Exchange Bank

Trust & Investment Management

TRUST & INVESTMENT UPDATE

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TRUST & INVESTMENT MANAGEMENT GROUP

Articles by:

Matthew C. Kelman
Vice President & Institutional Trust Fiduciary Manager

Emily Menjou
Vice President, Personal Trust Fiduciary Manager

Michelle Gordon
Investment Officer

Argus Research Company

Santa Rosa Office **707.524.3151**
Roseville Office **916.782.0123**
Silicon Valley Office **650.548.3100**

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Investment Review and Outlook

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

The first quarter of 2023 saw a continuation of many of the economic themes from the back half of the last year, with inflation staying elevated, unemployment at generational lows and central banks around the world focused on interest rate hikes to slow the global economy, the full impacts of which are only now starting to come into view. Residential housing and smaller technology companies were some of the first sectors of the economy to be impacted by increasingly tight credit conditions, but the traditional financial sector has also started to see the negative impacts due to the size and speed of the current hiking cycle. All of these add incrementally to even further tightening of credit conditions that should be expected in the months/quarters ahead which should also weigh on the economy and eventually inflation statistics, although a full-blown recession may be required to bring inflation down to the Federal Reserve's current target of 2%.

Additionally, the war in Ukraine passed its one-year mark in February, with economic and humanitarian tolls continuing to mount, the full ramifications of a de-globalizing world will take years to fully manifest. The possibility of a new cold war between the traditional western powers and a more separate sphere of influence surrounding China and its neighbors is something that may take decades to fully play out, but will continue to add volatility to economies, commodities, and supply chains in the nearer term.

During the first quarter, global equity markets saw broad-based gains, as resilient economic data, better than expected corporate earnings, and a drop in discount rates due to banking turmoil towards quarter-end allowed long duration risk markets to advance. Mega-cap Tech companies with significant current cash flows again led the market causing

MARKET PERCENTAGE TOTAL RETURNS AS OF MARCH 31, 2023

Index	Q1 2023	One Year	Five Years (annualized)	Ten Years (annualized)
Bloomberg U.S. Aggregate Bond Index	2.96	-4.78	0.91	1.36
S&P 500 Index	7.50	-7.73	11.19	12.24
Russell 2000 Index	2.74	-11.61	4.71	8.04
MSCI EAFE Index	8.47	-1.38	3.52	5.00
MSCI Emerging Markets Index	3.96	-10.70	-0.91	2.00

Growth stocks to outperform Value domestically, and large caps outperforming small. International stocks outdid their US counterparts by small margins this quarter as a falling dollar and cheaper valuations pushed developed markets relatively higher. Emerging markets also posted positive returns, although to a lesser extent due partly to commodity volatility on the slowing global economy. Overall, it was a positive quarter for a majority of the world's equity markets.

In fixed income markets, volatility reemerged with the Fed continuing its rate hiking campaign due to still elevated inflation concerns. These hikes pushed the Fed Funds rate to the highest levels since prior to the Global Financial Crisis, while also continuing to flatten the Treasury yield curve, with the 2s-10s spread moving further into inversion from -0.53% to -0.58%. The recent drop in longer-term rates coincided with the banking turmoil that first emerged in early March, and could be a precursor to larger financial system stresses and eventual recession. In the meantime, credit has continued to hold up well as recession predictions continue to get pushed back, while duration outperformed due to its multiplier effects on bond valuations.

Looking ahead, increasing stresses on the global economy emanating from coordinated tightening of credit conditions as well as geopolitical hostilities will likely bring down the elevated inflation that came from the unprecedented fiscal and monetary stimuli that were created in the wake of the COVID-19 pandemic. The economy overall has been more resilient than most economists had predicted, given the speed and magnitude of interest rate increases by central banks, but inflation remains well above the comfort level of most monetary authorities. Historically, central banks don't have a great track record of knowing the appropriate time to stop a rate hiking cycle in order to avoid recession, partly due to the long and variable lags that can occur between the hikes themselves and their impact on the economy. The fact that predictions for recession keep getting pushed back shows that this cycle may be different than what we have seen previously, but the impacts on markets, only tangentially connected to the economy, may be difficult if not impossible to predict in the year ahead.

How Does SECURE Act 2.0 Affect You?

By Michelle Gordon, *Investment Officer*

The SECURE Act 2.0 is now law, implementing changes this year and for the next 10 years!

Most of the new law's provisions are not effective until January 1, 2024 and following; however, some provisions are effective immediately. Highlights include: increasing the age at which retirees must begin taking Required Minimum Distributions (RMDs) from IRA and 401(k) accounts, catch-up contributions for older workers with workplace plans, changes to help younger people continue saving while paying off student debt, and saving for emergencies within retirement accounts.

Are You Near Retirement?

- **The required minimum distribution (RMD) age has been raised again!** It has increased from 72 years old to 73 and to 75 in 2033. Note*: If you turned 72 in 2022 or earlier, continue taking RMDs as scheduled. If you're turning 72 in 2023 and have already scheduled your withdrawal, you may want to consider updating your withdrawal plan.*
- **Turning 72 in 2023?** *Decide when to take your first RMD: Either by December 31, 2024, or delay until no later than April 1, 2025. Remember, if you delay your first RMD to April 1, 2025, you'll need to take two RMDs in one tax year: Your first by April 1, 2025, satisfying your required withdrawal for 2024, and your second by December 31, 2025, which satisfies your required withdrawal for 2025.*
- Higher employer retirement plan catch-up contribution limits start in 2025. The amount will increase to $10,000 for those 60 to 63 years old. *One caveat: If you earn more than $145,000 in the prior year, all catch-up contributions at age 50 or older will need to be made to a Roth account in after-tax dollars. If you earn $145,000 or less, adjusted for inflation going forward, you will be exempt from the Roth requirement.*
- IRA catch-up contribution limit for people age 50 and older is increasing starting in 2024. The limit will be indexed to inflation (i.e. may increase every year based on federally determined cost-of-living increases).
- RMDs will no longer be required from Roth accounts in employer retirement plans in 2024.

- Those who are 70½ and older may now elect as part of their Qualified Charitable Distributions (QCDs) a one-time gift up to $50,000 (adjusted annually for inflation) to a charitable remainder unitrust, a charitable remainder annuity trust, or a charitable gift annuity. This amount counts toward the annual RMD, if applicable. *Note: For gifts to count, they must come directly from your IRA by the end of the year. QCDs cannot be made to all charities.*

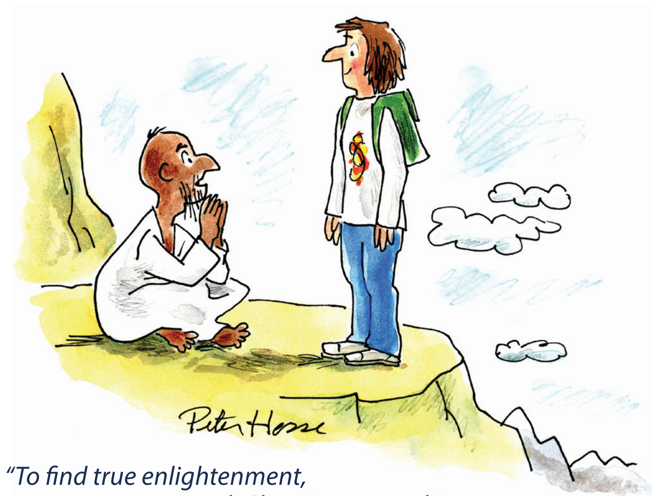
Are You Years Away from Retirement?

- Businesses adopting new 401(k) and 403(b) plans will automatically enroll eligible employees, starting at a contribution rate of at least 3% in 2025. The automatic transfer of a participant's account valued at under $5,000 into the new employer's retirement plan is now in place too (unless the participant chooses otherwise).
- Defined contribution retirement plans will be able to add an emergency savings account associated with a Roth account.
- Beginning in 2024, employers can make employer matching contributions for their employees' student loan payments, even if the employees aren't contributing to their plan. *These contributions could help employees who are paying off their student loans to start saving sooner, and/or more, for retirement!*
- After 15 years, 529 plan assets can be rolled over to a Roth IRA for the beneficiary, subject to annual Roth contribution limits and an aggregate lifetime limit of $35,000. *Note: Rollovers cannot exceed the aggregate before the 5-year period ending on the date of the distribution. The rollover is treated as a contribution towards the annual Roth IRA contribution limit.*

Final Thoughts
While SECURE 2.0 provides increased opportunities to save for retirement, everyone's financial situation is different. As always, consult your financial advisor or tax professional to understand how SECURE 2.0 changes specifically apply to you. Below are a few more helpful resources.

- SECURE 2.0 Section-by-Section Summary: https://www.finance.senate.gov/download/retirement-section-by-section-
- Various Blogs and Analyses: https://www.napa-net.org/secure-20
- Big Picture View of Savings Needed for Retirement: https://www.nerdwallet.com/investing/retirement-calculator

We advise you to prepare and educate yourself now, so you can make the most of the changes this year and for the next 10 years. As always, our Trust and Investment Management team is here to assist and offer you support. Give us a call. We're here to help!



"To find true enlightenment, you may want to ask Chat GPT instead."

Recent Economic Highlights

By Argus Research Company

UNEMPLOYMENT RATE DROPS TO 3.5%
The U.S. economy generated 236,000 new jobs in March, largely in line with consensus expectations. The unemployment rate dropped to 3.5% from 3.6% in February, remaining near January's 54-year low of 3.4%. The report suggests that the economy is still too strong for the Fed to pause its rate hike campaign. Average hourly earnings increased nine cents from the prior month and are now 4.4% higher year-over-year -- but an increase in the labor participation rate may limit wage increases. In March, job gains occurred in leisure and hospitality, government, professional and business services, and healthcare. Industries absent from the outsized gains included mining, quarrying, oil and gas extraction, construction, manufacturing, wholesale trade, and financial activities. February's job gains were revised higher to 326,000 from 311,000, suggesting that the consumer segment of the economy may grow for a few more months, despite the impact of interest rate hikes and the failure of Silicon Valley Bank. The number of job openings in February decreased by 632,000 according a separate report, but it is hard to imagine the Fed easing with 9.9 million openings for 5.8 million unemployed.

DOLLAR DROPS FROM HIGHS

The dollar has drifted 5% from its cycle high thus far in 2023, falling in part as the outlook for further rate hikes has cooled. The greenback spiked early in the pandemic, peaked in April 2020, declined into 2021, but then rose again for much of 2022, driven by the Russian invasion of Ukraine, soaring inflation, and higher global interest rates. By October, on a real trade-weighted basis, the dollar was 23% above its average valuation over the past 20 years. But inflation in the U.S. has trended lower since peaking in the summer, and the Fed is winding down its rate hike campaign. Meanwhile, Middle East sovereign wealth funds have become less risk averse and have been investing their windfall Petro-dollars in other markets.

HOME IMPROVEMENT SPENDING POISED TO SLOW

The pace of home improvement activity is poised to slow in 2023, according to the Leading Indicator of Remodeling Activity (LIRA) from Harvard University's Joint Center for Housing Studies. The LIRA helps forecast activity and turning points in the $475 billion national repair and remodeling market. It projects 14.1% year-over-year growth in remodeling activity in 1Q23 and 9.9% in 2Q, followed by deceleration to 5.8% in 3Q23, and 2.6% in 4Q23. The National Association of Home Builders' NAHB/Westlake Royal Remodeling Market Index (RMI) tells a similar story. In the fourth quarter of 2022, the RMI declined by 17 points year-over-year to 66, but continued to signal positive sentiment. The index scale is 0-100, and values over 50 indicate that a higher percentage of remodelers view conditions as good. The Current Conditions component of the RMI slipped to 75 in 4Q22 from 89 a year earlier. The Future Indicators component dropped to 58 from 77, as backlogs declined and the pace of new inquiries slowed. Home improvement activity may be slowing, but we don't expect a significant drop. Residential fixed investment currently sits at 4% of GDP, below the post-World War II average of 4.6% and well below the peak of 6.7% before the Great Recession. In addition, more than half of U.S. homes are over 40 years old and in need of repairs. Some 90% of homeowners also have locked-in mortgage rates, many near pandemic lows around 3%. They may make improvements rather than moving.

Exchange Bank Trust and Investment Management – Marin Office Opening in June!

Dear Clients and Friends:

We are proud to announce the opening of our new Trust and Investment Management office in Marin County. The construction of our new office, located near the Marin Civic Center at 3950 Civic Center Drive in San Rafael, is finally complete as of June 1st.

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.**