MP McShane Partners

March 2021 Insights

Investment Overview

A Review of *The Psychology of Money*

Much of what we do as wealth and investment advisors is help to manage those *emotional*, *behavioral*, and *psychological* aspects of money that are the source of so much *fear*, *frustration*, and *anxiety* for so many individuals and persistently plague even the *largest*, *most-seasoned* of investors. In last month's newsletter, we announced that McShane Partners would be starting a quarterly book club series for our clients, partners, and friends featuring book recommendations from our team members, beginning with *The Psychology of Money* by Morgan Housel. This month, the Investment Team will be summarizing several of the important ideas and significant themes featured throughout the book that underscore *fundamental financial and investment principles* applicable to *every investor* - regardless of age, assets, or ambitions - and meaningfully contribute to long-term success.

In addition to being insightful and thought-provoking, *The Psychology of Money* incorporates compelling and entertaining anecdotes to *humanize* the underlying objective analysis, while also emphasizing the real-world impact of psychology in dictating and influencing each individual's conceptions of and relationships with money. As such, the Investment Team believes that this book is particularly timely because of how closely it mirrors our own *investment philosophy,* our own *processes* and *procedures* for *mitigating negative behavioral* or *emotional biases*, and our *strategic approach* to helping our clients achieve their *long-term financial goals* in accordance with their respective *investment objectives* and *constraints*.

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Wealth Advisory Overview

The Spousal Lifetime Access Trust

The prospect of a 2026 sunset of the higher estate exemption amount has prompted individuals to look for ways to utilize their full exemption before it decreases. One such planning technique that should be considered is the use of a SLAT. A SLAT is a gift from the donor spouse to an irrevocable trust for the benefit of the beneficiary spouse. Although similar to a "bypass" or "credit shelter" trust, the SLAT is funded by gift while both spouses are alive.

The beneficiary spouse can receive distributions from the SLAT, however the trust is designed to be excluded from the beneficiary spouse's gross estate and therefore will not be subject to estate tax when the beneficiary spouse dies. To prevent the value of the assets of the SLAT from being included in the beneficiary spouse's gross estate, the SLAT will not qualify for the gift tax marital deduction, (either because the donor does not make the necessary election, or the terms of the trust prevent it from qualifying). If the value of the assets transferred to the SLAT exceeds the amount of the donor spouse's available gift tax exemption, a gift tax will be assessed.

To qualify for the federal gift tax marital deduction, the beneficiary spouse must, generally, receive all of the trust's income for life. However, because a SLAT does not qualify for the federal gift tax marital deduction, this restriction does not apply.

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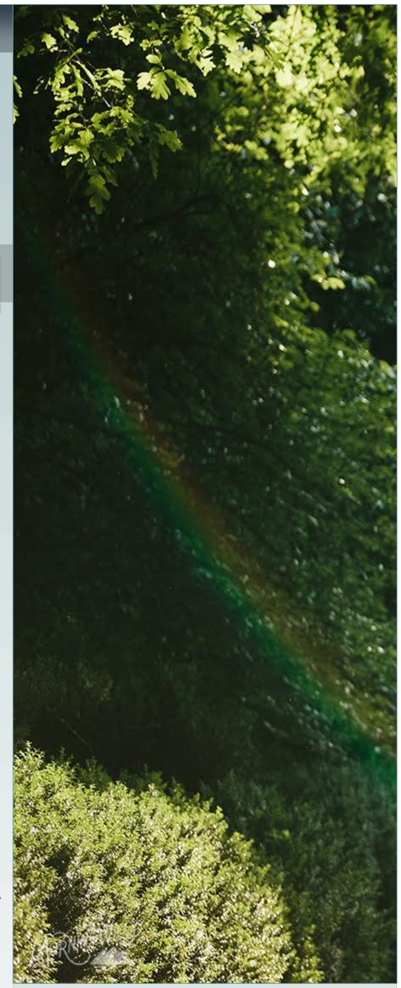

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Points of Interest

Investment Overview

A Review of *The Psychology of Money*

"Confounding Compounding"

Given the popularity of his proficient, celebrated career as an investor, it should come as no surprise that Warren Buffett is featured heavily in the stories and anecdotes throughout *The Psychology of Money*; in fact, as Morgan Housel states early on in the book, over **±2,000** books have been written about Warren Buffett, his storied successes as an investor, and how he built and amassed his fortune during his career. A crucial component of the vast wealth that Warren Buffett has accumulated that is often omitted or overlooked in these books, however, is *how long* he has been *continuously*, *uninterruptedly investing* in equity markets and the *power of compounding returns* over **±75 years**.

While most investors understand and appreciate the mathematics of *how* compounding generates *exponential growth* (i.e., returns) over time, few investors have the *intuition, patience, or endurance* to *wholly embrace* the concept and allow the *full, complete power of compounding* to work for them when managing their own investment portfolios. Instead, most investors discount the importance of time in compounding or building wealth and focus almost exclusively on *short-term returns*. By trying to generate *outsized returns*, however, investors may try to take *excessive risks* in their portfolios, which often prove *uncomfortable* and *unsustainable*, forcing individuals to cut the amount of time invested in the markets short at the most inopportune times:

> *But good investing isn't necessarily about earning the highest returns, because the highest returns tend to be one-off hits that can't be repeated. Its about earning pretty good returns that you can stick with and which can be repeated for the longest period of time. That's when compounding runs wild.* - Morgan Housel

This represents a central tenet of the Investment Team's investment philosophy: *minimizing downside* risks in order to *maximize long-term risk-adjusted returns* over a *full market cycle*. By preventing outsized drawdowns, investment portfolios can remain *fully-invested* in a diversified portfolio, based on the respective asset allocation strategy, thereby *increasing the duration* of the invested capital and allowing for the *power of compounding* to contribute to *repeatable*, *sustainable* rates of return.

"Getting Wealthy vs. Staying Wealthy"

With few exceptions, individuals seeking to gain or growth their wealth will be required to *take risks*, *remain optimistic about their prospects*, and *endure numerous setbacks* along the way to reaching or achieving their goals. Conversely, individuals looking to protect their wealth and stay wealthy need to *repress risk-seeking tendencies* and *adopt a humble paranoia* with respect to their past successes in building or accumulating their wealth, acknowledging that they are *not* guaranteed *ad infinitum*. Morgan Housel equates this humble paranoia to a *survival mentality* with three key precepts, which we have summarized, below:

(1) Desire to be Financially Unbreakable ⇨ Increase Endurance & Duration to Allow for Compounding

(2) Planning is Important ⇨ Plan on Positive/(Negative) Surprises with Adequate Room for Error (i.e., Margin of Safety)

(3) Maintain Barbelled Personality ⇨ Optimistic about Future, Paranoid about Risks/Obstacles

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Monthly Index Review
USD Total Return

Data as of February 28th 2021	February 2021	2021 YTD	2020	2019
S&P 500® Index	+2.76%	+1.72%	+18.40%	**+31.49%**
Dow Jones Industrial Average	+3.43%	+1.41%	+9.72%	+25.34%
NASDAQ Composite	+1.01%	+2.47%	**+44.92%**	**+36.69%**
Russell 2000	**+6.23%**	**+11.58%**	**+19.96%**	+25.52%
MSCI Emerging Markets	+0.77%	+3.89%	+18.69%	+18.88%
MSCI EAFE	+2.26%	+1.18%	+8.28%	+22.66%
Bloomberg Barclays U.S. Aggregate Bond Index	**-1.44%**	**-2.15%**	+7.51%	+8.72%

Investment Overview

A Review of *The Psychology of Money*

Again, this is a critical component of the comprehensive approach McShane Partners takes in the integration of our investment management and wealth advisory services for our clients; by incorporating the Investment Team's *long-term target return expectations* for our different *asset allocation strategies* into the Wealth Advisory Team's financial planning assumptions, we are able to illustrate the relationship between *risk-return* and provide recommendations in accordance with their *long-term financial goals and objectives*.

For many clients, we are able to show them how taking *less risk* in their investment portfolios than previously thought necessary may actually *increase* their ability to maximize and preserve their wealth. Conversely, for those clients primarily interested in building or accumulating wealth, we highlight the importance of *mitigating excessive, unnecessary risks* through *diversification*, while also emphasizing the importance of *preserving principal/capital* to allow for the *compounding of returns* over time.

This is a dynamic process that is vulnerable to short-term setbacks, headwinds, and/or obstacles, which is why individuals need to incorporate an adequate *margin of safety* into their plans or assumptions. A margin of safety allows individuals to feel more comfortable and confident in the face of near-term negative surprises, *enhancing endurance* as an investor and *increasing duration* of the underlying investment portfolio:

> *Margin of safety is raising the odds of success at a given level of risk by increasing your chances of survival. Its magic is that the higher your margin of safety, the smaller your edge needs to be to have a favorable outcome.   - Morgan Housel*

"Save Money"

The relatively straightforward concept of *higher/increased savings rates* having an outsized positive effect on building or accumulating wealth comes up repeatedly throughout *The Psychology of Money*. Once again, the importance of control in an individual's psychological relationship with money is central to the book's discussions about savings rates and their critical role in an individual's ability to generate wealth over time: "Personal savings and frugality - finance's conservation and efficiency - are parts of the money equation that are more in your control and have a 100% chance of being as effective in the future as they are today."

In addition to being able to control one's savings rate, the *ability to exercise control over time* as a variable within your personal framework of the aforementioned money equation can be a source of considerable upside potential in building - and even protecting - wealth. A higher savings rate not only translates into a *longer timeframe* (i.e., higher duration) for an individual's investment portfolio, it allows for *increased optionality* and *flexibility* in the individual's financial decision-making (i.e., *higher endurance*):

> *When you don't have control over your time, you're forced to accept whatever bad luck is thrown your way. But if you have flexibility you have the time to wait for no-brainer opportunities to fall in your lap. This is a hidden return on your savings.*
>
> *Savings in the bank that earn 0% interest might actually generate an extraordinary return if they give you the flexibility to take a job with a lower salary but more purpose, or wait for investment opportunities that come when those without flexibility turn desperate.   - Morgan Housel*

The Investment Team has been recommending a tactical overweight to Cash & Cash Equivalents for the better part of the past two years; this was not necessarily because we thought that, as an asset class, cash was particularly attractive, but, rather, because we believed that the *relative upside/(downside) potential* across other asset classes (e.g., U.S. Equity) was *negatively skewed* to the downside, making the *principal/capital preservation* function of Cash & Cash Equivalents incrementally *more attractive*. By focusing on and controlling the longer-term positioning of our investment portfolios, we are able to exercise discretion in the deployment of excess cash and liquidity reserves, *avoiding unnecessary downside* and *maximizing upside capture*.

"Room for Error"

There are inherent psychological obstacles that often prevent individuals from allowing for

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Investment Overview

A Review of *The Psychology of Money*

or incorporating sufficient *room for error* in their financial decision-making, including the belief or idea that *at least one prediction* for the future must be *100% accurate*, which feeds into the belief or idea that individuals can take action(s) based on that prediction with *100% certainty*. As a result, individuals and investors perceive any actions or decisions allowing for *room for error* or providing a *margin of safety* as being *conservative*, which fails to acknowledge the *intrinsic value* of the concept:

> *Room for error lets you endure a range of potential outcomes, and endurance lets you stick around long enough to let the odds of benefiting from a low-probability outcome fall in your favor… So the person with enough room for error in part of their strategy (cash) to let them endure hardship in another (stocks) has an edge over the person who gets wiped out, game over, insert more tokens, when they're wrong. - Morgan Housel*

As previously mentioned, our comprehensive approach allows us to incorporate sufficient room for error in the assumptions, predictions, and expectations that are reflected in the integrated recommendations made by our in-house Investment Team and Wealth Advisory Team.

"Nothing's Free"

One final idea discussed in *The Psychology of Money* worth highlighting given prevailing financial market conditions is how individuals and investors perceive the *explicit and implicit costs of investing*. Every investor would love to experience 100% of the upside and avoid 100% of the downside during the course a full market cycle, but this is unrealistic, and most attempts at trying to time the market not only eschew any room for error but also ignore the significant costs involved with doing so. As a result of trying to avoid incremental downside, investors often miss the subsequent upside, leaving them in a net negative position relative to where they started. While volatility is never comfortable, it is a natural part of investing that should be considered an *implicit cost/fee* vs. an *explicit fine/penalty*:

> *Thinking of market volatility as a fee rather than a fine is an important part of developing the kind of mindset that lets you stick around long enough for investing gains to work in your favor… The volatility/uncertainty fee - the price of returns - is the cost of admission to get returns greater than low-fee parks like cash and bonds.*
>
> *- Morgan Housel*

In order to alleviate excess volatility/uncertainty fees in your investment strategy, McShane Partners recommends reviewing your personal *risk tolerance* to reflect the amount of volatility you're willing and able to endure within your investment portfolio.

Stock & Strategy Spotlight

Name	Ticker	February 2021	2021 YTD
Vornado Realty Trust	VNO	+8.00%	+16.42%

Description & Investment Thesis

Vornado Realty Trust ("VNO") is a real estate investment trust ("REIT") that owns office, retail, merchandise mart properties, and other real estate and related investments, including several premier properties throughout New York City. Shares of VNO have been trading at *depressed absolute* and *relative valuations* over the past ±12 months for two reasons, which are primarily reflective of temporary, short-term headwinds; first, New York City was one of the earliest and hardest-hit areas during the coronavirus ("COVID") pandemic and shares of VNO sold off sharply during the bear-market correction in February-March 2020, but the stock has failed to recover or participate meaningfully in the subsequent rally/recovery; and second, valuations across the entire REIT complex have been pressured and are trading at depressed levels relative to other equity market sectors due to the industry's inherent interest rate sensitivities. The Investment Team believes that the eventual recovery in New York City, alongside other key end markets, should drive multiple expansion for shares of VNO, as investors become more comfortable with real estate market dynamics in a post-pandemic New York City. Moreover, As incremental concerns over percolating inflationary pressures and the trajectory of rising interest rates begin to stabilize/normalize, the Investment Team expects shares of VNO will benefit from incremental multiple expansion alongside the broader REIT sector/complex.

Wealth Advisory Overview

The Spousal Lifetime Access Trust

Although the SLAT can be drafted to require the beneficiary spouse receive the trust's income for life, this is not a necessary provision, allowing the SLAT to have multiple current beneficiaries, such as the beneficiary spouse and the couple's descendants.

Attributes of a SLAT

For married individuals who want to take advantage of the increased exemption from the estate and gift tax, but are not sure that they can irrevocably part with assets, a SLAT may be an appropriate solution. Because a SLAT allows the donor spouse to transfer up to the donor spouse's available exemption amount without a gift tax, the donor spouse will have used the exemption amount to shelter assets from the federal gift tax. Therefore, the exemption amount used is no longer available to shelter assets in the donor spouse's estate from estate tax. However, it is the appreciation on the assets in the SLAT that truly escapes federal estate tax. Because there is no claw back, any exemption amount used when the trust was funded over the exemption amount allowed at the time of the donor spouse's death should also escape federal estate tax.

To achieve these tax benefits, the SLAT must be an irrevocable trust. Therefore, when creating a SLAT the donor spouse must irrevocably transfer assets forever parting with the income from and use of those assets. Depending on the terms of the SLAT, the beneficiary spouse could receive distributions of income or principal from the trust, allowing the beneficiary spouse (and the donor spouse, indirectly) to access the transferred assets if needed. Of course, by accessing the assets in the trust, unless those assets are consumed, the couple returns assets to one of their estates, potentially subjecting their value to estate tax at death and losing some of the benefit of the original transfer.

For federal income tax purposes, a SLAT is treated as a grantor trust. This means that the donor spouse, as the grantor of the SLAT, is for income tax purposes treated as owning the assets of the SLAT. As such, the income from the trust's assets is included in the donor spouse's gross income, requiring the donor spouse to pay income tax related to the trust assets. However, although the donor spouse pays income tax on income received by the trust, there is an added benefit of allowing the assets of the trust to compound without being diminished by income taxes. Because the donor spouse is required to pay the income tax attributable to the trust's income, this tax payment is not a gift to the trust, and is not subject to gift tax.

Transferring assets to a SLAT may also provide a measure of protection from creditor claims for both the donor spouse and the beneficiary spouse. Assuming the transfer to the SLAT is not a fraudulent conveyance, the transferred assets should be free from the claims of the donor spouse's creditors. Further, assuming that the terms of the SLAT include a proper spendthrift clause, preventing the assignment of the SLAT's assets by its beneficiaries, if the beneficiary spouse has only a discretionary interest in the SLAT (that is, the beneficiary spouse will receive trust income or principal only in the discretion of an independent trustee) the assets of the SLAT should also be exempt from the beneficiary spouse's creditors.

March Tax Update: Important Reminders Before Filing 2020 Tax Returns

Becky Hoover
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Director of Tax | Wealth Advisor

1) Choose Direct Deposit/File Electronically – due to issues with postal delivery and the added backlog at the IRS, we recommend that you file returns electronically and elect direct deposit for refunds due. You can avoid a lot of headaches by eliminating human interaction between you and the IRS.

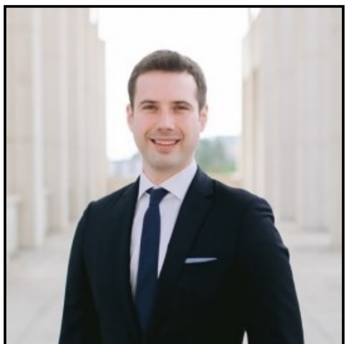
2) Federal Government Interest is Taxable – if you received interest from the IRS related to a tax refund, the interest you receive is taxable.

3) Home Office Deduction – this deduction is available to qualifying self-employed taxpayers, independent contractors, and workers in the gig economy. If you are an employee you are ineligible, even if you worked from home in 2020.

4) Charitable Donation for Those Who Don't itemize – a deduction of up to $300 may be available for charitable contributions made in 2020, even if you claim the standard deduction on your 2020 return.

5) Updated Identify Protection PIN – If you have previously used an IP PIN, remember that a new one is issued each calendar year. You will need it to file your 2020 tax returns. You can retrieve the number online if you cannot locate it or haven't received it. Go to www.IRS.gov and type IP PIN into the search window and follow the links to retrieve your IP PIN.

NextGen: Does Cryptocurrency Have a Place in Your Portfolio?



Ryan Vaudrin, CFP®
Wealth Advisor

With Bitcoin recently passing the $50,000 per unit mark, we find ourselves asking "What is cryptocurrency, and does it have a place in my portfolio?" As we previously discussed in January's article, having an appropriate asset allocation is one of the most important factors when setting up a successful investment portfolio. Typical asset allocations may include stocks, bonds, and cash investments, but how much of your asset allocation should include more higher risk investment opportunities such as cryptocurrency?

Cryptocurrency is a nonregulated form of digital currency that was developed to provide easy online transactions with lower fees. Out of the thousands of cryptocurrencies that have been created, Bitcoin is one of the most popular forms available. Since its creation in January 2009, Bitcoin has gained popularity as a currency and future investment opportunity. There are no physical coins available; instead, the purchases are completed within an online network, also known as a cryptocurrency exchange. Transactions and balances are held in an online public blockchain ledger which allows investors to keep track of their coins. Since the currency is unregulated, the public blockchain ledger provides a transparent record keeping system to store data and transaction history, while limiting fraud.

So why is Bitcoin popular and is it a good investment? When viewed as an asset class or investment, it has had a very volatile trading history. It is not uncommon for the cryptocurrency to have double digit gains followed by double digit losses. Causes of price fluctuations have changed over time with the adoption of mainstream media, institutional investors, and additional options to participate in the potential growth. Even with all the additional attention, the bottom line is that price swings can be dramatically affected by investor enthusiasm and the thought of potential future price increases.

As the cryptocurrency adoption continues to increase, cryptocurrency can be viewed like other high-beta stock holding positions. Due to potential multiple price fluctuations, high-beta positions should not comprise more than 5% of investable assets. Investors may find room for a cryptocurrency investment if it fits within their risk tolerance and time horizon objectives. Working with a dedicated investment team which maintains appropriate asset allocations and risk tolerance preferences may allow investors to experience more predictable and stable returns for long-term growth.

Senior Planning: CCRC Contract and Payment Options

Lorri Tomlin, FPQP™
Wealth Advisor

If you have considered moving to a Continuing Care Retirement Community, you may be confused by all the different types of payment options. Most require a one-time entrance fee that is determined by the size, location, and type of residence you choose. Some offer entrance fees that are partially refundable. In general, the higher the refund, the larger the entrance fee. In addition to the entrance fee, there are monthly service fees that cover dining, activities, utilities, amenities, maintenance and more.

Type A "Life Care" Contract—This type of contract requires an entrance fee and monthly service fees that provide you with lifetime access to independent living, assisted living, skilled nursing, and memory care. A "Life Care" community provides predictable monthly fees that are below market rates and will have little or no increase if you move up to a higher level of care. Even if one spouse/partner requires a different level of care, you will still pay one monthly rate. Some, but not all, even guarantee lifetime residency if you run out of money.

Type B Modified Life Care Contract—This type of contract generally requires a lower entrance fee and lower monthly service fees than the Type A contract. They offer the same amenities but provide a limited stay at higher levels of care and you will be charged extra for additional healthcare services, although usually at a discounted rate. Your monthly fee will increase based on the additional services your need. If a spouse/partner requires a different level of care you may be required to pay two monthly service fees for the two different levels of care.

Type C "Rental" or "Fee-for-Service" Contract— This type of contract usually requires the lowest entrance and monthly fees for independent living while providing the same services and amenities. However, if you require assisted living, memory care or skilled nursing, you are charged market rates increasing your monthly fee to cover the higher level of care.

Equity Model contract—There are a limited number of communities that offer an "equity" or purchase option. Instead of providing an entrance fee, you purchase your residence and pay the monthly service fees. When you require a higher level of care or upon your death, the residence is sold and the proceeds either fund your continued care or go to your estate.

One final consideration when choosing a CCRC is that some communities are non-profit while others are for-profit. Will your entrance fee and monthly payments fund your care needs or go to investors? Making the right decision for you and your family can be difficult so please contact us to discuss your options. We are happy to tour various facilities with you and guide you through the decision-making process.

Important 2021 Limits

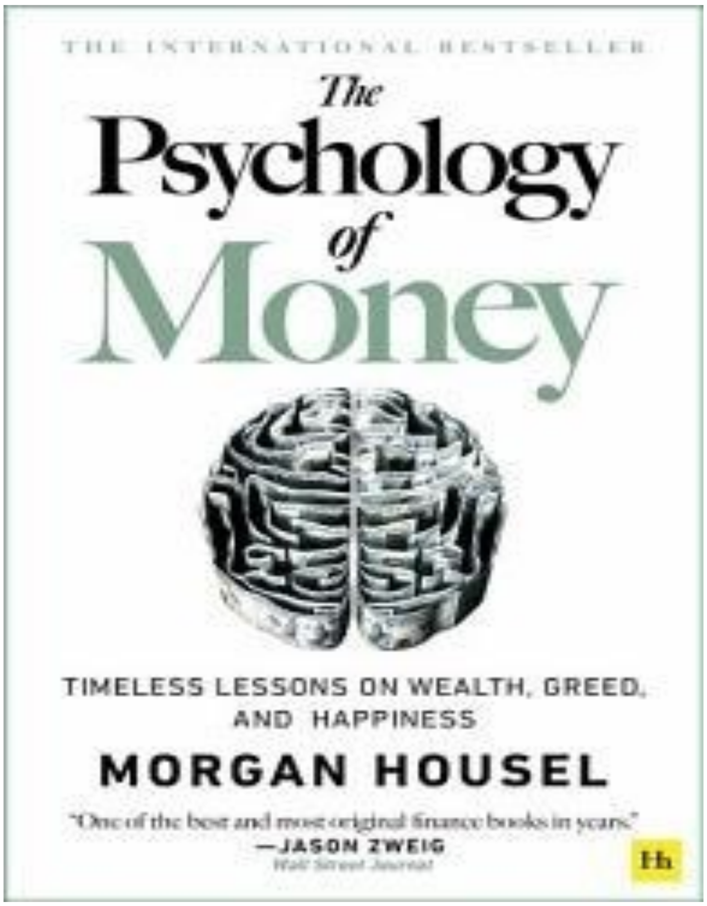
Maximum Elective Deferral Amount 401(k), 403(b), 457	**$19,500**
50+ Catch Up Contribution	*$6,500*
Maximum IRA Contribution (Traditional & Roth)	**$6,000**
50+ IRA Catch Up Contribution	*$1,000*
Gift Tax Annual Exclusion	**$15,000**

Around McShane Partners

McShane Partner Book Club

We are starting a Book Club where once a quarter we will highlight a book that we are reading. Email Abby here to request a copy and we will have it delivered to your home.

The Psychology of Money is the perfect book for the current market environment and will help clients better understand their relationship with money as well as the essence of McShane Partners investment philosophy. Rarely have we read a book that articulates the behavioral cornerstone or our investment process while simultaneously embodying the culture of our firm.



McShane Partners Building Update

We are scheduled to begin construction on our new building during March. The entire team is looking forward to helping with the demolition process. Stay tuned for more updates and pictures throughout the coming months.

Happy St. Patrick's Day!

We hope everyone has a wonderful and safe St. Patrick's. Charlotte has a multitude of upcoming celebrations, so everyone should be able to find something they enjoy!

Welcome to the Family, Gilbert!

We would like to introduce everyone to our newest McShane Partners family member—Gilbert, a three month old French Bulldog. He joins his older brother Hamilton in working directly with our Director of Research and Portfolio Manager, Elliott Van Ness. Keep an eye out for more updates!

McShane Partners

Wealth management is our only business; therefore, our attention is undivided, and our intentions are transparent.

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