FOURTH QUARTER 2020 – TRUST & INVESTMENT MANAGEMENT'S

WEALTH MANAGEMENT UPDATE

Exchange Bank

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TRUST & INVESTMENT MANAGEMENT GROUP

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Investment Review and Outlook

By Matthew C. Kelman,
Vice President & Institutional Trust Fiduciary Manager

Rising off of the base of the greatest quarterly contraction in the U.S. economy on record in the second quarter, the third quarter of 2020 saw what will most likely be regarded in the future as the greatest quarterly economic rebound ever. This rebound, coupled with slowing domestic COVID-19 transmission rates, translated into a favorable backdrop for global risk markets and hopes that the worst of the damage from the pandemic is behind us.

Building off the best second calendar quarter in post-war history for U.S. equity markets, third quarter risk asset returns were broadly positive with mid-to-high single-digit returns across most global equity markets. The rebound at the beginning of the quarter led to recent market highs for the S&P 500 on September 2nd, before coming back down in the beginnings of the lead up to the U.S. presidential election on November 3rd. Large-cap Growth and Technology stocks continued their leadership position, with the "Work from Home" environment set to continue for the foreseeable future. Much of the growth in this space was most likely destined to occur over time regardless, so some of the gains were probably just the pulling forward of demand that may not have occurred for a few more years without the pandemic. More economically sensitive Small-Cap and Value stocks continued to lag, as they have for much of the past decade, although signs have begun to appear that this may change as the world continues the slow rebound back to (the newest) normal.

Internationally, Emerging Market stocks outpaced their developed and U.S. counterparts, as many have been more successful at keeping a tighter lid on their numbers of virus cases and hospitalizations. In fact, one dominating Emerging Market, China, is projected to be the only major economy in the world that will end the year with real economic growth in positive territory.

MARKET PERCENTAGE TOTAL RETURNS AS OF SEPTEMBER 30, 2020

Index	Q4 2020	One Year	Five Years (annualized)	Ten Years (annualized)
Barclays U.S. Aggregate Bond Index	0.62	6.98	4.18	3.64
S&P 500 Index	8.93	15.15	14.15	13.74
Russell 2000 Index	4.93	0.39	8.00	9.85
MSCI EAFE Index	4.80	0.49	5.26	4.62
MSCI Emerging Markets Index	9.56	10.54	8.97	2.50

That combination, along with a decline in the U.S. Dollar, due to a combination of escalating U.S. budget deficits and a move away from the Dollar as a safe-haven asset, meant positive returns for international market stocks in Dollars, even with negative returns for some in their local currencies.

In fixed income markets, yields steepened the U.S. Treasury curve with the Fed's announcement of a policy change to keep short-term rates pinned to the Effective Lower Bound (aka zero) until maximum employment and an overshoot of their 2% inflation target are met, while long-term rates rose on expectations of more fiscal stimulus and increased longer-term inflation expectations partially due to the quickly increasing long-term federal debt. With those changes, the 2-10-year U.S. Treasury curve widened slightly from 0.50% to 0.56% by quarter-end. Credit spreads on corporate bonds (both investment-grade and high yield) and municipal securities continued to tighten during the quarter, following the extreme levels seen during the early months of the pandemic, due to the continued improvement in the economy and the prospects for additional stimulus along with the myriad of programs rolled out by the Federal Reserve to stabilize lending markets.

Looking ahead to the fourth quarter, we would expect to see higher levels of volatility in financial markets leading into the U.S. presidential election, with so many different potential outcomes possible, as well as the ongoing uncertainty regarding the course of the pandemic, additional government stimulus, and progression on the vaccination front. With so many variables in play, and so many possible scenarios playing out, our recommendations to clients continue to revolve around keeping a long-term perspective, and try to avoid making the mistakes that so many individual investors make in trying to time inflection points in the markets. Not only is it a difficult task to predict correctly, but the consequences of failure can impact your ability to meet your long-term goals if you are wrong.

Business Succession Planning Versus Estate Planning, and Why You May Need Both

By Emily Menjou,
Vice President & Personal Trust Fiduciary Manager

This article appeared in the 11/30/20 issue, volume 33, number 47 of the North Bay Business Journal.

For even the most successful business owners, succession planning and estate planning can be difficult to discuss. While both are vital for legacy protection, they are often overlooked or lumped together in clients' minds. Although estate planning and business succession planning are certainly connected, it is important to understand the differences between the two. The care you take in implementing each plan will have a significant impact on the ongoing success of your business and financial goals.

Estate planning refers to the process of preparing for the efficient transfer of your assets at death, or the management of your assets during a period of incapacity. Proper estate planning will ensure that your assets are managed and ultimately transferred in accordance with your wishes. Estate planning also has the capability of reducing exposure to estate and other taxes, to arrange for professional investment management for yourself or future generations, and to bypass probate (the court supervised process of administering a person's estate). The following are key estate planning documents which every business owner should have:

- Living Trust
- Will
- Durable Powers of Attorney for Finances and Healthcare
- Beneficiary Designations

Unlike estate planning, which focuses on the totality and transfer of your assets, business succession planning is specific to the continuity of your business. Succession planning is a strategic tool to smoothly transition operation, management and ownership to partners, future generations or successor owners. Succession planning typically includes the following considerations:

- Leadership positions and skills which are vital for business success
- Training and leadership preparation inside the organization
- Future needs of the business
- Future vision for the business
- Viability of business under control of future generations

For family owned businesses, owners must seriously consider whether future generations are interested and equipped to successfully transition into a leadership role. Business owners must also consider whether liquidity from the business will be necessary for long term financial health.

In many cases, a buy-sell agreement is a key component of a business succession plan, particularly in cases where a business is operated with a partner, or where key stakeholders have already been identified. A buy-sell agreement is an arrangement where the business interest is sold upon a triggering event, such as the retirement or death of a business owner.

Business succession planning should solidify the continuity structure for your business, whatever your wishes may be, while estate planning allows the opportunity to carry out your wishes for *all* of your assets (business and otherwise) during your lifetime, during a period of incapacity, and after your death. If you own a business, both types of planning are essential to help to streamline the transfer of your assets, to maximize family harmony, and ultimately to protect the legacy you've worked hard to create.

I'm a big subscriber to the old adage: "*There's no time like the present*," which applies perfectly to business succession and estate planning. For this reason, we always encourage our clients to begin planning discussions with their estate planning professionals as soon as possible.

Recent Economic Highlights

By Argus Research Company

GDP REBOUNDS 33% IN 3Q

U.S. GDP expanded at an astonishing 33.1% rate in 3Q20, as the economy rebounded from a coronavirus-driven 2Q20 plunge of 31.4%. As expected, personal consumption expenditures led the recovery and expanded by almost 41%. Spending on durable goods jumped 82%, while spending on services and nondurable goods grew 28% and 29%, respectively. Investment in equipment rebounded (with 70% growth) and housing investment increased 59%. Exports soared 60%, driven by a doubling in exports. The negatives? In this report, there were very few. Investment in intellectual property products fell 1.0%, while investment in structures declined 15%. Government spending fell 4.5%. There are larger negative implications from the GDP report, though. On an absolute basis, GDP advanced 8% in 3Q to $21.2 trillion. That does not make up for the 9% decline in 2Q. Indeed, at the current level, GDP is still 3% below its pre-pandemic high. Meanwhile, COVID-19 cases continue to climb, as the nation heads indoors for the winter.

UNEMPLOYMENT RATE DOWN TO 7.9%

The U.S. economy added back 661,000 jobs in September—a bit below Street expectations—as companies continued to bring employees back to work. The unemployment rate dropped to 7.9% from 8.4% in August. Employment rose sharply in Leisure and Hospitality (almost one-half of the month's total gains), Retail Trade, Healthcare and Professional & Business Services. The Government workforce was down more than 200,000, however, largely due to a reduction in educational employment. In addition, the Labor Department reported that another 837,000 people filed unemployment claims, and that continuing claims totaled 12.7 million. Those figures indicate that the employment environment, while improving, is still under stress. According to the Labor Department, the economy has added back more than 10 million jobs since April. But the pre-pandemic employment high in February is still more than 11 million jobs away. We expect the unemployment rate to remain high through 2020 as the U.S. economy slowly recovers—a recovery that will depend on the course of the pandemic, progress on vaccines and other treatments, and additional fiscal stimulus.

ONLY CHINA EXPECTED TO GROW IN 2020

The International Monetary Fund (IMF) projects a global GDP decline of 4.9% in 2020. Prior to the pandemic, the IMF had been forecasting growth of 3.2% for the year. The IMF expects that industrialized economies will decline the fastest and expects a GDP drop of 8% for these countries. Emerging markets are not expected to fall as fast, but the IMF still expects a decline of 3%. Only China is expected to grow in 2020. The IMF expects a sharp rebound in 2021. It projects global growth of 5.4%, with industrialized nations growing 4.8% and emerging markets growing

5.9%. China and India are expected to lead in 2021, with forecast growth rates of 8.2% and 6.0%, respectively. The baseline projections rest on key assumptions about the fallout from the pandemic. In economies with declining infection rates, the recovery path assumes persistent social distancing into the second half of 2020, and a hit to productivity as surviving businesses ramp up workplace health and safety measures. These assumptions are subject to significant revision.

HOUSING PRICES TICK HIGHER

The U.S. housing market is starting to rebound after a slump related to the onset of the pandemic. Building permits, which are a leading indicator for the industry, peaked in January at 1.55 million units and are down 5% (through August). But they are up 39% from April's lows. Existing home sales, which were down 32% in May from January, have started to rise and were up 2% month-to-month in August. Prices have held up as well, and inventory levels are tight. On the other side of the pandemic, we expect that demand for homes—with yards between neighbors and no elevator buttons to press—will remain strong.

COMMODITY PRICES START TO RECOVER

Trade issues hammered commodities in 2018-2019, and then the coronavirus piled on. Copper prices were down 28% in April from their 2018 highs as construction stalled, but they have since recovered 33%. Oil prices plunged 75%, but have more than doubled from their historic lows. Meanwhile, soybean prices have remained relatively steady and the price of gold has surged. Commodity investors are accustomed to volatility. The last time the commodities market bottomed was in January 2016, when oil prices were below $30 per barrel and copper was below $4,500 per metric ton. But recoveries tend to be sharp.

INFLATION MOVING HIGHER

Core prices are starting to increase, though we don't think the U.S. Federal Reserve is too worried. Currently, the central bank is busy backstopping mortgage markets, money-market mutual funds, small businesses, mid-sized businesses, corporate debt, and some state and local governments. The total bill? Ultimately, the central bank is likely to more than double the $4.1 trillion in assets that were on its balance sheet at year-end 2019 (the current total is $7.1 trillion). Meanwhile, most inflation measures remain below the Fed's target of 2.0%, though on average they are up month-over-month.

Tax Deadlines

Dear Clients,

It's hard to believe we are already in the fourth quarter of 2020. With year-end fast approaching, another tax season is also right around the corner. We understand this can be a busy and hectic time and we are standing by, ready to assist you. Below is a rough timeline of when you can expect to receive your tax documents from Exchange Bank:

1099 TAX INFORMATION STATEMENT *(for agency accounts and tax reserves)*

The IRS deadline to provide Form 1099-DIOB is February 15, with an option to extend to March 15. Due to delays at the fund level and complex reporting requirements, we expect to mail the majority of our 1099s by late February with the balance to be mailed in early March.

FORM 1099-R & 5498 *(for retirement accounts)*

If you've received a distribution from your retirement account, your 1099-R will be issued on or before the January 31 deadline. If a contribution was made to your IRA, your Form 5498 will be issued on or before the deadline of May 31.

FORM K-1 AND GRANTOR LETTERS *(for trusts)*

These forms are a component of each trust's fiduciary income tax return and carry the same filing deadline that you have as an individual (April 15). You should expect to receive your K-1 or Grantor Letter by mid to late March, with a few exceptions to be issued in early April.

We will make every effort to expedite our tax reporting documents in hopes of creating a smooth and easy tax season for all. If you haven't received your tax documents within the time periods specified above, please contact your account officer for a status update. And always, please let us know if you have any questions or if there is anything we can do to help.

Emily Menjou
Vice President and Personal Trust Fiduciary Manager

Email Delivery of Wealth Management Update
If you are a client or an estate planning professional and you have changed your email recently, please give us a call so that we can update our records. Print copies will continue to be mailed by request.

We hope you enjoy our quarterly update and musings, and we look forward to continuing our coverage of an array of wealth management topics that can assist you in meeting your investment, retirement, and estate planning goals.

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