CARLSON CAPITAL MANAGEMENT

QUARTERLY
Newsletter

OCTOBER 2021

Portfolio Management—Beyond the Returns

ADAM HOFFMANN, CFP®, AIF®, CHIEF INVESTMENT OFFICER

The shifting from summer to fall always fills me with an urge to prepare. It's not necessarily clear what I'm preparing for, but slowly darkening days, cooling temps, and seeing the harvest being brought in across the farms in our area triggers something deeply rooted inside me to know that change is on the horizon and it's time to get ready.

Professionally, there is a similar change in focus that occurs as October comes around, but, fortunately, the cause of this shift is more clearly understood. Each year as we enter the fourth quarter, CCM's integrated team works in partnership to finalize and execute clients' year-end tax plans. This is an exercise that includes not just the CPAs, but also the investment and financial planning teams, as we all have a role to play in the optimization of outcomes.

Although the CCM Investment Team is responsible for the research, construction, and trade execution that goes into the management of client portfolios, I learned early on in my career that although the returns that our clients experience truly matter to their financial outcomes, if we don't properly prepare for the reality of how those returns are *received*, we are only doing part of our job.

CUSTOMIZED APPROACH

The Investment Team's preparation for annual tax planning actually begins before any dollars are deployed into an asset allocation when a new client comes onboard at the firm. It's our responsibility as a fiduciary and trusted partner to build portfolios using the optimal investment solutions to help meet each client's specific needs. For most people, that will be through the utilization of mutual funds and exchange traded funds (ETFs) that allow for low-cost exposure to a globally diversified mix of stocks and bonds.

Continued on page 2

CARLSON CAPITAL MANAGEMENT
Integrated Wealth Management Since 1987

 continued from page 1

However, for others who may have legacy holdings that have been a part of their portfolio for a long time and carry high levels of appreciation, we may be unable to reallocate into these types of funds without incurring large, taxable gains.

For example, if someone was compensated with their employer's stock throughout their career and was fortunate to experience strong growth, it doesn't always make sense to just sell everything to start fresh. In these cases, we have other solutions, like direct indexing, that can allow us to maintain some or all of their highly appreciated positions while still accomplishing the goal of building a diversified portfolio. Addressing each client's specific circumstances to meet their unique needs is a key to success.

TAX-EFFICIENT FUNDS

When selecting funds to include in a portfolio, it's important to note that not all funds are created equally when it comes to taxation. Some mutual funds try to outguess the market by picking stocks or making tactical timing bets that can force upon their shareholders large and unwanted tax surprises if held outside of a retirement account. Morningstar calls this the tax-cost ratio.[1] It can be thought of as the lost value of an investment caused by ongoing taxation of a fund. In one infamous example, due to a large portfolio strategy change, a widely known mutual fund distributed such a large capital gain at the end of 2018 that its after-tax three-year return is only about half of the pre-tax value.[2] So, when pursuing these types of strategies, even if you win, you still may lose.

This is one reason we target mutual funds that actively try to reduce the impact these types of distributions can have on an individual's tax situation. It's also why we have a focus on using exchange-traded funds, as this structure can help to reduce the likelihood of taxable distributions even further.

ASSET LOCATION

Because we know that certain types of accounts like pre-tax IRAs, Roth IRAs, and individual brokerage accounts have different tax implications, rather than manage each account in a client household separately, we view accounts collectively in targeting our clients' desired asset allocation. By locating certain types of assets in these various accounts, we can optimize the total after-tax return a client experiences. In one study conducted by Vanguard, it was concluded that managing a portfolio in this manner could add 0.74% to an individual's after-tax return when compared to a portfolio that ignored the tax implications of their location decisions.[3]

Also, by locating assets strategically based on the specific needs of each of our clients and managing in view of the total portfolio, it can allow us to target our rebalancing efforts to reduce or eliminate current tax impacts. These are the types of benefits you can receive when you prepare.

TAX LOSS HARVESTING

No one enjoys having the value of their investments go down, but we know that bearing the risk of loss is one reason why we're rewarded as investors. Especially in stocks, to capture the relatively high returns that we have experienced in the past and expect in the future, it comes with the knowledge that there will be periods of loss. And if the value of an investment goes below the purchase price, we can turn a negative into a positive by selling the first investment and buying something similar on the same day. The act of selling is what allows the loss to be used to offset gains, and the act of buying is what allows you to participate in the future recovery.

This isn't always an applicable strategy for all portfolios during all market drawdowns, but when possible, it can add significant long-term value to after-tax returns. For example, with markets performing so strongly thus far in 2021 with relatively little downside volatility, there have been few opportunities to capture losses for most. Though in 2020, with the large global stock market drawdown in the first quarter, we were able to book tens of millions of losses for our clients, even though the returns for the year ended up sharply positive.

CONCLUSION

Proper portfolio management alone can't solve tax-related issues, but improper management can certainly cause them. A thorough understanding of the interconnectedness of investments and taxes is key to achieving ongoing and reliable success up to and through retirement. As the old saying goes, it's not what you make, it's what you keep, and we work hard to help you keep what you earn.

---

[1] *https://www.morningstar.com/content/dam/marketing/shared/research/methodology/678272-TaxCostRatioMethodology.pdf*

[2] Morningstar Direct as of 9/30/2021. Calculated by comparing the difference of the Post-tax Return (Pre-liquidation) Annualized 3 year and the Total Return Annualized 3 year.; *https://www.kiplinger.com/article/retirement/t041-c000-s004-hefty-fund-payouts-trigger-big-tax-hit.html*

[3] *https://advisors.vanguard.com/iwe/pdf/ISGQVAA.pdf*

FINANCIAL PLANNING

When Is It Time to Update Your Estate Plan?

DAN EDWARDS, CPA, DIRECTOR OF ESTATE PLANNING

The taxation of estates is in the headlines again as President Biden and several members of congress have introduced proposals to change the law. Possible changes have included a reduction of the estate exemption from $11,700,000 to $3,500,000; increasing the top estate tax rate from 40% to 45%; taking away the basis step up at death for individuals with gains exceeding $1,000,000; and eliminating or significantly changing strategies involving trusts and the use of discounts in transactions with family members. The most recent House Ways and Means Committee proposal reduces federal exemptions to around $6,000,000, but would not eliminate the basis step up. While nothing is finalized, the changes implemented could substantially change how many individuals spend down their assets and structure their estate plans.

THE RIGHT TIME

Many individuals put off making estate document changes until a new law is enacted or it's clear a proposal will become law. While on the surface this strategy seems prudent, we caution against it since the last time there were major estate tax law changes, many attorneys were booked and had to turn away clients, which is why we encourage you to start the process now.

Tax law changes are one reason an estate plan should be reviewed, but there are many reasons your plan may need an update. The mere passage of time is sufficient to warrant a review of your estate plan. It is recommended you review the documents every three to five years or after any major life changes for you or your family. Consider the following scenarios:

- If your marital status or the marital status of one of your children changes, it's a good time to make sure your estate plan documents still provide the intended result upon your death.
- The addition of a new baby or adopted child is another reason to review your documents. Make sure the person named as guardian of your children is still the person you want to fill the role.
- Have one or more of your beneficiaries predeceased you? If so, it is important to revise your documents and/or beneficiary designations to redistribute your property among beneficiaries.
- When you move from one state to another your estate documents will still be valid if they were properly executed in your prior state of residence, however, they should be updated to conform to the laws of the new state. Estate laws vary from state to state. For example, while most states don't assess an inheritance or estate tax, Minnesota and a few others still do.
- A revocable living trust may need to be updated for the named trustees and you should consider if the named personal representatives of your will are still appropriate.
- If you've purchased new property, be sure you have planned for it in your estate and, if it flows through your trust, ensure that it is titled in the name of the trust.
- Consider whether your beneficiaries have special or changed needs that you want your estate plan to address.

It's also important to keep in mind your will and trust are not the only documents you should periodically review. Both your financial power of attorney and health care directive should be reviewed to make sure they are still in line with your desires.

Having an updated estate plan in place ensures your family knows your last wishes and will provide you with significant peace of mind. We encourage you to take some time to think through your plan and if any of your wishes have changed. If you feel you may need to make changes to your estate plan documents, or if you just want to talk through your plan, please contact your CCM advisor.

Tax Projections: A WISE YEAR-END OPPORTUNITY

KEVIN KOSKI, CPA, PRINCIPAL TAX ADVISOR

As we approach the end of the year, it is a great time to evaluate your tax situation—both for this year and next. A crucial step in the evaluation process is having a tax projection completed. A tax projection is the process of preparing a pro-forma tax return based on actual year-to-date information and on forecasted information for the remainder of the year. In times such as the past several years where we've experienced complex and ever-changing tax laws, a projection also allows for careful analysis in terms of the impact of those changes on your personal situation.

- A tax projection is like a scorecard for the year. Having one completed will allow you to understand where you stand regarding potential refunds or balances owed. It helps to **avoid unexpected results** and unpleasant surprises at tax filing time.

- A tax projection can **uncover opportunities**. The projection will allow your team at CCM to understand what marginal tax bracket you will be subject to and whether you will be itemizing deductions or taking the standard deduction. For example, the results may lead to a recommendation that you consider a Roth IRA conversion or possibly the funding of a donor advised fund. Nobody likes to look back upon missed opportunities.

- A tax projection is **forward-looking**. A prepared tax return is backward-looking. We believe that forward-looking analysis through tax projections leads to better long-term financial outcomes because it places you in a position to proactively impact your situation. We strive to build out tax projections for multiple years at a time so we can readily see the results of decisions on both the current and future tax years to avoid unintended consequences. For example, you do not want to do something that saves you a small amount of tax this year at the cost of paying far more tax in future years.

- A tax projection leads to **communication**. Communication is important because it allows both us, and you, to ask questions and share important information. Communication allows us to more fully understand your situation and to learn of changes more quickly so that we can adapt and optimize.

The Tax Team at Carlson Capital Management will be integrating the tax projection process into many year-end client meetings. We encourage you to engage in the process by responding in as timely a manner possible to any requests for information. If you won't be meeting with our team before year-end, we encourage you to reach out at any time with questions, or if you become aware of changes in your situation that would merit that we complete an updated tax projection.

AT A GLANCE

THIRD QUARTER RETURNS

	Q3 2021	ANNUALIZED 1-YEAR RETURNS	ANNUALIZED 5-YEAR RETURNS	ANNUALIZED 10-YEAR RETURNS
S&P 500 Index	+ 0.58	+ 30.00	+ 16.90	+ 16.63
US Large Value	– 0.78	+ 35.01	+ 10.94	+ 13.51
US Small Cap	– 4.36	+ 47.68	+ 13.45	+ 14.63
US Small Value	– 2.98	+ 63.92	+ 11.03	+ 13.22
International Large Cap	– 0.45	+ 25.73	+ 8.81	+ 8.10
International Large Value	– 0.97	+ 30.66	+ 5.96	+ 5.97
International Small Cap	+ 0.90	+ 29.02	+ 10.38	+ 10.73
International Small Value	+ 0.14	+ 33.35	+ 8.14	+ 9.41
Emerging Markets	– 8.09	+ 18.20	+ 9.23	+ 6.09
US Short-Term Bonds	+ 0.02	+ 0.08	+ 1.25	+ 0.72
US Intermediate-Term Bonds	– 0.01	– 1.38	+ 1.98	+ 1.81
US Long-Term Treasury Bonds	+ 0.47	– 10.27	+ 3.31	+ 4.39

Key Takeaways:

- Global equity returns were mixed in the third quarter.
- International small companies were the best performer, with emerging markets performing worst.
- Interest rates were flat for the quarter, allowing higher yielding long-term bonds to outperform.
- Leading sectors in the quarter were Financials, Utilities, and Telecom.
- Lagging sectors in the quarter were Industrials, Materials, and Energy.

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 July 1, 2021, through September 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 EAFE Small Value NR USD; MSCI EM NR USD; Bloomberg Short Treasury TR USD; Bloomberg Intermediate Treasury TR USD; Bloomberg Long Term US Treasury TR USD.

YEAR-END DONATIONS

Many of our clients are responding to the numerous social challenges that surround us with increased charitable contributions. With this in mind, as end-of-year approaches, we encourage clients with donor-advised funds to note the submission deadlines to ensure your grant requests are fully processed in the 2021 calendar year. Schwab Charitable grant requests must be submitted by November 30. American Center for Philanthropy (ACP) grant requests must be submitted by December 15.

If you have any questions, please contact Jackie Rother, ACP Administrator, at *jackie@americancp.org* or 507.321.4027.

WHAT IS A DONOR-ADVISED FUND?

A donor-advised fund offers individuals and families an easier and more efficient way to manage their charitable giving. It allows them to make a charitable contribution and then recommend additional grants from the donor-advised fund over time. When the initial contribution is made, donors may receive a tax deduction.

Carlson Capital Management is pleased to offer clients donor-advised funds through the American Center for Philanthropy and Schwab Charitable. For more information about a donor-advised fund, please reach out to a member of your advisory team.

American Center *for* Philanthropy

SCHWAB CHARITABLE

REQUIRED MINIMUM DISTRIBUTIONS (RMDS) ARE BACK

While the COVID-19 pandemic temporarily suspended RMDs for 2020, they're in full force this year. As a reminder, RMDs are required for everyone with IRAs and retirement plan accounts (but not defined benefit plans) who is 72 years of age or older. Roth IRAs are not subject to RMDs until after the death of the owner.

Additionally, if you inherited an IRA prior to 2020, you are required to take a distribution every year, regardless of age. If you inherited an IRA in 2020 or later, you are not required to take a distribution every year, but you are required to distribute the full balance of the account within 10 years. There are some exceptions, such as for a surviving spouse, a child who has not reached the age of majority, a disabled or chronically ill person or a person not more than 10 years younger than the IRA account owner.

NEXT STEPS

We are in the process of reaching out to all individuals who require an RMD from a CCM-managed account and will be in touch soon if we haven't contacted you already. If you have any IRAs not managed by CCM, including inherited IRAs, please remember that you are responsible for fulfilling the RMD requirement from those accounts.

A CHARITABLE GIVING STRATEGY TO CONSIDER

Qualified Charitable Distributions (QCDs) are distributions made from an IRA directly to a qualified charity. Historically, those age 70½ or older have been able to apply their QCDs towards their RMDs. Despite the RMD age being increased to age 72, those individuals age 70½ and older are still allowed to make QCDs. Individuals are still permitted to make QCDs up to $100,000 in calendar year 2021. Note that funds from employer plans are not eligible for QCDs. QCDs can be a very attractive option as they support charitable organizations, satisfy an RMD, and can reduce taxable income.

CCM INCLUDED IN FINANCIAL ADVISOR MAGAZINE'S 2021 RIA RANKING

Financial Advisor magazine has included Carlson Capital Management in its **2021 RIA Ranking**, an annual list of independent registered investment advisors, ranked by assets under management. CCM has a long history of being ranked in *Financial Advisor.* The full listing can be found on our website ***carlsoncap.com/fa2021***

A key industry publication, *Financial Advisor* delivers monthly content to advisors across the nation, providing insight on sophisticated planning and investment strategies. In response to the ranking, CCM President Justin Stets, AIF®, says, "We are, of course, honored to be listed among our peers as a leading wealth advisory firm. But even more meaningful, are the relationships we build with our clients so that they can use their wealth to accomplish what is important to them."

On an annual basis Financial Advisor (FA) *magazine invites Registered Investment Advisor (RIA) firms to complete a survey for this ranking. Their specific criteria for ranking is not included in their summary article. CCM paid no fees to be included this ranking and CCM paid no fees to the magazine to promote this ranking. CCM completed a survey in order to be considered for this ranking. In 2021,* FA Magazine *included 607 firms listed by assets under management. The number of firms participating wasn't disclosed.* FA *magazine independently sets its ranking criteria and CCM has no influence on the criteria.*

CCM WELCOMES FIVE NEW COLLEAGUES

Chris Boshart, MBA
Investment Specialist

Jack Cronin
Paraplanner

Matthew Jaeger
Paraplanner

Ben Miller
Technology Support Specialist

Cody Tresselt-Warren, CFP®, CPA
Senior Integrated Wealth Advisor

COLLEAGUE ACCOLADES

TWO CCM COLLEAGUES EARN CFP® CERTIFICATION

Congratulations to CCM associate integrated wealth advisors **ABBI KRAMAS, CFP®**, and **ELIZABETH BOVEE, CFP®, MBA**, who earned the CERTIFIED FINANCIAL PLANNER™ certification, one of the most respected achievements in the industry. Individuals who hold CFP® certification are well trained in myriad disciplines of integrated wealth management and are equipped to support clients' financial plans throughout life transitions. **There are 18 CFP® certified advisors on the CCM team.**

CCM COLLEAGUES PROMOTED

We are pleased to share the news of two recent promotions at CCM—**CALLIE GEIST, CFP®, J.D.**, has been promoted to Senior Integrated Wealth Advisor, and **ABBI KRAMAS, CFP®**, (see left) has been promoted to Associate Integrated Wealth Advisor. Through their actions, these colleagues demonstrate a deep commitment to CCM's mission and guiding principles and unyielding loyalty to clients, colleagues, and the firm.

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

CCM Colleagues *Finally* Gather

SUMMER FARM EVENT

After nearly 18 months, CCM colleagues were able to safely gather en masse for an outdoor event at CEO Greg Carlson's family farm. Having weathered some of the most challenging days of our lives together as part of the CCM family, it felt so good to finally be together.

After a week-long weather delay, when the day finally arrived, CCM colleagues and their guests were treated to an outdoor barbeque, farm-fresh salads and roasted vegetables, locally sourced bread and desserts, and live music from Dan Ristrom and the Big Throwdown.

A CELEBRATION OF MARRIAGE

Proving that a pandemic can alter plans, but not put them on hold, CCM Senior Investment Specialist **TOM NOWARIAK** and his wife, Ali, were married in mid-August. The entire team at CCM is thrilled for the happy new couple.