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FIRST QUARTER | 2023

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Current Outlook & Portfolio Strategy

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Chief Investment Officer

The past year demonstrated a resurgence of volatility across all asset classes. Markets experienced sharp price increases and decreases throughout the year as various events unfolded – from the biggest geopolitical crisis in Europe since World War II to the highest rates of inflation around the globe in 40 years. The confluence of events showed investors that there was no place to hide in the markets. The broader stock market (S&P 500) declined 18%, but not all stocks performed the same. Growth stocks, which are more susceptible to rising interest rates, declined 29%, while dividend stocks declined only 8%. Many bond portfolios experienced short-term negative returns as the U.S. aggregate bond index declined 13%. Even hard-to-value assets such as gold and Bitcoin experienced negative returns. While there may be differing opinions on what caused the price declines across all asset classes, the main culprit appears to be higher than expected inflation and higher interest rates.

The U.S. Federal Reserve's (The Fed) textbook solution to higher-than-expected inflation is monetary tightening; that is, increasing short-term interest rates and reducing their massive post-Great Financial Crisis, post-COVID-19 balance sheet. The Fed quickly increased short-term interest rates from 0% to 4.50% during 2022, and we have seen early signs that inflation is responding. The latest release of the Consumer Price Index (CPI) showed headline inflation has continued to decline from its peak of 9.1% to 7.3%. More importantly, core inflation, which excludes the volatile changes in food and energy prices, has continued to slowly decline to 6.1%. These are encouraging signs for investors, but there is still work to be done. The Fed conveyed as much during their December meeting when they provided an update on their expected "terminal rate" – the level of interest rates at which they will stop. The expected terminal rate now stands at 5%, signaling that we are quite close to the end of interest-rate increases. However, we must keep in mind that this may change over the coming months.

We believe patient stock investors will be greatly rewarded.

As we look forward to a new calendar year, we expect the first half of 2023 to remain volatile as the Fed allows for their interest rate increases to work through the economy and, hopefully, dampen inflation. Market participants will be closely monitoring monthly inflation reports to assess if inflation is indeed declining towards the Fed's target inflation rate of 2% or if additional rate increases are required. At the same time, market participants will be monitoring the overall health of the economy by analyzing monthly jobs reports, the unemployment rate, wage growth and Gross Domestic Product (GDP) updates. These periodic updates will give investors some insight into how our economy is tolerating the higher interest rates. While there is discussion around the possibility of the U.S. economy entering a short, shallow recession during the year, it is far from certain right now.

So, what actions are we taking? Our clients' custom-built portfolios are based upon their unique individual financial goals and their respective time horizons. While stocks may continue to experience increased volatility this year, we believe patient stock investors will be greatly rewarded. Our investment management team continues to find attractively valued, high-quality dividend stocks, which would provide long-term investors annual cash-flows while the markets recover. Unsurprisingly, the sharp correction in growth stocks has provided attractive entry points into some great growth companies that may have become overvalued during the COVID-19 pandemic. Finally, fixed-income investments look more attractive after the Fed's interest rate increases, thus allowing us to lock-in higher fixed-interest rates on investment-grade bonds. We believe a diversified portfolio of dividend stocks, growth stocks, and, where appropriate, bonds will position our clients well for the current market environment while meeting their financial goals.

Investing - History Repeats Itself

S. Albert D. Hanser
Founder and Chairman

If history is a predictor of the future, I have a lot to share. Starting as a clerk on the floor of the New York Stock Exchange (NYSE) in 1959, I have witnessed numerous market cycles up close. The bull and bear markets of the 1960s. The devastating 1972-74 bear market. The 1987 crash that took 22% off stock prices in a single day! The technology meltdown of 2000-02 and the Great Financial Crisis of 2008-09. While each market cycle may feel unique, they often shared similar paths and outcomes. As the current market cycle courses through our economy, this is a good time to share some pieces of wisdom acquired over the years that may help guide you and your family through these turbulent times.

Stocks will outperform bonds over the long-term.

Looking back more than 90 years, the stock market has endured wars, innumerable financial crises, and inflationary environments, among other events. Yet almost 80% of those years ended with a positive return in the stock market. And in those critical periods, stocks performed better than short-term bonds 70% of the time. If you look at any 10-year period, stocks beat short-term bonds 85% of the time. More importantly, over any 20-year period, stocks outperformed bonds 100% of the time. If you have long-term financial goals and have patience, stocks will reward you.

The stock market is a leading indicator.

Today, investors and economists predict we may face another recession in 2023. If so, the stock market's 2022 decline already provided a clue. The stock market is forward-looking, and prices already reflect expectations of a 2023 recession. Similarly, the stock market will often rally well before a recession ends and when the headlines remain negative. Within one year after a recession, the market has averaged a 16% return – and this is often before the recession has officially been declared. Timing the market is tough during volatile economic periods. If you wait until there is an 'all-clear' signal, you will most certainly be left behind.

Bull markets follow bear markets.

We have experienced many wonderful bull markets and our fair share of bear markets over the past 70 years. While we often focus on those times when a bull market ends, it would be good to remember that bear markets will end too. This time is no different. History shows that when bear markets end, stocks rebounded almost 13% within the first month and 43% within the first year. We may not know exactly when the bear market will end, but we do know that patient investors who stick it out will be rewarded. Don't make a drastic change to your long-term gameplan based on short-term events, or you may miss the opportunity.

Popular does not always mean profitable.

Back in the late 1960s, the trend was to own the fastest-growing stocks called the "Nifty Fifty." Within just a few years, however, their share prices had collapsed an average of 90%. We saw a similar trend during the tech-bubble in early 2000, when the best stocks to own (supposedly) had little to no profit, but limitless growth potential. Unfortunately, many of us know too well how that ended. Now we are recovering from investors bidding up meme stocks, cryptocurrencies, and stay-at-home ecommerce stocks. Once again, investors are learning the hard way that hopes and dreams are not reason enough to ignore shaky balance sheets and unprofitable businesses. Owning high-quality growth and dividend companies with stable cash flows, strong balance sheets, and net profitability will lead to a profitable investment portfolio for you. You do get what you pay for.

History will repeat again, and the markets will rally as they have in the past; however, time frames are being compressed so it might happen even quicker. But it will happen. Those who have stayed the course with great American companies and did not try to time the market have prospered. Those who tried to time the cycles almost always failed to reinvest in time. That is the secret to achieving your unique individual long-term financial goals. We can help.

2023 Tax Changes and Planning Opportunities

Billie Ann Porter, CFP®, CTFA
Senior Trust Officer

Each year the Internal Revenue Service (IRS) reviews the economy and the inflation rate to make adjustments to various tax and deduction limits. Given the high inflationary environment we are in, the IRS is increasing many of these amounts. All of the details can be found in Internal Revenue Bulletin 2022-38.

It is important to revisit the plan to make sure it still matches your wishes, changes in your wealth, and family dynamics.

Probably the most well-known tax provision is the annual exclusion gift. This is the amount of money you can give any individual without gift-tax consequences. The annual exclusion gift rises to $17,000 in 2023, an increase of $1,000 from last year. Many clients use this amount as a guideline for gifting to family members and their spouses.

The federal marginal income tax rates will stay the same – 10%, 12%, 22%, 24%, 32%, 35%, and 37% - but each bracket's income limit has been adjusted upward due to inflation. This is especially important to individuals who are receiving cost of living adjustments for Social Security. You could see an inflation-adjusted boost to your pension income next year but remain in the same tax bracket. The brackets for capital gains taxes also benefited from an inflation adjustment to the thresholds.

While many taxpayers itemize deductions on their tax returns, the increased standard deduction tends to reduce the number of people who can itemize. The standard deduction for 2023 increases to $13,850 for single taxpayers, $27,700 for married taxpayers filing jointly, $13,850 for married taxpayers filing separately, and $20,800 for heads of households. Those taxpayers who are over 65 or blind can add an additional $1,500 to their standard deduction or $1,850 if they are unmarried and are not a surviving spouse.

There is a planning opportunity for individuals or couples whose estates are larger than $12 million or $24 million, respectively. Clients at this level of wealth may have included gifting as part of their wealth transfer strategy. The tax law enables them to gift any amount up to the threshold without filing a gift tax return, either in life or at their passing. The lifetime estate tax exclusion amount was also increased to account for inflation, which enables additional gifting. Consult your legal and tax professionals to take advantage of these gifting thresholds.

One threshold the IRS did not increase for 2023 was the amount that can be donated from a traditional IRA directly to a 501c3 public charity. Individuals who are at least 70 1/2 can give up to $100,000 each year directly to a charity from their IRA without incurring any income tax on the distribution. This strategy works well for those who do not need their required minimum distribution (RMD) to support their lifestyle and who are charitably inclined. The IRA custodian must send the check directly to your favorite charity to ensure it is not a taxable distribution to you.

With the beginning of a New Year comes a suggestion for your New Year's resolutions: If you have not looked at your estate plan in the last few years, let us help you with a review. It is important to revisit the plan to make sure it still matches your wishes, changes in your wealth, and family dynamics. An administrative review can help confirm that the plan works like it should or whether it needs updates by your estate planning attorney.

Best wishes to you and yours for a Happy and Healthy 2023!

Storm-Safe Your Finances

Megan Marquardt, CFP®, CTFA
Wealth Services

As our communities continue to recover and rebuild from Hurricane Ian, I reflect on an article I wrote last summer entitled, "Storm-Safe Your Finances." Little did I know how soon this advice would be needed! Whether it's a weather event, a house fire or any manner of emergency, the following tips can be one less thing to worry about and help keep you and your finances safe.

- Set up electronic payments for your utilities, credit cards and mortgage payments. In the event you are away from home, or the mail is delayed, you will have peace of mind knowing that your bills will be paid on time and services will not be shut off.
- Be sure to have a credit card with a low outstanding balance or a credit card on hand designated for emergencies.
- Have an emergency fund to cover food and lodging in the event you need to evacuate. This can be included in your annual budget. It is also important to have a sensible reserve of cash kept somewhere safely in your home – perhaps $1,000 - $2,000 in the event banks are temporarily closed. During Hurricane Ian, most banking institutions in our area opened the following day.
- Review your insurance coverage. Insurance can be complicated, so it is important to understand your policy – What is your deductible? What is covered with hurricane damage? Is flood insurance included? Who do you contact to initiate a claim? Some agents recommend that you take pictures of your home and furnishings today and have those on hand in the event there is damage.
- If you need to evacuate, be sure to have a 'Grab & Go' folder with important documents you may need. This would include insurance cards, insurance policies, social security cards, drivers' licenses, passports, birth certificates, mortgage paperwork, tax documents, and estate planning documents (Will, Power of Attorney, Health Care Surrogate, Living Will, and Trust documents).
- Be sure to have contact information for family members, your advisors, and your physicians.

As the saying goes, hindsight is always 20-20. Looking forward, here are a few financial tips learned:

- Make a concerted effort to go paperless. Most documents can be stored in the cloud. Verify with your financial advisors, estate planning attorneys and accountants that they are storing your confidential information in a safe manner.
- As you make decisions regarding insurance, renovations and real estate, consult your financial advisor. Financial planning is a powerful tool that can be utilized to demonstrate different financial scenarios. For example, how does my cash flow look if I decide to rebuild my home versus sell? Would it be beneficial to self-insure going forward?
- With inflation and rising insurance costs, review your budget and make adjustments as needed.
- Meet with your advisor to review your investment portfolio and asset allocation. Do you need additional cash in your emergency fund for upcoming repair costs? Does your portfolio need to generate more income to cover anticipated hurricane related expenses?
- Meet with your CPA to review how you can claim casualty losses on your tax return. How do you prove the fair market value of your home before and after the storm and what documentation is required?

Anyone impacted by Hurricane Ian understands the devastating property damage, clean-up and emotional toll this has taken on our communities and families. Having a strong team of advisors guiding you through these financial decisions will relieve some of the stress as you move forward. Let us know how we can help you.

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