MP McShane Partners

January 2022 Insights

Investment Overview

What to do in 2022

The daily inundation of inflammatory headlines from polarizing pundits reveals an obvious scarcity of consistent critical thinking and strategic, long-term perspective: fundamental research with and secular investing to preserve and grow multi-generational wealth is the core tenant of McShane Partners' culture. Unilaterally positioning investment portfolios for a *singular outcome*, for example, is not only *irresponsible* but *illogical* given the *outsized risk* of being wrong just once and the extremely unbalanced, unsavory consequences.

Correctly constructing and managing long-term investment portfolios capable of performing consistently regardless of economic or financial market conditions requires strategic decision-making and careful consideration of portfolio-level exposures to a myriad of factors that are continuously, uncomfortably in opposition of one another. Being able to reconcile and find peace with the uncertainty of not knowing what will happen next is crucial to this investment management philosophy. This is ***not*** the same, however, as not knowing or understanding the aforementioned factors dictating portfolio-level performance, as those must be continuously and critically scrutinized and assessed as part of the portfolio management process.

The Investment Team intentional avoids pioneering short-term predictions heading into 2022, as this would be inconsistent with our investment philosophy and fundamental emphasis on the long term and simultaneously planning for a multitude of scenarios. Instead, this newsletter summarizes our current thoughts on

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Wealth Advisory Overview

The Importance of Tax Sensitive Investing

When it comes to determining your financial future, one of the fundamental drivers of success is the mix of assets. While typical asset allocation discussions revolve around the asset type (equity, bond, etc.), you should also take care to manage your "tax allocation". When setting aside funds for long-term goals such as retirement, tax-deferred accounts are an incredibly valuable device for effective and tax efficient retirement saving. While a lot of investors know that to be a "truth", many people don't understand exactly why.

Here are important aspects to understand about tax-deferred saving and investment options:

Tax-Deferral

An account is tax-deferred if there is no tax due on income earned in the account. The ability to defer taxes on an investment can benefit individuals in two ways. The primary benefit comes in the form of tax-free growth. As an alternative to paying tax on the current returns of an investment, taxes are paid only at a future date, allowing the investment to grow without current tax implications. When you pay taxes on a current basis you have less money to invest, so the total dollars at work are smaller. This concept is commonly referred to as the time value of money. The ability to pay a tax bill in the future allows that money to continue to grow during the interim. Frequently the value of the growth earned over the deferral period either partially or completely offsets the liability itself.

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Points of Interest

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several fundamental factors that will likely affect and influence financial market performance throughout 2022: the Investment Team will continue to monitor, analyze, and adjust portfolio-level exposures to these factors and will provide timely, relevant updates as meaningful developments unfold.

Inflation

Following an orchestrated reduction in global supply levels in response to the pandemic-induced collapse in demand for fossil fuels throughout 2020, energy commodities and fossil fuel prices surged in 2021, driven by the rebound/rally in global economic activity and a concomitant recovery in aggregate demand for oil and gas. While painful for the collective combustion engine cohort, these sharp increases/spikes in gas prices should prove to be temporary and predominantly corroborative of a correction in supply-demand imbalances. The trend toward low-emissions, low-carbon, and sustainable sources of environmentally friendly energy and should prove to be secular in its inevitability, which the Investment Team believes will continue to attract a larger share of investable dollars across global financial and capital markets. This should not only help to moderate the pace of inflation in oil and gas prices over the next several years, but also limit the potential for exponential spikes in inflation; the time horizon for sufficient penetration and adoption, however, remains vague and variable given the relative elasticity of energy commodity markets.

Several high-quality sustainable stocks, however, are now trading at increasingly attractive absolute and relative valuations, with pent-up demand from both thematic portfolio managers and investors interested in adding incremental inflation protection. If forward-looking valuation multiples on environmentally focused information technology companies with proven business models continue to compress, the Investment Team will look to take advantage by initiating positions, where prudent and appropriate.

Wage inflation, on the other hand, is probably the most significant economic factor/variable with the largest influence on determining the longevity and duration of inflationary trends. While easier to research, analyze, and monitor given the frequency of the data, wage inflation is notoriously difficult to predict given the regional and occupational variegation of U.S. labor markets, as well as the accelerated implementation of productivity-enhancing technology.

Monetary Policy | Velocity of Money

Trends in money stock measures (i.e., money supply) provide critical insight into the underlying economic health and relative strength and stability of a given economy’s monetary base, including aggregate supply-demand for that economy’s fiat currency: this information is used to build out capital market expectations and define high-probability growth scenarios, financial market assumptions, and investment return expectations. The velocity of money is a particularly informative data point because it quantifies: the frequency at which one unit of currency is used to purchase domestically-produced goods and services within a given time period. In other words, it is the number of times one dollar is spent to buy goods and services per unit of time. If the velocity of money is **increasing**, then **more transactions** are occurring between individuals in an economy (Source: Federal Reserve Bank of St. Louis).

The velocity of money has dropped precipitously over the past **±12-18 months**, largely reflective of

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Monthly Index Review
USD Total Return

Data as of December 31st 2021	December 2021	2021	2020	2019
S&P 500® Index	+4.48%	**+28.71%**	+18.40%	**+31.49%**
Dow Jones Industrial Average	**+5.53%**	+20.95%	+9.72%	+25.34%
NASDAQ Composite	+0.74%	**+22.18%**	**+44.92%**	**+36.69%**
Russell 2000	+2.23%	+14.82%	**+19.96%**	+25.52%
MSCI Emerging Markets	+1.92%	**-2.22%**	+18.69%	+18.88%
MSCI EAFE	**+5.13%**	+11.78%	+8.28%	+22.66%
Bloomberg Barclays U.S. Aggregate Bond Index	**-0.26%**	**-1.54%**	+7.51%	+8.72%

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the *sharp deceleration in economic activity* attributable to the negative impact of the ongoing coronavirus ("COVID-19") pandemic. Despite experiencing a marginal bounce in mid-2020 following the stimulative fiscal policies and programs enacted to help stabilize and support economic activity during the height of the pandemic, the velocity of money has continued to be incrementally *less accommodative* ahead of forthcoming increases in the *federal funds rate*, and as the Federal Open Market Committee ("the FOMC") continues to taper its asset purchasing programs, the Investment Team expects this data series to receive additional attention from the financial media, economists, and market commentators, as the velocity of money should provide objective, unbiased indications of whether or not economic activity levels are recovering in-line with consensus estimates or if U.S. consumers/spenders are adjusting their spending-saving in response to rising/higher interest rates.

COVID-19 | Pandemic

Our way of life was abruptly altered in 2020 with the onset of Covid 19 and human interaction has been permanently adjusted for the foreseeable future. The implications continue to unfold as do new strains of the disease. Predicting what will happen with the disease does not seem like an efficient use our time but understanding the multitude of splintering investment implications will be critical for next year. For example, a balance of non-cyclical consumer staples companies such as Clorox and Kimberly Clark should remain in portfolios to hedge, not only against an economic downturn but a pandemic scare while pro-growth technology companies such as Microsoft will have long-term secular strength and protect against a pandemic-related suspension in economic growth. Conversely, the strong cyclical growth experienced coming out of Covid could continue thus we need to maintain inflation-hedges and cyclical exposure in the form of material and industrials such as Nucor.

Political Polarization

The barrage of inflammatory news over the **past ±12-18 months** appears to have succeeded in infusing political preferences into financial markets, contradicting the time-honored truism that, broadly speaking, the stock market is an *apolitical entity*: an adage that has been objectively corroborated by numerous statistical analyses of decades of econometric data. Unfortunately, pandering to partisan affiliations attracts audiences at both ends of the political spectrum, and reporting rationally on the reality of a topic/story does *not* attract the same money from sponsors or advertisers as *fueling fear*, *inciting antagonism*, or *instigating irrationality* to drive viewership.

McShane Partners' fundamental investment philosophy is *politically agnostic*; unfortunately, the world we live in is not and is becoming *increasingly polarized* along *alarmingly extreme party lines*, and our elected officials and politicians appear worryingly willing to fuel the flames of partisan antipathies instead of navigating ideological impasses to achieve meaningful progress. Should both sides of the aisle continue to dig in their heels, the risks of a *protracted government gridlock/stalemate* could have a *real, negative impact* on financial markets, while also weighing on near-/intermediate-term economic growth.

Wealth Gap | Income Inequality

U.S. equity markets recorded their third consecutive year of strong double-digit total returns in 2021, bringing the *cumulative* trailing three-year total return for the S&P 500® Index to ±**100.37%** as of December 31st 2021. Those U.S. investors able to participate via *direct* or *indirect ownership* of stocks during this time have enjoyed outsized gains and significant appreciation in their overall net worth; those with little-to-no investable wealth who were *unable* to invest in equities, however, have witnessed a *widening in the wealth gap* between themselves and the *aspirational middle class*, as the total net wealth of the country has become *increasingly concentrated* at the *upper-echelons of the socioeconomic strata*. Furthermore, despite persistently favorable *supply-demand dynamics* across U.S. labor markets putting upward pressure on the lower-end of the wage/income curve (Refer to McShane Partners December 2021 INSIGHTS), *rising inflationary pressures* are exacerbating an already untenable situation for many Americans who continue to live

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paycheck-to-paycheck.

While the Investment Team does not pretend to have the requisite non-partisan panacea to offer at this time, we do believe that the widening wealth gap between the richest and poorest U.S. citizens poses serious socioeconomic risks to potential long-term economic growth.

U.S. Dollar ("USD") | Currency Conundrum

The ongoing maturation of *decentralized finance* (i.e., "defi") can be seen in the increased popularity and proliferation of cryptocurrencies over the past several years, emblematic of what could very well be the most disruptive technological innovation since the internet. That said, the relative immaturity of the currency concept is evident in the multitude of competing standards, technologies, and companies. Deciding who will emerge to the top of the chaotic ocean of murky complication, has been impossible but 2022 could clarify crypto as central banks and regulators make a more concerted effort to domesticate and direct unification and stability while bridging the crypto and traditional currency worlds. Implications for gold, the US $ and monetary policy could be enormous.

CONCLUSION

Driving 2022 returns will be inflation, monetary policy, post pandemic reverberations, political polarization, wealth disparity and cryptocurrency. These factors could mature in a myriad of ways and are not currently either negative or positive. Valuations and low interest rates make investing in the current environment tricky, but not impossible. What is universally expensive is risk, momentum, and speculation. When risk mongering is leading the market, it often creates opportunities in the types of companies we prefer that are high-quality, dividend paying companies with solid balance sheets and muted cyclicality. The thirst for instantaneous wealth and risk has created an opportunistic environment for our investment style at a time where interest rates make it difficult to digest investing in bonds with the risk of inflation lingering and eroding cash balances.

"The test of a first-rate intelligence is the ability to hold two opposing ideas in mind at the same time and still retain the ability to function.'"

- F. Scott Fitzgerald

Stock & Strategy Spotlight

Name	Ticker	December	2021
Cerner Corp.	CERN	+32.21%	+19.52%

Description & Investment Thesis

On December 20th, Oracle Corp. ("ORCL") and Cerner Corp. ("CERN") announced that the two companies had entered into a definitive agreement for ORCL to purchase 100% of CERN through an all-cash tender offer of $95.00 per share of CERN common stock: a total equity valuation of approximately **±$28.3 billion**. The Investment Team added shares of CERN to applicable firm-wide buy lists in early-2021 after the stock sold off sharply in the days following the company reporting relatively disappointing fourth quarter 2020 ("4Q20") earnings results. While the original investment thesis for CERN was not predicated on a potential acquisition, the Investment Team believes the announced transaction helps to validate the valuation framework used in analyzing upside/(downside) scenarios for the stock, confirming the Investment Team's belief that shares of CERN were trading at an outsized discount relative to the intrinsic value of the company.

At this time, shares of ORCL remain on applicable firm-wide buy lists, and the Investment Team is assessing potential investment opportunities based on the relative size of existing holdings/positions, as shares have traded lower since announcing its pending acquisition of CERN and are currently trading around attractive levels of near-term support.

Wealth Advisory Overview

The Importance of Tax Sensitive Investing

Tax Bracket Management

The secondary benefit of tax-deferred investments may be a lower tax rate. The theory works best when earnings are excluded from tax while you are subject to a high tax bracket. By taking a deduction for an IRA contribution, or excluding 401(k) deferrals from taxable income, you may be avoiding a tax liability during working years when earnings and taxes are most often higher than earnings and taxes during retirement.

There is no requirement that matches up the avoided tax with the eventual tax liability. If you are in a 37% bracket today, additional income in the current year will be subject to tax at 37%. If you withdraw funds from a tax deferred account in a future year when your taxable income is lower, you owe taxes based on the rate in effect in that future year. The U.S. tax brackets are graduated, meaning they vary from a bracket of zero on the lowest taxable incomes, to a current high of 37% (on married couple incomes over $628,301). A married couple with taxable income of $250,000 in the current year would pay taxes on a withdrawal from a tax-deferred account at a 24% tax rate. The timing of tax deferred withdrawals can be as important as the length of tax deferral or the return on those investments!

Examples of Tax-Deferred Accounts

An employer-sponsored retirement plan (such as a 401(k), 457 or 403(b) plan) is an example of a tax-deferred retirement savings vehicle that allows participating employees to contribute a percentage of their pre-tax salary and direct it to one or more investment accounts. A regular IRA (also known as a traditional IRA) is also tax-deferred. An annuity and the cash surrender value of a whole life insurance policy also operate as tax-deferred accounts.

Tax Free!

A Roth IRA is not just tax-deferred; it is a tax-free account (no tax is owed on withdrawals). The contributions to a Roth IRA do not reduce your taxable income at the time of contribution, like 401(k) or Traditional IRA contributions do, so there are no future tax implications for Roth savings (unless you withdraw early). A Health Savings Account (HSA) is a tax-favored savings account that also provides tax-deferred growth. If withdrawals are used to pay for qualified medical expenses, HSAs are also tax-free.

Tax-Deferred Account vs. Tax-Exempt Income

Even without access to a tax-deferred account, individuals may invest in bonds which pay tax-exempt interest. Typically, such interest is exempt from federal tax. If the bond represents the debt of a state other than the individual's residence, that interest will be taxable on a state income tax return. Not only will the interest avoid taxation, it may also help your overall tax situation by keeping your taxable income lower, resulting in lighter taxed social security benefits and a lower bracket applicable to other income.

Planning for the Future

When considering the impact of tax deferred investing, it is critical that you understand the timing of future income streams and the timeframe of investing and withdrawal. Tax deferred accounts typically have penalties for withdrawals that occur prior to certain required timeframes and/or the taxpayer achieves certain ages. Some may also require distributions to occur whether the income is needed or not. There is no “right answer” for everyone. In addition, withdrawals from tax deferred accounts (IRAs and 401ks) are taxed as “ordinary income” since a deduction was permitted when the investments were made with earned income. The rates on earned income are the highest tax rates, which is what led to the famous Warren Buffet quote that his secretary paid higher taxes than he did.

If a taxpayer withdrew $200,000 from an IRA to pay living expenses, they would typically pay tax at a rate of either 24% or 32%. If that same amount were taken from a taxable account, the taxes due would be assessed at a rate of 15% (for investments held at least a year). Plus, the taxable account withdrawal is only taxed on appreciation, not on the total withdrawal. It is generally better to have a mix of retirement assets available to you, versus an entire portfolio of tax-deferred assets.

Final Caveat

Taxes can be a significant expense, and the deferral of a tax liability can greatly impact the value of your financial assets over time. However, taxes are not 100%. Rarely can the tax deferral on an account compensate for poor performance and/or high fees.

Final Final Caveat!!

The Build Back Better Plan, which has been in negotiations in the House for months, has significant changes to retirement plans for high income taxpayers, including changes to Required Minimum Distributions as well as contribution limits. We will keep you updated if the Democrats can get Manchin on board with the Bill.

Finance Corner: The Benchmark for SS Benefits—Primary Insurance Amount

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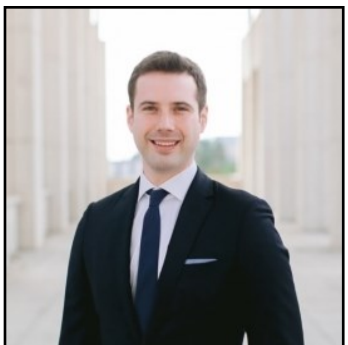
The primary insurance amount (PIA) is the basis for benefits that go to you and your family members. Your actual Social Security benefits may be lower or higher than the PIA for various reasons. Here are some examples of benefits:

- **Retired Worker:** You get 100 percent of your PIA if you retire at full retirement age (FRA). You can begin collecting as early as age 62, but the amount you will receive is reduced.
- **Disabled Worker:** You get 100 percent of your PIA. The benefit is not reduced for age and automatically switches to a retirement benefit when you reach FRA.
- **Spouse of Retiree or Disabled Worker:** You get 50 percent of the covered worker's PIA at FRA.
- **Spouse with Child:** You get 50 percent of the covered worker's PIA if the child is under 16 or disabled. You may be any age to collect without a reduction before FRA.
- **Divorced Spouse:** You get up to 50 percent of the covered worker's PIA at FRA. Your marriage must have lasted 10 years', and you must be unmarried to collect.
- **Widow/Widower (at any age), Caring for a Child Under 16:** You get 75 percent of the covered worker's PIA.

How much you get in Social Security benefits varies depending on your situation. Let McShane Partners know if we can help you determine what amount is right for you.

NextGen: 401(k) Review



Ryan Vaudrin, CFP®, CDFA®
Wealth Advisor

Over the past year we have discussed the importance of saving early and how easy it is to take advantage of an employer sponsored 401(k) plan. With high contribution limits, most individuals use their employer plan as their primary source of retirement savings. As this account grows, it is important to review your asset allocation on an annual basis to determine whether your investment options need to be rebalanced.

The first item to focus on during the 401(k)-review process is the amount of your contributions. Typically, an employer will provide employees with a contribution match as an incentive to save for retirement. This match is in effect free money. Therefore, you should ensure that the amount you are contributing will allow you to receive the maximum employer match. In addition to utilizing the company match, you should review your plan to determine whether your employer offers an after-tax savings option, such as a Roth. Depending on your individual tax situation, it might be advantageous to defer into this type of account when you are in a lower tax bracket because it grows tax free.

Next, it is time to focus on your asset allocation. Asset Allocation is one of the most important factors when investing and setting up a proper investment portfolio. As the account balance fluctuates, the overall asset allocation will differ from the targeted allocation. The typical rule of thumb is to rebalance the portfolio back to the targeted allocation when variances are more than 5%. If rebalancing does not occur, investors might find their portfolio allocation does not reflect their personal risk tolerance and subject their portfolio to fluctuations that they are not comfortable with.

In addition, rebalancing the 401(k) will present an opportunity to review any new funds that are available in the plan. Most plans will offer a variety of mutual funds that will have broad exposure to different investment strategies. It is important to select investment options that pair with any other personal investments that are not in the 401(k). Selecting appropriate funds will keep investors in line with long term investment goals and add overall portfolio diversification and growth.

Your employer sponsored 401(k) should not be a set it and forget it type of account. As personal lives change, it is important to review account contribution levels and whether these can be increased, institute a periodic rebalancing schedule, and select appropriate investments to meet long-term goals. At McShane Partners, we are available to help navigate 401(k) reviews and answer any questions concerning what is most appropriate for your individual situation.

Senior Planning: Contacting the Social Security Administration

Lorri Tomlin, FPQP™
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The SSA has one overriding goal, to make sure you end up with the correct benefit amount you're entitled to under the law. The SSA runs not only the basic Social Security protections for retirement, survivors, and disability, but also SSI for the poor. The SSA handles applications for Medicare and the deductions in benefits that pay for Medicare premiums. That is a lot of territory to navigate with many rules, technicalities and areas that can be confusing.

Sometimes, you may end up having to contact the SSA to determine the optimal outcome for your situation. Contacting the SSA isn't difficult. You can go to a field office, call a toll-free number, or go online:

- Field offices: SSA offices are located all over the country. To find the nearest SSA office, just go to www.ssa.gov/locator and enter your zip code. You will find the nearest office, along with the hours they are open to the public, typically Monday through Friday from 9 a.m. to 4 p.m.
- Phone: You can contact an SSA representative toll free at 800-772-1213 Monday through Friday, 7 a.m. to 7 p.m.
- Online: The SSA website (www.ssa.gov) has a great deal of information on benefits and rules that might affect your individual situation. You can also find forms you may need and begin applications for certain benefits, including retirement.

Social Security has increased its hours and staff at field offices to help shorten the long lines and waiting times on the telephone. If you're stretched for time and need to deal with the SSA, it helps to keep a couple of things in mind. First, waiting times on the phone and in offices tend to be longer early in the month and early in the week. Second, you can call the toll-free number to make an appointment with a local field office and save time when you arrive.

2022 Office Schedule

McShane Partners will be closed on the following dates in observance of the 2022 holiday schedule:

Monday, Jan. 17	Martin Luther King, Jr. Day
Monday, Feb. 21	President's Day
Friday, April 15	Good Friday
Monday, May 30	Memorial Day
Monday, June 20	Juneteenth National Independence Day (Observed)
Monday, July 4	Independence Day
Monday, Sep. 5	Labor Day
Thursday, Nov. 24 & Friday Nov. 25	Thanksgiving
Monday, Dec. 26	Christmas Day (Observed)
Monday, Jan. 2	New Year's Day (Observed)

Around McShane Partners

Building Update

Our bricks have arrived! We are currently in the process of laying the brick and are projected to move into the new building February 2022. Stay tuned for more developments and updates!

Riding into the New Year

The McShane Partners team enjoyed their year end party at the Carmel Country Club. We had a wonderful year and can't wait to see what 2022 has in store!

New Faces

Wealth Associate Daniel Hudspeth and wife Kara welcomed their first child over the holidays. Their son McClain, or "Mac", was born just before Thanksgiving weighing 8 pounds 1 oz. He is adjusting great and has been living the life ever since!

McShane Partners

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

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