THE PRUDENT SPECULATOR

Death & Taxes, but Not Death from Taxes

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Stocks have come a long way in the year since the market bottomed on March 23, 2020, even as the pandemic has been far more deadly and damaging to the economy than most expected. And there have been other more recent bricks in the Wall of Worry, including the early-November U.S. elections, the significant increase in interest rates this year, the Archegos implosion and the traffic jam in the Suez Canal caused by the vessel Ever Given running aground.

Nevertheless, Figure 1 shows that equities, especially those of the Value variety, have provided handsome rewards for those who stayed the course, remaining focused on their long-term investment objectives. No doubt, it was not easy to keep the faith, as there were numerous siren songs calling folks to the sidelines, especially as purveyors of doom and gloom always seem to sing loud. Happily, equities have provided yet another reminder that time in the market trumps market timing.

There are new concerns as we head into spring and summer. Most expect the economy to kick into high gear this year, including the all-important Federal Reserve, with Jerome H. Powell stating last month, "The recovery has progressed more quickly than generally expected and looks to be strengthening." However, the Fed Chair was quick to add, "But the recovery is far from complete, so, at the Fed, we will continue to provide the economy the support that it needs for as long as it takes."

Of course, that long-playing accommodative monetary policy stance has some folks fretting about the potential for higher inflation, but history shows that such an occurrence has not been a bad thing for Value stocks. And, the same can be said for perhaps the grandest cause of investor consternation today, the threat of higher taxes.

Total Returns			
Equity Index	Since December 31, 2020	Since October 31, 2020	Since March 23, 2020
Dow Jones Industrial Average	8.3%	25.6%	81.3%
NYSE Composite	8.0%	26.7%	82.3%
Russell 3000	5.8%	24.0%	87.1%
Russell 3000 Growth	-0.2%	15.8%	85.8%
Russell 3000 Value	**12.3%**	**33.0%**	**86.0%**
S&P 500 Equal Weighted	11.6%	33.0%	101.1%
S&P 500	5.8%	21.9%	80.0%
S&P 500 Growth	2.1%	16.6%	82.5%
S&P 500 Value	**10.8%**	**29.4%**	**76.0%**
S&P 500 Pure Growth	0.8%	18.3%	92.0%
S&P 500 Pure Value	**21.0%**	**49.8%**	**123.6%**

Figure 1: A Value Renaissance

Through 03.31.2021. Index definitions are available at the end of the Insight. SOURCE: Kovitz using data from Bloomberg Finance L.P.

UNCLE SAM IS GOOD FOR VALUE STOCKS

As Ben Franklin said, "In this world, nothing can be said to be certain, except death and taxes," and we know that a big concern for many folks is the current debate in Washington D.C. over higher taxes. Lawmakers have been contemplating sweeping changes to taxes on individual income, capital gains, dividends, estate values and corporate income, though specifics remain elusive as this Insight goes to press. Of course, Congress still has plenty of time to change course and may shelve changes for 2021 as the global economy climbs out of the pandemic-related recession. But even if nothing materializes this year, investors would be right to consider the implications of higher tax rates on their investments beginning in 2022.

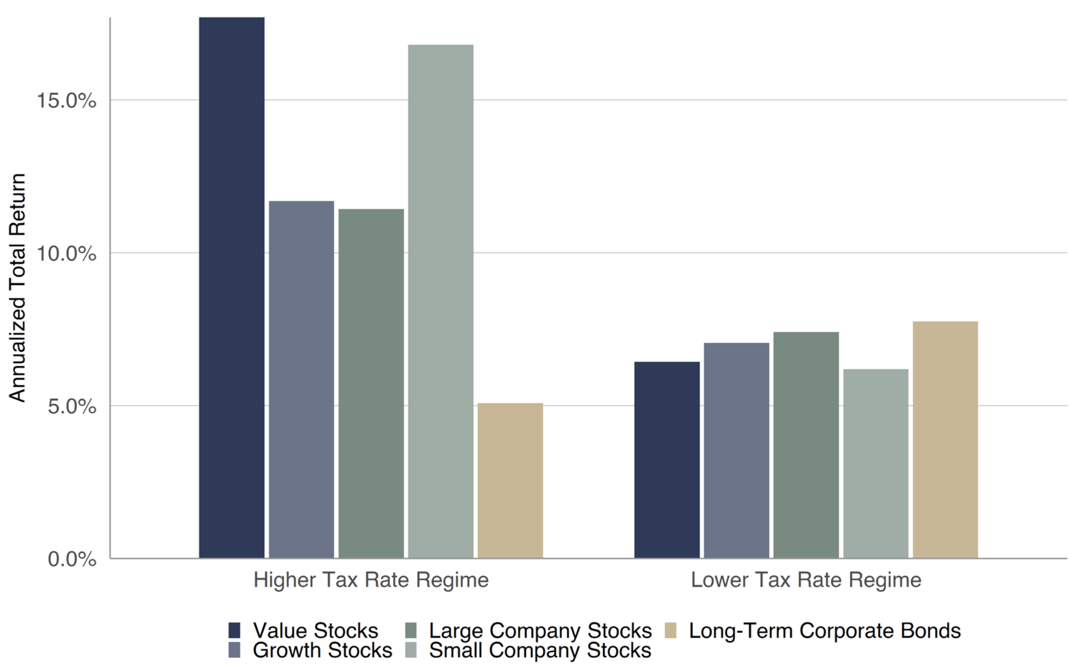
We, like almost everyone else, do not want to pay higher taxes, and we are not suggesting anyone should be happy about future tax hikes. However, income taxes and corporate taxes generally are not that high by historical standards, as we chart

Figure 2:
Long-Term
U.S. Tax Rates

Tax years 1930 through 2020. SOURCE: Kovitz using data from the Internal Revenue Service

Figure 3:
Market Performance
by Tax Rate Regime

From 12.31.1929 through 12.31.2020. Geometric average annualized total return. Index definitions are available at the end of the Insight. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French, Morningstar and the Internal Revenue Service



in Figure 2. And more than nine decades of data charted in Figure 3 shows that equities, led by Value stocks, have performed very well on average when personal tax rates are higher than the 39.6% rates levied in the Obama and Clinton administrations.

We take a more granular look at the years in which there has been an individual tax increase in Figure 4 and a corporate tax increase in Figure 5. The data suggest that, on average, Value stocks have enjoyed outsized returns in the year in which individual tax rates were raised and very good relative returns in the years in which corporate tax rates were hiked, with the caveat that wide gaps between maximum and minimum values suggest that macroeconomic conditions, including the Great Depression, and geopolitical events seem to have a more significant impact on market performance than tax rates.

Figure 4: Value and Small Company Stocks Shine

Tax years 1930 through 2020. Index, geometric average and simple average definitions are available at the end of this Insight. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French, Morningstar and the Internal Revenue Service

Returns in Years With Maximum U.S. Individual Income Tax Rate Increase

Year & Tax Rate Change	Value Stocks	Growth Stocks	Large Company Stocks	Small Company Stocks	Long-Term Corporate Bonds
1930: from 24% to 25%	-43.6%	-31.6%	-24.9%	-38.1%	8.0%
1932: from 25% to 63%	3.2%	-7.2%	-8.2%	-5.4%	10.8%
1936: from 63% to 79%	65.0%	29.8%	33.9%	64.8%	6.7%
1940: from 79% to 81.1%	-7.2%	-6.5%	-9.8%	-5.2%	3.4%
1942: from 81% to 88%	35.6%	15.9%	20.3%	44.5%	2.6%
1944: from 88% to 94%	44.0%	27.9%	19.8%	53.7%	4.7%
1950: from 82.13% to 84.36%	54.2%	27.2%	31.7%	38.7%	2.1%
1951: from 84.36% to 91%	13.0%	18.9%	24.0%	7.8%	-2.7%
1952: from 91% to 92%	13.9%	10.5%	18.4%	3.0%	3.5%
1968: from 70% to 75.25%	36.3%	17.5%	11.1%	36.0%	2.6%
1969: from 75.25% to 77%	-20.9%	-11.5%	-8.5%	-25.1%	-8.1%
1991: from 28% to 31%	33.8%	48.3%	30.5%	44.6%	19.9%
1993: from 31% to 39.6%	22.9%	5.7%	10.0%	21.0%	13.2%
2013: from 35% to 39.6%	41.0%	38.4%	32.4%	45.1%	-7.1%
Geometric Average Return	**16.6%**	**11.0%**	**11.3%**	**16.1%**	**4.0%**
Simple Average Return	**20.8%**	**13.1%**	**12.9%**	**20.4%**	**4.3%**
Maximum Return	**65.0%**	**48.3%**	**33.9%**	**64.8%**	**19.9%**
Minimum Return	**-43.6%**	**-31.6%**	**-24.9%**	**-38.1%**	**-8.1%**

Figure 5: Value and Small Company Stocks Outperform

Tax years 1930 through 2020. Index, geometric average and simple average definitions are available at the end of this Insight. SOURCE: Kovitz using data from Professors Eugene F. Fama and Kenneth R. French, Morningstar and the Internal Revenue Service

Returns in Years With Maximum U.S. Corporate Income Tax Rate Increase

Year & Tax Rate Change	Value Stocks	Growth Stocks	Large Company Stocks	Small Company Stocks	Long-Term Corporate Bonds
1930: from 11% to 12%	-43.6%	-31.6%	-24.9%	-38.1%	8.0%
1932: from 12% to 13.75%	3.2%	-7.2%	-8.2%	-5.4%	10.8%
1936: from 13.75% to 15%	65.0%	29.8%	33.9%	64.8%	6.7%
1938: from 15% to 19%	27.1%	39.5%	31.1%	32.8%	6.1%
1940: from 19% to 38.3%	-7.2%	-6.5%	-9.8%	-5.2%	3.4%
1941: from 38.3% to 44%	-3.4%	-14.6%	-11.6%	-9.0%	2.7%
1951: from 42% to 50.75%	13.0%	18.9%	24.0%	7.8%	-2.7%
1952: from 50.75% to 52%	13.9%	10.5%	18.4%	3.0%	3.5%
1968: from 48% to 52.8%	36.3%	17.5%	11.1%	36.0%	2.6%
Geometric Average Return	**7.5%**	**4.0%**	**5.2%**	**5.9%**	**4.5%**
Simple Average Return	**11.6%**	**6.3%**	**7.1%**	**9.6%**	**4.6%**
Maximum Return	**65.0%**	**39.5%**	**33.9%**	**64.8%**	**10.8%**
Minimum Return	**-43.6%**	**-31.6%**	**-24.9%**	**-38.1%**	**-2.7%**

FEAR NOT

With vaccines likely to help put the pandemic behind us, economic growth should be terrific this year. The Federal Reserve is likely to remain highly accommodative and valuations remain reasonable (please see our March 2021 Insight, *Not Bubbling Yet, available at Kovitz.com/Insights*) in certain segments of the market given the still-very-low interest rate environment, which leaves us steadfast in our affinity for Value stocks and our encouragement that investors stick with their long-term plans. True, there is no shortage of worries in the world today, but we like the perspective of Vannevar Bush, "Fear cannot be banished, but it can be calm and without panic; it can be mitigated by reason and evaluation." After all, as Lao Tzu said, "If you do not change direction, you may end up where you are heading."

PICKS FOR A RISING TAX RATE REGIME

In this report, we include our write-up for CVS Health, which we think is undervalued and believe may experience little negative impact from rising tax rates. And in our full report, available here: https://info.theprudentspeculator.com/lp/value-and-taxes), we offer CVS plus nine additional picks with write-ups.

CVS HEALTH (CVS)

CVS operates one of the largest domestic retail pharmacy networks and is a leading pharmacy benefits manager. CVS also serves an estimated 34 million people through traditional, voluntary and consumer-directed health insurance products and related services (via its Aetna merger). With assets that operate across the health care value chain, CVS has a great opportunity to improve health outcomes and costs, while adding convenience for its customers. The company continues to roll out its HealthHub model beyond the existing Minute Clinic format, while foot traffic for the drugstores is likely benefitting from the company's role in COVID-19 vaccination programs. Although the competitive landscape is challenging, the regulatory environment presents uncertainty and the opioid litigation threat remains front and center, we like that CVS continues to generate lots of cash and has strong potential to evolve its business to a broader health care delivery model. Shares trade for a very reasonable sub-ten times estimated 2021 earnings and yield 2.7%.

For additional information about subscribing to the *The Prudent Speculator* newsletter, or details about our asset management and wealth management services, please call Phil Edwards at 800.258.7786 or email pedwards@kovitz.com.

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The description of products, services, and performance results contained herein is not an offering or a solicitation of any kind. Past performance is not an indication of future results. Securities investments are subject to risk and may lose value.

All returns are geometric average unless otherwise stated. The geometric average is calculated using the mean of a set of products that takes into account the effects of compounding. The figure is calculated as the annualized return of the product of the chained individual returns. The simple average is the sum of the data set by the length of the data set.

The federal funds rate is the rate banks charge on loans to each other overnight.

The quoted forward yield for the S&P 500 uses the iShares S&P 500 ETF (ticker: SPY) as a proxy. The quoted forward yield for the S&P Core Value uses iShares Core S&P U.S. Value ETF (ticker: IUSV) as a proxy. The quoted forward yield for the S&P Core Growth uses iShares Core S&P U.S. Growth ETF (ticker: IUSG) as a proxy.

The factor-based (book value-to-price) portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into four groups: large value, large growth, small value and small growth. The aggregate Value and Growth portfolios are monthly averages of the two returns.

The Standard & Poors 500 index (S&P 500) is a broad stock market index based on the market capitalizations of the largest 500 companies listed in the U.S. Small company stocks, via Ibbotson Associates, are the bottom twenty percent of the New York Stock Exchange. Large company stocks, via Ibbotson Associates, are represented by the S&P 500 index. The S&P 500 Growth Index is a market capitalization weighted index. All the stocks in the underlying parent index are allocated into value or growth. Stocks that do not have pure value or pure growth characteristics have their market caps distributed between the value & growth indices. Prior to 12/19/2005 this index represented the S&P 500/Barra Growth Index. The S&P 500 Value Index is a market capitalization weighted index. All the stocks in the underlying parent index are allocated into value or growth. Stocks that do not have pure value or pure growth characteristics have their market caps distributed between the value & growth indices. Prior to 12/19/2005 this index represented the S&P 500/Barra Value Index. The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

Growth stocks = 50% Fama-French small growth and 50% Fama-French large growth returns rebalanced monthly. Value stocks = 50% Fama-French small value and 50% Fama-French large value returns rebalanced monthly. The portfolios are formed on Book Equity/Market Equity at the end of each June using NYSE breakpoints via Eugene F. Fama and Kenneth R. French. Dividend payers = 30% top of Fama-French dividend payers, 40% of middle Fama-French dividend payers, and 30% bottom of Fama-French dividend payers rebalanced monthly. Non-dividend payers = Fama-French stocks that do not pay a dividend.

Long term corporate bonds represented by the Ibbotson Associates SBBI US LT Corp Total Return index. Long term government bonds represented by the Ibbotson Associates SBBI US LT Govt Total Return index. Intermediate term government bonds represented by the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills represented by the Ibbotson Associates SBBI US 30 Day TBill Total Return index. Inflation represented by the Ibbotson Associates SBBI US Inflation index.

The NYSE Composite Index is a float-adjusted market-capitalization weighted index which includes all common stocks listed on the NYSE, including ADRs, REITs and tracking stocks and listings of foreign companies. The index was recalculated to reflect a base value of 5,000 as of December 31, 2002.

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

The Russell 3000 Index is composed of 3000 large U.S. companies, as determined by market capitalization. This portfolio of Securities represents approximately 98% of the investable U.S. equity market. The Russell 3000 Index is comprised of stocks within the Russell 1000 and the Russell 2000 Indices. Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values.

From 1927 to present, we utilized the dividend-weighted portfolio data from Eugene F. Fama and Kenneth R. French. The dataset is broken into five groups: non-dividend paying, top 30% of dividend payers, middle 40% of dividend payers, bottom 30% of dividend payers and all dividend payers (weighted 30% of top dividend payers, 40% of middle dividend payers and 30% of low dividend payers).

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