The ACM Journal

My Place in This World

Nipa and I spent a lot of time prior to Christmas trying to figure out what gifts to get for everyone in order to make the holidays special. The boys always want ski gear, which is easy for me to find and buy, and Nyla is young enough that we can usually find her some toys. But it is getting tougher every year, and that doesn't even include gifts for the two of us.

When asked what I wanted, I really didn't have any ideas at all. Over many years we have furnished our home, built up our stock of farm equipment, accumulated all the ski gear I need, and have even bought a few toys like kayaks and other outdoor gear. That covers most areas of our lives, and for sure mine. The farm and our house seem to delight us with their never-ending surprises, mishaps, and needs. But when we need something during the year, we generally just buy it. That leaves little room for surprises on Christmas and birthdays.

I don't think I've reached the Buddhist ideal of eliminating desire, but I find my wants these days are more centered around a healthy family, long-term financial security, personal relationships, and fulfilling experiences. Those are tough to put under the tree.

When pressed, I did ultimately come up with one gift idea: a manure fork. Nipa thought I was kidding, but I wasn't. I was overdue to clean out

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Should I Worry About Inflation?

It is well known that the stock and bond markets have generally gone up over time. Why else would anyone invest? Sure, there have been a few "speed bumps," such as the Great Depression and the decade of 2000 when things didn't work out so well (see nominal return graph), but generally investors have made money by being invested. But what happens when you factor in inflation?

US Inflation has averaged less than 3% annually over the past hundred years. Stocks and bonds have generated average compounded returns of almost 10.5% and 5.1%, respectively. Clearly, over time, inflation has been no match for the compounding of good investments. The problem is that this is true over time, but not all the time.

If we look at the same graph but subtract inflation from the returns of stocks and bonds, to get at their real returns, it paints a different picture (see real return graph). There is a 20-year period from roughly 1960 to 1980 where stocks earned no real return. They kept up with inflation, but investors would have taken a lot of risk just to maintain their purchasing power. Unfortunately, that was the good news. Bonds earned no real return from around 1940 to 1985, a 45-year period. Imagine saving and investing your whole life and being no better off for it after four decades.

Could something similar happen today? Is it happening already? Inflation certainly has picked up lately after many years of being fairly moderate. The Fed initially told us this inflation was "transitory" as the economy reopened after Covid and supply chains were disrupted. However, they are no longer using that word, and the threat of persistently high inflation seems to be increasing.

There are indications inflation could continue, such as supply chain issues that don't seem to have a quick fix, the continuation of easy money policies by the Fed, and a desire to pump more fiscal stimulus into the economy by our ruling party. However, there are

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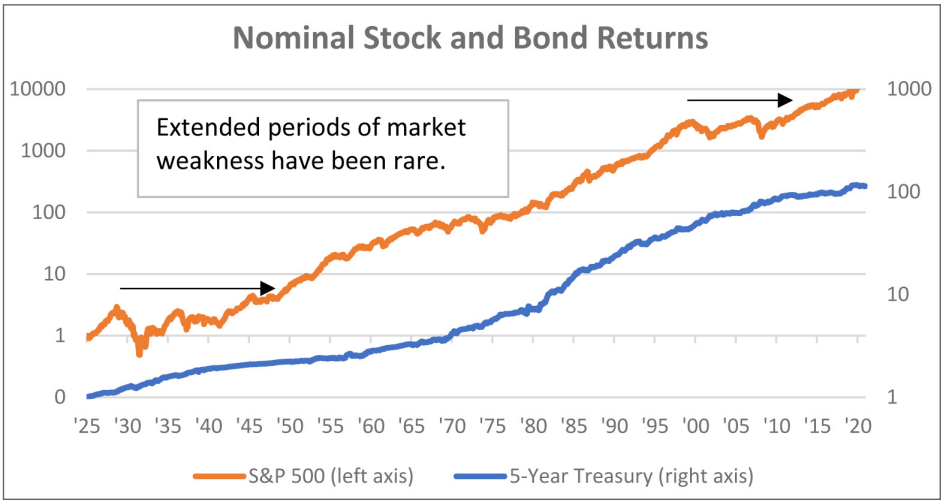
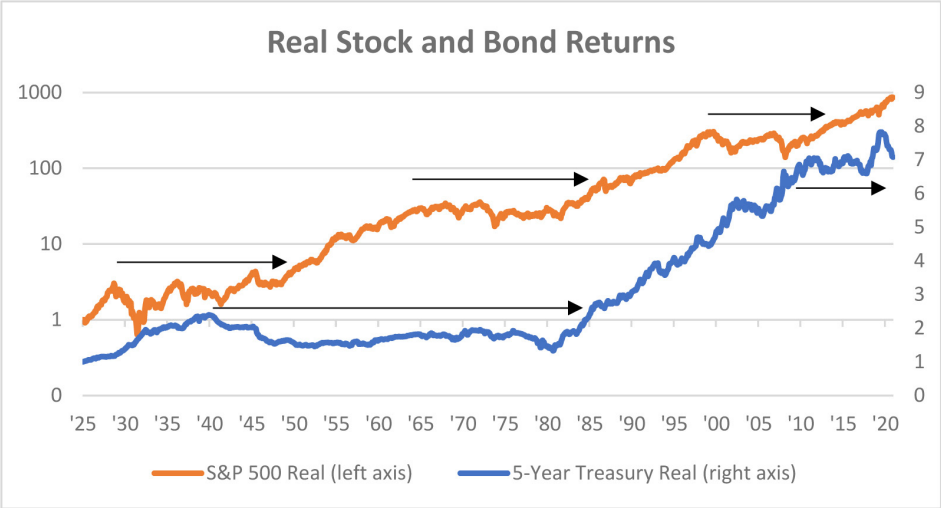


Source: DFA, Armbruster Capital Management



Source: DFA, Armbruster Capital Management

Should I Worry About Inflation?

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also reasons to hope inflation could subside. Some are optimistic, such as what appears to be increased fiscal responsibility from some quarters and a more hawkish tone from the Fed. But some are decidedly gloomier, such as an unprecedented debt overhang that threatens economic growth.

Just like trying to time the stock market, there is no good way to know for sure what will happen with inflation and the broader economy. There's an old joke that God created economists to make weather forecasters look good. So, while inflation is a concern, it isn't a foregone conclusion that we'll repeat the high inflation or even stagflation of the 1970s.

Still, even temporary inflation can be damaging for investors and savers. It is unlikely that the increases in inflation will reverse, as deflation is quite rare, so prices may be permanently set higher in some areas. That means sitting on large amounts of cash is counterproductive. It also means that bond returns, even if positive, will be negative in inflation-adjusted terms. Stocks will likely at least break even over longer time periods.

There are other asset classes that investors can consider to address inflation, and undoubtedly, you've heard about them lately in the news or from the financial media. Commodities, gold, TIPS, real estate, and even cryptocurrencies are cited as inflation hedges. Many of these assets have inflation hedging characteristics, but none is a true inflation hedge. In fact, many of them have gone down in value or held steady as inflation has heated up, see the recent performance of gold and Bitcoin as examples.

Diversifying into alternative asset classes and away from bonds isn't necessarily a bad idea, and in fact we have done just that for many years in an attempt to address historically low interest rates. However, reacting to inflation that may or may not be a longer-term problem seems rash, particularly when the solutions are imperfect at best.

So, for now we're sticking with our long-term approach of stocks for growth, high quality and short-duration bonds for safety and liquidity, and some alternative investments to help control the risk of stocks while reaching for a little better return than bonds. It sometimes seems quaint to hold the line and diversify, but long-term empirical data suggests that is the best approach.

Portfolio Review

The fourth quarter of 2021 was a microcosm of 2021 as a whole. Many of the trends that we saw throughout the year continued into year end. The emergence of a new COVID variant contributed to reimposed restrictions, supply chains disruptions, and rising inflation. And, the stock market responded similarly to prior COVID scares: a knee-jerk reaction down followed immediately by a rally that culminated in new record highs. Other trends also continued as international stocks continued to trail their US counterparts despite more attractive valuation metrics, and bonds delivered another quarter of lackluster results.

Market Leadership Shifting

Within the US stock market, leadership started to shift to more defensive sectors. Energy stocks rebounded quite well in 2021 after an uninspiring 2020. Energy was the strongest performer of all US sectors with impressive returns of over 50% for the full year. This was caused by a rebound in travel and tighter oil supply that drove crude oil prices from around $50 per barrel at the beginning of the year to above $85 per barrel in October. Tight supply and low interest rates also spurred excellent returns for real estate, which was the second-best performing stock market sector. Rounding out value stock sectors, financials also performed well. However, technology stocks, which are characteristically growth stocks, were no slouch, gaining almost 35% for the full year. While value stocks staged a significant rebound and outperformed growth stocks to start the year, growth stocks outperformed to end the year. This has been the trend for many years now, leaving valuation disparities among value and growth historically wide.

All domestic stock market sectors generated double-digit returns this year, however, there were pockets of the market that were not as fortunate. Stay-at-home stocks were the primary casualties, with prior Wall Street darlings such as Zoom (ZM) and Peloton (PTON) falling 45% and 76%, respectively. In another sign of market sentiment shift, pockets of growth stocks, primarily for companies that were unprofitable, also underperformed late in the year compared to the overall market. That being said, notable tech giants such as Microsoft, Apple, and Alphabet all outperformed the S&P 500 this year, increasing the index's concentration and valuation metrics to even higher levels.

Volatility Ahead

The world seems to be in flux, and the stock market is behaving similarly, making economic and financial forecasts even more difficult than usual. Indeed, economic projections made last year for 2021 have not been entirely accurate. In December of 2020, the Fed forecasted a 4.2% increase in GDP and an unemployment rate of 5%, which represents fairly anemic growth assuming a rebound from an almost complete shutdown of the global economy. In fact, the recovery will likely end up stronger than previously anticipated, as GDP appears to have increased in the 5-6% range and the unemployment rate will be closer to 4%. Monetary and fiscal policy, particularly when based on mistaken forecasts, will almost certainly result in higher market volatility in the year to come.

The downside to this strong growth, and the missed projections by policymakers, is that inflation is now running much hotter than expected. Last year's forecast by the Fed of 2% inflation, using its preferred metric of the PCE deflator, is now over 5% and still rising. The result is that interest rate hikes will likely occur quicker than previously anticipated. Last December, only one Federal Open Market Committee (FOMC) participant expected an increase in the Fed Funds target rate in 2022, but after the latest meeting, all participants expect rate hikes in 2022, with the majority expecting the rate to be increased three times. This is not unique to the US, as the Bank of England and many other central banks have already raised short-term interest rates as a measure to curb inflationary pressures.

Stabilizing Assets

While bonds continued to struggle throughout 2021 on account of the low interest rate environment, our preferred alternative investments were generally able to deliver more attractive returns. Funds we use for private real estate, alternative lending, and style premia each delivered very impressive returns for the full year. Our multi-strategy fund saw modest gains as well. Managed futures and reinsurance funds were not as impressive, but full year performance of these funds was comparable to the overall bond market.

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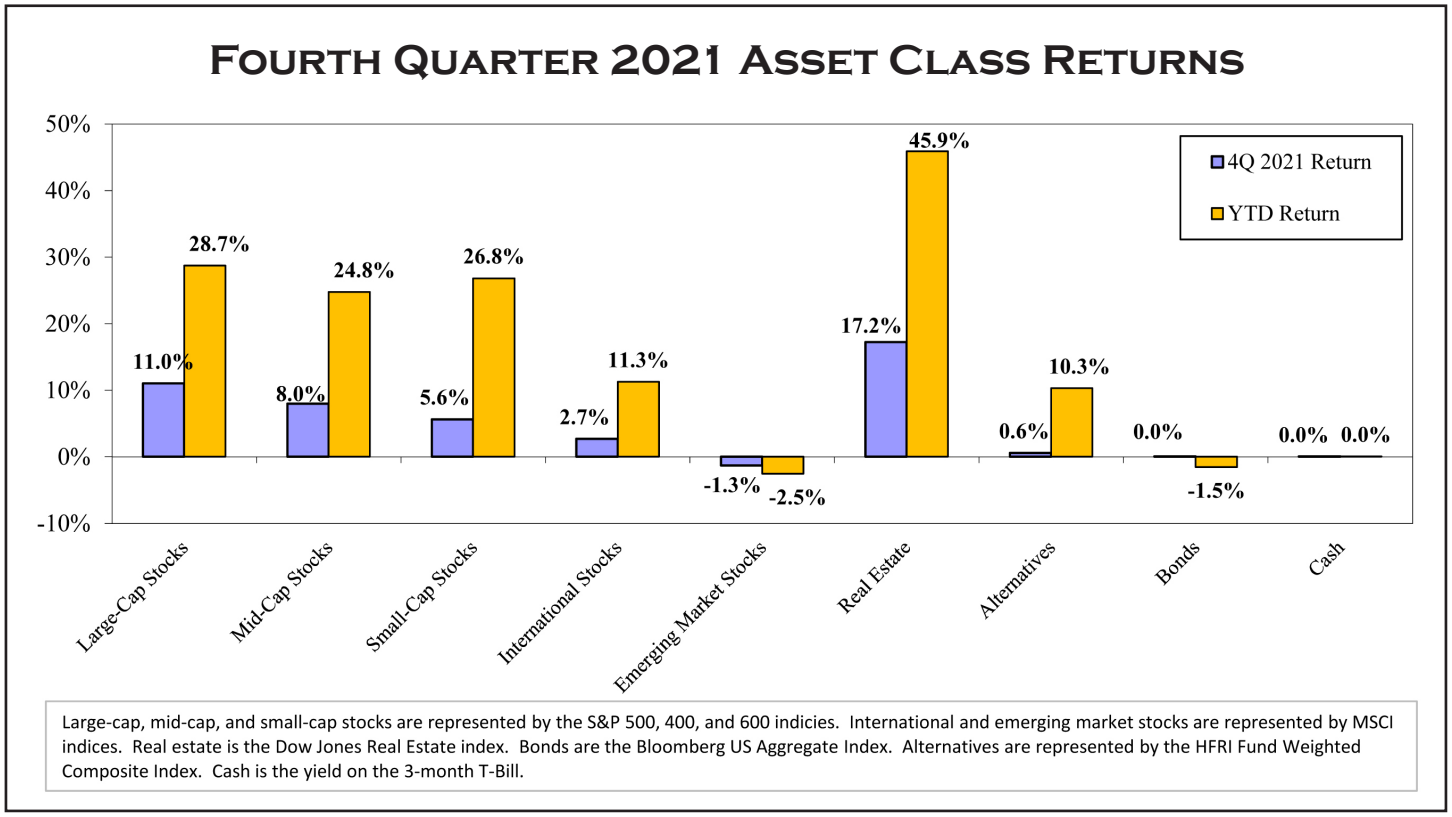

Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indicies. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Bonds are the Bloomberg US Aggregate Index. Alternatives are represented by the HFRI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

Firm News: A Big Year

Another year has come and gone. In our business the New Year means lots of reporting. Certainly, clients like to know how the year went for their portfolios, and doing those meetings is the fun part of our jobs. However, the other type of reporting that we could do without is filing documents each year with the SEC and other regulators. Still, it forces us to look at our business and take stock of our progress.

A Year of Growth

In that regard, 2021 was a very solid year for us. We brought on around twenty new clients, expanded our reach into the institutional market, and grew our managed assets significantly.

We have mostly approached growth organically over the years. Being technicians rather than salespeople, our focus has not always been on getting larger. We have become larger, but mostly because our clients and colleagues in the community have thought enough of us to spread the word. We certainly recognize that firms need to grow over time to remain relevant and stay in business, but we have made a conscious decision to sacrifice growth in an effort to retain our quality. We are still one of the few investment management firms in the Rochester region that individually manage portfolios and take care to focus on hard-to-manage details such as asset location, continual tax-loss selling, and other planning techniques. We like that we are able to do that but worry that at some point firms get too large to efficiently manage those details.

Apex Merger

Nevertheless, we did grow significantly in 2021. A big part of that was because of a merger we effected toward year end. I'd like to say that happened because of some deliberate planning on our part, but really it just sort of fell in our laps. Beth Barrette from Apex Advisors reached out and asked if we would be interested in discussing a combination. She did all the leg work, researched us, showed us how our philosophies were similar, and took the lead on all the legal stuff. She was the driver, and we're sure glad she was. Because, while we added roughly 40 new relationships and $85 million in new assets, mostly we added a very nice, smart new colleague with similar values. Beth is now a valuable member of our team and has transitioned in seamlessly.

Our managed assets now exceed $700 million, a far cry from the early days when it was Mark, a laptop computer, and a cell phone. After our first full year in business, at the end of 2009, we managed $16 million. Our goal is to hit $1 billion in managed assets before too many years, but we want to be deliberate about this growth and hope to add additional staff as we grow our client base.

Team Growth

In fact, we did add new staff last year to ensure adequate "horsepower" to support our clients. In particular, we hired two investment analysts early last year. Luca and Adam have significantly improved our efficiency in trading and portfolio management. They are both enrolled in the CFA program, recently passed the first level, and are shaping up to be well-rounded investment professionals. For those unfamiliar with the CFA program, it is a very difficult series of exams given over three years. The pass rate this year on the first level was only 27%, so we're exceptionally proud that both of our guys passed on their first try. Chris and I are in agreement that the firm has never been stronger or run as well as it does currently, thanks to our new analysts and of course our other operational superstars Tarryn and Craig.

VidCast Series

One initiative we worked on during 2021 for both growth and client service was our VidCast series. If you haven't checked them out, they are short educational videos we have been producing on timely investment and economic topics. We launched seven new VidCasts in 2021 and have others in the works. If there are topics you would like to see us discuss, just let us know. We're always looking for ideas. You can watch our VidCasts at www.youtube.com/ArmbrusterCapitalManagement or by searching YouTube for Armbruster Capital Management.

Our dedicated YouTube channel, ACM InvestEd, has racked up almost 3,000 views and 225 hours of watch time.

Along the lines of marketing, we have been working on a new logo, website, and other materials. We're not quite ready to launch, but they should be out shortly.

In an era with a lot of uncertainty, our little firm has performed quite well and grown nicely. This is largely because of the support of our clients, and our entire team is thankful for the trust you put in our hands.

Chris's Corner: Much Ado About Nothing

A not so new New Year! Most of us planner types spent 2021 worrying about one thing or another. For some of us, a lot of frenetic energy was spent on the projected, proposed, and much debated financial changes that the President, and much of Congress, hoped would reboot a lot of well-established financial plans.

Proposals included the removal of stepped-up cost basis upon death, annual taxation of unrealized capital gains, raising income and capital gains tax rates, lowering the estate and gift tax exemptions, taxation of grantor trusts, surcharging ultra-high earners, forced distribution of mega IRAs, and cancelling Roth conversions. While we remain neutral on the merits of the bill, the original Build Back Better Act proposal threatened highly significant changes to the accepted tenets of financial planning that we have been working with for years.

Although not unprecedented, it is rare for Congress to retroactively enact tax legislation, likely locking in the established rules for 2021 and, for now, 2022. Although Congress does have some upcoming deadlines, including passing a bill to keep the government running by February 19, 2022, and ongoing political chatter and proposals that would have impact to our financial plans, they seem less likely to pass and less radical in nature. With the upcoming midterm elections and continued political wrangling, it's likely that anything that does get approved won't knock the wheels off the apple cart as originally expected.

As we embark on a new tax year and reflect on the past one, it seems like a good time to remind ourselves to not get too excited about headlines and proposals. Though, it is also true that nothing is permanent except change. We can now focus our time and energy on the 2025 sunset date of the current Tax Cuts and Jobs Act (TCJA).

The TCJA was created with expiration dates for many of its provisions, most of them coming due in 2025. Although there are certain provisions, like 100% bonus depreciation on equipment, that begin to phase out starting in 2023, the 23 provisions relating to individual income taxes will end in 2025. The provisions scheduled to expire include the reduction of individual income tax rates, the increased child tax credit, increased AMT exemption phaseout, and the increased standard deduction. If nothing is modified before 2025, the tax code will revert to the 2017 law, filled with personal exemptions, limitations on itemized deductions, uncapped state and local tax deductions, and a variety of miscellaneous itemized deductions. One step forward, two steps back? Rest up planners!

If 2025 seems to too far in the future to worry about, here are some real time changes for 2022 to plan around:

IRS 2022 COLA - Inflation Adjustments

Unified Tax Credit	2022	2021	Change
Annual gift tax exemption per person	$16,000	$15,000	$1,000
Federal estate tax, generation skipping transfer tax, & lifetime gift tax exemption	$12,060,000	$11,700,000	$360,000

401(k) Defined Contributions Limits	2022	2021	Change
Maximum employee deferral	$20,500	$19,500	$1,000
Employee catch-up contribution (age 50+)	$6,500	$6,500	-
Defined contribution maximum (employee + employer)	$61,000	$58,000	$3,000
Defined contribution maximum (employee + employer age 50+)	$67,500	$64,500	$3,000
Employee compensation limit for calculating contributions	$305,000	$290,000	$15,000
Key employee top-heavy plan compensation test threshold	$200,000	$185,000	$15,000
HCE nondiscrimination testing threshold	$135,000	$130,000	$5,000

HSAs & High-Deductible Health Plans		2022	2021	Change
HSA contribution limit (employer + employee)	Self	$3,650	$3,600	$50
	Family	$7,300	$7,200	$100
HSA catch-up contributions (age 55+)	Self	$1,000	$1,000	-
HDHP minimum deductions	Self	$1,400	$1,400	-
	Family	$2,800	$2,800	-
HDHP maximum out-of-pocket expenses (excludes premiums)	Self	$7,050	$7,000	$50
	Family	$14,100	$14,000	$100
Health Care Flexible Spending Accounts (FSAs) Max salary deferral		$2,850	$2,750	$100

Earnings Subject to Social Security Payroll Tax	2022	2021	Change
Max earnings subject to 12.4% FICA tax (6.2% employer, 6.2% employee)	$147,000	$142,800	$4,200

IRA Contributions Limits	2022	2021	Change
Traditional or ROTH IRA Contribution Limit	$6,000	$6,000	-
Catch-Up Contribution (50+)	$7,000	$7,000	-

IRA AGI Deduction Phase-out Starting at	2022	2021	Change
Joint Return	$109,000	$105,000	$4,000
Single or Head of Household	$68,000	$66,000	$2,000

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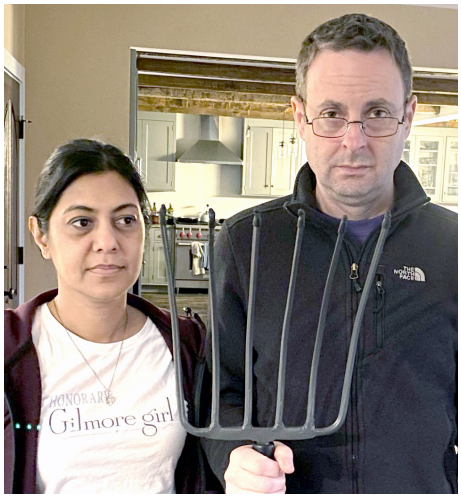
the chicken coop, which is an awful chore using the shovel I have. It just doesn't cut through the old straw that easily, and results in a long, arduous, and messy process. I figured a manure fork would make the job far easier, though I hadn't used one in probably 25 years.

Sure enough, my son Omar got me a proper manure fork (I was sure to specify that I didn't want an ordinary pitchfork) for Christmas. Its immediate use was as a prop in a picture posted to social media of Nipa and me a la American Gothic. However, I finally got around to using it for real on New Year's Day. I spent some quality time in the chicken coop, the job was far easier than before. Odd as it may sound, I actually found the experience quite enjoyable. I forked piles of soiled chicken bedding into the bucket of my tractor and drove them down to the compost pile. It was a cold, snowy day, but nice to be outside, particularly since the work kept me warm.

My day job and the tribulations of raising three kids can get stressful.



Farm work, even with all its surprises, can be calming and contemplative. Indeed, as our business grows, I find myself pulled in more directions. I get more attention and there are more demands on my time. It would be easy to start to feel self-important, but at home I'm reminded of my true place in this world and my true calling: shoveling manure.

Portfolio Review

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The exceptional returns in the stock market last year have caused some skepticism on future return projections, which we share. In a poll conducted by CNBC consisting of chief investment officers, equity strategists, and portfolio managers, inflation topped the list of what is worrying investors the most, followed by the Fed raising rates at the wrong time, and the economic impact of COVID. A full 80% of respondents believed the market would return less than 10% this year, with more investors anticipating flat or negative returns as opposed to returns above 10%. It is important to take these projections with a grain of salt. The big banks projected returns for the S&P 500 that fell in a range between 1% and 17% for 2021, all falling significantly short of the actual return of 28.7%. While current valuation levels suggest the market isn't poised for another year of robust growth, nothing is certain. Whether the projections of muted returns in the near future come to fruition or not, maintaining a well-diversified portfolio remains important in mitigating downside risk in bear markets while still capturing adequate returns during bull markets.

Armbruster
CAPITAL MANAGEMENT, INC.

Armbruster Capital Management, Inc.
(585) 381-4180
info@armbrustercapital.com | www.armbrustercapital.com