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

2022 was a year for geopolitics, the global economy and financial markets that most would like to forget. Coming out of the boom of the post-pandemic, stimulus-fueled expansion of 2021, "sticky" inflation, continued regional lockdowns in China, and the largest land-war in Europe since World War II, contributed to an up-and-down economy over the course of the year and the largest and fastest series of interest rate hikes by the Federal Reserve board in four decades. Equity and fixed income markets both declined by double-digit percentages for the first time in recorded history, with bond markets alone having their worst-year ever by total return measures, and by magnitudes greater than anything seen previously.

During the fourth quarter specifically, global equity markets ended the year on a high note, with broad-based gains across major markets. With fears of recession getting pushed back, unwinding of some U.S. dollar strength and continuing record corporate profits, stocks rallied nearly everywhere, with international stocks providing the greatest returns due to lower valuations, a falling dollar and the avoidance (thus far) of a cold winter which could have impacted their ability to fully fuel their economies. Value and small cap stocks outperformed their growth and larger-cap counterparts over both the three- and 12-month time horizons, with large cap growth stocks getting hit especially hard by the rising interest rate environment of the past year.

In fixed income markets, U.S. Treasury yields continued their bear flattening trend with rates continuing to rise as markets continuously re-adjusted expectations for ever more rate hikes before hitting an expected terminal rate at some point in 2023. The shape of the 2s-10s treasury curve moved further into inversion (a historically accurate predictor of recessions), moving from -0.39% to -0.53%

MARKET PERCENTAGE TOTAL RETURNS AS OF DECEMBER 31, 2022

Index	Q4 2022	One Year	Five Years (annualized)	Ten Years (annualized)
Bloomberg U.S. Aggregate Bond Index	1.87	-13.01	0.02	1.06
S&P 500 Index	7.56	-18.11	9.42	12.56
Russell 2000 Index	6.23	-20.44	4.13	9.01
MSCI EAFE Index	17.34	-14.45	1.54	4.67
MSCI Emerging Markets Index	9.70	-20.09	-1.40	1.44

over the course of the quarter. Interest rate increases were more modest than prior quarters though, and fixed income total returns were marginally positive during the fourth quarter, although recovering only a small fraction of what had been lost over the first nine-months of the year. Less interest-rate sensitive sectors of the fixed-income markets, such as credit and municipals outperformed over both the quarter and year as a whole.

Looking ahead, there are still many unanswered questions regarding the direction of both the domestic and global economies, not least of which are the continuing impacts of regional Chinese COVID lockdowns, the war in Ukraine and a coordinated effort by global central banks to reduce generational highs in inflation rates. Historically, periods of central bank rate hiking cycles meant to cool overheating economies have been followed in short order by recessions due to the long and variable lags before the rate hikes' full impact is felt. Often, rates continue to rise into a slowing economy before a swift economic reversal happens, as the Fed may be late to cut rates as the economy slows, similar to how they were late to raise rates while inflation was hitting multi-decade highs. Unfortunately, their track record is not great in this regard; however, timing these inflection points from a financial market standpoint has been a difficult endeavor, and as such, now as always is a great time to review the long-term expected risk/return characteristics of your portfolio as the risk side of equation may remain high for some time.

"Once upon a time there was a magical land where inflation never ran above 2%."

Social Security Changes for 2023: The biggest increase in benefits since 1982!

By Michelle Gordon, *Investment Officer*

Each year, the Social Security Administration revisits the cost-of-living adjustment (COLA) and makes changes to it to reflect increases in inflation and the Consumer Price Index (CPI). The goal is to ensure that recipients of Social Security benefits will maintain their purchasing power and standard of living.

In general, TO BE ELIGIBLE FOR SOCIAL SECURITY BENEFITS AS A WORKER YOU MUST BE:

Age 62 or older, or disabled or blind, and "Insured" by having enough work credits. For applications filed December 1, 1996 or later, you must either be a U.S. citizen or lawfully present alien in order to receive monthly Social Security benefits. Family members who qualify for benefits based on your earnings record may be eligible too.

Take a look at the 2023 Social Security changes, how they may affect your financial situation, and how to maximize your benefits.

2023 Social Security Changes Include:

- **Increase in COLA by 8.7%**. The amount you receive may be different depending on your work credits. The average monthly Social Security benefit is currently $1,681. With an 8.7 percent COLA increase, the average monthly Social Security benefit in January will be $1,827.
- **Increase in Income Threshold for Disabled.** Currently, those with a disability and working can earn up to $1,350 monthly and still receive benefits. This earning threshold will increase to $1,470 next year; therefore, you can earn more and still qualify for benefits.
- **Increase in Income Threshold for Early Retirees.** For those who choose to file for Social Security early (ages 62 to 66), there is a preset income threshold of how much they can earn as income without having some of their monthly benefit withheld. That threshold is increasing from $19,560 to $21,240.

- **Increase in Taxable Earnings Cap.** Employees and employers pay the payroll tax on wages and salaries up to $147,000. This amount is increasing to $160,200; therefore, higher earners will owe more tax.
- **Increase in Maximum Payout at Full Retirement Age.** At full retirement age retirees become eligible for 100% of their Social Security benefits. This amount will rise from $3,345 per month to $3,627 monthly.

How These Changes Affect You?

In General:

1. **Increase in Taxes Owed.** The majority of people receiving Social Security pay taxes on the benefits they collect. Receiving higher monthly checks can move you into a higher federal tax bracket. California taxes Social Security benefits, so you may owe state tax too.
2. **Increase in Medicare Costs.** The premiums for Part B (doctors) and Part D (medications) have an income-related threshold. So, if your monthly Social Security benefit increases, you may need to pay higher premiums.
3. **Ineligibility for Certain Programs.** Receiving an increase in Social Security monthly benefits can put some people over the threshold, no longer qualifying for assistance from Medicaid, nutrition assistance, disabled veterans' assistance, etc.

How Can You Maximize Your Social Security Benefits?

- **Earn Income for 35 Years or More.** The Social Security Administration (SSA) takes the figure you earned from the 35 highest earning years and computes what benefit you will receive when you reach your full retirement age.
- **Continue to Earn Income Past Age 60.** Any annual income earned after 60 years old can fill in for a previous lower earning year. This can make a big difference in the benefits you receive!
- **Wait Until Full Retirement Age.** There are some who need or want to take their benefits starting at age 62. But patience pays off for those who can wait to collect benefits. Waiting until 67 or 70 to collect yields even higher benefit checks.
- **Reduce Taxes on Benefits.** Moving to another state that does not collect taxes on SSA benefits is one option, but there are less drastic measures like contributing to retirement accounts like Roth IRAs, Roth 401(k)s, etc. to help reduce your taxes in your retirement years.

Give us a call. We're here to help!
We advise you to prepare and educate yourself now so you can make the most of the changes. Our Trust and Investment Management team is here to assist and offer you support.

Recent Economic Highlights

By Argus Research Company

GDP GREW 2.9% IN 4Q22
According to the "advance" estimate released by the Bureau of Economic Analysis, U.S. GDP expanded in 4Q22 at an annualized rate of 2.9%. Areas of strength included personal consumption expenditures on services, which rose at a 2.6% rate; personal consumption expenditures on durable goods, which rose at a 1.1% rate after falling over the previous three quarters; investment into intellectual property products, which advanced at a 5.3% rate; net exports, as exports grew 14.4% and imports declined 6.9%; government spending, which was up at a 3.7% pace; and inventories. Segments of the economy that struggled included investment in equipment (down 3.7%); exports of goods (down 7.0%); and residential investment (down 26.7%). The GDP report also contains data on inflation. The PCE price index rose 3.2% in 4Q, compared to a 4.8% increase in 3Q. Excluding food and energy prices, the PCE price index increased 3.9%, compared to an increase of 4.7% in 3Q. In our view, the report indicates that the Fed's rate hikes are already having an impact on economic conditions, as inflation has moderated and the housing sector is slumping. But the consumer remains resilient, with the pick-up in spending on durable goods a clear bright spot.

2023: A GLOBAL TROUGH YEAR
Global economic growth is expected to slide in 2023 before turning higher in 2024, according to the latest World Economic Outlook from the International Monetary Fund. The potential pick-up in 2024 assumes benefits from economic reopening in China, offset by the ongoing war in Ukraine and higher interest rates. The global economy is expected to expand at a 2.9% rate in 2023 after growth of 3.4% in 2022. In 2024, growth is expected to accelerate to 3.1%. All of these

rates are below the long-term historical global growth rate of 3.8%, due largely to the impact of inflation and higher interest rates. For industrialized economies, the IMF calls for miniscule growth of 1.2% in 2023 and 1.4% in 2024. For emerging economies, it expects growth of 4.0% in 2023 and 4.2% in 2024. The clear leaders are expected to be China and India, driven by population growth in India and productivity growth in China.

INFLATION CONTINUES TO EASE

The Bureau of Labor Statistics reported a 6.5% year-over-year increase in overall inflation in December, down from 7.1% in November and 9.1% back in June. Core inflation, excluding the impact of food and energy prices, also declined to 5.7% in December from 6.0% in November. The consensus forecasts had called for a 6.7% overall inflation rate and a 5.6% core rate. The overall rate benefited from falling energy prices (down 4.5% from the prior month), as well as from lower prices for new and used cars and commodities. The increase in transportation prices was modest at just 0.2%. But food and shelter inflation remained elevated (up 10.4% and 7.5% year-over-year, respectively). We think that the 9.1% CPI rate in June will prove to be the peak reading for this cycle, as the housing market cools, supplies of new vehicles are replenished, and oil stays below $90 per barrel. Even so, the Fed still has wood to chop in order to bring core inflation down to its target rate of 2.0%.

Marin County...Here we Come!

Dear Clients and Friends,

It is our great pleasure to announce the expansion of our Trust and Investment Management services into Marin County. Our new office, located near the Marin Civic Center at 3950 Civic Center Drive in San Rafael, is currently under construction and is set to open this summer.

Through our co-founder, Frank Doyle, and his early championing for the creation of the Golden Gate Bridge, we have deep ties connecting Exchange Bank to the Marin/San Francisco area which makes moving into Marin County a natural next step.

Exchange Bank has been offering full-service Trust and Investment Management services since 1963 and we are one of California's largest community bank trust departments with over $1.3 billion in assets under administration.

With offices in Santa Rosa, Roseville, Los Altos and now Marin, our experienced team provides professional, personalized services in the areas of:

- Trust Administration
- Estate Settlement
- Investment Management
- Retirement Services (IRA and plan management)

I will initially lead the office while we search for the right mix of experienced, local professionals in Marin County to join our team. We look forward to building strong relationships with families, businesses and professionals in Marin County.

Emily Menjou
Vice President & Personal Trust Fiduciary Manager

Emily Menjou brings 15 years of experience in trust administration and estate settlement. Menjou is a 2023 recipient of the American Banking Association's Under 40 Wealth Management Award, which recognizes wealth management and fiduciary professionals who are committed to the highest standards of achievement at work and in their communities.

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.**