SPRING 2022 VOLUME 12, ISSUE 2

THE LIGHT

A FREE QUARTERLY PUBLICATION OF

LIGHTHOUSE WEALTH MANAGEMENT, INC.

VOLATILITY RETURNS

GREG EMMONS, CFP®, PRESIDENT
INVESTMENT ADVISOR REPRESENTATIVE

If there's one thing we know about what drives volatility in the stock market, it is uncertainty. The market is constantly processing and digesting data at an exponentially fast rate which is why it's incredibly efficient. But when there are significant variables thrown into the equation, the market isn't quite sure how to interpret the information. To say that the market has a few unknowns that it's juggling at the moment is probably an understatement. Right now we have the following themes that are weighing heavily on the minds of investors around the world: inflation, interest rates, and the Russia/Ukraine war.

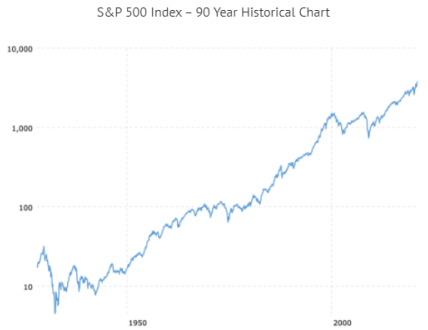
Let's start with inflation. The government shutdowns wreaked havoc on our global supply chain and increased the cost of everything from lumber to a pair of jeans. To combat the impact of the shutdowns and to keep consumers afloat, the central banks took drastic action by increasing the money supply by 40%. From a purely economic standpoint, increasing the money supply that fast is going to cause more inflation. As a result, consumer prices rose 7% in 2021 and when the Federal Reserve has a 2% long-term inflation target, you can easily see that they have their work cut out for them.

Combating inflation segues us nicely into the unknown of interest rates. The Fed has a few different options to stave off inflation, but probably none more important than its ability to increase short-term interest rates. As a result of this, banks pass along the cost of borrowing to consumers and businesses, which ultimately dampen the demand for borrowing and slow the growth of the economy. In the spirit of full transparency, they've tried to set a path to raise rates slowly and steadily, but raising them too quickly can run the risk of pushing the economy into a recession. Before a few weeks ago, they laid out a plan to raise rates 0.25% five different times, but with the uncertainty of the Russian/Ukraine war, they've acknowledged they might have to take a "wait and see" approach after the 0.25% hike they made in March. A 0.50% increase is definitely on the table for the next FOMC meeting on May 4th.

The market already had its hands full with inflation and a rising interest rate environment, and then a Russian invasion of Ukraine was thrown on top of it all. Hindsight is always 20/20. It looks so clear now why we have an increase in market volatility. The war in Ukraine is now in its second month and negotiations appear to be at a stalemate. By far, the human toll is the worst part of this conflict. The economic toll and the impact on energy markets seem trivial when compared to to impact on the Ukrainians.

The energy markets were already climbing before the war, and since the start of the invasion, they've continued to climb. Oil is now floating around $105/barrel, but at one point it was at $123 in the beginning of March. Russia is a key player in the oil markets and exports roughly 10% of the global oil supply. The US has banned Russian oil, but the EU has been a little more reluctant to take the same action. The EU also relies much more on Russia's natural gas. It has the largest reserves and is the largest exporter of natural gas. For everyone's sake, hopefully, peace can be made soon.

Historically, stock market returns move on a northeast track at an average annual clip of 10%. Take a look at a chart of the S&P 500. If you were to zoom in at any point, you would see that there are plenty of bumps along the way. Right now, we have a fair amount of uncertainty in the market, but there is good news for you. This isn't new! The history of the stock market shows us time after time that perseverance pays off and this time it is no different.



IN THIS ISSUE:

CAPITAL GAINS AND TAXES

BY TIM ROWSEY, CPA
INVESTMENT ADVISOR REP.

When filing 2021 tax returns, many investors were surprised to have an unexpected increase in their federal and state tax liability. In many cases this was caused by unusually large capital gains distributions from their mutual fund holdings. This can be confusing and we thought it would be helpful to review the rules relating to capital gains and taxation.

What exactly is a capital gain? A capital gain is the profit made from selling certain types of assets. Typically, these include investments in stocks, bonds or real estate. The capital gain is calculated by taking the total sale price minus the original cost of the asset. If the asset is held directly by the investor, the gain is a direct capital gain. Mutual funds also may have sales inside of their holdings that generate a capital gain. They are required to distribute this gain to the owners of the fund each year. Typically, these distributions happen in November or December. These are mutual fund capital gains distributions.

The taxation of capital gains is dependent on several factors. The first is where the asset is held. If the capital gain occurs inside a tax sheltered account such as an IRA or 401-k plan, then there is no tax on the gain. The taxation of these types of accounts is only levied when funds are withdrawn. At that time, the tax is at ordinary income rates and not capital gains rates. If the capital gain happens in a taxable account or from property held directly by the investor, then capital gains tax would apply.

The second factor that impacts capital gains tax is the length of time the investment is held. If the holding period for the capital gain is less than one year, then the gain is taxed at the taxpayer's ordinary income rates. If the holding period is one year or more, then the gain would qualify for a lower long-term rate. If a taxpayer has capital losses, then those can offset the capital gains and reduce the amount subject to tax.

The federal taxation of long-term capital gains can be somewhat complex. The rate can vary from 0% to 15% or even 20% depending on income level. Here are the tax rates for long-term capital gains in 2022:

	0% RATE	15% RATE	20% RATE
SINGLE	UP TO $41,675	$41,676 TO $459,750	OVER $459.750
MARRIED FILING JOINTLY	UP TO $83,350	$83,351 TO $517,200	OVER $517,200

Ohio taxes capital gains at the same rate as any other taxable income. Most states would also tax capital gains at the same rate as other income.

Now that we have covered the basics, a few examples might help.

James purchased 100 shares of Apple stock in a taxable account, held it for 18 months and then sold his stock. His gain on that sale was $5,000. Since his holding period was for more than one year, this would qualify for long-term capital gains treatment. If James is single and his other taxable income is $35,000, then he would fall in the 0% capital gains rate and he would pay no federal tax. James would pay approximately 3% in Ohio tax. If this had been a capital gains distribution from a mutual fund that was long term in the amount of $5,000, the tax result would be the same.

Mary and Chris are surprised when their taxes are prepared that they have $8,000 of capital gains even though they did not sell their mutual fund. Their taxable income is $105,000, so they are subject to the 15% capital gains tax rate. In addition to this, they also pay 3% Ohio tax on this $8,000 gain.

There are also implications on the share price of the mutual fund when a capital gain distribution occurs. In the example above, let's assume the price of the fund before the capital gains distribution was $10.00 per share and they owned 10,000 shares. Their total value was $100,000. When the $8,000 capital gain distribution occurred, the funds were reinvested and they bought 800 more shares at $10 per share.

The market value of the shares drops by the 8% distribution so the new share price is $9.26. They now own 10,800 shares with a value of $9.26 per share for a total value of $100,000. The capital gain distribution lowered the share price and increased their total basis to $108,000. If they would sell immediately after this event for $108,000, there would be NO additional capital gain because the capital gain distribution would have added $8,000 to their basis.

One of the challenges for us as advisors is balancing investment performance with tax issues. As this article indicates, the capital gains distribution and tax implications can be a complex issue. We always attempt to consider tax consequences as well as overall investment performance when helping clients with their investments.

MARKET RECAP

How the major indices performed in the 1st Qtr. 2022

DOW JONES INDUSTRIAL AVERAGE

1st QTR. RETURN: -4.57% YTD RETURN: -4.57%

S & P 500 COMPOSITE

1st QTR. RETURN: -4.95% YTD RETURN: -4.95%

RUSSELL 2000

1st QTR. RETURN: -7.8% YTD RETURN: -7.8%

BARCLAYS AGGREGATE BOND

1st QTR. RETURN: -5.93% YTD RETURN: -5.93%

NASDAQ COMPOSITE

1st QTR. RETURN: -9.1% YTD RETURN: -9.1%

**All indices are reported Total Return which includes Dividends*

MARKET UPDATE

BY GREG EMMONS, CFP®
INVESTMENT ADVISOR REP.

Sluggish Start for Stocks

The start of 2022 has been tough for equities. Inflation, increasing interest rates, and the war in Ukraine have all rippled through the markets here in the US and abroad. Thankfully the market started to climb back around the middle of March, but it still finished down overall for the quarter. The S&P 500 and NASDAQ were both down 4.9% and 9.1%, respectively.

Bonds Move Backwards

The US Aggregate Bond Index was down 5.93% for the first quarter of 2022. Increasing interest rates typically have this effect on the bond market. With the Fed having raised rates 0.25% in March and a possible 0.50% hike in May, the bond market might have a tough time finding its footing this year.

DID YOU KNOW?

TAX DAY WASN'T ALWAYS APRIL 15

In 1913, Tax day was March 1. Five years later, it was moved to March 15. Tax day didn't officially become April 15 until 1954.

FEW PEOPLE OWED INCOME TAX PRIOR TO WORLD WAR II

Because of a high personal exemption, only 1.1% of working Americans in 1916 needed to file a return and 17% of those filers didn't owe the government any additional tax. By 1942, the personal exemption dropped causing 85% of working Americans to file a tax return.

REST ASSURED...EVEN EINSTEIN DIDN'T UNDERSTAND TAXES

According to Einstein's tax preparer, Leo Mattersdorf, Einstein once said, "The hardest thing in the world to understand is the income tax."

LET'S DO THE MATH

The IRS estimates that the average return took tax filers 13 hours to complete. In 2019, the IRS processed over 154 million tax returns for individuals, which adds up to over 2 billion hours (or 83.4 million days) Americans spent on tax prep!

Our Part 2 of Form ADV: Firm Brochure, which provides information about the qualifications and business practices of Lighthouse Wealth Management, as well as our ADV Part 3: Client Relationship Summary are both available on our website www.lightwealth.com. To request paper copies contact us today at: 419-496-0016.

Lighthouse Wealth Management
1078 Commerce Parkway
Ashland, Ohio 44805

Tim Rowsey, CPA, Founder
Investment Advisor Representative
Cell: 567-215-3015
trowsey@lightwealth.com

Aaron Rowsey, Vice President
Investment Advisor Representative
Cell: 419-606-5239
arowsey@lightwealth.com

Greg Emmons, CFP®, President
Investment Advisor Representative
Cell: 419-651-1507
gemmons@lightwealth.com

Chris Bevington, CPA, MTAX, CFP®
Investment Advisor Representative
Cell: 419-569-2139
cbevington@lightwealth.com

Katie Brown, Office Manager
kbrown@lightwealth.com

TAKE A COMPLIMENTARY RISK ASSESSEMENT

Lighthouse Wealth Management is an independent, fee-only, investment advisory firm. We partner with you to help you navigate all the financial challenges of life. To learn more about the benefits of working with an independent advisor, visit **www.findyourindependentadvisor.com**

LET US GUIDE YOU WITH YOUR

INVESTMENTS

RETIREMENT PLANNING

401(k) ROLLOVERS

TAX PLANNING & PREPARATION

FINANCIAL QUESTIONS

CONTACT US TODAY FOR A FREE INVESTMENT REVIEW!