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Your Copperwynd Financial Newsletter: October 2021

Market Commentary

Entering the third quarter of the year is always an interesting transition time. It marks the end of summer and the beginning of the fall season and holidays to come. Historically, that inflection point has proven challenging for markets but before we look ahead to the end of 2021, let's look back at the summer we have passed.

The S&P 500 hit new all-time highs again in the third quarter as investors looked past a resurgence of COVID-19 cases in the U.S. and instead focused on the positive combination of a resilient economic recovery, ongoing historic support from the Federal Reserve, and strong corporate earnings. Market volatility did notably pick up during the final few weeks of September, however, reminding us that the transition to a post-pandemic "new normal" isn't always going to be smooth.

Stocks moved steadily higher to start the third quarter as the U.S. economy continued to return to pre-pandemic levels of activity while corporate earnings remained solid. To that point, second quarter earnings results, which were released in mid-to-late July, were stronger than expected and broadly did not show signs of the margin compression that some analysts feared might hurt corporate profitability. Additionally, at the July FOMC meeting, Fed Chair Powell reiterated that, despite economic progress, it was not yet time for the Fed to begin to reduce Quantitative Easing (QE), thereby ensuring the economy and markets would continue to enjoy full Fed support until late 2021. Those factors helped investors look past an increase in COVID-19 cases, especially across the Sunbelt, as the S&P 500 hit a new all-time high in late July.

That positive momentum for markets continued in August, powered by similar factors: Positive corporate commentary, solid economic activity, and continued supportive Fed rhetoric. Those forces again combined to help markets look past a further increase in COVID-19 cases. Unlike during the COVID-19 waves of 2020 and early 2021, government authorities did not re-impose economic restrictions or lockdowns in response to rising case counts. Instead, most policy responses centered around mask mandates, and as such, the economic headwinds from rising COVID-19 cases were mild compared to previous episodes. Meanwhile, politics once again became a focus of the markets in August. The Senate passed a $3.5 trillion budget reconciliation bill that would be the framework for potential changes to tax rates, entitlements, and climate policy. But what passed in August merely set the stage for the looming policy battle once Congress returned from the summer recess. Given that, stocks were able to look past future policy risks and climb steadily higher throughout the month with the S&P 500 ending August essentially at all-time highs.

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The market tone changed in September, however, as many of the positive factors that supported stocks earlier in the quarter began to fade. First, corporate commentary turned more cautious last month. Profit warnings that cited supply chain constraints and margin compression came from multiple industries, and that caused investors to become more concerned about the outlook for corporate earnings. Then, economic data from August showed that the rise in COVID-19 cases had weighed slightly on the economic recovery. Finally, after investors ignored the looming policy battle in August, politics once again became an influence on markets as Democrats unveiled new details on a $3.5 trillion spending and tax plan that included increases to the corporate tax, personal income taxes for high earners, and changes to capital gains and inheritance taxes. Those factors weighed on markets initially in September, but the volatility was compounded by the news that the second-largest property developer in China, Evergrande, was likely going to default on debt payments. Fear of potential financial market contagion hit stocks in late September and the S&P 500 suffered its first 5% pullback in nearly a year. Markets remained volatile into the end of the quarter as the Federal Reserve confirmed market expectations that it will begin to reduce Quantitative Easing before year-end, while Washington approached the looming deadline of a government shutdown with no extension in sight, although that was avoided in the last few days of the quarter. The S&P 500 finished September with moderate losses although the index still logged a positive return for the third quarter.

Market performance in the third quarter reflected continued improvement in the macroeconomic outlook as a society, the economy, and risk assets showed resilience in the face of another wave of COVID-19, while corporate earnings were better than expected. However, that resilient performance should not be taken as a signal that risks no longer remain. In fact, the next three months will bring important clarity on several unknowns including future Federal Reserve policy, taxes, the pandemic, and inflation.

Volatility going into the close of the quarter had us take a small amount of stock risk off the table and go to cash, but it was very short-lived as markets continue to be resilient. We expect continued volatility as all these factors – inflation, earnings, political maneuvering, decisions by the Federal Reserve, and supply chain constraints – will be with us through the balance of the year and likely into 2022. We never experienced an event the magnitude of this pandemic and a new normal will take some time to work itself out.

As always, if these worries keep you up at night and you are concerned about the markets we encourage you to reach out to us at the office and voice these concerns at your meetings with us so we can revisit your risk levels and make sure your plan is still on track.

Go enjoy the beautiful weather, some “leaf-peeping” and let us do the worrying for you!

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Financial Planning

Both a health savings account (HSA) and a flexible spending account (FSA) allow you to pay for medical care with pre-tax dollars, which reduces the cost. With healthcare accounting for 8.1% of Americans' average monthly expenses, these tax shelters are important financial tools.
But while an HSA and FSA sound similar, there are important differences between them.
HSAs are tax-advantaged accounts either you or an employer can open and contribute to if you have a qualifying high-deductible health plan (HDHP). HSAs allow you to make pre-tax contributions and take tax-free withdrawals to pay for covered care. The money in an HSA can be invested and grow over time and can also be withdrawn after 65 and will be taxed at your ordinary tax rate with no penalties.

You can also make pre-tax contributions and take tax-free withdrawals from FSAs, but they can only be opened by employers. These accounts serve as a short-term savings account rather than an investment account. You must decide at the start of the year how much to contribute, the money cannot be invested, and it is lost if not used for medical care in the year it is contributed or shortly thereafter.

HSAs provide much more flexibility on how you spend your money, while FSAs allow you to pay for both medical care and dependent care with pre-tax dollars. Here are a list of Pro's and Con's to think about before you start saving in one of these vehicles.

Pros and Cons	HSA	FSA
Pros	• Contributions can be invested • Account funds are not "use it or lose it" -- money remains in your account until you choose to withdraw it • You have flexibility to decide how much to contribute during the course of the year • Money can be withdrawn for any purpose without penalty after age 65	• You don't need a qualifying HDHP to contribute • You can put away pre-tax money not just for healthcare, but also for dependent care • You'll get immediate access to the funds you elect to contribute for the year
Cons	• You're eligible for an HSA only if you have a qualifying HDHP • You can access funds only after they've been contributed	• If you don't use your FSA contribution within the year it is made (or within any applicable grace period), you could lose the contributed funds • FSA money can be used only for medical expenses • Money in an FSA cannot be invested

And while FSAs offer less flexibility than HSAs, an FSA will still help you save money, and can be paired with any plan — if your employer offers it. Now how much should you begin to save? A good rule of thumb as you begin thinking about how much to contribute: Start with enough to cover your deductible, expected medication costs and anticipated doctor's visits.

Both a healthcare FSA and an HSA can help you pay out-of-pocket qualified medical expenses. Because your contributions are made on a pretax basis, a healthcare FSA directly reduces your taxable income, as well as the payroll taxes you pay. When you have a high deductible medical plan at work, an HSA can be critical for filling in the expense gap that comes along with it. The funds in an HSA carry over from year to year, are yours if you leave your employer and can be invested. If you have question regarding your benefit options, give us a call at the office and we can determine the best path forward!

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College and Tax Planning

It is that time of year again for those who have kids and grandkids that are headed to college to start the FAFSA application process! Parents sometimes wonder if it's worthwhile to file the Free Application for Federal Student Aid (FAFSA), especially if they think their income is too high to qualify for need-based federal financial aid. But, there are no simple FAFSA income limits, or income cutoffs on financial aid eligibility, in part due to the complexity of financial aid formulas.

Unless the parents earn more than $350,000 a year, have only one child and that child will enroll at an in-state public college, they should still file the FAFSA form, as there is a good chance they may qualify for federal student aid or state or institutional grants. They may also qualify for low-cost federal loans and federal work-study. Even if a college uses the CSS Profile to determine institutional aid eligibility, the student must still file the FAFSA to apply for federal financial aid.

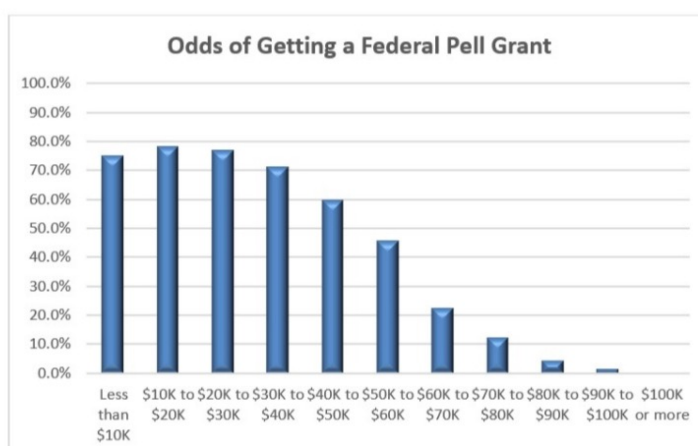
It is important to submit a financial aid application every year, even if you did not get anything other than a student loan last year. There are subtle factors that can affect eligibility requirements for need-based financial aid. These factors can change from one year to the next. Congress tinkers with the financial aid formulas periodically. If you don't file the FAFSA every year, you might miss out on financial aid. Financial aid is based on financial need, which is the difference between the cost of attendance (COA) and the expected family contribution (EFC). Financial need increases when the COA increases and when the EFC decreases.

Thus, a student who enrolls at a higher-cost college might qualify for some financial aid, while the same student might qualify for no financial aid at a low-cost college, such as an in-state public college. The parent contribution part of the EFC is divided by the number of children enrolled in college at the same time. When the number of children in college increases from one to two, it is almost like dividing the parent income in half, which can qualify both children for much more financial assistance than either could qualify for on their own.

For example, when the oldest child enrolls in college for the first time, that child might not qualify for much college financial aid. However, when the oldest and second oldest children both enroll in college at the same time, the number of children in college increases from one to two, potentially qualifying them for more financial aid. Thus, there are no clear FAFSA income limits. Eligibility for need-based financial aid depends on more than just income.

There is no explicit income cutoff on eligibility for the Federal Pell Grant. Eligibility for the Federal Pell Grant is based on the expected family contribution (EFC), not income. Based on data from the National Postsecondary Student Aid Study (NPSAS), more than 94% of Federal Pell Grant recipients in 2015-16 had an adjusted gross income (AGI) under $60,000 and 99.9% had an AGI under $100,000.

The odds of receiving a federal grant decrease with increasing income, as shown in this chart.



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As noted above, a family with two or more children in college may qualify for a Federal Pell Grant because the parent contribution is divided by the number of children in college. Also, the family may have special circumstances that affect their ability to pay for college. Eligible students may also qualify for other forms of financial aid, such as institutional grants. For example, some students whose parents earn $100,000 or more will qualify for grants from their college.

Some colleges require students who are applying only for merit aid to file the FAFSA, just to make sure they get any need-based aid for which they are eligible. Colleges often use need-based aid to offset part of a merit-based grant or scholarship. If there is any question as to whether a student might qualify for financial aid, use the college's net price calculator to get an estimate as to how much gift aid the student might get.

As you begin this process with your student and have questions on the aid you received, or how best to finance college for your kids and grandkids, give us a call at the office for a review!

401(K) Allocation

Risk Off?

At this very moment, models still have us fully invested, but the key indicator we use to pull risk off your portfolios here has been dancing around the trigger to sell at least once a week over the past three weeks. There are a few things on the horizon that are causing concern and uncertainty for these markets. When will the Federal Reserve begin tapering back bond purchases in its first move to return to "normal" after almost two years of accommodative policies and how will the market respond to that? What will the continued issues with supply chain disruptions mean for corporate profitability (earning season kicks off next week) and most importantly, what does forward guidance look like especially going into the height of consumer season – Christmas shopping? And out of nowhere comes the issues overseas in China with Evergrande and now "Fantasia", another Chinese property developer – who are failing to meet their loan payments, on top of an energy crunch due to coal shortages. There are more than a few things bubbling up out there to give pause. If you are feeling that stress – feel free to adjust your risk level down from the column you normally pick, but we are sticking with the asset allocations similar to last month and remaining fully invested.

	Agg. Growth ***100% Equity***	**Growth**	**Moderate**	**Balanced**	**Conservative**
	0%	**15%**	**30%**	**40%**	**65%**
Stable Asset - OR - Short Term Bond	*0%*	*15%*	*30%*	*40%*	*65%*
Total Return	*0%*	*0%*	*0%*	*0%*	*0%*
High Yield Bonds	*0%*	*0%*	*0%*	*0%*	*0%*
Inflation Protected Bonds	*0%*	*0%*	*0%*	*0%*	*0%*
	75%	**65%**	**50%**	**45%**	**25%**
Large Cap Growth	*35%*	*30%*	*20%*	*20%*	*10%*
Large Cap Value	*40%*	*35%*	*30%*	*25%*	*15%*
	20%	**15%**	**15%**	**10%**	**10%**
Mid Cap Growth	*10%*	*5%*	*5%*	*5%*	*5%*
Mid Cap Value	*10%*	*10%*	*10%*	*5%*	*5%*
	5%	**5%**	**5%**	**5%**	**0%**
Small Cap Growth	*0%*	*0%*	*0%*	*0%*	*0%*
Small Cap Value	*5%*	*5%*	*5%*	*5%*	*0%*
	0%	**0%**	**0%**	**0%**	**0%**
Developed International	*0%*	*0%*	*0%*	*5%*	*0%*
Emerging Markets	*0%*	*0%*	*0%*	*0%*	*0%*

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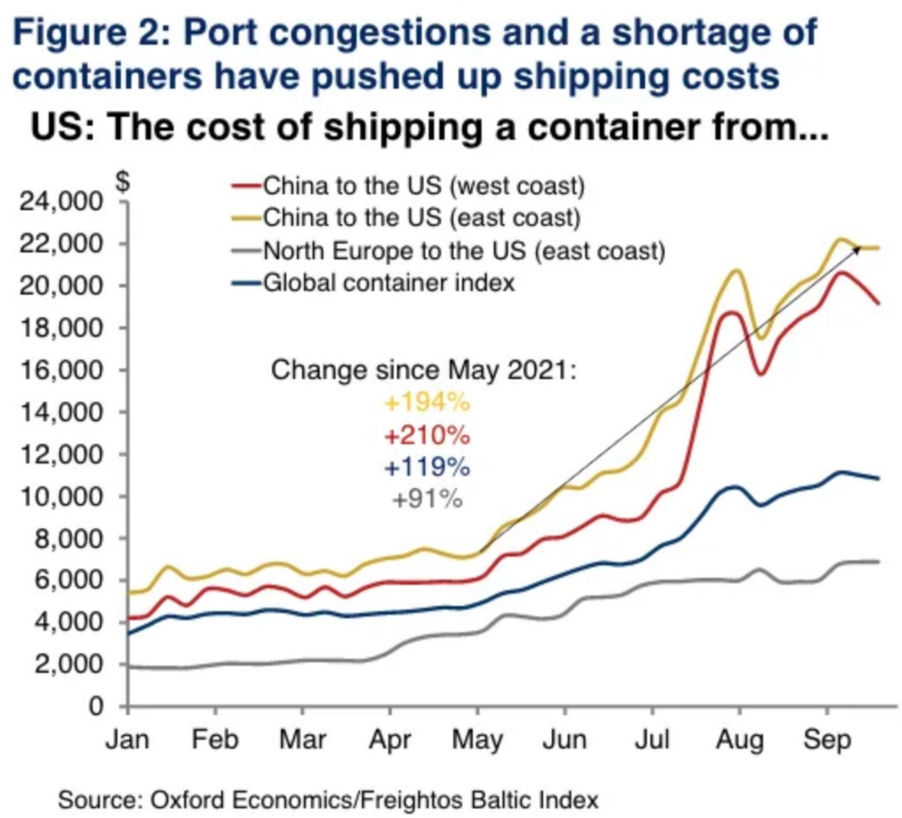
Graphic of the Month

It really is the perfect storm – increasing demand and decreasing availability of product and personnel. All this and we're going into the biggest shopping quarter of the year with Christmas now only 80 shopping days away! What happens when supply and demand are out of synch? Higher prices, that's what happens. And here is a good example of what you will find affecting your stocking this holiday season. Except no coal. That's having it's own shortage!



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