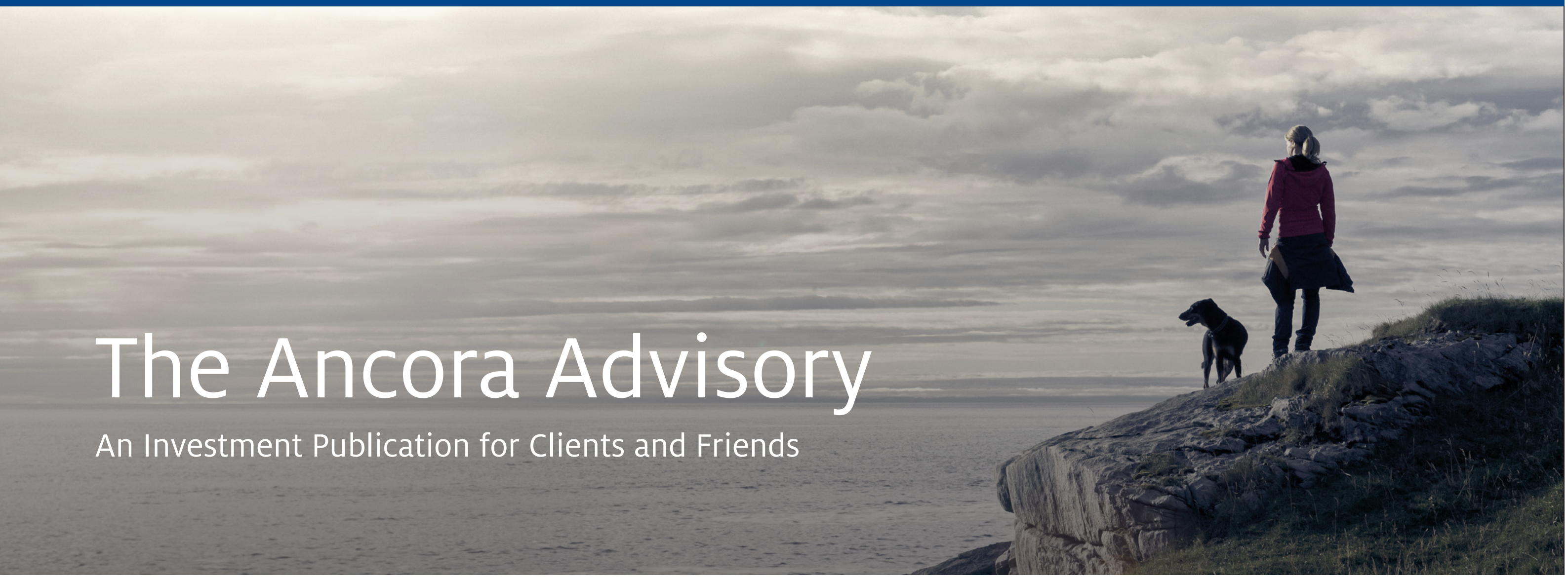
Second Quarter 2022



The Ancora Advisory

An Investment Publication for Clients and Friends

Ancora consists of three primary business units; Family Wealth, Asset Management and Retirement Plans. With experienced portfolio managers, proprietary investment strategies and an entrepreneurial spirit, Ancora delivers tailored solutions so you can achieve more ... on your terms.

Staying on the Right Track

John Micklitsch, CFA, CAIA
Chief Investment Officer

We can think of the world of equity investing as having two tracks that run in parallel but at times resemble completely different worlds. One track is the relatively consistent, long-term, upward-sloping trend of corporate earnings. The second track is the more winding and less predictable valuation path associated with emotions, fear, greed, the news cycle and interest rates. Like the bewildered parents of siblings who behave very differently wonder how the two can be related, the earnings track and the valuation track can befuddle even the most experienced investors.

Imagine, however, that you own a family business (as many of our clients do) and that business has served two or three generations with a steady stream of earnings that have grown over time, supporting family members in their life's pursuits. The business is good at what it does and, if managed properly, will serve additional family members for generations to come. The bulk of time at family board meetings is spent on the long-term prospects and earnings power of the company driven by innovation, new products, solutions and services that will better position the business to succeed in the marketplace.

The family business described above is not dissimilar from owning a portfolio of well-run and capably managed public companies, either individually or through a fund. The main differences between the two are control and pricing. You have less control over a public company than you do a family business and publicly traded "family businesses" have prices attached to them virtually every minute of every day, which can distract from what's important longer-term (not that you must act on that price). For reference, Warren Buffett has pointed out that Berkshire Hathaway has fallen by 50% three times during his tenure, but not once did he ever think of selling any of his interest. Mostly because the long-term earnings power of the business was far more likely to grow than contract over time and because his withdrawal needs were modest. Those two simple principles have been among the keys to his enormous wealth creation.

With most areas of the market currently either in correction territory (down more than 10%) or in outright bear markets (down more than 20%), we can speculate on what will cause stocks to regain their positive bias. Reasons could include signs of inflation easing, a resolution to the Russia/Ukraine war and China resolving its zero COVID policy. But the reality is that the market will regain its footing when participants exhaust their current fears and refocus on the long-term earnings power of their collectively held businesses and less on the prices that people trying to snatch those "family businesses" away from them are currently willing to pay.

As we've said before, the concepts behind successful investing, which include diversification, quality and time, are simple, but the execution of a long-term approach can be difficult, especially during times of market stress. Our mission at Ancora is to give you the tools, perspective and advice to be successful stewards of your portfolio of "family businesses," so you can stay on the right long-term track. ◊

As Stocks Enter Correction, Focus on Company Fundamentals

David Sowerby, CFA
Managing Director, Portfolio Manager

There has been little to like about the markets so far in 2022. The two major asset classes, stocks and bonds, are both down. Of the two, I would contend it is the bond market that has greater challenges ahead and has exhibited more prolonged weakness dating back nearly two years.

However, having managed both asset classes, I recognize it's always the stock market that gets the most attention.

The stock market, as measured by the S&P 500, has declined about 16% from its early January highs and is in correction mode, defined as a drop between 10 and 20%. Perhaps more concerning, the average S&P 500 stock is 25% below its own 52-week high. That statistic causes more concern for investor portfolios, with the next question being: How much more could the market drop?

Calling stock market bottoms, or even tops, is an exercise in futility. The batting average for the average Wall Street strategist is terrible. The current weakness is most related to the last 6 -12 months of higher inflation and rising interest rates, and what that will ultimately do to the economy and profits.

Recessions are inevitable and part of long-term cycles. Forecasting them is treacherous too. However, for what it's worth, we rarely get recessions when the employment market is as strong as it is today. In addition, the overall condition of both the consumer and corporate balance sheets is quite healthy.

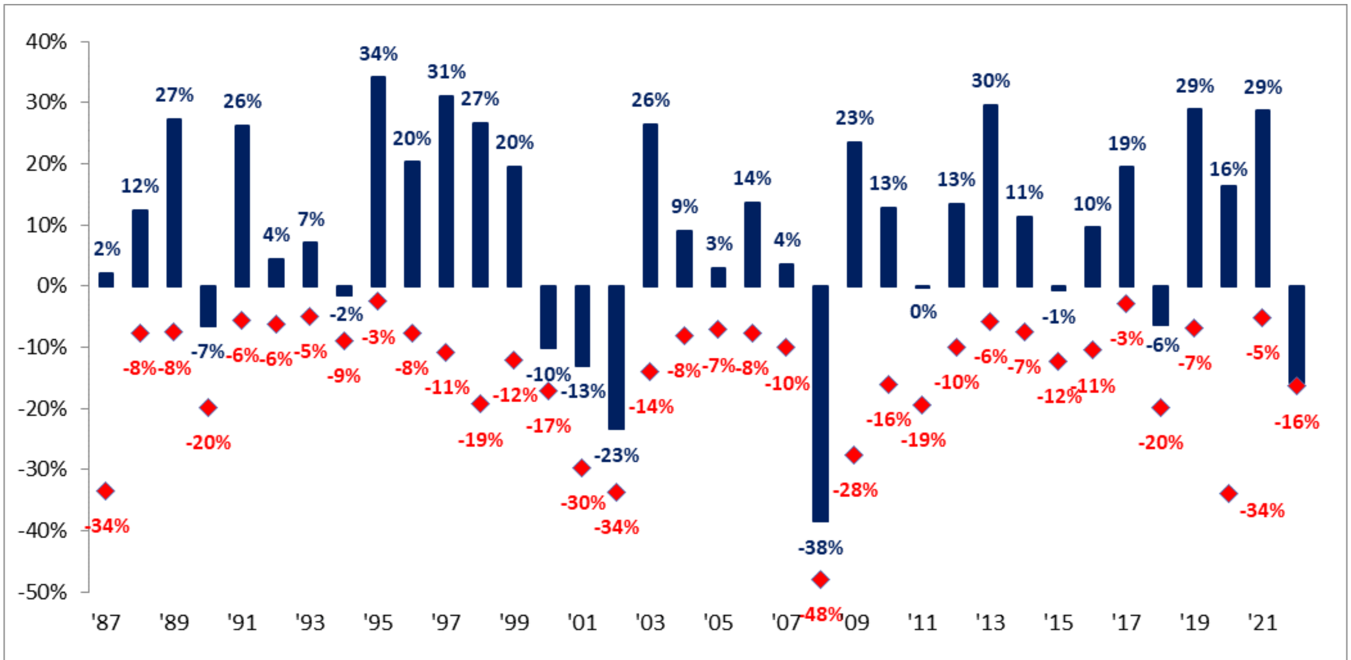
We are about three quarters of the way through first quarter profit reporting season. The news has erred on the good side, both for what has taken place and the forward guidance from management teams. The concern, which translates throughout the market, is the inflationary impact of higher prices and what that can do to sales, cash flow, earnings and margins.

Favorable sales growth, which is currently growing more than 10%, has a direct correlation to profit and cash flow margins remaining above average. In short, the micro forces of company performance remain compelling. The macro forces, however, notably inflation, interest rates and the Federal Reserve are winning the "tug of war" currently between the macro and the micro.

From our long-term perspective, the micro inevitably prevails for individual security selection for adding value beyond the near-term discomfort of intra-year stock market declines.

The following chart reinforces that the average intra-year decline has been about 13% for the last thirty-five years. Of course, with averages, there are both years of significant and not so significant declines. That is why the constant focus on the strength of a company's balance sheet, its cash flow generation and its overall business competitive advantage versus its peers is even more critical in 2022. That is the place to focus one's efforts for long-term success, in our view.

S&P 500 Calendar Year Return vs. Largest Intra-Year Decline



Source: Strategas, Bloomberg. 2022 data YTD as of 5/9/22. ◊

Between the Fed and a Hard Place

Kevin Gale
Managing Director, Head of Fixed Income

Soaring inflation and rising interest rates have led to questions on how the Federal Reserve will be able to engineer a soft landing for the economy. Historically, as the Fed begins to raise rates, slowing economic growth will lead to lower inflation. Just like every other time, it seems that this time may be different. Massive disruptions in the supply chain combined with the "great resignation" and excessive monetary and fiscal stimulus have led to soaring inflation that the Fed may struggle to control. This leads us to question whether the Fed will be able to engineer a soft landing or if it will be harder than intended.

A soft landing is when the Federal Reserve can slow economic growth and curb inflation without putting the economy into a deep recession, or negative GDP (Gross Domestic Product) growth. In a recent interview on May 12th, Federal Reserve Chairman Jerome Powell commented that "A soft landing is really just getting back to 2% inflation while keeping the labor market strong." A hard landing occurs when the Federal Reserve overshoots its rate hikes (pushing rates too high too quickly), thereby pushing the economy into a rapid decline in growth followed by a flat-to-low growth period.

The challenge the Federal Reserve has is two-fold. First, various stimulus packages, some of which are highlighted below, totaling about $9 trillion were introduced from March 2020 through March 2021. To put into perspective the amount of stimulus injected into the U.S. economy, in 2020 the total GDP of the United States was just under $21 trillion. Secondly, the supply side of the global economy remains an issue. With China taking a hard zero COVID policy stance, global disruptions of the supply chain are expected to continue.

Some highlights of the Federal Reserve's Response to COVID:

› March 15, 2020 – Cuts interest rates to 0%, announces it would purchase "at least" $700 billion of treasury and mortgage-backed securities over the coming months, with no limit. Ultimately, the Fed would purchase $4.1 trillion of securities, finally ending

purchases in March 2022.
- March 17, 2020 – Announces the creation of a new facility to purchase as much as $1 trillion of corporate bonds and commercial paper.
- April 6, 2020 – Announces three new Emergency Lending Facilities totaling $1.95 trillion.
- April 27, 2020 – Announces the expansion of Municipal Lending Facilities to $500 billion.
- June 15, 2020 – Main Street Lending Facility opens, providing emergency lending of $600 billion to small businesses.

Some highlights of fiscal stimulus provided for COVID relief:

- March 27, 2020 - $2 trillion CARES Act stimulus package was passed.
- December 20, 2020 - $900 billion COVID Relief package passed.
- March 10, 2021 - $1.9 trillion American Rescue Plan passed.

With the amount of fiscal and monetary stimulus provided over the past two years, combined with the challenging supply chain environment and shortage of workers, the Federal Reserve may have a very difficult job slowing inflation without significantly slowing the economy.

The initial stages of this effort by the Federal Reserve have begun. At its last two meetings, the Committee has raised short-term interest rates by a combined 0.75% and has ceased any further quantitative easing (purchasing of treasury and mortgage-backed securities). The Fed will now actually begin quantitative tightening by selling some of its holdings of treasury and mortgage-backed securities. The selling of securities could modestly increase interest rates as the process unfolds over time.

Although Chairman Powell defined a soft landing as getting back to 2% inflation while keeping the labor market strong, we believe the Fed could allow inflation to run above its stated long-term goal of 2% for an interim period, if that meant avoiding a recession. If the Fed can push inflation down to the 3-4% range in the near-term while maintaining a strong labor force, we would consider that a successful soft landing. Pushing inflation closer to the long-term goal of 2% will require the supply chain to begin to heal or the Fed to make the tough decision of continuing to raise rates, putting the economy at an increased risk of a recession over the next 12-18 months.

We believe the best way to defend against the uncertain near-term outlook is to maintain a well-diversified portfolio across multiple asset classes. A diversified higher-quality equity portfolio combined with fixed income and alternative investments can help cushion downside risk while maintaining the potential for portfolio growth. ◊

Retirement Plans Q&A: Best Practices in a Time of Market Stress

Bill Koenig, JD, MBA
Managing Director, Retirement Plan Advisor

Retirement plan sponsors and participants are not exempt from questions about market volatility. We discuss best practices that retirement plans can follow during times of market stress with Bill Koenig.

Q. Bill, what do you tell plan sponsors to focus on during times of market stress?
Ancora serves over 175 retirement plan clients as an investment fiduciary, which requires us to act in the plan sponsor and plan participants' best interest legally and ethically. During times of heightened volatility and market stress, we remind plan sponsors that we are following an objective, well thought out process to select, monitor, evaluate and replace, when necessary, the investment options chosen for their qualified plan.

We document retirement plan investment line-ups and this rigorous review process in the plan's Investment Policy Statement (IPS). Whether we meet annually or more frequently with plan sponsors and investment committees, Ancora adheres to this review process on a quarterly basis to ensure that, over the long term, plan sponsors are offering high quality and carefully researched and monitored investment options for plan participants to choose from. This can in turn give our clients peace of mind, even during times of volatility.

Q. How might your message differ when your team meets with plan participants?
Our advice to the 12,000+ plan participants that our team works with is similar. Granted, it's much more personal for participants because, for most of us, by the time we retire our retirement plan assets will be our largest asset, along with perhaps our primary residence.

It's cliché, but emphasizing time in the market and not timing the market is tremendously important for plan participants to keep in mind. The power of systematic payroll-deducted contributions, taking full advantage of potential employer matching contributions and the impact of long-term compounding are powerful for participants. When we help create a fund line-up for clients, Ancora includes either (and sometimes both) risk-based asset allocation models and/or target-date funds as investment options. Over time, diversification is important to help smooth out the effects of market volatility and hopefully prevent participants from a reaction like selling low and locking in short-term losses that they might regret later.

Q. What are some of the best practices you remind participants of during times of stress?
Don't panic and remember that investing in your retirement plan is a marathon, not a sprint. Stocks are long-term assets whose value is derived from their long-term earnings power, not simply what happens in the next few quarters. With that in mind during periods of increased volatility and stress like we are experiencing now, it makes sense for participants to revisit their time horizon and reassess their asset allocation. It is important to re-affirm what roles the various individual investments they hold play within the portfolio. Finally, stay optimistic. Markets ebb and flow, but over time, with proper diversification and high-quality investments, they have proven to be a great way to build long-term wealth.

Q. Any parting words to plan sponsors on the key components of a well-managed retirement plan?
Plan design is important. Plan sponsors should work with their service provider teams to select the plan provisions that can help attract and retain great employees, like a good employer match. Hire an ERISA investment fiduciary like Ancora that has an objective process for fund selection, monitoring and review. Ensure that plan service providers are competent by reviewing the services provided and fees charged by your recordkeeper, third-party administrator and investment advisor every few years. Provide ongoing opportunities throughout the year for plan participants to engage with the plan's investment advisor via group meetings and one-on-one sessions for more personalization. ◊

Revisiting Grantor Retained Annuity Trusts

Howard Essner, JD
Managing Director, Family Wealth Advisor

We've written about Grantor Retained Annuity Trusts (GRATs, for short) a few times over the years, most recently in the third quarter of 2020 when very low interest rates made these trusts more attractive for estate tax reduction. While current interest rates are less attractive, the recent market sell-off creates a whole new set of opportunities. Therefore, we thought now is a good time for a reminder about the value of this strategy for estate tax savings.

First, some basics. A GRAT is a simple concept with some very favorable gift tax consequences.

> A person (the Grantor) makes an irrevocable gift of assets to a trust that includes a provision that requires the trust to make an annual (or more frequent) payment of a specified amount back to the Grantor during the term of the trust. This payment is the "Retained Annuity" part of the trust.

> The GRAT will last a term of years and, at the end of the term, any assets remaining in the trust will be paid to the GRAT's

beneficiaries, which are usually the Grantor's heirs or another trust for the benefit of those heirs.

- For gift tax purposes, the Grantor has made a gift equal to the value of the assets transferred to the GRAT, less the "present value" of the annual payments retained by the Grantor under the terms of the trust.

- This present value of the annuity stream is the lump sum amount, invested at an assumed interest rate, that would produce enough money over time to make the required annual payments with a zero balance at the end.

The annual payments can be set at any amount but, typically, the Grantor sets the annual payments so that the present value of them roughly equals the value of the assets transferred. In that case, the gift to the GRAT will have a near-zero value for gift tax purposes and, as a result, will use little or none of the Grantor's lifetime gift and estate exemption. We call this a zeroed-out GRAT.

The magic of a zeroed-out GRAT comes from the way the present value of the annuity payments is calculated. The assumed interest rate is set by the IRS monthly based on current rates. If the assets in the GRAT earn a return greater than that assumed rate, the excess return is transferred to the beneficiaries. When we wrote about GRATs in 2020, the IRS rate was less than 0.5%. Now, the rate is around 3% (and rising each month). While that increased rate makes GRATs a bit less attractive, it's still presenting a relatively low hurdle.

So, why do we think GRATs are still attractive now? If the Grantor owns stocks with depressed values, those stocks can be contributed to a GRAT (there are no income tax consequences from this transfer). Let's say the market improves and these stocks gain 20% or 30% from their depressed values. All that gain, less the 3% assumed interest rate, is transferred to the Grantor's heirs free of any estate or gift tax.

A few other nuances to this strategy:

- There is almost no downside to this strategy. It will fail only if the assets fail to perform better than the assumed interest rate or if the Grantor dies before the end of the term. In those cases, however, the Grantor is in the same position as they would be if they had done nothing (except perhaps for some legal fees).

- A GRAT is not an income tax strategy. The GRAT is an ignored entity for income tax purposes and the taxable income of the GRAT will flow through to the Grantor's personal tax return. This is a good result because it increases the estate tax savings potential.

- It is possible, within limits, to backload the annuity payments to allow the assets more time to grow.

- The GRAT can be designed to allow the Grantor to substitute assets. Let's say a Grantor contributes a depressed stock to a GRAT and the stock rapidly returns to higher levels. The Grantor can then lock in the estate tax savings by substituting low-risk assets for the stock for the remainder of the term.

- A GRAT strategy can also be highly effective when the Grantor funds the GRAT with closely held business assets with positive cash flows. In this case, additional leverage can be obtained through valuation discounts for gifts of minority and non-controlling interests.

- Often, Grantors will set up a series of GRATs with different terms, increasing the chances that one or more of the GRATs will have successful investment outcomes and increasing the chances that the Grantor will survive the term of one or more of the GRATs.

- We have also seen Grantors set up a series of GRATs each with its own specific investment strategy. For example, rather than holding a diversified basket of stocks in a single GRAT, each GRAT in the series holds stocks in a single sector. If one sector underperforms, that GRAT might implode, but the other GRATs would not be affected by the loss. ◊

As always, don't hesitate to contact your Ancora advisor or relationship team if you have any questions or would like to learn more about these topics. Visit our website at www.ancora.net to read past newsletters and find other news and insights from the investment professionals at Ancora.