ROCKBRIDGE INVESTMENT MANAGEMENT

FINANCIAL COMMON SENSE April 2021

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Our vision at Rockbridge is to provide our clients with unrivaled financial advice; building lifelong relationships and empowering them to fully enjoy their lives.

We believe the success we share with our clients is driven by a relentless focus on our culture and core values: Honesty, Curiosity, Discipline and Excellence.

Bonds are Down on the Year and that is OK

by Ethan Gilbert

Most of our clients hold bonds and most of those bonds have "lost value" in the first three months of the year. That does not mean any of the bonds have defaulted. In fact, almost no bonds have defaulted in 2021. Rather, interest rates have risen causing the value of existing bonds to drop.

It may seem counterintuitive that yields going up means bonds are worth less. At first glance one might think if bonds are now paying higher interest rates, they should be worth more. While that is relatively true if you are buying new bonds, the bonds that investors hold are bonds that have been issued in the past.

The rise in interest rates is what caused our bonds to drop in value. The most common bond holding is an aggregate bond fund. Vanguard's Total Bond Market (VBTLX/BND) has an average bond duration of 6.6 years. The 7-year treasuries have seen a 0.75% increase in yield this year. Multiply the interest rate move (0.75%) by the duration (6.6) and you get a price movement of -4.9%. That, plus the interest earned, some movement in credit spreads, and stronger mortgage-backed performance, and you get a year-to-date return of -3.6%.

While this is painful in the short term, it means future returns will be higher, which benefits investors over the long run. Regardless of short-term performance, bonds make sense for many people for the following three reasons:

- **They pay interest:** Even if it's less than historical rates, it's better than nothing, which is what we are getting in checking/savings accounts.

- **They are less volatile than stocks:** So far, 2021 has been a bad year for bonds, and they are down 3.5%. A year ago, stocks were having a bad year and they were down 30%. The magnitude of bond movement is much less than stocks.

- **They provide a diversification benefit:** When the stock market is falling during times of economic turmoil, interest rates are normally falling as well. That means bonds are appreciating in value which gives us extra money to rebalance back into stocks, buying the stocks at cheap prices.

Lastly, while interest rates are expected to rise, it doesn't mean they will. At the start of 2019, the U.S. 10-year bond was at 2.66% and expected to rise. A year later it was at 1.88% and again forecasted to rise. At the start of this year, it was yielding 0.93%. No one knows what interest rates will do in the future, so we will maintain our discipline and continue holding bonds. ◆

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The American Rescue Plan Act of 2021: Understanding The 2021 Recovery Rebate Stimulus Payments *by the Rockbridge Team*

The American Rescue Plan Act of 2021 is now a done deal. Among the items of greatest interest to most Americans is a third round of stimulus checks – or IRS "recovery rebates" – of up to **$1,400** for every "eligible individual." That's the quick take. But what's the fine print?

How Much Will You Receive?

Each eligible individual in your household should receive **$1,400**. Eligible individuals include:

1. You, as an individual taxpayer
2. Your spouse (if you are filing a joint tax return)
3. Any dependents you are claiming on your tax return, ***regardless of their age***

> ***For example:*** A married couple filing jointly and claiming three dependents on their tax return would be eligible for $1,400 x 5 = **$7,000**. This is the case even if the dependent is, say, an adult child in college, or a parent in assisted living.

The catch? Whether you receive a full, a partial, or no rebate depends on your Adjusted Gross Income (AGI) on your tax return:

If you are …	You receive a full rebate if your AGI is …	You receive a partial rebate if your AGI is …	You won't receive a rebate if your AGI is …
Single, or married filing separate	Under $75,000	$75,000–$80,000	Over $80,000
Head of household	Under $112,500	$112,500–$120,000	Over $120,000
Married, filing jointly	Under $150,000	$150,000–$160,000	Over $160,000

All this begs the question: ***Which AGI are we talking about?*** Technically, the stimulus payment is a 2021 Recovery Rebate. But like our Great American Pastime (baseball), you actually get up to three "at bats," or years in which to qualify for a full or partial rebate.

Pitch #1: Your 2019 or 2020 Tax Return, Already Filed

Initially, the IRS will look at the AGI reported on the most recent tax return you've already filed, whether that's your 2019 or 2020 return. If your AGI falls within the "full rebate" parameters above, you can expect to receive your full 2021 Recovery Rebate. Where will the money go? If the IRS has a checking account on file for you, they should be able to issue a direct deposit into that account. Otherwise, they should mail you a check or debit card to your address on file.

> ***Note:*** Even if you end up reporting higher income in subsequent years, you will get to keep the full amount of any payment you receive from Pitch #1. The IRS will ***not*** come after you, asking for you to pay it back.

Pitch #2: Your 2020 Tax Return, To Be Filed

What if you've not yet filed your 2020 tax return, but your 2019 income was too high to qualify you for a full rebate? Good news: You get another chance once you file your 2020 return. At that time, the IRS will perform an "additional payment determination." If your 2020 return qualifies you for a higher rebate than your 2019 return did, the IRS will essentially send you the difference, again via direct deposit or mail. You could receive:

- **A full or partial payment:** If you received nothing based on your 2019 return, but you now qualify for one or the other based on your 2020 income.

The American Rescue Plan Act of 2021 *Continued*

- **A *second* partial payment:** If you already received a partial payment, but you now qualify for more based on your 2020 income.
- **Nothing:** If your AGI is still too high to qualify.

> ***Note***: To qualify for an additional payment determination, be sure to file your 2020 tax return on a timely basis, ***extended to May 17,2021.***

Pitch #3: Your 2021 Tax Return
What if neither your 2019 tax return nor your 2020 return qualify you for a full rebate? You still have one more chance. If your 2021 income is low enough to qualify, you will be able to file for a credit on your 2021 tax return for any amounts not already received.

Additional Ideas: What's a Taxpayer To Do?
You may have noticed, the range for receiving a partial payment is ***very*** narrow, which means fewer taxpayers will fall into it. Most of us will either qualify for a full rebate … or none at all.

If you do fall into the partial-rebate range, the amount you'll receive will be calculated based on a straight percentage.

> ***For example:*** A couple filing jointly with no dependents reports an AGI of $155,000, smack in the middle of the $150,000-$160,000 range. This means half of their rebate will be phased out. Instead of receiving $1,400 x 2 = $2,800, they'll receive half of that, or $1,400.

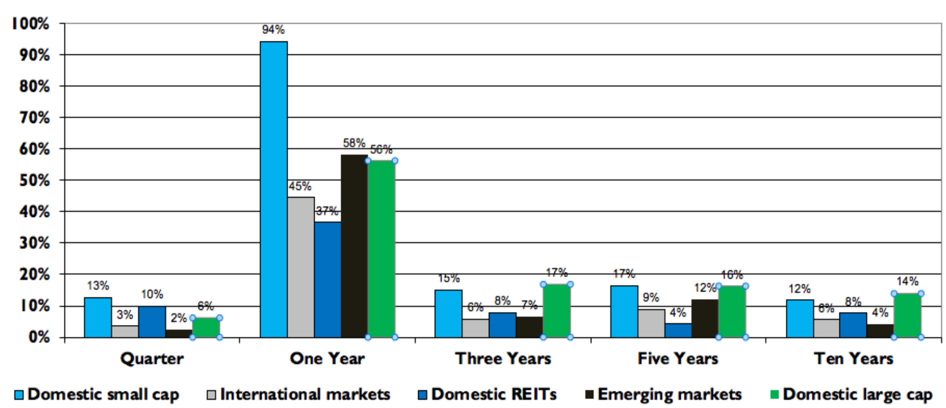
Also, the squeaky-tight gap between receiving a full payment versus nothing at all means a little tax planning could go a long way between now and year-end. Especially if your annual income is close to qualifying you for a recovery rebate, we should touch base soon to explore any 2020 or 2021 tax-planning opportunities that may help. Even if your income falls well within the "yes" or "no" recovery rebate ranges, please let us know if we can address any additional questions or comments. It's what we're here for! ◆

Market Commentary *by Bob Ryan*

Stock Markets

Stocks continued to climb in the first quarter and these results are signaling a robust economy ahead. Markets have made a dramatic rebound since the sharp fall in the first quarter last year. Look at the returns over the past twelve months in the chart to the right. Also note that stocks traded in domestic markets have outperformed in all periods. However, avoid extrapolating past results over long periods into the future.

Stock Market Returns over Periods Ending March 31, 2021
(Returns greater than a year are annualized)



Recent periods demonstrate the importance of diversification, which is the only "free lunch" in investing; it can increase expected returns without increased risk. To realize these benefits it is necessary to buy low and sell high; and while this sounds easy, it is not.

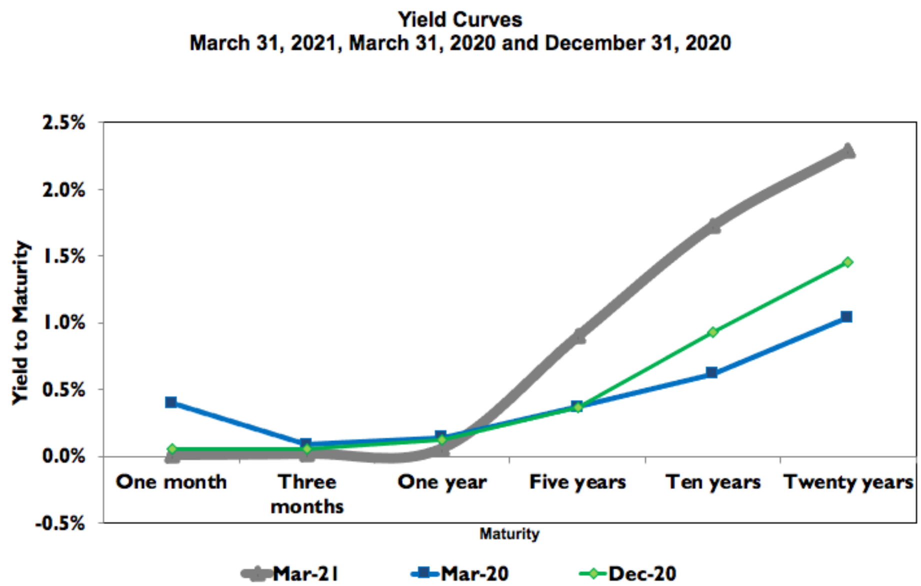
Market Commentary *Continued*

Monitoring a diversified portfolio must also be done with care. The usual process is to compare results against popular indices. Yet, a diversified portfolio will always behave differently from these benchmarks. Making good long-term decisions means understanding variances, not just measuring them. The slight variations among the portfolio's allocations versus that of a benchmark is apt to have a profound impact – comparisons must be done with care.

Bond yields at the longer end were up in the first quarter – the bellwether 10-year Treasury yield was up 0.8% this period. Short-term yields stayed at zero reflecting the Fed commitment to keep interest rates low. Bond returns are inversely related to changes in yield, which meant returns of about zero on short-term bonds – an index of long-term Treasury bonds was down almost 6% this quarter.

Bond Markets

The Yield Curve shows the pattern of yields to maturity of U.S. Treasury securities over several maturities can be thought of as a series of expected future short-term interest rates through time. The difference between the one-year yield and 10-year yield on Treasury securities is about 1.75% today. While the absolute levels of bond yields are low, this difference is large by historical standards and may be signaling higher rates ahead.



The Fed has been fighting the pandemic-induced recession by doing the best it can to keep interest rates low. Even though the Fed has announced it will maintain this strategy over the next few years, a more robust economy will provide cover for a rise in interest rates.

Based on the steepness of today's Yield Curve, a robust recovery and extraordinary government spending, "up" is the most likely answer to the question: Where are interest rates going? We will see.

Inflation

Inflation is beginning to be a concern. The $1.9 Trillion stimulus package plus talk of a $2 Trillion Infrastructure package all on top of a $3.1 Trillion deficit is unprecedented and brings uncertainty. The inflationary impact of spending to lessen the pain of a 100-year pandemic if managed well can be temporary. However, stimulus spending in a sharply growing economy, which many expect, can produce a sustained upward pressure on prices. Although there is no sign of anything that looks like inflation yet, from a historical perspective the ingredients are there. ◆

Returns from Various Markets

The following table shows the returns from various markets over periods ending March 31, 2021:

Market/Asset Class	Quarter	YTD	1 Year	3 Years	5 Years	10 Years	20 Years
FIXED INCOME							
3-Month US Treasury Bills	0.02%	0.02%	0.12%	1.50%	1.19%	0.63%	1.43%
Bloomberg Barclays US Agg Bond	-3.37%	-3.37%	0.71%	4.65%	3.11%	3.44%	4.50%
Bloomberg Barclays 1-5 Yr Credit	-0.57%	-0.57%	5.88%	4.31%	3.06%	2.90%	4.08%
DOMESTIC STOCKS							
S&P 500	6.17%	6.17%	56.35%	16.77%	16.30%	13.91%	8.47%
S&P 500 Value	10.77%	10.77%	50.37%	11.83%	12.32%	11.14%	7.00%
S&P 500 Growth	2.12%	2.12%	59.43%	20.58%	19.36%	16.16%	9.62%
Russell 2500	10.93%	10.93%	89.41%	15.34%	15.94%	12.20%	10.51%
Russell 2500 Value	16.83%	16.83%	87.47%	10.89%	12.16%	10.23%	9.89%
Russell 2500 Growth	2.49%	2.49%	87.49%	19.93%	19.91%	14.20%	10.82%
MSCI US REIT	8.76%	8.76%	37.69%	9.51%	5.32%	8.53%	9.92%
INTERNATIONAL STOCKS							
MSCI EAFE	3.48%	3.48%	44.57%	6.02%	8.85%	5.52%	5.45%
MSCI Emerging Markets	2.29%	2.29%	58.39%	6.48%	12.07%	3.65%	10.02%
U.S. Consumer Price Index	0.98%	0.98%	1.90%	1.77%	2.01%	1.64%	2.02%

Note: These results were developed by simulating past returns in the various markets included in each benchmark, assuming the reinvestment of dividends and other earnings. The BofA Merrill Lynch 3-Month U.S. Treasury Bill Index represents money market/cash; the Bloomberg Barclays US Aggregate Bond Index represents the total U.S. bond market; the Bloomberg Barclays 1-5 Yr Credit Index represents the U.S. corporate bond market; the S&P 500, S&P 500 Value Index and S&P 500 Growth Index represent the domestic large-cap market; the Russell 2500, Russell 2500 Value Index and Russell 2500 Growth Index represent the domestic small-cap market; the MSCI U.S. REIT Index represents the U.S. real estate market; the MSCI EAFE Index represents the developed international equity market; the MSCI Emerging Markets Index represents international emerging markets. Benchmark Portfolio returns include Real Estate and Emerging Markets allocations beginning in July 2011. Benchmark Portfolio returns do not include allocations to these asset classes prior to June 30, 2011. Benchmark portfolio returns include Corporate Bond Market as of January 1, 2019 and do not include an allocation to this asset class prior to this. This data is presented to show the long-term relationship between returns at various levels of investment risk. It is not intended to present performance results experienced by clients of Rockbridge Investment Management, but is intended to provide a benchmark against which actual performance might be judged. Also, readers should recognize that future investments would be made under different economic conditions. It should not be assumed that future investors would experience returns, if any, comparable to those shown above. The information given is historic and should not be taken as any indication of future investment results.

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