Wealth Management Bulletin
Summer 2020

Welcome to Summer ...

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I hope this finds you well and that you and your family are navigating the many adjustments we have all had to make during this very unusual time.

For the most part this Summer, your Wealth Management Team here at LCNB has been working remotely. Recently, however, with the completion of the Main Office branch renovation, we have been able to reopen our department. We are currently operating with limited in house staff, properly masked and socially distanced, of course.

Since the beginning of the Pandemic, I have had the unusual experience of attending a number of in person meetings in which everyone was wearing masks. While it is genuinely refreshing to be in the same room, it is unusual to be unable to see the expressions on a person's face. With the mask in place, a person's facial expressions can be more easily hidden making it more difficult to determine their true feelings and reactions to certain topics of conversation.

Fully understanding reactions and true feelings is essential in the financial services business. It is important to discuss and understand a person's needs and circumstances, but it is just as important to be able to assess motivations and true feelings. And while we have all been wearing figurative masks for years, I believe I have developed a reasonable ability to "read" people. How much of what we are discussing do they really understand? What economic and family dynamics cause them anxiety? How much confidence do they have in my ability to listen, process possibilities and realities, and create appropriate solutions to meet their needs?

That is really the charge for the entire LCNB Wealth Management Team. Listen, process, evaluate, and create solutions that truly meet our clients' needs. We have a lot of experience at looking behind a person's mask to see what is really going on. The current Pandemic has made that challenge a little more difficult.

Even though your Wealth Management Team is for the most part operating remotely, we are available to get together in a number of different ways. Telephone, email, WebEx, or in person, properly socially distanced, if you prefer. We'll look behind the mask to help you and your family meet your investment, estate planning, financial planning, retirement planning, and Trust needs.

Welcome to Summer. Mask up, be safe, and take care. Thank you for your continued confidence in LCNB.

Best Regards,

Mike

Economic Summary – Bungie Jump Data

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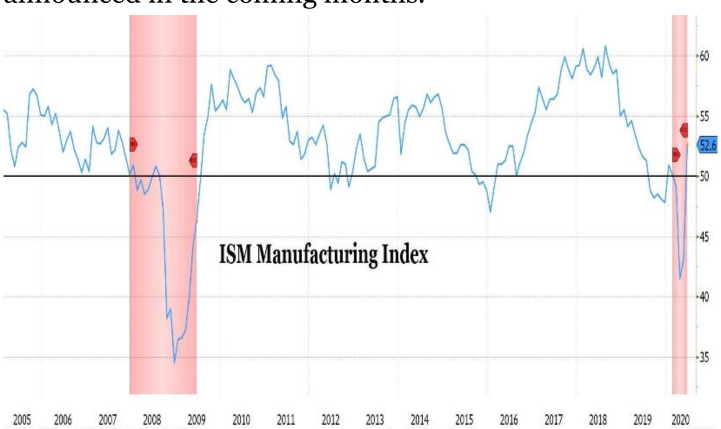
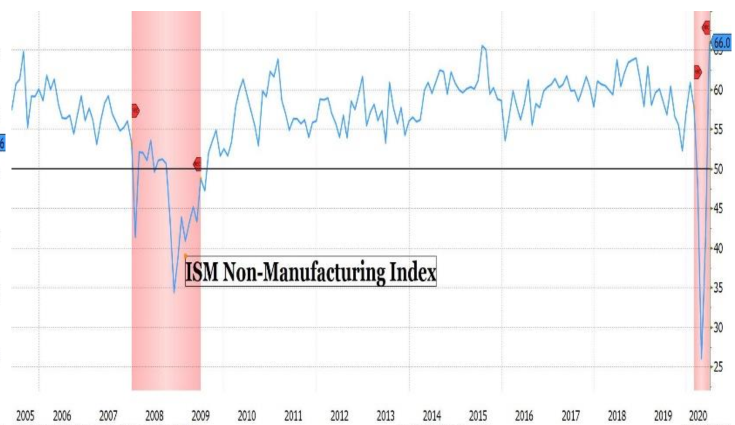
Economic data rebounded sharply in the second half of May and June following an unprecedented plunge from the Covid-19 shutdown. We continue to see historic swings in data as the global economy emerges from this initial shutdown phase. Returning to our self-induced coma analogy from our last Bulletin, we now see a patient that is up and moving and feeling decent. However, they are far from 100%. Absent a serious dose of steroids, they would likely still be in bed. In fact, much of the recovery, like the shutdown itself, is artificial in nature. The steroids in this case, came in the form of massive amounts of fiscal and monetary stimulus.

The Cares Act, and subsequent revisions, have provided over $2.4 trillion worth of relief so far. This includes an estimated $268 billion in employment benefits at $600 per week through July 31st, $293 billion in one-time recovery rebates, over $760 billion to small businesses in the form of PPP loans, and an additional $1.1 trillion in other programs. In addition to this massive fiscal stimulus, the Fed has cut rates to zero, expanded the balance sheet through quantitative easing, and established the Main Street Liquidity program to provide $2.3 trillion in future economic support.

Academics and politicians will likely argue about the efficiency, effectiveness, and long-term costs of these programs in the years and decades to come. However, there is little doubt that the short-term impact has been substantial and led to the bungie like bounce alluded to in the header. If nothing else, these efforts have kicked much of the economic pain from Covid-19 down the road. While news of bankruptcies and closures are starting to trickle in throughout the retail and hospitality sectors, we have little doubt that the failures would have been much more severe and sudden if not for the stimulus described above.

Covid-19 creates some clear winners and losers as U.S. consumer and business habits evolve. Large scale and technology-based companies have fared the best or even benefited from these changes. Smaller businesses and those in the retail or hospitality sectors have been the hardest hit. In contrast to the Financial Crisis of 2008 – 2009, this contraction is more pronounced on the services sectors (charts below) which make up a much larger portion of the economy. Even with another round of stimulus, we expect more bankruptcies and closures to be announced in the coming months.



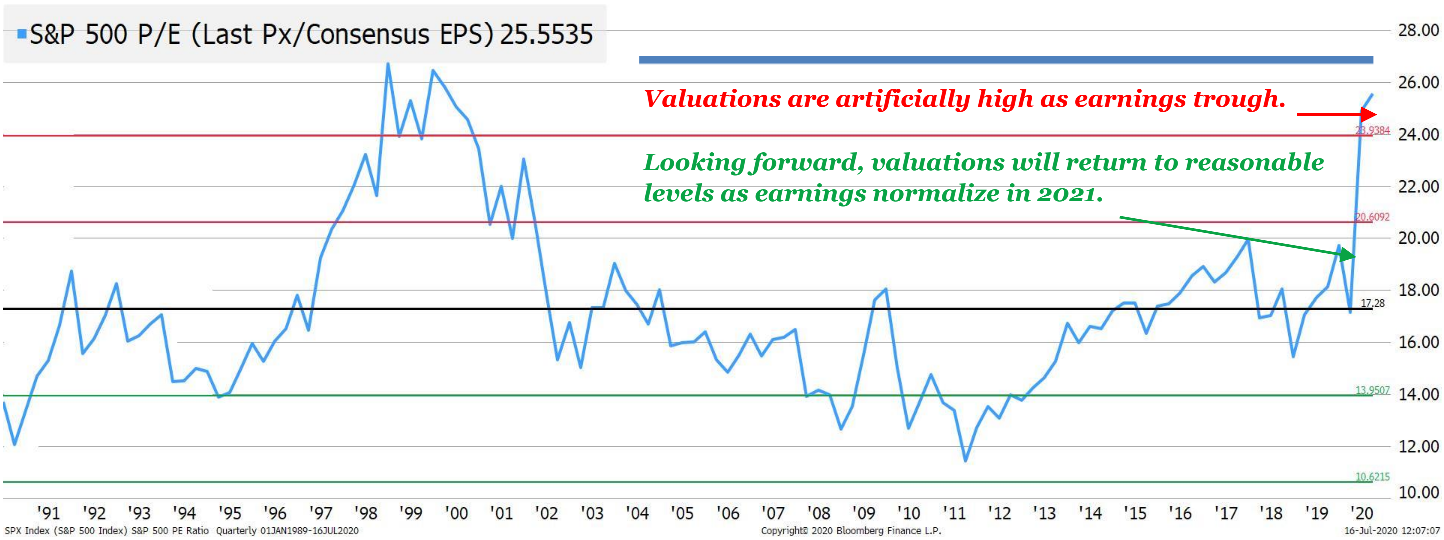


As we move into the second half of 2020 (I can't wait for it to be over), it is important to recognize that we still have more questions than answers. We are glad the patient is improving, but we recognize there is a long road ahead to a full recovery. How long until we have an effective cure or vaccine? Will sports and schools resume or are we headed for another shutdown? How will all of this impact the upcoming election and what will that mean for tax and spending policies in the next four years? Given all the uncertainty described above, we recommend investors take a conservative approach to the second half of the year. With stocks back near pre-Covid levels, it is a good time to build ample liquidity for the coming months and make sure portfolios are not over-extended on risk.

Equity Summary:	2nd Qtr	YTD	12 Month	3 YR	5 YR
S&P 500 (Large Cap Domestic)	20.54	-3.08	7.51	10.73	10.73
Russell 2000 (Small Cap Domestic)	25.42	-12.98	-6.63	2.01	4.29
MSCI ACWI Ex US (International)	16.12	-11.00	-4.80	1.13	2.26

Equity Update – Fuzzy Valuations

Stocks have made an historic rebound since the March 23rd low and now look complacently priced given the backdrop described above. With the S&P 500 Index trading above 3150, this marks an increase of 40% off the bottom. As jumpy as the economic data is, we expect earnings data to be equally volatile for the next few quarters. This can make valuations very fuzzy and is especially true for a very simplistic measure like the Price to Earnings ratio or P/E. While this can be a good way to quickly value a stock when earnings are fairly stable, it is not very reliable when earnings are unpredictable, as seen in the chart below. Take the current price of the index of 3150 and divide by expected 2020 earnings of $125 and you get a P/E of 25.2. Taken at face value, this would indicate that stocks are trading at more than 2 standard deviations above normal (translation: really expensive). For a new investor in 1999 that bought in at 2 standard deviations above normal, it took over ten years to see positive returns.



We remind investors that stock prices should reflect all future expected cash flows discounted to the present value. For long-term investors, looking past one or two bad quarters does make sense. If we fast forward a couple quarters, we see that consensus earnings estimates for 2021 are around $160 for the S&P 500 index. Take 3150/160 and we get a forward P/E ratio for 2021 of closer to 19.7. Still not cheap, but not nearly as expensive as the above chart might indicate. Drilling down further, we see that within the index there have been some clear winners and losers.

Given the move by businesses and consumers to remote operations and purchases, it is easy to see why technology stocks have done so well. Many domestic large cap growth stocks are now trading at all-time highs. This is in stark contrast to small stocks or those tied to energy, hospitality, retail, or financial services industries that have been hit much harder. Stock valuations in the latter categories seem to better reflect the economic and election uncertainties that lie ahead. We are currently positioning portfolios with an equal weight to most categories including small, mid cap, foreign (including emerging markets), and value. However, we recommend an underweight to large cap domestic growth stocks.

Fixed Income Summary:	2nd Qtr	YTD	12 Month	3 YR	5 YR
US T – Bill 90 Day Index	0.04	0.31	1.20	1.62	1.12
BC Municipals 5YR	2.97	2.60	4.16	3.18	2.79
BC Intermediate Government/Credit	2.81	5.28	7.12	4.43	3.46

Fixed Income Update – A Glass Half Full or Half Empty

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The current pandemic we find ourselves in has truly had a large impact on the way businesses operate and individuals communicate. Covid-19 has forced many employees to adjust to working from home, and video conferences have replaced face to face meetings. When going out in public, we are encouraged and sometimes required to wear protective face covering. We all hope that the current restrictions to which we find ourselves adapting are temporary and that a vaccine and treatment are discovered shortly. If the bond market's 2nd quarter rally is any indication, then maybe the worst is over for the economy and more importantly for the health of everyone effected by Covid-19. While we were all adjusting to social changes in the second quarter, treasury rates stabilized and credit spreads narrowed. It's commonly accepted that the bond market is typically a better economic predictor than the stock market. Bonds tend to act more rationally because it takes more money to move interest rates and spreads. During the past quarter both stock and bond markets showed signs of optimism for the economy and its recovery, but it's possible that the markets may have gotten ahead of themselves.

The 10-year treasury started the quarter yielding 0.70% and ended the quarter with a yield of 0.66% moving down just 4 basis points during the quarter. While the treasury market remained relatively quiet the real movement occurred in the credit markets. Both corporate and high yield bond markets rallied during the quarter. Starting the second quarter the corporate spread was 3.15% and by quarters end the spread was almost cut in half ending at 1.61%. During the first quarter, high yield bond spreads widened dramatically and ended the quarter with a spread of 9.19%. In the second quarter the spread narrowed to 6.39%. The Federal Reserve cut the Fed Funds rate to 0% in the first quarter and left it untouched during the second quarter. They did however continue to act as the "lender of last resort" as they continued their "unlimited" bond purchase program. On June 15th the Fed announced they would begin purchases of up to $250 billion in corporate-credit bonds and have the potential to purchase up to $750 billion in total.

Fixed-Income Index Returns

Broad Market Index	2Q20	1Q20	2019	2018	2017	2016	2015
Core Bond	2.82	3.20	8.65	0.13	3.40	2.55	0.62
Short-Term Core	1.06	1.58	5.17	1.35	1.37	1.58	1.05
Intermediate Core	2.92	2.11	8.38	0.56	3.15	2.48	1.25
Long-Term Core	5.75	7.03	20.07	-4.75	10.87	6.79	-3.91
Sector Indexes							
U.S. Treasury Bond	0.22	8.50	6.82	0.86	2.30	1.02	0.80
Asset-Backed	4.00	-1.87	4.08	2.00	1.82	1.92	1.05
Corporate Bond	9.22	-4.08	14.22	-2.23	6.13	5.98	-0.65
High-Yield Bond	10.29	-12.91	14.33	-2.27	7.30	17.46	-4.44
TIPS	4.05	1.65	8.16	-1.20	2.88	4.54	-1.15

Source: Morningstar, Inc. Data as of 06/30/2020.

Federal Reserve intervention led to lower treasury rates and increased demand for higher risk bond investments during the second quarter of 2020. Investors looking for income have been forced to abandon higher quality bonds pushing them down the credit quality ladder and potentially into investing in dividend yielding stocks. We are still waiting on the economic data from the second quarter, including corporate earnings, to be released. With historically low interest rates investors need to be careful with the bonds they invest in, as the risk may not be worth the reward. We believe that the risk of corporate defaults is higher than normal and corporate spreads may not be accounting for these defaults. As a result, some of our historical bond market exposure has been dedicated to cash and we will be looking for an opportunity to re-enter the bond market. Covid-19 remains the biggest question for the markets, we don't know when a vaccine will be discovered or if another state issued stay at home order may occur. Until we see more clarity, we hope that our clients stay safe and know that we will keep an eye on your investments.

Alternative Investments Summary:	2nd Qtr	YTD	12 Month	3 YR	5 YR
Bloomberg Commodity	5.08	-19.40	-17.38	-6.14	-7.69
Dow Jones Global Real Estate	11.98	-16.98	-10.73	1.39	3.54
Morningstar Broad Hedge Fund TR	6.96	-10.52	-7.23	0.56	0.70

Alternatives Update – All That Glitters is Gold

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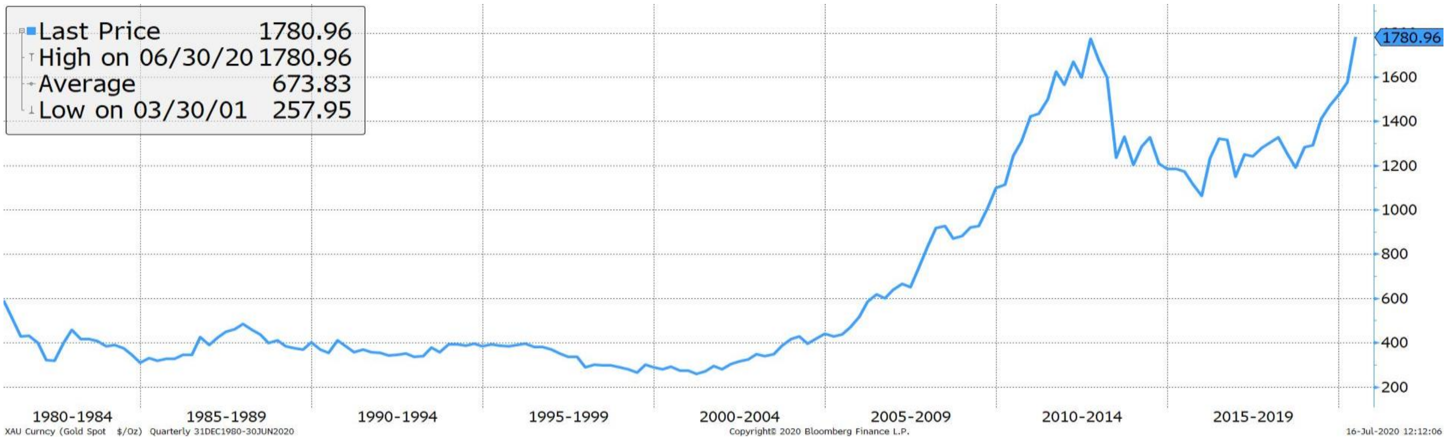
With equity markets arguably overvalued and the fixed income market offering little in the way of yield, we have been increasing our allocation to alternative investments. Other than REIT's (Real Estate Investment Trust), many asset classes within alternatives are currently attractive. Real estate investments could see an uptick in defaults as the hospitality and retail sectors continue to struggle, especially with the recent surge in Covid-19 cases. We see future opportunities arising in infrastructure as government stimulus packages begin to focus on that area to help support the U.S. economy. For example, the Heroes Act that the House Democrats passed in the beginning of June included $1 trillion to be invested into infrastructure.

The commodity asset class offers additional opportunities. As we mentioned in the Spring bulletin, gold tends to perform well during volatile times and in low interest rate environments. Gold closed out the 2nd quarter at all-time highs, pricing in at $1780.96/ounce. As governments around the world continue to print money with seemingly no limit, gold looks even more enticing right now. Gold can help preserve the wealth of investors if inflation increases and regular paper-denominated currency devalues. The Russia-Saudi dispute led to oil prices plummeting in the 1st quarter, but after reaching an agreement in April, WTI crude oil almost doubled to close the 2nd quarter at $39.27/barrel. The current prices should also push out some of the higher cost producers, decreasing overall output to better match demand and provide further stability.



The rise in oil and gold prices during the 2nd quarter led to the index posting a gain of 5.08%.

Another potential alternative strategy are long-short funds. The premise behind these funds are to sell short securities that are believed to be overvalued and have room to fall. The proceeds from these sales are used to purchase securities that the fund managers believe to be undervalued with expected growth. This type of fund helps to diversify a portfolio and increase the risk adjusted return given the low correlation to traditional asset classes. Typically, the long-short strategy will still participate when the market increases, even outpacing the market when it is trading sideways (not moving significantly up or down). The additional strength of this strategy is that when the market corrects, it should provide some protection.

As we mentioned above, we believe equity markets are expensive and bond markets are not providing adequate yield. Alternatives have the potential to provide higher risk adjusted returns going forward, and our team has been strategically adding more to that asset class. If you would like to discuss our market outlook or how alternatives might fit into your portfolio, please reach out to any of our LCNB Officers.

IRA Rollover and RMD Relief under the CARES Act

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There have been many new tax and wealth management-related changes this year due to the SECURE Act enacted in late December and the CARES Act enacted a few months ago to provide economic relief to taxpayers amid the pandemic. One such change under the CARES Act is the waiver of Required Minimum Distributions ("RMDs") from workplace retirement plans and IRAs. The waiver can provide substantial tax savings for you, if you are otherwise required to take the distributions but do not depend on the income. However, if you had already taken your RMD in 2020, it was uncertain whether you could utilize the tax savings by reversing the previous transaction.

Fortunately, the IRS recently provided new guidance on this issue in Notice 2020-51. Specifically, the IRS announced that anyone who already took an RMD in 2020 may roll those funds back or repay those funds into the retirement account and reap the tax savings, as long as they do so by **August 31, 2020**. The Notice further provides that the repayment is not subject to the one rollover per 12-month period limitation and the restriction on rollovers for inherited IRAs. If you withheld income taxes from your previous RMD this year, it remains unclear whether you may return those funds to your retirement account. Because of this uncertainty, we recommend that you limit the rollover or repayment to your net distribution (your retirement distribution after tax withholdings) and plan to receive a refund of the withheld taxes when you file your tax returns for 2020. (Due April 15, 2021).

There are many moving parts to the CARES Act that may cause confusion as to how the law may benefit you. Please do not hesitate to contact your LCNB trust officer and portfolio manager to discuss the impact of these changes on your personal situation in greater detail.

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During this time of uncertainty, each of us are finding new ways to accomplish routine tasks and fulfill our personal and professional responsibilities. Your LCNB Wealth Management team continues to collaborate daily to ensure that you receive the same attention and care to which you are accustomed. Clients can feel confident that we have been operating at full capacity and without interruption.

We are actively reaching out to our clients to ease any concerns and address questions that you may have. While we are not able to hold our valued face-to-face meetings, we are happy to speak with you virtually either by phone, WebEx, or FaceTime. To remain current about measures that LCNB is taking to support our clients, please visit LCNB.com, or click below.

LCNB National Bank

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 Mike Miller @ 513.932.1414, ext. 59101 or mmiller@LCNB.com for more information.