CITY STATE CS BANK

TRUST & INVESTMENTS

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"THIS TIME IT'S NEW" IS NOT NEW

In the last 20+ years, we have continually been told that the current market headwinds we were experiencing were "new this time." Whether it was the tech bubble in the late '90s, the financial crisis of 2008-9, or the recent pandemic - one predictably consistent fact was yes, this time it is new - again.

As sad as the struggles in Europe are today, challenges to global investors are normal, recurring, and although we cannot predict when or what will occur, they should be expected. A sound investment plan remains flexible and contemplates how a portfolio will react whenever the next challenge occurs rather than react once it does.

Inflated Inflation Concerns

Along with today's geopolitical tensions, there are concerns about rising interest rates and inflation negatively impacting equity markets. However, when you dig into actual results over the period from 1927-2020, equities have been much more effective than other asset classes in providing real returns to investors during both rising rates and inflation. This period is important because it includes not only recent history where inflation and rates were very low, but also times when both reached double digits. There are often short-term pressures when rising rates or inflation hit the news, but history shows us that a diverse equity portfolio is the best place to counter both.

Despite this fact, an allocation emphasizing equity assets may not be prudent for every-one's current situation or risk tolerance. For these investors, inflation protected securities such as TIPS are designed to provide a hedge against inflation. TIPS can be easily accessed through low-cost, no-load mutual funds or tax-efficient exchange traded funds (ETFs).

Planning for the Unexpected

Investors in global investment portfolios will face periods of geopolitical tension. Geopolitical events like military or economic conflicts can affect the markets in many ways. These events may lead to sanctions and other types of market disruptions and neither their timing nor breadth can be predicted. These events are normally widely followed by investors and the media. We believe current market prices quickly incorporate expectations about the effects of these events on economies and companies. Our investment approach centers on using information in current market prices rather than trying to outguess them. However, we believe the most effective way to mitigate the risk of unexpected events is through broad diversification and a flexible investment process.

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City State Bank Trusts & Investments
Q3 2022 Newsletter

CITY STATE BANK INVEST

NOW MIGHT BE A GOOD TIME FOR A ROTH CONVERSION

One silver lining in the current bear market is that this could be a good time to convert assets from a traditional IRA to a Roth IRA. Converted assets are subject to federal income tax in the year of conversion, which might be a substantial tax bill. However, if assets in your traditional IRA have lost value, you will pay taxes on a lower asset base when you convert. If all conditions are met, the Roth account will incur no further income tax liability for you or your designated beneficiaries, no matter how much growth the account experiences.

Tax Trade-Off

The logic behind deferring taxes on retirement savings is that you may be in a lower tax bracket when you retire, so a current tax deduction might be more appealing than tax-free income in retirement. However, lower rates set by the Tax Cuts and Jobs Act (set to expire after 2025) may have changed that calculation for you. A cost-benefit analysis could help determine whether it would be beneficial to pay taxes on some of your IRA assets now rather than later. One strategy is to "fill your tax bracket," meaning you would convert an asset value that would keep you in the same tax bracket. This requires projecting your income for 2022.

Lower Values, More Shares

As long as your traditional and Roth IRAs are with the same provider, you can typically transfer shares from one account to the other. Thus, when share prices are lower, you could theoretically convert more shares for each taxable dollar and would have more shares in your Roth account to pursue tax-free growth. Of course, there is also a risk that the converted assets will go down in value. You may have the option to take taxes directly out of your converted assets, but this is generally not wise.

Two Time Tests

Roth accounts are subject to two different five-year holding requirements: one related to withdrawals of earnings and the other related to conversions. For a tax-free and penalty-free withdrawal of earnings, including earnings on converted amounts, a Roth account must meet a five-year holding period beginning January 1 of the year your first Roth account was opened, and the withdrawal must take place after age 59½ or meet an IRS exception. If you have had a Roth IRA for some time, this may not be an issue, but it could come into play if you open your first Roth IRA for the conversion. Assets converted to a Roth IRA can be withdrawn free of ordinary income tax at any time, because you paid taxes at the time of the conversion. However, a 10% penalty may apply if you withdraw the assets before the end of a different five-year period, which begins January 1 of the year of each conversion, unless you are age 59½ or another exception applies.

More Favorable RMD Rules

Unlike a traditional IRA, Roth IRAs are not subject to required minimum distribution (RMD) rules during the lifetime of the original owner. Spouse beneficiaries who treat a Roth IRA as their own are also not subject to RMDs during their lifetimes. Other beneficiaries inheriting a Roth IRA are subject to the RMD rules. In any case, Roth distributions would be tax-free. The longer your investments can pursue growth, the more advantageous it may be for you and your beneficiaries to have tax-free income. All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

INSIDE THIS ISSUE

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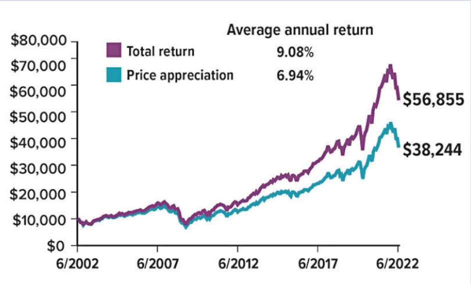

Source: Refinitiv, 2022, for the period 6/30/2002 to 6/30/2022. The S&P 500 index is an unmanaged group of securities considered representative of U.S. stocks. Expenses, fees, charges, and taxes are not considered and would reduce the performance shown if included. The performance of an unmanaged index is not indicative of the performance of any specific investment. Individuals cannot invest directly in an index. Past performance is not a guarantee of future results. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

Stock funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

1) BrainyQuote.com, 2022; 2) S&P Dow Jones Indices, 2022

DIVIDENDS FOR INCOME AND TOTAL RETURNS

John D. Rockefeller, one of the wealthiest Americans in history, loved receiving stock dividends. "Do you know the only thing that gives me pleasure?" he once asked. "It's to see my dividends coming in."[1]

There may be many things other than money that give you pleasure, but you can still appreciate the stabilizing role that dividends might play in your portfolio.

Steady and Dependable

Dividends can be a dependable source of income for retirees and others who want an income stream without selling their underlying investments. If you do not need your dividends for current income, reinvesting these relatively small payments can become a powerful growth engine (see chart). Because dividends are by definition a positive return, they can boost returns in an up market and help balance declining stock prices in a down market.

Whereas stock prices are often volatile and may be influenced by factors that do not reflect a company's fiscal strength (or weakness), dividend payments tend to be steadier and more directly reflect a company's financial position. Larger, well-established companies are more likely to pay dividends, but many midsize and smaller companies do as well. Stock funds usually pay dividends based on the dividends of the stocks held by the fund. Some funds focus specifically on dividend stocks.

The Power of Reinvestment

Growth in value of a hypothetical $10,000 investment in the S&P 500 index for the 20-year period ending in June 2022, comparing price appreciation and total return, which includes reinvesting dividends. *(see chart at left)*

Quarterly Payments

Dividends are typically paid quarterly but quoted by the annual dollar amount paid on each share, so your annual income from an individual stock can be estimated by multiplying the dividend payment by the number of shares you own. Of course, the income will change if the dividend increases or decreases, or you obtain additional shares.

Dividends are also expressed as yield — the annual dividend income per share divided by the current market price. By this measure, the yield increases as the share price decreases, and vice versa, assuming the dividend payment remains the same. Current dividend yields can be helpful in deciding whether to invest in a stock or stock fund, and historical yields can provide insight into what you might expect from dividends over the long term.

At the end of June 2022, the average yield of dividend-paying stocks in the S&P 500 (about 79% of companies) was 2.18%, but the yield of the S&P High Dividend Index, which focuses on 80 stocks that pay higher dividends, was 4.11%.[2]

Some Caveats

The flip side of dividend power is that dividend-paying stocks may not have as much growth potential as non-dividend payers that plow their profits back into the company. And there are times when dividend stocks may drag down, not boost, portfolio performance. Dividend stocks can be particularly sensitive to interest-rate changes. When rates rise, as in the current environment, higher yields of lower-risk, fixed-income investments may be more appealing to investors, placing downward pressure on dividend stocks. As long as a company maintains its dividend payments, however, lower stock prices could be an opportunity to buy shares with higher dividend yields.

Investing in dividends is a long-term commitment. Dividends are typically not guaranteed and could be changed or eliminated. The amount of a company's dividend can fluctuate with earnings, which are influenced by economic, market, and political events. The return and principal value of all investments fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments offering the potential for higher rates of return also involve higher risk.

WORKING WHILE RECEIVING SOCIAL SECURITY BENEFITS

The COVID-19 recession and the continuing pandemic pushed many older workers into retirement earlier than they had anticipated. A little more than 50% of Americans age 55 and older said they were retired in Q3 2021, up from about 48% two years earlier, before the pandemic.[1]

For people age 62 and older, retiring from the workforce often means claiming Social Security benefits. But what happens if you decide to go back to work? With the job market heating up, there are opportunities for people of all ages to return to the workforce. Or to look at it another way: What happens if you are working and want to claim Social Security benefits while staying on your job?

Retirement Earnings Test

Some people may think they can't work — or shouldn't work — while collecting Social Security benefits. But that's not the case. However, it's important to understand how the retirement earnings test (RET) could affect your benefits.

- The RET applies only if you are working and receiving Social Security benefits before reaching full retirement age (FRA). Any earnings after reaching full retirement age do not affect your Social Security benefit. Your FRA is based on your birth year: age 66 if born in 1943 to 1954; age 66 & 2 months to 66 &10 months if born in 1955 to 1959; age 67 if born in 1960 or later.
- If you are under full retirement age for the entire year in which you work, $1 in benefits will be deducted for every $2 in gross wages or net self-employment income above the annual exempt amount ($19,560 in 2022). The RET does not apply to income from investments, pensions, or retirement accounts.
- A monthly limit applies during the year you file for benefits ($1,630 in 2022), unless you are self-employed and work more than 45 hours per month in your business (15 hours in a highly skilled business). For example, if you file for benefits starting in July, you could earn more than the annual limit from January to June and still receive full benefits if you do not earn more than the monthly limit from July through December.
- In the year you reach full retirement age, the reduction in benefits is $1 for every $3 earned above a higher annual exempt amount ($51,960 in 2022 or$4,330 per month if the monthly limit applies). Starting in the month you reach full retirement age, there is no limit on earnings or reduction in benefits.
- The Social Security Administration may withhold benefits as soon as it determines that your earnings are on track to surpass the exempt amount. The estimated amount will typically be deducted from your monthly benefit in full. *(See example.)*
- The RET also applies to spousal, dependent, and survivor benefits if the spouse, dependent, or survivor works before full retirement age. Regardless of a spouse's or dependent's age, the RET may reduce a spousal or dependent benefit that is based on the benefit of a worker who is subject to the RET.

Back to Work

In this hypothetical example, Fred claimed Social Security in 2021 at age 62, and he was entitled to a $1,500 monthly benefit as of January 2022. Fred returned to work in April 2022 and is on track to earn $31,560 for the year — $12,000 above the $19,560 RET exempt amount. Thus, $6,000 ($1 for every $2 above the exempt amount) in benefits will be deducted. Assuming that the Social Security Administration (SSA) became aware of Fred's expected earnings before he returned to work, benefits might be paid as illustrated in the example at right.

The RET might seem like a stiff penalty, but the deducted benefits are not really lost. Your Social Security benefit amount is recalculated after you reach full retirement age. For example, if you claimed benefits at age 62 and forfeited the equivalent of 12 months' worth of benefits by the time you reached full retirement age, your benefit would be recalculated as if you had claimed it at age 63 instead of 62. You would receive this higher benefit for the rest of your life, so you could end up receiving substantially more than the amount that was withheld. There is no adjustment for lost spousal benefits or for lost survivor benefits that are based on having a dependent child.

If you regret taking your Social Security benefit before reaching full retirement age, you can apply to withdraw benefits within 12 months of the original claim. You must repay all benefits received on your claim, including any spousal or dependent benefits. This option is available only once in your lifetime.

In practice, benefits may be withheld earlier in the year or retroactively, depending on when the SSA becomes aware of earnings.

1) Pew Research Center, November 4, 2021