RWA ROBERTS WEALTH ADVISORS

Quarterly Commentary

July 2023

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Technology Runs the Game

The second quarter saw positive momentum carryover from the first quarter across the major asset classes and markets as well as some calming in the economic headlines that created an eventful start to the year.

Through the first six months of 2023, investors have seen positive returns across every major index which offers a stark reversal from the same six months last year. For U.S. equity investors, the S&P 500 has returned 16.89%, the more technology-heavy Nasdaq Composite has returned 32.32%, and the blue chip-oriented Dow Jones Industrial Average has returned 4.93%.

International equity investors have also been rewarded this year, though to a lesser degree, with developed international markets (as represented by the MSCI ACWI ex-USA) returning 9.47% and emerging markets (as represented by the MSCI Emerging Markets) posting a return of 4.89%. Bond investors are also seeing small but steady returns with the core U.S. bond benchmark up 2.09% so far this year.

One of the more pronounced features of the second quarter, however, has been the degree to which market returns have been driven by large technology stocks. S&P 500 performance during the second quarter came to +8.74%, while the same basket of S&P 500 stocks equally-weighted returned a more modest +3.99%. Additionally, most of the top ten positions by size in the index have surged this year and represent a combined 30% of the entire market capitalization of the index, well above both the 1999-2000 tech bubble (25%) and the average over the past 35 years (20%).

As further evidence of their contribution, year-to-date returns for the top seven are – Apple +48%, Microsoft +41%, Amazon +56%, Nvidia +191%, Tesla +128%, Alphabet +35%, and Meta +138% – without their inclusion the S&P 500 would only be up approximately 7.5% this year through the second quarter. As these stocks have grown in proportion to the overall index, they've also raised the valuation of the overall index as the S&P 500 has a forward PE (price to earnings) ratio of 18.9x, while the top 10 names have an average PE ratio of 39x.

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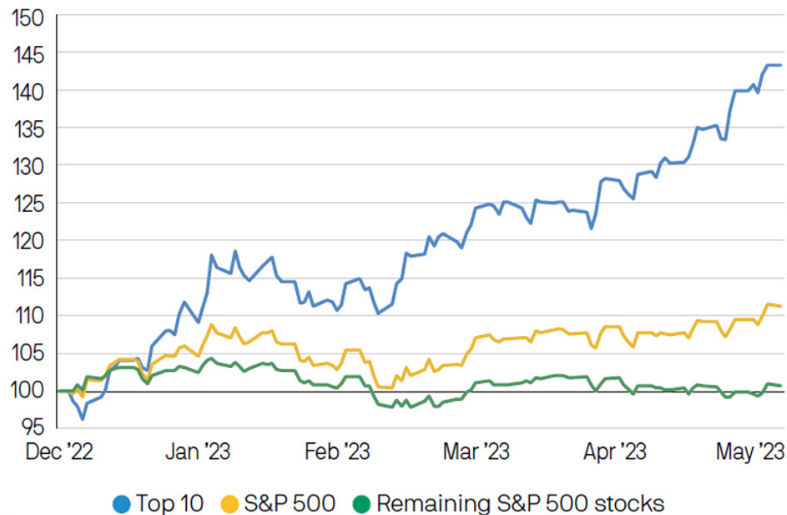
S&P 500 Return Concentration



JPM Asset Management's Midyear Outlook

Should the Federal Reserve continue to raise rates or hold them higher for longer, that increases the relative risk of the index as higher rates are generally indicative of deservedly lower valuations.

As part of our mid-year review and second half outlook, we circle back on our major economic concerns coming out of the first quarter to reevaluate any incurred impacts and further potential ones. Those headwinds were: fears of a recession, higher interest rates, the regional banking crisis, and the U.S. debt ceiling.

In terms of recession risk, the current environment continues to involve the most predicted and telegraphed recession in the U.S. markets for at least 50 years. While expectations for a recession have come down farther, they remain elevated for the next several quarters with professional forecasters indicating a 40-45% probability of a recession in the third or fourth quarter of this year. We continue to believe that such expectations have been at least partly factored into current market pricing, and we also maintain our belief that in the event a recession does occur, it should be short and relatively shallow in comparison to the past few recessions.

Our reasoning for that position rests largely on the sustained strength of the consumer, whose spending accounts for approximately two-thirds of the economic output, also known as the U.S.'s gross domestic product (GDP). As we originally argued several months ago, the U.S. consumer continues to remain strong with household debt as a percent of GDP hovering around the lowest levels since the early 2000s.

The flipside of that argument is that the household savings rate has remained around the lowest levels since the early 2000s, implying that consumers are spending heavily and saving very little of their income. However, total household savings remain robust and all but the bottom 20% of Americans by income continue to have excess savings from the pandemic in their bank accounts. Given current spending trends, those levels will continue to normalize, indicating at some point spending will likely need to slow; however, we do not believe that time is imminent given a strong job market and healthy wage growth.

Higher interest rates continue to be the major headline this year and were given renewed interest several weeks ago as the Fed decided to hold short-term interest rates steady for the first time in 15 months. Over that time period the Fed and its Chair, Jerome Powell, have raised rates a full 5% but now decided to slow the rate of further hikes to consider the cumulative effects of their policies and "the lags with which monetary policy affects economic activity and inflation".

At the time of our writing the market is pricing in a better than 86% chance that the Fed hikes rates just one more time this year by 0.25% followed by rate cuts starting in late 2023 or early 2024. Fed officials, on the other hand, indicated at the last meeting that two more hikes this year were likely, followed by declines at some point next year. The fixed income market has gradually adjusted to the Fed's projections in the short-term, but it is still pricing in rates at the end of next year approximately 1% lower than Fed estimates. That could lead to additional volatility in fixed income if the markets are forced to further adapt to Fed positioning, but for the time being, the convergence should lead to calmer markets.

With the regional banking crisis, the acquisition of First Republic out of FDIC receivership by J.P. Morgan Chase has for now put an end to the liquidity-inspired crisis that we wrote about in our commentary last quarter. The event led to the failure of three regional banks in the U.S. (three of the four largest in U.S. history) and has inspired fresh rounds of congressional dialogue on bank regulation. Thus, with some degree of confidence restored in the banking system and deposit outflows stabilizing, we agree with J.P. Morgan CEO, Jamie Dimon, that "this part of the crisis is over".

The next part of the crisis is not guaranteed to occur, but the obvious next shoe to drop would be a credit crisis from outsized regional bank commercial real estate (CRE) portfolios. The share of all CRE loans in the U.S. held by regional and small banks is estimated around 67%, while the share of all total loans held by the same institutions is estimated around 38%. As an estimated $1.4 trillion in CRE loans come due by the end of next year, some banks are likely to see pressure on their balance sheets that may be exacerbated by renewed depositor anxiety. We continue to maintain a position in J.P. Morgan Chase as we believe larger banks will continue to be the primary beneficiaries of the regional bank crisis.

Finally, the debt ceiling was a major concern heading into the second quarter which has now been pushed back to late 2024. Its delay should remove any nervousness in markets related to a U.S. default and higher associated interest rates. We don't anticipate any related concerns for the remainder of the year.

The Federal Reserve is likely to remain top of mind in the third quarter as investors try to decipher the latest move as a pause or a pivot. S&P 500 earnings in the second quarter likely saw their worst performance since the second quarter of 2020, but company guidance and analyst estimates are more positive for the back half of this year. We expect the status quo to dominate the trend in markets until there is more clarity on the future direction of interest rates.

The RMD Creep

Many Americans contribute to a tax deferred retirement plan like a 401k, SEP IRA or traditional IRA, because it is a tax efficient way to save for retirement. The term tax deferred means that while the contribution you make to these accounts today gives you a current tax deduction (and grows tax free over time), when the money is eventually withdrawn from the retirement account, it will be taxable to you as ordinary income, just like regular wages would be. This is an effective strategy to pay less tax, but only if you anticipate being in a lower tax bracket during your retirement years than you are today. What if you are in a higher tax bracket during retirement? Several factors could impact your future tax bracket, such as, working longer than originally planned, inheriting a taxable retirement account, a change in tax filing status from joint to single, or a decline in tax deductions from paying off your mortgage. One of the biggest increases to your retirement tax rate can come from a place you didn't expect, your RMD (Required Minimum Distribution).

RMD is the amount the government requires you to withdraw each year from your tax deferred accounts once you reach a certain age, and with the passage of SECURE Act 2.0 in 2022, the RMD age got pushed back for many. Currently, age 59 ½ to the year you turn 73 (or 75 if born after 1959) is a distinct window of time where you are allowed to take penalty-free withdrawals from your tax deferred retirement accounts, but not yet required to take withdrawals. In fact, according to a 2021 study by the Investment Company Institute, 78% of IRA owners delay taking money from their IRAs until age 70. Delaying withdrawals can have an enormous impact on the growth of the account, which is a good thing, but this can also result in larger than expected RMDs when the time comes. This distribution could "creep" you into a much higher tax bracket and leave you with a startling tax bill you didn't plan for. This is the surprising trend known as "RMD Creep".

There are a few ways to combat "RMD Creep", but the most powerful is through a series of deliberate Roth conversions. Simply put, a Roth conversion is the process of taking money from an IRA or other tax deferred account and converting it to an after-tax Roth retirement account. The taxpayer is required to pay tax on the amount converted today, but the beauty of the Roth IRA is that money will continue to grow tax free and will never be taxed again or subject to required minimum distributions. It effectively insulates those funds from any potential tax increases for you and your beneficiaries, reducing your lifelong tax expense and increasing your net worth. It's particularly effective when done during the retirement phase prior to your RMD age when income is typically lower.

Here's an example that illustrates the difference a carefully planned Roth conversion strategy can make.

Nicole is a 66-year-old, retired physician. Her annual income is $170,000 thanks to her pension and social security income and is sufficient to cover her living expenses. She is in the 24% tax bracket. Nicole has been a good retirement saver and has a traditional IRA account worth $1,000,000. She will begin taking RMDs in seven years at age 73.

- Nicole could **do nothing** and continue to let her IRA account grow until she is required to take RMDs at age 73.
- Or she could **convert about $40,000 each year** from her IRA to a Roth IRA while preserving her 24% tax bracket until she turns 73 and then starts taking required distributions.

These incremental conversions would result in her paying $100,000 less in cumulative lifetime income tax and her total portfolio assets would be $500,000 more at age 90. In addition, she will have a sizeable tax-free asset in the form of a Roth IRA to pass onto her heirs.

The idea of emptying the same tax-deferred bucket that you just spent the last 20 to 30 years or more filling up may seem counterintuitive, but the tax laws and RMD rules are unavoidable. While we have no way of knowing for sure if tax rates will go up in our later years, it is reasonable to expect that they will as a way to deal with our country's ongoing budget deficits and staggering debt. In addition, the Tax Cut and Jobs Act of 2017 is set to expire after 2025. If Congress doesn't act, tax rates will jump back to their pre-2018 levels. This makes tax planning a crucial part of overall wealth management and is the reason we ask for a copy of our clients' tax return each year. Knowing which tax bracket a client falls into helps us create a plan to minimize tax liability and maximize net worth.

Portfolio Activity

Our main focus during the second quarter centered around adding to names where we believe valuation had become particularly attractive as well as trimming certain positions where we felt price moves had become an obstacle to near-term performance. In aggregate, we were largely balanced this quarter in terms of the magnitude of our buys and sells with a slight bias towards portfolio additions.

Our sales focused on two names: AT&T (T), where we trimmed accounts that had run above our target allocation, and Apple (AAPL) where we made a similar decision to leave our target intact but trim overweight positions. As we expand on in our Featured Stock section, Apple is a stock that has performed incredibly well this year but one where we believe valuation may have moved too far, too fast.

Apple's principal revenue streams have grown to a size where saturation becomes a serious concern for future growth, and its two key growth avenues are far from guaranteed successes. Apple's augmented/virtual reality headset, the Vision Pro, is looking to win in a market where no other company has yet seen breakthrough success, and the long-touted Apple Car is likely years away if the company chooses to follow through on its development.

AT&T is a name that has been in the portfolio for some time and the decision to trim versus liquidate was based on our belief that the company's strategic turnaround and pivot to a pure play telecom provider continues to have legs. AT&T remains a solid dividend name with an undemanding valuation but is a position we will likely look to exit in the future given its longer-term debt dynamics and failure to invest in what we feel are secular growth drivers in the telecom industry.

Our main additions to the portfolio during the second quarter increased the size of our stakes in both American Tower (AMT) and Verizon Communications (VZ). Similar to AT&T, Verizon has been a core holding for a number of years and offers its highest dividend yield in more than a decade while sporting a reasonable valuation. Unlike AT&T, however, we believe that Verizon has been ahead of the game to invest in the next leg of 5G, and the subsequent few years will be marked by growth in revenues and cash flows as it begins to benefit from those investments.

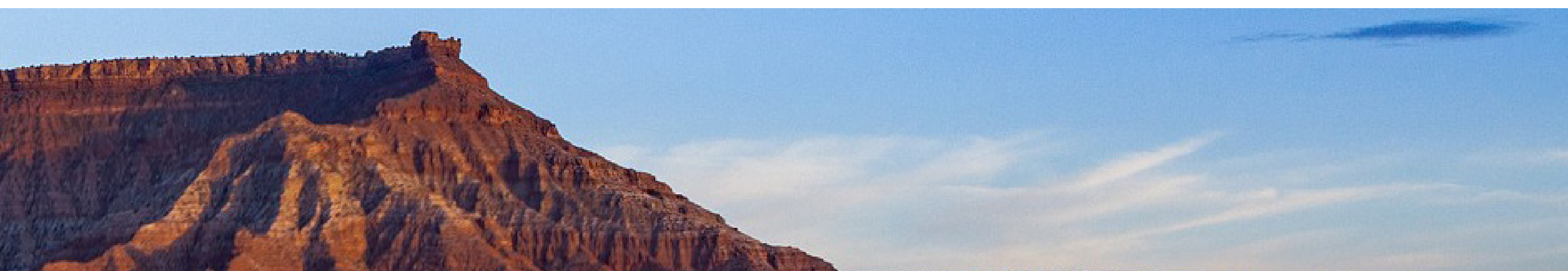
Index Performance	Q2	YTD
Dow Jones Industrial	3.97%	4.93%
Standard & Poor's 500	8.74%	16.89%
Nasdaq Composite	13.05%	32.32%
MSCI EAFE (Europe, Australasia, Far East)	2.95%	11.67%
Russell 2000 (Small Company)	5.21%	8.09%
MSCI ACWI (All Country World Index)	6.18%	13.93%
Barclays Intermediate Term Bond	-0.84%	2.09%
Barclays Municipal Bond	-0.10%	2.67%
Barclays Short Term Bond	-0.62%	1.19%

We also added to our position in American Tower as the stock price traded lower while our conviction in its story remains strong. American Tower is one of the world's largest cell tower companies, with a substantial portion of its revenues coming from the U.S. while also participating in growth markets internationally. The company also acquired one of the largest data center operators in the U.S. and is looking to combine those assets with its towers to build the framework for the process known as edge networking. Few companies have the ability to match American Tower's global infrastructure in this endeavor, and its bread-and-butter tower business will continue to generate inflation-proof profits in the background for decades.

Finally, towards the end of the quarter we liquidated our holdings in Digital Realty (DLR) and First Republic Bank (FRCB). With First Republic Bank, our analysis led us to the conclusion that common stockholders were likely to see little compensation in the face of government intervention, and we felt it made more sense to liquidate our position than hold on for a drawn-out legal proceeding. And with Digital Realty, we believe the secular trend towards the digitized economy remains intact and data centers will continue to benefit from that trend, but we discovered a number of idiosyncratic red flags in our research which warranted an exit from our position.

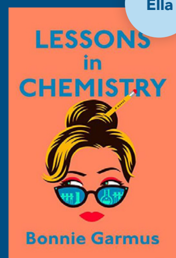
TOP 10
U.S. HOLDINGS

- Microsoft
- Apple
- Alphabet
- Amazon
- J.P. Morgan
- Trane Technologies
- American Tower
- Visa
- Cisco Systems
- Linde



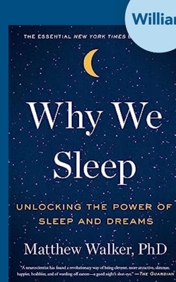
Staff Summer Picks

Lessons in Chemistry, book by Bonnie Garmus: A novel set in the early 1950's that follows a single mother as her career (and passion) in chemistry addresses both feminism and resilience. Her chemistry expertise takes an interesting turn when she finds herself the star chef on America's most sought-after cooking channel. This is a relevant read that has inspired the upcoming drama television series due to debut in October 2023.

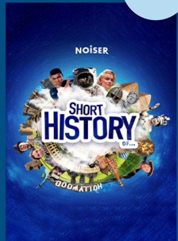


Margin Call, film by J.C. Chandor: The Big Short gets all the attention for movies about the 07-08' global financial crisis, but Margin Call gives a unique and in-depth look at how the wheels came off the wagon within a single bank over a 24-hour period. An easy and entertaining watch for all movie lovers.

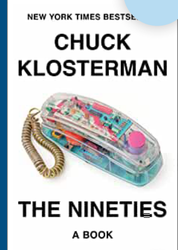
Why We Sleep, book by Matthew Walker: Sleep is one of the most important yet least understood parts of our life. Walker is a professor at UC Berkeley and founder of the Center for Human Sleep Science. Walker's book covers important aspects about sleep including circadian rhythm, the effects of alcohol and caffeine on sleep, the importance of REM sleep, diseases linked to sleep deprivation, and many more. The author makes many interesting claims that are both fascinating and easily digestible.



Short History Of..., podcast by Noiser: Each week a new 50-minute episode is released that brings a fascinating person, event, or place from history alive. A few of my favorite episodes include Muhammad Ali, The Rosetta Stone, and Female Spies of World War II. The production quality is outstanding and the show host, John Hopkins, has the perfect voice for storytelling. I could listen to him read the phone book.



The Nineties, book by Chuck Klosterman: Takes a reminiscent look at a decade kicked off by the release of Nirvana's album "Nevermind" and winds through the films, music, sports, and politics of the ensuing decade. A period that began with telephones plugged into walls and concluded with Alan Greenspan warnings of irrational exuberance and the onset of digital natives.



Next Level Chef, television series by Gordon Ramsay: We are fans of any Chef Ramsay show in our house and Next Level Chef is a new favorite. Chefs compete in a series of cooking challenges, divided into three teams under the guidance and judgment of three master chefs. In each episode, competitors cook in one of three (equipped to not so equipped) kitchens stacked on top of each other. Packed with Ramsay's trademark temper, all the dishes are judged blindly to find the world's newest cooking superstar.

Featured Stock: Apple (AAPL)

Apple is the largest company in the world as measured by stock market valuation and is a leader in consumer electronics, specifically in the mobile device space. The company's business is largely broken down into two key areas: devices and services. The devices segment mainly includes smartphones (iPhone), tablets (iPad), personal computers (Mac & MacBook), smartwatches (Apple Watch), and earphones (AirPods), but also includes other hardware such as the HomePod and Apple TV. The services segment, on the other hand, complements the devices business by offering subscriptions like Apple Music, Apple Health, and Apple TV+.

Apple is a name that has been in the portfolio for some time and because of its size and importance to the U.S. markets, it has generally been one of our largest names as well. However, due to the runup in technology stocks this year and its above average valuation, we trimmed down our position in Apple as we felt the valuation had moved ahead of near-term opportunity for the company. The stock currently trades around a 32x price-to-earnings ratio (PE), the highest since December 2021 and the stock price has since reached an all-time high.

The optimism in the stock price, in our opinion, has come at least partly from expectations over the company's newest technology, the Apple Vision Pro. This is Apple's first entry into the augmented reality/virtual reality (AR/VR) space, and it's doing so with a splash – the initial sales price for the device is $3,499, and if users have glasses and want to use the device, they will have to pay up to an additional $600 for custom prescription lenses. At some point, Apple is likely to offer a lower priced version for the device, similar to the iPhone SE or iPhone mini, but current expectations peg that device to arrive no sooner than 2025 and given the delays with the current device, that may end up being pushed out further.

We would also note that Apple's internal sales estimates for the Vision Pro have dropped twice, from an initial one million target to 350,000, and again from 350,000 to 150,000. For comparison, Meta, which largely popularized the AR/VR headset industry, launched its first headset in 2016 and has reportedly sold an estimated 20 million total devices at much lower price points that have averaged between $300-$500. Apple has a history of entering industries later and revolutionizing them, and while we are not ruling that out for the AR/VR experience, we believe expectations may be too high, valuation has gone too far, and measurable success in this area could be years away.

Topic Spotlight

Passport Renewal Purgatory

Historically, the demand for passport applications and renewals has been cyclical, the typical busy season is March to late summer, but right now, it seems constant. The U.S. Department of State processed more passports in 2022 than in any other year before. The surge in applications is credited to pent-up travel demand among those who postponed applying and renewing during the COVID-19 pandemic.

According to the State Department website, current processing times for new and renewed passports are 10 – 13 weeks (7 – 9 weeks expedited for a $60 fee). These processing times SHOULD NOT be relied upon. If you haven't experienced it yourself, it's not hard to find someone with a passport renewal scary story this year. Our very own Brian Roberts applied for renewal for his three children in December of 2022 to prepare for a trip to Europe in June of 2023. Two of the three passports arrived within eight weeks, but two weeks before they were scheduled to depart, the third passport had still not arrived, and the status just said "PROCESSING." Several days of waiting on hold with the passport line hoping for a sliver of information only to be told to call back tomorrow were not successful. The outcome did not look good, arrangements were made to care for the child that would not be able to travel. The final "Hail Mary" came the day before the scheduled departure as they drove to the San Francisco passport agency with the hope that the security guard would allow them to enter without an appointment. By some unexplainable luck, they were allowed to go in. They received the passport a few hours later!

Brian's story, thankfully, ended well, but that isn't the case for everyone. Walk-ins are not officially accepted, and "urgent" in-person appointments are hard to come by and you may need to fly to another location to get one. Do not assume you'll be able to get an appointment, or that your congressperson will be able to help you. Standard travel insurance will usually cover trip expenses due to a lost or stolen passport, but cancellation policies do not provide coverage if you have not received your passport by your departure date.

Minimize the headache and start planning ahead for your spring break and summer 2024 travel plans. Check your passport expiration date today! If it expires within the next 12 months, whether you have international travel plans or not, begin the application and renewal process now. Don't forget about the six-month validity rule, which means your passport actually expires six months before the stated expiration date. This is because some countries require that your passport be valid for six months after you enter the country. We hope everyone has a safe and happy summer!

Firm Announcement

Roberts Wealth Advisors is excited to announce William Kim has joined our team as a Research Analyst in the Park City, Utah office. Prior to joining RWA, William held several roles in the financial industry, with the most recent being a Research Associate at D.A. Davidson & Co. William was born in Chicago and attended DePaul University where he graduated with honors with a Bachelor of Science in Finance and a minor in Accountancy. Outside the office, William enjoys being active and is excited to explore Utah outdoors.

Past performance is not necessarily a guide to future performance. There are risks involved in investing, including possible loss of principal. This information is provided for informational purposes only and does not constitute a recommendation for any investment strategy, security or product described herein. Please contact us for a complete list of portfolio holdings.
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