APPLETON PARTNERS, INC.

The Gift of Giving

So often geopolitical crises can seem abstract, far removed from our daily lives. We live in an age of stunning prosperity and overall quality of life relative to preceding generations, and perspective can easily be lost. Unfortunately, disasters of various forms periodically produce shock, upset, and perhaps renewed reflection. What occurs far from our borders may seem remote, and a sense of powerlessness is an understandable reaction. The war in Ukraine is a tragedy on many dimensions, and along with our sympathies and concern for all those impacted, we offer a few wealth management and financial planning thoughts.

Maintaining a Prudent Long-Term Perspective

As investment advisors we must remain focused on our fiduciary responsibilities to clients. High levels of volatility typically characterize markets during geopolitical crisis, and the buildup, onset, and initial fallout of the Russian invasion of Ukraine has been no exception. The Chicago Board Options Exchange's (CBOE) VIX Index, a common measure of volatility, nearly doubled in January over three short weeks as the Russian buildup became increasingly ominous. Equity markets have reacted accordingly with numerous high volatility days in both directions after a long period of relative tranquility.

"Risk-off" flights to quality are often associated with troubling geopolitical events, although longer term impact on the equity markets has historically been much more benign. LPL Financial recently published data detailing 21 geopolitical crises from 1941 to the present and found that on average it took the equity markets 21 calendar days to bottom and only 45 days to subsequently recover.[1] As our market commentary of February 24th emphasized, the Ukrainian crisis, while heartbreaking on a human level, has not materially impacted our municipal or high grade corporate fixed income portfolio positioning.

In any environment, Appleton's investment process emphasizes quality in both bond analysis and stock selection. Our belief is that doing so helps preserve capital and enhances the long-term risk-reward profile of client portfolios. Developing an asset allocation strategy that aligns well with personal risk tolerance, liquidity needs, and financial objectives must take place long before dislocation hits the markets. The best insurance against panic selling or other potentially counterproductive emotional responses lies in knowing that one's financial plans and asset allocation strategy already factor in inevitable periods of market volatility.

Maximize the Effectiveness of Charitable Giving

Philanthropy is an essential contributor to society's ability to meet acute needs, particularly in times of crisis. Helping individuals and families with tax-efficient charitable giving is an important element of financial planning. When considering charitable donations individuals face two decisions - where to direct their support and by what means.

Tax-exempt organizations are not created equal as some are more efficient stewards of charitable donations than others. Evaluating whether an organization's mission aligns with your goals requires some research, and information of that nature is generally publicly available. Assuming you are comfortable with the stated mission, IRS Form 990 offers considerable detail concerning a charity's management and financial records. For example, one can see the percentage of donations that directly support the stated cause as opposed to funding overhead or marketing. Background concerning the Board of Directors and the extent to which there is independent Board oversight is also available. Form 990 and an organization's annual report can typically be found on their website or through resources such as GuideStar, 990 Finder, or Foundation Directory Online.

Americans gave ***$471.44 billion in 2020***, 69% of which came from individuals. (Giving USA, 2020 Annual Report)

Tax Efficient Giving Strategies

As outlined below, there are many ways to support worthy causes and Appleton can be a resource in determining what best meets your objectives. To discuss, please contact your portfolio manager.

Charitable Giving Mechanism	Background Notes
Appreciated securities	Allows one to avoid capital gains that would be incurred when selling a security while still receiving a charitable tax deduction.
Donor Advised Funds	Provides a current year tax deduction and avoids potential capital gains taxes, while offering professional management of donated assets, ease of use, and the flexibility to recommend donations over time.
Charitable Remainder Trust	Planned giving vehicle that enables donor to place appreciated assets in a trust that will then distribute a fixed stream of income to a beneficiary or donor while allowing for a current year tax deduction.
Qualified Charitable Distributions (QCDs)	Paid directly from an IRA to charitable beneficiaries for those of RMD age (at least 70 1/2 years of age) up to a maximum of $100,000.
Naming charities as retirement plan beneficiaries	Naming a charity as an IRA or other retirement plan beneficiary allows you, your heirs, or your estate to avoid income taxes on distributed assets, as well as estate taxes.
Private foundations	Established for a specific philanthropic purpose, although setting one up can be complicated and costly.
Bequests in a will	A simple straightforward estate planning consideration
Employer matching gifts	Many employers will match employee gifts, thereby multiplying the effect of your contributions.

1. LPL Financial, 2021

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MARKET OBSERVATIONS & IMPLICATIONS

Tax-Exempt Investment Grade Municipals

- Q1 saw municipal yields spike with the 10Yr AAA portion of the curve jumping from 1.03% at year-end to 2.18% as of 4/1/22.
- A change in curve structure was notable as accelerated Fed rate hike expectations pushed the short end up at a more rapid rate than longer maturities. The 2Yr AAA rose from a suppressed level of 0.24% to 1.77%.
- This produced a bear flattener illustrated by a decline in the spread between 2s and 10s from 0.79% at year-end '21 to 0.41%.

	12/31/21	4/1/22	QTD change
2-yr AAA Muni	0.24%	1.77%	+153 bps
10-yr AAA Muni	1.03%	2.18	+115 bps
30-yr AAA Muni	1.49%	2.53%	+104 bps

- Fed Funds expectations rose over the course of Q1 as the Fed scrambled to assert control over inflation. The market is now pricing the equivalent of 6 to 7 quarter point hikes in 2022.
- Although municipals initially lagged USTs in their yield response, they more recently have followed a notable upward path. Municipals are now attractive relative to USTs, with the 10-Year AAA Muni/UST ratio rising from 68% to 93% to close the quarter. The 2-Year ratio jumped from 33% to 75%
- Retail demand for municipals has temporarily abated in the face of inflation and rate driven price pressure. YTD net fund outflows of $21.9 billion (as of 3/30) reversed what had been an extended favorable technical environment.
- Longer duration underperformed given the rise in yields. The Long Bond Index (22+ years) was the worst performing segment of the Municipal Index, returning -8.65% during Q1, while the 1-Year Index led at -1.61%.
- Credit spread tightening experienced over the latter half of 2020 and throughout 2021 modestly reversed during Q1 leading back to a more normalized credit environment. BBB credits widened 23 bps vs. AAAs, while A rated paper widened 21 bps.
- Municipal market repricing has created an ability to reinvest income and new cash flow at significantly higher yields. It is our belief that income and total return potential is now more favorable than has been the case over the past few years.
- Yields across the curve have largely priced in rate hikes in our view. The curve could steepen a bit in coming months with the front-end trading lower in yield. Given this flattening, we are finding value on the "tails" of our 3 to 12-year buying range in the Intermediate strategy. This is reducing our 5 to 8-year maturity exposure.

Investment Grade Corporates & Treasuries

- Q1 was a turbulent period as IG Corporates were stung by inflation reports, tightening monetary policy, and geopolitical crisis. The Bloomberg Barclays US Corporate Bond Index fell by 7.69%, while Intermediates fared somewhat better at -5.25%.
- The IG markets regained their footing from a credit perspective to close the quarter, with high-grade credit spreads narrowing 5 bps over the last week and 30 bps from a peak earlier in March. Strong investor demand at higher yield levels, an improvement in funding conditions, and better geopolitical tone helped support credit spreads.
- We reside in the camp that foresees a 0.50% Fed Funds hike in May but feel that weakening growth influenced by fiscal tightening and slowing money supply may lead the Fed to pause after another 0.25% in July.
- Of note, the short end of the UST curve has already priced in a good deal more with the 2Yr at 2.47% and the 3Yr at 2.63% as of 4/1. We see significant value at those yield levels.
- Our UST trading range over the remainder of 2022 is 1.90%-2.60%. With yields residing at the upper end of that range we do not anticipate a significantly higher UST yield move from here.

Equities

- Despite rallying in March, the S&P 500 (-4.60%) and NASDAQ (-9.0%) both posted negative returns for Q1, marketing their worst quarters since the onset of the pandemic in Q1 2020. Commodities (+4.8%) and energy (+39%) were clear S&P 500 sector leaders in Q1, performance that reflected supply shocks heavily influenced by the crisis in Ukraine.
- Corporate profits need to deliver to sustain recent positive momentum although expectations are for +9.3% in 2022 and +9.7% in 2023. The upcoming earnings season will be telling, particularly relative to companies' ability to pass along rising input costs.
- Valuations have receded, with a forward S&P 500 P/E multiple of 19.5x reflecting a move higher in interest rates and a slowing economic outlook. Despite a sharp rise in bond yields, the S&P 500's earnings yield (E/P) of 5.1% still compares favorably to 10Yr UST yields of about 2.40% as Q2 began.
- Recent UST yield curve inversion has created considerable angst given the historic association with pending recessions. The picture is far from clear though and mitigating factors include a Fed that is raising rather than lowering rates, far from stressed credit and CDS spreads, and a median 20-month period between inversions and past recessions.

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