Wealth Management Bulletin
Fall 2023

LCNB | Wealth

Welcome to Fall …

Michael R. Miller, JD, CFP®
Executive Vice President
Director of LCNB |Wealth
513-228-7657
mmiller@LCNB.com

Blake wants to be a butterfly. In her mind, she will be pink and purple and have wings. Of course, she will be able to fly. And she is going to be a butterfly…for Halloween. I should explain that my granddaughter is four years old and already has big dreams.

Blake wants to be a butterfly. I want her to grow up and still be able to dream. I want her to be educated, responsible, thoughtful, and most importantly, independent. A strong, independent woman who will always believe that being a butterfly is possible.

Independence is a process. It involves paying attention to your experiences, and learning from your mistakes. It involves counting your blessings and fulfilling your personal responsibilities. Independence is a good thing, a goal that most people share. But independence, without interdependence, may not be so positive. It can be isolating, frightening, and even lead to negative consequences.

Like most people, my wife and I take pride in our home, in its current condition, and the inviting environment we have created. But a plumbing or electrical problem will make it clear that we are somewhat dependent on others. Interdependence means knowing your limitations and when seeking professional help is the proper, and necessary, course of action.

Investing is a lot like that. Independently, one can understand inflation, interest rates, dividends, the difference between stocks and bonds and any one of the myriads of investment alternatives available. But trying to deal with all those things at once requires a thorough understanding of how they interrelate. In short, qualified, professional expertise and advice. Investing on your own can be like me doing a plumbing project at my house. I can identify the problem and probably even make a list of the component parts required for the repair. Regardless, without professional help, I know there will be a leak somewhere.

The team at LCNB| Wealth is here to allow you to be interdependent when it comes to your financial reality. We understand how the component parts fit together to satisfy your financial needs. We have the expertise and experience to make sure there are no leaks in your unique financial situation. Solid investment advice, financial planning, insurance planning, and trust and estate services are areas in which we can assist you so that you can achieve financial independence and long-term security for you and your family. Let us have a conversation and see how we may help you to clarify and reach your financial goals.

Blake wants to be a butterfly. With my daughter-in-law's ingenuity and my son's creativity, at least for Halloween, she will be. Able to fly? Not with the costume. But with proper planning, paying attention to her emotional and physical growth, and the 529 Plan that Grandma and I have established for her, she will be able to spread her wings and be the responsible, strong, educated, intelligent, and independent woman that we all hope her to become. Then, she will be able to fly.

Happy Halloween. Don't forget, without dependence on others, there would be no candy.

Thank you for your relationship with LCNB| Wealth.

Best Regards,

Mike

Roth IRAs - A Wonderful Retirement Vehicle

Brady Fening, JD, CFP®
Vice President
Wealth Compliance Officer
Director of Financial Planning
513-228-7666
bfening@LCNB.com

A Roth IRA is a tax-advantaged individual retirement account that comes with attractive advantages when compared to traditional IRAs. The primary benefit of a Roth IRA is that your contributions and the earnings on those contributions can grow tax-free and be withdrawn tax-free after the age 59½ assuming the account has been open for at least five years. Another major benefit of a Roth IRA: You do not have to take required minimum distributions (RMDs) while you are alive. The IRS requires holders of traditional IRAs to start taking RMDs by April 1 of the year after they reach age 73. These distributions are taxable and will add to your tax liability whether you need the income or not. When combined with other sources of income like tax-deferred accounts and Social Security, a Roth IRA gives you greater flexibility in managing your taxes in retirement.

Anyone may convert their IRA account to a Roth IRA regardless of marital status, employment status or income. This conversion is a taxable event and is taxed as if you withdrew the funds for your personal use. That money was not taxed at the time you made contributions, so it is taxable now. Your conversion will be taxed at your marginal tax rate: The top tax bracket that the withdrawal puts you in when it is added to your other income. And while it may be tempting to use some of the money being converted to pay the taxes, this is not ideal and would reduce the amount you have saved for retirement. A better approach is to pay the taxes from your other available funds.

The conversion does not have to be an all-or-nothing decision. Some people would rather spread out the tax liability that will come due on a Roth IRA conversion, even if they believe that conversion is their best long-term financial strategy. Partial conversions, year after year, will allow you to better manage your exposure to taxes while gradually shifting your retirement accounts to tax-free status over time.

Roth IRAs are a fantastic vehicle for retirement funds. Please do not hesitate to reach out to me or your trust officer to discuss how Roth IRAs may fit into your retirement planning.

Economic Summary – Still Waiting for the Pot to Boil

Bradley A. Ruppert, CFA®
Executive Vice President
Chief Investment Officer
Director of Wealth Investments
513-228-7658
bruppert@LCNB.com

As we noted last quarter, economic cycles can evolve slowly and it can take a long time for the full impact of rate hikes to be felt. After 18 months and 525 basis points in Fed rate hikes, we are still waiting to see how much economic damage has been done. While the mortgage market was devastated in 2022 by the initial round of rate increases, the impact on bank balance sheets did not come into focus until Silicon Valley Bank collapsed this spring.

Despite the hit to banks and the mortgage market, recent data indicate that the Fed's effort to temper economic growth has yet to hit the broader economy. According to the Atlanta Fed's GDPNow forecast, the third quarter Gross Domestic Product (total US output) grew at an impressive 4.9% rate. The September jobs data from the Bureau of Labor Statistics showed 336,000 new jobs added for the month, nearly double the expected amount and a strong indication that a recession is not on the immediate horizon.

At present, the Fed seems content to pause their rate hiking campaign. Current futures markets forecast only a 23% probability of a hike at the November meeting. However, the latest inflation data as measured by the Consumer Price Index is rising at a 3.7% annual pace. This is well above the Fed's 2% target. If the economy and inflation do not cool down soon, there is little doubt that the Fed will decide to resume their hiking campaign. In other words, either the economy starts to slow due to past rate hikes or the Fed is going to keep pushing until it does. Eventually the pot will start to boil.

Equity Summary:	**3rd Qtr.**	**YTD**	**12 Mth**	**3 Yr.**	**5 Yr.**
S&P 500 (Large Cap Domestic)	-3.27	13.07	21.62	10.15	9.92
Russell 2000 (Small Cap Domestic)	-5.13	2.54	8.93	7.16	2.40
MSCI ACWI Ex US (International)	-3.77	5.34	20.39	3.74	2.58

Stock Market Update – Rolling Over

Last quarter we suggested that markets were top heavy and poised for a correction. We thought the downturn would be led by the same 10 growth stocks that have carried markets higher for most of 2023. As we start the fourth quarter, markets have hit a soft patch, with the S&P 500 Index down 3.27% for quarter and down almost 8% (not quite an official correction of 10%) from the July 31st YTD high. So far, this selloff has not been led by the 10 dominant large cap growth stocks.

Zooming out we look at the 10-year chart of the S&P 500 Index and see a pretty well-defined trading channel for most of the past decade. The two obvious breaks were the Covid 19 shutdown in March of 2020. This was followed by the "sugar high" recovery fueled by $6 trillion in stimulus that took the index to a record high of 4800 by the start of 2022.

We view the return to the trading channel and recent pullback as a healthy sign for the market. In the 21 months since the market top, corporate earnings have grinded higher allowing valuations to catch up to the market. The most recent pullback gets us back close to fair value. However, given the rapid move in interest rates and uncertain economic backdrop, we remain slightly underweight equities. We look for a pullback to the low end of the channel or about 3850 as an attractive price to bring our target weights back to neutral.

Our underweight remains to the large cap growth portion of the market with neutral weights on foreign and small/mid-cap domestic issues where we see more attractive long-term valuations. We remind investors that when we talk about an overweight or underweight position, we are referring to minor allocation tweaks.

Fixed Income – Past Performance is No Guarantee of Future Results

Chris Robinson, CIMA®
Vice President
Trust Investment Officer
513-932-1414 ext.59106
crobinson@lcnb.com

During the 3rd quarter of 2023, long-term interest rates spiked higher, erasing the mild positive returns we experienced in the first half of the year. Despite the brief pause at the beginning of the year, the 10-Year treasury has steadily risen since 2020. This is in stark contrast to the roughly 40 years of declining interest rates we witnessed prior to that, from 1980 – 2020. The Bloomberg Barclays Aggregate Bond Index is down roughly 5% annualized over the past 3 years, testing the resolve of bond investors.

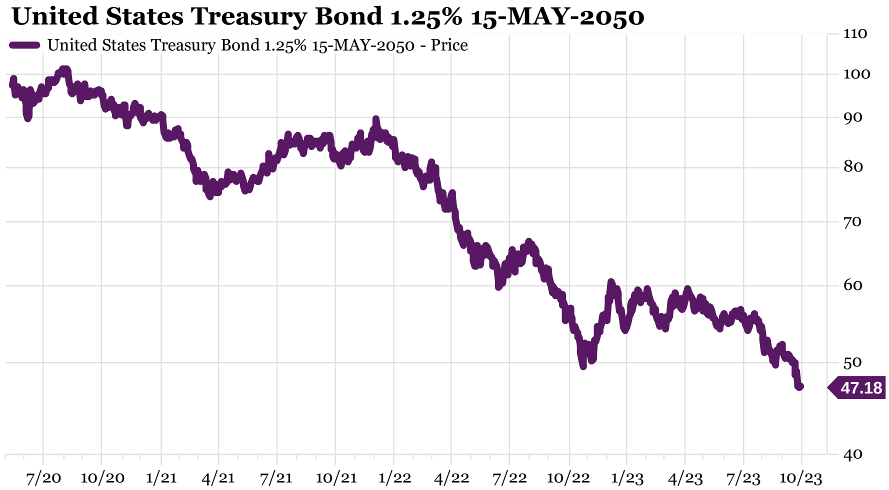
With any bond portfolio, the 3 main risks are:

1. Liquidity risk:
2. Credit risk:
3. Interest Rate risk:

Fixed Income Summary:	3rd Qtr.	YTD	12 Mth	3 Yr.	5 Yr.
US T-Bill 90 Day Index	1.24	2.40	4.10	1.50	1.59
BC Municipals 5Yr	-2.13	-1.00	2.02	-1.73	1.04
Bloomberg US Agg	-3.23	-1.21	0.64	-5.21	0.10
BC High Yield Corporate	0.46	5.86	10.28	1.76	2.96

If an investor was looking for a cash distribution from his bond investments and all of the bonds were thinly traded this increased liquidity risk could hurt long term performance. If the economy is struggling and corporate earnings are deteriorating, typically you would expect to see a widening of credit spreads due to increased default rates. During this time too much credit risk would lead to losses in the bond portfolio. And lastly if your bond investments have a long average maturity and interest rates move higher, the interest rate risk will negatively impact your portfolio.

Interest rate risk is what has led to the negative returns we have experienced over the past 3 years. In May of 2020 the government issued 30-year treasury bonds with a coupon of 1.25% at par. Today those bonds are trading at a price of approximately $47, more than half off the original price. While these bonds have almost zero liquidity and credit risk the interest rate risk was catastrophic to anyone who invested in these bonds.



At the end of the 3rd quarter the 10-year treasury closed at 4.57%, 76 basis points higher than the June 30th yield of 3.81%. The good news for bond investors is that the most recent move higher in interest rates has pushed rates slightly above their 230-year average. Going back to 1790 the average long term interest rates on US government issued bonds is 4.5%. While it is very possible that interest rates may continue their move higher the potential for future loss has dissipated greatly over the past 3 years.

While longer term bonds moved much higher during the 3rd quarter shorter term bonds also moved higher, the 2-year treasury moved higher 17 basis points from 4.87% up to 5.04%. During the quarter we did see the inverted yield curve flatten slightly on 6/30/2023 the spread sat at 1.06% by the end of the quarter this spread narrowed to 0.46%.

With the substantial move higher, we have seen in longer term interest rates during the 3rd quarter we view this as an opportunity to dip our toe into longer-term high-quality bonds. The Federal Reserve continues to point toward keeping inflation lower and has left the door open for future rate hikes, fueling our concern about the potential for a weakening economy and future recession. If that were to occur, historically long-term government bonds are one of the best investments and has led us to an overweight to bonds.

10 year yield (3 year chart) or 30 year price bond chart.

Alternative Investments Summary:	3rd Qtr.	YTD	12 Mth	3 Yr.	5 Yr.
Bloomberg Commodity	4.71	-3.44	-1.30	16.23	6.13
Dow Jones Global Real Estate	-6.00	-5.37	0.94	-1.58	-0.64
Morningstar Broad Hedge Fund TR	1.03	-0.98	1.41	16.47	8.28
Consumer Price Index	0.41	3.22	3.22	5.58	3.95

Alternatives Update – Up, Down, All Around

Erin K. Hawk, CFA®
Assistant Vice President
Wealth Investment Officer
513-228-7668
ehawk@LCNB.com

Commodities significantly outperformed other asset classes fueled by West Texas Intermediate (WTI) Oil returning an astounding 28% in the third quarter. OPEC+ cut production in the beginning of September; 2 members of OPEC+ (Saudi Arabia and Russia) also announced at the end of September that they would extend their voluntary output cuts through the end of 2023 helping to bolster oil prices further.

Conversely, gold continued to decline in the 3rd quarter ending at $1849/ounce. As we have mentioned in the past, higher interest rates exert downward pressure on the price of gold as investors no longer want to hold an asset that provides no income. This opportunity cost is amplified when rates are as elevated as they are right now – above the 230-year average as Chris mentioned above. These same headwinds have kept cryptocurrency prices weighed down with Bitcoin bouncing around the $27k range and Ethereum staying near the $1700 range.

The First Trust Long/Short Equity Fund (FTLS) that we spotlighted last quarter continues to provide a benefit to portfolios: while the S&P dropped 3.27% this quarter, FTLS was up 1.07%. Once again, long/short funds take strategic positions in assets based on relative over and underpricing. This allows the Portfolio Manager to capitalize on price discrepancies and decrease overall market 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.

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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.