CLIFFORD SWAN
INVESTMENT COUNSELORS

THE INVESTMENT COUNSELOR
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THE HEAD AND THE HEART

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In life, few things put us at the mercy of our emotions the way investing can. The last three years in the markets have been especially unnerving, exhibiting the plot elements of a Shakespeare play. We witnessed drama as the world locked down during Covid, a supernatural-like intervention by Congress and the Federal Reserve to bring the economy back to life, and the spectacular fall of many high-flying glamor stocks when the end to economic stimulus brought investors back to reality.

For the markets to experience losses in 2022 isn't remarkable on its face. After all, volatility is a mainstay of investing. But how the past year unfolded is a sobering reminder that markets rarely follow a prescribed order:

- With risk appetites tumbling, many would have expected government bonds to outperform in a flight to safety. Instead, they had their worst year on record — a byproduct of an unprecedented increase in the federal funds rate (interest rates) to fight inflation.
- If there was a period for gold to triumph, it should have been in 2022 against a backdrop of geopolitical danger and surging prices. Instead, gold lost money on a real return basis (that is, when you adjust for inflation).
- An area of the stock market that did outperform tremendously, the energy sector, did so with the price of crude being flat on the year. And the behavior of crude prices itself was peculiar given the constraints on global supply due to the West's sanctions against Russia.

Investors have experienced a wide gamut of emotions — among them exhaustion, confusion, and worry — and with those have come ominous predictions of recession. It's the very kind of malaise that forced a generation of investors to the sideline when the dot-com bubble burst in 2000-2002 and again when the Great Financial crisis struck in 2008-2009.

And on this, behavioral science can be illuminating. It tells us that our emotions can be blunt tools: help-

> *"Our emotions can be blunt tools: helpful in real moments of danger yet counterproductive in modern arenas like investing."*

ful in real moments of danger yet counterproductive in modern arenas like investing. That's because in the hundreds of thousands of years man is estimated to have roamed the planet, we have treated threats as more urgent than opportunities. It's how we survived and reproduced in the face of war, disease, and predators. But even as primitive worries have given way to contemporary ones — like oversleeping on the day of an important exam or losing out on a job promotion — our old emotional circuitry has endured. It's why consecutive days of losses can feel debilitating and better days feel very far away during a bear market. We've become calibrated to over-worry, and in investing, it means the head often loses ground to the heart.

An important part of the solution is to make a habit of studying market history. And that history tells us that business cycles are perfectly natural and even indispensable to growth. In underappreciated ways, downcycles direct our attention and resources towards higher potential pursuits in a process known most simply as innovation. This isn't to say that we should root actively and often for recessions. But harsh conditions sow the seeds for growth as a scarcity of resources forces businesses to get better and stronger, evidenced by the fact that many of today's most dominant companies laid the groundwork for success in recessions. Costco, formerly Price Club, was founded during the oil price shocks of the 1970s, which was an extremely challenging time for businesses and families alike. Also consider that, with the bursting of the dot-com bubble in 2001, operators' only chance at survival was to reconfigure themselves towards profitability, spawning the likes of Amazon, Google, and PayPal. Primed with more focused operating models, they were well-positioned to later capitalize on expansionary business conditions.

To be sure, while there is reason to be hopeful about the future, this isn't a call to throw caution to the wind. In fact, the same emotional machinery that makes market losses so difficult are the very ones that cause us to lose our discipline in better times. A new danger emerges when our brains receive an "all clear" signal and we begin to experience a different kind of worry: that of losing out on experi-

The Head and the Heart |
Continued on page 2

The Head and the Heart

Continued from page 1

ences as it stirs a primal fear of social ostracism. The fear of missing out, or FOMO, is why investors chase trends to their detriment. It's what makes us behave as though trees grow to the sky, represented in the most recent market cycle by speculative bets on the blockchain, the green energy revolution, and do-everything-from-home.

Looking again at investing through the lens of history, we see that spotting a trend is far easier than identifying the winners of those trends. In the early 1900s, if you guessed correctly that commercial planes would become a fixture in mainstream travel, you might have still lost money on one of many companies in the boneyard of early adopters, among them Air America and Florida Airway, two of the best-regarded operators at one point. Similar lessons follow from the travails of personal computing and countless other promising industries wherein many early movers floundered. There are many reasons for this, including the high costs of scattershot R&D and a regulatory landscape that isn't yet set (i.e., innovating against a moving target). But the key lesson for investors is that many nascent industries are not worth investing in, and if they are, it may take years before the best ones become investable.

> *"...spotting a trend is far easier than identifying the winners of those trends."*

Becoming better long-term investors doesn't require that we change our wiring. There's no hope of that — not when modern living represents an infinitesimal fraction of our existence as a species. Instead, it calls for two things that are far simpler in scope. The first is to develop a better awareness of how we get in our own way and, when we find ourselves in heightened emotional states, to try to delay critical decisions. The second is to build a foundation of knowledge about the things that matter most to investing — business fundamentals and the nature of economic cycles — so that we're better equipped to see past the fog of our emotions. With these tools in tow, the process of building wealth can feel much more like an enriching and gratifying journey rather than a storm in open waters.

TAX AND RETIREMENT UPDATES

New Beginning Ages for RMDs

The SECURE Act that was signed into law at the end of 2019 changed key rules around Individual Retirement Accounts (IRAs). Notably, the age to begin taking required minimum distributions increased from 70.5 to 72. The Act also eliminated the stretch IRA for inherited IRAs and introduced the 10-year withdrawal rule for those accounts.

Enacted at the end of 2022, the SECURE 2.0 Act further increased the initial age for taking a first RMD from an Individual Retirement Account (IRA) from age 72 to:

- Age 73 if you were born between 1951 and 1959
- Age 75 if you were born in 1960 or after

This is significant because the longer a retiree can wait to start taking withdrawals from a retirement account, the longer the tax-deferred assets have an opportunity to grow — which is generally a good thing for retirees.

Withdrawal Rules for Inherited IRAs

While the original SECURE Act introduced the 10-year withdrawal rule for inherited IRAs, it did not provide clear guidance on when and how distributions need to be taken. Given the uncertainty around the rule, the IRS issued a notice in October effectively waiving RMDs for inherited IRAs in 2021 and 2022 and outlining regulations for RMDs starting in 2023. The current draft regulations for inherited IRA beneficiaries subject to the 10-year rule are:

- If the original IRA owner started taking distributions before death, RMDs are required in years one through nine and the final distribution must be made by year 10.
- If the original IRA owner had not started taking distributions before death, then RMDs are not required in years one through nine, but complete distribution must still be made within 10 years.

California Tax Deadline Extension

The IRS and California Franchise Tax Board offered some relief to California taxpayers affected by the winter storms in December and January. For individual and business taxpayers in impacted counties (identified by the Federal Emergency Management Agency), the 2023 deadline to file state and federal tax returns, and make certain payments, has been extended from April 18 to May 15.

Boost in Social Security Benefits

The largest cost-of-living adjustment in more than 40 years resulted in Social Security benefits increasing by 8.7% in January.

Lower Medicare Premiums

Medicare Part B (medical insurance) premiums declined slightly for most retirees at the start of the year, the first decrease in over a decade. Because these premiums are typically deducted directly from Social Security payments, this will result in a larger net Social Security benefit for most retirees.

UPDATE: CHARITABLE GIFT ANNUITIES MORE ATTRACTIVE AS PAYOUT RATES RISE AGAIN

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Now is a good time for those wanting to give to consider establishing a charitable gift annuity. At its core, a CGA is an arrangement whereby assets are given to a charity in return for the charity's promise to make lifetime payments of a fixed amount to a beneficiary, who is often the donor. This stable income stream makes CGAs a popular planned giving vehicle.

For two reasons, charitable gift annuities are increasingly attractive in 2023:

Rising Payout Rates

In August, we wrote about how payout rates for charitable gift annuities were rising along with interest rates. Starting January 1, 2023, the American Council on Gift Annuities (ACGA) once again increased its recommended maximum annuity rates, replacing the rates last updated on July 1, 2022. The sharp rise in interest rates in the second half of 2022 prompted the ACGA to increase its suggested CGA payout rates after just six months.

While the rates offered for an annuity vary based on the charity, most institutions follow the ACGA's recommendations. The new recommended rates are the highest in over a decade.

Fund a CGA with IRA Assets

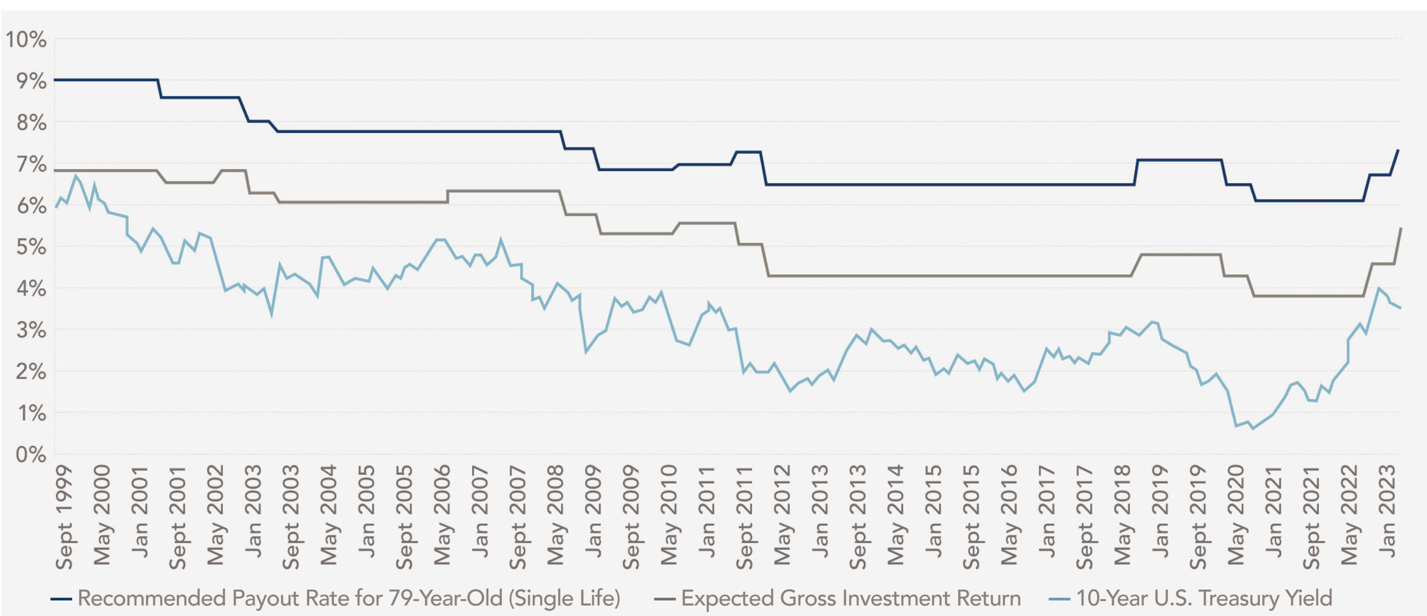
The SECURE 2.0 Act enacted at the end of 2022 includes a provision giving IRA owners at least 70.5 years old the option to make a one-time qualified charitable distribution (QCD) to fund a charitable gift annuity up to $50,000. Additionally, this amount can count toward the donor's required minimum distribution.

> *"In 2023, a QCD can let you access rising rates with the extra advantage of a tax-free withdrawl from an IRA."*

This new opportunity supplements the other attractive qualities CGAs offer donors, notably a tax-free withdrawal which can go towards meeting your RMD. Remarkably, a donor can get these benefits and an income stream! In 2023, a QCD can let you access rising rates with the extra advantage of a tax-free withdrawal from an IRA.

Charitable Gift Annuities |
Continued on page 4

HISTORICAL ACGA RECOMMENDED PAYOUT RATES



Note: Historical ACGA Payout rates for a single life 79-year-old.

Sources: American Council on Gift Annuities, The Federal Reserve Bank of St. Louis

Charitable Gift Annuities |

Continued from page 3

The timeless qualities of charitable gift annuities make them a good fit for some donors. Higher payout rates and the new option to fund a charitable gift annuity with retirement assets make this philanthropic tool even more attractive. If you are looking for ways to give, we urge you to talk with your counselor about what gifting strategy is right for you.

ACGA RECOMMENDED ANNUAL ANNUITY PAYMENT (79-YEAR-OLD)

Gift Annuity Amount	7/1/2020 to 6/30/2022	7/1/2022 to 12/31/2022	After 1/1/2023
$15,000	$930	$1,020	$1,110
$25,000	$1,550	$1,700	$1,850
$50,000	$3,100	$3,400	$3,700
$100,000	$6,200	$6,800	$7,400
$125,000	$7,750	$8,500	$9,250
$150,000	$9,300	$10,200	$11,100
$200,000	$12,400	$13,600	$14,800

Note: ACGA recommend annual annuity payments for a single life 79-year-old.

CONGRATULATIONS AND WELCOME

Peter J. Boyle, CFA
Chief Executive Officer

We recently thanked Jim Brown and Dianne Barrios for their years of dedicated service and welcomed David Nelson and Diane Riveros.

After over two decades at Clifford Swan, Jim Brown retired on December 31, 2022. Jim joined the firm in 1999 and served as Chief Operating Officer. Through his leadership, the firm's day-to-day operations ran smoothly, and his contributions to the long-term strength of the firm were innumerable.

You might see Jim in our offices as he continues in a consulting role to facilitate a smooth transition to our new COO, David Nelson. David previously oversaw Operations and Accounting for a subsidiary of the global asset management company Affiliated Managers Group. His professional experience also includes leading audits of mutual funds and investment companies with Deloitte. Outside the office, David serves as Treasurer of a 501(c)(3) organization that provides food, school supplies, and sports equipment to orphanages and schools internationally. He also enjoys spending time outdoors with his family.

Dianne Barrios also retired at the end of the year after serving as our talented receptionist for 18 years. Her professionalism and cheerfulness were constants in our office. In her place, we are delighted to welcome Diane Riveros. Diane comes to us with administrative experience as a bookkeeper and through prior roles at KKAJ Certified Public Accountants and Transamerica Financial Advisors. In her free time, Diane enjoys volunteering at her children's school and her church.

Please join us in congratulating Jim and Dianne and welcoming David and Diane!

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