The ACM Journal

Clinging to my Youth

As I get older, I find myself more inclined to outdoor adventures, including skiing, hiking, kayaking, and others. This takes some time away from home life, but I guess it is better than a proper mid-life crisis. However, I sometimes forget the realities of my age. Such was the case in late March this year.

We spent a lot of weekends this winter driving to ski races all over the state. I booked a hotel in Lake Placid for one final race in late March, but later discovered that the race had been moved to the prior weekend. I reserved a new hotel room for the proper weekend and focused on the work for the upcoming races. Logistics not only for our kids, but for all the kids going from our local team can take a lot of planning. Ski waxing was also one of my responsibilities, which would entail many hours of work. In the haze of these preparations, I forgot to cancel the original hotel reservation.

By the time I realized, it was too late to cancel without penalty, so I asked Nipa if she would like to get away for the weekend. It had been ages since we did anything without kids, and she agreed that

continued on page 4

IN THIS ISSUE

Clinging to my Youth 1
Portfolio Review 1
Inflation on the Horizon? 3
Chris's Corner 5
Compliance Corner 5

Portfolio Review

The first quarter of 2021 was a solid one for stock investors, but not so great if you own bonds. However, for both stocks and bonds it was a period of transition, reversing trends that have been in place for many years.

For stocks, the overall market as measured by the S&P 500 rose 8.3% in the first quarter. This is a very solid return for a three-month period. However, other parts of the stock market performed even better. Mid-cap stocks earned 13.5% and small-cap stocks gained 18.2%.

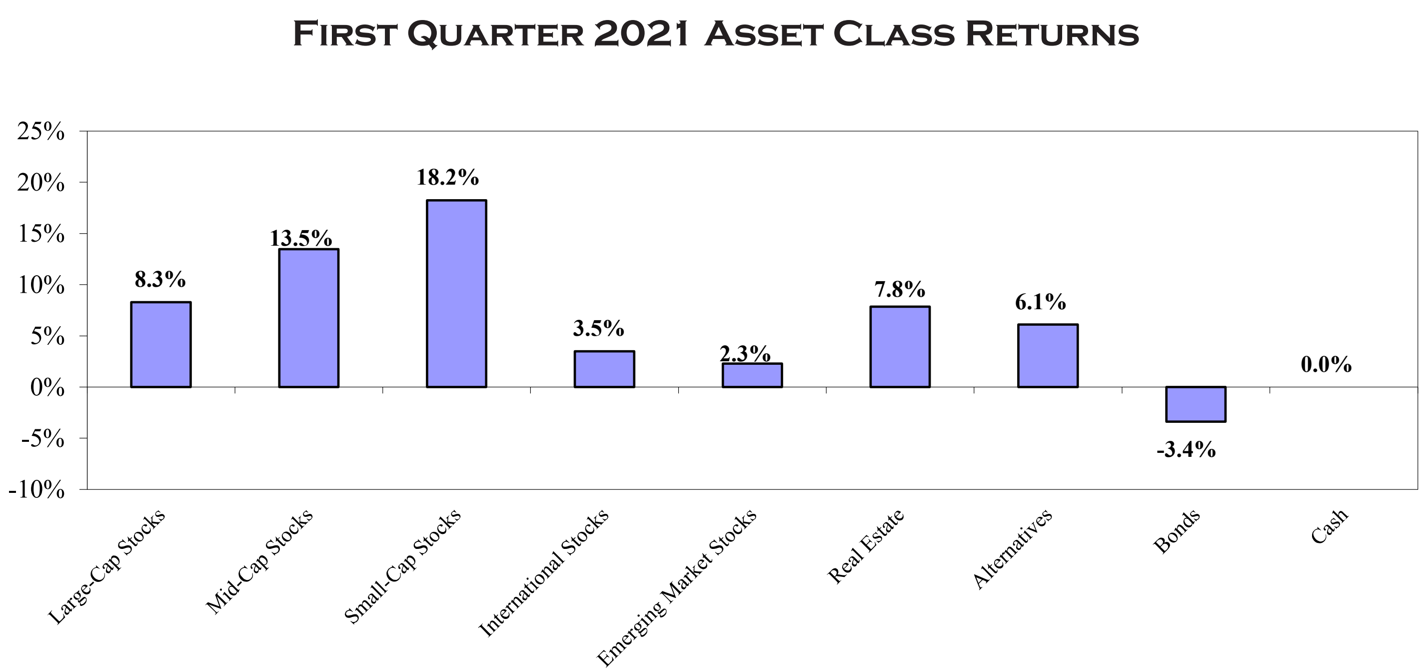
The bigger news was the return over the past year. The S&P 500 was up almost 75% since the trough of the market last March 16th. Small-cap stocks rose 121% over the same period. This was the largest and fastest rebound in the stock market ever.

The rotation from larger stocks to smaller stocks was a big change, as the largest stocks, particularly large technology stocks, have been the primary drivers of the stock market's growth for the past several years. In fact, diversification has been a liability for the better part of a decade now. Being concentrated only in high-growth, U.S.-based, large-cap stocks has been the best bet. Deviating from that resulted in lower performance. However, while periods such as this are not unprecedented, they do not last forever. The strong growth of large tech stocks has pushed valuations for many to extreme levels and made for relative bargains in other parts of the market. Cheaper small-cap stocks have finally responded, and those stocks are catching up with their large-cap brethren.

The same is true with value stocks. While they have experienced roughly a decade of underwhelming performance, they roared back to life in the first quarter, outpacing growth stocks by over twenty percentage points. There is still ground to make up, but when value rallies occur, they tend to last for multiple-year periods. Despite the recent rebound, value stocks still trade at large discounts to growth stocks, which should allow the value rally to continue for some time, even if it comes in fits and starts.

International stocks are one part of the stock market where relatively cheap stocks have not responded. International stocks continue to lag behind U.S. stocks, despite being priced at far more attractive levels. Perhaps this is because developed international economies such as those in Western Europe and Japan are still languishing. They are plagued by negative interest rates, slow GDP growth, and have not made the same progress as the U.S. with regard to vaccination. We expect to see international

continued on page 2



Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indices. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are represented by the HFRI Fund Weighted Composite Index. Bonds are the Barclays Aggregate Bond Index. Cash is the yield on the 3-month T-Bill.

Portfolio Review

continued from page 1

stocks, particularly those in the emerging markets, perk up in the not-too-distant future, but it isn't happening yet.

Alternative investments also had a solid quarter. While not all the funds performed well, a couple were very strong, leading to solid performance for the overall alternative investment portfolio. Times of transition are often good for alternative investments, as volatility and dislocations can uncover profit opportunities that are lacking when stocks trend higher for long periods. Particularly with rising interest rates and a threat of inflation on the horizon, it would not be surprising to see alternative investments outpace bonds and even rival the performance of stocks in the coming decade.

That leaves just the bond market with poor returns for the first quarter. Rising interest rates drove down bond prices, which resulted in a loss for the overall bond market. Twelve months ago, the ten-year Treasury bond yielded around 0.50%. At the end of the first quarter it was close to 1.7%. This also may be the start of a longer-term transition to rising interest rates.

While rapid changes in interest rates can be painful for bond investors, the current level represents a more normal and sustainable rate. Interest rates may rise even further in the future, particularly if inflation materializes, and we have generally taken a more defensive bond position in response.

That defensive position includes shortening the duration, and therefore the interest rate sensitivity, of the portfolio, as well as increasing credit quality. Given the low yield environment we're in, it just doesn't make sense to take a lot of risk in the bond market.

Even with negative bond returns, the first quarter was solid for investors with diversified portfolios. There are certainly many clouds gathering on the horizon, but continued government stimulus and monetary accommodation could lead to further gains in the near term.

Inflation on the Horizon?

There is a lot of talk of impending inflation lately. Massive amounts of government stimulus during the pandemic have resulted in the largest rise in money supply on record, and the current administration promises far more in the future. Similar measures have been taken overseas, resulting in unprecedented global liquidity. Lots of money in the system, along with the reopening economy, will create a lot of demand for goods and services.

On the supply side, the economy seems ill prepared to meet this rising demand. Supply chains globally have been curtailed because of the pandemic, ice storms in Texas, a shortage of shipping containers, and a clogged Suez Canal. This has made it hard for manufacturers to secure needed raw materials and components to keep their lines moving. Indeed, major automotive manufacturers and others have announced plans to idle plants because of a lack of resources to keep them going.

For those of us who learned that inflation results from too much money chasing too few goods, there is cause to worry.

A rise in short-term inflation is almost a foregone conclusion but isn't necessarily problematic. Comparing today's prices in a recovering economy to those last year during a severe recession will result in "easy comps". That's analyst speak for numbers that look stronger than they otherwise would because the prior year was unusually weak. Easy comps, by definition, are not sustainable, and often result in hard comps down the road. Thus, it may be that the elevated inflation we see in the coming months is not indicative of a longer-term general rise in prices.

That said, prices have risen across broad swaths of the economy of late. Gas and food prices hikes are often cited, but they are notoriously volatile, and aren't necessarily indicative of overall inflation. However, a semiconductor shortage has driven up prices for many types of goods, including new and used automobiles. Housing prices are also up materially not just because of a shortage of houses for sale, but also because material costs for lumber, concrete, and steel are up. Even worse, in some cases components aren't just more expensive, but almost impossible to source. That is true of resin used to make plastics for numerous items. Much of U.S. resin production is located in Texas, and plants were closed during the ice storms in February. This has caused a shortage that manufacturers likely won't catch up with until 2022.

The Federal Reserve has assured us that the bigger risk to the economy is weak growth and even deflation. They reason that if sustained inflation does appear, they have the tools to deal with it. Though, it isn't clear to many economists that the Fed has credibility in this regard, as the tools to deal with rising inflation mostly include raising short-term interest rates. Higher rates in a fragile economy can result in a recession, and the Fed has historically been loath to trigger economic downturns.

However, the Fed may not have to step in at all. While all the money printing by the federal government may be creating inflationary forces in the short-term, a load of new government debt will likely weight on economic growth longer term. Harvard economists Kenneth Rogoff and Carmen Reinhart wrote a paper showing the impact that sovereign debt has on economic growth. As debt levels rise, particularly as they rise above 90% of GDP, growth potential slows significantly. U.S. debt to GDP finished 2020 at 129%. It is therefore possible that the growth we experience from the economy reopening will be temporary, and that our longer-term challenges, while significant, will not include inflation. We can look to Japan to see how this sort of scenario plays out.

Of course, it is possible to have both weak economic growth and inflation simultaneously, such as the stagflation we experienced in the 1970s. It is a fairly rare occurrence, and probably requires some sort of adverse policy response to kick in. During the 1970s the policies that resulted in stagflation included tariffs, price controls, and money printing by going off the gold standard. There are certainly analogues today. Tariffs are still in wide use, sanctions limit global supply of goods like oil, and prices may rise because corporations will face rising operational costs from higher taxes, minimum wages, and regulatory costs. These actions could result in a slow-growth, high-inflation economy, but it is far too early to predict that with any authority.

While it is in vogue to worry about inflation these days, it is impossible to know for sure if it is coming. It is also very hard to hedge, and costly

continued on page 4

Inflation on the Horizon?

continued from page 3

if you are wrong. For example, most popular inflation hedges don't actually do a very good job of hedging inflation. Real estate, many commodities, gold, and even inflation-protected bonds (TIPS) generally aren't great inflation hedges. None of them have a high enough correlation to inflation to make them solid coincident offsets to inflation. They may help compensate for the adverse impact of inflation on average over time or for shorter periods, but they are not true inflation hedges because their returns do not ebb and flow with inflation with a strong enough relationship.

However, a lot of these investments are not great long-term investments without inflation. Gold, for example, has been a reasonable short-term hedge against inflation, but its returns have failed to keep pace over longer periods. Gold is also very volatile, and low returns and high risk are the opposite of what investors want. So, it is hard to simultaneously hedge inflation and reach for solid long-term returns.

We believe the best approach is to accept that inflation will be part of the investment experience over very long periods, even if it causes some short-term disruptions. A diversified portfolio that includes a healthy allocation to stocks should more than outgrow inflation over time. That doesn't mean your bonds won't suffer or that a severe, unexpected inflationary shock won't cause stocks to dip in the short run. But, for long-term investors, a stable, globally diversified, long-term asset allocation is still the best bet.

Clinging to my Youth

continued from page 1

we were overdue. It would also be nice to go to Lake Placid as adults, staying in a proper hotel and eating at better restaurants, rather than our usual no-frills team trips. But, over the subsequent days the realities of leaving our kids at home alone for the first time sunk in, and Nipa thought better of our plan. Undaunted, I decided that I deserved a weekend focused more on fun than prepping for ski races. So, I grabbed our middle child, Amer, and we headed off to Lake Placid together.

My new travel partner would necessitate a change in plans, but I figured we could do some skiing and hiking, and still find some nice restaurants to relax at in the evening. The trip was short, and the new agenda included a lot of activities. It certainly was going to be busy, but seemed reasonable, at least on paper.

It is a five hour drive each way, so I pulled Amer out of school on Friday to make the most of our weekend. We left early and made our first stop at Paul Smith's College near Saranac Lake. The college has its own cross-country ski trail network, and neither Amer nor I had ever skied there before. We figured we would get in an easy ski then drive the last bit to Lake Placid, check into our hotel, and find a good restaurant. In the end, we enjoyed the ski trails so much that we kept pushing each other and ended up skiing almost 20 miles. Amer could have kept going, but two hours of working out is my limit without food and water. Exhausted, we got into the car and headed to the hotel.

After we checked in, we walked to a nearby restaurant that I knew. It was closed for Covid. We tried another, but it had a long line, so we finally settled for a dumpy nearby pizza joint. We were hungry after burning so many calories during our ski and didn't have the luxury of continuing to search for something better. Oh well, we would find a nicer place tomorrow.

On Saturday we woke up and set out for our first real winter hike. We were going to climb Giant Mountain, one of the "46ers" in the Adirondacks. We had our backpacks and snowshoes ready to go, but Amer realized he forgot to bring his ice spikes. Never mind that I had reminded him at least three times to get the spikes from his brother before we left home. I don't remember exactly what happened next, but there may have been some yelling involved. Fortunately, as we got near the trailhead, we found a mountaineering store that opened early in the morning. That allowed us to buy some new spikes. I was prepared to set off without them, but it turns out that would not have been a smart idea.

continued on page 6

Chris's Corner: CARES Act Update and The Benefits of Gifting Stock

Some elements of the 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act have been extended into 2021. On the positive side, individuals who do not itemize deductions on their tax returns can still claim the $300 universal charitable deduction that was part of the original CARES act. Even better, the 2021 extension has doubled the amount to $600 for couples who file their tax returns jointly.

Unfortunately, other elements of the CARES act were not extended. Required minimum distributions (RMDs) on qualified retirement accounts (IRAs, inherited IRAs, 401(k)s, etc.) were waived last year, but are back on in 2021. As a result, anyone age 72 or older as of December 31, 2021, must take their RMD by year-end to avoid penalties. There is an exception, which extends the deadline to April 1, 2022, if this is your first time drawing the RMD.

Recently there have been a lot of news articles and chatter about potential upcoming tax law changes. Although nothing has been finalized, some of the more radical proposals could have a significant impact on estate plans. Predicting what will ultimately be enacted is impossible. However, there are still strategies that should be considered regardless of the proposed changes. Using appreciated stocks for gifting is one of these.

The benefits of gifting appreciated stocks to charities include a charitable deduction for the full value of the donated shares, as well as avoiding capital gains taxes. A less used, but still valid strategy is using stock for gifts to individuals, including family members.

The annual gift tax exclusion limit to individuals is still $15,000 per person and $30,000 for married couples. The value of the gift is determined on the day you transfer the stock, and any amount given over $15,000 ($30,000 if married) counts towards your lifetime exclusion, which is currently $11.58 million or double that if married. Although you won't receive the same tax benefits you get for charitable gifts, using stock for gifts to individuals will help you avoid paying capital gains tax on the appreciated stock.

When you gift stock to an individual, you also transfer your original cost basis. This may make sense if your child, parent, or friend is in a lower tax bracket or won't pay any capital gains tax. Capital gains tax rates depend on income brackets. For individuals with taxable income under $40,400, or $80,800 for couples filing jointly, capital gains are not taxed. Also important to note, is that the individual who receives the stock only incurs capital gains taxes when they sell the shares.

As with all aspects of our complicated tax code, there are a couple special situations. For example, if you are gifting stock to minors (children or grandchildren) you should be mindful of the "kiddie tax" rules. Also, having a lot of assets in a child's name could have a negative effect when applying for need-based aid for college tuition.

In summary, gifting stock can sometimes be a more efficient way to transfer money than using cash. We're happy to talk through your situation in more detail if you think this could make sense for you.

Compliance Corner

We are in a highly regulated business, which causes a few headaches, but also offers our clients important protections. There are certain disclosures that we are required to make regularly regarding our policies and procedures, including:

As a registered investment adviser with the United States Securities and Exchange Commission (SEC), we must adopt policies and procedures to protect clients' nonpublic, personal information. Our policy mandates that ACM employees are prohibited from disclosing nonpublic, personal information to any person or entity outside of our firm, except as authorized by our clients or an appropriate regulatory institution. We also take all reasonable measures to ensure secure transfer and/or disposal of documents containing sensitive information about our clients.

You will receive a copy of our full privacy policy either via mail or uploaded to your client

continued on page 6

Clinging to my Youth

continued from page 4

The hike was rigorous. We covered around seven miles, which wouldn't be too bad in the summer, but during the winter there is deep snow that makes the tough vertical ascents quite treacherous. Making matters worse, I wore old hiking boots that started to give me blisters within 45 minutes. Literally every step hurt. We pushed on though and eventually reached the summit, where ice spikes were a necessity. The bad weather meant there was no view other than clouds. The wind was blowing so hard that we had to lean into it to avoid being blown over. It also made the precipitation, which was mostly little ice balls, blow horizontally. This hit our faces with a stinging force that made it difficult to open our eyes for more than a couple seconds at a time. I snapped a quick picture of Amer, who looked like he was being tortured, and we hightailed it out of there. The hike took us around four hours, and we probably spent 15 seconds on the peak.

During the hike I had a couple bottles of water and a power bar, which was hardly enough for a four-hour excursion. I was well past the level at which I could function without real food, so we drove to the nearest diner and ate as much as we could keep down. It wasn't gourmet, but it sure hit the spot.

We vegged out the rest of the day, but when it came time for dinner, we were still too exhausted to do much. Our second and final opportunity for a good dinner ended up in another night of pizza. At least it was from a different place.

On Sunday morning my blisters were hurting a lot, every muscle was stiff, and I was pretty run down from two days of intense activity. I asked Amer if he wanted to do anything else before we headed for home, and he thought we should try to do a short ski somewhere. We didn't want to go back to Paul Smith's, and the Olympic venue is very nice, but expensive. So, we opted for a backcountry ski.

What was supposed to be an easy, gentle ski through the woods turned into a ten-mile adventure to a secluded mountain lake quite a distance into the woods. We had some tough climbing to reach our destination, and the deep snow required a lot of effort, even on the easier terrain. It was beautiful once we arrived there, and really fun to ski across the frozen lake.

When we finished our ski, we stowed our gear, jumped in the car, and drove five hours home. We ate power bars and potato chips for lunch on the road. By the time we got back, I was so stiff I could barely walk to the house from the car.

We never did get to even one decent restaurant, and the trip had a very different tenor than it would have if Nipa had gone with me. However, it was a fantastic experience. Amer and I got to spend some quality time together and had some really cool adventures. By Monday morning he was fully recovered and ready to get back to school. It took me almost a whole week to get over my aches and pains.

Compliance Corner

continued from page 5

portal. It is also always available on our website.

Additionally, registered investment advisors are required to file Form ADV with the SEC or state securities regulators on an annual basis. A copy of our updated Form ADV is available at any time upon request, or it may be downloaded from our website. We encourage each of you to read it. Please let us know if you would like us to send you a copy.

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