms allowing them to be bought and sold directly or though intermediary vehicles, the implicit and explicit fees associated with these trades can be many percentage points of the traded value.

Given that inflation is a measure of the price change of goods and services, buying the raw components of the "goods" through a basket of commodities should certainly be an inflation hedge, right? Sadly, no. There are many challenges with commodities if you're trying to hedge against inflation. One is that they don't cover the services side of inflation well, and with our economy and many expenses tied to this half of the equation, we may not actually be tracking experienced inflation. A second challenge is easy to see when reviewing their returns of over the past 15 years—a time in which a broad basket of commodities lost value half the time and ended with a return of -4% per year with volatility higher than the S&P 500, which gained 9.9% per year.[5] And although this year has been a great time to invest in commodities like oil, steel, and timber due to massive price increases from pandemic-related supply chain shortages and a reopening of our economy, we have already started to see some prices fall sharply, with lumber down well over 50% from highs.[6]

Treasury inflation protected securities are bonds that have a built in inflationary adjustment and should be a great way to track inflation, which is true, but the challenge with these is that the market mechanism for which inflationary expectations get priced in have been shown to be less accurate in the short term than assuming that inflation stays constant year over year.[7]

*Continued on page 4*

[5] JP Morgan Guide to the Markets, June 30, 2021
[6] *https://tradingeconomics.com/commodity/lumber*
[7] *https://www.frbsf.org/economic-research/publications/economic-letter/2015/september/market-based-inflation-forecasting-and-alternative-methods/*

# *Have You Considered the Future of Your Family Cabin?*

JASON KLEY, CFP®, AIF®, MBA, DIRECTOR OF FINANCIAL PLANNING & SENIOR INTEGRATED WEALTH ADVISOR

Cabin season is here! It is the time of year when roads fill up on Fridays and Sundays as people trek to and from cabin getaways. Some of my fondest memories growing up were spending time at my aunt and uncle's cabin navigating the boat with my grandpa and cousin for the hot fishing spots. The fish tales made their way to the eulogy I gave for my grandpa a few years ago. When my kids were younger, my wife and I would rent a cabin every year over the Fourth of July. After a brief hiatus to explore other parts of the country, this year we resumed renting a cabin to create the same types of memories for our kids that we had growing up.

Whether you call it a cabin, cottage, or second home, it's not just an asset, but rather a box full of memories. This can add complexity when deciding how to transfer ownership of the cabin due to death, disability, or simply having the memory box at capacity.

The first step in considering the transfer of cabin ownership is to have a family conversation to determine whether anyone is interested in keeping the cabin within the family. If a child is interested, is that child willing to own the property instead of some other inheritance? Is the interested child in a position to pay ongoing expenses and provide maintenance for the cabin? If multiple children are interested, do the siblings get along and could they be co-owners of the cabin? The sooner these questions are addressed, the more time there will be to put a plan into place.

Once you decide upon future ownership of the cabin, there are numerous strategies that can be implemented depending on your desires:

**Outright Gift or Sale:** Transfer the title of the cabin through a gift or sale.

**Limited Liability Company:** Transfer partial ownership over time and create a maintenance fund for the recipient of the cabin.

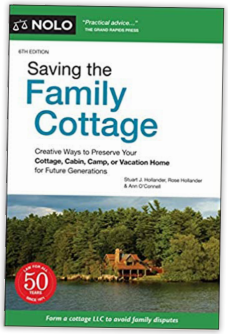
**Revocable Trust or Transfer on Death (TOD) Deed:** Facilitate the transfer upon death to avoid probate for the cabin.

**Irrevocable Trust:** Transfer the cabin outside of your estate, which may force you to "pay rent" for usage of the cabin in exchange for potentially saving on estate taxes.

All of these scenarios could have various tax implications for you. If you are contemplating transferring ownership of a cabin, it is important to also integrate it with your overall estate plan. With potential changes for estate taxes and capital gains taxes on the horizon, a cabin may be a good asset to shift out of your estate for future generations to continue creating lasting memories.

Please contact your CCM advisor should you have additional questions about cabin ownership and your overall wealth transfer strategy.

INTERESTED IN READING MORE ON THIS TOPIC? Look for the sixth edition of *Saving the Family Cottage* by Stuart J. Hollander, Attorney, Rose Hollander, and Ann O'Connell, Attorney, at your local library or bookstore.



# *Do You Qualify for a* MEGA BACKDOOR ROTH?

KEVIN KOSKI, CPA, PRINCIPAL TAX ADVISOR

Roth accounts play a very important role in creating a tax-diversified retirement savings strategy, providing tax-free income during retirement. Because Roth accounts are funded with after-tax contributions, they grow completely free of income taxes. As a result, we work with many clients to maximize the amount accumulated within Roth accounts under the principle that accumulating as much money in Roth accounts as soon as possible allows for the most tax-free growth.

The most common strategies for Roth accumulation include making annual contributions to Roth IRA and Roth 401(k) accounts and strategically converting funds from Traditional IRA accounts to Roth IRA accounts as opportunities arise from a tax-planning standpoint. A mega backdoor Roth is an additional strategy that is available to some.

A mega backdoor Roth allows you to save up to an additional $38,500 into a Roth account in 2021 through your employer-sponsored 401(k) plan. This amount is in addition to the $19,500 ($26,000 if age 50 or older) that you can contribute to the Roth 401(k) or Traditional 401(k), resulting in a maximum total contribution of $58,000 ($64,500 if age 50 or older). This amount would be in addition to the $6,000 ($7,000 if age 50 or older) you may contribute to a Roth IRA account annually either directly or as a backdoor contribution.

Here is what you need to know to determine if you qualify:

- Are you making the maximum contribution to your Roth 401(k) or Traditional 401(k) and the maximum contribution to your Roth IRA either directly or as a backdoor contribution and still have the capacity to save more?
- Does your employer's 401(k) plan allow for after-tax contributions to be made to the plan?
- Does your employer's 401(k) plan allow for in-service distributions from the after-tax account, which would allow you to convert funds from the after-tax account to the Roth 401(k) account?

If you can answer "yes" to all three questions, you are in an ideal position to implement a mega backdoor Roth strategy and maximize the tax-free growth of your income. The next step is to explore the specific details and rules of your employer's 401(k) plan to determine the appropriate actions steps to put the strategy in place. Please reach out to your CCM advisor, and we will work through these details with you.

LET'S TALK ABOUT INFLATION *continued from page 2*

### OUR VIEW ON THE BEST WAY

So what does work? Our view is that owning stocks is the best way to tap into global growth and be a part of the economic engine that participates in increasing prices of goods and services. Stocks are not an inflationary hedge, rather they outperform inflation over time, allowing your wealth to increase in purchasing power.

Shorter term government bonds have historically been a reliable hedge against inflation. They're not an exciting story with incredible upside, but they offer principal protection without locking in a long-term yield so you can benefit if rates increase.

Lastly, looking outside of the portfolio and into solutions in other parts of your financial life can be incredibly valuable. One example is the strategic utilization of debt. It can be a great tool and potentially allow you to borrow money at rates much lower than inflation over time. Another could be prepayment of known future liabilities. Although there can be opportunity costs of prepaying, locking in today's prices for large purchases or expenses may be a great decision if future costs are much higher.

Unfortunately, there is no magic bullet to protect against high levels of inflation, and there is no surefire way to forecast its arrival, but that doesn't mean that we can't build an all-weather portfolio to mitigate its impact if, or when, it comes.

AT A GLANCE

# SECOND QUARTER RETURNS

| | Q2 2021 | ANNUALIZED 1-YEAR RETURNS | 5-YEAR RETURNS | 10-YEAR RETURNS |
|---|---|---|---|---|
| S&P 500 Index | + 8.55 | + 40.79 | + 17.65 | + 14.84 |
| US Large Value | + 5.21 | + 43.68 | + 11.87 | + 11.61 |
| US Small Cap | + 4.29 | + 62.03 | + 16.47 | + 12.34 |
| US Small Value | + 4.56 | + 73.28 | + 13.62 | + 10.85 |
| International Large Cap | + 5.17 | + 32.35 | + 10.28 | + 5.89 |
| International Large Value | + 3.01 | + 33.50 | + 7.81 | + 3.86 |
| International Small Cap | + 4.34 | + 40.98 | + 12.03 | + 8.38 |
| International Small Value | + 3.47 | + 42.77 | + 10.13 | + 7.09 |
| Emerging Markets | + 5.05 | + 40.90 | + 13.03 | + 4.28 |
| US Short-Term Bonds | + 0.27 | + 0.40 | + 2.18 | + 1.98 |
| US Intermediate-Term Bonds | + 1.83 | – 0.33 | + 3.03 | + 3.39 |

*Data represents past performance. Past performance is no guarantee of future results. Chart is for illustrative purposes only. Returns are based on data from the S&P 500, Russell Investments for U.S. indices, MSCI for international, and Barclays for bonds for the time period of April 1, 2021, through June 30, 2021.*

*Indexes used for the table are as follows: S&P 500 TR USD; Russell 1000 Value TR USD; Russell 2000 TR USD; Russell 2000 Value TR USD; MSCI EAFE NR USD; MSCI Value NR USD; MSCI EAFE Small Cap NR USD; MSCI Small Value NR USD; MSCI EM NR USD; Barclays U.S. Govt/ Credit 1-5 Yr TR USD; Barclays U.S. Agg Bond TR USD.*

**Key Takeaways:**

- Another strong quarter of returns for global stock markets, led by large U.S. companies.
- Interest rates steadily declined throughout the quarter, leading to gains for longer-maturity bonds.
- Leading sectors in the first quarter were technology, energy, and communication services.
- Lagging sectors in the first quarter were utilities, consumer staples, and industrials.

# MEETINGS AT CCM

Beginning this month, life at CCM will start to look a bit more normal as colleagues transition back to our offices in Northfield, Bloomington, Rochester, and Hastings. As we do so, we will continue to follow guidance from the CDC and Minnesota Department of Health, and monitor the impact of COVID-19 in our communities.

The last 16 months have challenged us all, and we have genuinely missed engaging with you in the ways that were most familiar. We are excited to welcome you back into our offices for in-person meetings. In addition, we are very happy to continue offering virtual meeting options, either by phone or Zoom. When your next meeting is scheduled, please let us know which meeting type you prefer.

## CARLSON CAPITAL MANAGEMENT NAMED A TOP WORKPLACE

Carlson Capital Management has been named one of the 2021 Top 175 Workplaces in Minnesota by the *Star Tribune*. The award, which is given annually, recognizes companies with more than 50 employees in Minnesota that, based on employee opinions, score most favorably in the areas of engagement, organizational health, and satisfaction. Of the nearly 3,000 organizations invited to participate, CCM ranks sixteenth in the Small Employer category. A complete list of those selected is available on the *Star Tribune* website.

*"We are honored to be named a Top Workplace. This award is especially meaningful because our colleagues, through their responses, have affirmed our commitment to fostering a culture that upholds the core values of integrity, stewardship, care, and expertise. I believe wholeheartedly in the exceptional talent and quality of our team, and I'm thrilled that, as a result of this award, more people will come to know Carlson Capital Management and the many colleagues who contribute to our success."*

— JUSTIN STETS, AIF®, PRESIDENT OF CARLSON CAPITAL MANAGEMENT

*Related disclosures: The criteria for the Star Tribune's Top Workplace award can be found here [https://www.startribune.com/nominations-open-for-star-tribune-s-top-workplaces-2021/600006640/]. The Star Tribune partnered with an independent organization, Energage, to conduct the research and administer employee surveys in order to determine awardees. CCM did not pay a fee to receive this award, and has paid no fees to the Star Tribune to promote this award. The Star Tribune independently honored CCM. Additional important disclosure information related to rankings and awards [https://carlsoncap.com/disclosures/].*

## CCM WELCOMES NEW COLLEAGUES

We're pleased to introduce you to three new CCM colleagues.

**Elizbeth Bovee, MBA**

*Associate Integrated Wealth Advisor*

Elizbeth works as part of the CCM advisory team on all aspects of planning and portfolio management to provide an exceptional client experience.

**Shelly Greshik**

*Operations Specialist*

Shelly collaborates with colleagues to provide accurate data management and reporting for clients and helps to ensure CCM's quality assurance processes.

**David Sayers, MBA, CFP®, ChFC®, CLU®, CDFA®**

*Senior Integrated Wealth Advisor*

David joins CCM with nearly 15 years of experience as a wealth manager for individuals and families across the Twin Cities. With a background in engineering, David has a unique appreciation for efficient processes and staying disciplined to them, and is passionate about providing integrated wealth management solutions.

Full biographies are featured at *carlsoncap.com/team* where you can also connect directly with any colleague at the firm.

## JACOB GOTTO PROMOTED

CCM's Jacob Gotto has been promoted to Data Analyst. In his new role, Jacob will lead continuous improvement efforts to ensure a high level of functionality between key enterprise systems. His work will center on creating optimal experiences for CCM clients and colleagues.

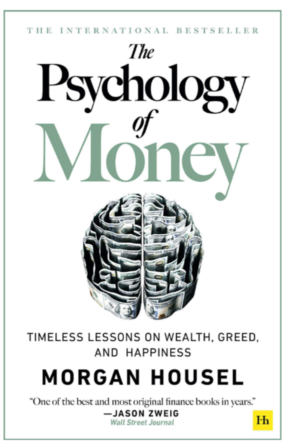
## MEET THE YOUNGEST MEMBER OF CCM'S FAMILY

In May, Associate Integrated Wealth Advisor Brent Lange, CFP®, CFA, welcomed a new baby into the family—Crew! The new family of four is happily settling into the sweetest summer yet.

# *What We're Reading and Listening To*

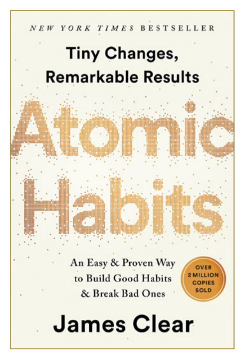
Back by popular demand! This month, we're sharing with you some of the content our CCM colleagues are consuming during the summer months.

### READING




KIM DIEMER, CFP®, Integrated Wealth Advisor, is currently reading *Psychology of Money* by Morgan Housel. This international bestseller is a collection of short stories on wealth and how decisions are made with it.

CAMI PETERSON, CPA, CPFA, AIF®, Director of Carlson Retirement Plan Services, is enjoying reading *Atomic Habits: An Easy & Proven Way to Build Good Habits & Break Bad Ones* by James Clear. In the book, "He draws on the most proven ideas from biology, psychology, and neuroscience to create an easy-to-understand guide for making good habits inevitable and bad habits impossible ...[to] reshape the way you think about progress and success, and give you the tools and strategies you need to transform your habits."





### LISTENING TO

President JUSTIN STETS, AIF®, is enjoying the new podcast series *70 Over 70*, a show about how we make the most of the time we have left. He says, "We are all granted a finite amount of time to impact the world around us. With this gift comes tremendous opportunity. I love to listen and learn from those who have wisdom to share. Everyone has a story and experiences that help us understand what it means to be fully alive and fully human."

COMING UP IN THE NEXT ISSUE

# *When to Make Updates to Your Estate Plan*

**Dan Edwards, CPA**
*Director of Estate Planning*

With several proposals on the table to change the laws related to the taxation of estates, now is an ideal time to begin thinking about what changes might be necessary to ensure your wealth is transferred in a way that best meets your wishes. In the next issue, CCM's Dan Edwards, CPA, will outline key elements of the proposals and life events that warrant estate plan updates. Make time before October to read your estate plan so that you're optimally prepared to leverage the changes.

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