Fiduciary
Trust
International

2019 OUTLOOK

Growing, Giving and Receiving Wealth

WHAT'S INSIDE

Letter from the CEO

Our Outlook for the Economy and Markets

Wealth Planning Strategies for 2019

JOHN M. DOWD
CHIEF EXECUTIVE OFFICER

As we approach 2019, the pace of change shows no sign of slowing down. Technology is disrupting the status quo, complex investment strategies are rapidly working their way into the mainstream, and profound demographic shifts are reshaping society.

I see these changes unfolding around me every day, among my colleagues in the workplace and across the families we have the privilege of serving—including clients who represent the fourth generation of a family's relationship with Fiduciary Trust. These young professionals and entrepreneurs of the millennial generation already outnumber baby boomers in the US workforce, and they are expected to surpass boomers across the entire US population in 2019. They are also beginning to inherit some of the $30 trillion they are expected to receive over the next several decades as part of the largest transfer of wealth in US history.

In this year's Outlook, *Growing, Giving, and Receiving Wealth*, we take a closer look at these shifts and offer what we hope is actionable advice every generation can use to preserve and grow wealth as the landscape evolves—from the brightest investment opportunities to the most tax-efficient strategies for transferring wealth. We're keeping our hands on the wheel and our eyes on the road, but also scanning the horizon to be sure we're ready for the changes that lie ahead.

In this respect, I'm proud to report that Fiduciary Trust took a giant leap forward into the Digital Age this summer. A new partnership with one of the leading providers of financial planning technologies is helping us bring your entire financial life into sharper focus, offering a clear picture of where you are today and the progress you are making toward your goals for the future.

And we continue to develop new resources to help the "next generation" become responsible stewards of wealth. We are also strengthening our investment capabilities in non-traditional areas such as private equity and socially responsible investing, and helping clients like you simplify more of life's complexities.

The future looks bright for Fiduciary Trust and our valued clients.

In the year ahead, we wish you and your family health, happiness and the time to enjoy them.

As always, we are here to help in any way we can.

John M. Dowd

John M. Dowd
Chief Executive Officer

What's beyond the peak?

The trek back to 'normal' begins

As we are closing in on the tenth year of the current economic cycle, US equities have returned roughly 400% since the low in March 2009 and have spent the last five years above the prior cycle peak. Recent pro-growth policies have temporarily pushed both economic and earnings growth above their trend rates to what we believe will be cycle peaks. Now, as 2018 comes to a close, a rising chorus of investors is asking the same question, "What's beyond the peak?"

To answer this question, it helps to keep a few things in perspective. Economic cycles do not have a prescribed length. There are examples of cycles in developed markets lasting in excess of twenty years—more than double the length of this cycle. Additionally, the recent acceleration in economic and earnings growth is mainly attributable to fiscal stimulus.

As the initial benefits wear off, we believe the economy will be able to return to growth near its cycle trend rate. Moreover, there are far fewer imbalances in the economy than there were in the cycle that led to the global financial crisis. Altogether, while we have not yet reached the end of this cycle, we believe the next phase will be marked by moderating market returns and slower economic growth, accompanied by higher volatility as we depart the ideal policy backdrop we have occupied for the last few years.

Forming twin peaks

Ultra-easy monetary policy supported the first part of this cycle, hall-marked by 2% real economic growth. Already accelerating growth, aided by fiscal stimulus enacted

this past year, has resulted in an economy that should expand north of 3% in 2018—a likely high-water mark for the cycle. In our view, a moderation of growth closer to 2.5% seems more likely to follow than a significant economic contraction.

With momentum already building, the recent tax cuts provided an additional boost to earnings. Corporations are on pace to grow profits by more than 20% in 2018, which also may be a peak level for the cycle.

But even if economic and earnings growth have peaked, we believe the backdrop that follows will more closely resemble a plateau than a cliff as economic and corporate fundamentals remain on solid footing.

Defining the next phase of the cycle

One statistic often cited by skeptics is the duration of the current US economic cycle—the second-longest expansion since the end of World War II. But in terms of magnitude, it does not come close to the cumulative growth of prior cycles that lasted longer than five years (CHART 1). This is important to keep in mind when assessing buildups in the economy or markets that produce bubbles, known as imbalances, which tend to take root when the economy is surging. In this period of "lower for longer" growth, however, we see fewer imbalances in the economy and markets that typically bring an abrupt end to the cycle or trigger a recession.

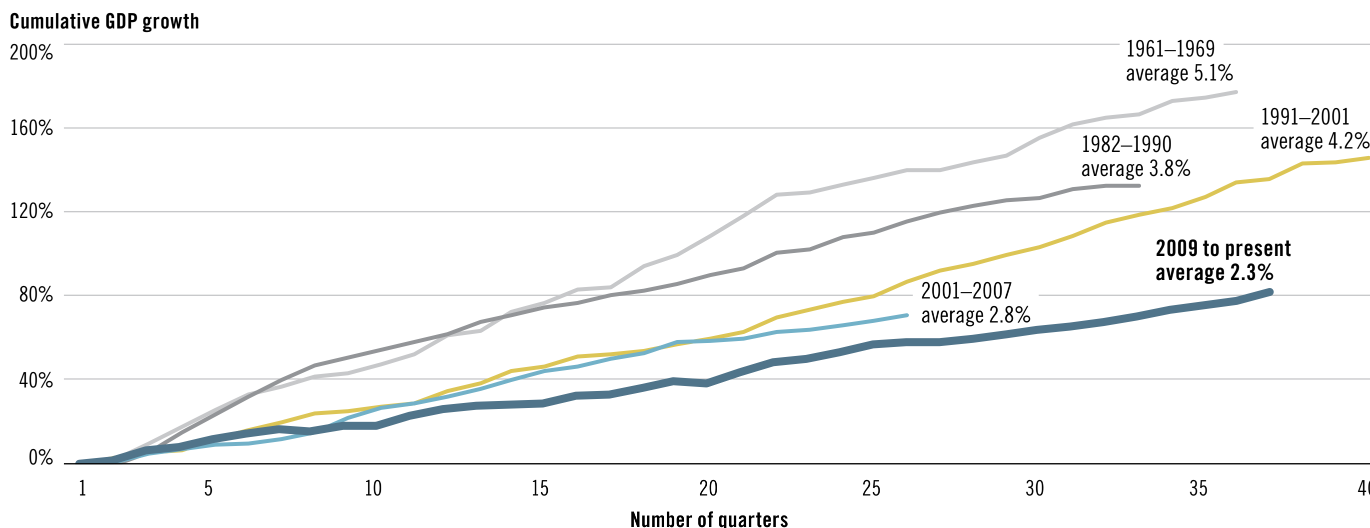
In fact, the economy might be able to grind along, albeit at a slower pace, in part because modest economic growth has kept inflationary pressures at bay. Core CPI continues to hover around the Fed's 2% target, and wages are growing modestly at 2.9%, well below the 4% threshold that is typically considered the pain point for corporate profit margins. This has allowed the Federal Reserve to take a gradual approach to normalizing monetary policy which has yet to enter restrictive territory.

In the equity market, valuations remain near historical averages, well below the speculative levels seen prior to the tech bubble bursting. This phase represents a departure from the "Goldilocks" environment that propelled markets in 2017, where financial conditions were extraordinarily favorable for equities. We are now shifting into an environment that is merely supportive, but not yet problematic, for equities in the near term.

Perhaps most importantly, imbalances in the economy do not appear to be driven by consumers or corporations. This reduces the risk of a systemic crisis the likes of 2008. Mortgage debt as a percent of gross domestic product (GDP) is more than 20 percentage points below the peak of the housing bubble, and the ratio of total household debt to disposable income is below the peaks of the last two cycles as well as the long-term average (CHART 2). Companies are also in a better position to service their admittedly higher debt.

CHART 1: A LONG BUT MILD ECONOMIC RECOVERY BY HISTORICAL STANDARDS

Cumulative GDP growth during all post-war expansions lasting more than five years



Source: Bloomberg as of October 15, 2018. Averages represent quarter-over-quarter annualized real GDP growth during the cycle.

Taking all of these factors into account, we do not presently see any alarming vulnerabilities in the household or corporate sector, though we remain mindful of rising corporate debt levels.

Risks that bear watching

Thanks in large part to the record stimulus injected into the economy during the financial crisis, the public debt burden has ballooned to more than 100% of GDP. Other countries have been able to maintain debt burdens well in excess of GDP, but this is a number we will keep a close eye on in 2019 and beyond.

We are also closely monitoring the political climate for any indication that tariffs or trade conflicts are weighing on global supply chains, corporate margins, and ultimately, economic growth. Although the US economy remains on solid footing, there is always the risk of an external event sending shockwaves through the US.

Historically, cycles come to an end when central banks raise rates too aggressively and stifle economic growth. The Federal Reserve does not appear to be at that point, but the risk of a policy error is always present and will increase as we move further along the global normalization path.

Another potential concern is the US housing market. While excessive bullishness led to a housing bubble during the last cycle, the opposite problem appears to be presenting itself today. Housing starts and sales are both sputtering, and affordability concerns loom against a backdrop of rising interest rates.

Staying the course

As we move into this next phase of the cycle, we think investors should moderate their return expectations. As we wrote at the end of last year, we saw room for valuation compression in equities, which we continue to expect going forward. In this environment, stocks can continue to perform well, but are unlikely to deliver the peak double-digit returns and low volatility seen in recent years. This new environment may also produce more dispersion between asset classes and within, which should bode well for active management and stock selection.

While there are countless scenarios that could play out from here to the end of the cycle, we do not believe the end is upon us. The looming risks posed by geopolitical uncertainty and the future path of monetary policy are counterbalanced by a private economy that is far less imbalanced and levered than the last cycle, and market valuations that are in line with historical averages.

RONALD J. SANCHEZ, CFA®
CHIEF INVESTMENT OFFICER

CHART 2: RED FLAGS? NOT NEARLY AS MANY AS PREVIOUS PEAKS

	Current	June 2007 (prior to global financial crisis)	September 2000 (prior to dot-com bust)	Long-term average
Mortgage debt as % of GDP[1]	50.0%	71.9%	45.7%	48.7%
Household debt service as % of disposable income[1]	9.8%	13.0%	11.8%	11.3%
Inflation[3]	2.1%	2.2%	2.6%	3.1%
Wage growth[1]	2.8%	3.3%	3.9%	2.7%
US public debt as % of GDP[1]	103.8%	61.7%	55.0%	65.4%
Corporate debt service ratio[2]	41.1%	42.6%	46.1%	41.0%
S&P 500 forward price/earnings[3]	16.9	16.1	24.4	17.1

■ Are not considered risks ■ Could present challenges in the future

1. As of June 30, 2018.
2. As of March 30, 2018.
3. As of November 30, 2018.

Sources: Bloomberg, St. Louis Federal Reserve, Bureau of Labor Statistics. Long-term average represents the period starting January 1980, or since inception for shorter data series.

How are we positioning for change?

Handle 'normal' with care

As volatility returned to more normal levels in 2018, investors were reminded that there is heightened uncertainty in this environment of evolving monetary policy, trade tensions and a maturing business cycle. While these risks should continue for the foreseeable future, we expect markets to be supported by strong economic and corporate fundamentals, aided by fiscal thrust that remains in the pipeline, even if the initial benefits have taken effect.

While the path may feel bumpy at times, we feel the environment should continue to benefit investors willing to maintain a moderate risk-on allocation.

Equities: A supportive backdrop

In the US, we are overweight mid- and small-cap equities. Smaller companies should reap the rewards of continued economic growth—albeit at more moderate levels—and residual benefits from tax cuts and deregulation. With trade issues carrying over into 2019, we are reiterating our bias toward companies with domestically focused revenues that may act as a hedge against any trade-related volatility.

In international developed markets, we continue to have a positive outlook for Japanese equities. Japanese stocks should enjoy the benefits of a recent surge in capital expenditures, improved corporate governance and a weaker yen.

In emerging markets, we maintain a neutral view. The sell-off in 2018 has forced domestic governments and central banks to re-adjust current policies. Selectivity remains key as some countries are further along this process than others.

Fixed Income: Slightly improved

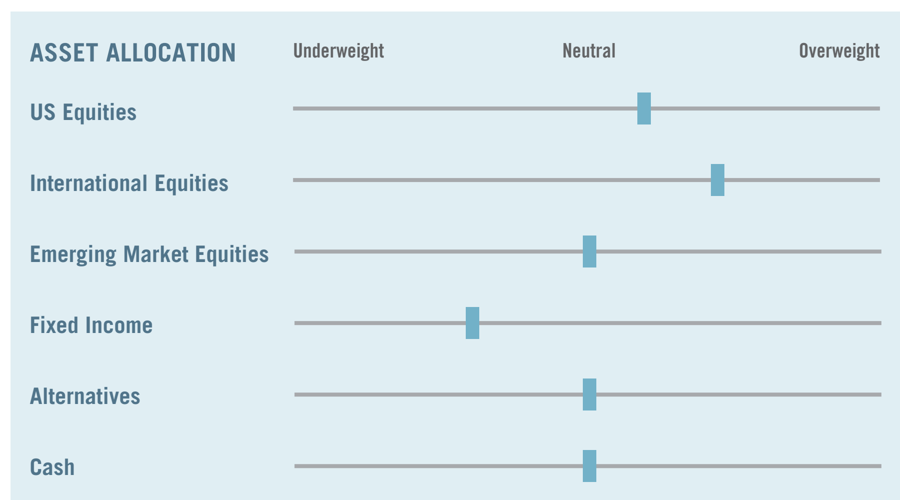
Rising rates remain at the forefront of investors' minds as the calendar flips to 2019. This year, the US 10-year Treasury yield hit a cycle high thanks to better economic growth expectations, a recalibration of the Federal Reserve's rate hike path, rising oil prices and increased supply.

Within our taxable fixed income allocation, we prefer US investment-grade credit and are maintaining our short duration bias relative to our benchmark to guard against interest rate risk. For investors in high tax brackets, the municipal bond market continues to offer tax-advantaged income.

Alternatives: An opportune market

With more idiosyncratic events taking place in markets, we think this presents a good opportunity for alternative funds to generate alpha. Alternatives could also offer valuable downside protection for multi-asset-class portfolios, as the volatility we saw in 2018 isn't likely to abate anytime soon.

VIRAJ B. PATEL, CFA®, FRM®, CAIA
HEAD OF ASSET ALLOCATION



Where are the equity market opportunities?

Investing in durable growth as the economy matures

Our outlook for US equities remains positive for 2019, but the environment will become more challenging as the policy landscape shifts from monetary to fiscal stimulus.

Our approach to the market will be influenced by dynamics that have been gathering momentum for some time. On one hand, we expect uncertainty over interest rates and US trade policy to continue weighing on investor sentiment. On the other hand, we also see fiscal stimulus continuing to breathe life into the US economy, contributing to improvements in consumer confidence and corporate reinvestment in technology, equipment and other capital improvements. S&P 500 earnings grew by approximately 20% in 2018 and are expected to advance roughly 10% next year, based on consensus analyst estimates.

While estimates may be optimistic, ultimately we believe economic and corporate fundaments are strong enough to extend this market cycle for some time; but the pace of growth appears likely to moderate.

Managing the risk of rising rates

As the Fed's efforts to normalize rates continue, we would expect rising rates to increase production and delivery costs, possibly dampening consumer demand. Along with economic growth, we also anticipate a natural level of inflation, which can put additional pressure on corporate earnings and market valuations. But there are ways to manage interest rate and inflation risk in the equity market. For example, one of the factors we look at when researching and selecting stocks is a company's ability to pass costs on to customers without jeopardizing sales. Strong competitors with proven track records in this area can typically grow their earnings even when rates are rising and input costs are higher.

In the Financials sector, interest rates are often tied more directly to performance. Specifically, banks have seen their profit margins improve over the past few years as short-term rates moved up and regulations eased. But further increases in rates could also bring higher expenses for banks in 2019, including the cost of capital (interest paid on savings accounts, for example) and loan loss provisions (higher rates increase the risk of delinquencies and defaults). Growth will need to come from other sources, such as technology innovation and market share gains.

Tax reform boosts corporate spending

While the US economy may be in the later stages of economic growth, as demonstrated by metrics such as employment, we believe the capital expenditure or investment cycle has legs, propelled by fiscal stimulus. This bodes well for the Industrials sector, as an uptick in

manufacturing activity is likely to lift demand for parts, equipment and technologies that make production more efficient. Factories are also modernizing, which is good news for suppliers of automation technologies, and spending has improved across many segments of the defense, aerospace and energy industries.

One of the biggest beneficiaries of tax reform could be technology, as companies use surplus cash to purchase new hardware, software, and cloud-based services. It's worth mentioning that the S&P recently moved many of our favorite tech categories—businesses at the forefront of the "digital revolution"—into a new sector called Communications Services. This shift reflects the profound impact technology is having in areas such as entertainment, communications, banking and retailing, among others.

Our main focus is on tech companies that are disrupting traditional business models; including suppliers of products and services used in cloud computing, digital payment processing and artificial intelligence. In the consumer market, we are investing in companies that are pushing the boundaries of online entertainment and interactive gaming, including content and platform providers.

Tracking trade policy developments

Concerns about US trade policy contributed to some deterioration of economic and market conditions in Europe, Japan and emerging markets last year. Those concerns weren't as pronounced in the US, where investors focused more closely on strong economic and corporate fundamentals.

However, we will be keeping a close eye on foreign markets in the coming year because they can influence US market valuations. The average S&P 500 company earns roughly 40% of its revenues outside the US. So, weaker demand from international buyers would be concerning. There is also a risk of contagion for the US equity market. If weakness in foreign markets is dramatic enough, US investors could see it as a sign to take a more defensive, risk-off approach to equities here at home.

Trade policy is already having an impact on automobile manufacturers and consumer goods companies, as tariffs increase the cost of importing raw materials such as steel and aluminum. It has also been weighing on investor sentiment in the tech sector for some time, since high-tech companies (especially semiconductor manufacturers) rely more heavily on international sales and are subject to regulations related to data security and privacy concerns. But, for now, we believe the financial risks they present for the tech sector are limited and market fears are largely overblown.

Multiple contraction should continue

From a historical perspective, US market valuations were high in 2018. But when we look at them in the context of the current landscape—an expanding economy, earnings growth and relatively low rates—they appear reasonable.

Still, we believe the contraction in multiples we experienced in 2018 is likely to continue next year because, at some point, rising rates start to weigh on equity market valuations. Historically, that point has been around the time 10-year Treasury notes are yielding approximately 5%, as investors start to find the fixed income market more attractive and are less willing to pay for "expensive" equities. This time around, rates are moving higher from an extremely low starting point, so they could put pressure on valuations sooner than usual, possibly around the time the yield on 10-year Treasuries reaches 3.5%.

How the strongest companies will thrive

While there are foreseeable risks and unforeseeable risks for equities in the year ahead, we believe investors can achieve positive returns by focusing on companies that: 1) can weather rising interest rates through cost-management and pricing power, 2) continuously innovate to navigate an ever-changing competitive landscape, and 3) benefit from capital expenditures via technology or manufacturing. As always, valuations will play a key role in determining returns.

CARIN L. PAI, CFA®
HEAD OF PORTFOLIO MANAGEMENT

How will rates affect the bond market?

The Fed's march toward neutral reduces the risk of negative returns

The Fed has raised rates eight times in the past three years, inching closer to a normalized level of interest rates that aims to encourage full employment and keep inflation in check. Although that precise target remains uncertain, it seems clear that the Fed is moving beyond monetary policy conditions that it considers accommodative and into an environment where it expects less tightening to be required.

It's too early to start celebrating, but this is encouraging news for fixed income investors. Each rate hike brings us closer to the end of the current tightening cycle, and as we approach a pause in tightening the risk of higher rates delivering negative returns to fixed income investors is reduced. Also, unlike earlier in this cycle, the ability to earn more income through higher rates can provide investors with a buffer against interest rate-related price declines in the event rates continue to drift higher as we expect.

Munis: Stronger demand, tighter supply

The municipal bond market appears well positioned for the environment ahead, with solid demand for munis expected at a time when supply continues to be constrained.

As rates rise, we expect the tax-advantaged income municipal bonds offer to continue to be attractive to investors in high tax brackets. At the same time, the new tax code could reduce supply in two ways: First, federal income tax deductions for state and local tax payments are now capped at $10,000. So local taxpayers could become less inclined to approve new bond issuances, which tend to raise property taxes. Second, the new tax code prohibits the issuance of any more pre-refunded munis, further constricting market supply. In our view, this combination of weak supply and strong demand should support muni prices and reward investors next year.

Within the muni market, our outlook is most favorable for high-quality revenue bonds as we expect the tailwind of a strong US economy to support the fees and taxes that service the payment of the debt

from those issuers. Our view of general obligation bonds has improved slightly as the strong US economy has supported tax collections at the state and local level, but the overhang of unfunded pension liabilities is likely to continue to challenge some issuers in this sector going forward.

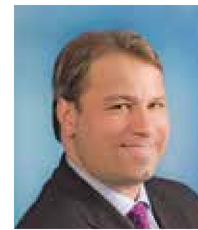
Corporate Bonds: Focusing on Credit Quality

In broad terms, we expect the climate to be favorable for corporate bonds next year. Tax reform should put downward pressure on issuance as we expect overseas cash repatriation and solid earnings to reduce the need for companies to borrow. Also, as part of the new tax plan, the deductibility of interest against corporate earnings has been capped, making it less tax-efficient for companies to leverage up their balance sheets.

Within the corporate bond market, we continue to retain a positive outlook for investment-grade credit, which should benefit from continued economic growth and strong corporate fundamentals.

Volatility late in the year has increased investor concerns regarding leverage on corporate balance sheets. While we acknowledge and share these concerns for specific issuers, we believe the broader corporate bond market still maintains a solid ability to refinance and service its debt.

For below-investment-grade issuers, we have seen isolated examples of deteriorating underwriting standards against a backdrop of strong demand. While the additional income offered by high yield may continue to be attractive to investors, we remain cautious regarding underwriting quality and investor risk appetite for high yield bonds in 2019.



JEFFREY S. MACDONALD, CFA®
HEAD OF FIXED INCOME STRATEGIES

IF INFLATION REMAINS MODEST, THE FED CAN RAISE RATES GRADUALLY

Investor expectations for inflation remain stable around the Federal Reserve's target (Average rate of inflation expected over the next five years, measured daily in 2018)

Source: Federal Reserve Bank of St. Louis, January through October 2018.
This data shows the expected rate of inflation rate in five years.

Why invest in alternatives?

Unique characteristics complement stocks and bonds

Alternative investments are not homogeneous, and each category within this broad universe offers a unique relationship with traditional stocks and bonds. As we approach the later stages of the economic cycle in the US and begin to see diverging monetary policy across the globe, we believe it is more important than ever to keep these characteristics in mind.

Hedge funds and liquid alternatives

Investor appetite for hedge funds has diminished over the past several years as equity market performance has been robust. Another factor has been their relatively high fees and a lack of flexibility; most hedge funds are structured as limited partnerships, so they have lock-up periods and less liquidity than traditional investments.

But it's important to keep in mind that market conditions can change quickly. Does anybody remember the so-called lost decade? From the beginning of 2000 to the end of 2009, the S&P 500 provided an average annual return of -0.95%. As we approach an economic cycle that is in the later stages, we believe hedged investments will begin to add diversification benefits to portfolios due to their unique characteristics. Specifically, they offer returns that are expected to exceed bonds, and volatility that is anticipated to be well below stocks.

Furthermore, we have seen the emergence of the liquid alternatives category, which has provided our clients with low realized beta of 0.31 against equities over the past three years. This low correlation to equities offered a meaningful degree of downside protection during periods of market volatility. We continue to support moderate allocations to hedging strategies in the range of 5% to 10% for most client portfolios.

Private equity

Investor appetite for risk has steadily increased over the past 10 years, fueling demand for private equity investments. The challenge for investors in 2019 will be finding private equity managers who take a disciplined approach to entry-point valuations and don't overpay. The cycle for private equity is much longer than liquid asset classes, so we are being extremely selective in seeking true value-add strategies.

That said, we are maintaining our constructive view on the venture capital category, as opportunities have expanded beyond information technology and software to now include industrials, the financial services landscape and the energy complex. Disruptive business models are popping up everywhere and new generations of consumers are demanding products and services that suit their preferences and support more efficient lifestyles. We are not underestimating this changing dynamic, and venture investments often represent the first dollars that flow into these emerging businesses.

Commodities

Commodities are typically a good diversifier for portfolios during periods of high inflation, albeit with low or no income yield and unfriendly tax implications.

Real estate

We are also taking a selective approach to real estate in 2019. Valuations have recovered from the financial crisis, particularly in metropolitan areas, and funding costs are on the rise. Within the REIT category, we favor real estate companies tied to the fulfillment of technology and telecommunications growth. Additionally, we are exploring newly-created Opportunity Zone incentives that were written into the 2017 tax changes. Many clients have unrealized gains in their portfolios, and the ability to defer taxes and invest in impact-oriented strategies is an intriguing concept that has some merit.

WAYNE A. SPRAGUE
HEAD OF STRATEGIC ADVISORY

Tackling the tax code

Smart strategies for 2019 and beyond

The Tax Cuts and Jobs Act that was signed in December 2017 lowered ordinary tax rates, reduced deductions and significantly increased the estate and gift tax exemption. New tax laws always require fresh, new thinking. With a little planning, the following strategies could take the sting out of your tax bill next year and for generations to come. As always, we're here to help find opportunities.

Leave appreciated property to your heirs

With the estate and gift tax exemptions set at $11.4 million per person and $22.8 million for a couple in 2019, it's even more important to recognize the importance of the "step-up" of income tax basis at your death.

If you sell appreciated property, any gains are subject to capital gains taxes as high as 23.8% for federal taxes plus potential state taxes, depending on your income. Similarly, when you gift appreciated property to your heirs during your lifetime, the gains stay with the property, and your heirs will pay capital gains tax when they sell.

However, if your heirs inherit the property at your death, the cost basis will be "stepped-up" to its then-current market value. Your heirs will only pay capital gains tax on appreciation that occurs *after* they receive the property. Because of the higher estate tax exemption, maximizing the "step-up" at your death can now be much more important than avoiding estate taxes, depending on the size of your estate.

Facing estate taxes? Run the numbers

As we mentioned, the federal estate tax exemption is significantly higher under the new law. But the new higher numbers are set to go back down in 2026 and may even disappear sooner if there is a change in legislation. If your estate will exceed the new exemption amounts, consider gifting assets during your lifetime to use the higher exemptions before they're gone. Due to the "step-up" of cost basis at death, giving cash or other assets that have little or no built-in gains is the most efficient way to gift during your lifetime. In any case, we can help you run the numbers to help you determine whether to make lifetime gifts and decide which assets to give first.

Bundle charitable donations with a donor advised fund

If your deductions are not high enough to itemize under the new thresholds ($12,200 for an individual; $24,400 for a couple in 2019), bundling several years' worth of donations into a single year could push you over the standard deduction threshold, allowing you to take a deduction for your gifts.

With a contribution to a Donor Advised Fund, you can take an immediate deduction and decide on the charities that will receive the funds at a later date. Donor Advised Funds can also be used to bundle gifts into years you have higher-than-usual income to help reduce the tax bite.

Donate appreciated property—not cash

If you have charitable intent and hold investments with unrealized gains, consider gifting appreciated property to charity rather than gifting cash. You avoid the capital gains that you would incur if you sold the shares, and it is possible to receive an income tax deduction equal to the full fair market value of the property you give away, as long as you held the property for more than one year.

For example, if you invested $20,000 in a stock that is now worth $100,000, you could sell the stock and recognize capital gains of $80,000. Because you will pay capital gains tax on that profit, the amount left to give to charity would be far less than the original $100,000.

Alternatively, if you gave the stock to charity directly, the charity would receive a $100,000 benefit since it can sell the stock tax free. Meanwhile, you would receive an income tax deduction for the full fair market value of $100,000 and not recognize any capital gains.

Give your required minimum IRA distributions to charity

If you are 70 ½ and required to take distributions from your IRA but don't need the income or the new tax laws may make it beneficial to take the standard deduction, consider transferring up to $100,000 to charities directly from your IRA.

You won't receive a deduction for the gift, but you will also not have to include it as income on your tax return.

Maximize 529 plan contributions

Thanks to tax reform, you can now use a 529 College Savings Account to pay for up to $10,000 a year in tuition for grammar school and high school students.

There is no federal income tax on qualified distributions or appreciation in 529 accounts, and additional tax benefits might be available in your state's plan.

Inspect your business structures carefully

The new tax laws are business friendly. If you have a C-corporation, your business may now benefit from the new flat corporate tax rate of 21%. If you have a pass-through business such as a sole proprietorship, partnership or S-corporation, you may be eligible for the new 20% deduction for "qualified business income."

The deduction for qualified business income can provide significant savings, but you need to navigate a complex set of thresholds and limitations that could effectively tax your business income at 29.6% if you are in the top bracket.

Transfer income from the sale of your business to a trust

Under the new tax rules, deductions for state and local tax payments are capped at $10,000. This may make you rethink the state income taxes you stand to pay upon the sale of your business.

An option to avoid state-level income taxes is to transfer ownership of your interest in a business to a trust situated in Delaware, which does not tax the income of the trust. A Delaware Incomplete Non-Grantor (DING) Trust may allow you to retain ownership of the business for gift tax purposes, while moving the income from the sale out of your home state.

BRYAN D. KIRK
MANAGING DIRECTOR AND TRUST COUNSEL

CRAIG RICHARDS, CPA/PFS, CFP®
DIRECTOR OF TAX SERVICES AND STRATEGY

Changing the conversation

Women are taking a holistic view of their financial lives

Women now control more than half of the total wealth in the US, earn more advanced degrees, and are becoming the primary breadwinners in more households. They are also broadening the conversation about finances by focusing on the bigger picture and on achieving multiple goals. Regional Managing Directors Linda Krouner and Paulina Mejia share how these more direct and multi-faceted conversations are benefitting clients.

Q: How are women changing the conversation about finances?

LINDA: I find that women I've helped over the years are seeking a deeper dialogue about their financial concerns and are asking a broader set of questions, resulting in more thoughtful and comprehensive conversations.

For example, a discussion that comes up often, especially for women who oversee their own finances, stems from a concern about ultimately running out of money. I hear comments like, "I can't afford to leave my job" or "I feel I shouldn't take this vacation," even from women who can afford to do so.

When women feel this type of pressure—even if they are financially secure—it is our job as advisors to give them a realistic assessment of their whole financial picture, so they can feel comfortable making decisions on how they spend money.

PAULINA: Women also tend look at the implications their finances might have for other family members, not only for themselves. This elevates our discussions to address the family, kids, parents, career ambitions, lifestyle, security—not just investments. These are extended conversations that really start to uncover gaps and opportunities that we begin to address holistically.

Q: How can investment risk be put into perspective?

PAULINA: I have found that women tend to be very protective of their wealth. And that attitude is understandable, because women often take time out of the workforce to raise families and they know they have longer average lifespans than men. In some cases, they are also less confident about their finances because their husbands have been handling the family's finances. So they may not have all the information they need to make decisions about planning and investing.

LINDA: This can translate into a fear of taking 'too much' risk. But the real risk comes into play if they don't take *enough* risk in their portfolios. For example, they may attempt to protect wealth by investing mainly in bonds or holding a lot of cash. But ten years later, they find their assets haven't grown as much as they needed to. Sometimes the portfolio hasn't even kept up with inflation

and spending—if they are taking 3% to 4% out of their portfolio each year and only earning 2% on their investments, their net worth will invariably go down.

PAULINA: It's also important to remember that different risk profiles are appropriate at different stages of life, especially during a transition such as divorce, sending kids to college, or the death of a spouse. Does their plan reflect what their future needs will be? We always encourage women to be forward-thinking and adjust their financial plans as life evolves, while also making the most of current market conditions.

Lastly, I'll add that collaboration among all advisors is key. When we work with clients, we like to have at least an annual meeting with all their advisors to make sure we are on the same page and everyone's advice is aligned.

Q: What is the best approach for navigating stressful situations?

LINDA: Stressful events can be paralyzing, especially if they are looked at in isolation. For example, I've helped several clients navigate their finances after a divorce. One of those situations happened in 2009, when the market environment was extremely volatile. After discussing investment strategies, this client understood that despite the volatility, the equity market at the time offered low valuations and high dividend yields, presenting her with both the income and growth potential she would need for future years. She is extremely grateful that she's been able to grow and use that money over time.

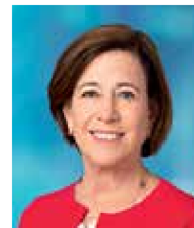
In another case, a client was funding a large wedding for her daughter. She called me in a panic feeling that she had overcommitted on the cost. I walked her through what she was spending in context of her net worth and other financial obligations. Reviewing her overall picture showed the relatively small effect this expense would have on her finances in the long run. This understanding gave her the frame of reference she needed—she even called me late that night to thank me for helping to put it into perspective.

Q: What advice can you share about legacy planning?

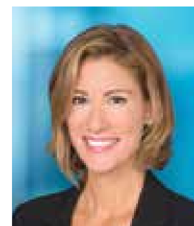
LINDA: Legacy planning is a high priority for many families we work with. We often discuss when children should be brought into the conversation and how extensively they should be involved. This can come up with women who have outlived their spouses, especially if these conversations had not been started beforehand. We start this discussion by helping them outline their values, goals and what wealth represents to them personally—numbers don't have to be attached. In the end, it's important for family members to have the same information and that there are no surprises, good or bad.

PAULINA: I also find that parents often want their children to be financially secure, but they don't want an inheritance to take away their incentive to become productive members of society. So, we discuss how to make wealth a tool for empowerment versus a source of demotivation.

A good way to facilitate these discussions is through multi-generational family meetings, which can take many forms. On one end of the spectrum, some families naturally have these conversations with one another and they can occur more organically. On the other end, we see families that are not accustomed to talking about their wealth at all, and in these cases, it can be helpful for a wealth advisor or another neutral party to lead the meetings. The important thing is to open a dialogue about the meaning of their family's wealth beyond the numbers, and to engage all generations in common goals and values.



LINDA KROUNER
REGIONAL MANAGING DIRECTOR, PORTFOLIO MANAGER



PAULINA MEJIA
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Rethinking retirement accounts

How your IRA can benefit generations ahead

Individual Retirement Accounts (IRAs) can play a valuable role in estate planning—allowing you to accumulate tax-advantaged wealth and pass it along to future generations. Gerry Joyce, National Head of Trusts and Estates, answers common questions about weaving IRAs into long-term wealth plans.

Q: What is a "stretch" IRA and how can it be used to pass wealth to future generations?

A "stretch" IRA preserves the account's tax-deferred status for your future beneficiaries. It also minimizes the distribution requirements that would normally apply if your beneficiaries were to take direct ownership. This allows the assets to be preserved and handed down to future generations, while continuing to grow tax free.

Here's how it works: Let's say you name your 25-year-old grandson as the beneficiary of your IRA. When you pass away, your grandson will need to contact the IRA's custodian to retitle the account. The custodian will change the account's ownership to reflect both your name as the decedent, and your grandson's name as the inheritor. This title change makes it an inherited IRA, which can now grow tax free and requires only modest distributions to be taken from the account.

As the beneficiary, your grandson can use as much of the assets as he'd like, but can also take just the required minimum distributions, which would allow the account, based on his life expectancy, to 'stretch' to future generations, such as his own children. He can even repeat the cycle by following the same process.

Q: Can a Roth IRA also be stretched?

Yes. In fact, Roth IRAs offer several advantages when it comes to estate planning. Most importantly, you are not required to take distributions from a Roth IRA in your lifetime. And the withdrawals your heirs take will be tax free. Keep in mind that if you leave a Roth IRA to several individuals, it must be split by December 31 of the year following your death. The custodian will retitle each beneficiary's share and distributions can be stretched out over their life expectancies and to future beneficiaries.

Q: How can I maximize my IRA contributions to get the most tax benefits?

There are several contribution restrictions for both types of IRAs that can make it difficult to make large contributions. First, your contributions must come from earned income—so, you must be working. Second, total contributions are capped at $6,000 a year (or $7,000 if you are over 50) for 2019. You can allocate an IRA contribution any way you'd like, across traditional and Roth IRAs, as long as you stay within the limits.

In addition, you cannot contribute to a traditional IRA if you are over the age of 70½. There are no age restrictions for Roth IRA contributions; however, your ability to contribute is reduced if your income reaches a certain level, and you cannot make any contributions if your modified adjusted gross income exceeds $137,000 ($203,000 for couples) in 2019.

Q: Does a "back door" strategy eliminate the income barrier for a Roth IRA?

In many cases, the so-called "back door" strategy is a viable alternative for individuals who want to use a Roth IRA but exceed the income limits. The approach typically involves opening a traditional IRA, which does not have income restrictions, making after-tax contributions (usually called a "non-deductible" contribution since no tax credit or deduction is allowed), and then converting it to a Roth IRA. While there are income limits on Roth contributions, they do not apply to Roth conversions.

But caution is advised if you have deductible and non-deductible IRA assets because the IRS takes all your IRAs into consideration when calculating the tax on any conversion, using its "pro-rata" rule. For non-deductible IRAs funded with after-tax dollars, only the earnings are factored into the tax. But for tax-deductible accounts, all assets are included, even "outside" IRAs. So, be careful when converting an IRA if you have deductible or earnings on non-deductible assets as part of your retirement portfolio.

If you have tax-deductible IRA assets, or earnings on non-deductible assets, there are several steps we can take to mitigate or offset the conversion tax. You can pair the conversion with charitable giving, or it might also be possible to roll those deductible assets into your company's 401K plan, removing them from the pro-rata tax calculation. Our retirement team can help you determine the best approach to paying conversion taxes, based on your individual circumstances.

Q: How does a Roth conversion affect estate taxes?

That depends on several variables, including your current tax rate, the size of your estate, and how much appreciation your traditional IRA earned. The good news is that your conversion tax, plus any future appreciation those funds might have earned, is not included in the value of your taxable estate, preventing the "double taxation" of those assets. If the value of your estate is just beyond the exemption limits, and the subtractions are significant enough, they might even bring your estate below the trigger point for the 40% federal estate tax.

Q: Can a traditional IRA be used to reduce estate taxes?

If you own a traditional IRA and don't want to convert to a Roth IRA, there are two strategies that could help with estate taxes—and they both involve charitable contributions. First, if you are taking required minimum distributions and don't need the income, you can take advantage of a strategy called Qualified Charitable Distributions. When done properly, this technique allows you to donate your distributions, up to $100,000 a year, to charity. This can reduce your taxable income and remove the assets from your estate. Second, you can leave some or all of your IRA assets to a qualified charity, either in your will or as part of your estate plan. This strategy also reduces the value of your estate, and the charity receives 100% of the assets tax free.

GERARD F. JOYCE, JR.
NATIONAL HEAD OF TRUSTS & ESTATES

Greg Bourne, Manager of Retirement Services, contributed to this article.

Preparing the next generation for wealth

How to build bridges and encourage accomplishments

Baby boomers will pass down an estimated $30 trillion over the next several decades, and the lion's share of that wealth will go to millennials. The question is: How can we prepare them to inherit this wealth? Fiduciary Trust CEO John M. Dowd and Franklin Templeton Investments former Chairman and CEO Charlie Johnson offer their best advice.

BUILD BRIDGES TO THE FUTURE

To prepare the next generation for the future, start by giving them a sense of your history. Then help them develop the discipline they'll need to find their own path to success.

Document your journey

Put your story in writing for the next generation, including the benefits and limitations of what wealth could provide at various points in your life. Even a simple letter will provide your descendants with a unifying set of values to guide their decisions as they build and manage wealth in the future.

Demonstrate discipline

Inviting the next generation to attend a regularly scheduled meeting with your advisor will help them appreciate the value of a formal agenda and demonstrate smart financial habits, such as updating your financial plan to reflect life changes. It also reminds them that wealth serves them—not the other way around. Be sure to map out a plan for the most appropriate times to broach various topics, such as the specific terms of your trust.

Test their abilities

One coaching method I have seen work very successfully for families with private foundations is giving the next generation responsibility for evaluating grant opportunities, making site visits, and determining the potential impact a grant might have. Ask the next generation to provide a report explaining how the applicants were evaluated. This is the perfect opportunity to test drive their skills.

Encourage lifelong planning

Successfully managing family wealth requires many of the same skills as running a business: setting goals, building budgets and measuring progress. In addition, you need to consider the unknowns—such as market returns, costs and changing goals. Following a disciplined and flexible financial plan is a characteristic shared by successful businesses and families alike. It provides a playbook for navigating a changing environment.

Build a financial framework

Finally, ask the next generation and your wealth advisor to develop a framework for understanding how the markets and the economy move. Early in my career, I got some great advice on how to sort through the overwhelming amount of financial information that is available by starting with six key factors: interest rates, the US dollar, inflation, earnings, employment and GDP. Our educational resources are specifically designed to help the next generation understand these dynamics.

JOHN M. DOWD
CHIEF EXECUTIVE OFFICER

ENCOURAGE HARD WORK AND ACCOMPLISHMENTS

Charlie Johnson was named CEO of Franklin Templeton Investments in 1957, taking the reins of a company his father created ten years earlier. (Franklin Templeton is the parent company of Fiduciary Trust.) When Charlie retired in 2013, the next generation of his family stepped up. This is a brief glimpse into his views on family wealth.

Learning that financial rewards are earned

In the 1970s, when the mutual fund industry and Franklin Templeton were just getting started, earnings were slim. So, Charlie's children worked summer jobs and learned important lessons about the value of a dollar.

In the early 1980s, when the company started to enjoy financial success, Charlie awarded 2,000 shares of company stock to each of his children, with some degree of hesitation.

> ***"My father was a very practical man. When I was about 12 years old, he told me, 'Too much money has ruined more lives than not enough money.' I didn't understand his comment at the time, but I've come to learn that it's very true. Fortunately, my children were not spoiled by too much wealth early in life. They seem to have their feet on the ground."***

Motivating the next generation

Charlie also wants to prevent family wealth from distorting the views of his grandchildren, who are now between the ages of 12 and 25. So he set up a generation-skipping trust that encourages them to roll up their sleeves, work hard and lead a life of "endeavor and entrepreneurship."

His grandchildren can use distributions to supplement their incomes, allowing them to pursue their passions in careers that make valuable contributions to society even if they offer only modest financial rewards, such as running a foundation.

> ***"Inheriting too much wealth can distort a young person's perception of money because it is often held in less regard than wealth they have earned on their own."***

Making fair and objective distributions

The trust document does not include specific benchmarks or incentives, and does not name a family member as trustee. Instead, the responsibility is assigned to a professional trustee who has enough discretion to allow distributions that encourage hard work, while preventing distributions that beneficiaries may use irresponsibly.

> ***"Appointing a family member as trustee can put a lot of personal pressure on them. If they say no to a distribution request, feelings get hurt. That can influence their decisions."***

CHARLES B. JOHNSON
FORMER CHAIRMAN AND CEO, FRANKLIN TEMPLETON INVESTMENTS

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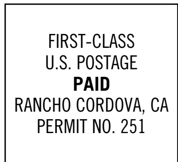
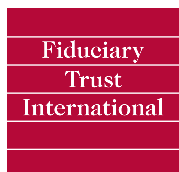


GROWING AND PROTECTING WEALTH FOR GENERATIONS

Fiduciary Trust is a wealth management firm founded in 1931 by families for families, with a singular focus on growing and protecting your wealth through generations. We work closely with individuals, families and foundations to build and manage personalized investment portfolios, and to develop estate plans that extend wealth to future generations.

- Wealth Planning
- Wealth Administration
- Investment Management and Solutions



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