Exchange Bank

Trust & Investment Management

TRUST & INVESTMENT UPDATE

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Investment Review and Outlook

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

The third quarter of 2022 saw a continuation of the economic and financial market volatility that exemplified the first half of the year as cross-currents impacting the world continued to exert their influence around the globe. The ongoing war in Ukraine along with COVID-19 flareups in China, a strengthening US dollar, and a coordinated effort by central banks to reign in multi-decade highs in inflation were partially counteracted by recovering logistical supply chains and multi-decade lows in the US headline unemployment rate. With so much uncertainty about the economy's direction of travel, financial markets of all stripes saw volatility measures stay elevated with possible recession risks on the horizon.

Global equity markets dropped for the third consecutive quarter as inflation's persistence, central bank monetary tightening and geopolitical questions combined to cause a continued contraction in equity market valuations. Although corporate earnings have held up so far at record levels, increasing recession risks may foreshadow a forthcoming drop which could pressure equity markets further. Thus far, equity market volatility has mostly been contained to the valuation side of stock prices, but falling corporate earnings could precipitate another leg lower for them.

Within equity markets, domestic stocks outpaced their international counterparts during the quarter with the US dollar strengthening to record highs against virtually all major currencies. Developed markets also outperformed emerging markets as cracks in the Chinese economy, primarily from their continued insistence on their ongoing COVID-zero policy as well as major cracks forming in their real estate market due to rising interest rates and years of over-building. Back home, growth stocks slightly outperformed value stocks and small-caps beat large during the quarter, but with the

MARKET PERCENTAGE TOTAL RETURNS AS OF SEPTEMBER 30, 2022

Index	Q3 2022	One Year	Five Years (annualized)	Ten Years (annualized)
Bloomberg U.S. Aggregate Bond Index	-4.75	-14.60	-0.27	0.89
S&P 500 Index	-4.88	-15.47	9.24	11.70
Russell 2000 Index	-2.19	-23.50	3.55	8.55
MSCI EAFE Index	-9.36	-25.13	-0.84	3.67
MSCI Emerging Markets Index	-11.57	-28.11	-1.81	1.05

exception of the energy sector, almost everything else is down well into the double-digits (percentage-wise) year-to-date.

In fixed income markets, interest rate volatility remained high as the Federal Reserve continued its rate hiking campaign with two 75 basis point hikes during the third quarter. The markets began to question whether the Fed can pull off the economic "soft-landing" it was hoping for, as the yield curve bear flattened with portions of the curve inverting by quarter-end. Historically the yield curve inverts when the market is pricing in the probability of a recession with Fed rate *cuts*, so with the heavily watched 2s-10s treasury curve falling from 0.06% to *negative* 0.39% during the quarter, implied is a rising recession probability in the next one to two years. In the meantime, credit (such as investment-grade corporates and high-yield bonds) and municipals outperformed the broad bond market due to their reduced interest rate sensitivities.

Looking ahead, the global economy appears on increasingly shaky ground as it slows down amid rising interest rates and falling liquidity due to major central banks continuing their campaign to reduce inflation from generational highs. Historically, the real economy responds to rising interest rates by slowing with a lag of six- to 18-months. However, the speed, magnitude and coincidental coordination to tighten financial conditions simultaneously across economies may cause these effects to amplified in the coming quarters. In the meantime, high nominal growth rates may allow corporate earnings to remain elevated before the full impacts are felt. Historically, attempting to time these inflection points perfectly has led to sub-optimal returns, however it is always a good time to review your risk-tolerance to ensure that your investments are built to withstand no more risk than you are willing to take over a time frame associated with your specific goals.

Retirement Reminders

By Michelle Gordon, *Investment Officer*

What do these numbers have in common? 50, 55, 62, 65, 72

That's right! They are important retirement ages linked to retirement milestones.

50: Catch-Up Contributions

For 2022, employees who are younger than age 50 can contribute a maximum of $20,500 to a 401(k). If you're age 50 and older, you can add an extra $6,500 per year in "catch-up" contributions, bringing your total 401(k) contributions for 2022 to $27,000. Similarly, the annual IRA contribution limit is $6,000 in 2022 ($7,000 if age 50 or older). The IRA contribution limits apply to your combined traditional and Roth IRA contributions. This means if you have a Roth IRA and a traditional IRA, your contributions to both cannot exceed the $6,000 limit ($7,000 if age 50 or older). Catch-up contributions can exponentially increase your retirement nest egg while providing tax advantages!

55: 401(k) Withdrawal Without Penalty

55 is the age that you can withdraw money from your current 401(k) plan without penalty if you are separate from your employer. The Rule of 55 is an IRS regulation that allows those 55 and older to withdraw funds from their 401(k) or 403(b) without a tax penalty. However, the Rule of 55 *only* applies to assets in your *current* 401(k) or 403(b), meaning the one you invested in while you were at the job you leave at age 55 or older. The rule does not apply to any retirement plans from previous employers, such as 401(k) or 403(b). You would have to wait until age 59 1/2 to begin withdrawing funds from those accounts without paying the 10% penalty. The rule of 55 also does not apply to individual retirement accounts (IRAs). If you were to move assets into a rollover IRA upon leaving your job, you would not be eligible for early withdrawal with no penalty.

62: Social Security Benefits

You can start receiving your Social Security retirement benefits as early as age 62. However, you are entitled to full benefits when you reach your full retirement age (FRA). If you delay taking your benefits from your FRA up to age 70, your benefit amount will increase 8% each year. Conversely, your benefits can be reduced up to 30 percent for taking them early and remember, both reductions and increases in your benefit amount are permanent. While it may make financial sense to wait, determining the right age to take Social Security can be tricky. Factors such as life expectancy and even your family makeup should be considered.

65: Medicare Eligibility
Medicare eligibility can be an important benefit to check into as you plan for retirement. In general, you become eligible for Medicare at the age of 65. Although many people link Social Security and Medicare together, you can enroll in Medicare before you choose to take Social Security benefits. And remember: Medicare comes in different parts, and unlike popular belief, it's not free!

72: Required Minimum Distributions
Age 72 is when you must take Requirement Minimum Distributions (RMDs) from your tax-advantaged retirement plans. If you don't take RMDs when the IRS requires you to, you could face steep tax penalties – up to 50 percent of the required amount. Specifically, the first RMD is due April 1 of the year in which you turn 72. In subsequent years, they are due on December 31. (Make note: If you were born before July 1, 1949, you had to start taking RMDs at age 70-½.)

Keeping track of important retirement ages can be challenging, but as you can see, missing certain milestones can result in lost benefits and added penalties. Our Trust & Investment Management team is here to help!

Recent Economic Highlights

By Argus Research Company

GDP POSITIVE IN 3Q AFTER TWO DOWN QUARTERS
US GDP expanded in the third quarter at an annualized rate of 2.6%, according to the "advance" estimate released by the Bureau of Economic Analysis. The reading reverses two consecutive quarters of contracting GDP. Pockets of strength in the third quarter included personal consumption expenditures on services, investment into equipment and intellectual property products, net exports, and government spending. Segments of the economy that struggled included PCE-durable goods, PCE-nondurable goods, residential investment and investment in structures.

263,000 NEW JOBS IN SEPTEMBER
The US economy generated a solid 263,000 new jobs in September, in line with consensus expectations. The unemployment rate ticked lower to 3.5%—the pre-pandemic level—as the labor force participation rate declined by 10 basis points to 62.3%. Average hourly earnings rose $0.10 from the prior month and 5.0% from the prior year, down slightly from 5.2% year-over-year growth in August. Revisions to the job totals in the two prior months added 11,000 jobs. In September, employment gains occurred in leisure and hospitality, professional and business services, healthcare, construction and manufacturing. Retail employment was relatively steady. The employment gains in September, though down from August, suggest that the consumer segment of the economy is likely to remain on a growth track—despite the impact of Fed rate hikes, the Russian invasion of Ukraine and high prices at the pump.

ONCE AGAIN, LITTLE IMPROVEMENT IN INFLATION
The September CPI report showed broad-based inflationary pressures in the US. The Bureau of Labor Statistics reported an 8.2% year-over-year increase in overall inflation in September, little changed from the 8.3% increase in August. The core inflation rate, excluding food and energy prices, rose to 6.6% in September from 6.3% in August. The overall rate benefited primarily from falling energy prices, as well as from lower prices for used cars, apparel and medical commodities. Food prices were steady, but shelter and new vehicle prices continued to rise, as did transportation costs. We think that the 9.1% CPI rate in July will prove to be the peak reading for the index in 2022, as gas prices slide and the housing market cools. Even so, the Fed still has a lot of wood to chop to bring core inflation down to its 2.0% target.

HOLIDAY SHOPPING OUTLOOK
The fourth quarter is the most important period of the year for the retail industry, and stores can record as much as 30%-45% of their annual sales during the holiday season. Sales typically grow from the prior year, and the average annual sales gain over the past 20 years has been 4%. The high was 14% (in the pandemic recovery year of 2021) and the low was negative 5% (as the economy entered the Great Recession in 2008). Mastercard provides forecasts—and it expects in-store sales to grow 7.9% this holiday season. That is faster than its forecast of 4.2% growth in e-commerce sales. According to MasterCard, in-store sales should also benefit from the return of "door-buster" deals.

Tax Forms Reminder

Dear Clients,

Happy Holidays! With the holiday season upon us, we know that another tax season is right around the corner. We recognize how busy you'll be over the next few months, and we are here to assist you. Below is a rough timeline as to when you can expect to receive your tax documents from Exchange Bank for your 2022 income tax reporting:

- **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 18, 2023). 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 for a smooth and easy tax season for all. If you haven't received your tax documents within the time periods specified above, feel free to 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.

Your Exchange Bank Trust and Investment Management Team

What's New in T & I

Exchange Bank Welcomes Greg Finn, Personal Trust Officer

Exchange Bank welcomes Greg Finn to our Roseville office, reporting to Emily Menjou, VP, Trust Fiduciary Manager. In his role, Greg will administer a book of personal trust relationships, including irrevocable trusts, special needs trusts, and managed agency accounts.

Greg brings over 37 years of financial experience in financial services, most recently serving for 13 years as a trust officer and business development officer for Fremont Bank. Greg attended Santa Clara University where he earned both his bachelor's degree in Finance and MBA in International Finance. Greg has also completed a non-degree graduate program at the University of Kent in Canterbury, England and a wine tasting certificate at Las Positas College.

Greg was born in New York but raised in Los Angeles. He now lives in Sacramento with his wife, Karen and their three children. They both enjoy traveling and have enjoyed many trips to Ireland and the UK. Greg also enjoys wine tasting and wine making and belongs to about 10 wine clubs.

Join us in welcoming Greg to the Exchange Bank family!

Emily Menjou
Vice President, 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.

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.

If you would like to be removed from our mailing list, please contact: **ebmarketing@exchangebank.com.**