RIVERVIEW QUARTERLY INSIGHTS

RIVERVIEW trust company

THE VIEW FROM A DISTANCE

We've been buried by an avalanche of data over the past six months: Worst-ever economic downturn. The S&P 500 falls 34% from peak (March). The S&P 500 turns positive for the year (June, and again in July). Tech stocks go nuts in value. Best August for stocks since 1984. No vaccine, yet (although there are hundreds in varying stages of trials), and U.S. infections are headed for a third peak (September). And then came the Election. Everyone has an opinion about what moves the markets from moment to moment. But as fiduciary investors, we don't time the market or try to pick stocks, and we focus on the long-term. So despite these mind-bending disruptions that have happened in an amazingly short span of time, our approach doesn't change. Which makes it really hard to write a lead newsletter column every quarter.

So instead, we're going to ask that you put down your newspaper, turn off the social media (maybe forever!), and just watch the grass grow, financially speaking. Two "Intelligent Investor" columns in The Wall Street Journal written by Jason Zweig (I know, we quote him a lot) help with this longer-term view.

The first, which appeared in the August 8/9 edition, was essentially a book review of the soon-to-be-released "The Psychology of Money" by Morgan Housel. This book posits that

> Money isn't a store of value. Money is a conduit of emotion and ego, carrying hopes and fears, dreams and heartbreak, confidence and surprise, envy and regret.

Housel begins his book by comparing a tech millionaire who bought thousands of dollars in gold coins so that he could skip them across the water at the beach like stones "just for fun" (he later went broke), with the Vermont janitor who died at age 92, leaving over $6 million to charities, because he built a fortune by scrimping, putting every spare penny into the stock market.

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This comparison demonstrates, to Zweig, that "[i]nvesting isn't an IQ test; it's a test of character." The janitor had "no need to spend big so other people wouldn't think he was small." Rather, he was able to defer gratification and maintain his discipline.

Housel's book uses Warren Buffett as an example. Held up almost universally as a paragon of disciplined investing, Mr. Buffett acquired 95% of his wealth after age 65 (he just celebrated his 90th birthday). "His skill is investing, but his secret is time." In fact, if he had made his returns for only 30 years, he would be worth 99.9% less (which, admittedly, would still be a lot!).

Mr. Housel concludes that there is a difference between being "rich" (that is, having a high income) and being "wealthy" ("having the freedom to choose not to spend money"). Zweig summarizes it by observing that "[w]ealth consists in caring less about what others think about you and more about using your money to control how you spend your time."

These points are made even more clearly in Zweig's August 29/30 column, "Warren Buffett and the $300,000 Haircut," in which Zweig again looks at Mr. Buffett's long view of investing. The explosive growth in the value of an investment over long periods of compound returns is the key to his success. At a growth rate of 10% (aggressive, I know, but it's Zweig's column, not ours), a $1,000 investment grows to $1,600 in five years; $2,600 in 10 years; $10,800 in 25 years; and $117,400 in 50 years.

What's interesting about that illustration is not the absolute number after 50 years (although it's impressive), it's how small it is, relatively, after 25. The truly meaningful growth in the value of an investment happens after very long periods - long after Great Recessions and Pandemics become things grandparents talk about.

Recognizing this, Mr. Buffett could be heard, when young, saying things like, "do I really want to spend $300,000 on this haircut?" The few dollars spent in the present were hundreds of thousands of foregone value in the future. He understood in a way that few others do that the value today and that in the future were not equivalent.

Zweig puts it this way:

> Recognizing that every dollar you spend today is $10 or $100 or $1,000 you won't have in the future doesn't have to make you a miser. It teaches you to acknowledge the importance of measuring trade-offs. You should always weigh the need or desire that today's spending fulfills against what you could accomplish with that money after letting it grow for years or decades into the future.

Compared with the current news cycle, a thirty-, forty- or fifty-year investment horizon seems like geologic time. But it makes clear an even more important point: from purely an investment perspective, current events (the political strife, the economic landscape and the Pandemic) are meaningless.

This is not, of course, to ignore the devastation the Pandemic has wrought. If you've lost a loved one or been in the ICU, if you've lost your job or your business, then this Pandemic is horrific. But if you're simply facing the relatively minor inconvenience of suffering the free-floating angst of the economic news, fear no more.

We discuss this topic in our podcast entitled, "Investing and the Law of the Farm" (https://riverviewtrust.com/resources/podcast/), in which we make the point that growing wealth is more akin to the very long, organic process of planting, growing and harvesting than it is to cramming the night before a big test. Many of our clients tell us of their experience of seeing what appeared to be little or no growth in their portfolios for years, and then finding that, almost overnight, they seemed to be very close to achieving their financial goals. This is the slow, secret power of time.

Having experienced both the Great Recession and the Pandemic within twelve years of each other can lead to emotional scarring, to investment PTSD. But the cure for these ills is to take the long view. Realize that, so long as you have enough cash on hand to weather a downturn, these events (horrendous as they were and are) are irrelevant to your investments.

SPOTLIGHT ON PLANNING

IS NOW A GOOD TIME TO CONSIDER A ROTH CONVERSION?

This year has been challenging on many fronts, but one financial opportunity may have emerged from the economic turbulence. If you've been thinking about converting your traditional IRA to a Roth, now might be an appropriate time to do so.

**And now for the requisite disclaimer: Riverview Trust Company does not provide tax advice. We encourage you to consult with your tax advisor to determine whether a Roth Conversion strategy is appropriate for your situation.*

Conversion Basics

Roth IRAs offer tax-free income in retirement. Contributions to a Roth IRA are not tax-deductible, but qualified withdrawals, including any earnings, are free of federal income tax. Such withdrawals may also be free of any state income tax that would apply to retirement plan distributions.

Generally, a Roth distribution is considered "qualified" if it meets a five-year holding requirement and you are age 59½ or older, become permanently disabled, or die (other exceptions may apply).

Regardless of your filing status or how much you earn, you can convert assets in a traditional IRA to a Roth IRA. Though annual IRA contribution limits are relatively low ($6,000 to all IRAs combined in 2020, or $7,000 if you are age 50 or older), there is no limit to the amount you can convert or the number of conversions you can make during a calendar year. An inherited traditional IRA cannot be converted to a Roth, but a spouse beneficiary who treats an inherited IRA as his or her own can convert the assets.

Converted assets are subject to federal income tax in the year of conversion and may also be subject to state taxes. This could result in a substantial tax bill, depending on the value of your account, and could move you into a higher tax bracket. However, if all conditions are met, the Roth account will incur no further income tax liability and you won't be subject to required minimum distributions. (Designated beneficiaries are required to take withdrawals based on certain rules and time frames, depending on their age and relationship to the original account holder, but such withdrawals would be free of federal tax.)

Why Now?

Comparatively low income tax rates combined with the impact of the economic downturn might make this an appropriate time to consider a Roth conversion.

The lower income tax rates passed in 2017 are scheduled to expire at year-end 2025; however, some industry observers have noted that taxes may rise even sooner due to rising deficits exacerbated by the pandemic relief measures.

Moreover, if the value of your IRA remains below its pre-pandemic value, the tax obligation on your conversion will be lower than if you had converted prior to the downturn. If your income is lower in 2020 due to the economic challenges, your tax rate could be lower as well.

Any or all of these factors may make it worth considering a Roth conversion, provided you have the funds available to cover the tax obligation.

As long as your traditional and Roth IRAs are with the same provider, you can typically transfer shares from one account to the other. When share prices are lower, as they may be in the current market environment, you could theoretically convert more shares for each dollar and would have more shares in your Roth account to pursue tax-free growth. Of course, there is also a risk that the converted assets will go down in value.

Using Conversions to Make “Annual Contributions”

Finally, if you are not eligible to contribute to a Roth IRA because your modified adjusted gross income (MAGI) is too high (see table), a Roth conversion may offer a workaround. You can make nondeductible contributions to a traditional IRA and then convert traditional IRA assets to a Roth. This is often called a “back-door” Roth IRA.

As this history-making year approaches its end, this is a good time to think about last-minute moves that might benefit your financial and tax situation. A Roth conversion could be an appropriate strategy.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

If your federal tax filing status is:	Your 2020 Roth contribution is reduced if your MAGI is:	You can’t contribute to a Roth IRA for 2020 if your MAGI is:
Single or head of household	More than $124,000 but less than $139,000	$139,000 or more
Married filing jointly or qualifying widow(er)	More than $196,000 but less than $206,000	$206,000 or more
Married filing separately	More than $0 but less than $10,000	$10,000 or more

Note that your contributions generally cannot exceed earned income for the year. (Special rules apply to spousal IRAs.)

IMPORTANT DISCLOSURES

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MARKET SNAPSHOT

MARKET SUMMARY – Short- and Long-Term Index Returns

Stocks continued to stage a healthy rally in the third quarter following the massive correction in Q1 2020. Except for global real estate, which is having a tepid recovery given the uncertain future of commercial properties in the COVID era, equity markets are now positive for the last one year. Bonds posted a decent return despite some interest rate volatility during the quarter.

	STOCKS				BONDS	
	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
3rd Qtr 20	9.21%	4.92%	9.56%	2.37%	0.62%	0.68%
1 Year	15.00%	0.16%	10.54%	-18.58%	6.98%	1.82%
5 Years	13.69%	5.32%	8.97%	2.20%	4.18%	4.33%
10 Years	13.48%	4.37%	2.50%	5.58%	3.64%	4.06%

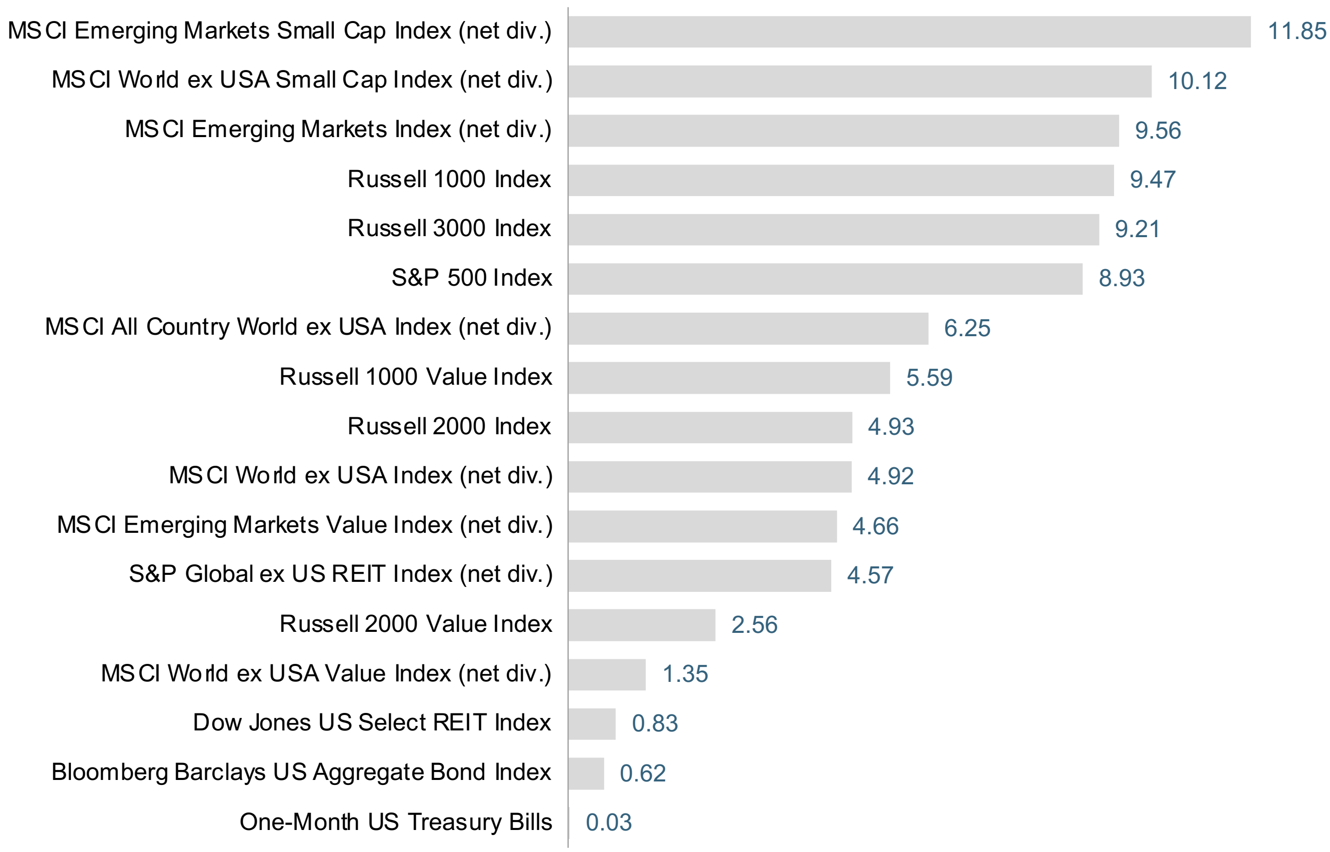
See important disclosure information

GLOBAL MARKETS - Third Quarter 2020 Index Returns (%)

Equity markets around the globe posted positive returns in the third quarter. Looking at broad market indices, emerging markets equities outperformed US and non-US developed markets for the quarter.

Value underperformed growth across regions. Small caps outperformed large caps in non-US developed and emerging markets but underperformed in the US.

REIT indices underperformed equity market indices in both the US and non-US developed markets.



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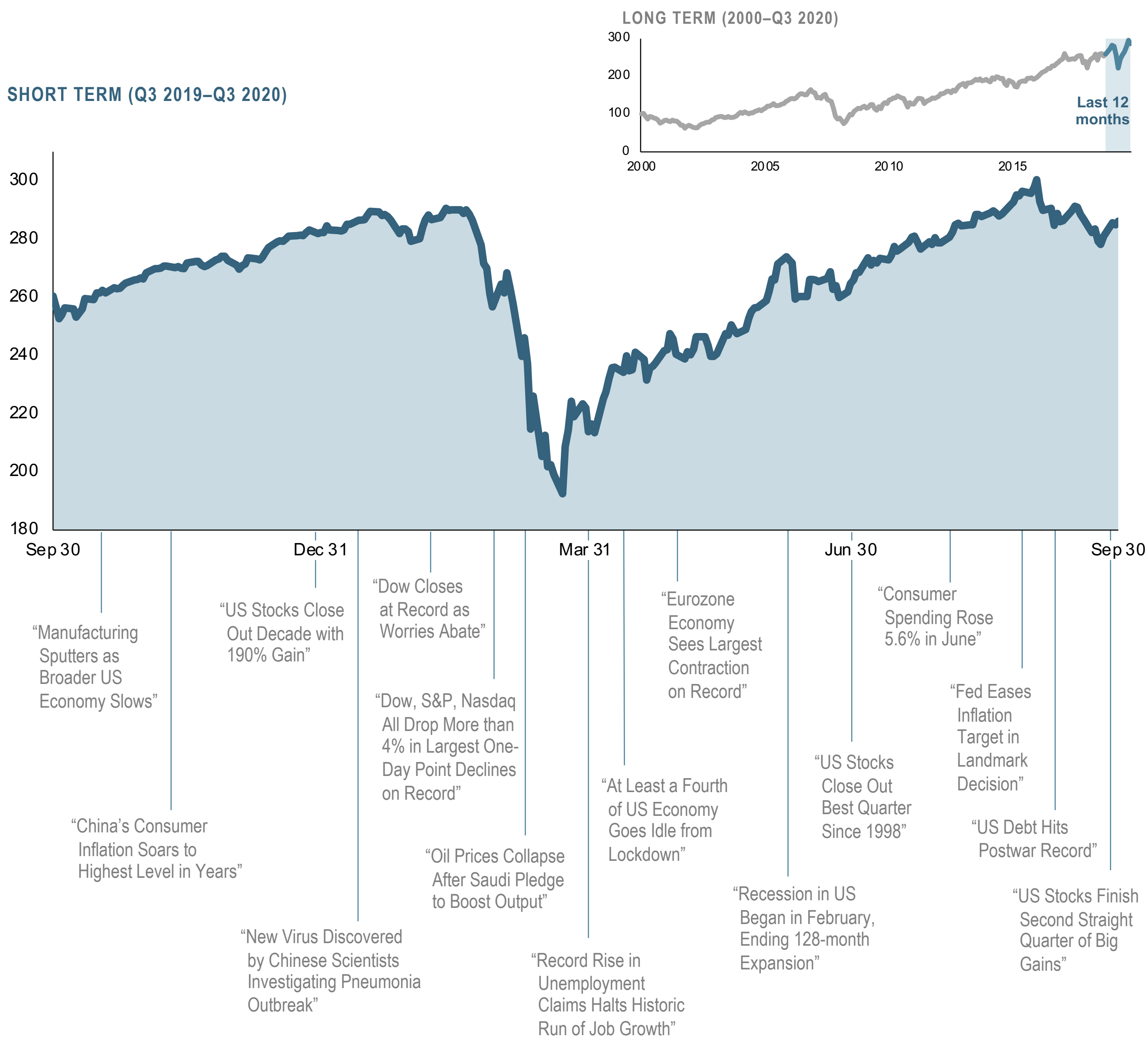
WORLD STOCK MARKET PERFORMANCE

MSCI All Country World Index with selected headlines from past 12 months

These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.



Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2020, all rights reserved. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

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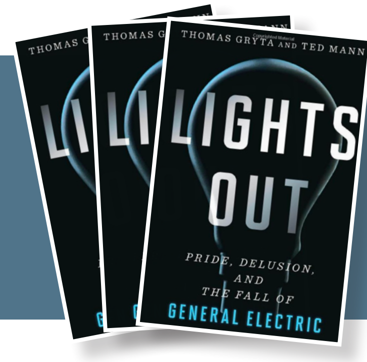
BOOK REVIEW



LIGHTS OUT

Thomas Gryta and Ted Mann

I have a confession: I'm kind of addicted to books about businesses and economies that fall apart through hubris. My first taste was Barbarians at the Gate thirty years ago, about the leveraged buyout of RJR Nabisco. And how it fell apart. Then there was Enron: The Smartest Guys in the Room, about that particular bit of corporate corruption. Ten years ago, I read every book I could about the Great Recession from the perspective of Bear Stearns, Lehman and others that blew up. I'm not sure I like what it says about me, but I'm fascinated by "people" (by which I mean middle-aged, ex-jock white men) who think they're brilliant and, through greed and stupidity, tear down venerated institutions.

The latest installment is *Lights Out: Pride, Delusion and the Fall of General Electric*. Another great read. The inside flap says it all:

> Since its founding in 1892, GE has been more than just a corporation. For generations, it provided job security, a solidly safe investment, and an elite business education for top managers. GE electrified America, powering everything from lightbulbs to airliners, and became fully integrated into the nation's societal mindset as few companies ever had. GE entered the twenty-first century, after two decades under legendary CEO Jack Welch, as America's most valuable corporation.
>
> Yet fewer than two decades later, the GE of old was gone.

General Electric had its beginnings with two American titans: Thomas Edison and (more importantly) J. P. Morgan. Its iconic corporate logo (known by GE old-timers as "The Meatball") was found on "jet engines, ultrasound scanners, wind turbines, televisions, commercial loan agreements, clock radios, toasters, nuclear reactors, lightbulbs" . . . you get the idea. It owned its own financing arm, and NBC. It provided security for generations of employees and investors. So how could it all come undone?

To begin with, "legendary" CEO Jack Welch was not really that great. In fact, he was kind of an egomaniacal jerk whose obsession with regularly growing earnings and dividends sowed the seeds of the company's destruction. According to the authors, he had a great mind for strategy, ripping out layers of bureaucracy that had built up in the company over the years. But he also acquired the nickname "Neutron Jack" because (like a neutron bomb) he "removed the people [through firings] while the buildings were left standing."

More notoriously, he instituted a policy of "rank-and-yank," under which all managers were required to rank the annual performance of their employees, and the bottom ten percent were put on notice and eventually fired. Although initially effective for increasing the bottom line, it eventually led to corporate tension and misbehavior, not to mention the eventual firing of good employees once the true underperformers were mostly eliminated.

Welch became a celebrity. As he managed to grow the giant conglomerate while the very notion of a conglomerate was dying, his personal myth, and the broader myth of GE's managerial genius, grew. When a new GE board member asked a more senior director about a board member's role, the answer was, "applause."

However, Welch was responsible for the three major flaws in the corporate structure that eventually brought it down. First, many of his acquisitions were not successful, yet he managed the incredible financial growth through one business line: GE Capital. Starting as the finance arm of the business for its industrial sales, it grew under Welch to become a shadow bank, an unregulated lender with fingers in many pies. Its ability to generate revenue masked the shortcomings in other business lines. Second, Welch's relentless focus on meeting and exceeding revenue numbers led to management and accounting practices that, while barely legal and ethical, hid flaws in business lines that eventually would hobble the company, preventing it from recovering from the Great Recession (which exposed many of GE Capital's dangerous investments). Third, Welch (and later Jeff Immelt, his hand-picked successor) had essentially no one overseeing their activities; as both CEO and board chairman, each man's power was absolute. So as the wheels eventually fell off, each man was allowed to run the company into the dirt.

Most of the book focuses on Immelt and his failure to guide the company through its difficulties, instead creating problems of his own that made the company fall harder, faster. Ill-conceived ventures into oil and gas and real estate, together with more dodgy accounting practices, prevented Immelt from righting the ship and eventually led to his downfall. And in many ways, as the last big conglomerate, GE's fall probably was inevitable.

But while Immelt (with more of a sales background and perspective) certainly seems to have been the wrong man for the job, in my opinion the authors let Welch off the hook much too easily.

Since we all know how it ends, I'll stop summarizing and let you read it for yourself. But some important conclusions can be drawn. First, there's no such thing as an amazing company, the investment in which is a sure thing. At the height of its success, some investors actually said that you didn't need to diversify, just hold GE. What they were really holding was an unregulated bank.

Second, there's no such thing as a superstar CEO. They all have strengths and weaknesses. And some of the best keep a pretty low profile. In fact, if a CEO becomes a celebrity, we might want to consider that to be a warning sign.

Finally, although reading books like this after the fact can be illuminating and entertaining, the truth is that there's tragedy behind them. Not for Jack Welch or Jeff Immelt, both of whom left the company with millions in their own pockets despite their destruction, but for the thousands of employees and small investors who put their faith in the apparently steady performance of a company that was not what it seemed. It's fine to be addicted to books like this, just don't get addicted to the companies that the books get written about.

IMPORTANT DISCLOSURE INFORMATION

Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citi WGBI ex USA 1-30 Years [Hedged to USD]).

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