Wealth Management Bulletin
Winter 2023

LCNB | Wealth

Welcome to Winter …

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One month into 2023, we are all to be congratulated for having survived the financial turmoil that was 2022. I am not certain what you expected back in January of last year, but I am certain that it was different than what we got. A war in Ukraine, prices rising due to unusually high inflation, severe weather events, and a more divisive than usual political climate were among the things that I personally did not expect last year.

Many years ago, the Greek philosopher, Heraclitus (535 BC- 475 BC), a man much wiser than me, said… "If you do not expect the unexpected, you will not find it, for it is hard to be sought out and difficult." He believed that fire is the origin of all things, and that permanence is an illusion, everything being in a process of constant change.

I am fairly certain that you did not expect me to be quoting the words of a man from 500 BC. Nor do I expect us to have a discussion about fire being the origin of all things. But I do think we can all agree with his view that everything is in the process of constant change.

The Irish playwright, Oscar Wilde, (1854 - 1900), put a more modern spin on Heraclitus' words, when he said… "To expect the unexpected shows a thoroughly modern intellect." By definition, an expectation is a strong belief that something will happen or be the case in the future. Based on our own experiences, we all expect that things will change. But how do we learn to expect the unexpected?

When it comes to your family, legacy and financial future, there will be many changes. A change in employment or other personal financial circumstances. A change in financial focus based on the needs and evolution of your family dynamic. A change in direction as careers move laterally or wind down. And of course, there will be changes in the markets as the financial winds shift.

Some of the changes will be positive as we discuss in the succeeding article, "2023: By the Numbers," that highlights some retirement planning enhancements. Others may prove negative, such as an unexpected health condition, or a change in the family dynamic. Changes that are positive in some circumstances can prove negative in others.

I rather think that Oscar got it right. To expect the unexpected is the smart thing to do. Our team at LCNB |Wealth is here to help you navigate through the expected and unexpected matters that can impact your family's financial legacy. Our experience and expertise can help you better understand what to look for and how to respond to those things that you did not see coming. Let's have a conversation.

Welcome to Winter. We are expecting good things for you and your family.

Thank you for your relationship with LCNB |Wealth.

Best Regards,

Mike

2023: By the Numbers

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New Year usually brings a few changes to Estate Planning. One of these is the IRS adjustments based on inflation. This year those changes are more noticeable due to higher-than-usual inflation.

Among the most significant changes affecting us this year are income tax brackets. The good news is that some may see a smaller tax bill this year due to the increase in the tax brackets.

There are many additional changes involving tax deductions and credits, so it is beneficial to contact your CPA now to start planning for the 2023 tax season. The goal is to adjust your tax withholding, so you don't owe anything and get nothing from IRS. Getting a refund check only means that you gave the government an interest-free loan.

Tax Rate	2023 Brackets	2022 Brackets
37%	Income over $578,125 ($693,750 for married couples filing jointly)	Income over $539,900 ($647,850 for married couples filing jointly)
35%	Income over $231,250 ($462,500 for married couples filing jointly)	Income over $215,950 ($431,900 for married couples filing jointly)
32%	Income over $182,100 ($364,200 for married couples filing jointly)	Income over $170,050 ($340,100 for married couples filing jointly)
24%	Income over $95,375 ($190,750 for married couples filing jointly)	Income over $89,075 ($178,150 for married couples filing jointly)
22%	Income over $44,725 ($89,450 for married couples filing jointly)	Income over $41,775 ($83,550 for married couples filing jointly)
12%	Income over $11,000 ($22,000 for married couples filing jointly)	Income over $10,275 ($20,550 for married couples filing jointly)
10%	Income below $11,000 ($22,000 for married couples filing jointly)	Income below $10,275 ($20,550 for married couples filing jointly)

Below are a few other changes for the 2023 year that may affect you:

- Increase the maximum allowable contribution to 401(k) or 403(b) to $22,500 with additional $7,500 catch-up contributions if you are 50 or older.
- Increase the maximum allowable contribution to Health Savings Accounts (HSA) from $3,650 for individuals ($7,300 for families) to $3,850 for individuals ($7,750 for families). Plus, a $1,000 catch-up contribution over 50.
- IRA contribution limits increased to $6,500 for both Traditional and ROTH IRAs, with an additional $1,000 catch-up contribution if you are 50 or older.

Remember that maximizing your contribution is an excellent planning and tax savings tool!

- Additionally, the Annual Exclusion for gifts increases to $17,000 for the calendar year 2023, up from $16,000 in 2022. Estates of decedents who die during 2023 will have a Basic Exclusion amount of $12,920,000, up from $12,060,000 in 2022.

For more changes, please visit: https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2023.

In addition to the above-referenced changes, congress passed the SECURE ACT 2.0. One of the most significant impacts of this bill is the increase of age individuals must start taking the Required Minimum Distribution from their IRA or other retirement accounts from age 72 to 73 beginning January 2023.

IRS is also working on finalizing the approval of the Inherited IRA rule update from the original SECURE ACT 2019 for some beneficiaries. Initially, certain heirs, known as "non-eligible designated beneficiaries," had to deplete inherited retirement accounts within ten years. This is known as the "10-year rule." IRS proposes requiring an annual RMD if the original owner has already reached their "required beginning date," but the calculation details are still pending. We are monitoring the changes and will notify current Inherited IRA beneficiaries that might be affected if this change occurs.

Please mark your calendars for Tax Day – April 18th, 2023! Don't hesitate to contact your Trust Administrator to schedule an appointment if you have additional questions. Have a Happy and Prosperous 2023!

Economic Summary – Falling Dominoes

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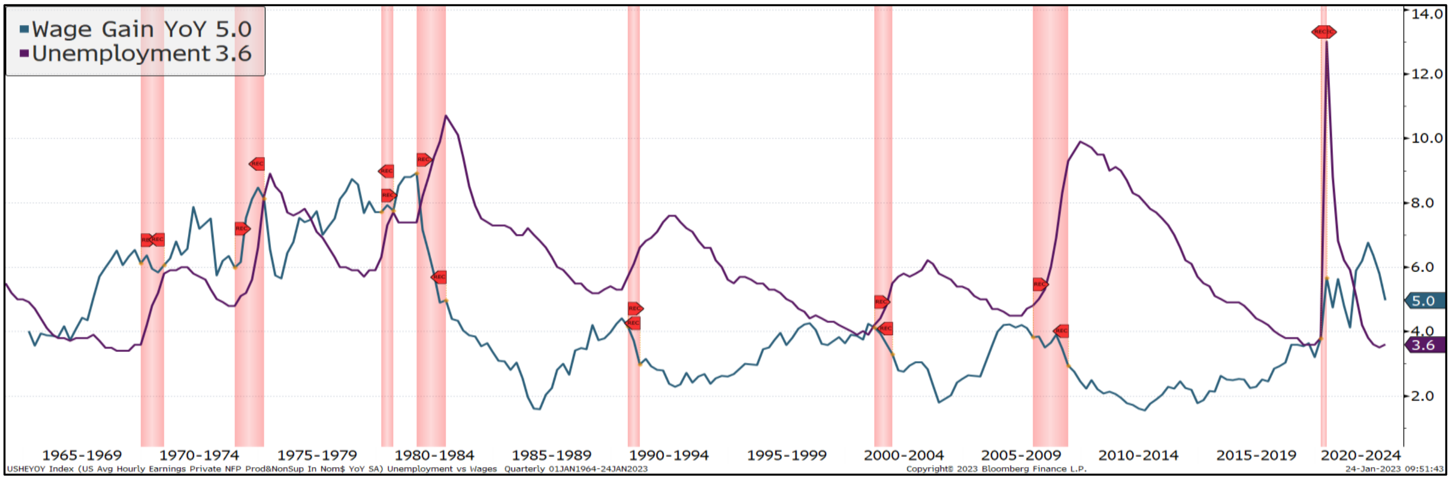
Economists and market participants are on recession watch as we flip the calendar to 2023. The Federal Open Market Committee, or Fed, embarked on an aggressive campaign to fight inflation in 2022 that is just now starting to wind down. The Fed is expected to bump rates by a quarter point at the February meeting and then one last time at the March meeting. At that point, they are expected to hit the pause button and wait to see just how much damage has been inflicted.

So far, the results are somewhat mixed. Inflation as measured by the Consumer Price Index has started to roll over but remains elevated. After peaking at an annual rate of 9.1% this past summer, the latest CPI number from December has cooled to 6.5%. Much of the decrease has come in the more volatile food and energy components of the index where prices have dropped significantly. Some of the fall is related to the normalization of global supply chains. However, the Fed's aggressive actions have no doubt started to have an impact as well.

Signs of a slowing economy are popping up all over as the increase in interest rates take their toll. The rate increases had an immediate impact on housing as borrowing costs more than doubled early in the year and new housing starts and refinancing activity stalled dramatically. The change in interest rates also had an immediate impact on financial markets. Investors saw one of the worst years since the Great Financial Crisis with both stock and bond prices tumbling.

We noted last quarter that the Leading Economic Indicators Index turned negative. This along with an inverted yield curve are strong signs of an economic contraction in the months ahead. However, despite all these falling dominoes, there are two very important dominoes still standing. While some cracks have started to appear, the labor market and closely related consumer spending measures are holding strong. With nearly two thirds of the U.S. economy tied to consumer spending, we are not likely to get a recession unless these last dominoes topple over.

Some signs of a weaker consumer are apparent with potential retail bankruptcies from Bed Bath and Beyond as well as Party City reported recently. Additionally, the tech sector is trying to protect profits with large layoff announcements from Tesla, Twitter, Microsoft, Alphabet, and Amazon to name a few. Despite these large layoffs, the unemployment rate is just 3.5% as of the most recent Bureau of Labor report. There are still nearly 2 jobs for every unemployed person with 10.1 million jobs not filled as of the January 4th data. Finally, wage gains remain elevated at an annual increase of 5.8% year-over-year which further supports consumer spending.



We will be watching these last two dominoes closely in the months ahead. If they fall, then the expectation is for a shallow recession. If they remain standing, then the Fed will have achieved the soft landing they were aiming for. In either case, we are looking at little to no economic growth in 2023 and much of this is likely priced into financial markets.

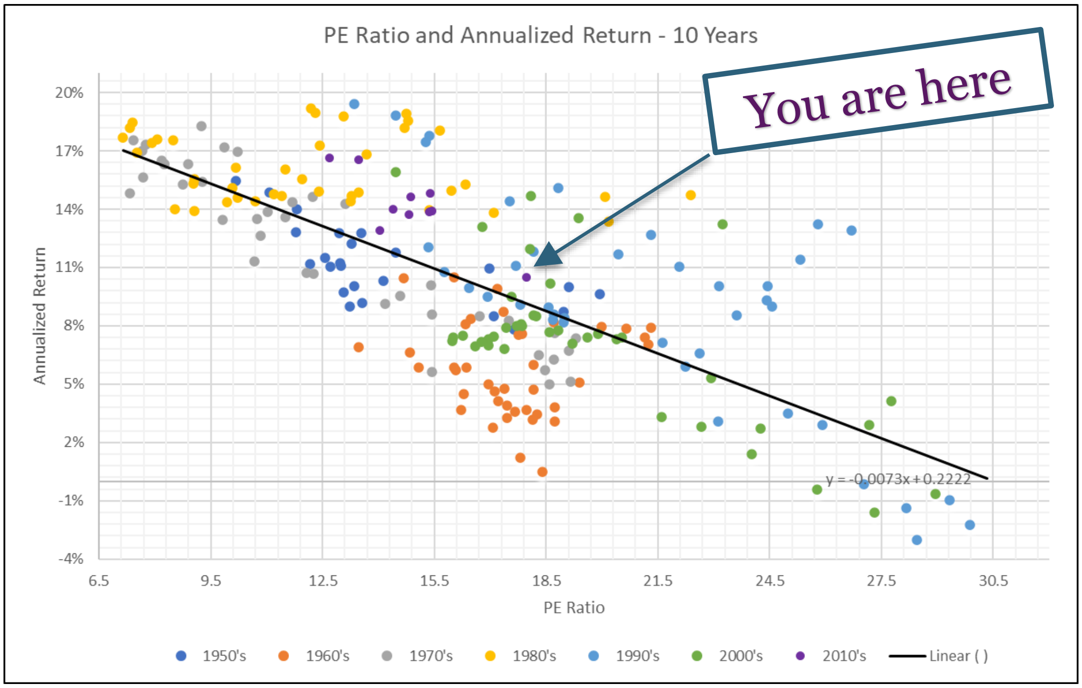
Equity Summary:	4th Qtr	YTD	12 Mth	3 Yr	5 Yr
S&P 500 (Large Cap Domestic)	-4.88	-18.11	-18.11	7.66	9.42
Russell 2000 (Small Cap Domestic)	-2.19	-20.44	-20.44	3.10	4.13
MSCI ACWI Ex US (International)	-9.91	-16.00	-16.00	0.07	0.88

Stock Market Update – Ouch!

Rising interest rates hammered stocks in 2022 with the S&P 500 Index down almost 27% at the October low. Stocks did rally in the fourth quarter as inflation started to cool and the Fed began to pivot away from aggressive tightening. The S&P 500 Index finished the year down over 18%. Stock valuations are a discount on future expected cashflows so as the discount rate goes up, prices go down. Growth stocks that rely the most on future expected earnings were especially hard hit as the Russel 1000 Growth Index lost over 29% in 2022. Value stocks fared much better but still lost 7.6% for the year. The value outperformance reverses a 15-year trend going back to the Great Financial Crisis and may have a little further to go before the gap between growth and value stocks is fully closed. One surprise in 2022 was the outperformance of international stocks versus the S&P 500 Index. The MSCI ACWI-ex US Index was down 16% for the year. The outperformance was very modest, and it is a little too early to say if this is the start of a longer trend or not.

The good news for stocks is that the Fed is winding down its fight on inflation and should be ready to pause by the end of the first quarter. The bad news is that the slowing economic conditions may not be fully priced in just yet. We noted last quarter that in a recessionary environment we might expect S&P earnings in 2023 to be close to the $205 level. Wall St. expectations are still calling for earnings this year of around $230. Much will depend on the labor and consumer spending variables discussed in the economic section above.

In either case, valuations are reasonable for long-term investors. The current forward PE ratio shown below would suggest a projected 10-year annualized return of 9.7%. Even if we adjust for our more pessimistic earnings expectation of $205 and a forward PE of 19.27, the regression analysis below would still predict a 10-year annualized return of 8.15%. While projections and forecasts are never perfect, we do believe stocks are reasonably valued at today's prices. While we expect a bumpy ride, we have moved our equity targets to neutral to start 2023.



Fixed Income Summary:	4th Qtr	YTD	12 Mth	3 Yr	5 Yr
US T-Bill 90 Day Index	0.66	2.01	2.01	1.28	0.78
BC Municipals 5Yr	-2.78	-5.02	-5.02	-0.22	1.27
BC Intermediate Government/Credit	-3.06	-8.23	-8.23	-1.26	0.73
BC High Yield Corporate	-0.65	-11.19	-11.19	0.05	2.31

2022… The Year of the Fed

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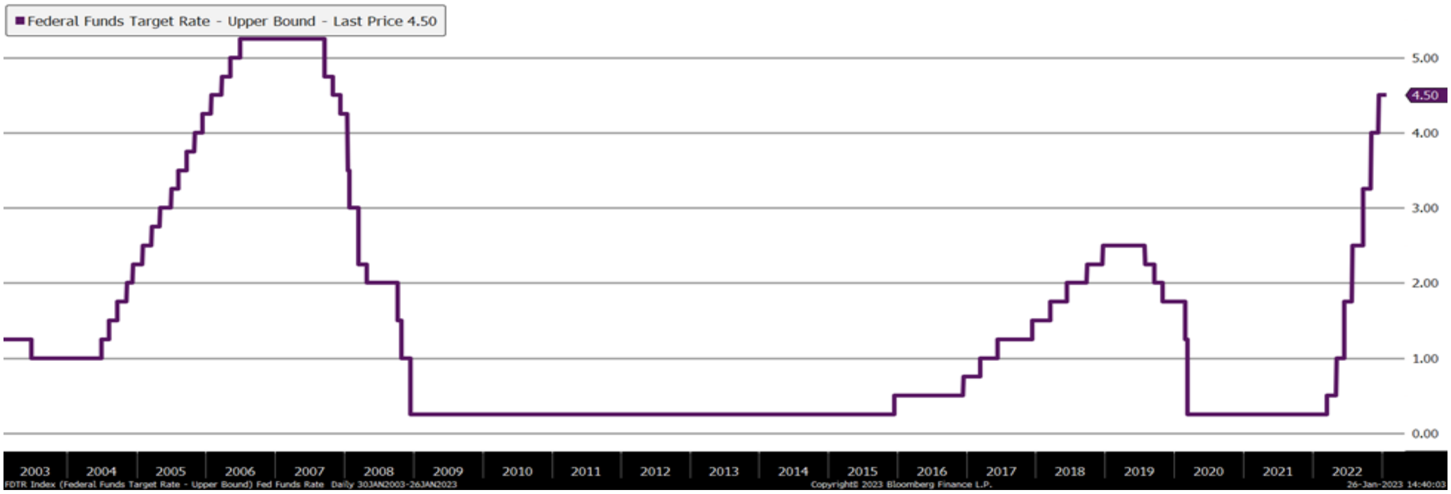
In 2021 interest rates started to trend higher with the fear of inflation and concerns the Federal Reserve may have to move the Fed Funds rate higher during 2022. On January 1st 2022, futures were pricing in 3 rate hikes or a 0.75% increase in the Fed Funds rate. As CPI data showed higher levels of inflation than expected the Fed was quick to raise the Fed Funds rate and when the dust settled, we ended 2022 with the Fed Funds rate at 4.50%. We continue to see the effects of these rate hikes and CPI readings continue to indicate a dampening level of inflation. We still believe by the time we fully see the impact of all these rate hikes, the Fed may have raised rates too far stalling the economy and will be forced to cut rates in 2023 to promote economic growth.

While the Federal Reserve continued their rate hikes pushing short term rates higher, the 10-year Treasury started to plateau ending the year at 3.87%. The 2-year Treasury ended the year at 4.42% further amplifying the yield curve inversion, the current spread between the 2 and 10-year treasury sits at -0.55%.



Over the last 45 years investors in the Bloomberg Barclays Aggregate Bond index have seen 5 years of negative calendar year returns, none worse than the -13% return we realized in 2022. This marks the second consecutive year of negative returns for bond investors. While bond investments have struggled over the past two years, this provides an opportunity for bond investors increasing future income and potential returns. As you would expect the increase in interest rates have made their way to cash equivalents, and money markets. Rates on money markets have surpassed 4% for the first time since 2008. If the Fed is successful in their fight against inflation, we may actually see a real return in money markets. With continued economic uncertainty and a Fed set on slowing inflation we have increased our cash position, awaiting additional clarity from the Fed and financial markets.

Similar to the stock market, there was nowhere to hide in the bond market. Every major bond index was negative in 2022, with long term treasuries being hit the most, down over 29%. Coming into 2022 we had shorter than benchmark average maturity avoiding some of the losses we saw in 2022, we started looking for opportunities to lengthen our maturities in mid-2022. As I have mentioned in the past few investment bulletins credit spreads widened in 2022. At the beginning of the year high yield credit spreads started at 2.82% and ended the year at 4.69%. These spreads narrowed in the 4th quarter of the year as signs of inflation and a potential recession dampened.

Over the year we took advantage of rising rates and widening yield spreads, increasing our exposure to high yield bonds, and lengthening our duration. We continue to look for opportunity to increase our credit risk and lengthen our duration even further. The most recent moves by the Fed have started to show signs of slowing inflation further supporting the moves we made in 2022. The risk we now have to monitor is a resurgence of inflation that could cause the Fed to raise rates even further. As always, we are paying attention to the signals provided by the Fed and look to take advantage of opportunities in the bond market.

Alternative Investments Summary:	4th Qtr	YTD	12 Mth	3 Yr	5 Yr
Bloomberg Commodity	-4.11	16.09	16.09	12.65	6.44
Dow Jones Global Real Estate	-12.02	-24.33	-24.33	-4.85	0.15
Morningstar Broad Hedge Fund TR	10.23	21.02	21.02	12.59	8.92
Consumer Price Index	0.17	6.84	6.84	5.04	3.86

Alternatives Update – Something Had to Work!

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The financial textbooks tell us we should build well diversified portfolios with investments from a broad range of asset classes. The idea being that lower correlated (when one goes up the other goes down) investments can help smooth out portfolio returns over time. With this in mind, we began adding alternative investments to portfolios over a decade ago. We define alternatives as any investment that does not fit in the traditional stock and bond categories. Examples include commodities, MLP's, Real Estate and Infrastructure, as well as hedged strategies that can go long and short a market.

Historically we have targeted less than 10% in alternative strategies. At the start of 2022, both stocks and bonds were looking vulnerable to rising rates. We moved our asset allocation targets to above 15% for alternatives in most portfolios. In hindsight we should have done more as stocks and bonds were hammered in the rising rate environment. While not all alternative strategies worked in 2022, commodities and hedged strategies both performed well in 2022. Our four most widely held alternative strategies in the Trust department:

- DWS RREEF Real Asset Fund – Invests in a mix of real estate, infrastructure, MLP's, commodities, and inflation protected securities.
- First Trust Long/Short Equity Fund – Invests in a long/short strategy designed to capture most of the market upside with little market downside.
- Merger Fund – Designed to have bond like returns without interest rate risk by investing in merger arbitrage strategy.
- Loomis Sales Strategic Alpha Fund – Invests in a hedged fixed income strategy.

The results for the above funds were not all positive in 2022, but they did outperform their stock and bond counterparts and therefore added some downside protection in a challenging year. As we start 2023, stock and bond valuations have improved, and we are now dialing back our alternative exposure. In short, they did their job last year and now we are giving them a little break by moving our targets back below 10% for this year.

NCCJ Open House – Welcome!

Accompanied by Chief Operating Officer, Larry Mulligan and VP of Consumer Lending, Meko Boose, LCNB| Wealth Officers, Nakia Lipscomb and Amanda Luman visited the expanded NCCJ office in downtown Dayton. The new space is home to members of NCCJ who work with local schools to bring diversity, equity and inclusion education to students of all ages. Included in the additional space is a recording booth for the NCCJ podcast, Gem City Diversity.

Walk Where You Are – Taking Steps to Aid Breast Cancer Research!

Members from the LCNB IT, Lending, Compliance, Mortgage, and Trust Departments gathered in October to participate in the Susan B Komen Walk Where You Are 5k. Trust Associate, Brittnay Mustard-Smith led the charge by creating the 5k map and engaging the entire bank in a competition to create the T-shirt design. In all, the bank was able to raise over $1,000 to donate toward breast cancer treatment research.

Hispanic Chamber Cincinnati 2022 Annual Celebration – Building Bridges for a Better Future

Assistant Trust Officer, Amanda Luman and Loan Compliance Officer, Mike Gionnatta had the pleasure of attending the Hispanic Chamber Cincinnati's 2022 Annual Celebration at TQL Stadium. After a brief tour of the stadium's Tunnel Club, locker rooms, and team conditioning areas, attendees gathered to hear members of the Hispanic Chamber outline all of the community work that made 2022 a successful year of growth and outreach.

The evening's keynote speaker, Visael "Bobby" Rodriguez - Vice President of Diversity, Inclusion, and Community Relations for Cincinnati Children's Hospital, highlighted the importance of medical professionals to display cultural competence to offer the best care possible.

Pancreatic Cancer Awareness – We think Purple!

As a tribute to an LCNB employee that lost their fight to the disease, on Thursday, November 17th, the LCNB| Wealth Group wore purple to honor those that are battling Pancreatic Cancer.

Photos of teams across the bank were collected to be given to the family, creating a photo-album of support for their children.

2022 UNCF Mayor's Luncheon – A Mind is a Terrible Thing to Waste!

Amanda Luman and Brittnay Mustard-Smith were invited to attend the 2022 UNCF Mayor's Luncheon, held in downtown Cincinnati in November. This fundraising event builds community through highlighting the ways that area businesses and schools work together to bring funding for higher education to black students across the city.

In his speech, TriHealth CEO, Mark Clement outlined the School-to-Work Program that is offered to Cincinnati Public School (CPS) students. This program allows students to shadow health care professionals, find where they would like to study, and then gain comprehensive guidance, coupled with scholarships to work toward accomplishing their career goals after high school.

The Greatest Christmas Gift – Ezra Hawk

Christmas Day celebrations saw the arrival of a new addition to Trust Investment Officer, Erin Hawk's family! Ezra Hawk was born a month early, weighing in at 4lbs 13oz. Join us in wishing a heartfelt congratulations to Erin and her husband Kiel!

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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.