The Renaissance Report

Providing customized financial, estate and investment management solutions.

Fall 2022

“It’s worth remembering that it is often the small steps, not the giant leaps, that bring about the most lasting change.”

Queen Elizabeth II
1926 - 2022

welcome to

The Renaissance Report

Trevor M. Forbes

Presdient and
Chief Investment Officer

October, 2022

The stunning Fall colors in the Berkshires remind us of impending winter but also encourages us to consider the Spring renewal. Capital markets seem to have been struck by a winter chill for much of this year. However, in the investment article we explore why this may start to change as we approach the new year. The passing of the venerable Queen Elizabeth II allows us to reflect on what her reign teaches us about long term investing.

Tom's article reminds us of the importance of selecting an appropriate executor to look after our affairs when we, too, pass. Choosing the best, detail oriented executor will help in the appropriate and speedy exercise of your will to the benefit of your beneficiaries, again an example of renewal, passing your wealth to the succeeding generation. As well as providing the most appropriate investments to suit your individual needs, reaching out and engaging with your upcoming generation is an important part of the service provided by your team at Renaissance.

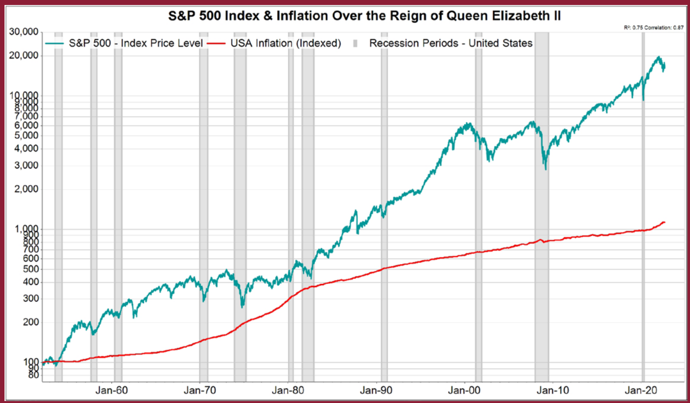
So, as we approach the holidays and season of goodwill, we wish you and your families an early season's greeting with the hope that 2023 provides a more settled environment for investments.

A Historical Perspective

by Trevor M. Forbes

During the extraordinary 70-year reign of Queen Elizabeth II there were 13 separate bear markets in the U.S., and yet the S&P 500 price index rallied 16,000%, or 7.6% annualized. Adding in dividends, the annualized total return was over 10%.

The Queen met 13 U.S. presidents (LBJ was the only sitting president she did not meet in person) as well as numerous world leaders and was the sovereign for 15 UK Prime Ministers from Winston Churchill to Liz Truss.

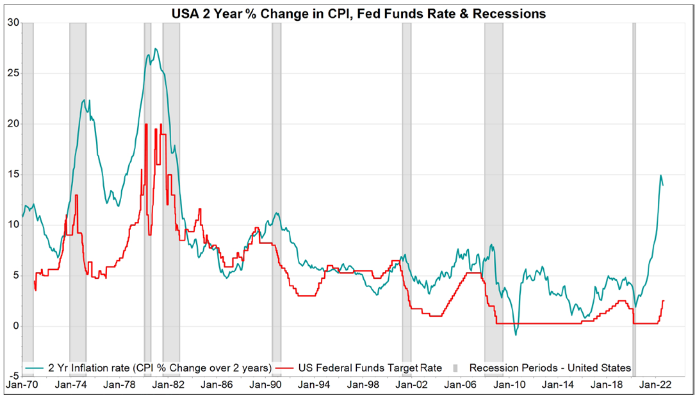


The perspective this teaches us is that this incredible return from so called real assets (equities / stocks) was incremental. We can also see that this period was marked by eleven recessions including two major financial crises. Consumer prices increased by 'just' 1,200% over the same period, so stocks provided a very significant 'real' return.

Inflation and the Federal Reserve Bank

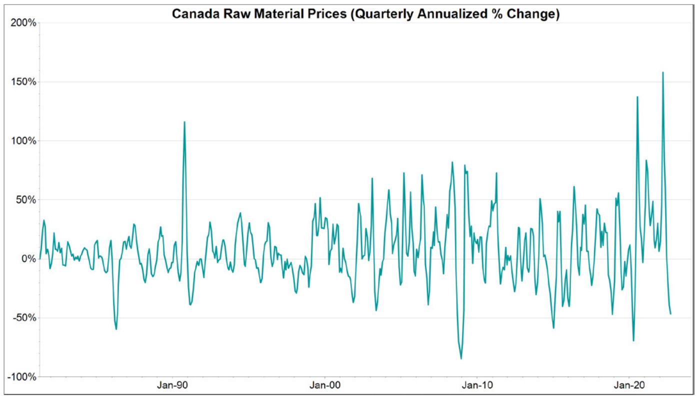
Inflation is the key area of debate for policymakers around the globe and was sure to have been the key debating topic at the recent meeting of central bankers and finance ministers at Jackson Hole. Since the meeting, several central banks have raised interest rates aggressively by ½% to ¾%. The U.S. Federal Reserve Bank, European Central Bank, Bank of England, and the reserve banks of Australia, Canada and New Zealand are among those citing inflation pressures as a reason to raise rates.

The link between inflation and Federal Reserve policy can be seen clearly in the chart comparing interest rates with the two-year inflation rate in the U.S. This chart also shows how far behind the Federal Reserve Bank has been compared to previous periods of inflation:

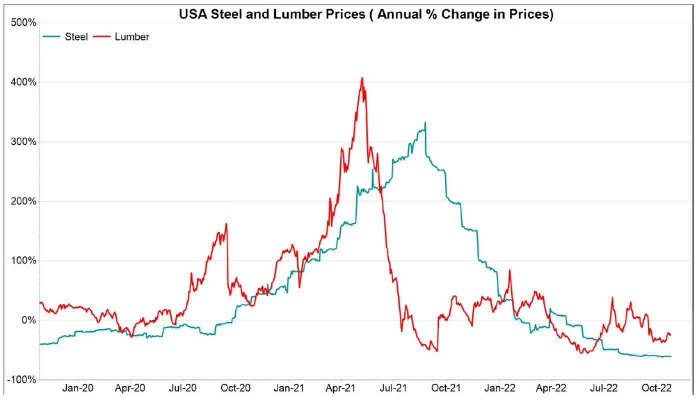


Listening to Jerome Powell, Fed chair, it is possible to conclude that the recent dramatic increase in prices, as measured by the Consumer Price Index (CPI), is accelerating and here to stay unless the central banks acts to reduce domestic demand significantly.

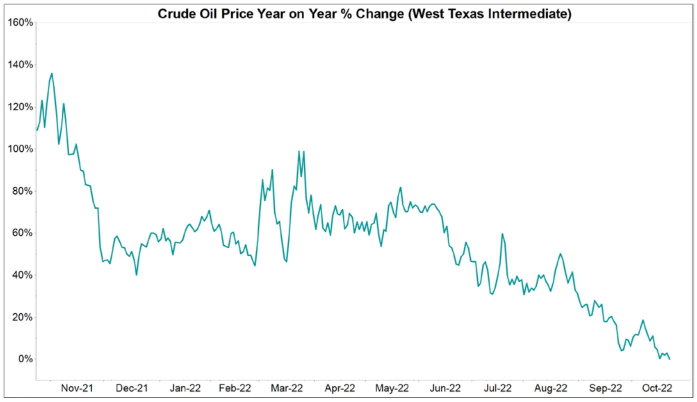
However, as we discussed in last quarter's newsletter, data point to a rather different conclusion. Indeed, disinflationary pressures seem to have increased dramatically over the last three months. It may be too early to call this deflationary, that is when overall prices fall, but clearly there has been a drastic change to which our policymakers appear oblivious. One measure of future inflation is the change in the cost of materials which are made into products we use. Canada has an interesting measure of these raw material costs dating back to 1981. The chart shows the change in raw material prices over the last quarter at an annualized rate. The rate of change in this index over the last five months shows the steepest decline in the last forty years:



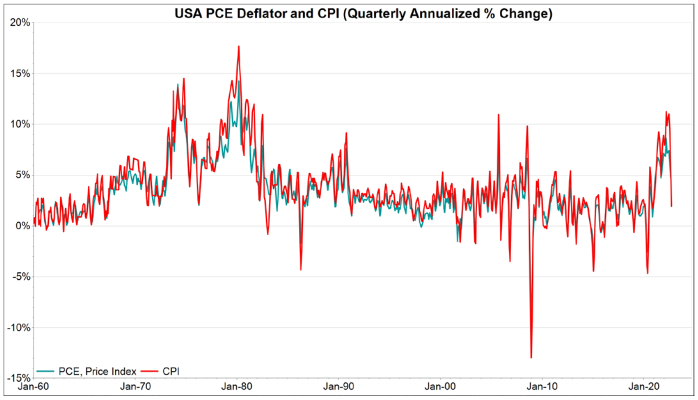
While some commodity prices, such as natural gas and some grains, remain elevated, a wide selection of commodities are registering price declines over the last twelve months. Among these are steel and lumber – key building blocks for much of industry and housing / construction. Steel prices are currently almost 60% lower than a year ago while the price of lumber has fallen by nearly 40% over the same period:



Even the price of crude oil is only 3% higher than mid-September 2021:

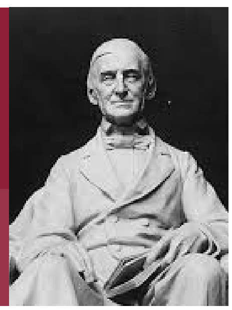


Meanwhile, the two measures policymakers seem to rely on are the price deflator incorporated in the personal income and expenditure survey and, of course, the consumer price index (CPI). Annualizing the change in these measures over the last three months shows a significant downward path, lending credence to the view that the rate of inflation peaked in the second quarter:

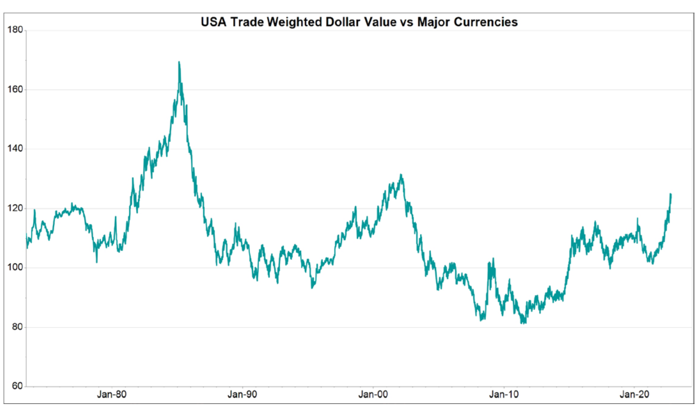


All of these numbers seem to contradict Powell who stated in late September: "Price pressures remain evident across a broad range of goods and services."

> "Life is a succession of lessons which must be lived to be understood. All is riddle, and the key to a riddle is another riddle."
>
> *Ralph Waldo Emerson*
> *Essayist 1803 –1882*



The wider problem with the dogged stance of the Federal Reserve Bank has been the impact of higher interest rates and bond yields on the attractiveness of the U.S. dollar to foreign investors. This has driven the value of the greenback to its highest in two decades and close to the highest for forty years:

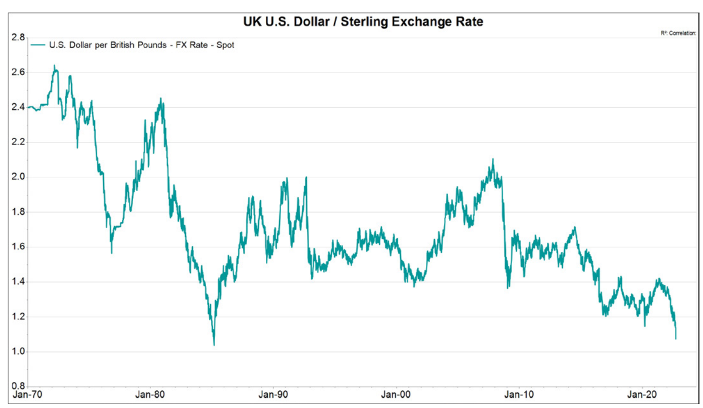


The attraction of investing in the U.S. can also be seen in the success of the Treasury in securing foreign investors to buy issues of new debt. Recent Treasury bond auctions, which fund the government's burgeoning deficits, are seeing up to 80% being bought by overseas investors. This is a significant help to the U.S. Treasury.

Unfortunately, in this interconnected world, the U.S. is not the only country struggling with unsustainable debt levels and the need to encourage offshore investors to invest in their government bonds. The problem globally is that the U.S. dollar is the world's reserve currency. Most raw materials and many finished goods are priced in dollars, which means that countries need to hold dollars and dollar assets to finance trade irrespective of how attractive these assets may be.

These fortunate attributes for the U.S. help the government finance its deficit caused by spending more than it generates in taxation. For many countries, however, the only path to encouraging inward investment is to make their bonds competitively attractive. This can only be done by a strong economy naturally encouraging inflows of capital investment, by providing an attractive yield / interest rate or, in extremis, by devaluing their currency.

The world has just been served a textbook example of how this can work. The UK economy is clearly in recession and is failing to attract foreign investors. The UK government has just announced a series of measures designed to stimulate growth; but at the same time it will increase the government's need to increase its borrowings. Global investors, sensing a significant level of economic vulnerability, immediately started selling UK government bonds. Bond yields rose dramatically, increasing the future interest cost to the UK Treasury. As a result, the British pound fell precipitously relative to the U.S. dollar before the Bank of England stepped in, spending nearly $70 billion to support the government bond market and the currency.



Interestingly, it wasn't the only currency to fall relative to the greenback, but it was the most extreme. The Japanese central bank has spent a similar amount to support the declining value of the yen relative to the dollar. Unfortunately, most of this forced spending appears to have counted for little, with both sterling and the yen currently trading close to their lows. At a time when, for global reasons post Russia's invasion of Ukraine, the U.S. has naturally attracted foreign investors seeking safety and security, the Federal Reserve Bank has, in effect, doubled down by making the U.S. dollar even more attractive by raising interest rates more aggressively than economies such as the UK.

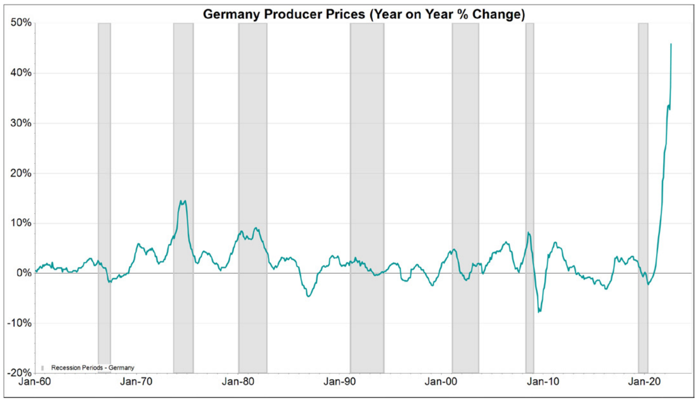
These moves by U.S. policymakers to rein in domestic demand have inevitably caused massive instability in capital markets globally. The United Nations has recently entered the fray, outlining the global imbalances caused by a strong dollar especially for emerging economies. However, unlike previous currency crises which were largely contained to emerging economies, this crisis is centered on the largest economies globally.

As a result, we do expect some reflection by Federal Reserve officials as inflation eases, prompting a more pragmatic approach during the balance of the current year and into 2023. While we don't expect interest rates to be lowered, declining inflation may provide the context for any further increases to be more modest.

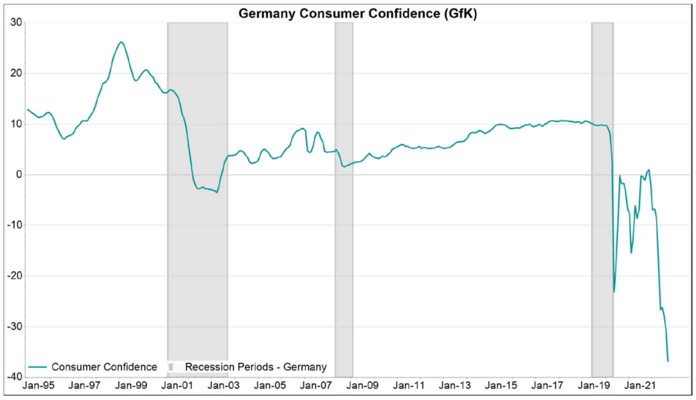
So, what is happening to the U.S. economy?

We can't look at the U.S. in isolation even though this appears to be the Federal Reserve's favored approach.

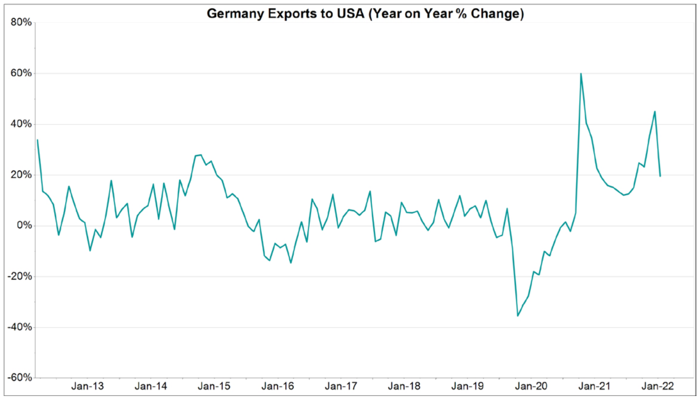
Globally, international economic activity is in a very difficult position. Inflation is much more onerous thanks to the sharp rise in the value of the dollar which inflates the costs of imports. Just consider the problems surrounding Germany. This is the largest economy in Europe and the fourth largest globally. The economy has been hit by punitive energy costs, thanks to Russia's Ukraine war, which not only hits the consumer but also the entire industrial manufacturing establishment. Input prices for manufacturers have soared to the highest for at least seventy years:



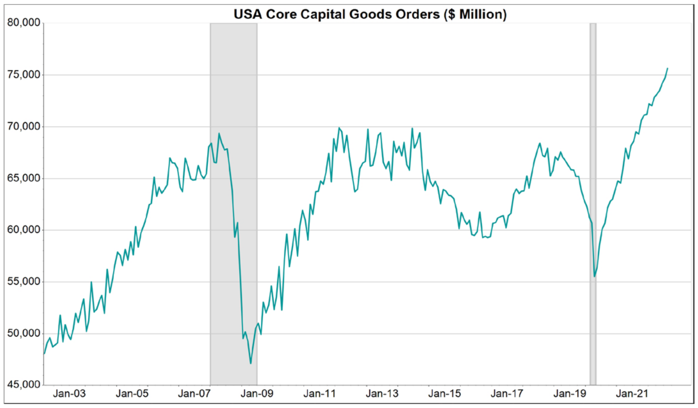
Meanwhile, consumer confidence has fallen to its lowest level on record:



Increasingly for Germany, the only game in town is exporting to the USA but even here there are some signs of a significant slowdown as the Federal Reserve Bank's policies are starting to reduce demand:



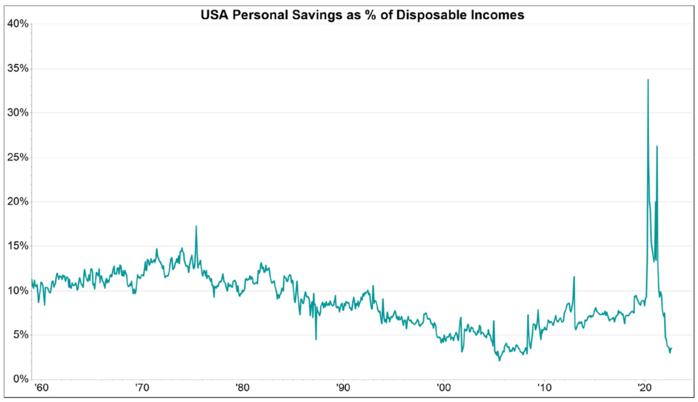
Evidence continues to point towards the U.S. economy having been in a recession for the last nine months but with one key positive area. The drive to increase the proportion of goods sourced from North America continues apace:



However, consumer spending, which accounts for two-thirds of U.S. economic activity, is clearly under pressure. The average 30-year mortgage rate has risen to the highest in fourteen years, while the pace of change over the last year has been the greatest since records began fifty years ago.

The impact on the demand for homes has been immediate and equally dramatic. The level of mortgage applications for purchasing properties has fallen to the lowest level since 2015 except for the pandemic-induced lockdown, falling 30% over the last year. As a result, housing inventory has risen with the number of unsold new homes at the highest level since mid-2006.

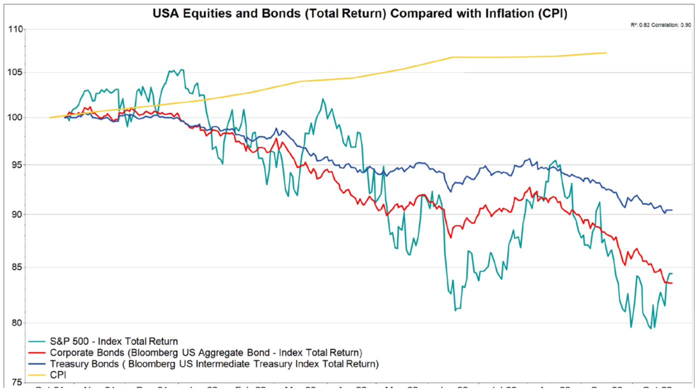
Consumer sentiment remains at levels rarely seen in the last 70 years, except during times of recession, although retail spending has held up relatively well. The main reason appears to be consumers 'eating' into their savings which are now reduced to levels last seen in early 2008:



While this tightening of the domestic economy may be exactly what the Federal Reserve Bank has been looking for, evidence increasingly points to a policy that may be too tight.

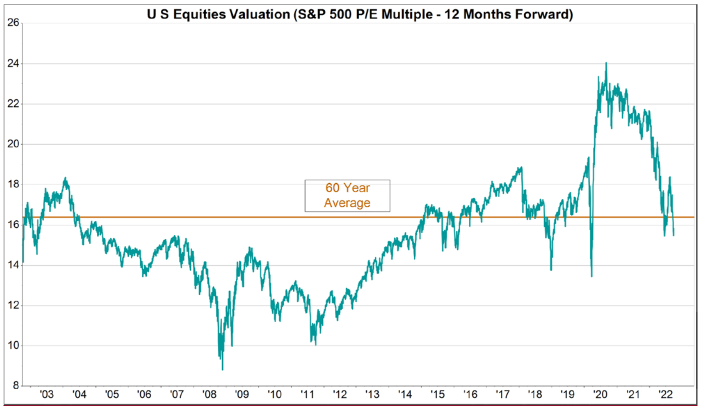
All these indicators - easing inflation pressure, global capital market instability and signs of a significant easing in domestic U.S. economic activity - suggest we may be closer to a reassessment of policy than the stock market performance indicates.

The stock market has been under considerable pressure from the start of the year, but it is not alone. Bonds too have been falling with total returns under considerable pressure:



While the action of the Federal Reserve policymakers has undoubtedly increased financial risk, and this can be seen in the performance of corporate bonds, especially lower quality, even Treasuries have not been spared. These moves have been very problematic for holders of bond mutual funds, where the lack of maturity means there is no capital preservation. However, for investors holding short-dated Treasuries and holding them until maturity, this has been an excellent way to protect capital.

The valuation of equities has reduced significantly to a point where it is now below the long-term average:

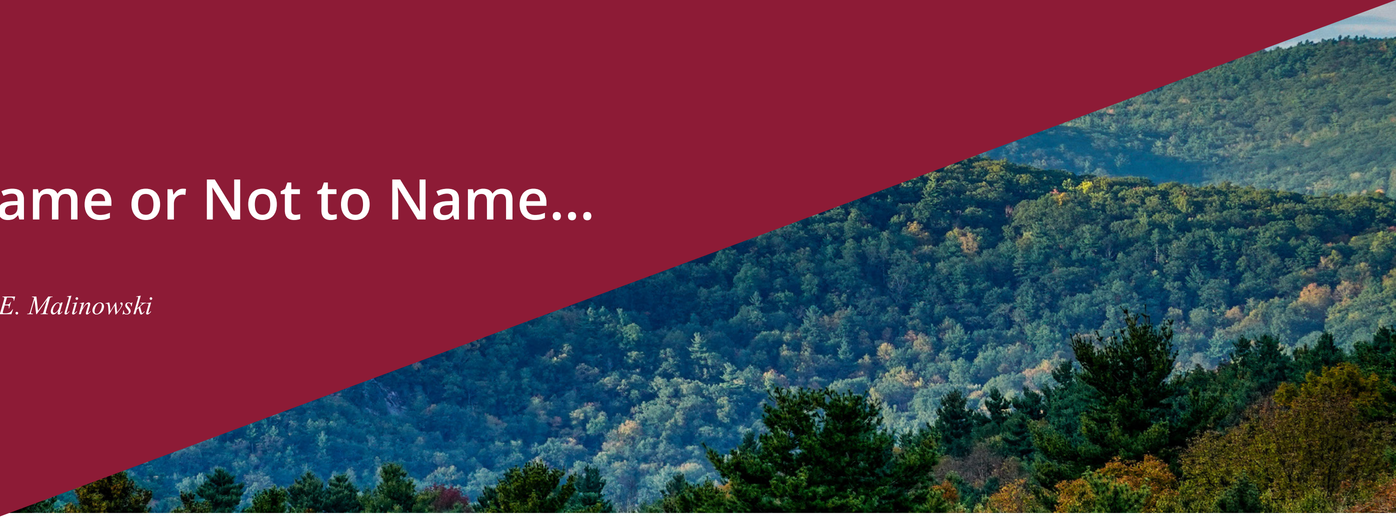


Although it is difficult to precisely pinpoint a reversal in what has been a very difficult year for equities, there is mounting evidence of value being created across a wide range of stocks.

Ever mindful of the psychological impact of extreme volatility, however, we continue to recommend a prudent investment strategy that pairs investment in financially sound companies with high quality Treasury bonds where it is now possible to find a reasonable return – at least until the strategy of the central banks and hence global economies becomes clearer. §§

To Name or Not to Name...

by Thomas E. Malinowski



We believe estate planning documents, including wills, trusts, and powers of attorney, should be reviewed at least every five years. This is important because there are often significant changes in one's assets, family dynamics, or Federal or state estate tax law. One provision to review is the choice of executor, titled personal representative in Massachusetts. Often clients simply choose their spouse or oldest child, when in fact this may not be the most effective choice. In this article I will describe the role of an executor, the specific responsibilities, and the type of individual well suited for this role.

Role of an Executor

In general terms, the executor has the responsibility to carry out the terms of the will and the intentions of the deceased. This includes understanding the financial position of the deceased, paying any outstanding debts and taxes due, and finally distributing remaining assets to the named beneficiary or beneficiaries. Depending upon the complexity of the estate, this could be a very challenging and demanding role requiring significant effort.

Specific Responsibilities of an Executor

As you will see, the specific responsibilities of an executor could be wide and varied. I have summarized the more common ones.

1. Locate latest original will and any trust documents which may have been executed. In most states the original will, not a copy, must be filed in probate. The executor should be well informed beforehand of the physical location of these documents. Often the attorney who drafted the documents will retain the originals.

2. Assemble a complete inventory of all assets and debts. It is the responsibility of the executor to prepare a specific summary of all assets and debts of the decedent. Again, it is important to have prepared beforehand what we refer to as an estate tax balance which describes all assets, liabilities, and life insurance. The executor should be provided with this information or the location of the statement prior to the death of the decedent. The executor is also required to value all assets, which may entail the use of a qualified appraiser.

3. Protect assets. An executor has the legal responsibility to protect and secure the assets of a decedent. This will include ensuring property and casualty insurance premiums continue to be paid in a timely manner, maintaining real estate to avoid deterioration and providing any necessary security.

4. Hire qualified professionals including an attorney and accountant. Often the decedent's attorney who drafted the documents will be appropriate. However, depending upon the age of the documents, the attorney may no longer be available, and a new attorney must be hired. Similarly, an accountant will be necessary to help sort through many of the income tax aspects of the estate.

5. Provide the attorney with the names of beneficiaries and heirs. Typically, the attorney will file the will with the appropriate probate court and notify all interested parties, whether beneficiaries or heirs at law. Therefore, it is important that the executor be provided with a "family tree" of their names and addresses.

6. Claim all insurance benefits. This will include any life insurance in force at the time of death, in addition to any medical and long-term health insurance claims which were valid at the date of death. To claim benefits, death certificates are required. The funeral home or the attorney will be able to assist in obtaining them.

7. File all tax returns. Depending upon the nature of the estate, there will be a final income tax return, recognizing the decedent's income to the date of death; an estate income tax return recognizing any income earned following death, and depending upon the size of the estate, estate tax returns.

8. Create a detailed record keeping apparatus. The executor has the responsibility to pay any outstanding bills and the costs associated with preserving assets. Therefore, an estate checking account is often required. The executor should keep a detailed bookkeeping of all funds coming into and leaving the estate.

9. Sale of real estate. Often it is necessary to sell real estate owned by the decedent, either to a third party or a family member who is interested in owning the property, such as a vacation home. The executor must hire a real estate agent, obtain the necessary appraisals, and make the decision to sell at an offered price.

10. Sale of personal property. Personal property includes furniture and household items as well as any artwork, collections, or jewelry. Such items are usually left to family members but if there is no interest in owning these assets, an estate sale may be required to dispose of them. Initially, an assessment is required to determine which items should be passed on to charities and not be part of a sale.

11. Notify Social Security. It is important that Social Security be notified as soon as possible following the death to cease benefit payments. If there is a delay in notifying Social Security, there will be a claim against the estate for unauthorized payment.

12. Distribute assets to beneficiaries. Finally, after the payment of all outstanding liabilities, including taxes, and the receipt of the necessary documentation from probate court, the executor is responsible for the distribution of the assets to the named beneficiaries. This will include obtaining the required wiring instructions from various banks and brokerage firms.

Type of Individual Required

Having described the responsibilities of an executor in some detail, the individual chosen should be a very detailed oriented person who possess the time and the ability to carry out this role.

The individual should be, although in many states it is not required, a resident of the state or community of the decedent, especially if real estate and personal property are involved. If not, much travel may be necessary.

The executor should not be similar in age or older than the decedent. At the time required the named executor may not be available to serve.

It will also be helpful to name someone who is familiar with the family dynamics involved. Here it becomes important that the executor is made aware of the intentions of the decedent.

Finally, any individual you chose as executor must be willing to serve in this capacity. As mentioned, this could be a very labor-intensive position and that person must be willing to devote the time and the energy required.

If you are interested in discussing your specific circumstances and the appropriateness of an individual chosen to fulfill this role, please do not hesitate to contact us at Renaissance.

Client Referrals

Renaissance prides itself on delivering exceptional levels of service and customized asset management solutions. While we are very selective about bringing on new clients, we always welcome referrals from our existing clients and close business partners.

If you believe someone could benefit from working with our team, Chris Silipigno is available to discuss what options might exist. He can be reached at:

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