

PLAYING OFFENSE IN A WASH OUT



TRUXTON TRUST
A PRIVATE BANK



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When sentiment turns nasty and the markets choppy, what strategies might one deploy to better position themselves to improve long-term financial outcomes? The silver lining is that market downdrafts present opportunities to play offense from both a planning and investment perspective. Awareness of these opportunities and execution can greatly enhance the performance of your family's balance sheet.

If you are considering gifting assets to family members or trusts, gifting assets while values are depressed will preserve more of your lifetime gift and estate and generation skipping tax exemption. Assets with strong appreciation potential, gifted at depressed asset values are ideal assets to gift since their future potential appreciation is out of your taxable estate. For families with a high level of estate tax exposure, current tax law and still historically low interest rates present many favorable planning opportunities. In 2026, lifetime estate and generation-skipping tax exemptions under current law are set to be reduced by a meaningful amount. We encourage those who wish to benefit from the current tax and market environment to begin exploring planning opportunities now.

Market downdrafts also produce opportunities to reduce investment expenses, improve forward tax efficiency and reduce outsized risks posed by concentrated holdings. Downdrafts often provide the opportunity to reduce high expense pooled investment vehicles like Mutual Funds and Common Trust Funds, which are not a great fit for wealthy investors. Even if you sell pooled investment vehicles and realize gains, a forward cost saving analysis may indicate selling high expense / low tax efficiency assets in favor of individual stocks, ETF's and Bonds is a wise decision. Reducing exposure to pooled investment vehicles will also improve forward tax efficiency by eliminating year-end capital gains distributions. After several years of outsized gains in the stock market, many pooled investment vehicles have a high level of embedded tax liability that can be passed out to shareholders

even when they do not sell their shares. A transition from pooled investments to individual holdings will allow investors to fully control the timing and magnitude of capital gains realization. We all know concentrated portfolio positions are risky. During a downdraft, you might realize portfolio losses to offset gains generated from sales to reduce the concentrated position. Realizing losses in other portfolio holdings will help to limit the tax impact of transitioning to a more diversified portfolio. If you generate net realized losses, you will then have a tax loss carryforward that will be used to offset future capital gains. In short, downdrafts often provide good tax cover to restructure portfolios for enhanced after-tax returns.

From 1980 through the end of April 2022, the S&P 500 has experienced average intra-year drops of 14.0%, yet annual returns were positive in 32 out of 42 years. The market has shown remarkable resiliency in the face of seemingly endless challenges and uncertainty. As market conditions ebb and flow, we move opportunistically to rebalance portfolios to each client's strategic allocation and to express our best thinking on the capital markets and individual investments. In addition to taking actions to reduce tax exposure, we are also exploring new investment opportunities. While market volatility is always unwelcome, it often presents a more robust set of attractive investment opportunities.

We anticipate a continuation of heightened market volatility in the coming months as investors digest the implications of the Fed's

rate hiking campaign and quantitative tightening in its battle to cool persistently high inflation readings. Already, we have seen a dramatic move higher in interest rates in 2022. The pronounced move has of course produced downward price pressure on both bonds and stocks. Geopolitical risk will continue to further fuel investor worries and create noise in the macro-economic environment. While we acknowledge the risks, we have been encouraged by earnings for the first quarter; believe the U.S. economy is on a solid footing for continued but lower growth; and believe the Fed is committed to tackling inflation. It remains to be seen if the Fed can control inflation without producing a recession. While a recession is certainly not out of the question, if there is one, we believe it will be shallow given the strength of the U.S. consumer's balance sheet and a strong domestic job market. Our focus in the coming quarters will remain on earnings results and the outlook for inflation. Given the downdraft in both stocks and bonds, our long-term forward outlook on both asset classes has improved. We believe we remain well positioned and remain committed to long-term strategies. Our portfolios continue to emphasize durable businesses and will maintain an appropriate level diversification in risk exposure. We are also well positioned to take advantage of market conditions. While we do not purport to know the next catalyst for market sentiment to improve, we do have confidence in our team and process and remain focused on our clients' success. ■