CAMBRIDGE TRUST

PRIVATE BANKING WEALTH MANAGEMENT

# Markets & Economic Update *and* Tax Updates - 2022

Client Video Conference Call - November 30, 2022

# Economic Update & Outlook

# Themes & Agenda
*(…a look inside a CT Asset Allocation meeting)*

**Risks:**

**Sticky Inflation, Aggressive Fed, Margin/Earnings Pressure, US/Global Recession, Ukraine/Geopolitics, Weather (Diesel, etc.), Housing, China COVID outbreaks, Layoffs Rising**

**VERSUS**

**Supports:**

**Good Balance Sheets, Inflation Peaked, Labor Strong (for now), US COVID Easing, Ukraine Resolution?, Valuation?, Peak Pessimism?, Buybacks, End of Tax Loss Selling and Clean Slate for the New Year**

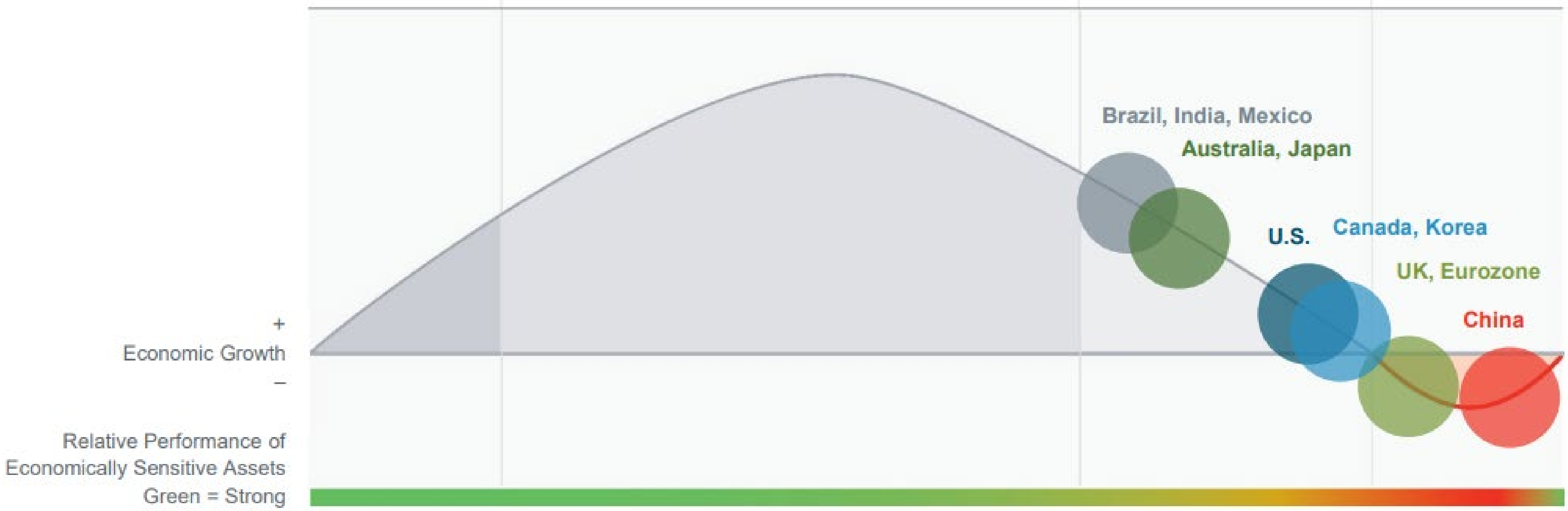
<u>Current positioning to re-underwrite</u>

1. Underweight equities
2. Neutral / market weight bonds
3. Moderate overweight to cash
4. Overweight to Alternatives (0% in benchmark) via call-writing fund

# Business Cycle Trending Down

## Business Cycle Framework

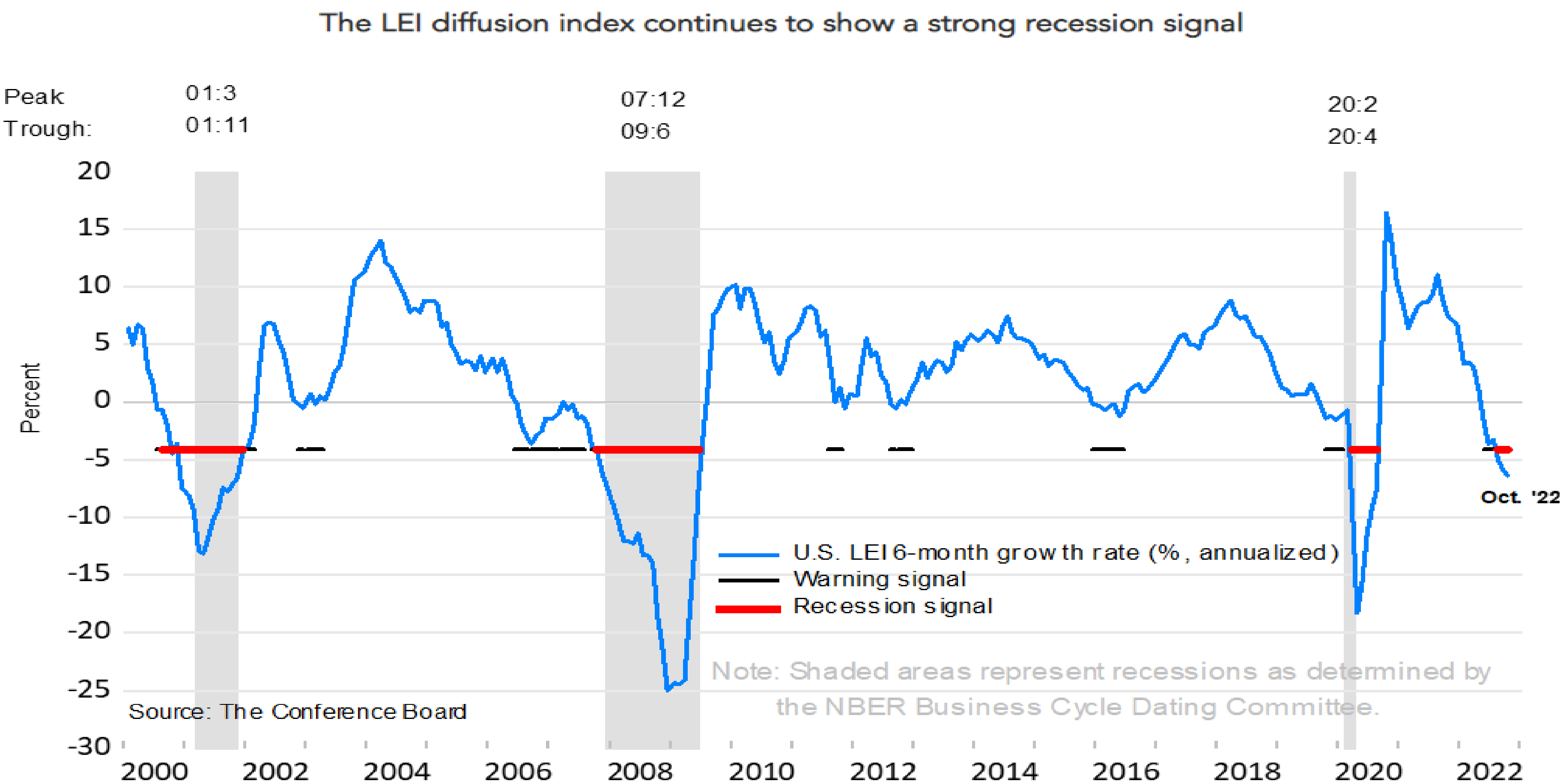
| Cycle Phases | EARLY | MID | LATE | RECESSION |
|---|---|---|---|---|
| | • Activity rebounds (GDP, IP, employment)<br>• Credit begins to grow<br>• Profits grow rapidly<br>• Policy still stimulative<br>• Inventories low; sales improve | • Growth peaking<br>• Credit growth strong<br>• Profit growth peaks<br>• Policy neutral<br>• Inventories, sales grow; equilibrium reached | • Growth moderating<br>• Credit tightens<br>• Earnings under pressure<br>• Policy contractionary<br>• Inventories grow, sales growth falls | • Falling activity<br>• Credit dries up<br>• Profits decline<br>• Policy eases<br>• Inventories, sales fall |




Source: Fidelity

The U.S. is in the late cycle expansion phase with rising risk of tipping into a recession. More banks are tightening their lending standards and a chorus of layoff announcements may suggest employment may weaken.

# Leading Economic Indicator Signaling Recession




"The downturn in the LEI reflects consumers' worsening outlook amid high inflation and rising interest rates, as well as declining prospects for housing construction and manufacturing." Altaman Ozzildirim (Senior Director at the Conference Board)

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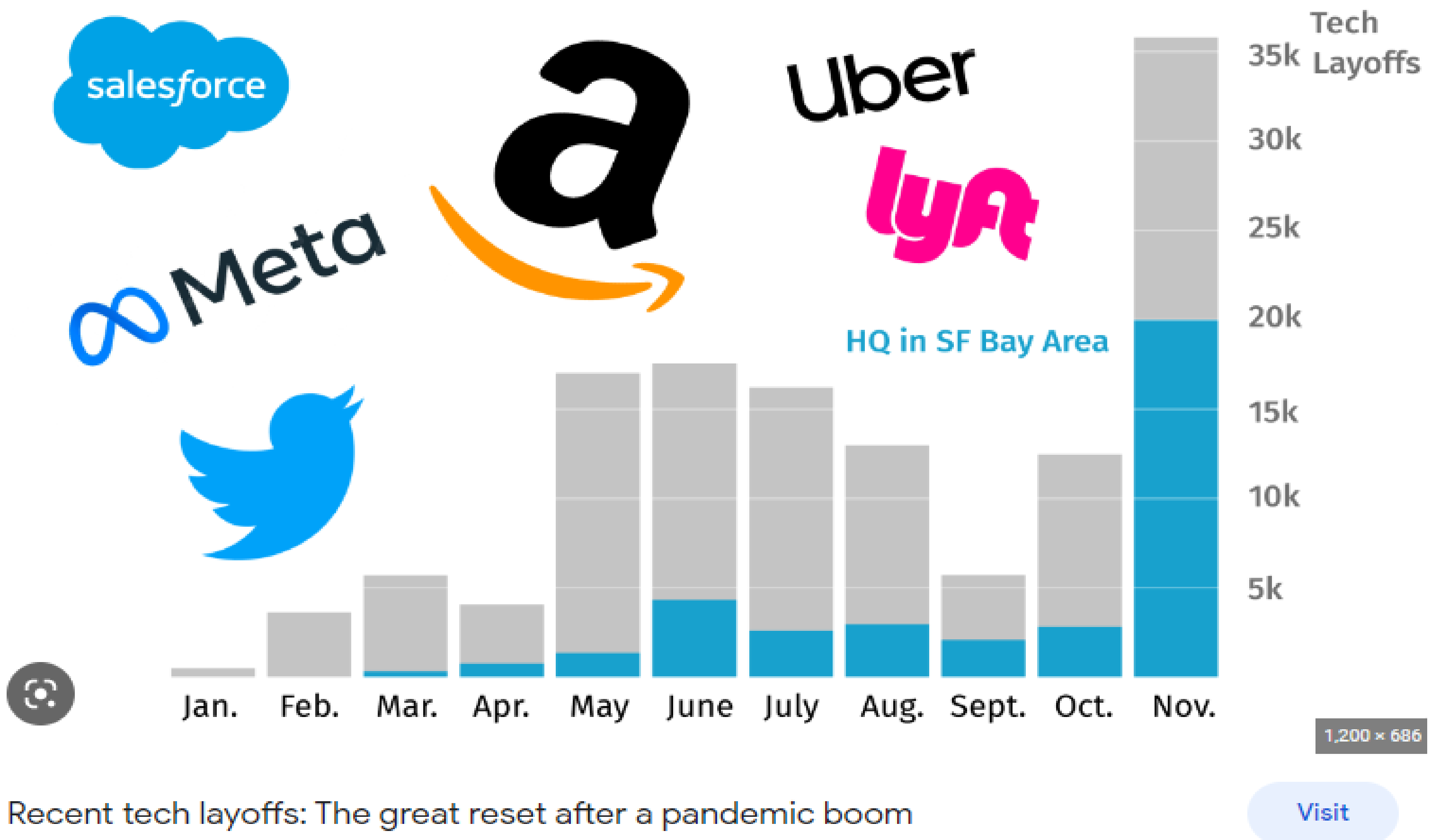
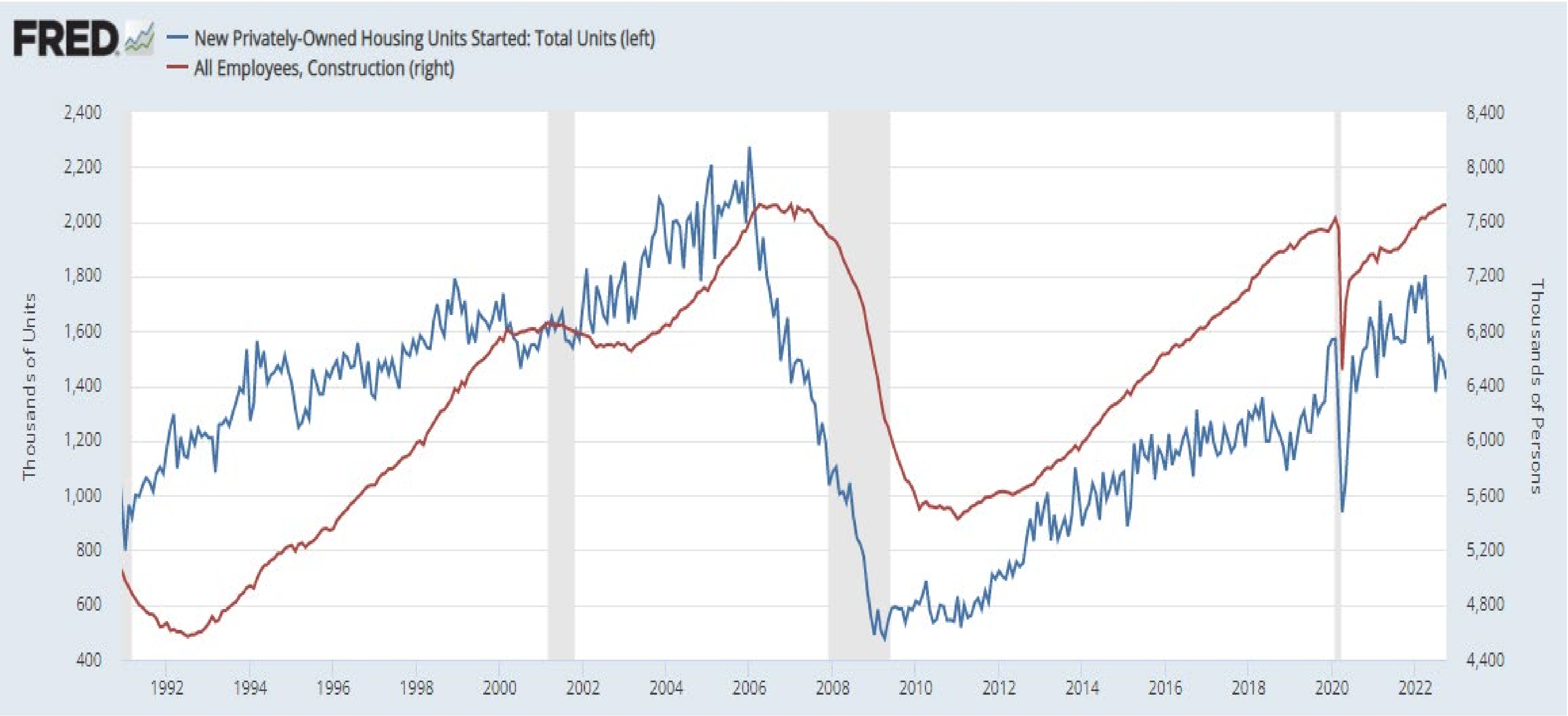
# Tech Layoffs Growing




Source: missonlocal.org and layoffs.fyi -- 11/17/22

Tech layoffs are accumulating. The industry is resetting staff levels after a period of over hiring and hoarding talent.

# Weaker Housing --> Weaker Construction Employment?



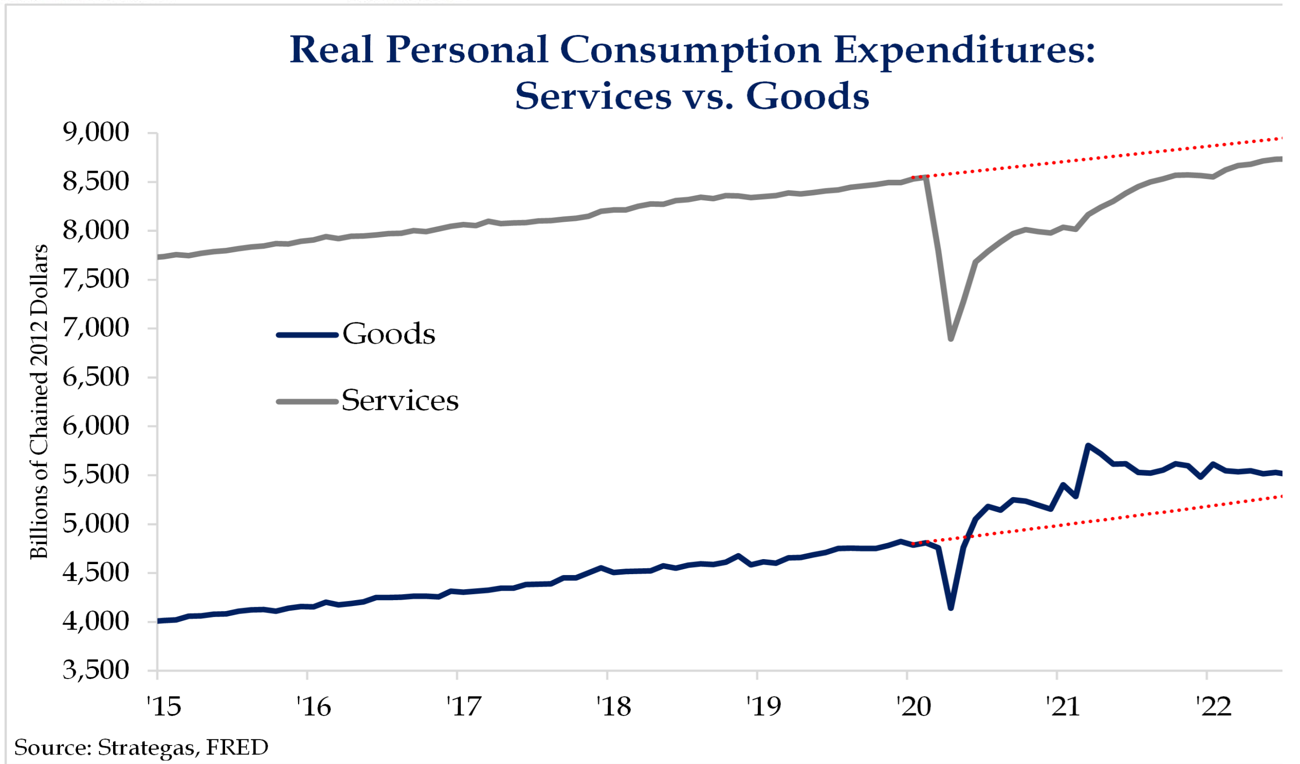

Source: St. Louis Federal Reserve

The rolling over of housing starts is likely to eventually move construction employment lower.

# Inflation Rolling Over and Consumption Mean Reverting

**Exhibit 4:** If Inflation really is a monetary phenomenon, it's headed a lot lower next year

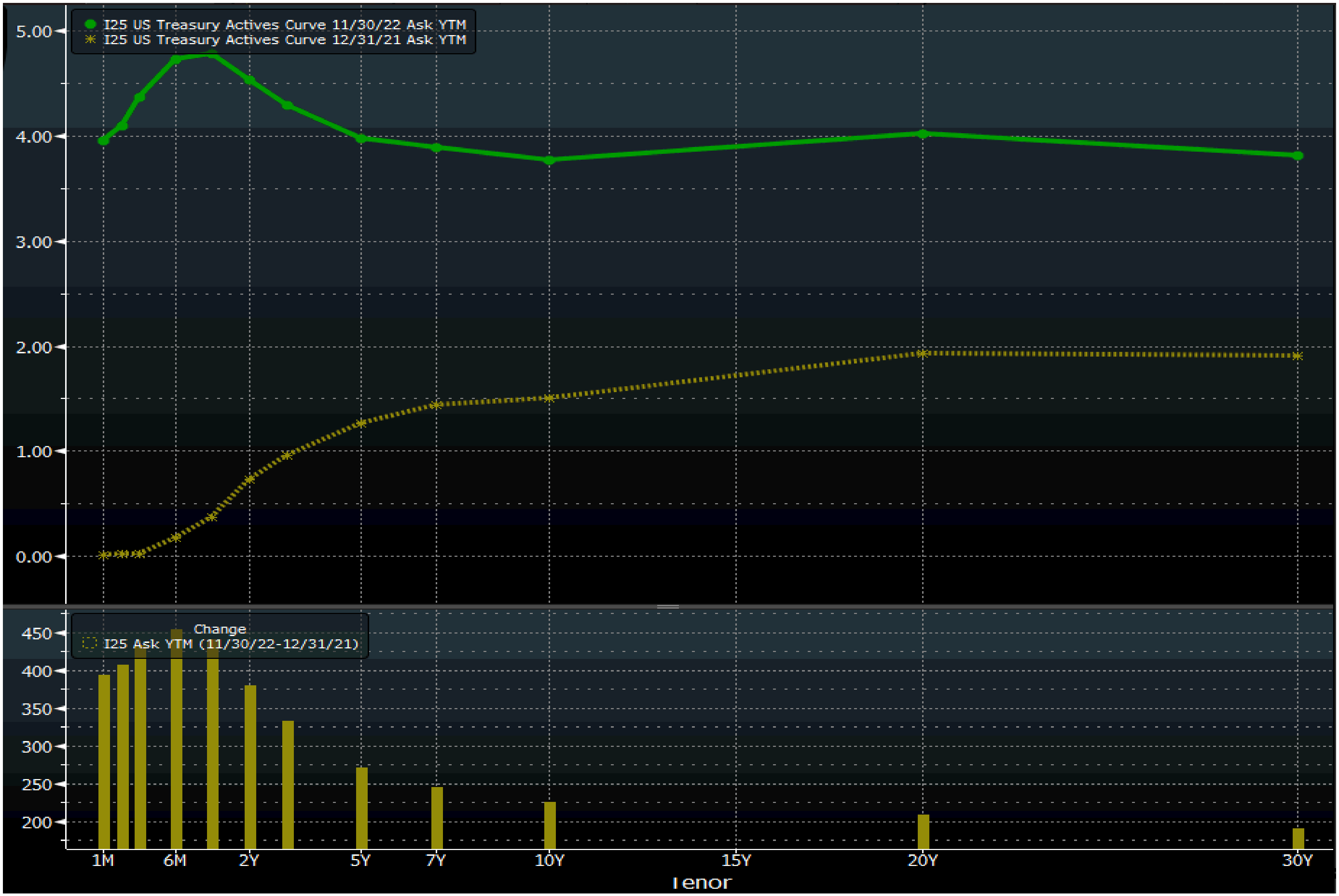

Source: Bloomberg, Morgan Stanley Research




Source: Strategas, FRED

11/25/2022

# US Bond Yield Curve – 2023: Much Higher & Deeply Inverted

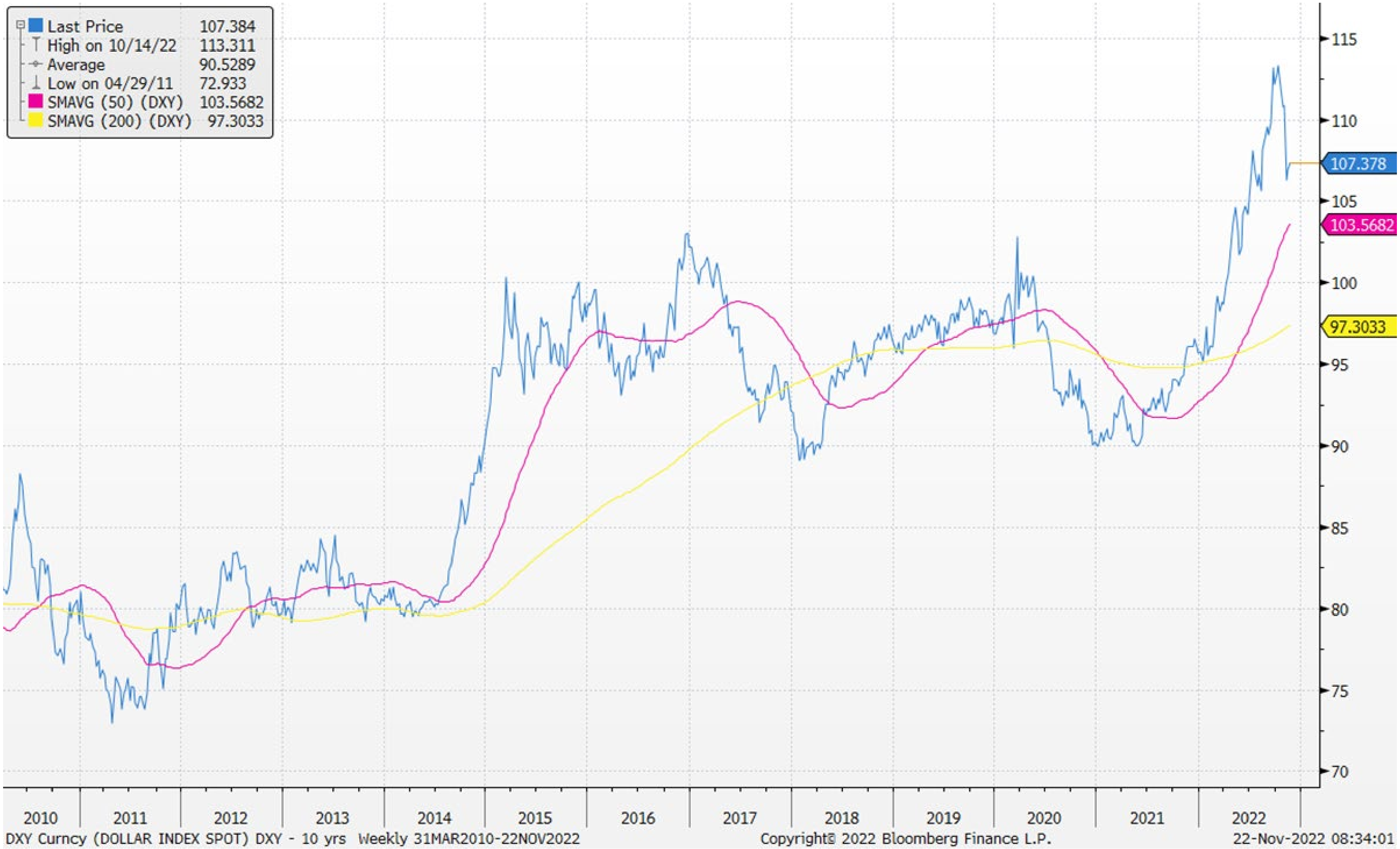



Source: Bloomberg

# Corporate Bond Yields Competitive with Equities Again


Source: Bloomberg

# Will the US Dollar's Downturn Continue?




Source: Bloomberg

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# Global Equities

# A Painful Year

## S&P 500 Index


Source: CNBC 11/28/22

The stock market fell by 24% at its low in early October but has since rallied on a lower-than-expected CPI print along with the unknowns of the mid-term election and Q3 earnings season mostly behind us.

# Sector Rotation: Energy Still the Top Performer


Source: Bloomberg– Data as of 11/25/22

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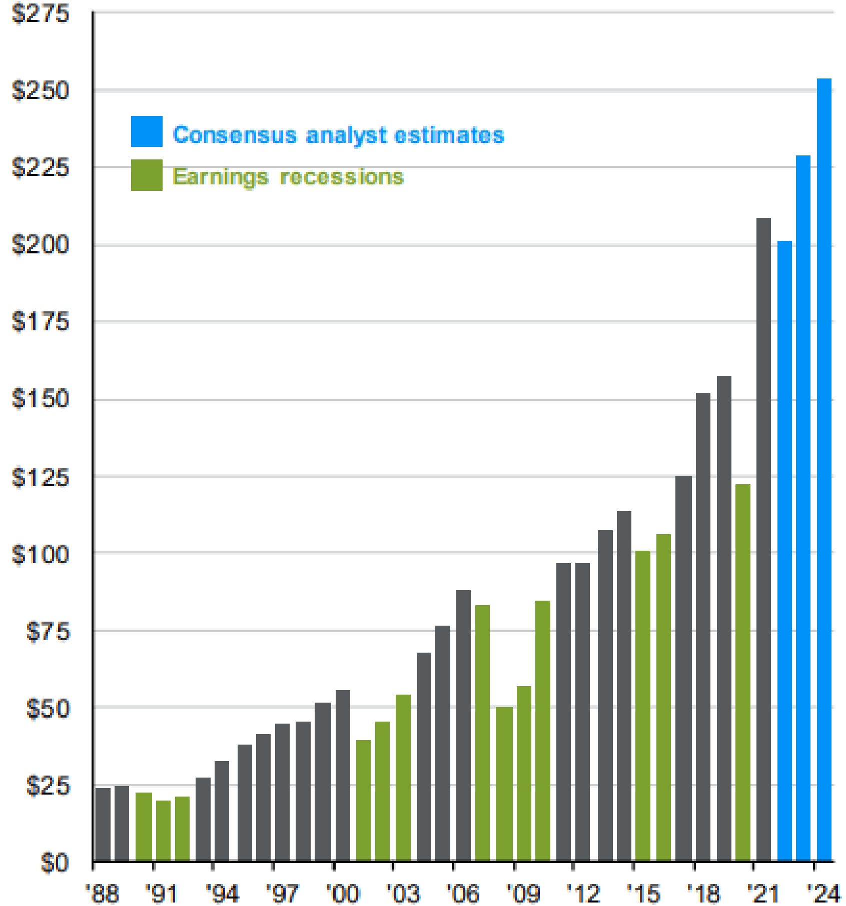
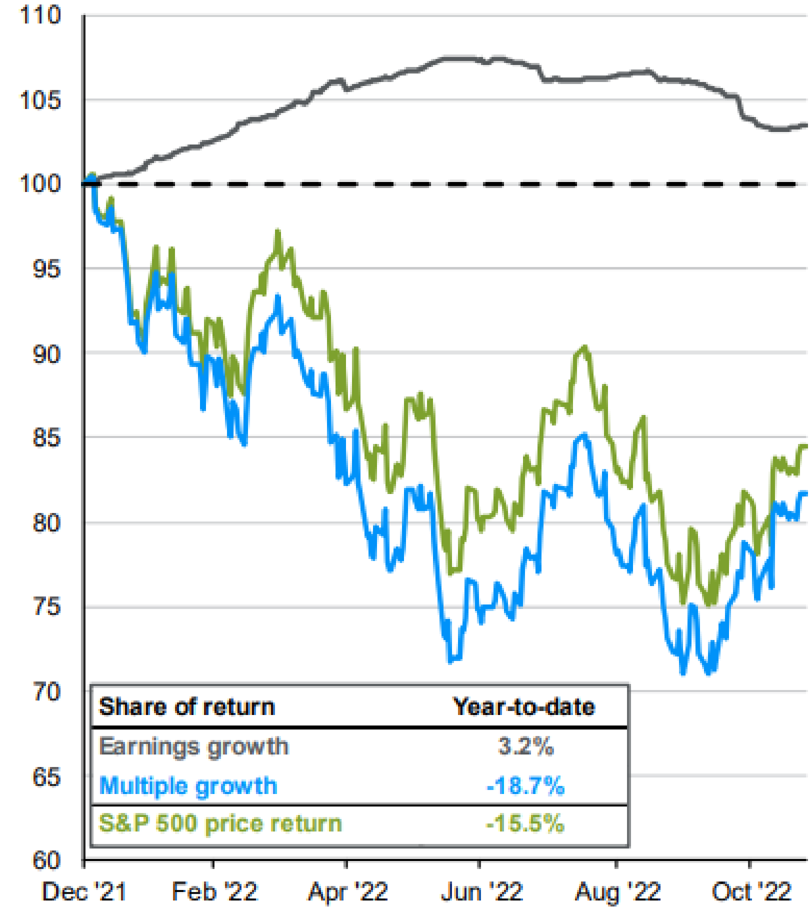
# S&P Earnings and Sources of Total Return

**S&P 500 earnings per share**
Index annual operating earnings




**Percent change in S&P 500, earnings and valuations***
Year-to-date, indexed to 100




Source: Compustat, FactSet, Standard & Poors, JP Morgan. - Data as of 11/28/22

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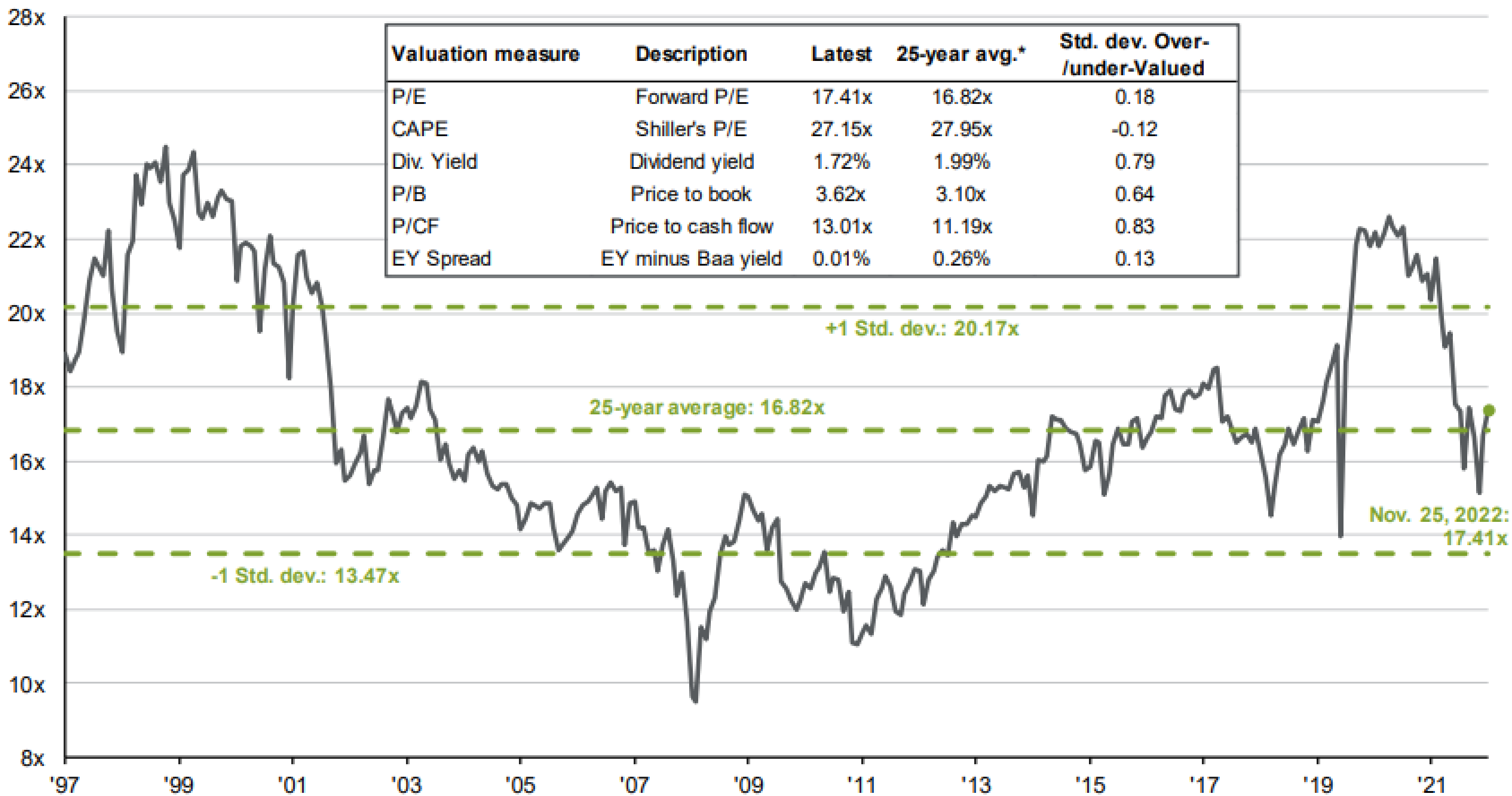
# Valuation: Better, But Still Not "Cheap"

**S&P 500 Index: Forward P/E ratio**

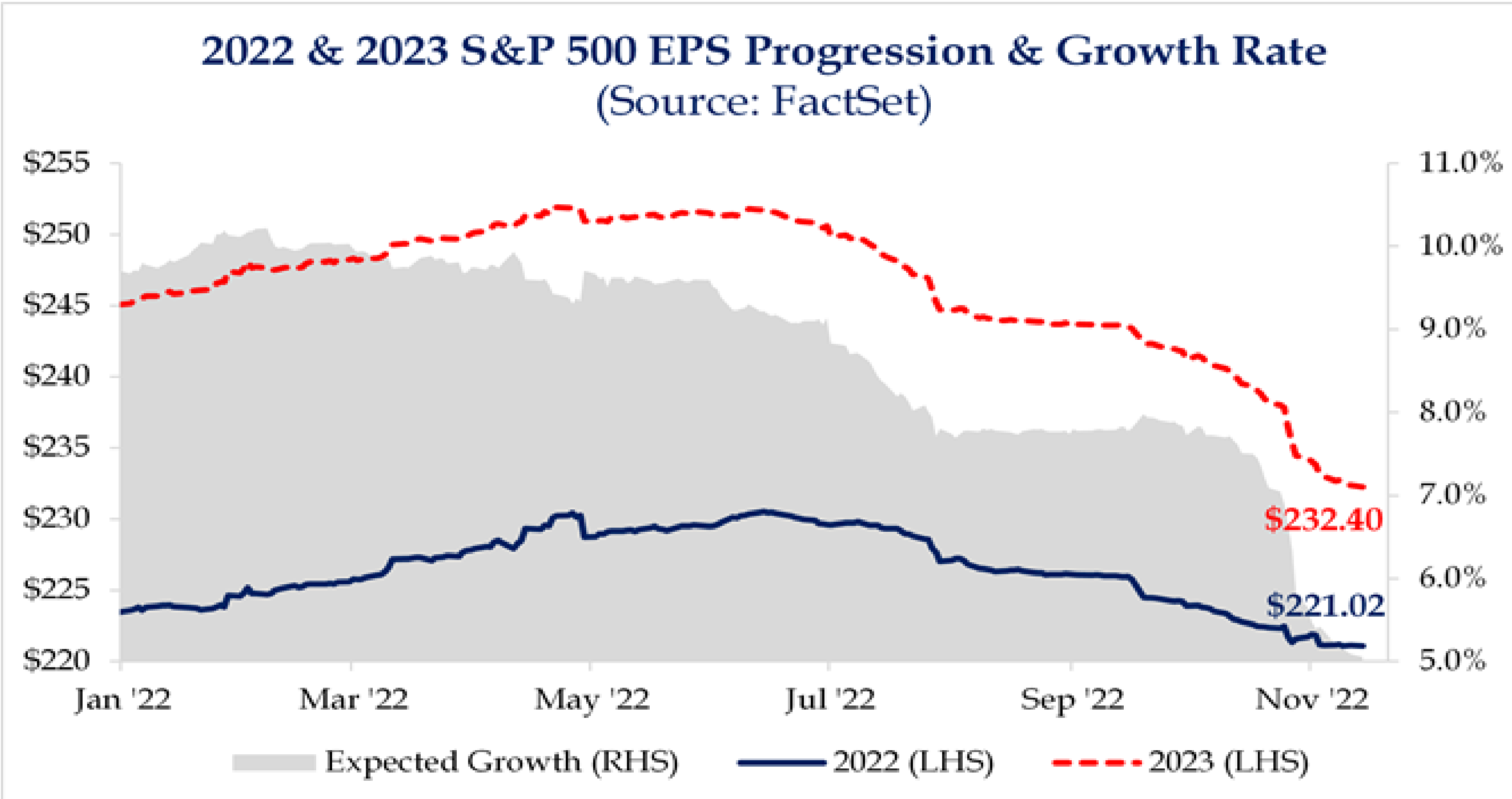



| Valuation measure | Description | Latest | 25-year avg.* | Std. dev. Over-/under-Valued |
|---|---|---|---|---|
| P/E | Forward P/E | 17.41x | 16.82x | 0.18 |
| CAPE | Shiller's P/E | 27.15x | 27.95x | -0.12 |
| Div. Yield | Dividend yield | 1.72% | 1.99% | 0.79 |
| P/B | Price to book | 3.62x | 3.10x | 0.64 |
| P/CF | Price to cash flow | 13.01x | 11.19x | 0.83 |
| EY Spread | EY minus Baa yield | 0.01% | 0.26% | 0.13 |

Source: JP Morgan - Data as of 11/28/22

Stock market valuation, in terms of price-to-earnings ratio (P/E) has fallen dramatically in 2022, as stock prices have fallen while corporate earnings have held on to mild growth. Valuation is currently near the 25-year average. A primary concern is that earnings expectations will fall further, which may drive prices lower still.

# 2022 and 2023 EPS Progression

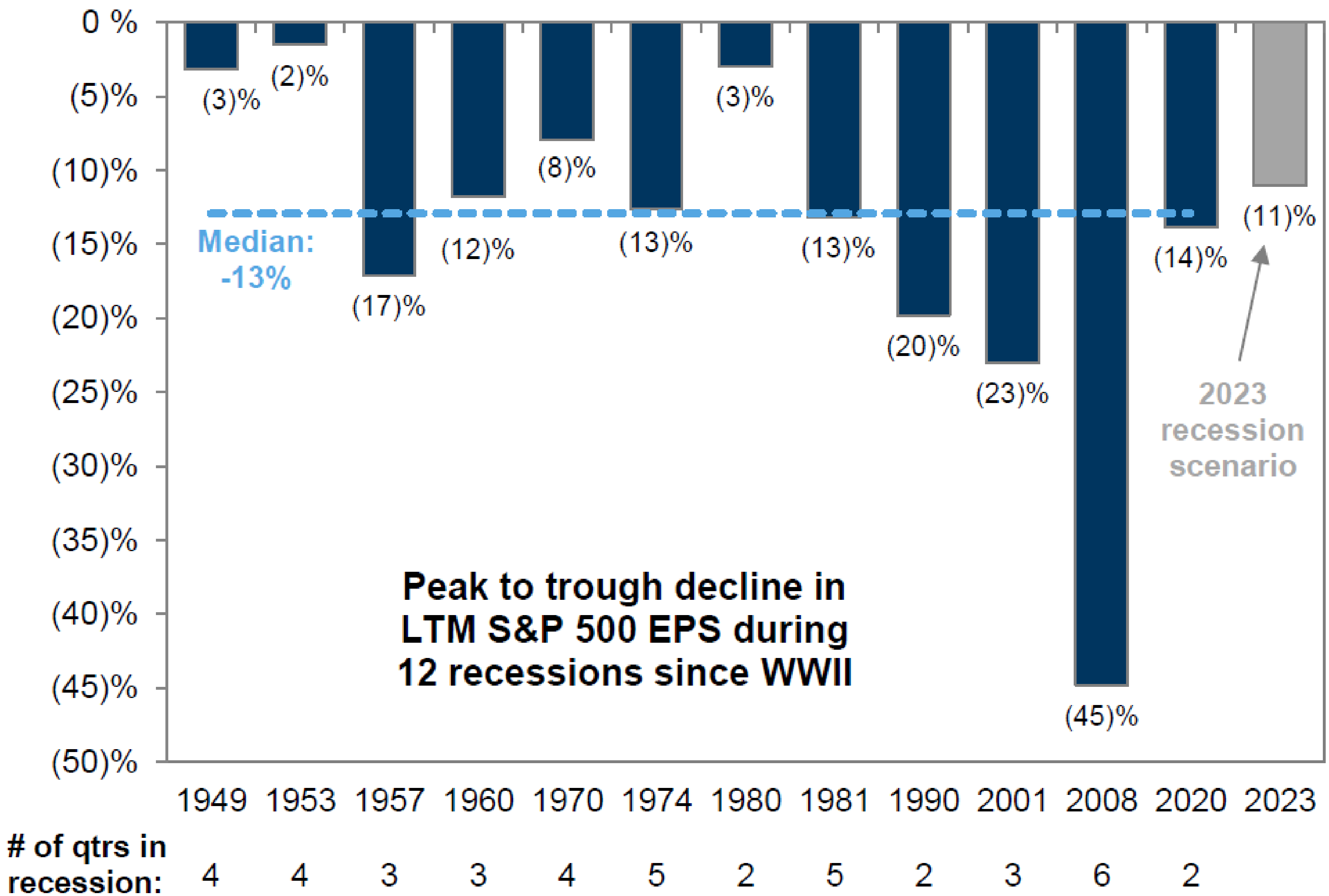



Source: FactSet, Strategas - Data as of 11/23/22

**2023 EPS Decline Slows With Earnings Season Commencing**

The 2023 EPS estimate saw a significant decline during the quarter and has currently settled just above $232, with the growth rate for next year declining to 5.1%. As a result, we continue to believe that this figure needs to be revised lower. However, over the next six weeks lower revisions will likely slow as earning season wraps up as we enter the wait-and-see mode again. ***-- Strategas - Data as of 11/23/22***

# S&P 500 Recession Earnings Declines




Source: Goldman Sachs Global Investment Research - Data as of 11/21/22

# S&P 500 Q3 – Earnings Growth

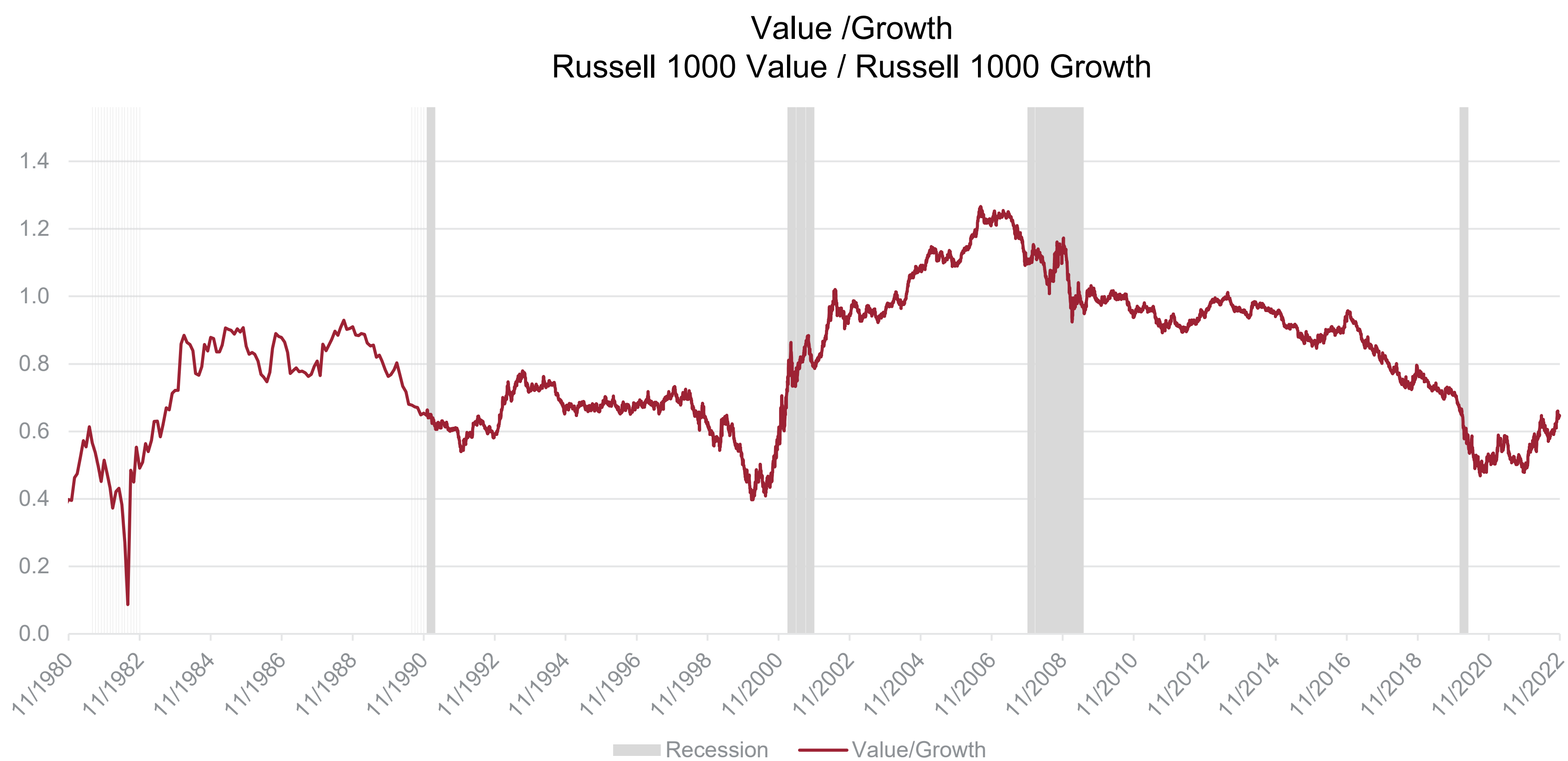
S&P 500 INDEX

Surprise | Growth

| Sector (GICS) | Reported | Sales Growth | Earnings Growth |
|---|---|---|---|
| 11) All Securities | 486 / 500 | 11.48% | 3.42% |
| 12) > Energy | 23 / 23 | 49.88% | 149.95% |
| 13) > Materials | 28 / 28 | 5.56% | -16.01% |
| 14) > Industrials | 70 / 71 | 12.70% | 16.59% |
| 15) > Consumer Discretionary | 54 / 56 | 14.69% | 16.13% |
| 16) > Consumer Staples | 29 / 33 | 8.18% | 0.38% |
| 17) > Health Care | 63 / 64 | 5.40% | -2.25% |
| 18) > Financials | 67 / 67 | 7.06% | -15.74% |
| 19) > Information Technology | 69 / 75 | 5.51% | -3.57% |
| 20) > Communication Services | 22 / 22 | 2.20% | -22.76% |
| 21) > Utilities | 30 / 30 | 14.26% | 2.22% |
| 22) > Real Estate | 31 / 31 | 13.96% | 18.69% |

Source: Bloomberg- Data as of 11/29/22

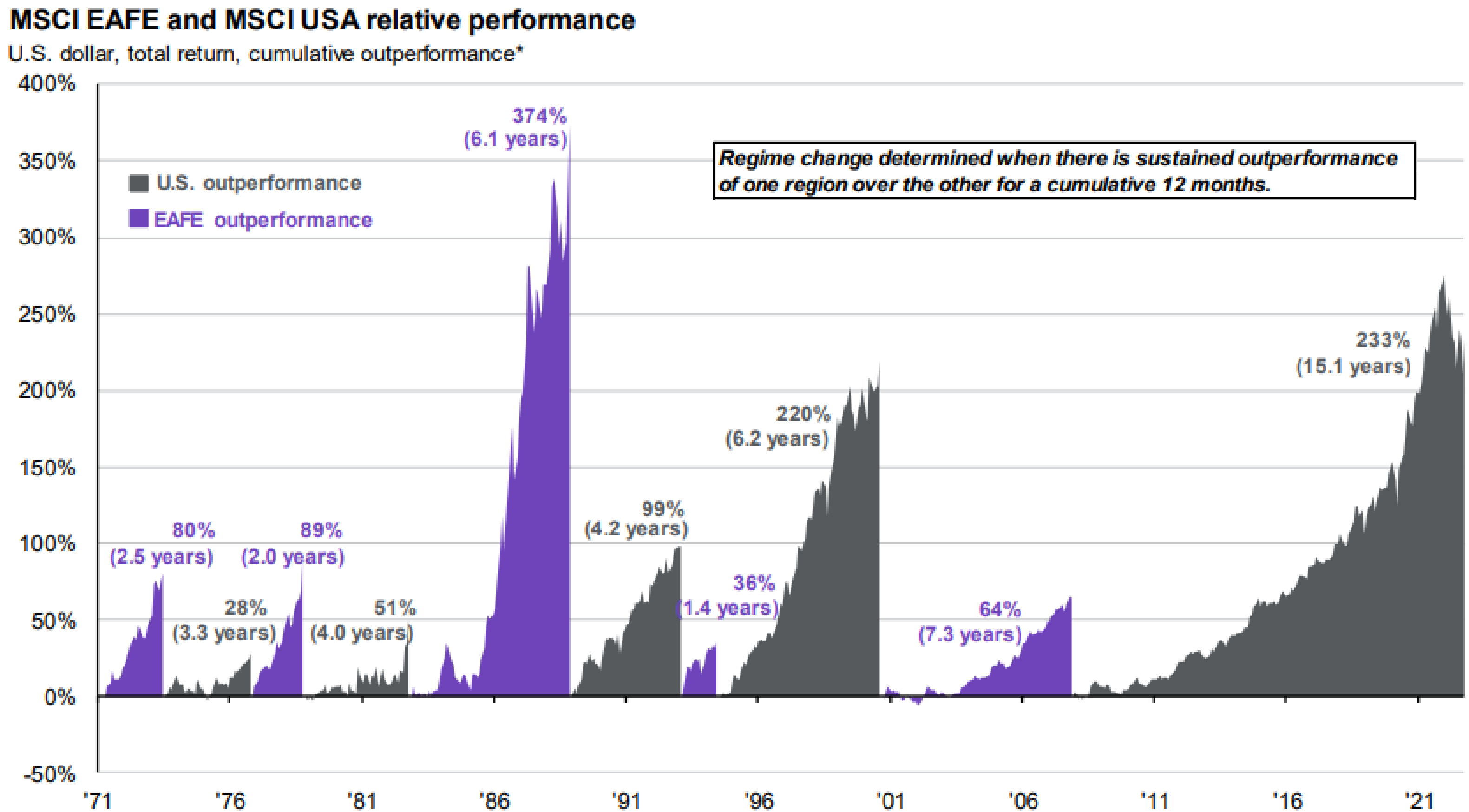
# Growth vs Value: A Potential Change in Direction




Source: Bloomberg - Data as of 11/28/22

After a long period of growth style factor outperformance, the value style factor has recently outperformed. There might be more to go in this rotation given the higher rate environment, though it is difficult to predict. Quality growth companies are still solid long-term holdings, particularly if economic growth becomes scarce in the coming quarters.

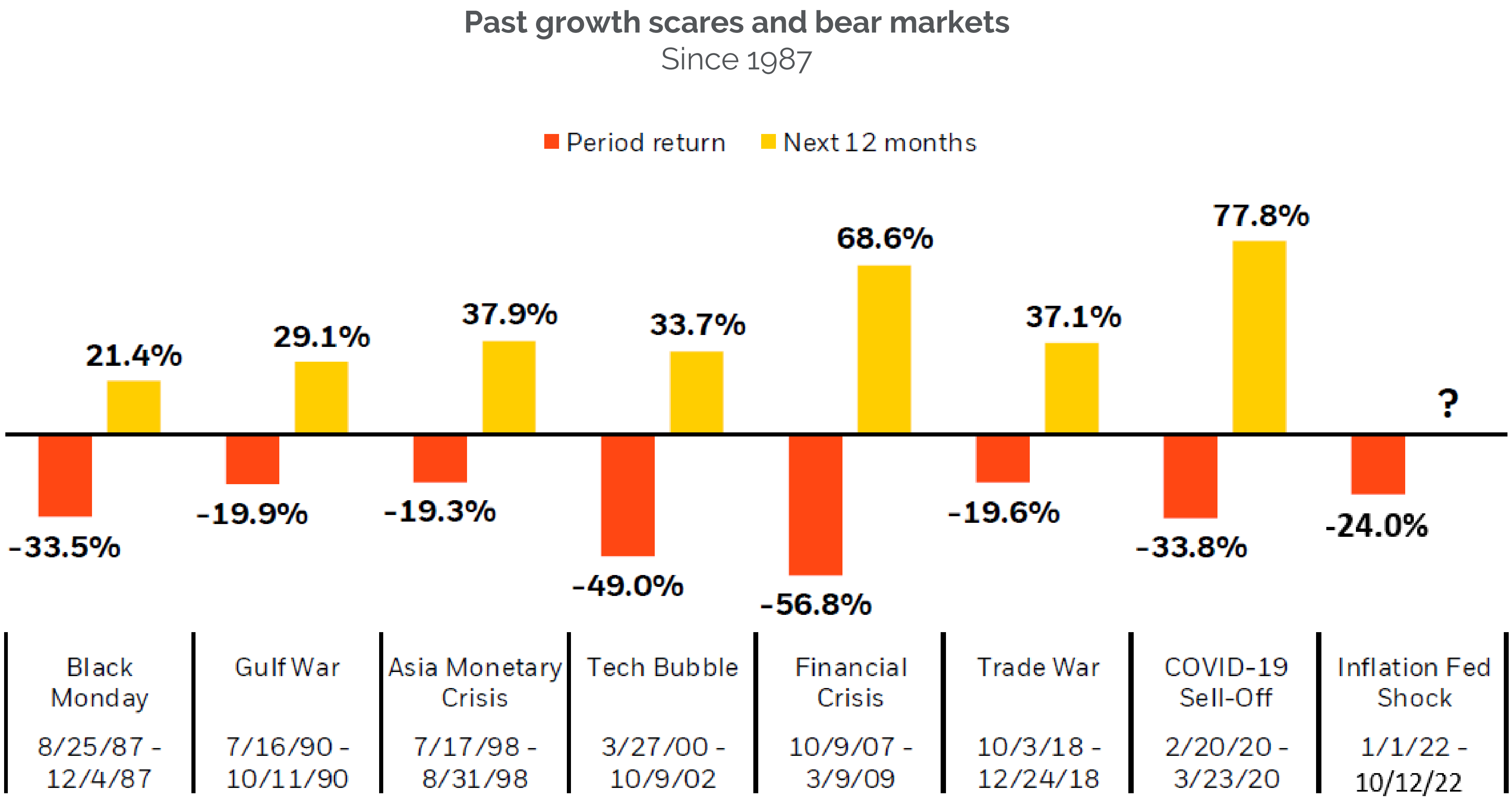
# International Equities: Ongoing Risks Have Opportunity on Pause




Source: FactSet, MSCI, P Morgan; Data as of 11/25/22

U.S. equities have outperformed international equities for extended periods of time and continue to outperform this year. We remain underweight international equities. Valuations and economic prospects were looking better at the start of the year, but the war in Ukraine poses new geopolitical and recession risks, especially to European countries. We continue to monitor global events for attractive entry points.

# Recent Market Corrections




Source: Blackrock, Morningstar (9/30/22), FactSet (11/28/22)

Source: BlackRock; Morningstar as of 9/30/22. U.S. stocks are represented by the S&P 500 Index from 1/1/89 to 9/30/22, an unmanaged indexes that is generally considered representative of the U.S. stock market. 'Day-to-day returns prior to 1989 are represented by the S&P 500 PR Index. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. It is not possible to invest directly in an index.

# Conclusion –

We are not out of the woods yet, but the longer horizon is looking better from these starting prices and yields

# Cambridge Trust Market Outlook (November 2022)

## Economy & Markets

1. The U.S. economy grew at a 2.6% annual rate in the third quarter, the first positive quarter this year.
2. Consumer spending has continued growing in the face of rising inflation making the Fed's job of slowing the economy more difficult.
3. Hourly earnings rose 4.7% in October versus 3-3.5% in early 2020.

## Equity

- Thus far, 3rd quarter earnings have been resilient. However, we continue to expect profit margins and earnings to come under pressure due to higher costs and slowing demand.
- Energy, industrials, and healthcare sectors currently represent market leadership, while growth stocks have languished due to higher interest rates.

## Fixed Income

- Negative returns YTD are driven by rising interest rates. High quality is more attractive in the face of uncertain economic conditions. We have increased our fixed income allocation to hedge against further equity volatility and take advantage of more attractive rates.

## Consumer

- Unemployment remains near historic lows. We expect it to slowly rise over the next year.
- Consumer balance sheets remain healthy, thereby supportive of continued spending.
- Job openings rose in October to 10.7 million versus an unemployed population of 5.8 million.

## Federal Reserve

- The Fed raised rates by 75 basis points in November to a range of 3.75 – 4.0%, up from nearly zero in March.
- Inflation will most likely stay elevated if employment remains strong.

## Issues to Watch

- Mortgage rates rose to over 7% for 30-year mortgages, forcing homebuyers to delay purchases.
- Fed chairman Powell said it is "very premature" to be thinking about pausing their rate increase strategy.
- Election results in November may lead to contentious debates over further fiscal policies.

| Economic Metric | 2022[1] as of 10/31/22 | 2023 Projected | |
|---|---|---|---|
| GDP (y-o-y) | 1.7%[2] | 0.4%[2] | ▼ [5] |
| Global GDP (y-o-y) | 2.9%[3] | 2.3%[3] | ▼ |
| Inflation (CPI) | 8.2% | 3.2%[4] | |
| Fed Funds | 3.75% – 4.00%[6] | 4.75% – 5.00%[4] | ▲ |
| 10yr Treasury | 4.05% | 4.40%[4] | |
| Unemployment | 3.5% | 4.4%[4] | |
| Crude Oil (WTI) | $86.53 | $75 - $110[4] | ▼ |

[1] Data provided by Bloomberg. Metrics are as of month-end or most recent publication.
[2] Provided by US Real GDP Economic Forecast Survey Median.
[3] Provided by World Real Economic Forecast Survey Median.
[4] Represents Cambridge Trust year-end projections.
[5] Arrows represent a month over month change.
[6] Reflects the Fed rate hike from November 2nd.

| Index Returns *as of 10/31/22* | 1-Month % | YTD % |
|---|---|---|
| S&P 500 *(Large-cap stocks)* | 8.10% | -17.70% |
| Russell 2000 *(Small-cap stocks)* | 11.01% | -16.86% |
| MSCI ACWI Ex-US *(Int'l. stocks)* | 2.99% | -24.31% |
| MSCI EAFE *(Developed Market. Int'l stocks)* | 5.38% | -23.17% |
| MSCI EM *(Emerging Market stocks)* | -3.10% | -29.42% |
| Inter. Govt. / Credit Bond Index | -0.44% | -10.02% |
| U.S. Aggregate Bond Index | -1.30% | -15.72% |
| ICE BofA 1-10Y US Muni Index | -0.18% | -7.42% |
| Commodities *(Bloomberg Index)* | 1.99% | 15.83% |

# Asset Allocation / Tactical Positioning (November 2022)

| Asset Class | Over-Weight | Neutral | Under-weight | Direction[5] | Opportunity | Challenge |
|---|---|---|---|---|---|---|
| **Equity[1]** | | | ✓ | ▼ | **Inflation Peak, Max Pessimism** | **Slowing Growth/Recession** |
| U.S. Equities | ✓ | | | | Long Term Outperformance | Slowing Earnings/Valuations |
| International Developed Markets | | | ✓ | | Attractive Valuations | Inflation/Currency/Energy |
| Emerging Markets | | | ✓ | ▲ | Attractive Valuations | Dollar Strength/Global Growth |
| **Fixed Income[2]** | | ✓ | | ▲ | **Attractive Yields** | **Inflation/Hawkish Fed** |
| U.S. Government | | | ✓ | ▲ | Safe Haven Asset | Duration |
| Investment Grade Corporate | ✓ | | | ▼ | Attractive Yields | Recession |
| Below Investment Grade[3] | ✓ | | | | Lower Vol Equity Alternative | Recession |
| **Alternative[4]** | ✓ | | | | **Diversification** | **Recession** |
| Income Fund | ✓ | | | ▲ | Income Buffer | Market Disruptions |
| **Cash** | ✓ | | | | **Risk Reduction** | **Inflation** |

*[1] Equity tactical weights are relative to the Cambridge Trust Core Equity allocation and is comprised of 80% S&P 500 and 20% MSCI AC World ex-U.S. Index.*
*[2] Fixed Income tactical weights are relative to the Cambridge Trust Core Taxable allocation and is comprised of 100% Barclays Intermediate Gov/Credit Index.*
*[3] Below investment grade holdings include high yield, bank loans and emerging market debt mutual funds. Represents an out-of-benchmark allocation that will be reflected as an overweight position relative to the Barclays Intermediate Gov/Credit Index if any allocation is held.*
*[4] Alternative tactical weights represent an out-of-benchmark allocation that will be reflected as an overweight position when utilized.*
*[5] Direction refers to last change of the overall allocation as a result of a tactical asset allocation or strategy change.*

# Tax Updates: 2022

November 30, 2022

Michael Bannister, JD, CPA
Vice President, Tax Manager
Michael.Bannister@cambridgetrust.com

# Year-End Planning

**Required Minimum Distributions (RMD)**

- Make sure you take your RMD by 12/31/2022.
- For taxpayers who have their first RMD in 2022 (turn 72 in 2022), you have until April 1, 2023, to take the distribution.

**Capital Gains/Losses**

- If you have capital gains during the year, now could be the time to offset gains with capital losses due to the decline in the stock market.

**Maximize Retirement Accounts in 2022**

- **401k** – $20,500 ($27,000 ages 50+)
- **IRA** - $6,000 ($7,000 ages 50+)

# Qualified Charitable Distribution (QCD)

**QCD – giving an IRA distribution directly to a charity**

- A taxpayer may directly donate **up to $100,000** to a 501(c)(3) charity and that distribution will not be taxable income on their Form 1040.

- The taxpayer must be at least **70.5**-year-old to qualify for a QCD.

- An RMD can be satisfied through a QCD.

- A charitable donation to a Donor Advised Fund (DAF) does not qualify for a QCD.

# Inherited IRAs and the 10 Year Rule

**Inherited IRAs**

- With the passage of the Secure Act, for deaths after December 31, 2019, **non-spouse IRA beneficiaries** need to withdraw the funds within 10 years.

- Proposed regulations released in the spring of 2022 say that the beneficiaries need to take an RMD based on their life expectancy.

- The final regulations have not been issued yet but **Notice 2022-53** states that the IRS will have final regulations shortly and non-spouse beneficiaries who do not take RMDs in 2021 or 2022 will not be subject to the excise tax penalty.

- Secure Act 2.0??? – Potential RMDs starting at age 75.

# 2022 Miscellaneous Year-End Thoughts

- The **charitable deduction for non-itemizing taxpayers** was not extended, so you can no longer deduct up to $600 for a married filing joint (MFJ) return.

- The **MA 529 College Savings Plan tax deduction** (up to $2,000 MFJ) is now permanent on Schedule Y.

- If you **pay rent in MA**, you can deduct up to $3,000, per return, on your MA individual income tax return.

- **Review your estate plan** and consider if it still meets your goals. If you do not have an estate plan, find a qualified estate planning attorney who can prepare an estate plan for you and your family.

# 2023 Tax Updates

**Retirement Contributions**

- **401k** –$22,500 in 2023 ($30,000 ages 50+)
- **IRA** - $6,500 in 2023 ($7,500 ages 50+)
- **SEP-IRA** - $66,000 in 2023

**Standard Deduction**

- Married Filing Jointly (MFJ) - $27,700 (single $13,850)

**Annual Gift Exclusion**

- $17,000

**Estate Tax Exemption**

- $12.92M