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McShane Partners

September 2021 Insights

Investment Overview

Interest Rate Roulette

With the COVID-19 pandemic-induced recession triggering a return to *zero-bound interest rate policy* ("ZIRP") across global financial markets, investing in *high-quality, investment-grade fixed income assets* (i.e., bonds) has once again become a harrowing endeavor instead of an essential exercise in routine rebalancing. Regardless of the trajectory, magnitude, or longevity of inflation, interest rates are *low*, and if current inflationary pressures prove *persistent vs. transitory*, then interest rates are *dramatically low*. Either way, depressed interest rates relative to economic realities are making it extremely difficult to buy and/or hold safe-haven bonds to mitigate incremental volatility, while, at the same time, positioning portfolios to generate attractive, *less-volatile* returns. This is the current conundrum.

As a refresher, investment-grade bonds serve as the ballast for diversified investment portfolios, allowing for a degree of conservatism by providing stability during periods of heightened equity market volatility and preserving principal by mitigating downside/drawdown capture. The idea being that investment-grade bonds, particularly U.S. Treasury bonds, are *inversely correlated* with equities, suggesting that when equity prices *decline*, bond prices *increase* or, at a minimum, remain flat. Additionally, the consistency of the income stream from bond coupons has historically been the basis for funding liquidity requirements and cash flow needs, regardless of economic conditions or price volatility across stock markets.

The severity of the present anomaly in bond markets is that both of Continued on next page

Wealth Advisory Overview

Update on the Biden Estate Tax Proposals

Two weeks ago, the Wealth Advisory team attended virtual sessions detailing the latest in estate tax proposals. We found the discussions alarming and confusing. Since then, we have received various articles and opinion pieces from clients who have become similarly concerned regarding the new "death tax". It turns out that many of these pieces have taken an amalgamation of proposals and combined the proposed changes from different sources into a "worst case" scenario. Here is an attempt to separate the hyperbole from the facts.

President Biden has announced three proposals from the White House related to taxes in 2021, The American Rescue Plan (January), The American Jobs Plan (March), and the American Families Plan (April). These proposals were announced in Fact Sheets.

American Rescue Plan

The Fact Sheet was approximately 18 pages long and largely proposed targeted COVID emergency measures, testing, vaccinations and provided emergency payments to taxpayers. It also included a proposal to raise the minimum wage to $15/hour. Following its release, President Biden worked with various parties until a Bill was introduced on February 24th in the House by John Yarmuth. The Bill was eventually passed into law and signed by the President on March 11th. The Final Bill was 242 pages and did not include an increase to the minimum wage, as well as other items.

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Investment Team

Daniele Donahoe, CFA
CEO | Chief Investment Officer

Elliott Van Ness, CFA
Director of Research | Portfolio Manager

Abby Williams
Investment Associate

Wealth Advisory Team

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

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

Lorri Tomlin, FPQP™
Wealth Advisor

Ryan Vaudrin, CFP®, CDFA®
Wealth Advisor

Daniel Hudspeth, CFP®,
Wealth Associate

Corey Meyer
Wealth Associate

Points of Interest

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Interest Rate Roulette

these fundamental tenets of utilizing bonds for portfolio protection and fixed income generation are directly challenged by artificially low interest rates. First, bond and equity prices have recently become *positively correlated* and have been moving up in tandem. Second, interest rates are so low that high-quality, investment-grade bond portfolios are not able to generate sufficient safe, predictable income to fund ongoing cash flow needs for even the highest-net-worth individuals and largest investment portfolios.

According to Warren Pies, there have only been three other periods or instances of simultaneous positive performance across both equity and fixed income markets since 1998: these occurred in 2003, 2011, and 2020. In each of these instances, the U.S. economy had been recovering from a negative macroeconomic shock, and, in each case, the subsequent reversion to the mean in terms of correlations between stocks and bonds came at the

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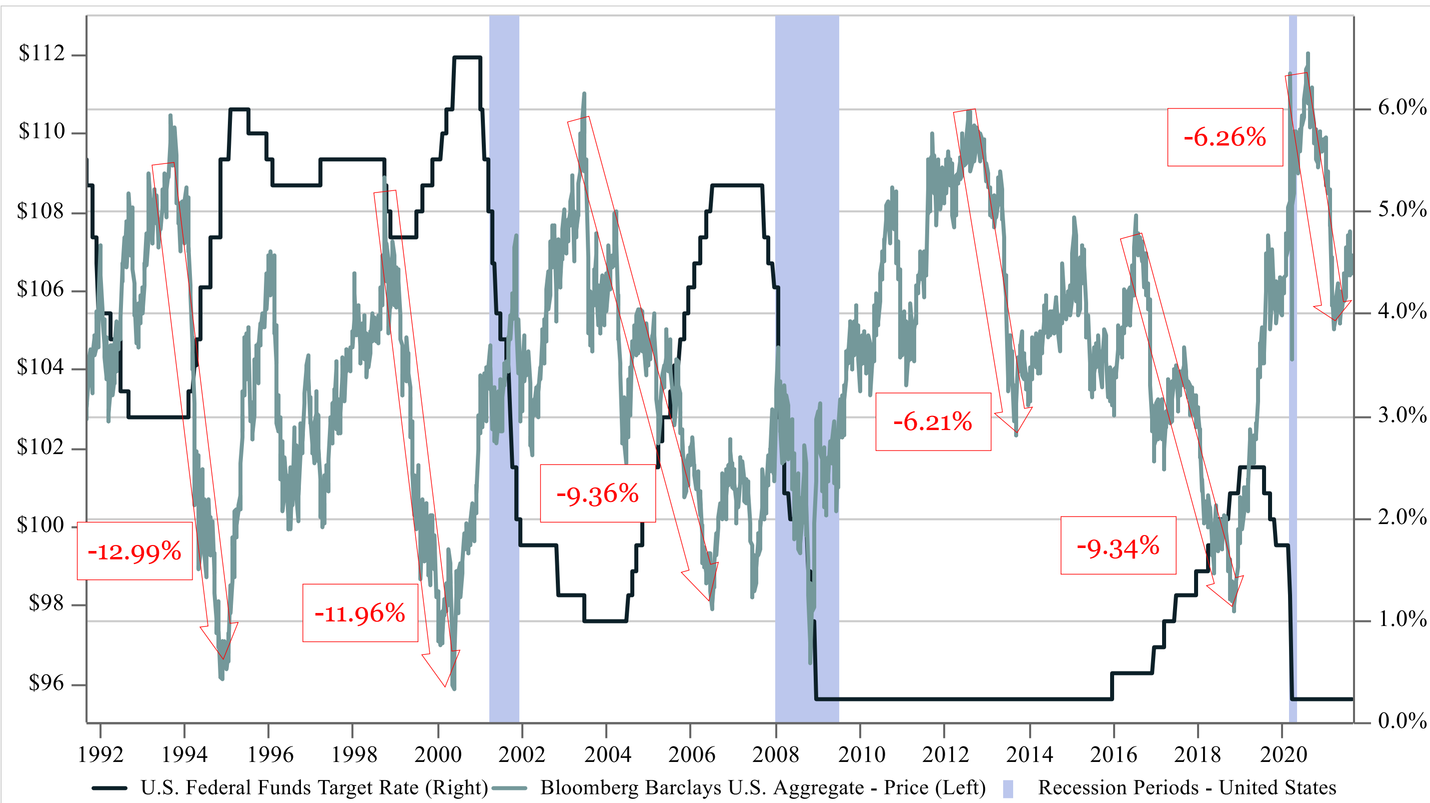
Chart I: U.S. Fixed Income Prices vs. Federal Funds Target Rate



Source: McShane Partners - FactSet Research Systems, Inc.

Monthly Index Review USD Total Return				
Data as of August 31st 2021	**August 2021**	**2021 YTD**	**2020**	**2019**
S&P 500® Index	**+3.04%**	**+21.58%**	+18.40%	**+31.49%**
Dow Jones Industrial Average	+1.50%	+17.04%	+9.72%	+25.34%
NASDAQ Composite	**+4.08%**	**+18.92%**	**+44.92%**	**+36.69%**
Russell 2000	+2.24%	+15.83%	**+19.96%**	+25.52%
MSCI Emerging Markets	+2.65%	+3.07%	+18.69%	+18.88%
MSCI EAFE	+1.77%	+11.96%	+8.28%	+22.66%
Bloomberg Barclays U.S. Aggregate Bond Index	**-0.19%**	**-0.69%**	+7.51%	+8.72%

Investment Overview

Interest Rate Roulette

expense of fixed income markets, as stocks have historically continued to climb incrementally higher. Timing is always elusive, but these anomalies have always corrected, and the Investment Team does not expect this time to be any different and has positioned portfolios in anticipation of additional weakness in bond prices as interest rates rise to adjust to the current rate of inflation, suppressing speculation and tempering excessive exuberance.

"We just don't have enough investor protection in crypto. Frankly, at this time, it's more like the Wild West."
- U.S. SEC Chairman Gary Gensler

Once firmly ensconced in a rising rate cycle, equity markets should quiver and correct. Interest rate movements dictate the timing of closing *underweights* in Fixed Income allocations and reducing *overweights* in U.S. Equity exposures. As can be seen in Chart I on the previous page, corrections in bond prices, as represented by the Bloomberg Barclays U.S. Aggregate Bond Index (i.e., **the teal line**), during the initial phase of the rate hiking cycle, as represented by the U.S. Federal Funds Target Rate (i.e., **dark blue line**), normally take *more than a year* and average **±9.35%**. With bond markets having bounced recently after an initial correction, the Investment Team believes there is additional near-term downside risk to bond prices that necessitate an *overweight positioning* in Cash & Cash Equivalents and a *persistent underweight* in Fixed Income until bond prices fall further alongside a concurrent rise in interest rates.

Stock & Strategy Spotlight

Name	Ticker	August 2021	2021 YTD
National Presto Industries, Inc.	NPK	-13.41%	+1.54%

Description & Investment Thesis

Over the past several weeks, the Investment Team has been conducting in-depth due diligence and fundamental analysis on National Presto Industries, Inc. ("NPK"), shares of which are trading at extremely attractive absolute and relative valuations. Given the company's pristine balance sheet and reliable track record of returning capital to shareholders, the Investment Team believes that the probability-weighted downside risk to the stock posed by potential worst-case scenario is negligible at current levels, providing a much-needed floor to the share price over the near-/intermediate-term. That said, however, NPK faces numerous headwinds to its core business segments that necessitate heightened conservatism with respect to projecting financial results and/or operating performance over the next **±6-12 months**; for example, NPK has yet to provide any updated commentary or guidance as to the potential impact of recent geopolitical developments on the company's Defense Segment, which comprised **±66.5%** of company-level revenues in fiscal year 2020 ("FY2020"). Moreover, the company's Housewares/Small Appliances Segment has experienced deteriorating profitability and decremental margins due to inflationary pressures and rising commodity costs, although the company expects to be able to take advantage of seasonal strength over the coming months and improve profit margins by passing along these increased costs via higher prices.

While the Investment Team believes that its fundamental framework for analyzing and valuing shares of NPK incorporates sufficiently severe scenarios in terms of potential upside/(downside), the most significant impediment to initiating firm-wide positions in NPK is the unfortunate lack of trading volume. Until there is adequate liquidity in shares of NPK to ensure efficient entry and exit points at desired price levels, the Investment Team will be prohibited from including shares of NPK in firm-wide buy lists or actively recommending the stock for all applicable client investment portfolios.

Wealth Advisory Overview

Update on the Biden Estate Tax Proposals

American Jobs Plan

The Fact Sheet was approximately 28 pages long and includes most of the infrastructure spending projects that President Biden wants to see. In it the President announced a proposal for corporate tax reform (Titled the Made in America Tax Plan) and provides a one-paragraph overview of certain proposed tax changes. The Infrastructure Proposal became a Bill that has passed the Senate and will see a vote in the House by Sept 27th. The Senate Bill is 2,702 pages long and does NOT include the proposed corporate tax changes. This Bill has not become law.

American Families Plan

The Fact Sheet was approximately 18 pages long and laid out proposed education improvements, childcare, healthcare, and other aid targeted to families and children. It describes changes to individual taxes that the President has proposed. The proposals included an acceleration of the sunset for the 2017 top tax rate decrease, and changes to the taxation of capital gains (eliminate carried interest and long-term gains for taxpayers with earnings over $1.0m from preferential taxation). It also describes eliminating the step up in basis for inherited assets over $1.0m (per decedent). There is no mention of changing the estate tax rates or exemption amounts.

2022 Green Book

Every year the Presidential Administration releases a “Green Book” which is the Administration’s recommendations for the next fiscal year’s budget. This year’s Green Book was released in May and is 114 pages long. It has two main sections titled “American Jobs Plan”, which outlines infrastructure spending and corporate tax increases, and the “American Families Plan”, which outlines the child and family tax credits, as well as proposed tax increases for individuals. While the Green Book gives a little more detail around what the President wants to see in future tax legislation, it does not set policy or create law. However, it does signal to Congress what measures the President supports.

The Green Book expands on the proposal for changes to capital gain taxation. Under the proposal, gifts or bequests of appreciated property would cause the donor (or decedent) to recognize the gain on a federal gift or estate tax return. Gains on tangible personal property would be excluded, as well as gains on a personal residence ($250,000 per person and $500,00 per couple), and the exclusion for small businesses would continue to apply. There would be an exclusion up to $1.0m per person ($2.0m per couple, indexed for inflation) of appreciated property to pass to a recipient without any gain recognition. No gain recognition occurs when property is transferred to a spouse or charitable organization. For a transfer to a spouse, any gain recognition would be delayed until the recipient spouse’s death. There are also provisions to stretch the tax payment on the transfer of illiquid property and to apply tax when transfers are made to an irrevocable trust, partnership, or other non-corporate entity or from a revocable trust to someone other than a spouse or owner. The brief sentence on the transfer to trusts or other entities has created much of the uproar amongst estate planners due to its vagueness and potentially wide application.

In Summary

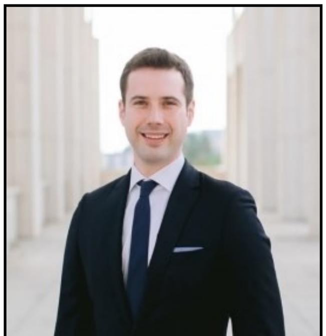
Note that there has been no proposal by President Biden to reduce the estate and gift tax lifetime exemption, or to increase the estate tax rates. The current lifetime exemption is approximately $11.7m per person ($23.4m per couple, indexed for inflation). The lifetime exemption is set to sunset to previous levels (projected at $6.0m per person and $12.0m per couple, indexed for inflation) in 2026.

Senator Van Hollen (along with several other Democratic Senators) has offered a discussion draft of legislation and Congressman Pascrell has introduced a bill that would treat gifts and bequests as realization events in a somewhat similar manner to the administration’s proposal. Both Senator Bernie Sanders and Senator Elizabeth Warren released tax proposals in 2019 during their Presidential campaigns. Many of the aspects included in those two plans, along with Biden’s statements during his campaign, have been combined with President Biden’s proposals since winning the White House in articles and discussions around income and estate tax reform.

However, we have a long road ahead of us with many discussions and arguments to be had, thousands of pages to be written and re-written until we have any definitive changes to our current estate or individual income tax systems.

Wealth Advisory Overview

Ryan Vaudrin is a Certified Divorce Financial Analyst® Professional



Ryan Vaudrin, CFP®, CDFA®
Wealth Advisor

At McShane Partners, we are continuously striving to learn and grow as Wealth Advisors. A part of this process includes taking new courses and obtaining new designations to better assist our clients. McShane Partners is happy to announce that Ryan Vaudrin, CFP®, CDFA® passed his fourth and final exam on August 20th and joins Sandy Carlson, CFP®, CPA, CDFA® and Becky Hoover, CFP®, CPA, CDFA® as the newest Certified Divorce Financial Analyst® professional at McShane Partners.

What is a CDFA®?

The role of a CDFA professional is to support the client and their attorney by helping all parties understand how financial decisions pursuant to a divorce will affect the client's future. Here are some of the examples of how a CDFA® can help clients navigate divorce:

Financial Analysis Conducted Early in the Divorce Process Can Save Time

The average length of the U.S. divorce process is one year. In the beginning stages of the process, both parties spend a great deal of time trying to get a clear understanding of the financial aspects and terminology of the separation. A CDFA can explain all financial aspects of the pending decisions and help to empower their clients to make educated decisions throughout the proceedings.

Help Clients Save Money During the Divorce Process

By using a CDFA, you can have a clearer view of your financial future. Only then can you approach a legal settlement that fully addresses your financial needs and capabilities. A legal settlement that floats back and forth between attorneys, without the client having a clear understanding of all financial ramifications, can be detrimental, time consuming and expensive. A CDFA can educate their clients by providing thorough knowledge and understanding of the often-complicated financial decisions.

Help Clients Avoid Long-Term Financial Pitfalls Related to Divorce Agreements

Working with a client and their attorney, a CDFA can forecast the long-term effects of the divorce settlement. This includes details of all tax liabilities and benefits. Developing a long-term forecast for their financial situation is far better than a short-term snapshot. Financial decisions must be made that not only take care of immediate family needs, but retirement needs as well.

Assist Clients with Developing Detailed Household Budgets to Avoid Post-Divorce Financial Struggles

A CDFA can help clients think through what the divorce will really cost in the long run and develop a realistic monthly budget during the financial analysis process. Expenses such as life insurance, health insurance and cost of living increases must be taken into consideration when agreeing on a final financial settlement.

Reduce the Amount of Apprehension and Misunderstanding About the Divorce Process

Misinformation and misconceptions about the divorce process can be detrimental. Many have false expectations that they will be able to secure a divorce settlement allowing them to continue with their accustomed style of living. Financial divorce analysis helps to ensure a good, stable economic future and prevent long-term regret with financial decisions made during the divorce process.

Credit: Institute for Divorce Financial Analysts

The Certified Divorce Financial Analyst is one of several designations we utilize to help clients. As we continue to grow, we look forward to highlighting additional designations and achievements in the future.

Wealth Advisory Overview

Finance Corner: Letter of Instruction

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

If you are like most people, estate planning is not one of your favorite conversation topics. However, making decisions about the end of your life can save your family members and friends a lot of stress during an already difficult time.

Most people have heard of a will. A will is a document that is meant to tell your loved ones how to distribute your belongings, it does not detail where to find them or how to access them. This is where a Letter of Instruction is beneficial.

What is a Letter of Instruction?

A letter of instruction (also known as a letter of intent) is an informal supplement to your estate planning documents which provides your Executor with detailed information concerning your wishes after you die. While a letter of instruction is not as legally binding as other estate planning documents, it provides important financial information that will likely not be included elsewhere. Not only can you use it to leave detailed instructions about your assets, but you can also use it to make personal requests, like which music to play at your wake or funeral.

What To Add to a Letter of Instruction

Most letters of instruction are divided into two main sections: financial information and personal information. Some items often include:

- Specific bequests for personal property, such as family heirlooms, jewelry, firearms, etc.
- Personal desires concerning your burial, funeral, etc.
- Personal sentiments, messages to your loved ones, and expressions of love to be read when you are gone.
- Instructions for the care of any pets.
- Information to manage your digital life (passwords to social media accounts).
- Details of the whereabouts and content of a safe deposit box.
- The locations of important legal documents like your estate plan, birth and marriage certificates, tax returns, divorce or citizenship papers, and military records.
- Contact information on any debtors (mortgages, credit cards, car loans).
- Names and contact information for any professionals who handle your assets, like attorneys, CPAs, bankers, or wealth advisors.

Why Write a Letter of Instruction?

Although you likely know your financial information, such as which banks you have accounts with and how to access them, your loved ones may not. If you do not provide this information, it can add a lot of unnecessary administrative work and cause delays in the distribution of your estate. You may wonder why this type of information is not generally included in your will or trust? The reason it is not included is because you would not want to amend or replace your estate documents every time this information changes, which could be costly. Therefore, because these types of bequests may change frequently, it is more cost-effective for clients to put this type of detailed information in the letter of instruction and update it regularly.

When Should I Update a Letter of Instruction?

As with any estate planning documents, you should update your letter of instruction after you experience any major life events or significant changes to your assets or your debts. For example, you might want to update your letter of instruction if you get divorced or if you pay off your mortgage. In addition, it’s useful to review your letter of instruction once per year to ensure it still reflects your wishes and preferences, as well as accurate financial information.

After updating your letter of instruction, you should print, sign, and date it. You can provide copies to your executor, estate planning attorney, or loved ones, or you can keep it with your other estate planning documents. While we often caution clients against doing their own estate planning, this is one document that you can feel free to update on your own, as often as you like.

Around McShane Partners

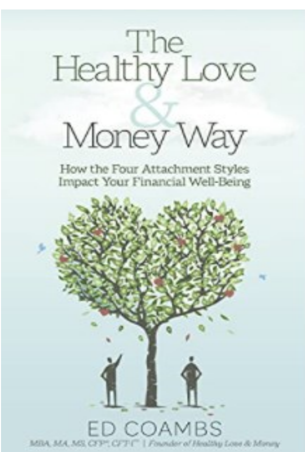
Charlotte Squawks

We recently enjoyed an evening out at the Blumenthal Performing Arts Center for the Charlotte Squawks comedy show. Showings for Charlotte Squawks began August 19th and will conclude September 12th.

McShane Partners Baby Shower

The McShane Partners family recently held a baby shower at Carmel Country club for Wealth Associate Daniel Hudspeth. Daniel and his wife Kara are expecting a baby boy who is due in November.

McShane Partners Book Club



Ed Coambs, CFP®, LMFT, CFT-I™ is the author of our Quarterly Book Club feature The Healthy Love & Money Way: How the Four Attachment Styles Impact Your Financial Well-Being. If you are interested in a copy, please email Abby Williams here.

Labor Day Holiday

We will be closed Monday, September 6th in observation of Labor Day. We wish everyone a safe and relaxing holiday weekend as everyone returns from season end vacations.

McShane Partners

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

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