McShane Partners

June 2021 Insights

Investment Overview

11 Years of Persistent Consistency

Given the remarkable rebound in financial markets over the past ±12 months and the ongoing recovery in economic activity, relevant discussions regarding asset allocation and/or portfolio-level positioning are front-and-center for investors struggling to understand or rationalize a seemingly limitless capacity for debt, stimulus, and sentiment-driven momentum. A frenetic optimism and surge in calls/comments from media pundits has fueled an unsettled sense of urgency to "do something" and take action quickly (e.g., investing excess cash). At such times, it is critical that investors remain *persistent* and *consistent* with their long-term investment strategies, appreciating and acknowledging that portfolios have successfully navigated similar shifts in market forces/conditions. A *persistent consistency* in *analyzing* financial market conditions, *identifying* underlying drivers of short-term trends, and *understanding* when and/or how to adjust portfolio-level positioning, accordingly, is crucial to navigating the near-term predictions of prognosticators whose long-term track records are mixed, at best.

Given what feels like the nascent capitulation of a ***very long*** market cycle, the Investment Team has included a review of the past **±11 years** since it began building out McShane Partners' in-house investment platform. The goal of this exercise is to identify past episodes that may provide perspective on current capital market conditions and economic environment, with very little having changed in terms of underlying drivers and fundamental factors.

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Wealth Advisory Overview

Roth IRA Conversions

The consensus seems to indicate that tax rates will be higher in the future than they are today. If that is the case, the question regarding the optimal time to consider converting a Traditional IRA to a Roth has been gaining momentum. While each situation is unique, here are some things to consider before making a conversion.

Where Will You Live in Retirement?

If you anticipate that your federal income tax brackets will remain unchanged, it may be possible that your state income tax rates may change with a move following retirement. Some states either do not have an income tax, or they partially or entirely exclude retirement income – such as distributions from a traditional IRA – from state income tax. Therefore, any conversions should be completed either prior to or following any change in residence, depending upon the more favorable option.

Required Minimum Distributions

A conversion of some or all of your traditional IRA to a Roth will either reduce or eliminate future Required Minimum Distributions (RMDs). This is because Roth IRAs do not have required minimum distributions during the life of the original owner, while RMDs from traditional IRAs begin at age 72. Therefore, it is optimal that conversions are completed prior to age 72 when RMDs will tend to bump individuals up into higher tax brackets.

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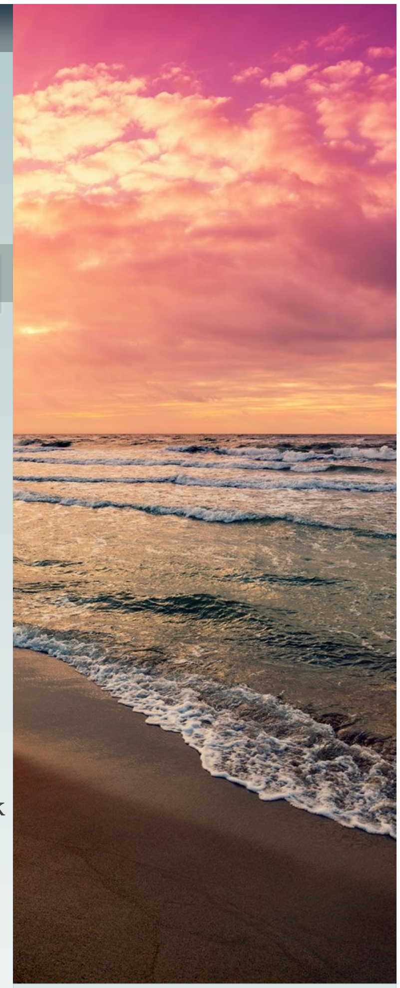

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Points of Interest

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March 2011: Inaugural Quarterly Economic Overview
- Despite Volatility, Equities Relatively Attractive vs. Bonds
  - Focus on High-Quality, Dividend-Yielding Equities Capable of Sustainably Growing Dividends per Share ("DPS")

April 2011: First Quarter 2011 ("1Q11") Economic Overview
- Heightened Uncertainty Ahead of Impending End to FOMC's Second Round of Quantitative Easing ("QE2")
  - Spike in Oil Prices Sparks Commodity Inflation Concerns

April 2012: First Quarter 2012 ("1Q12") Economic Overview
- Highlighted Discrepancies in Growth in Money Supply (i.e., M2) vs. Declining Velocity of Money
  - Stimulus (e.g., QE) Providing Significant Support, Driving Incremental Market Momentum

May 2013: Introduction of "RWM Core 20 Tracker Portfolio"
- Hypothetical Portfolio of Top 20 Stock Picks Based on In-House Investment Philosophy
  - Emphasis on Defensive Businesses Trading at Attractive Valuations, as well as Propensity of DPS Growth

August 2013: Second Quarter 2013 ("2Q13") Economic Overview
- "Taper Tantrum" Triggers Spike in Interest Rates, Sell-Off in Safe-Haven Assets (e.g., Bonds)
  - Concurrent Factors Behind Sharp Rise in Interest Rates: Potential "Tapering" of FOMC Asset Purchases, Improving Economic Backdrop, and Unraveling of Overbought Bond Market

April 2015: The Almighty Dollar
- Analysis of the U.S. Dollar ("USD") as the Global Reserve Currency and its Impact on Global Financial Markets

May 2015: Second Quarter 2015 ("2Q15") Economic Overview
- Highlighted Job Openings & Labor Turnover Survey ("JOLTS") Data as Indicator for Potential Wage Inflation, as Job Openings *Exceeded* Hiring Activity

December 2015: Wage Inflation
- Interest Rate Normalization Requires Sustained Wage Inflation, Acceleration in Velocity of Money
  - Shifting Labor Market Supply-Demand Dynamics Could Contribute to Wage Inflation

February 2016: Alternative Investment Strategies Portfolio Manager Panel
- Debate Regarding Diversification Benefits of High-Quality Alternative Investment Strategies (i.e., Hybrids)

February 2017: Emerging Markets ("EM") Equity Portfolio Manager Panel | Whitepaper
- Expert Panelists Provided Insights, Outlooks, and Recommendations Regarding Opportunities in EM Equities After Years of Significant Underperformance
  - McShane Partners' Whitepaper on EM Economic Factors, Market Fundamentals

January 2018: Balanced Opportunities & Expectations in 2018
- Persistent Employment Gap in Job Openings vs. Hiring Activity, Prompting Changes in Investment Team's Perspective of Inflation Expectations and Portfolio-Level Positioning at Onset of Early-2018
  - Inflation Concerns Spark **-19.8%** Sell-Off in S&P 500® Index during Fourth Quarter of 2018 ("4Q18")

February 2018: Investing in Infrastructure Portfolio Manager Panel
- Decades of Underinvestment in Critical Infrastructure Systems will Require Meaningful Capital Investment Over the Next Several Years to Avoid Catastrophic Failures
  - Introduction of "McShane Partners' Thematic High-Quality Water Equity Index"

February 2019: Late-Cycle Investment Strategies Portfolio Manager Panel
- Differentiated Strategies for Long-Term Investors in the Later Stages of an Extended Bull Market

February 2020: Small Cap Equity Portfolio Manager Panel
- Expert Discussion Regarding Relative Appeal of High-Quality Opportunities in Small-Cap Equity Market

December 2020: Sector-Level Dispersion | Growth vs. Value
- Sudden Swings, Shifts in Market Momentum Reveal Importance of Managing Portfolio-Level Positioning, Risk-Return Exposures

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11 Years of Persistent Consistency

Navigating Shifts in Interest Rate & Inflation Expectations

There have been several bouts of short-term spikes in interest rates driven by the *fear of higher-than-expected inflation* over the past **±11 years**. During such instances, Fixed Income allocations have faced near-term selling pressures but have, eventually, stabilized; as such, the Investment Team does not believe there is sufficient evidence following this most recent episode of relative underperformance is to substantiate the utter abandonment of Fixed Income across client investment portfolios. Where prudent and appropriate, tactical underweight allocations to Fixed Income facilitate the methodical deployment of new cash into bonds in response to interest rate fluctuations, allowing for the implementation and construction of long-term investment portfolios through what could very well be a lengthy, elongated period of upward trend in interest rates. Current levels of economic activity, near-term commodity scarcity, and reduced labor supplies warrant *higher interest rates*. Despite the natural tendency for interest rates to rise in response to better-than-expected economic data and higher inflation, self-correcting market mechanisms are being invalidated by central banks' insistence on near-zero interest rates and exceptionally easy monetary policies, as history has shown that any sign of incremental tightening precipitates acute and adverse corrections in risk assets, including equity markets.

During the second quarter of 2013 ("2Q13"), U.S. fixed income assets (i.e., bonds) sold of sharply following a rapid rise in interest rates triggered by the convergence of several concurrent factors: mounting concerns over a potential "tapering" of asset purchases by the Federal Open Market Committee ("FOMC"), ongoing improvements in economic conditions and continued strength across U.S. equity markets, and the unraveling of massively overbought conditions in U.S. bond markets. From May 2nd to July 5th 2013, the yield on 10-Year U.S. Treasury bonds rose **±111 basis points ("bps")** from **1.63%** to **2.74%**, precipitating a decline of **-10.68%** in the price of those bonds.

The Investment Team believes that interest rates typically follow inflation, while inflation expectations tend to follow and reflect tightening labor market conditions. Accordingly, a basic understanding of the directional tendencies of inflation and interest rates is critical to determining the potential relative performance expectations for and appropriate positioning of fixed income assets. In January 2018, the Investment Team emphasized how since early-2015, the U.S. labor market faced interesting supply-demand dynamics due to a persistent "employment gap" between *job openings* and *hiring activity*, which shifted our perception of pent-up inflationary pressures, informing our decision to employ a *tactical underweight* in Fixed Income in anticipation of financial markets adjusting to a relatively new paradigm wherein *upward-trending inflation* could precipitate *rising interest rates*. This supply-demand imbalance contributed to *moderate wage inflation* as measured by the sustained acceleration in year-over-year ("YoY") growth in average hourly earnings.

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Monthly Index Review
USD Total Return

Data as of May 31st 2021	May 2021	2021 YTD	2020	2019
S&P 500® Index	+0.70%	+12.62%	+18.40%	**+31.49%**
Dow Jones Industrial Average	**+2.21%**	**+13.76%**	+9.72%	+25.34%
NASDAQ Composite	**-1.44%**	+6.98%	**+44.92%**	**+36.69%**
Russell 2000	+0.21%	**+15.30%**	**+19.96%**	+25.52%
MSCI Emerging Markets	+1.16%	+6.13%	+18.69%	+18.88%
MSCI EAFE	**+3.68%**	+10.74%	+8.28%	+22.66%
Bloomberg Barclays U.S. Aggregate Bond Index	+0.33%	**-2.29%**	+7.51%	+8.72%

Investment Overview

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Market Cycles & Sector Rotation

Over the past several months, the Investment Team has repeatedly discussed how the *lack of prudent diversification* from a sector and industry perspective has resulted in short-term relative underperformance for investors with concentrated positioning in and exposure to *high-growth*, *momentum-driven* sectors (e.g., the Information Technology). The sharp reversal in momentum and rotation out of those stocks and sectors, however, has revealed the importance of *proper portfolio construction* reflective of *multiple scenarios* in order to avoid reacting to *unfavorable market cyclicality*. In particular, a long-term investment portfolio should reflect a careful combination of *risk-return exposures*, including allocations to *in-favor momentum stocks* with *long-term secular growth drivers* and *out-of-favor*, *inexpensive stocks* of *high-quality companies* offering *attractive relative downside protection*.

As part of the Investment Team's processes for researching and analyzing financial market cycles, sector-/industry-level trends provide significant insight into attractive investment opportunities with *positively skewed risk-return potential*. In early-2018, the Investment Team highlighted how the market capitalization ("market cap") of the Consumer Staples sector as a percentage of the total market cap of the S&P 500® Index was hovering around historic lows. Given *attractive sector-level valuations*, *severely oversold conditions*, and *pervasive negative investor sentiment*, the Investment Team increased and/or added critical sector-level exposure to Consumer Staples that provided positive contribution and incremental volatility mitigation through year-end.

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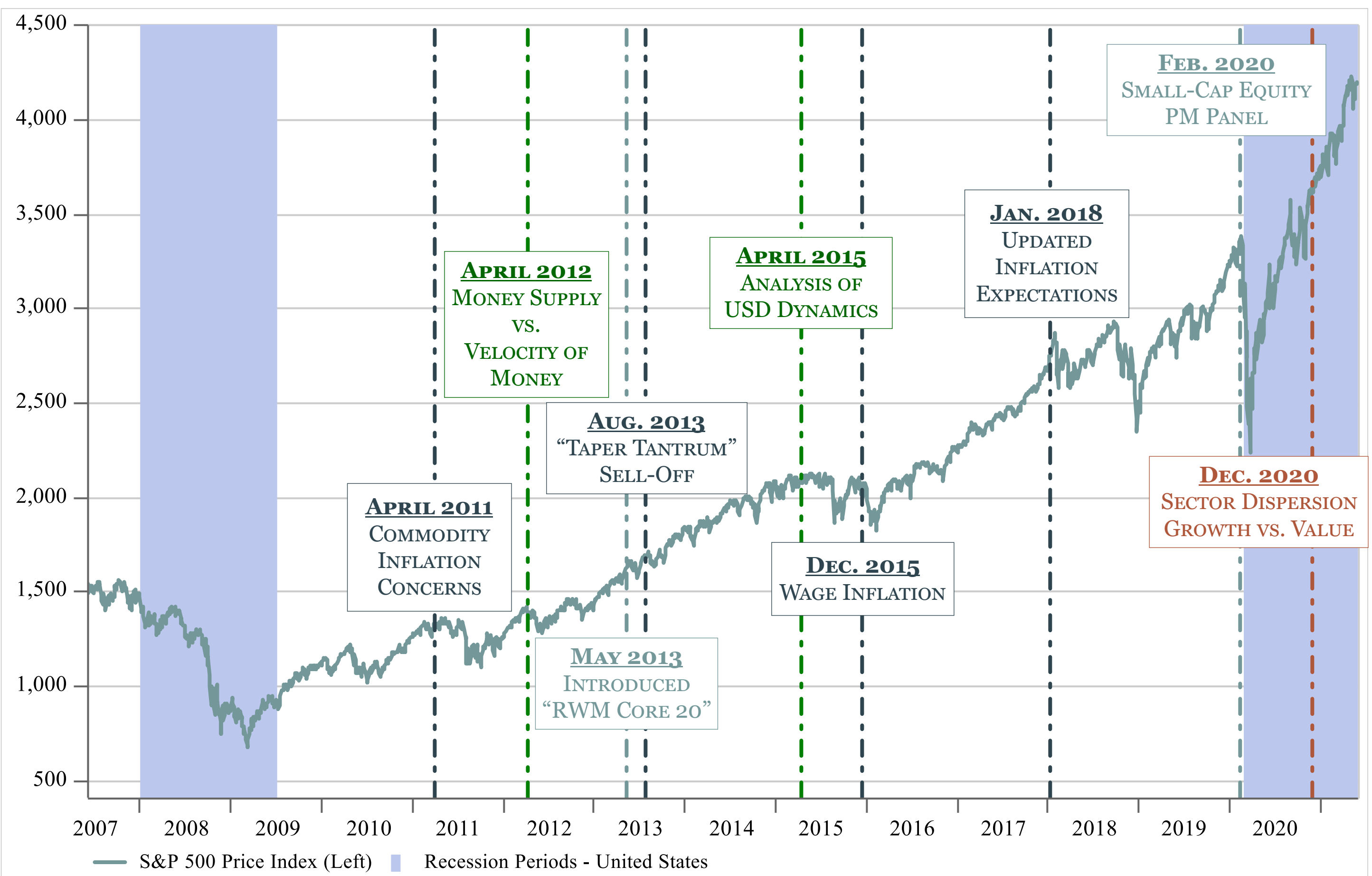
Chart I: McShane Partners Timeline vs. S&P 500® Index



Source: McShane Partners - FactSet Research Systems, Inc.

Investment Overview

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U.S. Dollar ("USD") Drama

As the established global reserve currency, the U.S. dollar ("USD") represents a prominent factor within the Investment Team's decision-making framework, especially with respect to managing portfolio-level exposures to non-USD assets (e.g., International Equity). Short-term fluctuations in the relative value of USD can have pronounced implications for International Equity allocations but should be considered and analyzed in relation to the potential long-term investment opportunities created by a sudden appreciation/(depreciation) in USD prices. Over the past several years, the Investment Team has systematically taken advantage of episodic strength in the USD to initiate and/or add to emerging markets ("EM") equities within International Equity portfolios, as the concomitant sell-off in EM equities often create opportunities to buy high-quality secular growth stories at *excessive discounts* in terms of *absolute* and *relative valuation levels*.

"Inflation is taxation without legislation."

- Milton Friedman

While there have been intervals of steady, sustained appreciation in USD prices of the past **±11 years**, EM equity allocations have proven resilient and capable of navigating a higher USD after an initial adjustment period, as is often the case when *rates of change* in *macroeconomic variables* accelerate/(decelerate) unexpectedly.

At the End of the Day, It's Demographics

One of the fundamental arguments supporting strategic positions in and long-term allocations to EM equities is the exposure to superior demographic trends driving/contributing to above-average growth in those economies. Developed market ("DM") economies, including the United States, have been suffering from stagnating or deteriorating demographics for the **past ±20 years**, if not longer, making it difficult for these economies to sustain long-term economic growth in-line with historical average trends. While central banks have been able to stimulate incremental growth at the expense of overleveraged government balance sheets, this is not a long-term solution and supports dedicated allocations outsized of DM economies via high-quality EM equities.

Stock & Strategy Spotlight

Name	Ticker	May 2021	2021 YTD
Kimberly-Clark Corp.	KMB	-2.02%	-2.27%

Description & Investment Thesis

Kimberly-Clark Corp. ("KMB") is a quintessential global consumer staples company with a high dividend yield and a predictable business model resistant to cyclicality given the necessary nature of their products. Most of KMB's product portfolio consists of paper and paper-derivative products, as well as a diverse offering of diaper products.

Shares of KMB have sold off recently alongside the broader rotation out of those recession-resilient sectors and industries that provided meaningful downside protection during the worst part of the pandemic-induced market correction and economic recession, as investors have flocked toward higher-risk, pro-cyclical stocks with greater exposure to the ongoing economic recovery.

The stock is trading below its average historical ranges across many pertinent valuation metrics. Any reversion to the mean should contribute to relative appreciation over the short-/intermediate-term, while negative near-term surprises regarding the post-pandemic economic recovery would likely result in incremental multiple expansion relative to the broader market, which should, at minimum, drive substantial relative outperformance in the event of another market sell-off/correction or economic slowdown/downturn.

Wealth Advisory Overview

Roth IRA Conversions

The 3.8% Medicare Surtax

The Affordable Care Act of 2010 included a provision for a 3.8% net investment income tax, also know as the Medicare surtax, to fund Medicare expansion. This surtax applies to taxpayers who have income above certain thresholds depending on filing status. The amount that you convert from a traditional IRA to a Roth IRA is treated as income and would therefore potentially move you above these thresholds causing you to incur the additional Medicare surtax on your net investment income.

Net Unrealized Appreciation

If you are retiring and have appreciated company stock in your traditional 401(k), you may want to consider the net unrealized appreciation (NUA) option prior to converting any of these assets to a Roth IRA. If you qualify, there are special tax rules that allow you to take a lump-sum distribution of your company stock from the 401(k) plan and pay income tax on your cost basis in the stock. This special tax provision allows you to defer taxes on the unrealized appreciation until you sell the stock.

College Financial Aid

If you have children who are applying for financial aid, a Roth conversion can affect the amount awarded as any Roth conversion amounts converted will be counted as income and will be included in the needs test on the Free Application for Federal Student Aid (FAFSA). This can raise a parent's expected financial contribution and reduce the amount of aid awarded. It may be an option for the university to remove such income from their calculations, however if your child is seeking federal aid, it may make sense to wait given that federal financial aid formulas will not adjust their calculations for such income.

Funds to Pay for the Conversion

Converting traditional IRA funds to a Roth will generally create a tax liability. Typically, it is best to pay the tax liability from the conversion with the assets that will earn a lower after-tax return (taxable assets outside of the Roth IRA). This is because the rate of return is generally higher for a Roth IRA than for taxable assets since the return for the taxable account is reduced for taxes due on dividends, interest and capital gains. In addition, paying the taxes out of the taxable account and not the IRA will allow a greater portion of the IRA to be converted to a Roth.

Back Door Roth IRA

One loophole that is still available is the back door Roth IRA. A backdoor Roth IRA lets you convert a traditional IRA to a Roth, even if your income is too high to make a normal Roth IRA contribution. The procedure requires opening a traditional IRA and making a non-deductible IRA contribution, then converting this non-deductible contribution to a Roth IRA account. However, it is important to note that the IRS requires conversions from traditional IRAs to Roth IRAs to be done pro rata. Therefore, you cannot convert only after-tax money making this option optimal if you do not have any assets within a traditional IRA and are only converting the non-deductible contributions that are made on an annual basis.

There are cases where a Roth IRA conversion can be extremely strategic and effective, and then there are cases where it does not make any sense at all. If you are interested in understanding whether a Roth IRA conversion is right for your situation, please contact your Wealth Advisor prior to any conversion and we will be happy to evaluate your options and find a customized solution for you.

Tax Update: Retroactive Effect Proposed for Potential Capital Gain Increase

Becky Hoover
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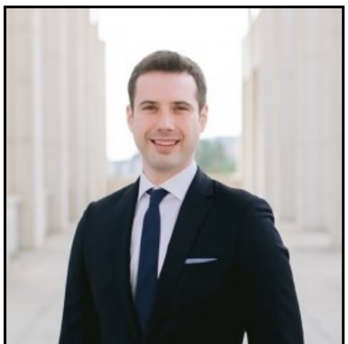
Partner | Director of Tax
Wealth Advisor

As I detailed in the article last month, one of the proposed tax changes that has been included in President Biden's Budget is an increase to the capital gain rate for certain taxpayers. Long term capital gains (for example resulting from the sale of stock held for more than a year) are currently taxed at preferential rates from zero to 20%, depending on the total income level of the taxpayer. The rates are lower than the rates applied to "ordinary income" such as wages and business profits. The proposed budget would eliminate the preferential rates on capital gains when a taxpayer has gross income in excess of $1 Million.

Although tax changes have historically been prospective, there has been a trend toward retroactive effective dates when implementing rate increase or anti-avoidance measures. The President announced the proposal on April 28th and has proposed an effective date as of the announcement. The rationale is that the timing of capital gain recognition is generally under significant control of taxpayers. Per the Wall Street Journal last week, capital gain realizations jumped 60% in 1986 and 40% in 2012 before tax rate increases took effect.

While the majority of Biden's proposals would become effective in 2022, the capital gain rate increase may apply to any gains recognized after April 28th, 2021. We will keep you updated on the status of the proposed changes as they occur.

NextGen: When Do You Need a Prenuptial Agreement



Ryan Vaudrin, CFP®
Wealth Advisor

Many details go into planning a wedding to ensure the special day goes off without a hitch. For most individuals, prenuptial agreements are usually not at the top of this list and are often overlooked when starting a new life together. A prenuptial agreement or a "prenup" is a legal agreement that designates how assets are treated if the marriage were to end. Navigating a prenup discussion can be difficult and we are often asked "when is a prenup discussion warranted"? The list below details a few scenarios where it might make sense to discuss whether a prenup makes sense for your individual situation.

Wealth Disparity
Each state has different rules and guidelines for marital and pre-marital assets. One individual may have substantial wealth prior to marriage, while the other party may have substantial debt. Establishing a prenup can provide guidelines for what property is classified as premarital assets and how the distribution or repayment of those assets should be treated if the marriage were to dissolve.

Small Business Assets
Building a small business can be a challenging endeavor and valuing a business can be even more complex. Designating the business as a separate property or specifying business ownership in a prenup can mitigate disputes and expensive valuations in the future.

Income Earning Potential
One spouse may decide to alter their career and become a homemaker to support the primary earner. A prenup can help establish an appropriate value for spousal support for individuals who may have limited future earning potential resulting from these decisions.

Although these are only a few examples of the need for a prenuptial agreement, it is important to have a conversation about finances before you get married. Working with a premarital counselor is a great option to keep the conversation focused to achieve both parties' goals. If a decision is made to not have a prenup, it is recommended that premarital assets are kept separate so that they do not become marital assets by default.

Senior Planning: Rental CCRC vs Life Care CCRC

Lorri Tomlin, FPQP™
Partner | Wealth Advisor

There are several factors to consider when evaluating a retirement community, including among other things the financial costs. Most Continuing Care Retirement Communities ("CCRCs") require a large "upfront" entrance fee, in addition to monthly fees. However, facilities that provide a "rental" option have recently begun to gain recognition. At first glance, the rental option may appear to be the better bargain. However, upon closer evaluation that may not always be the case.

Monthly fees for the rental option are almost always higher than the monthly fees for a comparable Life Care facility that requires a large upfront entrance fee. In addition, the monthly rental fees usually increase as you move up to higher levels of care. Contrast this escalation in fees with the monthly fees at a Life Care facility that typically remain the same (or are discounted) as you move up to higher levels of care. Therefore, to adequately compare the two alternatives, it is important to look at your projected lifetime costs.

The Breakeven Analysis

As with all options, there will be a breakeven point for each alternative depending on the required level of care during your lifetime. If you never require a higher level of care, the monthly rental option could prove to be better from a lifetime cost perspective. However, if you do end up requiring several years in Assisted Living, the discounted monthly cost of the Life Care community becomes a better financial option. In addition to the lower monthly rates, many CCRCs offer a partially refundable entrance fee option which makes this alternative even more attractive financially.

In the illustration below, you can see that the total cost of the Life Care CCRC is not much more than the cost of the Rental CCRC over a period of 10 years assuming 5 years in Assisted Living. The total cost is even less with the refundable entrance fee option despite the higher initial entrance fee.

Monthly Rate for Life Care (or non-rental CCRC) all levels	$3,600.00
Monthly Rate for Independent Living @ Rental CCRC	$4,500.00
Monthly Rate for Assisted Living @ Rental CCRC	$6,700.00

	Life Care CCRC	**Rental CCRC**	**Life Care with 90% Refund**
Entrance Fee	$250,000.00	$0.00	$350,000.00
Monthly rate for 5 years 80-85: Independent Living	$216,000.00	$270,000.00	$216,000.00
Monthly rate for 5 years 85-90: Assisted Living	$216,000.00	$402,000.00	$216,000.00
Entrance Fee refund 90%	$0.00	$0.00	($315,000.00)
Total cost over 10 years	***$682,000.00***	***$672,000.00***	***$467,000.00***

A Life Care facility guarantees care for life, even if you run out of money through no fault of your own. Rental type facilities typically do not.

Month to Month Advantages:

- No initial financial and/or medical criteria to qualify.
- No large upfront fee.
- Could lose large entrance fee if CCRC goes bankrupt.
- Flexibility to move to another community if needed/desired.

Monthly rates and entrance fees vary drastically based on the type, size, and location of the desired residence. Therefore, a true comparison requires researching the actual costs of the prospective CCRCs. Additionally, it is important to consider your family and personal health history to gain perspective on the longevity of a potential stay within any of the above-mentioned facilities.

Around McShane Partners

Building Update

Construction is under way at our new 2150 Park Drive location. The project is on schedule and moving along. Stay tuned for future developments and updates!

Swim into Summer with McShane Partners

McShane Partners is a proud sponsor of the Charlotte Swim and Racquet Club. Be on the lookout for McShane Partners starting blocks at the next swim meet!

Family Additions

McShane Partners Wealth Associate Daniel Hudspeth and wife Kara are expecting their first child— a baby boy who will be arriving this Thanksgiving!

McShane Partners

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

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