MP McShane Partners

April 2022 Insights

Investment Overview

Stagflation

Inflation is *not* the real enemy. Inflation with no economic growth (i.e., *stagflation*) is the true nemesis, and the media has been casually invoking this term over the past several months. Given the increased relevancy of stagflation, it may be worth asking the question: is stagflation merely an overly inflammatory term, igniting unnecessary fear, or is it truly the beginning of a systemic economic overhang?

Definition | History

Stagflation can be defined as the combination of high inflation and weak economic growth (i.e., *stagnation*). Stagflation occurs when sudden, dramatic declines in aggregate supply levels push prices *higher*, precipitating increased inflationary pressures throughout an economy. Concurrent reductions in supply levels and persistently elevated prices constrain economic activity, inhibit aggregate demand, and weigh on measures of total economic output, such as gross domestic product ("GDP"), which, eventually, begin to stagnate or decline, making stubbornly inflated price levels increasingly unpalatable.

In order to confirm that the U.S. economy has entered a period of stagflation, broad-based measures of year-over-year ("YoY") inflation will need to continue to trend higher or remain elevated vs. pre-pandemic levels, while aggregate economic growth will need to decelerate on a YoY basis: often a predictable precursor to an economy entering a technical recession (i.e., two consecutive quarters of negative YoY growth).

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Wealth Advisory Overview

Inheriting an IRA Post-Secure Act

If you inherited all or part of an individual retirement account (IRA) or a qualified retirement plan, you may be wondering what you should do with the account. The rules governing inherited IRAs are complex, all the more so since the passage of the SECURE Act of 2019. The options available will depend on several factors, including the type of account inherited, when it was inherited, the relationship to the deceased, and at what age the death occurred.

The SECURE Act

The SECURE Act of 2019 made the options and requirements for inherited retirement accounts significantly more complicated. Among the changes, it allowed for a new option for distributing assets, defined a third category of beneficiaries, and increased the age at which RMDs are required to begin. It also eliminated the Stretch IRA for non-eligible designated beneficiaries (Non-EBDs) and non-designated beneficiaries.

Before the SECURE Act, an IRA owner generally needed to start taking RMDs by April 1st following the calendar year in which they reached age 70½. By changing the RMD age to 72, the SECURE Act effectively changed this RBD. For those who turned 70½ in 2019, the RBD is still April 1, 2020, but those who turn age 70½ in 2020 or later can wait until April 1st of the year following their 72nd birthday.

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Points of Interest

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

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Previous Occurrences

Historical episodes of stagflation have generally been preceded by unanticipated, sharp spikes in raw material and oil prices. Chart I, below, overlays inflation, as measured by the YoY change in monthly U.S. Consumer Price Index ("CPI") data (**the dark blue line**), and economic growth, as measured by YoY growth in quarterly U.S. Real GDP data (**the blue-green bars**), over multiple economic cycles, herein defined as the time between the end of one recessionary period and the start of the subsequent recession. The most notable occurrence/incidence of stagflation spanned multiple market cycles and recessionary periods, beginning in late-1973 and lingering through late-1982, as indicated in Chart I, below; successive oil crises and simmering geopolitical tensions triggered sharp spikes in the price of oil, contributing to outsized inflationary pressures and persistently elevated price levels that weighed on global economic growth for the better part of a decade. Stagflation has consistently appeared during the later stages of a market cycle, which may challenge or contradict the long-held opinion that stagflation is an aberration and uniquely destructive to market cycles instead of a normal, naturally occurring end to any maturing market cycle.

In the aftermath of the Global Financial Crisis ("GFC"), the U.S. Federal Reserve ("the Fed") shifted focus from managing inflation to averting *deflation*, which posed a much more immediate and ominous threat to the U.S. economy at the time. This necessitated an unprecedented amount of accommodative, stimulative easy monetary policy initiatives given the significant concerns regarding massive federal, corporate, and household debt levels: deflation is detrimental to debt issuers because falling asset prices increase the costs of debt. As shown below in Chart I, instances of deflation in the U.S. economy manifested for the first time following the collapse of the housing market during the post-GFC 2008-2009 recession. Deflation remained a residual risk for ±10 years given the Fed's inability to stimulate incremental inflation, enabling the Fed to remain accommodative and keep the federal funds target rate ("the fed funds rate") lower-for-longer.

As such, the sudden resurgence of inflation necessitates a rapid shift in the Fed's policy, with the problem now being that interest rate hikes are increasingly necessary to control inflation at a time when faltering or declining GDP growth may

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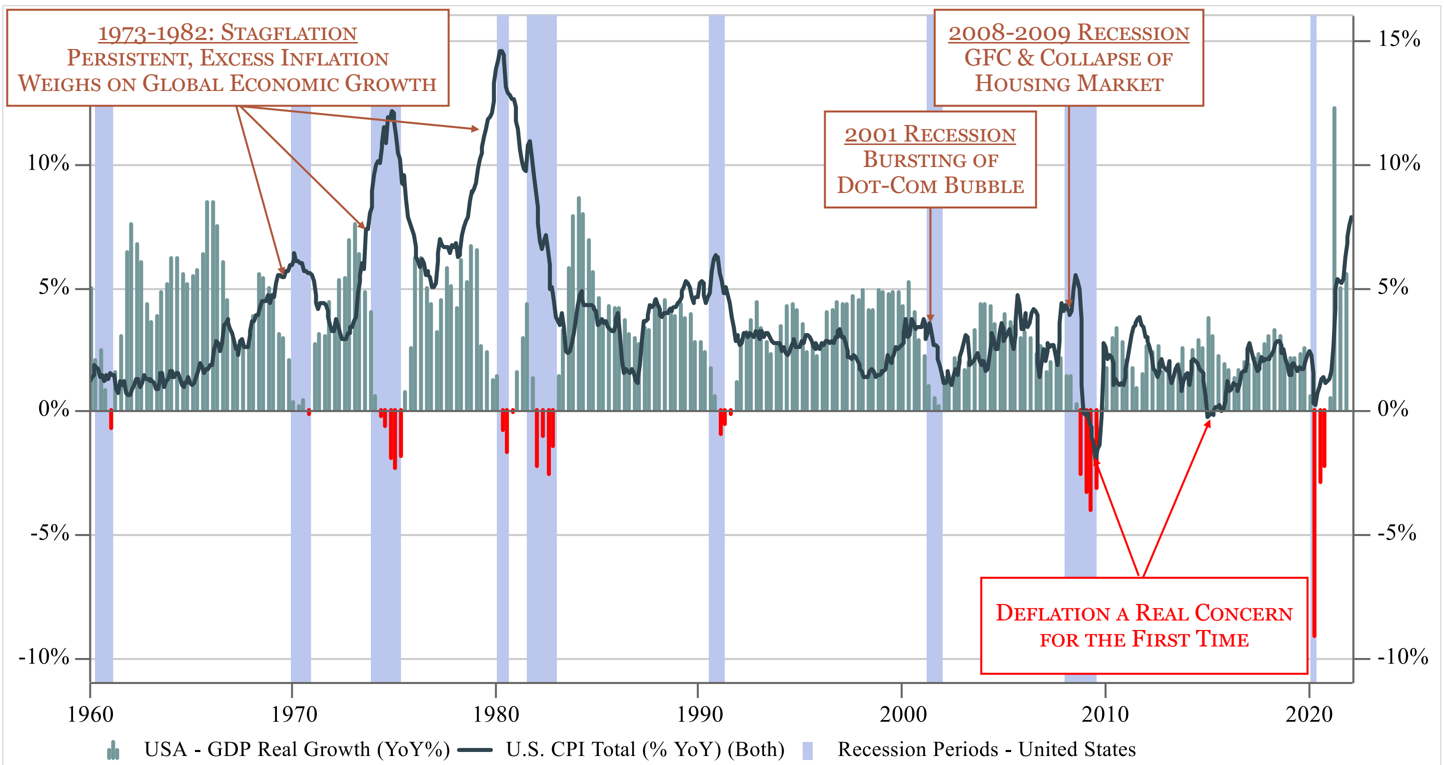
Chart I: U.S. Real GDP Growth vs. CPI (% YoY)



Source: McShane Partners - FactSet Research Systems, Inc.

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inadvertently push the U.S. economy into a recession, with the Fed having limited capacity for additional quantitative easing to stimulate economic activity in the event of a recession: this is why global financial markets have not been hyper-focused on stagflation, which, until only recently, had largely been dismissed as irrelevant, if not completely obsolete.

One question remains unanswered: how did we manage to create runaway inflation after more than a decade of the Fed desperately trying to stimulate inflation? The Investment Team believes that the Fed may have finally succeeded in increasing the *money supply* - represented by the M1 monetary aggregate (**the dashed green line**) in Chart II - to a suffocating level, albeit with a terrifyingly dramatic decline in the *velocity of money* (**the blue-green line**), which measures transactional frequency and provides an effective gauge of economic activity. When the Fed *lowers* the fed funds rate, it is attempting to *reduce* the cost of borrowing money and encourage additional lending in order to stimulate economic activity and effectively mitigate the likelihood, length, or severity of an economic slowdown or recession. Since the GFC recession of 2008-2009, the corresponding reaction in the velocity of money has been disconcerting because an increasing amount of support in the money supply is required to sustain the U.S. economy with a disappointing level of associated increase in economic activity, as measured by the velocity of money. The breakdown in this relationship and the efficacy of increasing the money supply may now be contributing to sustained inflation even though there is no demographic or productivity drivers to support it. Inevitably, this disconnect between money supply and the velocity of money could create systemic stagflation that lingers longer than the typical economic cycle.

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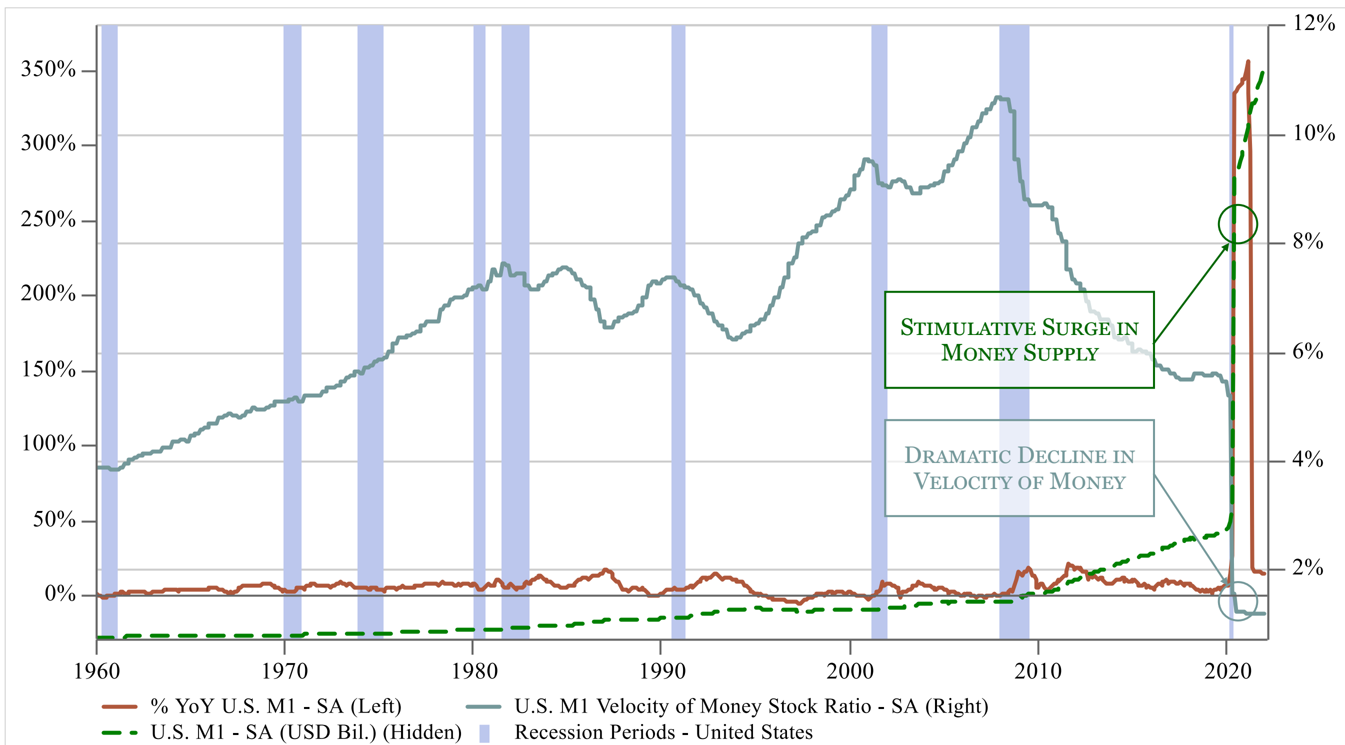
"Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output."

- Milton Friedman

Chart II: U.S. Money Supply vs. Velocity



Source: McShane Partners - FactSet Research Systems, Inc.

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Stagflation

What to do with Stagflation?

Portfolio & Investment Implications

Stagflation poses nuanced dilemmas for investors given the pervasive paradigm shift away from the deflationary landscape of the past ±13 years, as well as the corresponding implications for risk-return expectations across asset classes and financial markets:

Fixed Income **Negative**

Tactical Underweight ⇨ Increased Inflation Risk + Incremental Duration Risk (i.e., Rising Nominal Interest Rates)

✓ Once interest rates have risen enough to compensate for inflation, the asset class should begin to offer more attractive opportunities for long-term investors, but, until then, the short-/intermediate-term implications of stagflation for fixed income assets (i.e., bonds) remain negative.

Equities **Neutral | Highly Selective**

Reduce Tactical Overweight ⇨ Profit Margins Pressured + Falling Output due to Declining Demand

✓ Investors should consider reducing any residual overweight to equities relative to their target allocations by trimming broad-based equity market risk (i.e., beta), where prudent and applicable.

↳ Individual stock selection and active asset management should become more important as growth becomes scarce or non-existent, which will likely pressure broader equity market performance.

↳ With respect to sector, industry, and individual stock selection, investors will need to be increasingly cognizant of underlying fundamentals and profitability metrics vs. myopically focusing on outsized top-line (i.e., revenue) growth, as higher inflationary pressures will have an inordinate impact on the bottom lines of unprofitable companies.

Commodities **Positive**

Maintain In-Line Allocation (Direct + Indirect Investments) ⇨ Rising Price Levels + Improved Profit Margins

✓ Portfolios should benefit from in-line allocations to both direct and indirect investments in commodities given their relative appeal as a hedge against upside surprises in inflation, which will likely remain volatile through the end of the market cycle.

↳ Several safe-haven, store-of-value assets (e.g., gold) will likely continue to perform better until interest rates are considerably higher.

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Monthly Index Review
USD Total Return

Data as of March 31st 2022	March 2022	2022 YTD	2021	2020
S&P 500® Index	**+3.71%**	-4.60%	**+28.71%**	+18.40%
Dow Jones Industrial Average	+2.49%	-4.10%	+20.95%	+9.72%
NASDAQ Composite	**+3.48%**	**-8.95%**	**+22.18%**	**+44.92%**
Russell 2000	+1.24%	**-7.53%**	+14.82%	**+19.96%**
MSCI Emerging Markets	**-2.22%**	-6.92%	**-2.22%**	+18.69%
MSCI EAFE	+0.76%	-5.79%	+11.78%	+8.28%
Bloomberg U.S. Aggregate Bond Index	**-2.78%**	-5.93%	**-1.54%**	+7.51%

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Conclusion

The terrifying truth is that there is no surefire panacea if and/or when stagflation occurs, thus positioning a portfolio unilaterally for the most unfortunate economic outcome possible seems premature and draconian at this stage. Currently, financial markets are vacillating between paralyzing fears over stagflation and anecdotal optimism that the Fed will be able to engineer a soft landing by tactfully tightening monetary policy to moderate inflation without triggering a recession. This would be a triumph and testament to the Fed's acumen, should it be accomplished. The ultimate resolution to the shocking spike in inflation remains elusive but is a serious consideration and requires patience in the portfolio management process given the underlying implications for interest rates and the impact to both asset allocation positioning and individual security selection. Given the uncertain outcome, the Investment Team remains committed to managing portfolios to account for multiple scenarios, constantly monitoring ongoing developments, and making prudent, well-informed decisions.

Stock & Strategy Spotlight

Name	Ticker	March 2022	2022 YTD
Nuveen Preferred Securities Fund	NPSRX	-0.95%	-4.67%

Description & Investment Thesis

Given the increased volatility across global financial markets and in interest rates year-to-date ("YTD"), a surprising number of asset classes have behaved erratically in their respective underperformance relative to expectations. With both fixed income and equity markets digesting countless socioeconomic and geopolitical risks (e.g., ongoing COVID-19 pandemic, Russia-Ukraine war, inflation, moderating global growth, etc.), the Investment Team is evaluating all assets with an added emphasis on identifying attractive opportunities to earn *incremental income* while *mitigating excess volatility*. After reviewing the preferred securities sector and speaking with the portfolio manager of the Nuveen Preferred Securities Fund ("the Fund" or "NPSRX"), the Investment Team is reiterating its positive opinion of the Fund and recommending increasing positioning in NPSRX as a *high-quality*, *low-duration* solution for strategic exposure to the preferred securities sector.

As interest rates *rise*, the Financials sector, particularly the Banking and Insurance industries, become *more attractive* because they can *arbitrage* the difference between what they pay out on deposits vs. what they earn on loans. This is referred to as *net interest margin* ("NIM"), which *improves* as interest rates continue to rise. The Fund has **±80.0%** of portfolio-level assets invested in the Banking and Insurance industries and is yielding north of **±4.0%**, while also having *superior placement* in the capital structures of its underlying portfolio companies; in other words, the preferred stocks of the Banking and Insurance companies owned by the Fund carry *less risk* than the common stocks of those companies because preferred stock shareholders get paid *before* common stock shareholders. Moreover, the Banking and Insurance industries are flush with cash, which has two important implications: first, the balance sheets and financial health of these companies are the best they have been in decades; and second, they should not need to issue new preferred securities, which should provide *positive technical support* to *supply-demand dynamics* for these higher-yielding preferred securities relative to shares of the common stock.

With clarity on *rising interest rates*, the Investment Team believes additional exposure to the preferred securities market is warranted at this time. As such, we will be *incrementally increasing* positioning across client investment portfolios as an increasingly volatile socioeconomic and geopolitical backdrop has provided a relatively attractive buying opportunity. Interest rate movements are still a primary consideration, which is why the Investment Team prefers the Fund for high-quality exposure given the portfolio management team's likeminded view on the marketplace and stated intention to keep *duration* (i.e., *interest rate risk*) *lower*,

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In addition, most Non-EDBs who inherit an IRA on or after January 1, 2020, may no longer use the Stretch IRA strategy. The change applies to Roth IRAs as well as pre-tax IRAs. Although the tax implications for Roth IRAs are negligible (since distributions from a Roth are tax free), the change still forces tax-free dollars out of the inherited Roth IRA sooner than previously required, reducing the ability to let the dollars grow tax-free for longer than 10 years.

Ownership/Distribution Options

All beneficiaries have the option to use the lump sum method. The following details the additional options available for each type of beneficiary.

Spouse

Spousal eligible designated beneficiaries have multiple options in addition to taking a lump sum. If you are the primary beneficiary of your spouse's retirement assets, you can generally treat inherited assets as if they are your own. Only in the case of pre-tax Traditional IRAs, if the decedent-spouse was subject to RMDs at the time of their passing, an RMD is required in the year of death if your spouse did not already take it prior to passing away. Otherwise, you can wait until your RBD to begin RMDs.

Non-Eligible Designated Beneficiaries

The most common example of a Designated Beneficiary is an adult child. Designated beneficiaries only have one option in addition to the lump sum, which is the 10-year method.

For the 10-year option for designated beneficiaries, RMDs are not required in years 1-9 (although allowed), but the account must be fully distributed by December 31st of the tenth year after the original account holder died. For a pre-tax Traditional inherited IRA, if the original account owner was subject to RMDs at the time of their passing, an RMD would be required in the year of death if the original account owner did not take it prior to their passing.

Converting a Pre-Tax Retirement Account to an Inherited Roth IRA

For a non-spouse designated beneficiary of an employer-sponsored retirement plan (like a 401k), you have the option to roll over your inherited assets into an inherited Roth IRA. In this case, the entire account balance would be added to your taxable income in the year of transfer, and you would be subject to the 10-year method for distributions. However, those distributions from the inherited Roth IRA would not be taxed again after the year of the initial rollover.

It's important to differentiate the rules for an inherited pre-tax Traditional IRA, as a non-spouse designated beneficiary is NOT allowed to convert an inherited Traditional IRA into an inherited Roth IRA.

As a spouse beneficiary, you have the option to treat the inherited assets as your own. Therefore, after you rollover your late-spouse's assets into your own retirement account, you have the option to convert to a Roth IRA, pay taxes in the year of transfer, and then benefit from tax-free distributions going forward, as long as you have met the 5-year rule.

Multiple Beneficiaries of Inherited Assets Must Act Independently

When a retirement account contains multiple beneficiaries, the IRA must be divided into separate accounts for each beneficiary by September 30 of the calendar year following the calendar year of the original account owner's death. If the IRA is not split by September 30, and all beneficiaries are individuals, then the beneficiary with the shortest life expectancy will be considered the designated beneficiary for purposes of calculating any RMD amounts and for determining whether they are an eligible designated beneficiary. Distributions to a non-EDB must follow the 10-year Method.

If you have inherited an IRA or 401k account, please contact your Wealth Advisor to discuss the distribution options available to you to determine what is best for your individual situation.

Senior Planning: How to Choose an Executor

Lorri Tomlin, FPQP™
Partner | Wealth Advisor

Planning for your death probably won't make the "Top Ten" list of favorite things to do. However, it is an important task that will ensure your estate is distributed per your wishes and not per the state statute should you die intestate (without a Will). Therefore, the executor of your Will is an important appointment because they ensure that your assets are handled appropriately and distributed as you intended after your death. The executor may need to sell property, pay creditors, distribute assets, and close out accounts. Choosing the right executor to handle the settlement of your affairs can be a tough decision and there are several things to consider that will help you to select the best person for the job.

Start by looking for someone who is responsible, trustworthy, conscientious, organized and in good financial standing. They may need to handle potentially difficult situations, so they also need to be emotionally stable and strong. An estate settlement could take several months. Are they able handle the role of executor along with their own life responsibilities?

Where the executor lives should also be considered. It may be more convenient if the person lives near you, but it is not required. The executor can always hire people to help with tasks such as removing furniture, meeting with repairmen or other professionals.

Are two executors better than one? Some people may consider having co-executors. Perhaps they want siblings to share the responsibility to avoid any potential conflicts or hard feelings. However, having more than one executor can make the process more complicated and cumbersome especially if the two people don't get along. In this case, it may be wise to consider a professional executor such an attorney, accountant, or trust company. Remember that a professional executor will most likely charge a fee for this service.

There are certain individuals cannot qualify to be an executor. Minors, former felons, and non-US citizens living outside of the U.S. are almost always disqualified from being appointed. Having a "back up" or successor executor is also a good idea. A successor executor assumes the role if the original executor predeceases you or chooses not to serve. Selecting someone younger than yourself can help eliminate the likelihood of your executor dying before you.

Regardless of who you choose for an executor, it is recommended that you talk to the person ahead of time to discuss your intentions with them and to see if they are willing to take on the role. Choosing an executor for your Will is only one component of a complete estate planning process. Choosing someone to fill other roles including Powers of Attorney or Trustee is also very important. The same qualities would be recommended in deciding who should take on these responsibilities.

Finally, it is important to review your estate documents frequently and especially if there have been significant life changes such as divorce, death, birth, or a major asset acquisition. This will help ensure that they are current and in keeping with your intentions.

Tax Update: Retirement Changes Ahead

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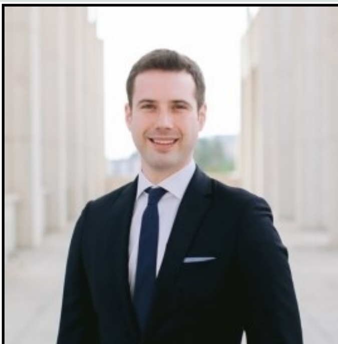
In a rare act of bipartisan agreement, the House passed the Securing a Strong Retirement Act of 2022 in a vote of 414 to 5 on March 29th. Referred to as Secure 2.0, this legislation builds off The Secure Act that passed on a bipartisan basis in late 2019 and provides a number of retirement reforms, including expanding auto-enrollment, helping those still paying student loans, assisting both small and large businesses offer more retirement savings options, and raising the age for required minimum distributions (RMDs) to tax deferred retirement accounts like IRAs.

The proposed legislation would again push back the age Americans need to take RMDs from retirement accounts like IRAs from the current age of 72 to 73 in 2023, 74 in 2030 and 75 in 2033. This could help retirees who don't need their money immediately to keep more of their savings invested longer and continue to defer paying taxes. To help those playing catchup, Secure 2.0 also raises the maximum catch-up contribution level from $6,500 to $10,000 for Americans ages 62 to 64, although catch up contributions will be required to be made from after-tax funds.

We will keep you updated as the legislation continues to move through the Senate.

NextGen: When Do I Need a Financial Plan



Ryan Vaudrin, CFP®, CDFA®
Partner | Wealth Advisor

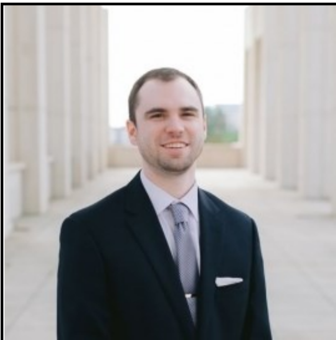
Meeting personal financial goals can be challenging for young investors as they begin their financial journey. Utilizing a financial professional and their resources can provide clarity while navigating goals and needs. A well-developed financial plan serves as a blueprint for the future and may be the difference between *almost* and *success*. So, what is a financial plan exactly?

A financial plan is a comprehensive analysis of an individual's current financial situation including cash flows, budgets, and planned savings combined with their expectations and goals for the future. A financial professional then projects these known facts with future variables to determine if goals can realistically be met, and if not, what needs to change to increase the probability that their goals are achieved.

The first version of the financial plan is the baseline plan. This initial plan illustrates whether a client is likely to be successful considering their current savings and spending strategy. Once a baseline plan is established, the financial professional can develop alternate scenarios to model different situations. For example, scenarios may include increased savings, early retirement, or the purchase of a second home. Base and alternate scenarios provide information and guidance that allow individuals the ability to make decisions and see how these decisions may impact their future short-term and long-term goals.

At McShane Partners, we feel that financial plans are universally beneficial as they provide guidance for dynamic goals as personal situations change. Financial plans can also serve to help keep clients accountable and on track, so they are typically updated annually, or as major life events occur. Financial plans are just one of many powerful tools that McShane Partners utilize to provide the greatest probability for future success.

NextGen: Student Loan Repayment Options, Part II



Daniel Hudspeth, CFP®
Wealth Associate

As we approach May 1, 2022, millions of outstanding student loans are scheduled to resume after more than two years in deferment. Last month we reviewed four of the most common repayment options available to borrowers – Standard Repayment, Graduated Repayment, Extended Repayment, and Income Sensitive Repayment. This month we will cover the four remaining plans which include Pay as You Earn, Revised Pay as You Earn, Income Based Repayment, and Income Contingent Repayment.

Pay as You Earn (PAYE)

Available to borrowers with a Direct Loan made to students after October 1, 2007, or those who received disbursements of a Direct Loan after October 1, 2011. Those with PAYE loans will typically pay 10% of their discretionary income per month, up to the amount that would be required under the Standard Repayment Plan. Payments are recalculated every year and may change depending on income and family size. PAYE may also be a good choice for borrowers seeking Public Service Loan Forgiveness or PLSF.

Revised Pay as You Earn (REPAYE)

This plan is very similar to the Pay as You Earn plan with two key differences: (1) REPAYE payments for married borrowers consider a spouse's income and debt even if filing taxes separately and (2) REPAYE outstanding balances will typically be forgiven after 20 years for undergraduate or 25 years for graduate/professional study loans. Please note, forgiven balances may trigger an income tax event.

Income Based Repayment (IBR)

Available for the same loan types as PAYE and REPAYE plans. Loans are available to borrowers with a high debt to income ratio and will normally result in payments of 10-15% of discretionary income. IBR differs from REPAYE since married borrowers do not have to consider a spouse's income or debt if filing taxes separately. IBR outstanding balances may be forgiven after 20 to 25 years but may also trigger an income tax event upon forgiveness.

Income Contingent Repayment (ICR)

Available to all eligible borrowers with a Direct Loan made to students. ICR payments will typically be the lesser of 20% of discretionary income or what the required fixed payment would have been over 12 years based on income. Married borrowers do not need to consider a spouse's income or debt if filing taxes separately. Outstanding balances will typically be forgiven after 25 years.

Please contact your McShane Partners advisor for more information or questions and stay tuned for future developments.

Around McShane Partners

McShane Partners Golf Balls

Sandy recently visited our clients in the sunshine state of Florida. The weather was beautiful, and clients enjoyed a round of golf with our McShane Partners customized golf balls. We have plenty of these left so please let us know if you would like a pair.

Building Update

The McShane Partners team at our on-site building inspection. The building is finally being finished and our move in date is scheduled for April 29th!

Celebrations

Sandy and Daniele joined friends to celebrate Justin Carlson's 50th birthday at Carmel Country Club.

McShane Partners

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

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