MP McShane Partners

December 2021 Insights

Investment Overview

Inflation Domino

Inflation is the foremost economic factor affecting all aspects of wealth and investment management; initial indications of *higher-than-expected* or *rising inflation* command the complete and absolute attention of the entire financial services industry, with market commentators, economists, and media pundits clamoring to shine the spotlight on the *all-encompassing implications of inflation* for their respective audiences. Because inflation is so pervasive, once the underlying data begin to hint at an established trend, the subsequent domino effects can be mindboggling. As shown in Table I on the following page, inflation is a fundamental variable in the Investment Team's strategic framework for its absolute target return expectations and is used by the Wealth Advisory Team throughout the financial planning process. Therefore, careful consideration must be given to any material change in inflation assumptions due to the corresponding, significant impact on portfolio risk-return expectations and long-term planning projections. Inflation is *not* to be unappreciated or ignored in its importance to comprehensive wealth management because of its critical influence on financial market performance and economic trends.

Financial markets are *not* currently pricing in *higher long-term inflation*, and the Federal Reserve ("the Fed") has *not* adjusted short-term policies to suggest an active campaign against *runaway inflation*, but year-to-date ("YTD") inflation data have consistently surprised to the *upside* and come in *higher* than consensus estimates. This is a unique paradox that has troubled investors over the past

Continued on next page

Wealth Advisory Overview

Year-End Checklist

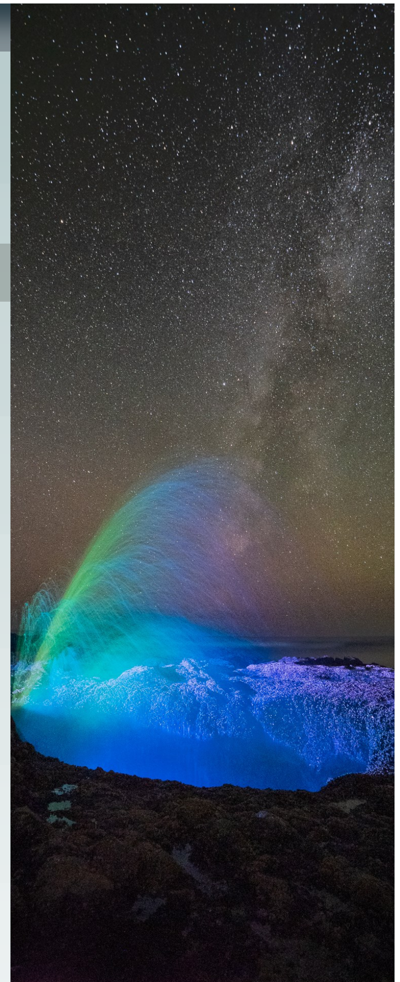
As 2021 comes to a close and we head into 2022, it is a great time to think about planning ahead to consider tax strategies while staying on track to meet your personal financial planning goals. The following checklist will help you to identify important action items to consider as part of your 2021 year-end income and transfer tax planning, as well as preparing for 2022. As your trusted adviser, we would appreciate the opportunity to talk with you about how these might fit into your unique and personal situation.

One main caveat that spans much of the below-mentioned planning items is that there is still much uncertainty regarding proposed legislation surrounding income and estate taxes. Careful consideration will need to be given and perhaps even a "wait and see" approach until we receive further clarity.

1) Budgets: Year-end can be a great time to review how you are managing your cash flow. Review your 2021 spending and create a 2022 budget. Account for upcoming purchases, significant sales, and/or debt and loan options. Consider refinancing a home mortgage or home equity loan and pay off any consumer debt, if possible.

2) Flexible Spending and Health Savings Accounts: Check your Flexible Spending Account balance. If your employer plan does not allow rolling money over into the

Continued on page 7



Investment Team

Daniele Donahoe, CFA
CEO | Chief Investment Officer

Elliott Van Ness, CFA
Director of Research | Portfolio Manager

Abby Williams
Investment Associate

Wealth Advisory Team

Sandy Carlson, CFP®, CPA, CDFA®
President | Wealth Advisor

Rebecca Hoover, CFP®, CPA, CDFA®
Director of Tax | Wealth Advisor

Lorri Tomlin, FPQP™
Wealth Advisor

Ryan Vaudrin, CFP®, CDFA®
Wealth Advisor

Daniel Hudspeth, CFP®,
Wealth Associate

Corey Meyer
Wealth Associate

Points of Interest

- Monthly Index Review
- Stock & Strategy Spotlight
- Around McShane Partners

Investment Overview

Inflation Domino

Table I: McShane Partners Target Return Expectations

Economic Variables & Inputs	Value	Rationale & Commentary
Inflation	2.00%	Depressed near-term inflation expected to rise moderately due to effects of substantial fiscal and monetary policy stimulus.
Gross Domestic Product ("GDP") Growth	2.00%	Long-term economic growth remains depressed relative to historical trends due to negative effects from unfavorable demographics and significantly elevated debt levels.
Risk-Free Rate of Return ("R_{FR}")	1.00%	Federal Reserve expected to remain accommodative with respect to maintaining federal funds target rate at lower-bound (i.e., 0.25%) through the first half of 2022 ("1H22").
Additional Equity Risk Premium ("ERP")	0.50%	Amount of additional return on investment relative to the R_{FR} required by equity market participants for increased exposure to incremental volatility and risk.

Risk Tolerance:	Ultra Conservative	Conservative	Conservative Balanced	Balanced	Growth	Aggressive Growth
Target Return:	3.50%	4.00%	4.50%	5.00%	5.50%	6.00%

Source: McShane Partners

several months, although the Investment Team would argue that, with returns from risk assets and investments meaningfully outpacing inflation, low-to-mid-single digit inflation numbers should actually be considered a *net positive* for debt-driven economies (e.g., the United States), provided monetary policy remains *rational*, *rules-based*, and *incrementally accommodative* and *supportive* of long-term economic growth. Any federal government with a balance sheet as ominously leveraged as the U.S. would much rather see *inflation* than *deflation*, which is why the Fed has exercised extreme and exotic measures to avoid the slightest slip into *deflation*. Deflation is detrimental to debt issuers (i.e., debtors) given the underlying implications for economic growth vis-à-vis fundamental asset price levels: in other words, deflation is characterized by *falling asset prices* or *expectations of lower price levels* over a corresponding timeframe, which *increases* the risk of potential defaults for debtors by *decreasing* the expected future value of their assets, while the outstanding balances on any/all interest-bearing debt remain relatively *fixed* on their balance sheets.

Wage Inflation | Labor Market Dynamics

For the past several years, the Investment Team has highlighted several trends in the U.S. labor market indicative of *percolating wage inflation* in excess of general inflationary trends throughout the broader economy, as reflected in the *consumer price index* ("CPI"); as can be seen in Chart I on the following page, the widening gap between ***total job openings*** and ***total hiring activity*** likely contributed to the recovery/rebound in YoY growth in ***average hourly earnings*** from late-2014 through early-2020. The ongoing coronavirus pandemic, however,

Continued on next page

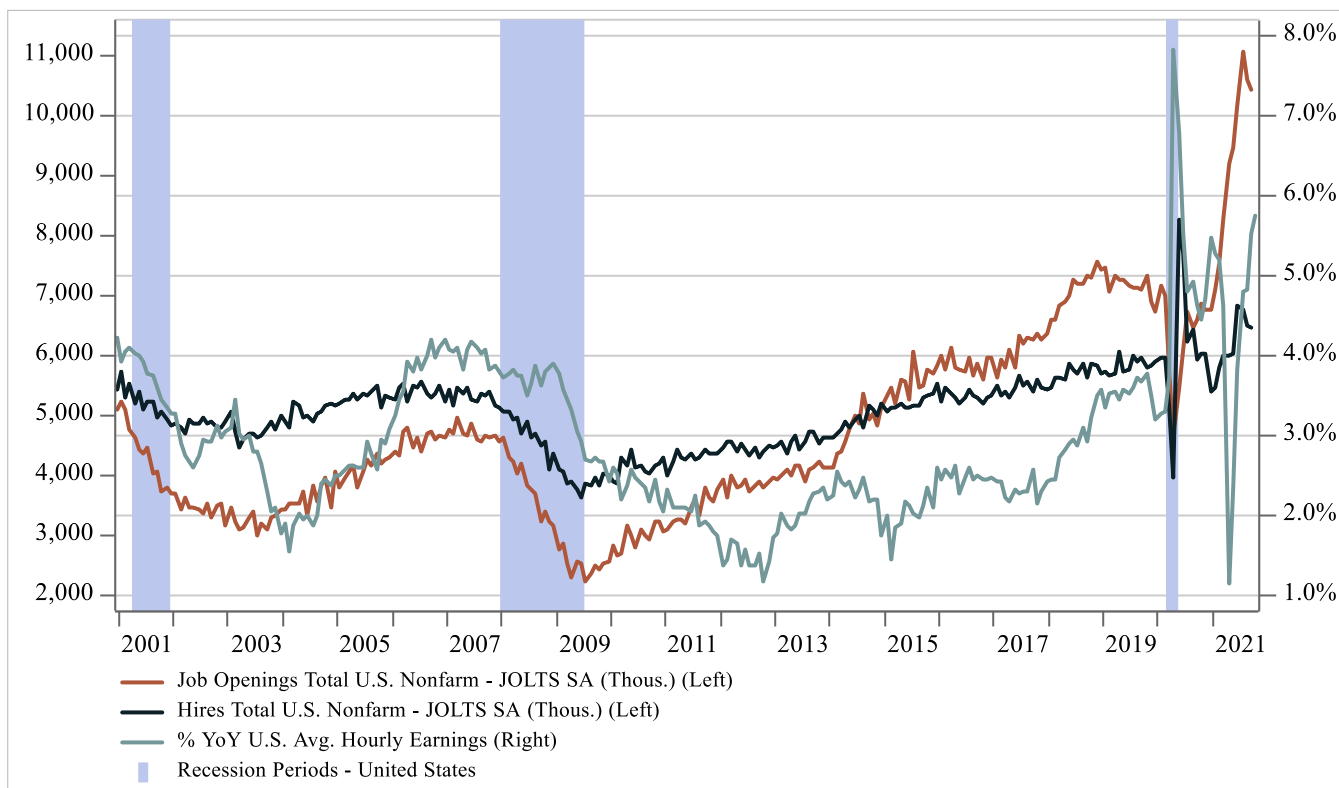
Monthly Index Review
USD Total Return

Data as of November 30th 2021	November 2021	2021 YTD	2020	2019
S&P 500® Index	-0.69%	**+23.18%**	+18.40%	**+31.49%**
Dow Jones Industrial Average	-3.50%	+14.61%	+9.72%	+25.34%
NASDAQ Composite	**+0.33%**	**+21.28%**	**+44.92%**	**+36.69%**
Russell 2000	**-4.17%**	+12.31%	**+19.96%**	+25.52%
MSCI Emerging Markets	-4.07%	**-4.07%**	+18.69%	+18.88%
MSCI EAFE	**-4.64%**	+6.32%	+8.28%	+22.66%
Bloomberg Barclays U.S. Aggregate Bond Index	**+0.30%**	**-1.29%**	+7.51%	+8.72%

Investment Overview

Inflation Domino

Chart I: U.S. Labor Market & Wage Inflation Trends



Source: McShane Partners - FactSet Research Systems, Inc.

exacerbated the secular shifts of an already complex labor market dynamic into a full-fledged labor-shortage crisis with no obvious answer or short-term solution to cyclical headwinds. One logical deduction from the current labor market situation is that *more* constituents from older segments of the *working-age population* (e.g., baby boomers) have been leaving the workforce and/or retiring *earlier than expected*. This dynamic may have contributed to a *steeper-than-expected decline* in the U.S. working-age population, which the Investment Team defines as people aged 15-64 in the U.S., as illustrated in Chart II on the following page. These recent retirees are *less likely* to return to the workforce than comparable departees from younger segments of the workforce for several reasons, one of which would seem to be their much-improved financial positioning from replenished banking accounts and appreciated retirement accounts over the past **±12-18 months**.

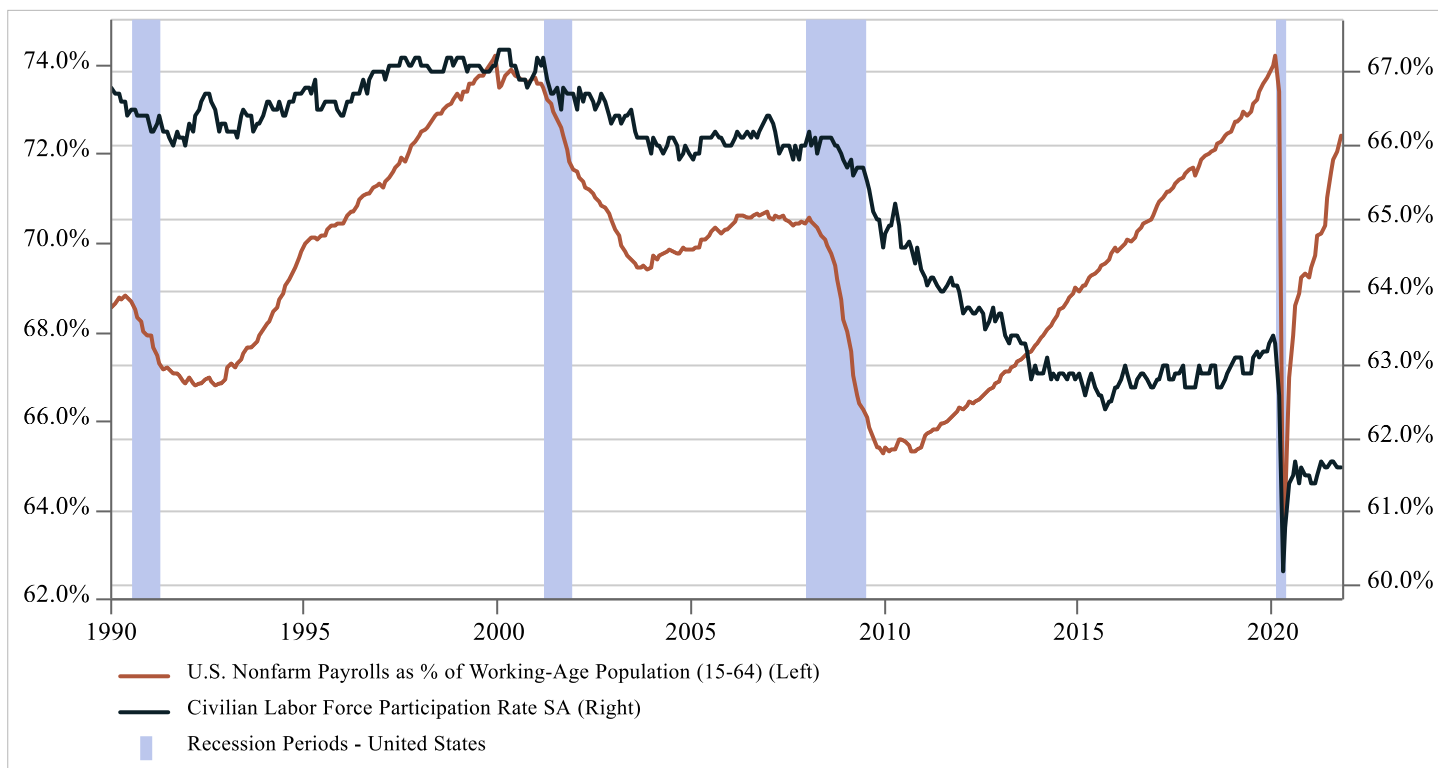
It remains unclear as to whether or not enhanced unemployment insurance or minimum wage mandates have been the determining factor in the decisions of many discouraged and/or underemployed workers to remain out of the workforce over the past year and a half. While the underlying socioeconomic variables are diverse, the *macroeconomics of labor market supply-demand dynamics* dictate that *a new equilibrium* will eventually be established because economies cannot operate out-of-balance in perpetuity; increased adoption of innovative technologies, for example, should continue to enhance efficiencies by *reducing* the amount of *human capital* required to complete time-consuming, labor-intensive, and dangerous functions, but this process could render numerous sectors or industries obsolete at the expense of an untold number of jobs with a very real human cost component. The recent shortfall in unskilled labor should ultimately be remedied by *technological capital*, but the global economy has just experienced an accelerated version of a long-term process over a very short period of time, which has shocked and awed and revealed fundamental imbalances in labor markets around the world. The short-term scarcities endured by many could ultimately hasten much-needed policies and actions to address *systemic flaws in current labor market economics*, although the impetus behind any such

Continued on next page

Investment Overview

Inflation Domino

Chart II: U.S. Nonfarm Payrolls as % of Working-Age Population vs. Labor Force Participation



Source: McShane Partners - FactSet Research Systems, Inc.

efforts will likely fade as economic activity returns to normalized, pre-pandemic levels alongside a stabilization and moderation in inflationary pressures.

Inflation Indications

With headline inflation numbers hitting their highest levels in **±30 years**, the Investment Team believes that focusing on the *underlying components* driving the sharp spikes in inflation year-to-date ("YTD") in 2021 provides much-needed context for analyzing the long-term implications of recent upside surprises in inflation. First and foremost, it is important to remember that popular inflation indices are *backward-looking* (i.e., *lagging economic indicators*) and quantify *observed changes in prices paid* throughout the U.S. during a given period (e.g., month-over-month, etc.). The following inflation indices have been included in Chart III on the following page:

- U.S. Consumer Price Index ("CPI")
  - ✓ Measure of the changes in prices paid by consumers for goods and services
- U.S. Core Consumer Price Index ("Core CPI")
  - ✓ Excludes the changes in prices paid by consumers for food and energy (i.e., less food and energy)
- U.S. Personal Consumption Expenditures ("PCE") Index
  - ✓ A measure of consumer prices paid by, or on behalf of, people living in the United States

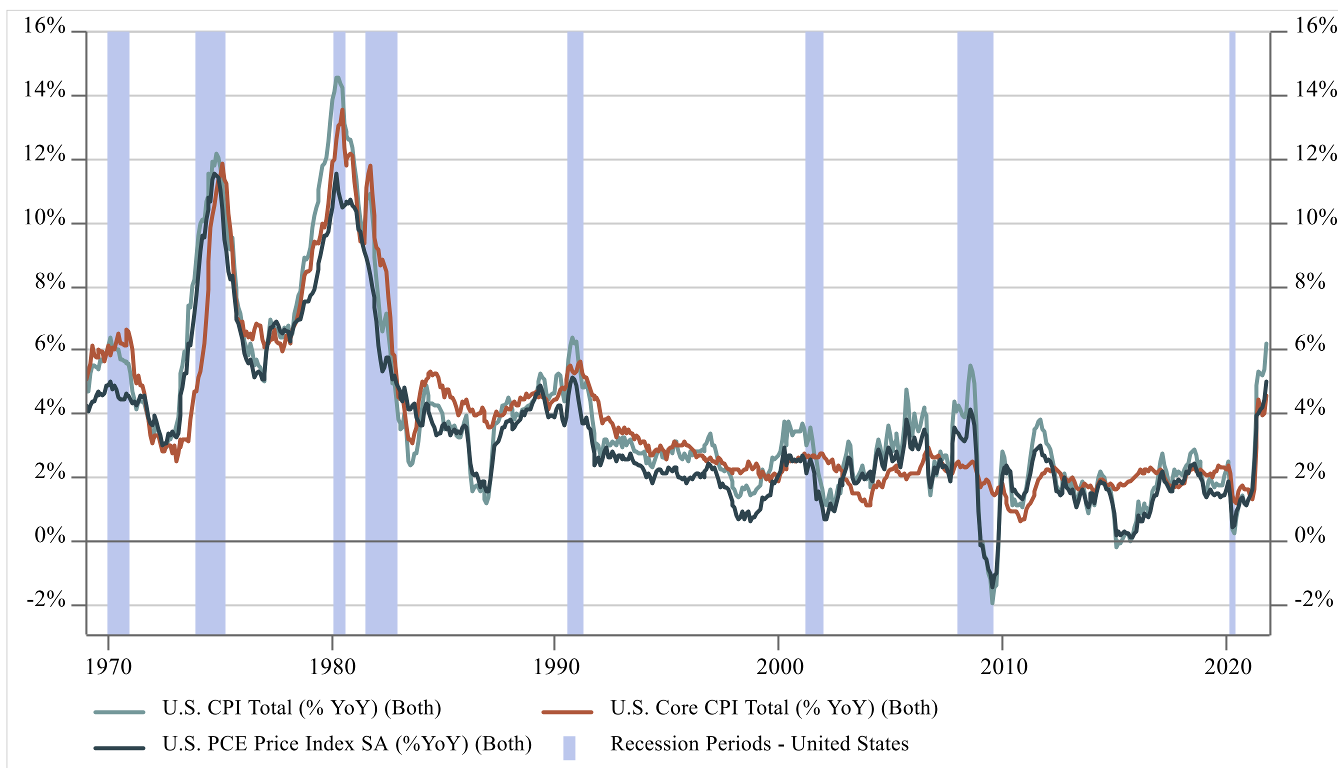
The CPI and Core CPI typically receive the most attention from the media, but the PCE Index is generally considered *more comprehensive* in terms of its representation of a broader set of consumer spending categories, which is one of the reasons why the Fed pays particular attention to the PCE Index and subsets of the PCE Index (e.g., Core PCE Index).

Continued on next page

Investment Overview

Inflation Domino

Chart III: U.S. Inflation Indices



Source: McShane Partners - FactSet Research Systems, Inc.

While the indices may diverge in their construction methodology, they have historically been *positively correlated* with one another, especially during periods of fluctuating and volatile consumer prices. As can be seen on the right-hand side of Chart III, all three inflation indices experienced meaningful moderations through the first half of 2020 (“1H20”), reflective of the pandemic-induced recession and corresponding slowdown in economic activity. Despite consistent readings across all three indices, any extrapolation of the data with respect to foreshadowing future trends in inflation would have been ill-advised.

“Deflation is defined as a general decline in prices, with emphasis on the word ‘general.’”

- Ben Bernanke

Suffice it to say that, the coincidence of steep declines or outsized negative YoY changes in volatile subindices (e.g., energy goods & services) will eventually correct to new equilibrium baselines based on prevailing supply-demand dynamics; that is not to say, however, that inflationary pressures should be ignored, but, rather, contextualized against financial market conditions and the broader macroeconomic environment.

Continued on next page

Investment Overview

Inflation Domino

Final Thoughts

The Investment Team does not believe that there is currently sufficient long-term support for extrapolating *hyper-inflation* into the future, but elevated inflation for longer than expected could have negative consequences for the global economy given the record-high wealth inequality; therefore, the eventual rise in food costs will have a disastrous effect on the spending and sustainability of lower-income populations around the world.

Next year the combination of *more-difficult* earnings comparisons and the debilitating impact of higher-than-expected, transitory inflation will be headwinds for global financial markets. Exacerbating this potential portfolio management pitfall are the difficulties fixed income investors currently face in the bond markets, as current interest rates are so dramatically depressed by accommodative monetary policies that they do not even remotely reflect moderate long-term inflation expectations, much less the **±5-6%** inflation that U.S. investors are currently experiencing. Buying high-quality, investment-grade fixed income with *negative real yields* (i.e., yields below the rate of inflation) has the potential to generate nominal losses across bond portfolios, as bond prices will likely fall as interest rates eventually move higher to more accurately reflect inflation.

Therefore, attempting to insulate diversified investment portfolios against stock market volatility via strategic allocations to investment-grade fixed income investments remains a daunting task for asset managers and financial advisors. Despite equity markets being at record-setting levels and healthy economic growth, next year is setting up to be incrementally *more difficult* due to the multitude of reverberations from inflation.

Stock & Strategy Spotlight

Name	Ticker	November 2021	2021 YTD
Vestas Wind Systems AS ADR	VWDRY	-23.18%	-28.70%

Description & Investment Thesis

The Investment Team is actively looking at shares of Vestas Wind Systems A/S ADR ("VWDRY") as a potential candidate for applicable firm-wide buy lists following a sharp sell-off in the stock in response to incrementally disappointing earnings results and downward revisions to forward-looking guidance. While the stock is now trading well off recent price levels, justified valuation multiples are still *slightly elevated* on an absolute and relative basis due to negative adjustments to consensus earnings estimates amongst analysts covering VWDRY; that said, the company's long-term track record, industry-leading results, and pristine balance sheet do warrant a certain premium with respect to valuation, especially when considering the secular tailwinds and positive catalysts that should continue to support long-term growth for several years. As such, the Investment Team believes there is a price point at which shares of VWDRY represent a high-quality investment opportunity for long-term investors but remains actively on the sidelines for the time being.

Wealth Advisory Overview

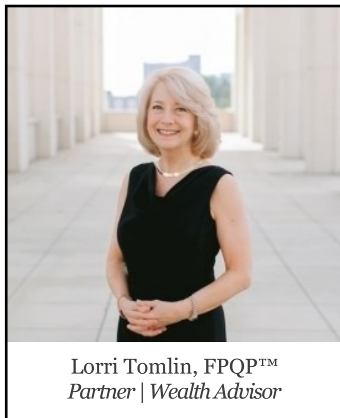
Year-End Checklist

next year, make sure you spend the balance on qualified expenses so that you do not forfeit those contributions. Check your Health Savings Account (HSA) year-to-date contributions to make sure you maximize your deduction.

3) Take your Required Minimum Distribution: Although the CARES Act suspended all RMDs for 2020, they are back in effect for 2021. Work with your advisor to determine the appropriate amount that should be taken. If you do not take your RMD from accounts that require it, you could be subject to taxes and penalties.
4) Review charitable contributions to maximize deductions: Consider a qualified charitable distribution (QCD). No matter your RMD amount, you can give up to $100,000 to charities from an IRA as QCDs. If you make a QCD from your IRA, this amount is not included in income and may reduce the amount of tax owed. Consider donating appreciated assets that have been held for more than one year, rather than cash. Opening and funding a Donor Advised Fund (DAF) is an appealing option as it allows for a tax-deductible gift in the current year, while providing the ability to disperse those funds out to charities over multiple years.
5) Gifting: Each year, you can give any individual up to $15,000 in cash or assets with no tax consequences. However, gifts of over $15,000 require that you file a gift tax return. When contributing to medical and education institutions, make your checks out directly to the institutions so the gifts do not count toward the annual exclusion. Additionally, make sure you notify your accountant of all completed gifts that occurred during the year.
6) Select next year’s employer benefits: Open enrollment is typically in December. Consider taking advantage of all available options, including a flexible spending account, health savings account, life insurance and more.
7) Review 401k and IRA contributions: It’s generally a good idea to maximize your contributions to qualified retirement accounts. Maximizing the amount that you contribute takes advantage of available tax deductions and employer matching contributions.
8) Consider a Roth conversion: Weigh the benefits of converting your Traditional IRA to a Roth IRA to lock in lower tax rates on some of your pre-tax retirement accounts. Remember that Roth conversions can no longer be recharacterized so there is no reversing a conversion once executed. Additionally, keep in mind that Roth conversions will be more beneficial when the tax can be paid by funds outside of the IRA. If you are unable to contribute to a Roth IRA directly because you do not qualify based on income limits, you may benefit from contributing to a Traditional IRA, then converting the funds to a Roth IRA.
9) Review any tax losses: If you have losing stock positions, consider selling them to offset gains and reduce taxable income. Remember the IRS only allows $3,000 of losses per year against ordinary income. However, any unused losses can be carried forward to use in future years.
10) Review your estate plan: Review your wills, revocable living trusts and powers of attorney to ensure that you have the appropriate executors, trustees, and guardians in place. Additionally, confirm that your overall estate planning documents reflect your current wishes regarding how you would like your assets distributed.
11) Review your beneficiaries: Let us know about any major changes in your life such as marriages, divorces, births, or deaths in the family, as well as any changes in residency. This will allow us to confirm whether changes or updates are needed on your accounts.
12) Review insurance policies: Review your insurance portfolio to make sure it meets your coverage needs, especially timely in the season of annual benefits enrollment. Review your home, auto, umbrella, life, and disability insurance policies to determine if you have enough coverage or if deductibles need to be adjusted.

The most important decision you can make as the year comes to a close is to speak with your Wealth Advisor to ensure that everything is in order with your overall financial situation. There is still time left to take any necessary action if needed. If you would like a year-end review of your financial situation, or if you have questions regarding year-end strategies, please schedule a call with your Wealth Advisor.

Senior Planning: Beneficiary Strategies to Manage Shortened Inherited IRA Distribution Window



Lorri Tomlin, FPQP™
Partner | Wealth Advisor

The Secure Act of December 2019 resulted in a loss of the stretch provision for certain non-eligible designated beneficiaries who inherit individual retirement accounts (IRAs). Those beneficiaries are now subject to the new 10-Year Rule. Instead of taking a required amount each year "stretched out" over their lifetime, they are now required to deplete the entire inherited account balance within 10 years of the original account holder's death. This could result in a potential tax burden on beneficiaries if they are pushed into a higher tax bracket and are required to pay higher taxes on the additional income created by the larger distributions.

While limited, there are some strategies to help mitigate the tax impact of this new 10-year Rule. Some strategies can be implemented by the beneficiary, and some can be implemented by the original account holder prior to their passing. This month we will look at options available to beneficiaries.

I. Do Nothing and Distribute the Entire Account Balance in the Tenth Year

1. For beneficiaries who are already in the highest tax bracket, this scenario may make sense. A distribution of any amount will not push the beneficiary up into a higher tax bracket so it may be advisable to let the account grow, tax deferred for ten years and then take the entire distribution in one lump sum in the tenth year. (Note: there could be other tax impacts so be sure to work with your advisor and tax professional if you think this option may be the best alternative) Also, stay alert to any potential tax rate increases. If the highest tax bracket is increased in the future, you may want to consider taking a distribution in the year prior to the increase.
2. For beneficiaries who inherit smaller IRA accounts, say $10,000-$15,000, this may be a good option. Even if the account value doubles over 10 years, the resulting account value and resulting distribution may not be enough to push the beneficiary into a higher tax bracket. Therefore, waiting until the tenth year to distribute the entire account balance would allow the account to grow tax-deferred for 10 years.
3. For beneficiaries of Roth IRA accounts, this will always be the best option. No taxes are owed on distributions from Inherited Roth IRAs. Therefore, distributions should be avoided if possible until the tenth year after the original owner's death allowing the account to grow tax free during that time.

II. Take Equal Distributions Over the 10-Year Period

1. For most beneficiaries, this may be the best strategy resulting in smaller annual distributions that are easier to manage and allow the beneficiary to remain in the same tax bracket. These distributions can even be stretched over 11 years if a distribution is taken in the year of the original owner's death.

III. Adjust Distributions to Coincide with Income Each Year

1. For beneficiaries whose income fluctuates annually, they can adjust their distributions so that smaller distributions are taken in years of higher income and larger distributions are taken in years of lower income.
2. For beneficiaries who anticipate a reduction in income within the 10-year window (such as retirement), they can take smaller distributions in the years prior to the event, or they can simply wait and take all distributions later when their income decreases.

Next month we will review strategies that account owners can use to minimize the potential tax burden to their heirs due to larger distributions. As always, McShane Partners is here to help answer any questions you may have related to your retirement accounts or inherited retirement accounts.

Tax Update: Expanded Tax Benefits for 2021 Charitable Giving

Becky Hoover
CFP®, CPA, CDFA®
Partner & Director of Tax
Wealth Advisor

As we approach year-end, I wanted to recap the tax benefits for charitable giving. To encourage taxpayers to make donations in 2021, some benefits have been expanded. To take advantage of these benefits, donations must occur before December 31, 2021.

Deduction for Taxpayers Who Don't Itemize

Taxpayers are permitted to take a deduction for up to $300 ($600 per couple) for cash contributions made to qualifying charities (not including Donor Advised Funds, and other private entities).

Cash Donations

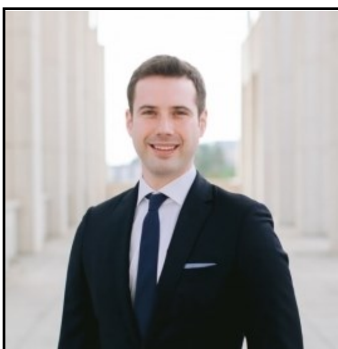
Limitations have always been higher for cash contributions, but for 2021 Congress reduced the limitations. Generally, limitations are between 20% to 60% of adjusted gross income, depending on the type of contribution and the type of charity. For 2021 taxpayers may deduct up to 100% of their adjusted gross income for cash contributions to qualifying charities.

Qualified Charitable Distribution (QCD)

Taxpayers over 70 ½ may direct distributions from their IRA to a qualifying charity in the form of a QCD. The qualifying distribution is excluded from income and therefore excluded from ordinary income rates. For 2021, taxpayers over 59 ½ may essentially enjoy this benefit due to the expanded cash deduction. By receiving a distribution from an IRA and contributing that cash to a qualifying charity, you will essentially exclude that income from taxation.

Itemized deduction limits for taxpayers contributing appreciated stock are unchanged. Please let your Wealth Advisor know if you have any questions regarding year-end charitable giving!

NextGen: McShane Partners Client Portals



Ryan Vaudrin, CFP®, CDFA®
Wealth Advisor

One area that is often confusing for clients relates to our client portals. Therefore, we felt like it was time to revisit how they work, how to set them up, as well as highlight the tools and reports that are available.

The first important point to note is that there are two separate client portals. The first portal is powered by the software company Tamarac. This software is used by the investment team to calculate investment performance, run reports, etc. It is within this portal that we post your quarterly investment reports. You should receive an email each quarter letting you know when these reports have been posted. The second portal is powered by the software company eMoney. This software is used by the Wealth Advisory team to run and update financial plans. In addition, from this portal clients can view and update a living Net Worth Statement, use our budgeting features, and access secure files in the vault.

As a new client, you will typically receive two portal activation emails. Each portal will need to be individually activated. The User ID will be your email address and a password will need to be established for each portal. Once each portal is activated, clients will be able to link both portals together allowing access to each portal with only one login.

To link the two portals together, you will need to make sure that you are logged into the Wealth Advisory portal. Next, you will select the icon at the top of the page and input your investment portal login credentials. This process only needs to be completed once to successfully bridge the link between the two portals. In addition, once you are in the investment portal, you will repeat the same process and input your wealth advisory portal login credentials. This will ensure that you can successfully transition from one portal to another.

The set-up process takes a few steps; however, it should be easier to manage once established. Please let us know if you have any questions about this process and or any additional features that are available in our McShane Partners client portals.

Around McShane Partners

Building Update

Daniele Donahoe on-site at the location of the new McShane Partners building. The windows are in and we are awaiting the brick. Our projected move in date is February 2022.

Quarterly Book Club

ANGELA DUCKWORTH
GRIT
THE POWER of PASSION and PERSEVERANCE

Angela Duckworth is the author of our Quarterly Book Club feature GRIT. If you are interested in a copy, please email Abby Williams here.

Happy Thanksgiving From London!

Sandy Carlson and her husband Justin celebrate Thanksgiving at the top of the London Eye!

McShane Partners

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

338 S. Sharon Amity Road | #401
Charlotte, NC 28211
Phone: (980) 585-3390
Fax: (980) 265-1274
Email: mcshane@mcshanepartners.com

Information provided in this newsletter should not be considered or interpreted as advice for your particular financial situation. Please consult a professional advisor for advice regarding your specific financial needs.

CIRCULAR 230 NOTICE: To comply with requirements imposed by the United States Treasury Department, any information regarding any U.S. federal tax matters contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, as advice for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

This newsletter is for discussion purposes only and represents the opinions of McShane Partners.

McShane Partners is a Registered Investment Advisor.