Wealth Management Bulletin
Autumn 2022

LCNB | Wealth

Welcome to Autumn …

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The days are getting cooler and the leaves are changing color. It's almost time for that ritual when some dress up and pretend to be who they really are not. No, I'm not talking about the midterm elections, but rather talking about the annual ritual of Trick or Treating. My three-year-old granddaughter is excited to be dressing up as the Disney Princess Sophia. Me? I'm just going to dress in my usual costume of a disgruntled tax payer. In that context, unfortunately, there are many more tricks than treats.

Have you ever wondered about the origins of Trick or Treating? Apparently, the practice began with the Celtic tradition of celebrating the end of the year by dressing up as evil spirits. That morphed into All Hallows Eve, All Soul's Day, and All Saint's Day with more people dressing as saints and angels rather than demons. But that tradition did not make an immediate transition to the celebration we know today. In the US, the tradition of Trick or Treating didn't take hold until the 1920's and 30's, and with the exception of sugar rationing during World War II, has been with us ever since.

As a kid, Trick or Treating was a great thing. Free candy for "threatening" a trick. Just open your sack and find a whole pile of full-size Hershey bars, Reese's cups, Sweet Tarts, Blow Pops, Smarties, popcorn balls, and caramel apples. My mouth waters at the memory. The real trick of course, was the cavities that came with eating all those treats. You got the candy and Mom and Dad got the dental bill.

But isn't that the way real life ends up being. Trick or treat? Bad or good? Action or consequence? We've seen some of that recently. Living life in a nice warm climate like Florida (Treat) but having to deal with the horrific damage of a hurricane (Trick). The benefit of lower interest rates (Treat) but the inevitable inflation which accompanies a slow return to fiscal normalcy (Trick). Basking in the comfort of our own familiar status quo while failing to account for the needs of others (Treat), leading to the cultural and political upheaval in which we are currently entrenched (Trick).

Your family financial planning falls into a similar vein. Properly planning for your family's long term financial hopes and dreams can be very complex sometimes seeming very tricky. But the rewards that can accompany proper estate, financial legacy, tax, insurance, and retirement planning can be the sweetest treats of all. The professionals at LCNB| Wealth are ready to help you go through your Halloween candy to select the best treats. No Tricks involved. Let us know how we can be of service. And be sure to review Kasheen's article on Avoiding Tax Scams, so you are not susceptible to the tricks of others.

It's Autumn. When the little ones (like my granddaughter) come to your door this Halloween, give generously. And please, no matter which side of the political aisle you may be on; research the candidates and issues, and Vote.

Thank you for your relationship with LCNB| Wealth.

Best Regards,

Mike

Avoiding Tax Scams

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The Internal Revenue Service (IRS) published Fact Sheet 2022-23 in July. It is designed to help taxpayers avoid tax scams. The IRS has been concerned because of the many phone, text, email and in-person scams in which the fraudsters identify themselves as IRS agents. The IRS almost exclusively contacts taxpayers via a written correspondence.

With the growing number of tax scams, it is important for you to separate legitimate IRS contacts from a scam. Here are some ways to protect yourself from fraudulent IRS communications:

1. **Text Messages.** The IRS does not send text messages to individuals with links. Scammers will frequently send a text message that includes a bogus link. If you receive an unexpected text from someone identifying themselves from the IRS, you should **NOT** click on links or open attachments. If you do receive a suspicious text message, you should email a screenshot of it as an attachment to phishing@irs.gov.
2. **E-mail.** IRS does not ask for personal or financial information with initial contact by e-mail. The standard IRS contact will be through several letters by regular mail. The suspicious e-mail should also be forwarded to phishing@irs.gov. There is a "Report Phishing and Online Scams" page on www.IRS.gov with specific instructions.
3. **Individuals Who Owe Tax.** If you owe tax to the IRS, you can expect to receive several letters prior to a phone call. The IRS may follow up the letters with a phone call if you have an overdue tax bill, a delinquent tax return, or have failed to make an unemployment tax deposit. The IRS emphasizes it will not demand immediate payment with a debit, gift, or credit card, threaten you with arrest by the local police, or demand tax payments without giving you an opportunity to appeal the claim. Such strategies all indicate that you are receiving communications from a fraudster and not the IRS.
4. **In-Person Visits.** Generally, IRS officers visit in person only after you have received several notices by mail. An IRS agent may visit for the purpose of education, investigation, and/or appropriate enforcement steps. IRS auditors may mail an initial appointment letter and will generally call to confirm the date prior to a scheduled audit appointment. If you have an in-person visit with an IRS representative, you should always ask for his or her credentials and HSPD-12 card, which is a standard government form of identification.
5. **Resolving Tax Issues.** The IRS website, www.IRS.gov, provides information to help taxpayers create payment plans. You can pay taxes through an online account with IRS Direct Pay or with your debit or credit card. There are individuals who may qualify for a payment plan or an Offer in Compromise. Again, the IRS will not demand immediate payment, ask for credit or debit card numbers, or threaten to have you arrested by local police. The IRS will always offer an opportunity to appeal and an IRS Appeals Officer may review your case prior to any further action.

Tax related scams have become significantly more frequent and sophisticated. Many of the fraudsters build a relationship with the victim through multiple emails or phone calls prior to theft. Please be careful if you have been contacted by someone claiming to be from the IRS and always, always verify with the IRS before proceeding.

Economic Summary –

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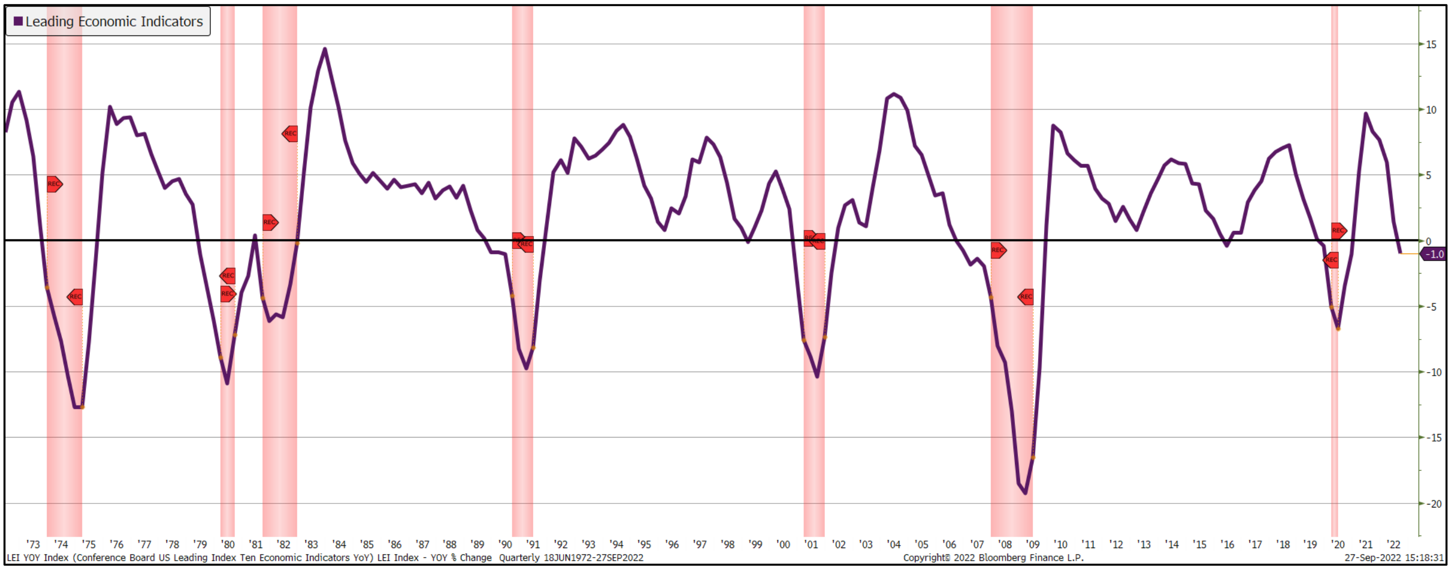
Last quarter we wrote about economic crosscurrents and a Fed determined to raise interest rates until inflation subsides. In many respects, not much has changed over the past 3 months.

- The labor market remains tight with the latest unemployment rate at 3.5%. According to the Bureau of Labor Statistics, the economy added 263,000 jobs in September and wage gains remain elevated at 5.8%.
- Inflation, as measured by the Consumer Price Index increased by 8.2% over the prior 12 months. The month over month increase of 0.4% shows some signs of cooling but is still above the expected rate of 0.2% signaling the Fed still has work to do.
- Geopolitical risks in Eastern Europe, China/Taiwan, and North Korea continue to add to inflationary pressures while threatening economic growth. Growth in China has stalled and Europe is likely already in a recession.
- All of this has the Fed determined to keep pushing interest rates up. Futures contracts now expect another 75-basis point increase on November 2nd and an additional 75 -100 points more before then end of the hiking cycle.

Changes in interest rates can take a while to impact economic activity and it is unlikely that the full impact of increases so far this year are reflected in current economic data. And as we noted last quarter, there are already signs that the economy is cooling even as the Fed continues to hike rates. The Leading Economic Indicators Index, produced by the Conference Board, is a composite index of 10 components that are highly correlated to changes in the direction of economic activity. The LEI Index has now gone below 50, a signal that the economy is likely to be contracting soon. Last quarter we stated that the odds of recession in 2023 were about 50/50. We now think those odds are well above 50 percent.



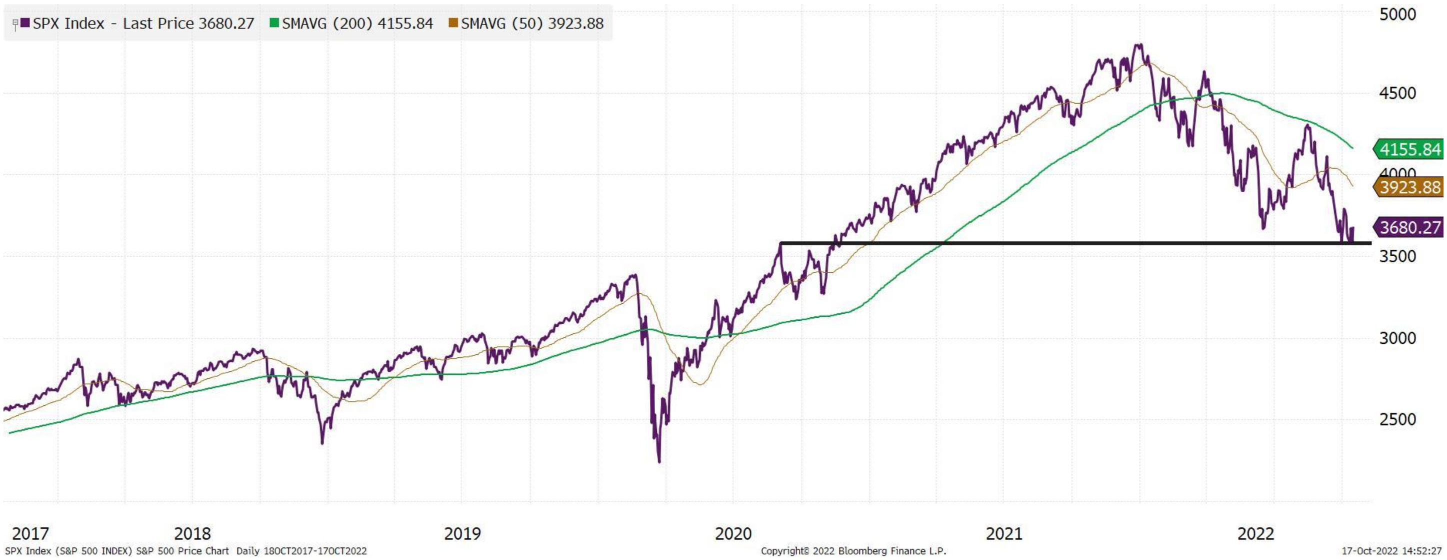
However, there is some good news for investors. For one, stocks and bonds are both components of the LEI Index. As such, they tend to move before a slowdown is reported in official economic data. Therefore, it is likely that the stock and bond markets will bottom out well before the National Bureau of Economic Research officially declares a recession. While markets are likely to remain volatile for several more quarters, there is some hope that most of the pain is already reflected in financial markets.

Equity Summary:	3rd Qtr	YTD	12 Mth	3 Yr	5 Yr
S&P 500 (Large Cap Domestic)	-4.88	-23.87	-15.47	8.16	9.24
Russell 2000 (Small Cap Domestic)	-2.19	-25.10	-23.50	4.29	3.55
MSCI ACWI Ex US (International)	-9.91	-26.50	-25.17	-1.52	-0.81

Equity Update – Where is the Fed Pivot?

Our theme for 2022 has been – *Don't Fight the Fed* and we don't see any reason to change that stance just yet. The S&P 500 Index extended the losses for the year dropping another 4.88% in the 3rd quarter. The large-cap US stock index was down almost 24% by the end of the quarter and dipped a little further in early October. We are sticking with our view that it may take a Fed Pivot for the markets to find a firm bottom. With the latest CPI and employment data still running strong we may have a little further to go. The Fed remains determined to keep pushing rates up which will weigh on financial markets.

While we wait for a Fed Pivot and market bottom, it is important for investors to focus on valuations. We know that markets often overshoot to the upside and downside and so predicting a bottom is always difficult. In the long-run, stock valuations depend on the underlying earnings, expected growth, and interest rates. With all the noise surrounding Covid and the stimulus fueled rebound that followed, getting a handle on earnings can be tricky. Coming into 2022, Wall St. firms were estimating north of $250 in aggregate S&P 500 Index earnings. Those estimates are rapidly coming down, but where should they land?



If we go all the way back to pre- Covid, the earnings estimate for 2020 was about $180 for the S&P. Much has changed in the world since then including what we all spend on goods and services. Compound inflation is running 15% over the pre-Covid level as measured by the CPI Index. It stands to reason that these excess consumer expenses translate into excess revenue and therefore earnings for US corporations. Applying this 15% increase in corporate revenue and earnings to the 2020 estimate of $180 would give us a conservative estimate of $205 for the next 12 months. Heading into this year, we had ultra-low interest rates and higher expected growth which translated into a forward earnings multiple above 20. With higher rates and a slowing economy, we should expect a lower earnings multiple. Using 17 (about 10% below the long-term average) we get a fair value estimate of 17*$205 = $3485 for the S&P 500 Index. That is just about 3% below the current level of $3600, suggesting the market is close to fair value today.

Fixed Income Summary:	3rd Qtr	YTD	12 Mth	3 Yr	5 Yr
US T – Bill 90 Day Index	0.66	1.01	1.02	0.60	1.14
BC Municipals 5YR	-2.78	-7.83	-7.76	-0.87	0.50
BC Intermediate Government/Credit	-3.06	-9.62	-10.14	-1.64	0.38
BC High Yield Corporate	-0.65	-14.74	-14.14	-0.45	1.57

Fixed Income Update – Up, Up and Away…… For Now

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The Federal Reserve continued its fight against inflation during the 3rd quarter by raising the Fed Funds rate 1.50%. Today, the Fed Funds rate sits at 3.25%, 3% higher than at the beginning of the year and its highest level since December 2007 – which marked the beginning of the financial crisis. The Fed has kept its hawkish tone in its most recent announcements, leading many investors to believe they are not done raising rates just yet. Fed futures are pricing in an additional 1% hike by years end. We have started to see some of the impact of these rate hikes as the most recent CPI readings indicate an annual inflation rate less than 5%, versus the peak 9% inflation we saw earlier this year. By the time we fully see the impact of all these rate hikes, the Fed will have likely overshot the Fed Funds rate forcing rate cuts in 2023 to promote economic growth.

The 10-year Treasury continued its march higher, starting the third quarter of 2022 at 3.01% and ending the quarter at 3.82%. Short-term interest rates also moved higher during the 3rd quarter with the 2-year Treasury moving significantly from 2.95% all the way up to 4.27%. The inverted yield curve does not only continue to exist but has widened substantially as the spread between the 2 and 10-year Treasury currently sits at .45% - a level we have not seen since 2000. As I mentioned last quarter, this inverted yield curve is an ominous sign for the economy and signals a high probability of a recession.

At the beginning of the 3rd quarter, high yield credit spreads were at 5.70%. By the end of the quarter, credit spreads had settled to 5.52%. As the probability of a recession has grown so has the likelihood that these spreads will widen further. We did start initiating some exposure to higher yielding bond investments in the 3rd quarter and will look for opportunities to continue if spreads widen even further.

Last quarter, I mentioned we would begin to extend our duration, closing the gap between our current portfolios and their appropriate benchmark. We will continue to do this across our portfolios. We have also started to take advantage of wider credit spreads, looking to establish positions in safe but slightly riskier bond investments. As always, we are paying attention to the signals provided by the Fed and continue to take advantage of opportunities in the bond market.

Alternative Investments Summary:	3rd Qtr	YTD	12 Mth	3 Yr	5 Yr
Bloomberg Commodity	-4.11	13.57	11.80	13.45	6.96
Dow Jones Global Real Estate	-12.02	-29.07	-23.31	-5.75	-0.36
Morningstar Broad Hedge Fund TR	10.21	30.25	33.33	16.63	11.39
Consumer Price Index	-0.03	6.25	7.99	4.88	3.72

Alternatives Update – Timber!

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Commodities across the board cooled in the 3rd quarter. West Texas Intermediate (WTI) Crude Oil continued its decline ending the quarter down almost 25% at $79.49/barrel. In addition to the US dipping into their petroleum reserves to boost supply, inflation pressures helped to dampen demand. As of this writing, the Organization of the Petroleum Exporting Countries (OPEC+) members have agreed to cut output to help bolster prices and limit further declines. Gold also continued its decline, losing just shy of 8% and ending with a price of $1672/ounce with the trend from last quarter persisting: investors are ditching non-income producing assets for assets that yield cash flow. Higher interest rates have impacted other areas of the commodity markets as well. Housing starts have decreased and we have seen a decrease in the strength of home prices. This led to lumber erasing all of the gains that happened in the last 2 years, ending the quarter at a price of $422.50/thousand board feet – the lowest price since June 2020.

While commodities were a drag in the alternatives space, alternative assets were still able to soften the losses in overall markets – mainly led by negatively correlated assets like Hedge Funds. The Broad Hedge Fund Index was one of the few asset classes that provided a positive 3rd quarter return. We continue to overweight the allocation to the alternative asset class in our portfolios with real asset and long-short exposure. As always, we are available to help you meet your financial goals – reach out to any of our LCNB| Wealth officers for a more detailed discussion.

Fall Fling -Having an axe-some time!

Members of the LCNB| Wealth team got together for a fun evening of Axe Throwing at Wild Axe in Beavercreek! There were a lot of laughs and some friendly competition – the group split into two teams and competed with three different games. Each team won a game, and they tied on the third!

Clutter 2 Care – Turning donations into Hope!

Two groups from LCNB| Wealth volunteered time at Clutter 2 Care, a Cincinnati nonprofit that sells used clothing and household items and then donates the proceeds to local charities across the Greater Cincinnati region. Both groups helped sort clothing as an introduction to Clutter 2 Care's mission, followed by sorting Christmas supplies to help the nonprofit get a jump start on the holiday season.

On top of their boutique-style thrift store, Clutter 2 Care also make packages that go to new mothers and children to provide essential items – ranging from winter coats to nursery items, to twin beds!

NCCJ Friendship Celebration – 45 Years of Honoring Humanitarianism

Nakia Lipscomb, Erin Hawk, and Amanda Luman attended the 45th Annual NCCJ Friendship Fund Raising Event at Levitt Pavilion in Dayton. This event honors individuals from all over the Greater Dayton area for their humanitarian work surrounding Diversity, Equity, and Inclusion. Nakia serves on the board for NCCJ and has been instrumental in collaborating with this group of diversity and inclusion experts to facilitate learning for the LCNB DEI Council members.

Hispanic Volunteer Day – Giving back to a vibrant community!

LCNB's second year of participating in Hispanic Volunteer Day was just as fun as we remembered! Lead by Amanda Luman, members from across the bank met at Robert's Academy in Price Hill to work in a predominantly Hispanic and Latino community. We spent time clearing honeysuckle and undergrowth from a path that connects Rapid Run Park with Route 264, and though the work was hot and dirty, the crew laughed the whole time!

President of the Hispanic Chamber of Commerce – Cincinnati, Alfonso Cornejo, said in his opening remarks that the 2022 Hispanic Volunteer Day had a record year with over 340 participants.

OBL Women in Banking Conference – You in the Pilot Seat!

Women from all over the state of Ohio gathered to share in fellowship, mentorship, and learning to support and empower one another to be successful on Wednesday, October 12th. Women from LCNB's leading departments are pictured here, including Amanda Luman, Erin Hawk, and Melanie Crane, of the LCNB| Wealth team.

The keynote speaker, Black Hawk Pilot Elizabeth McCormick, taught attendees how to fly a helicopter, reminding them that they are all in control of their own flight through life. One of her many lessons of note was the power of "I Can" when faced with challenges. Other topical sessions included finding what one needs to thrive, rather than survive and how to clarify and amplify one's unique brilliance in order to make the most impact in life.

While each woman took home her own personal lessons from this conference, there is no doubt that the LCNB| Wealth team will benefit significantly from the participation of so many of our leading team members.

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We hope that we are exceeding your expectations. The best compliment we could receive would be a referral of your friends and family. Please contact Josh Shapiro @ 513-228-7659 or jshapiro@LCNB.com for more information.