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Current Outlook & Portfolio Strategy

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The third quarter of 2021 was another profitable quarter for U.S. equity markets overall. Interestingly, markets largely ignored a nationwide resurgence in COVID-19 cases, which was felt rather acutely here in Florida as hospital systems were once again put under tremendous strains. However, the overall sense of disregard does make some sense. With a large swath of the population now vaccinated, consumers (and by extension investors) seemed willing to resume life as normal and avoid the sorts of lockdowns we experienced last year. The lockdowns were deemed medically necessary, but they nevertheless zapped economic growth and consumer confidence. While the Delta variant of COVID-19 undoubtedly tested our collective resolve, it is heartening to see infections beginning to subside in areas hardest hit just a few months ago, and providing some hope for other geographies that have yet to be affected.

We experienced another solid cycle of corporate earnings results during the second quarter. Moreover, forward sales and earnings estimates remain quite strong overall. Those concerned about the U.S. economy are focusing mostly on supply-chain issues, believed to be somewhat temporary, meaning there is less concern about weakening consumer demand – the ultimate driver of economic growth. Coupled with excessively accommodative monetary and fiscal policies, it is understandable why investors have been willing to purchase stocks at higher and higher valuations. While we continue to believe that economic activity will remain robust through the end of this year and into next, we also understand capital markets look forward, and some amount of future optimism is being priced into stocks today, particularly here in the U.S. For that reason, we are being mindful in our valuation work to safeguard against systematically overpaying for the investments we purchase on behalf of our clients.

The fixed-income (bond) markets seem to be exhibiting a more cautious tenor. Interest rates remain rather low despite annualized inflation – as measured by the Consumer Price Index (CPI) – tracking upwards of 4%, even after removing the effects of food and energy. The fact that interest rates are not rising commensurate with inflation indicates there is some concern among investors that economic growth will not remain as robust going forward. While we still expect no change in the Federal Funds rate before late 2022 or early 2023, we do anticipate that the Federal Reserve Board will reduce its bond purchase program later this year, which would be the first attempt to tighten the money supply since the beginning of the pandemic. However, if economic growth begins to wane in the months ahead, the Fed may decide to delay any change in current policy. Regardless, we will be watching closely to see how the Fed navigates these interesting conditions given the implications for asset prices and market volatility.

It also seems likely that a new fiscal spending package along with some changes to existing tax law are forthcoming. Any incremental government spending will impact economic growth positively in the short term, while tax law changes affect corporations and individuals much differently depending on a variety of factors. That said, our focus will remain on sourcing and managing high-quality investments for our clients, while also considering the associated risks. As always, we do this best by understanding clients' individual goals and constraints and building a portfolio that best suits those unique circumstances.

Inflation - Transitory or Persistent?

Gary W. Dyer, CFA
Portfolio Management

Over the past 18 months, Congress and the Federal Reserve Board have used a variety of methods to stimulate and inject liquidity into the economy following the first signs of COVID-19. Those actions included benefit payments to individuals (including enhanced unemployment insurance), loans and grants to businesses, cuts in interest rates, and open-market bond buying by the Fed. These fiscal and monetary steps were necessary to stave off a prolonged recession.

Given the significant longer-term deficit spending approved by Congress, history would expect the Fed to hike short-term interest rates to cool off the growth of the economy and stave off inflation. Interestingly, the deficit spending has not yet had a negative impact on inflation, which for years stayed under the Fed's 2% -3% target.

However, the unprecedented amount of stimulus and liquidity since early 2020 appears to be putting the U.S. economy on a more typical growth and inflationary trajectory. Real GDP rose approximately 6.5% in the first half of 2021, and the Consumer Price Index (a main benchmark of inflation) was rising at 5% annual rates in the second quarter, the highest level since September of 2008.

This leads to the question, is inflation a shorter or longer-term Issue? The Federal Reserve continues to believe the inflation is "transitory." By maintaining short-term interest rates near zero, the Fed has signaled it is more concerned about the state of the economy than the risk of inflation. The bond market is also signaling that inflationary pressures are short-term given the fact that 10-year Treasury bonds are yielding just 1.5%. Interest rates are closely tied to inflation, so the recent jump in consumer prices does not seem to concern bond investors.

In addition, the recent increase in U.S. consumer spending, which is helping push up prices, can largely be attributed to COVID unemployment benefits that first were saved in 2020 and now are being spent. Those benefits are being phased out. We note, too, that supply-chain imbalances across the world are causing shipping costs to skyrocket, and that while it was naïve to think supply-chains could return to normal overnight once vaccines were approved, it may also be naïve to think that these same broken chains won't be fixed.

On the flip side, there are rationales for longer-term inflation. Historically, when inflation starts to surge, it adds fuel to future inflation by creating unwanted consequences: A tight labor market forces employers to pay significantly higher wages; and the supply of goods doesn't keep up with higher demand.

In the case of labor, shortages have been experienced in lower-paying service jobs such as retail, restaurants, and hospitality. Part of the reason it has been difficult to fill these positions has been many of these individuals have earned more income from federal and state unemployment benefits than they earned working. Benefits have since been reduced, but employers still feel the need to permanently raise wage levels above pre-pandemic levels to lure workers back.

Prices aren't just the result of supply and demand forces; they are also an indication of what prices are expected to be in the future. For example, lumber prices had risen close to 550% over a 13-month period ending in May as housing demand became extremely strong and lumber scarce. While prices have backed off since May, it is unlikely the spike in prices of lumber and other goods will revert to pre-pandemic levels anytime soon, if ever.

It also remains to be seen if the unequalled deficit spending of the past 18 months will significantly reduce the value of the U.S. dollar against our trading partners' currencies, an event that would cause the cost of imported goods to rise and help create ongoing inflationary pressures.

While The Trust Company's investment team will closely monitor the level and duration of inflation, it is important to note the Federal Reserve is edging closer to removing some of the monetary stimulus (by paring back its bond purchases) which should modestly cool inflation. Nevertheless, in such times we aim to construct 'all weather' portfolios that perform well over long-term market cycles. This keeps us from focusing too much on shorter-term fluctuations in economic indicators.

Protect Yourself from Cybercrime

Joel A. Johnson, CFA, CFP®
Portfolio Management

Recently we visited with Network Security Engineer, Evan Lutz of Blueshift Technologies to discuss some of the most frequent and trending issues among cyber hackers and how to deal with them. Too often we hear of friends and family who have been the victim of cybercrime.

Evan explained that a few tactics are among the most common scams to which victims fall prey:
- **Phishing emails** are designed to compromise a person's email, whereby if you "take the bait" by responding, opening an attachment, or clicking on a link, they will pursue you further.
- **Smishing** is the same as phishing - except by text. The scammer's goal in both cases is to gain more and more access to your identity and your money.
- **Credential Phishing** is where the user clicks on a fraudulent link that looks legitimate, such as a message from Microsoft. The email address will not be precisely correct, and the home page looks close to what you would expect, so the scammer hopes you won't notice. If you enter your login and password to the fake Microsoft home page, hackers now have your "login credentials" and can manipulate your computer and gain sensitive information.
- **Gift Cards** are popular among con artists. They ask the user to purchase a gift card to pay a bill, fee, some other debt or obligation or even claim a prize. The request comes from a scammer impersonating someone you know or an organization you consider a credible source. Don't believe it! You will never be contacted and asked to pay for anything with gift cards. Whether you are contacted by text, email or a phone call – end the connection and don't click on any links! Then BLOCK the sender.
- **Social Media** give scammers a plethora of your personal information. Much of what you put on social media can be used against you by a scammer. For instance, they are watching for hints to your security questions which may include the name of a pet, children or grandchildren, hobby, name of school, etc. They also use social media simply to gather information like this to impersonate you in order to trick someone you know - as explained above in the "Gift Card" scam.

What Top 3 Steps can you take to prevent criminals from gaining access to your data?

1) Use a reliable password management tool. There are several available such as, LastPass, NordPass, Keeper and others. So many people use the same or similar passwords for all their online access, which is easy for hackers to break. "Using a password management tool significantly reduces risk and is much more convenient. It is cloud-based (not on your hard drive) and houses all of your passwords in one place, and you should enable the two-factor authentication, so only you can access it," Evan said. He also cautions his clients against keeping a physical list that can be lost, which could be catastrophic.
2) Have good protection: Keep your antivirus and malware up to date.
3) Limit and be particular about your exposure and activity on social media, as mentioned above.

Is one type of device more susceptible to cybercrime than another?

The issue is the age of your device rather than the type. Tablets and cell phones that are 10 years old or more are considered at "end of life." They may still work but are vulnerable to viruses and hacking because their developers will "sunset" an outdated device and no longer create fixes for it.

What are the first steps to take to mitigate damage if you have been the victim of a cybercrime?

Change your passwords and logins immediately. Contact your local law enforcement's fraud division. Contact your financial institutions and credit card companies and inquire about freezing your credit through the major credit bureaus of TransUnion, Experian and Equifax, so no one can open accounts or credit cards in your name.

Additionally, it can be reassuring to have a trusted Information Technology (IT) manager among your contacts to assist you as needed for situations like this. He or she will help bring your computer or device back to normal status.

For more information on Blueshift Cybersecurity and their solutions visit www.cigent.com/cigent-xdr

Florida Creates "Community Property" Opportunity

T. John Costello, Jr., J.D.
Trust & Estate Services

The new Florida Community Property Trust Act, which was signed by Governor Ron DeSantis and went into effect July 1, is already creating buzz in the legal profession as a potential boon to property owning residents. It allows couples domiciled in Florida to elect to treat property as "community property" by transferring it to a Community Property Trust (CPT). These trusts may be attractive to married couples who own highly appreciated assets and want to take the tax advantage of the full step-up in cost basis.

Florida has now joined Alaska, Tennessee, South Dakota and Kentucky to become the fifth state to provide its citizens with the opportunity to create Community Property Trusts.

Florida is a common law (or "separate property") jurisdiction, which generally means that property titled in one spouse's name is presumed to be that spouse's own property. Alternately, in community property jurisdictions, any assets acquired during the marriage (with a few exceptions) are viewed as assets of both spouses regardless of how those assets are titled or which spouse bought them. There are currently nine "true" community property states and one state (Alaska) that has a modified version of community property law. A majority of countries outside the U.S. have community property laws.

Community property enjoys a significant income tax benefit because upon the death of the first spouse, federal laws provide that the cost basis of 100% of the community property is adjusted to the fair market value of the property as of the date of death (often referred to as the "step-up" in basis rule). In common law jurisdictions, only property included in the deceased spouse's estate for estate tax purposes receives a basis adjustment. For property held by a married couple as joint tenants or a tenancy by the entirety, the basis adjustment is limited to 50% of the joint property. Thus, the tax burden on surviving spouses in community property jurisdictions is often much lower than that for surviving spouses residing in common law jurisdictions.

Long ago, Florida permitted residents to keep community property. Under the Uniform Disposition of Community Property Rights at Death Act, a married couple that moved to Florida owning community property from elsewhere could claim community property status when the first spouse died. The Uniform Disposition act, however, did not allow Florida residents to create community property on their Florida assets. The new act signed by DeSantis allows Florida assets to be put into a CPT.

There are certain requirements to creating a CPT. First, the trust must expressly state that it is a Florida Community Property Trust. Second, at least one trustee must either be a trustee located in Florida or a corporate trustee that has authority to act as a Florida trustee. Both spouses must sign the trust, and the trust must include special language that clearly spells out that the consequences of creating community property may be extensive.

These trusts do not come without risk. For example, some practitioners believe that because these trusts allow Florida residents to "opt-in" to community property, there is a risk that the IRS will challenge them in the future and attempt to limit the basis adjustment to only 50% of the trust's property. Further, the creation of community property may expose the property to the creditors of both spouses. It is important to work with a competent estate planning attorney who can properly advise you prior to creating a Florida CPT.

If you are interested in creating a Community Property Trust, contact us at The Trust Company and we can work with you and your attorney to determine if this is an appropriate tool for your estate plan.

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