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August 2021

Growth or value

What kind of investor are you?

When you buy stocks, are you looking for growth or value? For the uninitiated the question may seem nonsensical—everyone wants both growth *and* value, and large portions please! But these terms have a specific meaning to professional investors. The terms imply significantly different risk profiles and expectations for rates of return on investments.

Tom Hardin and Brandon Bischof published a comparison of growth and value performance for NASDAQ last May (https://www.nasdaq.com/articles/value-vs-growth%3A-a-brief-historical-view-2021-05-06). Key observations:

- For the six months prior to publication, value stocks as a whole outperformed the growth stocks.
- From 1994 to the tech bubble of 2000, growth beat value consistently but experienced a sharp fall when the tech bubble burst.
- Value stocks were doing better until the financial crisis of 2008, but they underperformed afterward until the pandemic.
- In the very long view, going back to 1926, value stocks have outperformed far more often and were better overall.

The authors concluded: "Every dog will have its day, and value has certainly had many good *decades*."

Definitions

The traditional "value" investor seeks to invest in companies at relatively low valuation levels. These bargain hunters of the investment world typically search for low ratios of stock price to earnings (the price-earnings ratio, or P/E), or a low ratio of price to sales. They are hoping to discover investment opportunities "overlooked" by other investors and by the market as a whole. Very often these companies are out of favor on Wall Street and may be undergoing a restructuring or other transformation expected to "unlock" great future value. Patience is an attribute most often associated with value investors. Their patience may be rewarded with relatively higher dividend yields and lower risk of disappointment.

Growth investors, residing at the other end of the spectrum, generally pursue explosive growth of sales and earnings with little regard to price. The companies in which they invest typically sport

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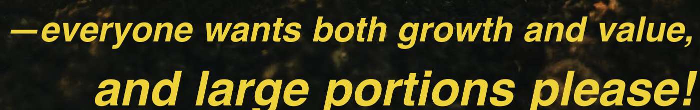


high P/Es, and market capitalizations that are multiples of sales because their superior past records are well established. These Wall Street favorites can offer excitement and above-market rates of return. However, these characteristics tend to be accompanied by greater price volatility and risk of loss, especially when earnings soften or at the start of an economic downturn.

Value investors are generally thought to be more conservative, accepting lower returns in exchange for more stable prices. Growth investors, by taking greater risks in search of superior rewards over a shorter time frame, are thought to be more aggressive.

Then we have the middle ground identified by Peter Lynch as "growth at a reasonable price." Or there is "blend," which is a balance of both growth and value stocks in the portfolio.

Size may also matter

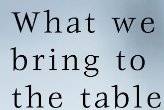
Another important consideration is the size of the company selected for investment. Large-cap companies are those with a market capitalization of more than $10 billion, small caps are less than $2 billion, and the mid-caps fall in between those ranges.

One expects that smaller companies present a greater risk, and therefore they should deliver a premium return to investors. That has been observed from time to time. Larger companies have more resources to work with and so should be less vulnerable to economic shocks, providing steadier returns. On the other hand, very large companies require extraordinary success to deliver high-percentage returns for their investors.

Can we tell you more?

Designing a balanced investment portfolio for the long term is a job that most people will delegate to trained professionals. If you are young with plenty of years to retirement, taking stock tips from the internet can be fun, and even in some cases, rewarding. As you approach retirement, or as your portfolio grows more substantial, investing becomes less of a game and more of a serious undertaking.

Like to know more about our services for investors? Call on us! We look forward to discussing your requirements in detail, in person. ☐



We'd like to be able to say that we have a magical solution to every investor's needs right now. We don't. No one does. And you probably already understand that. What we do have are trust and investment services that are *objective, personalized,* and *comprehensive*.

Objective. Our investment advice reflects the same high standards that guide our work as trustee. We don't deal in exotic financial engineering; we invest in instruments that ordinary people have heard of and can understand. To remove any chance of conflict between our organization's interests and our client's interests, we do not work on commission. Instead, we charge moderate annual fees, based on the market value of our clients' holdings. When the dollar value of a client's account grows over the years, we receive more dollars of compensation. If a client's account shrinks in value, so does our compensation.

Personalized. As we see it, our business is not simply managing investment programs. Our business is helping people—helping our clients achieve their financial goals. We've learned that serious investors can't settle for a "one size fits all" approach. We see each of our clients as possessing a unique mix of financial facts, family circumstances, and personal goals. The better we understand each client's unique situation, including his or her tax picture, the better we are able to serve our clients.

Comprehensive. In addition to providing our investment clients with unbiased guidance, we keep accurate records, submit detailed statements, and safeguard securities under strict audit control—all for moderate fees that can be substantially lower than the fees at some other firms.

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Pandemic scams

The downturn in economic activity during the pandemic lockdowns did not lead to a pause in various forms of financial fraud. In fact, new twists on identity theft are emerging all the time, so everyone must remain on guard.

Medicare fraud

Medicare loses an estimated $60 billion per year to fraud, waste, errors, and abuse. That covers much territory, from billing for services never received to providing services for duplicate or unnecessary prescriptions. Some of the scams are aimed at seniors, including phony Medicare plans. Keep in mind:

- Medicare does not make calls to "update" or "verify" information.
- Neither do they call demanding payment of medical bills.
- Medicare does not send representatives to homes to verify information, conduct a home-safety inspection, or deliver products or equipment.

Keeping a medical-care diary and reviewing paperwork promptly are important steps in combating Medicare fraud.

Unemployment fraud

Along with the sharp increase in unemployment last year came an increase in fraudulent unemployment claims. The scammer with a stolen ID filed for unemployment, and the benefits were sent to the scammer. The victim won't know what has happened until he or she receives a Form 1099-G reporting their unemployment compensation. Unless the fraud is reported and corrected, the victim could be taxed on the fraudulent benefits.

Scams aimed at tax professionals

Two approaches have been reported for phishing for critical information from tax professionals. One is the "new client" approach, in which the scammer asks to become a new client and attaches a prior year's tax return and perhaps an IRS notice. The attachments may contain malware, so they should not be downloaded or opened.

The other is an email that purports to be from "IRS Tax E-Filing" and asks that the professional takes steps to update or renew Electronic Filing Identification Numbers (EFIN) and Centralized Authorization File (CAF) numbers. Such emails should be reported to the Treasury Inspector General for Tax Administration. ☐

The IRS' "dirty dozen"

The IRS recently updated their list of 12 scams to watch out for:

IRS impersonators. Happily, there has been a significant decline in telephone callers pretending to be from the IRS and demanding immediate tax payments. The IRS received 36,000 reports of these scams in 2019, and only 20,500 in 2020. But that is still 20,500 too many.

The IRS normally contacts taxpayers first by mail, not telephone. When the Service does make telephone contact, it never demands payment using an iTunes card, gift card, prepaid debit card, money order, or wire transfer.

Offers-in-compromise mills. The IRS has a program for settling tax debts, and in some circumstances those debts may be reduced. There has been an explosion of radio and television advertising from firms offering to help taxpayers navigate offers in compromise. The IRS is not happy about that development. "We're increasingly concerned that people having trouble paying their taxes are being duped into misleading claims about settling their tax debts for 'pennies on the dollar'," said IRS Commissioner Chuck Rettig.

Taxpayers may use an IRS-developed tool at https://irs.treasury.gov/oic_pre_qualifier/ to determine their eligibility for an offer in compromise.

IP Pins. The IRS made its Identity Protection PIN (IP PIN program) available this year to all taxpayers, not just to victims of ID theft or taxpayers in certain states as earlier. The IP PIN is a six-digit code known only to the taxpayer and to the IRS. Using an IP PIN is, in essence, a way to lock a tax account. The IP PIN serves as the key to opening that account. Electronic returns that do not contain the correct IP PIN will be rejected, and paper returns will go through additional scrutiny for fraud.

The full report on the dirty dozen may be found at https://www.irs.gov/newsroom/dirty-dozen.

“Buy, Borrow, Die”

The Wall Street Journal reports a boom in borrowing against securities portfolios (margin loans), especially by the wealthy [*Buy, Borrow, Die: How Rich Americans Live Off Their Paper Wealth*, July 13, 2021]. Such loans offer an easy way to take advantage of stock market gains without incurring income taxes on the capital appreciation. What’s more, today’s low interest rates make such loans very attractive from a financial planning perspective. Loan proceeds may be used for additional investments, adding leverage to the portfolio, but the *Journal* reports they are also being used to pay for vacations or other major purchases.

Unlike home mortgage interest, there is no dollar cap on the deduction for interest paid on margin loans. Rather, the limit is set by the amount of the taxpayer’s investment income and is subject to certain exceptions.

The more important tax break in this arrangement is that appreciated assets that are held until death get a tax-free step-up in basis to fair market value, which can lead to the strategy of “buy, borrow, die.” When the basis step-up rule was created, the tax forgiveness was offset by the imposition of the federal estate tax at fairly high rates. With today’s much higher federal exemption from the federal estate tax, most families can forget about estate taxes entirely and focus instead on managing taxes on their long-term gains.

The Biden administration has proposed a major change to this calculus. The proposal calls for treating the transfer of appreciated assets at death as a realization event, requiring the recognition of capital gain and the payment of associated taxes. The exemption for such taxes would be limited to $1 million per taxpayer. In addition, the proposal calls for treating a lifetime gift of appreciated property the same way. Under current law, gifts get no basis step-up, but the tax on capital gains may be deferred indefinitely simply by never selling the asset.

Such a change in the tax law would reduce tax benefits but not eliminate the attractiveness of the strategy. It would have the potential of raising more revenue than the federal estate and gift tax bring in currently to the IRS. Whether the idea will gain traction in the Congress is presently uncertain. ☐

QUOTABLE

“Ordinary people don’t think about debt the way billionaires think about debt. Once you’re already rich, it’s simple, it’s easy. It’s just buy, borrow, die. These are planks of the law that have been in place for 100 years.”

—*Edward McCaffery,* University of Southern California law professor, quoted in *The Wall Street Journal, July 13, 2021*

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