

INVESTMENT OVERVIEW

SECTOR SENSIBILITY

SECTOR SELECTION CAN ADD ALPHA

McShane Partners consistently applies a few, clearly defined principles when investing client assets. One of these principles is employing contrarian investing based on the theory that markets and asset prices are mean reverting. This principle can be employed in asset allocation as well as individual security selection, and additionally we use extensive macroeconomic and market cycle diagnostics to also generate alpha through contrarian sector positioning within portfolios. Essentially, identifying oversold sectors in a timely fashion can add incrementally to performance when done correctly.

One methodology for identifying neglected sectors within the S&P 500 is to track the sector as a percentage of the S&P 500 itself. An early signal of a sector sell-off can be seen in diverging sector performance underlying the total performance of the S&P 500. A dashboard for tracking the composition of the performance of the S&P is provided on the next page. Top and bottom performing sectors are highlighted in green and red, respectively. Shifts in investor sentiment and risk appetite can be detected early by monitoring trailing 3-month performance as investors subtly migrate to less cyclical, lower risk sectors with slightly lower beta when they become more cautious on the economic and market outlook. In 2017 and

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WEALTH ADVISORY OVERVIEW

QUALIFIED OPPORTUNITY FUNDS: THE LATEST TAX PLANNING IDEA

The Tax Cuts and Jobs Act (TCJA) created the Opportunity Zone program in December 2017 to revitalize economically distressed areas using private investments instead of taxpayer dollars. To stimulate private participation in the Opportunity Zone program, investors receive preferential capital gains treatment for investments within a Qualified Opportunity Fund (QOF). This article will define the key terms associated with opportunity zones, discuss the tax treatment of QOF investments, and review the key items to consider when contemplating a QOF investment opportunity.

QUALIFIED OPPORTUNITY ZONE (“QOZ”)

Qualified opportunity zones are low-income census tracts, or census tracts contiguous with a low-income census tract, which were nominated by the chief executive of a state or territory (typically the governor of the state in which it is located) and have been certified by the Treasury Department. There are currently 8,760 certified opportunity zones nationwide, located in a mix of urban, suburban and rural geographies.

QUALIFIED OPPORTUNITY FUND (“QOF”)

The TCJA describes a QOF as any investment vehicle organized as a partnership or corporation that holds 90 percent or more of its assets in qualified opportunity zone property (QOZP), other than another qualified opportunity fund. Proposed regulations would require 70 percent, or “substantially all,” of a

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INVESTMENT TEAM

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Chief Investment Officer
Elliott Van Ness, CFA
Director of Research | Portfolio Manager
Thomas Mack
Research Analyst

WEALTH ADVISORY TEAM

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SPECIAL POINTS OF INTEREST

- [Monthly Index Review](#)
- [Stock & Strategy Spotlight](#)
- [Around McShane Partners](#)

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the first half of 2018, we noticed cumulative underperformance in the Staples sector which lead us to further analysis and ultimately a move toward overweighting Staples within our portfolios. Fortuitously, the market reverted quickly away from risk driving strong relative and absolute performance in the staples sector in the third and fourth quarters of 2018 as evidenced in the table below by the consecutive green boxes in the Staples sector month after month until January of 2019. This sector heatmap is a critical portfolio management tool as it not only helps identify buying opportunities, but it also helps take a pulse of the risk appetite.

CHART I: S&P 500 SECTOR HEATMAP

SECTORS	S&P SECTOR TOTAL RETURNS			S&P SECTOR TRAILING 3-MONTH RELATIVE PERFORMANCE											
	2017	2018	YTD	7/25/18	8/24/18	9/24/18	10/25/18	11/22/18	12/23/18	1/22/19	2/22/19	3/24/19	4/24/19	5/25/19	6/24/19
DEFENSIVES															
Utilities	12.11%	4.11%	17.18%	-4.01%	-4.11%	-3.53%	5.54%	8.43%	18.64%	11.02%	3.49%	4.77%	-7.46%	4.90%	2.15%
Telecom	-1.25%	-12.53%	20.07%	-10.54%	-2.11%	3.05%	3.01%	1.76%	3.29%	1.18%	-1.04%	4.05%	3.82%	1.42%	1.28%
Health Care	22.08%	6.47%	9.33%	1.30%	2.86%	7.00%	6.35%	6.40%	6.07%	3.57%	1.07%	-5.93%	-16.17%	-6.00%	-3.55%
Staples	13.49%	-8.38%	17.35%	-7.03%	-1.19%	2.49%	7.54%	7.80%	10.76%	6.06%	-3.89%	-2.01%	-4.35%	3.54%	2.43%
NEAR CYCLICALS															
Energy	-1.01%	-18.10%	12.95%	5.52%	-7.36%	-6.56%	-11.01%	-8.24%	-7.27%	-8.02%	-5.09%	-1.41%	0.96%	-7.72%	-7.56%
Financials	22.18%	-13.03%	15.51%	-5.94%	-5.92%	-3.03%	-3.18%	-0.43%	-2.44%	2.91%	-2.39%	-7.22%	-1.85%	-1.13%	-3.00%
Real Estate	10.85%	-2.22%	23.57%	-2.48%	0.41%	-3.62%	-0.16%	6.45%	9.63%	10.24%	6.99%	5.46%	-1.24%	2.48%	3.69%
CYCLICALS															
Technology	38.83%	-0.29%	27.37%	6.71%	5.18%	-0.68%	0.21%	-3.25%	-5.10%	-5.31%	-1.32%	6.54%	10.27%	5.79%	4.77%
Discretionary	22.98%	0.83%	22.26%	2.99%	1.79%	2.21%	-1.88%	-3.37%	-4.01%	-1.90%	1.73%	1.98%	4.96%	-0.41%	3.36%
Industrials	21.03%	-13.29%	20.98%	-6.55%	-2.61%	-1.79%	-2.14%	-3.36%	-2.16%	-2.71%	6.02%	-0.40%	5.15%	-1.76%	-4.58%
Materials	23.84%	-14.70%	15.48%	-3.75%	-4.80%	-4.66%	-11.62%	-4.21%	-1.25%	0.61%	3.24%	-1.56%	-3.43%	-3.80%	-0.63%
S&P 500	21.83%	-4.38%	18.87%	8.40%	9.28%	8.54%	0.11%	-5.29%	-16.20%	-9.09%	3.72%	2.13%	17.49%	5.24%	6.62%

Source: McShane Partners & FactSet Research Systems, Inc.

After noticing sustained relative under performance and attractive valuations in the consumer staples sector, an analysis of consumer staples as a percentage of the S&P 500 revealed that the sector was tracking at 6.6% of the S&P500, representing a considerable discount to the historical average of 10.8% and close to a cycle bottom. This triggered the addition of VDC, the Consumer Staples ETF, on May 18th, 2018, three months prior to the aforementioned period of staples sector outperformance, resulting in a 20.4% return versus the S&P 500's 8.9% return since the addition to portfolios as the sector gained relative strength to represent 7.2% vs. 6.6% of the S&P500.

Simultaneously, we noticed that Information Technology, Consumer Discretionary, and

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MONTHLY INDEX REVIEW
USD TOTAL RETURN

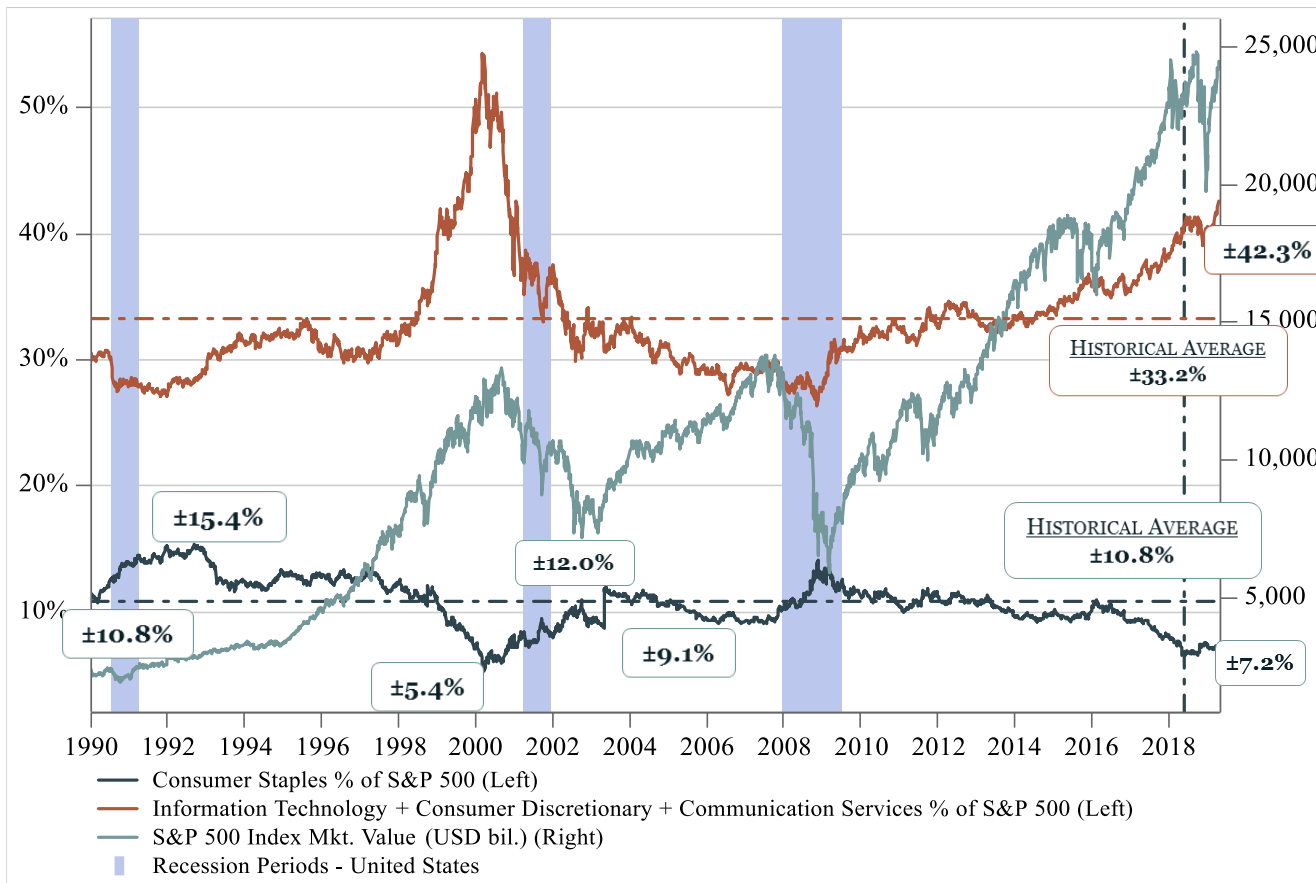
DATA AS OF JUNE 30 TH 2019	JUNE 2019	2019 YTD	2018	2017
S&P 500®	+7.05%	+18.54%	-4.38%	+21.83%
Dow Jones Industrial Average	+7.31%	+15.50%	-3.48%	+28.11%
NASDAQ Composite	+7.51%	+21.33%	-2.84%	+29.64%
Russell 2000	+7.07%	+16.98%	-11.01%	+14.65%
MSCI Emerging Markets	+6.32%	+10.76%	-14.24%	+37.75%
MSCI EAFE	+5.97%	+14.49%	-13.36%	+25.62%
Bloomberg Barclays U.S. Aggregate Bond Index	+1.26%	+6.11%	+0.01%	+3.54%

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Communications sectors (indicated above by the orange line) currently account for 42.3% S&P 500, trading at a rich 27.4% premium and 910 bps over its historical average which included the “dot-com” bubble frenzy in 1999. Following this proclamation, this group of technology and consumer cyclicals were the worst performing sectors in the fourth quarter correction. Since the beginning of 2019 with the strong market rally, these riskier, growth sectors now make up a larger percentage (42.3%) of the S&P 500 than heading into last year’s steep correction making us once again cautious about exposure to this group relative to lower risk, less

CHART II: CONSUMER STAPLES & INFORMATION TECHNOLOGY SECTORS AS PERCENTAGE OF



Source: McShane Partners & FactSet Research Systems, Inc.

cyclical sectors. Staples still looks attractive, but Healthcare recently emerged as a sector to consider after the pronounced year-to-date underperformance.

Contrarian indicators in isolation do not provide enough ammunition to take a position within portfolios, thus valuation work provides additional solidarity and is integral to sector positioning in our opinion. While the Information Technology sector is certainly a heftier chunk of the S&P 500 market cap than it has been traditionally, the sector’s valuation is not excessive. Given the secular growth profile of the technology sector, earnings growth has outpaced many of the traditional sectors. Thus, companies have become larger; Apple has a \$910 billion market capitalization, but Price to Earnings valuations have remained palatable given the ever-increasing denominator (earnings). Consequently, as we are concerned about the delirium and over-ownership surrounding technology stocks, the reasonable valuation and superior growth profile keeps us engaged in the sector albeit with muted excitement.

Furthermore, just because the Information Technology sector becomes an ever bigger portion of the S&P 500 market cap does not necessarily indicate ominous outcomes. The stock market is a barometer for future

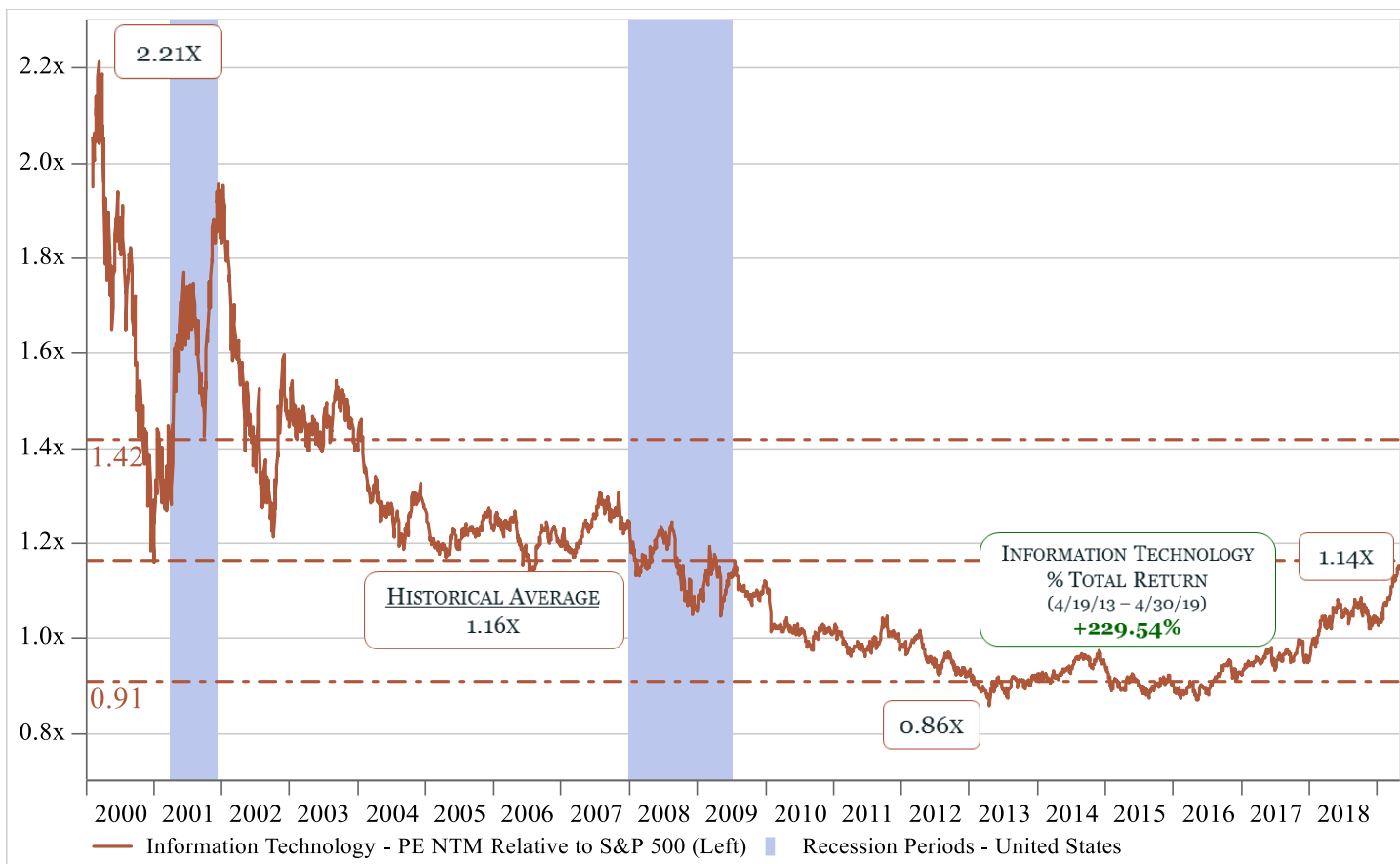
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earnings trends and a leading indicator as to where investors see future growth. It is apparent from daily life, corporate innovation, government utilization, and technological permeation throughout all sectors including smart technology and artificial intelligence that Information Technology products and services are becoming evermore integrated into the economy as a whole. A notable conclusion from this chart is that valuation can provide additional ammunition for sector exposure levels in portfolios. In Chart III the NTM PE of the Information Technology sector bottomed out at the

CHART III: INFORMATION TECHNOLOGY SECTOR VALUATION



Source: McShane Partners & FactSet Research Systems, Inc.

lower end of its historic band at a 26% discount to its historic average the middle of 2012. Astute investors noticing this underappreciated sector could have gone overweight Information Technology at attractive prices and profited nicely as the Information Technology sector multiple expanded back to its historic average resulting in almost 230% appreciation versus an 89% appreciation for the S&P 500 over the same period. Clearly, oversold or underappreciated sectors as defined by low multiples relative to history can have predictive benefits if interpreted correctly alongside supportive fundamental and market analysis.

Looking at this analysis leads us to employ a similar methodology to the currently underperforming Healthcare sector. The Healthcare sector has seen some volatility in terms of its percentage of the S&P 500. In terms of the economic cycle, it tends to peak during recessionary periods given the critical nature of its services as most of these companies structure their business models to be much less sensitive to compression in discretionary spending that occurs in less

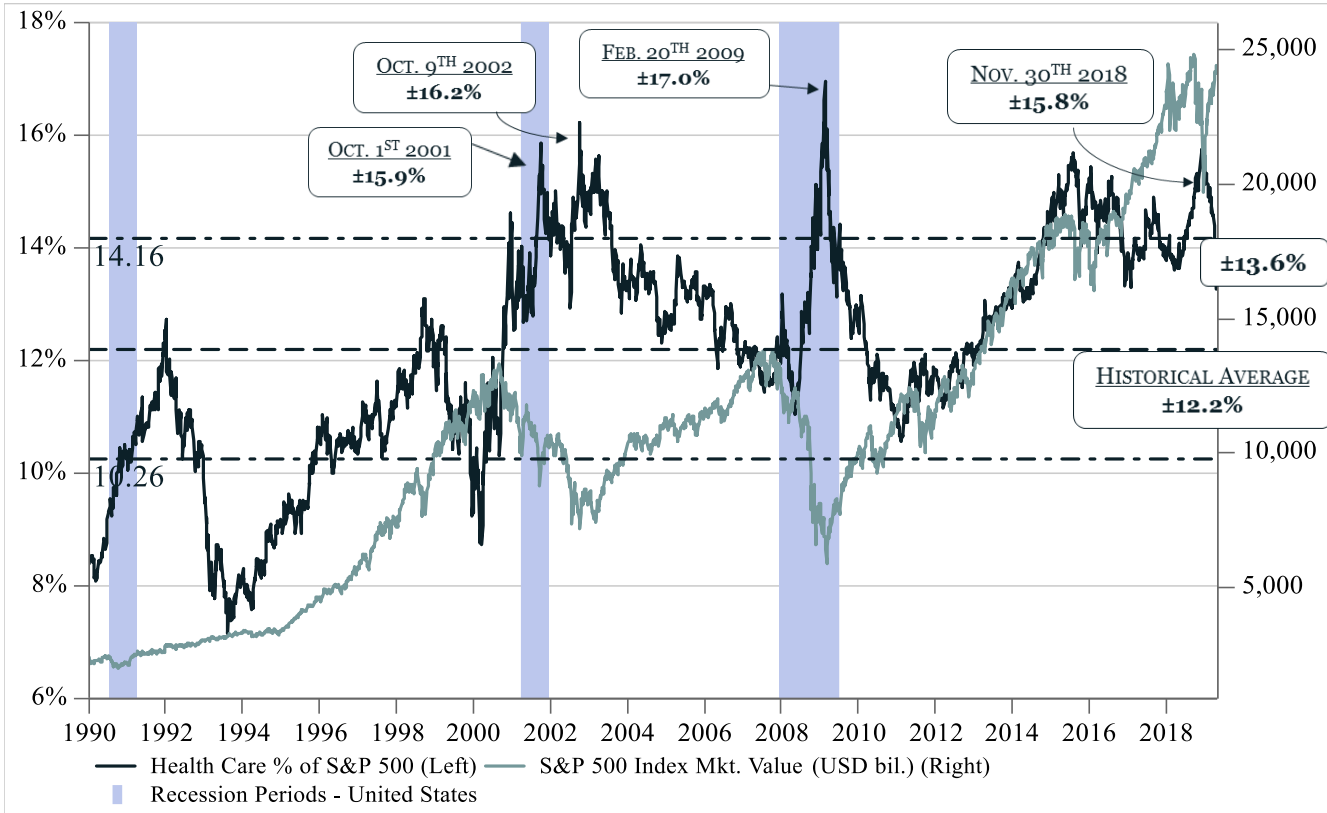
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critical, cyclical sectors. Notably, the Healthcare portion of the S&P 500 rose to 15.8% during this strong bull market period but recently contracted due to fundamental overhangs such as efforts to dismantle the Affordable Care Act and increased momentum behind a Medicare movement which clouds the horizons of providers in terms of future investment and coverage, not to mention the surging backlash against rising prescription prices.

CHART IV: HEALTHCARE AS A PERCENTAGE OF S&P 500



Source: McShane Partners & FactSet Research Systems, Inc.

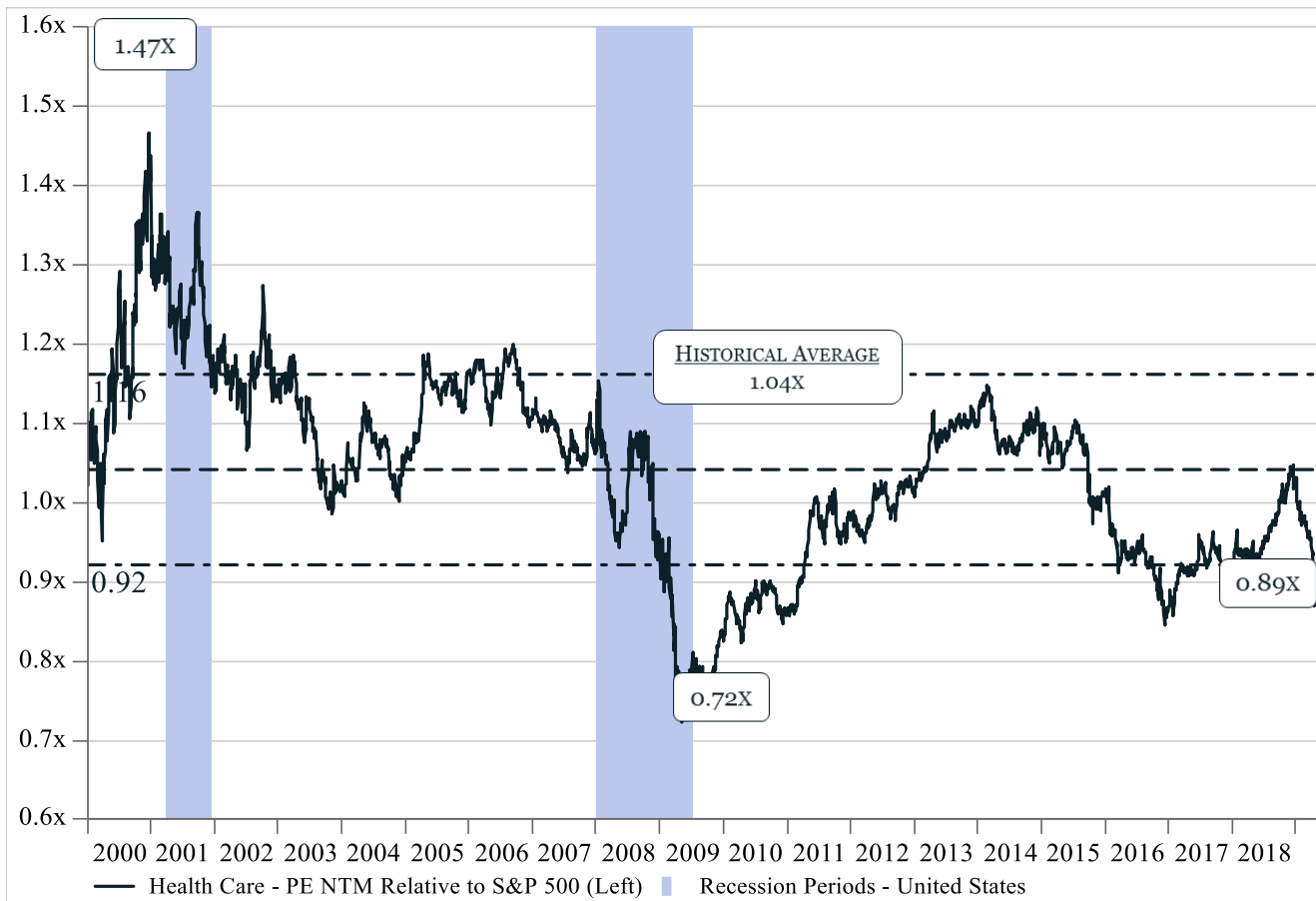
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While the Healthcare sector has seen strong growth, its sector valuation is at a 14% discount to its historical average and at the lower end of its almost two decade trading range. Similar to the picture on Chart III outlining the technology sector, healthcare appears to be setting up well from a valuation perspective. Given a plethora of macro data that shows a peaking in the economic cycle coupled with relatively low valuations, the Healthcare sector appears to be a solid, long-term play given the recent volatility in the market and a safe-haven if recessionary fears creep further into the limelight and potentially realized.

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CHART V: HEALTHCARE VALUATION



Source: McShane Partners & FactSet Research Systems, Inc.

INVESTMENT OVERVIEW**SECTOR SENSIBILITY**

"We need to stop pretending that we can divine the future, and instead concentrate on understanding the present, and preparing for the unknown."

- James Montier

STOCK & STRATEGY SPOTLIGHT

NAME	TICKER	2019 YTD
Oracle Corporation	ORCL	+28.04%

DESCRIPTION & INVESTMENT THESIS

Last month, shares of Oracle Corp. ("ORCL") sold off sharply and dramatically alongside other U.S. large-cap information technology ("IT") stocks and the broader U.S. equity market, retreating -8.55% vs. a comparable decline of -8.91% and -6.58% for the S&P 500 Information Technology Sector Index and the S&P 500 Index, respectively.

As the stock continued to trade lower into month-end and began approaching near-term support levels, the Investment Team took advantage of what it believed to be an exaggerated sell-off and short-term buying opportunity by initiating new positions in ORCL across applicable client investment portfolios, including adding the stock to the McShane Partners Core Contrarian Equity Portfolio ("MP Core Contrarian") Strategy, while also tactically increasing existing long-term holdings, where appropriate. At the time, the Investment Team believed that the market and investors were indiscriminately selling ORCL after the stock had rallied an impressive +22.55% year-to-date ("YTD") in 2019 through the end of April, without accurately assessing the relative strength of the company's underlying fundamentals compared to its large-cap IT peers.

Furthermore, despite strong YTD outperformance, shares of ORCL continue to trade at extremely reasonable relative and absolute valuation levels reflective of the company's steady, stable, and persistent operational track record heading into the month of May: as the stock traded down throughout the month, however, valuation became increasingly attractive, with ORCL trading at significant discounts that warranted a closer look to determine whether or not the Investment Team had missed a deterioration in the company's underlying fundamentals. After reassessing the company's financial positioning, including the health of its balance sheet, the Investment Team determined that the relative risk-return proposition for shares of ORCL, despite short-term headwinds and negative headline risks from recent sell-side analysts, was attractive for long-term investors and proceeded to add the stock to applicable client investment portfolios.

At least for the near term, the Investment Team's contrarian approach to assessing stock-specific risks and identifying attractive buying opportunities in individual companies appears to have yielded positive results, as shares of ORCL rebounded +14.41% for the month of June vs. a comparable return of +7.05% for the S&P 500. This near-term outperformance was largely driven by a sharp jump in the stock after reporting better-than-expected quarterly earnings that beat consensus estimates, with the company also providing updated guidance ahead of consensus estimates.

While the Investment Team believes in the long-term outlook for ORCL, it also acknowledges the fact that there will be other short-term buying opportunities to revisit the stock and add to existing holdings/positions at more attractive price levels, as shares of ORCL have not been immune to broader headline risks and macro-level concerns. Overall, however, the company has a long-term track record of successfully navigating the later stages of past market cycles and operating through prior economic downturns, which should be encouraging for long-term investors willing and able to look beyond short-term risks and market fluctuations

WEALTH ADVISORY OVERVIEW**QUALIFIED OPPORTUNITY FUNDS: THE LATEST TAX PLANNING IDEA**

business' tangible business property be in an opportunity zone to qualify for QOF funding. Combining the 90 percent asset requirement for opportunity funds with the 70 percent tangible property requirement for qualifying businesses means that a QOF may be as minimally invested in a zone as 63 percent. These proposed regulations would also require that "50 percent of the gross income of a qualified opportunity zone business [be] derived from the active conduct of a trade or business in the qualified opportunity zone."

QUALIFIED OPPORTUNITY ZONE PROPERTY ("QOZP")

QOZP is defined as, (1) qualified opportunity zone stock; (2) qualified opportunity zone partnership interest, and (3) qualified opportunity zone business property. Qualified opportunity zone stock is any domestic stock that is: (1) acquired after 12/31/17 at original issue, (2) the corporation was an OZ Business at the time the stock was issued, and (3) during substantially all (i.e., 90%) of the QOF's holding period, such corporation qualifies as an OZ business. A qualified opportunity zone partnership is defined as any capital or profits interest in a domestic partnership if 1) acquired after 12/31/17 from the partnership for cash, 2) the partnership was an OZ Business at the time ownership is issued, and 3) during substantially all (i.e., 90%) of the QOF's holding period, such partnership qualifies as an OZ Business. Qualified opportunity zone business property is tangible property used in a trade or business of the QOF if 1) acquired after 12/31/17 by purchase, 2) the original use of such property in the OZ begins with the QOF or the QOF substantially improves the property, and 3) during substantially all (i.e., 90%) of the QOF's holding period for such property, substantially all (i.e., 70%) of the use of such property was in an OZ.

QUALIFIED OPPORTUNITY ZONE BUSINESS ("QOZB")

A QOZB is a trade or business in which "substantially all" of the tangible property owned or leased is QOZBP and which derives 50% of its gross income from within the QOZ.

TAX TREATMENT OF QOF INVESTMENTS

An investor can receive up to three tax benefits by reinvesting capital gains in a QOF. The first is temporary tax deferral on any capital gains reinvested in a QOF within 180 days of realization. Tax payment is deferred

until the investment is sold or exchanged, or until December 31, 2026, whichever comes first. The second benefit is a 10 percent step-up in basis for capital gains reinvested in a QOF if the investment is held for five years. The basis is increased an additional 5 percent for any investments held for seven years. This step-up in basis means taxpayers can exclude up to 15 percent of the value of their reinvested capital gains from their taxable income, decreasing the taxpayer's tax liability when he or she sells or can no longer defer taxation. The third benefit is that investors can permanently exclude from taxation any capital gains that accrue after their investment in a QOF, if the investment is held for at least 10 years. Opportunity zones increase the basis of any investment held in a QOF for 10 years to 100 percent of its fair market value on the date it is sold or exchanged.

The following table shows an example of an investor who sold Apple stock for \$2.3 million with a cost basis of \$1 million and contributes the \$2.3 million proceeds to a QCF, which he holds for 7 years. Under the traditional system, he would owe \$309,400 in capital gains taxes. However, if the investor invested the \$2.3 million proceeds in a QOF, he would save \$46,410 in capital gains taxes. This is because the step-up in basis (15% times \$1.3 million gain) means he pays taxes on just \$1,105,000 of capital gains, rather than the original capital gain of \$1.3 million.

OPTIONS TO INVEST

There are three investment paths from which a taxpayer may choose. The first one is to "go it alone," which would involve finding a property or business to start-up in a QOZ. This would entail substantial risk, high start-up costs, professional fees, and 100% of the management time would fall on the investor. In addition, there would be no scale to negotiate lower fees from developers and professional advisors. The second option is to invest in a QOF. When evaluating if it makes sense for you to invest in a QOF, you should consider the following: fees, potential risks, start-up time before cash flow, potential conflicts of interest, as well as the holding periods to get the tax benefits. The third option is to partner with institutional investors. This would only be an option for family offices, insurance companies, and qualified plans who have investment capital of \$50 million or more.

WEALTH ADVISORY OVERVIEW

QUALIFIED OPPORTUNITY FUNDS: THE LATEST TAX PLANNING IDEA

Example of Capital Gains Tax on QOF Investment Held for 7 Years

Traditional Investment			QOF Investment Held For 7 Years		
Sales Proceeds	\$	2,300,000	Sales Proceeds	\$	2,300,000
Cost Basis	\$	1,000,000	Cost Basis	\$	1,000,000
Capital Gain	\$	1,300,000	Capital Gain	\$	1,300,000
Capital Gain Tax Rate		23.8%	Capital Gain Transferred to QOF	\$	1,300,000
Capital Gain Tax Due	\$	309,400	Increased Basis	\$	1,195,000
Post Tax Earnings	\$	1,990,600	New Calculated Gain	\$	1,105,000
			Capital Gain Tax Rate		23.8%
			Capital Gain Tax Due	\$	262,990
			Post Tax Earnings	\$	2,037,010
			Tax Savings	\$	46,410

The next table shows that any gain accrued after the \$1.3 million investment in the QOF is exempt from taxation if it is held for 10 years or longer. Assuming the investor made another \$200,000 over the decade of the QOF investment, the investor would save an additional \$47,600 in capital gains taxes.

Example of Capital Gains Tax on Accrued Earnings of QOF Investment Held For 10 Years

Traditional Investment			Earnings Accrued From QOF Investment Held For 10 Years		
Sales Proceeds	\$	1,500,000	Sales Proceeds	\$	1,500,000
Cost Basis	\$	1,300,000	Cost Basis	\$	1,300,000
Capital Gain	\$	200,000	Capital Gain	\$	200,000
Capital Gain Tax Rate		23.8%	Capital Gain Tax Rate	\$	-
Capital Gain Tax Due	\$	47,600	Capital Gain Tax Due	\$	-
Post Tax Earnings	\$	152,400	Post Tax Earnings	\$	200,000
Tax Savings	\$	-	Tax Savings	\$	47,600

In total, this investor would save \$94,010 in capital gains taxes by reinvesting his \$1.3million capital gain in an opportunity zone and holding that investment for 10 years. Note that the above examples do not take into account state income taxes.

WHAT KIND OF CAPITAL GAIN CAN YOU DEFER AND WHO QUALIFIES?

Eligible capital gains include gains arising from an actual or deemed sale or exchange, or any other gain that is required to be included in a taxpayer’s computation of capital gain. Any taxpayer that realized an eligible gain for federal tax purposes may elect to defer that gain if all requirements are met. These taxpayers include individuals, C corporations, partnerships, S Corporations, trusts, and estates. A taxpayer is not required to invest the entire proceeds from the sale or exchange giving rise to the eligible gain. Rather, the taxpayer must reinvest only the capital gain portion of the proceeds. Thus, unlike a Section 1031 exchange, a taxpayer reinvesting in a QOF can pocket the cash received in excess of the gain amount.

CONCLUSION

We see this strategy as a good tax planning opportunity for taxpayers who own highly appreciated stock or property and are looking for a creative way to defer and reduce taxes. That said, it is important to remember that this is an investment that should be carefully evaluated and not pursued for tax planning purposes only. We can help you carefully assess QOF investment opportunities alongside your CPA and attorney.

AROUND McSHANE PARTNERS

McSHANE PARTNERS IN HICKORY, NC



Daniele Donahoe and Erik Rosenwood with clients in Hickory, NC.

FREEDOM SCHOOL DROP EVERYTHING AND READ (D.E.A.R.) PROGRAM

McShane Partners will volunteer again this year with the Freedom School on July 17th for their Drop Everything and Read (D.E.A.R.) program. The Freedom School promotes the long-term success of children by preventing summer learning loss through igniting a passion for reading and inspiring a love of learning.

McSHANE PARTNERS' FIRST QUARTER 2019 ECONOMIC OVERVIEW AND LUNCHEON

We would like to thank our participants for joining us for lunch and an in-person presentation of McShane Partners' First Quarter 2019 Economic Overview on Friday, May 31st. We discussed our thoughts on the

significant financial, economic, and political developments throughout the first quarter of 2019, as well as our perspective on current economic conditions and our near-term outlook for global financial markets.

WELCOME REBECCA HOOVER - NEW WEALTH ADVISOR

Rebecca, "Becky" is a Certified Public Accountant (CPA) and International Tax Consultant, 26 years of experience, including the taxation of executive compensation arrangements, tax and financial modeling, corporate and flow through tax planning, SEC filings, tax accounting, due diligence, and restructuring.



We are elated to welcome Becky into the McShane family, Her versatile background and credentials, as well as her creative, integrated work toward wealth-management solutions, will be an immense asset to our clients." Her considerable experience with executive compensation models and corporate compliance requirements will be additive to McShane Partners' experienced bench of planning professionals.

Becky Hoover is originally from Tallahassee and went to school at the University of Florida. Outside of work, she enjoys yoga, playing bass guitar, and golf.

HAPPY FOURTH OF JULY!



McSHANE PARTNERS

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

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