Avantia

July 9th, 2021

Quarterly Market Review

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Summary of Market Review:

We are slightly overweight equities with a focus on international and emerging markets. We are overweight value relative to growth and small cap relative to large cap. The recovery from COVID 19 is well underway in the US and is beginning in Europe though the UK still faces challenges related to Brexit. In emerging markets, an index-based approach will likely lead to poor results in 2021, thus a tilt toward value is important.

The low-rate environment, expected inflation, and likelihood of rising rates encourages us to be underweight duration and overweight credit. Within our credit exposure we prefer to allocate to Floating Rate Notes to lower effective duration.

We have modest conviction that inflation is transitory and can largely be traced to supply constraints that are typical with a rapid recovery. As such we prefer to have exposure to asset classes that provide an inflation hedge such as REITs, Equities, Energy, and inflation-protected bonds.

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Market Commentary:

Each quarter our team meets to distill the research we have read and discuss our outlook on the economy and global markets. While this does not change our long-term investment outlook nor our strategic asset allocation for you as a client, we do try to add value on an after-tax, net of fee basis by taking advantage of shorter-term dislocations and opportunities.

Asset Class Views:

Asset Class		Opportunity Set	UW	N	OW	Change	Conviction
Major Asset Classes		Equities			◆		High
		Duration	◆			▼	Low
		Credit			◆		Low
		Cash	◆				Moderate
Preference by Asset Class	Equities	U.S.			◆		Low
		International			◆		Low
		Emerging Markets		◆		▼	Moderate
	Fixed Income	Municipal Investment Grade	◆				
		Municial High Yield		◆			
		Corporate Investment Grade		◆		▼	
		Corporate High Yield			◆		Moderate
	Currency	USD	◆				Moderate
		EUR			◆		Low
		EM			◆	▲	Moderate

Equities:

Currently, our strongest conviction is to be slightly overweight equities with a focus toward US and international while being thoughtful towards Emerging Markets. In all geographies we seek to be overweight value relative to growth and small cap relative to large cap. The US recovery is well underway and this trickles into the credit markets as well through lower default rates. In Europe, the recovery is beginning and gaining steam though the UK is still dealing with Brexit issues. In Emerging markets, index-based approaches will lead most investors to be too tilted toward growth to outperform in 2021, but thoughtful investors will recognize this aspect of the benchmark and lean toward value and away from technology stocks. Value companies are generally cash flow rich and well positioned to take advantage of the post-pandemic reopening and small companies are generally more nimble and able to take advantage of new markets and opportunities than their larger counterparts.

Fixed Income:

The low-rate environment keeps yields low and investors should expect downward pressure on prices as rates, particularly in the middle and far end of the curve, rise. Thus, one of our strongest conviction ideas is to be underweight duration and overweight credit. Within our credit exposure we currently prefer to be overweight Floating Rate Notes while maintaining an allocation to High Yield Bonds. High Yield Bonds tend to have an average effective duration (a measure of the price sensitivity to a change in interest rates) of just over 7 for Municipal bonds and just over 3 for corporate bonds. The benchmark for these two assets classes, the Barclays Aggregate Bond Index has a duration of 6. Floating rate generally has a duration of around 0.5.

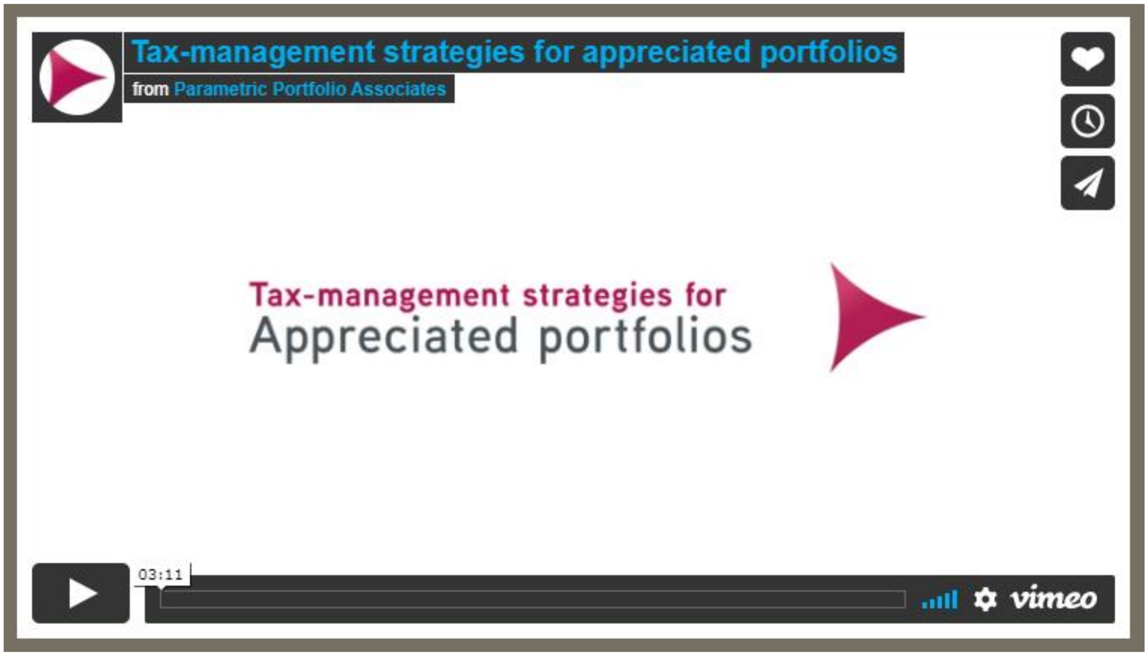
Real Assets:

We have modest conviction that inflation is increasing in the short term, will abate somewhat by the end of the year and into early 2022 but will continue to rise in the latter half of 2022 and beyond. This near-term inflation is transitory and can largely be traced to supply constraints that are typical with a rapid recovery. As such we prefer to have exposure to asset classes that provide an inflation hedge such as REITs, Equities, and Energy. We think many investors should consider an allocation to inflation protected fixed income as an important way to inoculate their portfolios and future spending needs to the risk of inflation

Wealth Advisory Thoughts:

Earlier this year we spent some time reviewing the concept of "Strategic Gain Recognition." This is when a client may choose to sell an appreciated asset at current long term capital gain rates to avoid the risk of selling under a future year's potentially higher capital gain rates. In this note we will expand upon that concept and contemplate tax loss harvesting.

As we see in this video (See Video on Right) from our friends at Parametric, there are many ways in which tax loss harvesting can be employed and many "problems" for which it can be a tool when applied properly. That said, every person's situation is different, so we encourage our clients to engage with us on their specific situation and to ensure the client's accountant has a chance to opine on the tax aspects of the decision.



https://www.avantiamfo.com/tax-loss-harvesting

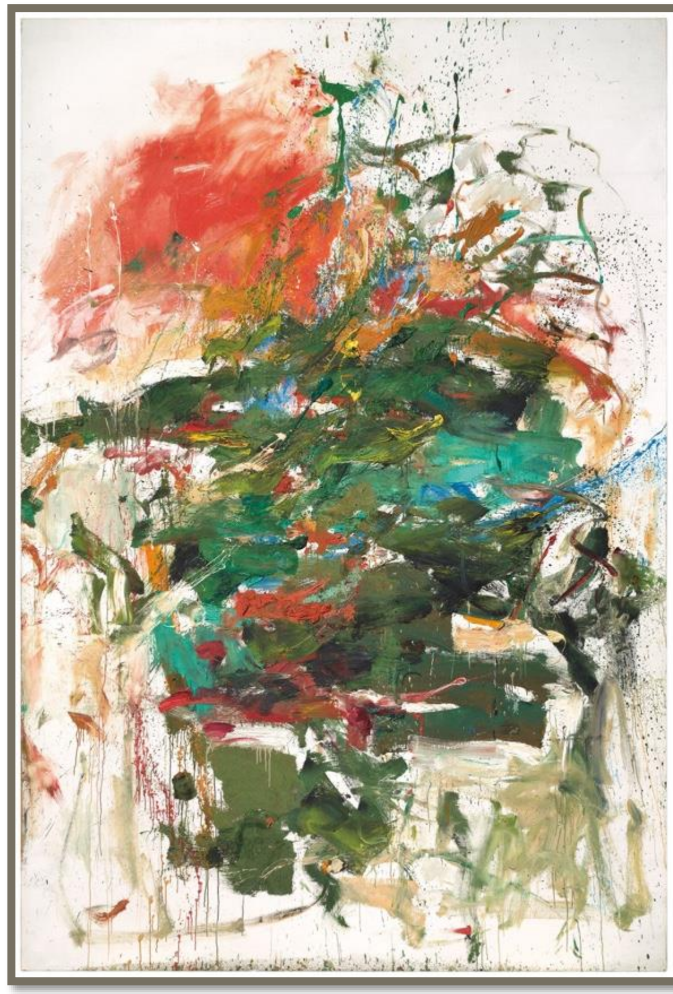
Wealthy clients will often acquire many different types of assets over their lifetimes. When a sale of an asset becomes appropriate, this sale may affect a client's capital gain situation. At Avantia we work with our clients and their accountants to understand the existing capital gain situation, the current and future year's capital gain expectations, and the capital gain exposure present on the balance sheet as well as consider the existing tax landscape and how that could potentially change in the future. We often find that our new clients have a long history of either not utilizing a proper capital gain strategy within their financial structure, use too much of it (potentially leading to higher fees), or have not used the various levers within the strategy to optimize it. This is most often the case when the wealth manager and the accountant are not in an active dialog.

For some client's taxes may also be relevant at the state. In fact, some states have a capital gain tax regime and/or an income tax regime. In these situations, it is important that your advisory team understand this dynamic and are advising appropriately. This can make tax loss harvesting more valuable (in higher tax jurisdictions), but it does not necessarily mean a client should employ more loss harvesting. If expected capital gains are dramatically overshadowed by the size of the losses that have been and continue to be harvested, a client can end up with a large "tax asset" imbedded in their tax return. If those losses can be carried forward indefinitely, and used in the future, that is a benefit. It should also be considered in the financial structure and asset location. However, if those losses and the systematic lower basis that is a "side effect" of the loss harvesting process go unchecked and congress changes the step-up in basis rules then the value of this tax asset can evaporate and potentially become a future liability for the next generation to inherit the appreciated securities. This poses a risk to clients that should be considered and discussed periodically as needed.

Tax Loss Harvesting, as the video shows the reader, is much more than selling the losses. Understanding the relative tracker error of the portfolio to its applicable benchmark, as well as minimizing the time out of the market are both vitally important to investment returns. Afterall, the goal for any client is seldom lose money to save taxes, rather the goal is often to make money and pay as little tax as possible on that gain!

Avantia Lifestyle

Investing in Art: Joan Mitchell



The Painting 12 Hawks at 3 O'clock, 1962 is a masterpiece example from Joan Mitchell's body of work and was first acquired by Mitchell's close friend, the renowned artist Sam Francis. Barney Ebsworth, a prominent collector of 20th Century American Art, later acquired the Painting at auction for $310,500 on May 7, 1997 and it sold for $14,037,500 on November 13, 2018, which resulted in a price appreciation of 45 times the purchase price at an annual appreciation of 19.4%. Sometimes art can be a good investment!

Biography:

Born in 1925 in Chicago, Illinois, Joan Mitchell was part of the second generation of Abstract Expressionist painters and one of the rare female artists of the time to garner equal acclaim to her male contemporaries. Mitchell first studied art and English at Smith College in Massachusetts before transferring in 1944 to the Art Institute of Chicago where she pursued painting. Upon her graduation from the Institute, she received a James Nelson Raymond Foreign Traveling Fellowship, allowing her to spend a year in France. During this trip abroad, her style became decidedly more abstract, and, once she returned to New York, she was included in the seminal 9th Street Show in 1951 alongside other Abstract Expressionist painters—such as Jackson Pollock and Robert Rauschenberg—an exhibition organized by the now famous gallerist Leo Castelli. The following year Mitchell had her first solo exhibition at the New Gallery, which was critically praised and led to a yearly exhibition at the Stable Gallery.

Even after returning to New York from her year abroad, Mitchell continued to return to France regularly, but in 1955 she relocated to France permanently. Despite being away from the New York art world that had by then fully embraced her work, Mitchell continued to paint prolifically for the next several decades until her death in 1992. Her oeuvre is somewhat unique in its overall consistency; although trendier and more popular movements and approaches proliferated in the last decades of the 20th century, Mitchell stayed true to Abstract Expressionism, developing, as critic Klaus Kertess described, "a vocabulary so completely her own that it could become ours as well."

Bibliography:

Tax Management Strategies for Appreciated Portfolios | Parametric | https://www.parametricportfolio.com/insights-and-research/tax-management-strategies-for-appreciated-portfolios-video

Photos of 12 Hawks at 3 O'clock | Masterworks | https://www.masterworks.io/research/artist/69ec1c1ac3c5837

Works by Joan Mitchell | Southbys.com | https://www.sothebys.com/en/artists/joan-mitchell

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