# STILL NO HINT OF RECESSION, BUT FED SET TO STIMULATE

## BUT FIRST, PLEASE PAY ATTENTION TO HOW YOU REPORT GAINS AND LOSSES TO THE IRS

With respect to non-retirement accounts, custodians such as Shareholders Service Group must report the sales proceeds from all investment securities that were disposed of during a given year to the IRS. (Because retirement accounts are taxed differently, they are reported differently so this discussion applies only to non-retirement accounts.) Reporting the sales proceeds from all sales transactions occurring within a given year provides the IRS with at least some of the information it needs to assess the accuracy of the taxable gains and deductible losses investors later report on their income tax returns. Before I go further, it's worth noting that an investor's taxable profit or deductible loss for a given tax year is determined by the following equation:

> Gross Sales Proceeds — Basis = Profit (Loss)
>
> Note: An investor's "basis" in an asset refers to how much that investor is considered to have invested in that asset. In cases where an investor acquires an asset via purchase. the investor's basis is simply the cost of that asset. The investor's basis is then referred to as "cost basis." In cases where an investor acquires an asset via gift or inheritance, other rules apply. In terms of tax reporting, that investor is said to have a basis "other" than cost. And CPAs wonder why people steer clear of them at parties ...

In cases where gross sales proceeds exceed basis, an investor will have a profit. When the converse is true, the investor will have a loss. **While custodians automatically report *all* sales proceeds to the tax authorities, they do not necessarily report *all* basis. To the extent any portion of an investor's basis goes unreported to the IRS, that investor's taxable gains will be overstated or his or her deductible losses will be understated. Either way, the investor stands to lose. Therefore, it's in your interest to ensure your income tax returns reflect 100% of the basis you have in any investment securities that have been sold during a given tax year.** Again, this issue applies only to non-retirement accounts.

## WHY DON'T CUSTODIANS NECESSARILY REPORT ALL BASIS?

There's no conspiracy. Years ago, the job of tracking basis and reporting it to the IRS fell in the laps of investors/taxpayers and occurred solely through the income-tax-filing process.

However, tracking the basis of investment securities requires meticulous record keeping. And, because taxpayers often hold their investment securities for extended periods, taxpayers were tasked with maintaining those meticulous records for many years or even decades. Unsurprisingly, they had difficulty complying with these record-keeping requirements so Congress stepped in to shift the burdens associated with tracking and reporting basis from taxpayers to custodians which now automatically report that data to the IRS … for transactions *covered* by these rules.

### "COVERED" VS "NONCOVERED" TRANSACTIONS

To allow custodians time to adapt and comply with the automated basis tracking and reporting rules that are now in effect, different types of securities became subject to the automated reporting requirements over a span of years. In cases where an investment security is acquired *after* the automated basis tracking and reporting rules began applying to that type of security, any subsequent *sale* of that security is said to be "covered" by those rules. That is, the custodian that handles the subsequent sale must not only report to the IRS the gross proceeds from its sale (which it must do whether the sale is "covered" or "noncovered"), it must *also* report the *basis* associated with that security. In cases where an investment security is acquired *prior* to the time the automated basis tracking and reporting rules began to apply to that type of security, the subsequent sales transaction is deemed to be "noncovered" by those

**Summary of Form 1099-B**

Details are reported to the IRS. Refer to the 1099-B section of this statement for those details.

| | Amount |
|---|---|
| Gross Proceeds (Covered and Noncovered Transactions) When preparing your tax returns, do not | 82,896.86 ✓ |
| Cost or Other Basis (Covered Transactions Only) assume this basis figure is complete! ⟶ | 46,143.12 ✗ |
| **Federal Tax Withheld - Proceeds** | **0.00** |
| State Tax Withheld - Proceeds | 0.00 |
| ***Regulated Futures and Foreign Currency Forward Contracts:*** | |
| Profit or (Loss) Realized in 2018 | 0.00 |
| Unrealized Profit or (Loss) on Open Contracts - 12/31/2017 | 0.00 |
| Unrealized Profit or (Loss) on Open Contracts - 12/31/2018 | 0.00 |
| Aggregate Profit or (Loss) | 0.00 |
| **Fed. Tax Withheld - Reg. Futures and Foreign Curr. Forward Contracts** | **0.00** |
| State Tax Withheld - Reg. Futures and Foreign Curr. Forward Contracts | 0.00 |

automated reporting rules. Note the example on the previous page. This summary, which is transmitted directly to the IRS by Shareholders Service Group, specifies that the basis included in the summary pertains only to "covered" securities.

### INFORMATIONAL ASYMMETRY MEANS YOU CAN LOSE, BUT YOU CAN NEVER BENEFIT

Since custodians report the gross proceeds from sales transactions to the IRS whether a given sales transaction is "covered" or "noncovered" under the automated basis tracking and reporting rules, but report the basis associated with those sales only for "covered" transactions, the IRS receives *complete* tax information directly from custodians for "covered" transactions, but *possibly incomplete* information from them for "noncovered" ones.

Using the figures at the left, the IRS knew, upon receiving information directly from Shareholders Service Group, that this taxpayer received $82,897 in gross proceeds from the sale of investment securities during the year in question. The IRS also knew that this taxpayer had "basis" in those sales transactions of *at least* $46,143 because it received basis information directly from SSG *only for* "covered" transactions. Until the IRS receives an actual income tax return, it has no way of knowing whether any additional basis for "noncovered" transactions exists for this, or any other taxpayer.

In cases where a taxpayer or a paid preparer relies upon the basis figure presented in the Summary of Form 1099-B without checking to see if any noncovered basis exists, that taxpayer may or may not face an artificially high tax bill. Whereas it may appear as though the taxpayer in this example needed to report gains totaling $36,754 ($82,897 minus $46,143) to the IRS and to any relevant state department of revenue, this taxpayer's actual gain was only $13,581, as shown on the following page. Assuming a typical capital-gains rate of 15%, the impact of this error would be $3,475. However, because capital-gains rates can approach 40% in certain cases and because gross sales proceeds figures can easily run into the hundreds of thousands of dollars, the financial damage that can result from ignoring this issue could be severe.

Because the IRS has an informational deficit with respect to “noncovered” basis and because this issue can work only to a taxpayer’s detriment, it’s in your interest to ensure 100% of your basis gets captured on your income tax returns.

## THE SOLUTION — LOOK IN YOUR DECEMBER STATEMENT FOR THIS SCHEDULE

I was aware of this problem when I began my practice in 2003, which was well before Congress shifted basis tracking and reporting duties to custodians. I was also aware that if I didn’t address this problem efficiently, I would face an onslaught of requests each filing season from people needing help determining their basis in sold securities.

**Schedule of Realized Gains and Losses Year-to-Date *(continued)***

| Description | Date Disposed | Date Acquired | Designation | Disposition Method / Transaction | Quantity | Proceeds | Cost Basis | Realized Gain/Loss |
|---|---|---|---|---|---|---|---|---|
| **Long Term** *(continued)* | | | | | | | | |
| CANADIAN IMPERIAL BK CE<br>Security Identifier: 136069101 | 04/17/18 | 11/19/15 | Covered | High Cost / SELL | 130.000 | 11,483.96 | 9,843.94 | 1,640.02 |
| CLAYMORE EXCHANGE-TR GUGGENHEIM BULLETSHARES 2018 HIGH YIELD CORP BD FD ETF<br>Security Identifier: 18383M381 | 02/20/18 | 12/28/15 | Covered | High Cost / SELL | 410.000 | 10,263.62 | 9,757.51 | 506.11 |
| DREYFUS SMALL-CAP ST FUND<br>Security Identifier: 26200Q204 | 04/17/18 | 06/03/16 | Covered | High Cost / SELL | 122.268 | 4,010.39 | 3,300.00 | 710.39 |
| FIRST TR EXCHANGE-TR NORTH AMERN ENERGY INFRASTRUCTURE FD<br>Security Identifier: 33738D101 | 07/18/18 | 11/30/15 | Covered | High Cost / SELL | 140.000 | 3,249.30 | 2,889.24 | 360.06 |
| MAGNA INTERNATIONAL IN#CA5592224011<br>Security Identifier: 559222401 | 09/07/18 | 11/19/15 | Covered | High Cost / SELL | 107.000 | 5,581.97 | 4,838.43 | 743.54 |
| THE NEW ECONOMY FUND<br>Security Identifier: 643822406 | 09/07/18 | 06/03/16 | Covered | High Cost / SELL | 140.924 | 6,822.13 | 5,000.00 | 1,822.13 |
| ORACLE CORP COM<br>Security Identifier: 68389X105 | 04/17/18 | 08/19/13 | Covered | High Cost / SELL | 110.000 | 5,119.15 | 3,548.44 | 1,570.71 |
| PROCTER & GAMBLE CO<br>Security Identifier: 742718109 | 09/07/18 | 07/02/10 | Noncovered[*,1] | High Cost / SELL | 126.000 | 10,294.49 | 7,481.88 | 2,812.61 |
| **Total Long Term** | | | | | | 80,021.87 | 66,416.10 | 13,605.77 |
| **Total Short and Long Term** | | | | | | 82,896.86 | 69,315.97 | 13,580.89 |

Consequently, I contracted with Shareholders Service Group to track all sales proceeds (the easy part) as well as all basis (more complicated). Accordingly, it prepares the following schedule at the close of each year and automatically includes it as part of your December statement, **but it is not permitted to remit this information to the IRS**.

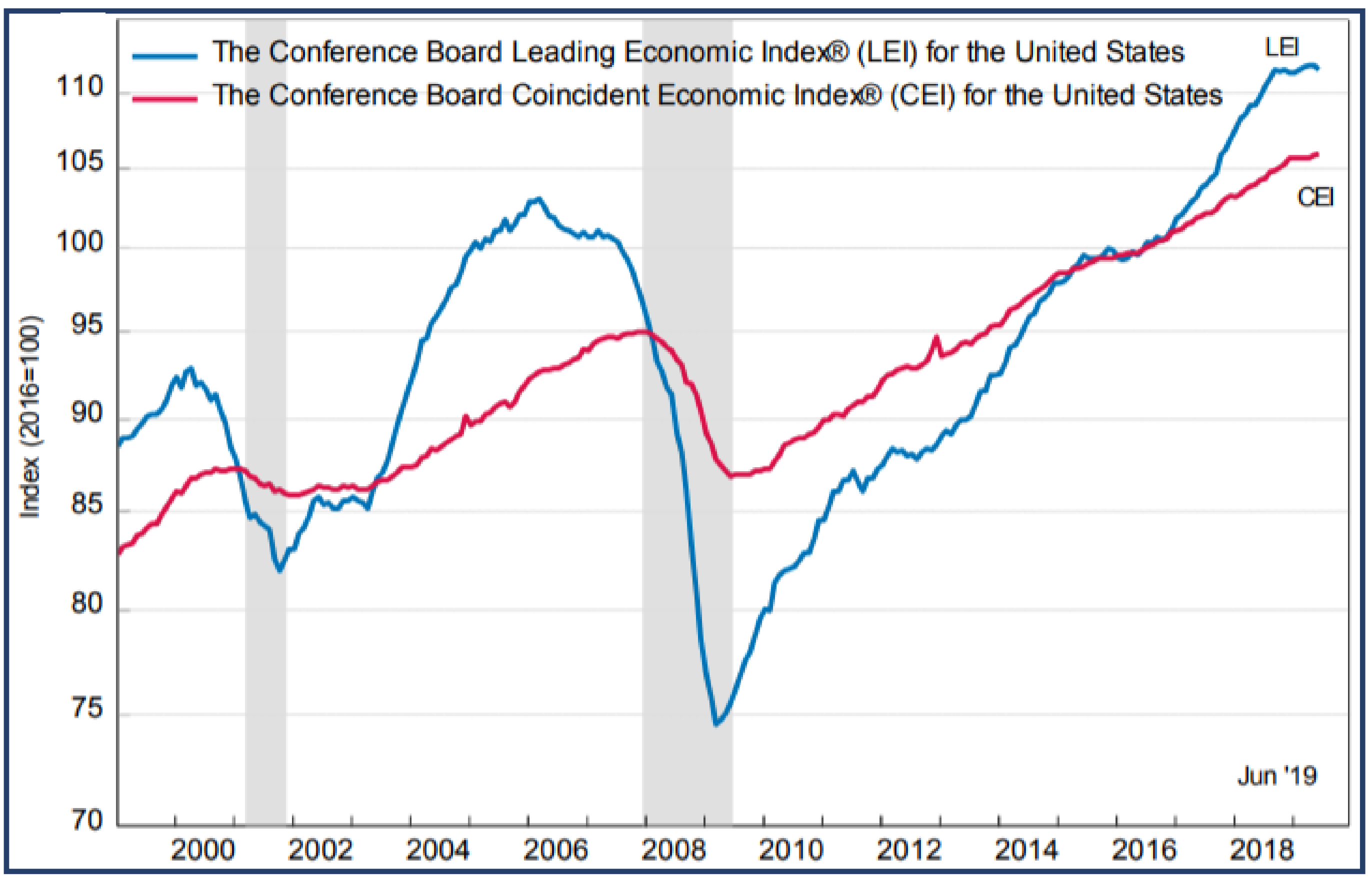
Although Shareholders Service Group will report a Summary of Form 1099-B (as depicted on page 2) to the IRS, that summary represents only a starting point for reporting gains and losses on your income tax returns.

Once you locate the Schedule of Realized Gains and Losses Year-to-Date in your December statement:

- The "Proceeds" figure ought to match the "Gross Proceeds" figure in the Summary of Form 1099-B,
- However, the "Cost Basis" figure in this schedule *may or may not* match the "Cost or Other Basis" figure in the Summary of Form 1099-B. **If the basis figure in this schedule does not match the figure in the box on page 2, you have additional basis that ought to be reported on your income tax return. If you (or your tax preparer) allows this additional basis to escape your income tax return, you will be overreporting your gains and/or underreporting your losses.**

## LEADING ECONOMIC INDEX® STALLS …

GDP increased at an annualized rate of 3.1% during the first quarter of 2019, but second quarter growth is expected to slow a rate of about 1.9%. This is not too surprising.



## WORLD ECONOMIC OUTLOOK "SUBDUED" AS PER THE INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) generally publishes its World Economic Outlook a couple of times per year. As part of that effort, its economists analyze the likely near- and medium-term impact of economic developments throughout the world. As of July 18th, the IMF summarized its outlook as follows:

> "Global growth remains subdued. Global growth is forecast at 3.2 percent in 2019, picking up to 3.5 percent in 2020 (0.1 percentage point lower than in the April World economic Outlook projections for both years). GDP (Gross Domestic Product) releases so far this year, together with generally softening inflation, point to weaker-than-anticipated global activity."

Although the IMF characterizes global economic growth as being subdued and even though it now projects growth during 2020 to be a tenth of a percent less than it projected a few months ago, it still expects worldwide GDP to increase next year. As is typically the case, the IMF expects the more embryonic economies to outpace more developed ones such as our own and Europe as a whole.

Mario Draghi, the president of the European Central Bank, recently described the eurozone's economic outlook as "getting worse and worse." The IMF projects a slowing in the Eurozone during 2019, but it expects 2020 to be a bit better. Over here, investors are concerned with international trade tensions amid this slowing global growth. Here's a more granular look at the IMF's expectations for GDP growth in the world's various regions:

**Overview of *World Economic Outlook* Projections**

*Gross Domestic Product – % change*

Decelerating / Accelerating

| | 2017 | 2018 | Projected 2019 | Projected 2020 |
|---|---|---|---|---|
| **Advanced Economies** | **2.4** | **2.2** | **1.9** | **1.7** |
| United States | 2.2 | 2.9 | 2.6 | 1.9 |
| Euro Area | 2.4 | 1.9 | 1.3 | 1.6 |
| Germany | 2.2 | 1.4 | 0.7 | 1.7 |
| France | 2.3 | 1.7 | 1.3 | 1.4 |
| Italy | 1.7 | 0.9 | 0.1 | 0.8 |
| Spain | 3.0 | 2.6 | 2.3 | 1.9 |
| Japan | 1.9 | 0.8 | 0.9 | 0.4 |
| United Kingdom | 1.8 | 1.4 | 1.3 | 1.4 |
| Canada | 3.0 | 1.9 | 1.5 | 1.9 |
| Other Advanced Economies | 2.9 | 2.6 | 2.1 | 2.4 |
| | | | | |
| **Emerging Economies** | **4.8** | **4.5** | **4.1** | **4.7** |
| Russia | 1.6 | 2.3 | 1.2 | 1.9 |
| Emerging Asia | 6.6 | 6.4 | 6.2 | 6.2 |
| China | 6.8 | 6.6 | 6.2 | 6.0 |
| India | 7.2 | 6.8 | 7.0 | 7.2 |
| Emerging Europe | 6.1 | 3.5 | 1.0 | 2.3 |
| Latin America & Caribbean | 1.2 | 1.0 | 0.6 | 2.3 |
| Brazil | 1.1 | 1.1 | 0.8 | 2.4 |
| Mexico | 2.1 | 2.0 | 0.9 | 1.9 |
| Saudi Arabia | -0.7 | 2.2 | 1.9 | 3.0 |
| Sub-Saharan Africa | 2.9 | 3.1 | 3.4 | 3.6 |
| Nigeria | 0.8 | 1.9 | 2.3 | 2.6 |
| South Africa | 1.4 | 0.8 | 0.7 | 1.1 |

With respect to economic prospects within the U.S., the Federal Reserve was inclined at the onset of 2019 to raise interest rates a time or two during the year. Since raising rates would ostensibly thwart economic growth to a degree, the Fed's interest in restoring some of the recession-fighting ammo it spent combating our last recession presumably outweighed whatever concerns it may have had at the time about a slumping U.S. economy. By spring, however, the Fed became increasingly concerned that protracted trade disputes could exacerbate an already slowing, U.S. economy. By then, the Fed seemed inclined to forego the rate increases it previously envisioned for 2019, presumably because it sensed that the U.S. economy was no longer robust enough to well tolerate those increases.

## PROACTIVE FED SEEMS SET TO WARD OFF ANY HINT OF RECESSION

Most recently, the Fed has signaled that it is likely to reduce the target for its benchmark Federal Funds rate during the policy meeting it has scheduled for the end of July. Even though the U.S, economy does not seem to be on the cusp of recession, the Fed appears to be concerned that it may previously have raised rates more than was necessary. So, the Fed now seems set to proactively promote growth prior to the development of an actual economic hiccup.

## OTHER CONSIDERATIONS

Although changes in GDP and corporate earnings certainly influence the valuations of stocks and other capital assets, a myriad of other factors may also come into play at any time. In some instances, those other factors could dominate investors' collective notion of value. For example, if the U.S. and China are unable to settle their trade differences, or if those differences are sorted out in an environment where the U.S. appears to have permanently relinquished some of the market share it previously possessed, investors' appetite for (or tolerance of) risk could wane. Or, investor sentiment may fade if Brexit goes badly, or if we enter into armed conflict with Iran, or if the U.S. gets whacked by a bunch of storms this fall. To the extent investors collectively conclude that earnings streams have been impaired, even if only temporarily, or that those streams will be created in an environment of heightened risk, equity valuations would likely fall.

If history is a guide, however, it would make sense to not only remain committed to equities, but to take advantage of that weakness by rebalancing your portfolio into that weakness. Feel free to let me know if you see things differently. — Glenn Wessel