Fiduciary Trust International

2018 OUTLOOK

Planning for What's Ahead

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ONLINE

Updates on Tax Reform

JOHN M. DOWD
CHIEF EXECUTIVE OFFICER

In 2017, the financial markets and global economy once again reminded us that change is constant. Whether we look back at a shifting political landscape, economic expansion in Europe or sector rotations within the US stock market, an undercurrent of change was constantly in motion, exposing new risks to manage and new opportunities to capture.

In this year's Outlook, we offer our best advice on how to navigate a landscape that is sure to bring more changes again in 2018—not by making predictions about what the future holds, but by explaining how we are preparing for whatever comes our way. In all kinds of weather, we believe the key to achieving financial success is building a long-term plan that is both disciplined and flexible, focusing on individual goals, separating the signals from the short-term noise and adapting to change. It is a recipe for success that has served our clients well for more than 85 years.

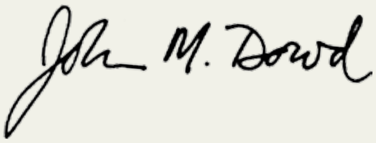
One way Fiduciary Trust is helping our clients prepare for whatever comes next is by investing in tools and technologies that make our portfolio management process more efficient, reduce risk and broaden the menu of advice we offer. An important first step in this initiative was our recent redesign of your performance reports. Additionally, in 2017 we redesigned your Investment Policy Statements, which guide portfolio management decisions and help to ensure your investment strategy remains on track.

You can expect to see more enhancements in 2018, including the expansion of our wealth planning tools that can provide you with a clearer view of your financial picture and a pathway to achieving your goals.

One of my personal passions is helping the next generation plan for the future. We are developing programs directly aimed at this effort that I hope will benefit you and your family. In this Outlook for the new year, I offer my personal advice to those who are just getting started.

Finally, while we are leveraging all the advantages modern technology has to offer, we recognize its limitations. No algorithm or software program can replace the guidance of an experienced portfolio manager, trust attorney or tax specialist working with an individual to address complex wealth management issues. Technology doesn't threaten those relationships—it strengthens them.

As you plan for 2018, we wish you health, happiness and prosperity. As always, we are here to help in any way we can.



John M. Dowd
Chief Executive Officer

INVESTMENTS AND MARKETS

Economic Outlook

Calm waters and a steady breeze, but the winds may fade in 2018

The past year has been filled with populist rhetoric across the globe, geopolitical tensions and policy uncertainty with respect to both US and international politics. The UK continued to weave its way through the unknown framework of exiting the European Union, strife in the Middle East flared up in several countries and North Korea brashly defied unilateral opposition to missile tests. Meanwhile in the US, attempts to overhaul the healthcare system proved futile and political discourse within the Republican Party failed to find a unifying framework.

Given this backdrop and the fact that the US economy just completed its eighth consecutive year of expansion, one might expect that 2017 was a year in which markets experienced a more challenging environment with mixed returns, or at the very least, elevated volatility. But, in stark contrast, markets were historically stable and registered robust returns across the globe.

Fundamentals, not headlines, drove markets

So, what factors drove such favorable market conditions? In our view, we see three primary drivers of the 2017 return profile: 1. resynchronized global economic growth, 2. corporate earnings, and 3. optimal financial conditions.

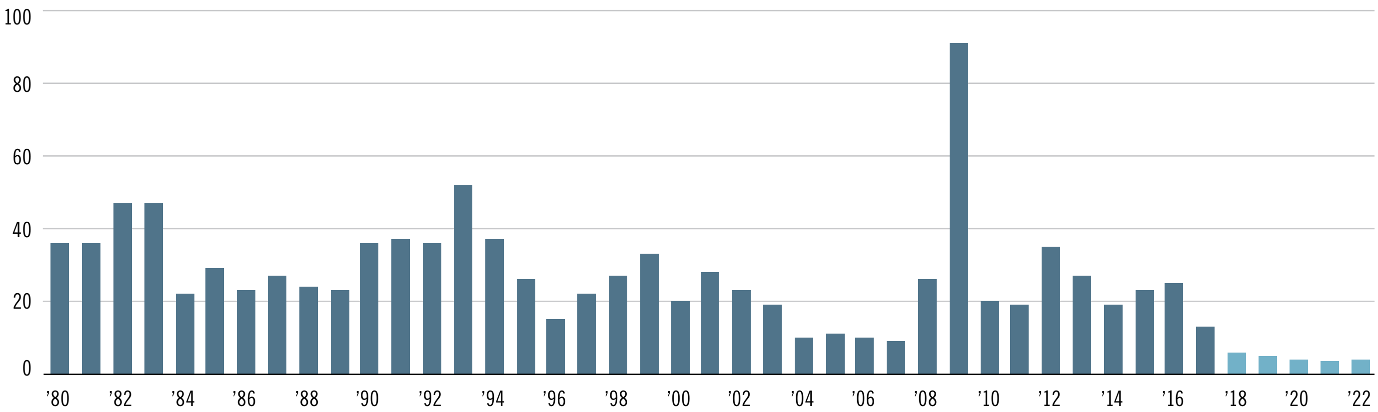
1. Going into 2017, our call was for a resynchronization of global economic growth, a theme that came to fruition over the year and is likely to continue. By IMF estimates, the next few years are forecast to see the lowest number of economies experiencing a recession in the modern era (CHART 1). When final data are released for the year, prognosticators expect global growth of 3.5%, energized by increased participation from the Eurozone and Japan, which are projected to grow by 2.2% and 1.5%, respectively. China, while slowing, is still expected to generate growth in excess of 6%. Possibly even more important, the destabilizing fears that emanated from China's financial markets in early 2016 were largely absent in 2017. On the other hand, the US scorecard is likely to show more of the same, or in other words, moderate—but not great—expansion.

2. On the corporate front, earnings benefited from synchronized global conditions and reemerged from a slump in 2016. When final numbers for 2017 are released, US companies are projected to show roughly 10% profit growth over the prior year, while European, Japanese and emerging market companies are expected to generate 12%, 19%, and 22%, respectively. In the case of US equities, which are already in the midst of a seasoned bull market, earnings were especially supported by increased economic activity abroad, a shift from prior years where companies were largely dependent on domestic demand.

3. Lastly, ideal financial conditions added further support to the 2017 market environment. Interest rates were incredibly stable and remained historically low, driven primarily by

CHART 1: THE NUMBER OF COUNTRIES IN A RECESSION FELL TO A MULTI-DECADE LOW

Based on annual GDP growth or shrinkage



Source: IMF, World Economic Outlook Database, October 2017.

stubbornly low inflation readings for much of the year. Given the strong economic and corporate fundamentals, credit spreads remained tight throughout the year and even touched their lowest levels of the current expansion—meaning companies were able to continue borrowing at favorable rates. Adding fuel to the rally was a decline in the dollar as it reached its weakest levels since 2014, which benefited US companies with an international focus.

Rational exuberance

For US investors, this bull market has the feeling of fatigue. Since the bottom of the S&P 500 in March 2009, the market has averaged annualized total returns of 19.1%, while valuations have gradually crept higher and are currently sitting at around 21 times last 12 months earnings—well above historical averages. Combine that with the fact that volatility in markets has effectively been nonexistent, and it becomes clear why investors might view the current rally as excessive and nearing its end. However, put in context of the year we just experienced, with broad global economic growth, solid corporate fundamentals and ideal financial conditions, we view these levels as justified.

Historical data show that in low inflation regimes, price-to-earnings (P/E) ratios in the low 20s are well within norms (CHART 2). With inflation in check, interest rates remained anchored, which provided direct benefits to the private sector via low borrowing costs, and in turn, healthier profit margins. Even without the benefit of low rates, earnings have benefited from a larger opportunity set; that is, increased global economic activity provided US multinationals with other sources of demand.

From a historical perspective, prior high P/E regimes were often accompanied by excessive risk-taking and speculation in equity markets—for example, in the late 1990s during the technology bubble. Thus far, we have not seen the signs of excesses from prior cycles. In fact, during the past year, returns have been driven more from earnings growth than multiple expansion. Perhaps even more surprising is that during this rally, flows into US equity markets have actually been negative. In contrast, US bonds experienced record inflows in 2017.

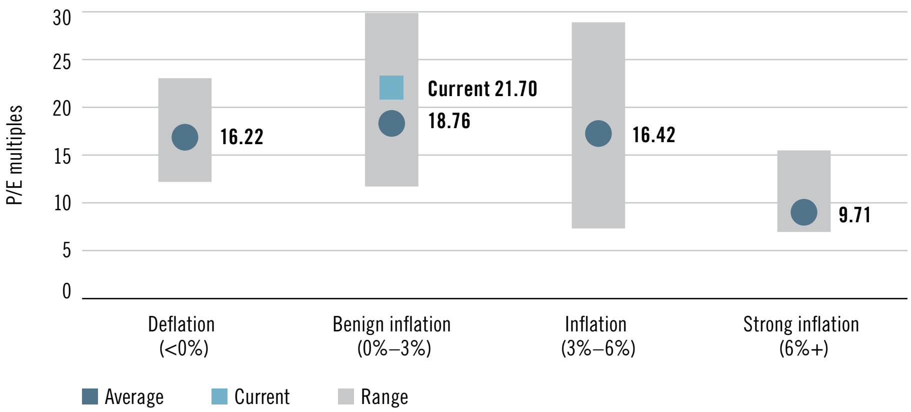
2017 will be a tough act to follow

From an economic perspective, we expect much of the same in 2018. Economies around the world should continue to grow in a synchronized fashion. Companies may find it difficult to maintain earnings growth at the same pace given the solid year in 2017, but we still expect some positive momentum. The dollar weakness we experienced over the last year should continue to be a tailwind, but with valuations already nearly full we see few prospects for multiple expansion.

Additionally, we believe financial conditions most likely peaked this past year, but we do not expect a sudden tightening. Inflation shows no signs of accelerating, and central banks have thus far been patient as they seek to normalize monetary policy. To be sure, an unexpected spike in inflation would have profound and destabilizing

CHART 2: MULTIPLES HAVE BEEN HIGHER IN PREVIOUS PERIODS OF LOW INFLATION

Monthly P/E ratios for the S&P 500 during different inflationary cycles over the past 60 years



Source: Bloomberg.

implications for financial markets, but this is not our base case. Against this backdrop, we expect stock market returns to moderate in 2018 and anticipate a pickup in volatility.

On the fiscal policy front, tax reform and other stimulus measures could be net positives for the US market, but any expansionary benefits of a tax overhaul plan could take several years to percolate through the US economy. The main takeaway is that while it may provide a boost to markets, our base case is not dependent on tax reform.

Finding opportunities abroad

Taking these factors into consideration, we are slightly overweight equities going into 2018, and are optimistic about pockets of opportunity both at home and abroad. We expect international markets to present opportunities, and we continue to seek wider diversification in select areas such as Europe and Japan, where valuations appear reasonable and economies are in the early stages of a growth cycle.

Additionally, select areas in US equities appear particularly attractive, including technology, healthcare and financials, and we are watching several emerging trends driven by the tastes and lifestyles of millennials. We also see potential opportunities in carefully selected municipal bonds and certain hedge funds for their potential to provide additional diversification and guard against volatility.

RONALD J. SANCHEZ, CFA®
CHIEF INVESTMENT OFFICER

Key Takeaways

1 Markets were unusually stable in 2017

Resynchronized global economic growth, corporate earnings and optimal financial conditions fueled equity market growth in 2017.

2 Earnings growth could be tough to beat in 2018

Companies may find it difficult to maintain earnings growth at the pace seen in 2017, but we still expect some positive momentum in 2018.

3 Returns and market volatility are likely to normalize

We expect US stock market returns to moderate and volatility to pick up this year.

INVESTMENTS AND MARKETS

Asset Allocation Outlook

Positioning for a tougher year ahead

2017 was a banner year for risk assets across the globe. While the global economy should remain strong, we expect year-over-year earnings comparisons will get tougher, moderating our expectations for equity returns in 2018. However, we are overweight equities, favoring international developed markets over their US counterparts, and remain underweight fixed income.

Equities: keeping the international tilt

Across developed markets we see the most promising return opportunities in Europe and Japan. In these regions, the political landscape has stabilized, the economic growth cycle appears younger than the US, and valuations remain cheaper on a relative basis.

In emerging markets, we maintain our recommendation of a neutral weight. However, after a year of improvement in the economic and fundamental backdrop, we continue to look for opportunities to raise our outlook on the asset class.

Fixed income: underweight in a challenging environment

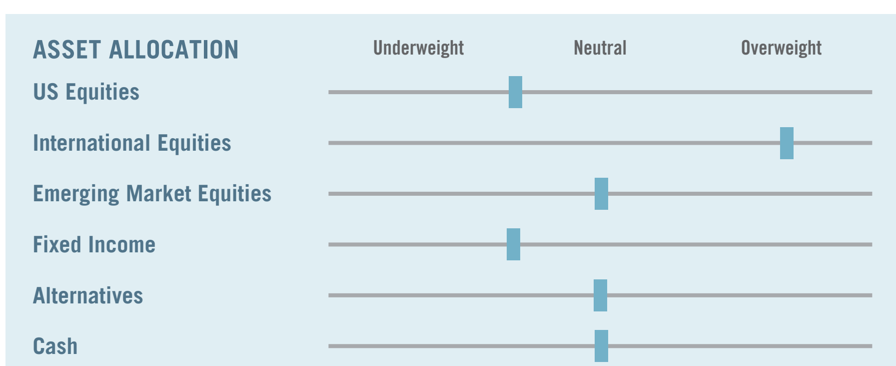
As the Federal Reserve continues to normalize monetary policy, bonds appear to offer limited total return opportunities. Within fixed income, we still prefer US investment-grade credit to government bonds, and in an effort to guard against interest rate risk, we are maintaining our short-duration bias relative to the benchmark.

For investors in high tax brackets, the municipal bond market continues to offer tax-advantaged income, although selectivity remains key.

Liquid alternatives: a hedge against volatility

Low market volatility and interest rates have weighed on hedge fund performance in recent years, but rising rates in 2018 and beyond could present hedge funds with new opportunities. As we look for market volatility to pick up, alternatives could offer investors downside protection and further diversification in multi-asset-class portfolios.

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



INVESTMENTS AND MARKETS

Equity Outlook

Separating leaders from laggards as technology changes the world

From agriculture to telecommunications, technology is shaking up the status quo. In all sectors of the global economy, technology is disrupting traditional business models and changing the way we live. Our mission is to capture the growth opportunities presented by tech innovators and avoid businesses that are likely to be left behind, using a combination of fundamental security analysis and active portfolio management to separate the leaders from the laggards.

The tech sector matures

The tech sector has come a long way since the dot-com crash of 2000. It is well established, representing almost a quarter of the S&P's total market capitalization, and is a primary driver of corporate earnings growth. In fact, if the tech sector is excluded from 2017 results, earnings growth for the index falls from 11% to 6%. In light of these strong fundamentals, we do not consider tech valuations unreasonably high. We also believe that overall equity market valuations, while extended by historical averages, are not excessive, given the corresponding corporate profitability. Corporate tax reform could also have the potential to boost EPS an additional 5%.

Technology is also driving efficiency improvements across the board, from industrials to energy to health care. Our focus is on companies that are using technology as a competitive advantage, either by creating new demand for their products or services or by driving the cost structure down. Since innovation creates wealth, we are looking for technological breakthroughs that cut across all sectors, mainly from well-established technology leaders but also from emerging companies on the cutting edge of innovation.

The sharing economy blossoms

The practice of sharing isn't new. Consider the tradition of buying health insurance, for example, which is essentially the practice of pooling money and sharing the costs of healthcare, or owning a timeshare for family vacations. But an "always connected" world has also sparked demand for services that allow consumers to share everyday items like bicycles, designer jewelry or even their home Wi-Fi signals. Technology now allows two people to telecommute and share a single job, giving parents more flexibility to raise their children but complicating the science of measuring worker productivity.

Artificial intelligence improves healthcare

Artificial intelligence is a powerful technology that allows computers to perform tasks that usually require human intelligence such as analyzing data, recognizing speech patterns and making decisions. Artificial intelligence is already being used to help medical researchers sort through data to identify diseases and develop new treatments. Developments in digital healthcare could change the way doctors diagnose irregular heartbeats, replacing large, expensive heart monitors with small, waterproof patches that monitor a person's heart rhythms and send the data back for analysis.

Productivity gains in manufacturing

In the industrials sector, connectivity between manufacturing and distribution systems is becoming standard practice. Data is being collected and combined with the power of cloud computing and artificial intelligence to transform traditional, non-tech industries into more efficient global enterprises. The "smart factory" of tomorrow could lead the world's economy into a new industrial revolution.

Innovation in the transportation business

We have also seen early evidence of what technology is capable of in transportation. Smartphone applications are notifying travelers of train schedule delays, reporting highway traffic and rerouting drivers. Smart transportation grids use artificial intelligence to analyze traffic patterns and adjust the timing of traffic lights during rush hour, and automobile manufacturers are testing systems that can distinguish a police car from a taxi. Robots are being tested in self-driving cars and self-piloting airplanes. Science fiction is moving closer to reality every day.

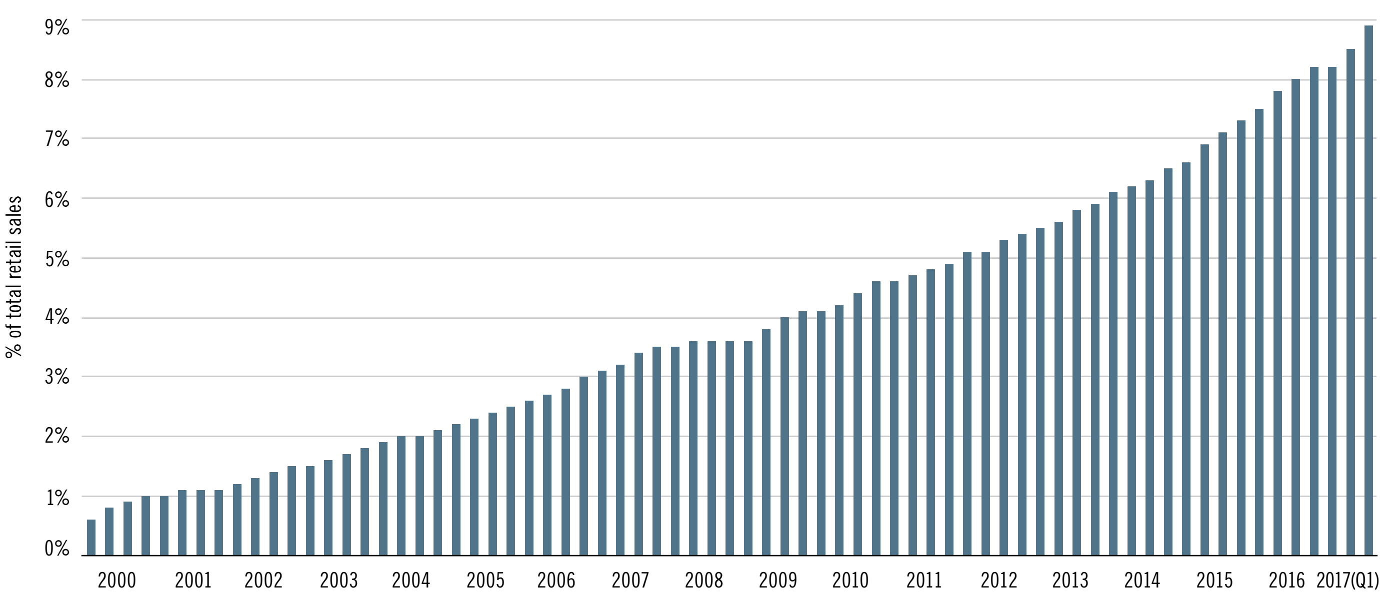
E-commerce shakes up the retail sector

In the retail sector, vendors who have traditionally relied on brick-and-mortar locations are quickly adopting technologies that put the shopping experience in the palm of the consumer's hands. A strong appetite for sophisticated, on-demand services has given rise to experimental distribution methods such as using drones to deliver packages and subscription services that deliver fresh groceries.

E-commerce has been gaining market share rapidly, capturing 9% of all retail sales in the United States (CHART) and more in some markets overseas. We are tracking a number of retailers that are using technology to expand internationally. Challenges include the collection of state sales taxes from online retailers and the pressure to spend more on marketing.

E-COMMERCE'S SHARE OF US RETAIL SALES HAS TRIPLED IN THE PAST DECADE BUT IS ONLY 9% OF TOTAL SALES

Percentage of total US retail sales



Source: US Census Bureau. Estimates are based on data from the Monthly Retail Trade Survey and administrative records. Adjusted for seasonal variation, but not for price changes. Total sales estimates are also adjusted for trading-day differences and moving holidays.

Millennials are cutting the cord

Technology is also making entertainment more convenient, streaming video-on-demand and other content over the internet to mobile devices, which is in high demand by millennials. We expect to see continued weakness in traditional box office sales as digital delivery platforms become more sophisticated and providers expand their à la carte menu offerings for at-home entertainment. We also see the potential for further industry consolidation among leading entertainment content providers in 2018, which should increase their pricing power. We also expect advertising budgets to continue migrating away from TV and toward social media, but internet TV enjoys the same capacity as social media to target audiences with specific demographic characteristics.

Financial companies invest in tech

Technology is also revolutionizing banking and financial services, allowing investors to place stop-loss orders on mobile trading platforms, apply for mortgages online and use algorithm-driven investing methods that were once the purview of professionals. These services increase the need for robust encryption programs and cybersecurity controls to safeguard personal information.

Banks, insurance companies and brokerage firms are all scrambling to keep pace with technology and the expectations of consumers, investing more than $27 billion in fintech and digital innovation since 2015, according to KPMG. Much of this investment has been in the form of mergers and acquisitions, which we expect to continue. Larger banks are allocating more R&D resources to technology than regional banks, which generally wait until a service is adopted and then try to replicate it. We are also evaluating several companies that provide critical back-office technologies for banks.

Fundamental analysis in Silicon Valley

Across all sectors, we are focusing on companies that are leaders or emerging leaders in technology, with strong management teams and healthy balance sheets. Ultimately, our goal is to find capital growth opportunities that are attractive regardless of geopolitical headwinds, economic cycles or market volatility. When searching for attractive valuations in the tech sector, we think one of our strong suits is the fact that our parent company, Franklin Templeton, is located in the heart of California's Silicon Valley, so our research team can visit these companies without leaving town.

In this rapidly changing world, we believe keeping our finger on the pulse of innovation is a distinct advantage for our portfolio managers and our clients.

CARIN L. PAI, CFA®
EXECUTIVE VICE PRESIDENT, HEAD OF PORTFOLIO MANAGEMENT

Key Takeaways

1 Separating tech leaders from laggards

We are always searching for companies that are leveraging technology to improve earnings and avoiding companies that could be left behind.

2 Innovation across all market sectors

We remain positive on the tech sector and we are also finding innovators in healthcare, manufacturing, transportation, e-commerce, entertainment and financial services.

3 Fundamental analysis drives investment decisions

As always, our investment decisions are based primarily on the health of a company's balance sheet and the vision of its management team. Broader trends are a secondary consideration.

INVESTMENTS AND MARKETS

Fixed Income Outlook

On the horizon: bond markets sail into uncharted territory

Many developed countries expect continued economic improvements in 2018. But a key question looming over the fixed income market today is how investors will react when global central banks join the US in unwinding their massive balance sheets and raise rates. While the pace of balance sheet reduction is likely to be glacial and market reaction is expected to be muted, the sheer size of these programs and unprecedented nature of these policies introduces an element of uncertainty into the outlook.

Budget constraints challenge the muni market

We are witnessing some credit deterioration in certain parts of the market as tax revenue growth slows and budgets continue to be pressured. Tax reform could have a significant impact on the market.

With these factors in mind, we still believe carefully selected municipal bonds offer attractive tax-exempt value and diversification benefits within the broader credit markets. We expect credit quality to be a focus in 2018 as the economy and policy in Washington evolve. Default risk in the near term should remain muted.

Tax reform could chill corporate bond issuance

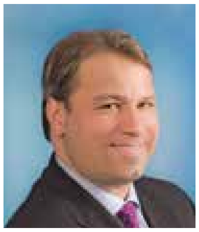
In the corporate bond market, a reduction in interest tax deductibility and repatriation of earnings held overseas could reduce the desire for companies to borrow. New issuance has been rising steadily against a backdrop of strong demand, keeping yields low and credit spreads tight. Aggressively tighter monetary policy would likely cause credit spreads to widen and valuations to ease, but we expect that process to evolve slowly. Economic improvements in large, developed markets overseas could also buoy corporate yields in the US.

In line with our view of global economic resynchronization, we continue to have a broadly positive view of US corporate fundamentals. Interest rates remain low, inflation muted, corporate balance sheets are solid, and debt-service costs appear manageable. Despite historically tight credit spreads, select corporates still offer attractive yields compared to US government bonds.

In the corporate and muni bond markets, careful credit analysis and a high degree of selectivity are the cornerstone of our portfolio construction process.

Managing rate risk with shorter maturities

Interest rate risk remains a concern of ours. While inflation and upward yield pressures have been muted, tighter labor markets in the US and more synchronized global growth suggest both could move higher. We continue to manage interest rate risk by investing in shorter maturities, which are less sensitive to price deterioration as interest rates rise. As these bonds mature, proceeds can be reinvested at what we expect to be higher rates.



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

INVESTMENTS AND MARKETS

Alternative Investments Outlook

A renaissance in private equity attracts individual investors

Private equity is going through a period of renewal as the global economic recovery continues. Investors are receiving distributions through realizations of long-term investments, and private equity sponsors are fundraising with vigor for future opportunities.

How it works: investing in a partnership

Private equity funds take concentrated ownership stakes in companies across a variety of sectors and industries that are not publicly traded. They are created as limited partnerships, providing a management fee of 1.5% to 2% of committed capital and a performance fee that is typically 20% of realized profits. Outside investors are considered limited partners (LPs), and they receive income and capital gains generated by the fund's investments.

Less liquidity, longer investment horizons

The lifespan of a private equity fund is finite and it includes two distinct phases: a four-year period in which the general partner is making investments, and another six to eight years when the investments are being realized (the acquired companies go public, are sold or recapitalize). This is when investors see a return on their investment.

Performance is usually negative in the early stages due to capital outlays for acquisitions, fees and administration. Returns should then climb upward in subsequent years. Funds are illiquid in nature; although a secondary market exists, the process is cumbersome and transactions are executed at a healthy discount to fair value.

Buyout and venture capital strategies

There are two main types of private equity strategies:

- **Buyout strategies** use borrowed funds and equity to buy a firm outright or purchase an ownership stake. The loan is repaid using the cash flow generated by sales, operations, and/or sales proceeds.
- **Venture capital strategies** focus on startups and early-stage companies, often with innovative technologies or a patented process. Most investors are underweight in this category, which has the potential to offer compelling returns, albeit with incremental risk.

Finding the best private equity investments

Measuring the risks and returns of private equity investments is complicated and can vary significantly across different private equity firms. To learn more, please contact your Fiduciary Trust portfolio manager.

WAYNE A. SPRAGUE
EXECUTIVE VICE PRESIDENT, HEAD OF STRATEGIC ADVISORY

WEALTH PLANNING

Your New Year's Resolution

Make planning a priority in 2018

It can be easy to postpone your long-term wealth plans—sometimes because the future seems far away, or often because topics like death, incapacity and even retirement can be uncomfortable to think about. But to make the most of your finances during your lifetime and leave behind a legacy, it's important to have a plan.

You are never too young, too old, too busy or uncertain to be in control of your decisions. The choices you make today in your will or other documents can always be changed tomorrow.

First things first: four estate planning essentials

No matter what your financial circumstances are, there are important estate planning documents everyone should have. These include a will, powers of attorney and a healthcare directive. In most cases, they also include a revocable or "living" trust and beneficiary designations.

Putting these documents in place is how you ensure your wishes are followed if you die or lose capacity. This is especially important when you have young children or other dependents, including parents, siblings or friends, who look to you for financial support.

1. Revocable Trust: the workhorse of the modern estate plan.
In most US states, a revocable or "living" trust is the central document of an estate plan. A properly funded revocable trust can avoid the need for a probate court proceeding after death. It can also facilitate the handling of your property during your lifetime in the event of incapacity.

With a revocable trust, you transfer the title of your assets into your name as trustee. During your lifetime, you remain the beneficiary of the trust and generally can deal with the trust property in the same manner as if the trust were not in existence. You can revoke or amend the terms of the trust at any time.

If you become unable to act as trustee, the successor trustee you have named will take control of the trust property and continue to administer the trust for your benefit. Upon your death, the trust property will be distributed to the people and organizations you name in the trust instrument. And, this is all accomplished without the cost, delay and publicity of a court proceeding.

A revocable trust may not be necessary in all circumstances, but you should consider one if you:

- Are concerned about paying expenses or distributing assets to your heirs shortly after your death.
- Have assets whose management would be hampered by court process or supervision.
- Want to maintain the privacy of information about your property interests and their disposition.
- Have a simple estate that you'd like to be handled swiftly after your death.

2. A will: still necessary, but may not be as important as it once was.
When most people think of estate planning, the first, and maybe only, document they think about is a will. But due to the advent of revocable trusts, the purpose of a will is not as broad as it once was.

Your will is still typically the legal document in which you name guardians for your minor children, making it an especially important document for young families. It is also generally the place to exercise any powers you may have to appoint (that is, direct the distribution of) property held in an irrevocable trust.

If you have a revocable trust, your will is usually a "pour-over" will, which means any assets you may not have transferred into your name as trustee during your lifetime should be added to your trust following your death. Typically, your will would provide for a broader distribution of assets only if you do not have a revocable trust and you are comfortable with having a probate proceeding at your death.

3. Title your assets: a critical step.
Ultimately, even if you have a revocable trust or will, the titling of your assets determines what happens to them when you die. For a revocable trust to function effectively, the title to your assets must be held in your name as trustee (e.g., Jane Smith as trustee of the Smith Family Trust). If title to an asset is in your individual name (e.g., Jane Smith), a probate proceeding may still be necessary and the terms of your will control who receives the property, even if it is your revocable trust.

In the process of estate planning, it is critical to review the deeds, account statements and other documents of title for your property interests to ensure formal ownership of your property is accurate and aligned with your current intentions—especially if the property was purchased a long time ago or your family situation has changed.

4. Name beneficiaries: never overlook life insurance and retirement accounts.
Similar to the title to your assets, beneficiary designations can also take precedence over the terms of a will or revocable trust. With retirement accounts and insurance policies, you are generally required to name beneficiaries as part of the initial paperwork. But it is important to remember you typically can change those beneficiary designations at any time and should always make sure your designations are aligned with the other terms of your estate plan.

Your insurance company or retirement account administrator should be able to provide you with a copy of your current beneficiary designation as well as the forms necessary to make any changes.

Keep your documents up to date

Your planning documents are only as good as the information in them. Once you have your documents in place, your next step is to conduct a regular review, usually at least every three to five years. If your beneficiaries or other plans change, update your documents immediately. Reviewing your instructions regularly is the only way to ensure your assets pass the way you intend.

HOW ESSENTIAL ESTATE PLANNING DOCUMENTS WORK TOGETHER

YOU ▸ YOUR SPOUSE

YOUR WILL
- Guardians
- Powers of appointment

YOUR TRUST
- Joint bank accounts
- Joint investment accounts
- Real estate
- Other property

YOUR BENEFICIARY DESIGNATIONS
- Retirement accounts
- Life insurance

CHILDREN

BRYAN KIRK
MANAGING DIRECTOR,
TRUST COUNSEL

WEALTH PLANNING

The Family Business

Succession plans that work for every generation

Transitioning your family business to the next generation is not a one-time event. When done properly, it is a process that begins long before you hand over the keys to the kingdom.

Throughout my career in wealth management, I have been privileged to help family business owners create the framework to start having honest conversations with their children and build long-term, formal succession plans that ensured a smooth transition over the course of several years. With a bit of guidance, they recognized the value of opening the lines of communication, sharing financial statements, managing expectations and mentoring successors so they were fully prepared to take on such a large responsibility.

Eliminating the family business blind spot

There have also been heartbreaking stories about the opposite happening: Successful and well-intentioned entrepreneurs decide that a formal succession plan isn't necessary because ownership will simply be divided equally among all children when they pass away. The results are predictable: siblings squabble over the direction of the firm, the business pays excessive taxes, and in worst-case scenarios the successors end up selling the family business below its optimized value.

What is causing this breakdown? Succession planning appears to be a blind spot for quite a number of family business owners. Despite the fact that they might have worked for 20 or 30 years to build a multimillion-dollar company from the ground up, successful business professionals often assume that younger family members will simply step in to fill their shoes when the time comes. Procrastination, indecision and secrecy are the worst enemies of prudent succession planning. With a modest amount of planning, these problems can be effectively avoided.

Bringing in a neutral third-party moderator

When family dynamics collide with smart business planning, the territory can be difficult to maneuver.

In many cases, the sticking point may be business owners who think the next generation isn't ready to step up, but don't know how to develop a blueprint to make that happen. Others have such a strong emotional attachment to the business that they subconsciously avoid conversations about how and when, if ever, they will cede control.

This is where a multidisciplinary approach that involves all stakeholders in the family business and a team of experienced wealth planning professionals can be critical. This ensures everyone is on the same page and, before any disagreements or conflicts arise, ground rules can be established for how they will be handled. Nothing is left to chance.

Good corporate governance sets the stage

In our experience, about half of family business owners express an interest in remaining active in the firm and retaining some influence over the direction of the company. At the same time, increasing numbers of owners are bringing the next generation into their businesses, either at an executive level or as rank-and-file employees. PricewaterhouseCoopers reports that 74% of family firms in the US employed next-generation family members in 2016, up from 59% two years earlier.

Business founders are living longer, sometimes working until they are no longer physically able, while ambitious and typically tech-savvy successors grow impatient. But there are techniques that can bridge this divide.

First, all parties with a vested interest in the company should become active participants in shaping a business governance structure, which includes a roadmap with milestones that specify when and how each role or responsibility should be transferred. Two critical topics are covered in a good governance plan: how the decision to sell the business will be made, and just as importantly, how disputes or disagreements will be resolved.

Boosting professionalism in your business

Many families also benefit from annual performance reviews and documented compensation packages for family members. And, as the next generation becomes more active, it becomes more important to have regularly scheduled board meetings and shareholder meetings. Part of this process entails keeping detailed notes that successors can reference in the future, and written business agreements for relationships you might have with business partners, suppliers or customers.

Some larger businesses develop a family constitution that explains how the business operates and also articulates its core values—from best practices on maintaining relationships with employees to educating and developing future generations and promoting philanthropy.

Legal structures can help ensure continuity

Of course, there are also legal structures that can establish formal requirements for your successors.

For example, a shareholder agreement can set parameters on the transfer of ownership within the family and limit or prevent the sale of business interests to non-family members. Other legal structures provide significant tax benefits. In addition, certain types of trust agreements can ensure that business assets are distributed fairly—but not necessarily equally—granting ownership rights to heirs who are interested in running the family business and bequeathing other assets from your estate to heirs with other plans for the future.

Finally, the financial terms of the transition can also go a long way toward ensuring a smooth and successful transition. Depending on your circumstances, you might consider options such as gifting all or some of the business to your successors (taking advantage of the lifetime gift exemption) and drawing income from the new owners, lending new owners funds to acquire the company, making an outright sale, setting up a trust, or using some combination of these options. Keep in mind that if you sell the business at a discount, the IRS will treat any amount under fair market value as a gift.

The best time to start planning is today

At Fiduciary Trust, our portfolio managers often say that the best time to start investing was 10 years ago, and the second-best time is today. The same holds true for succession planning, especially if you have business holdings outside the continental US.

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

WEALTH PLANNING

Crossing Borders

Estate planning for families with international ties

As the world gets smaller, wealth planning has become a bit more complicated for families who live and work in a number of different countries. Non-US citizens who own property in the United States face unique tax challenges, as do citizens of the US with business or personal ties outside the country.

Be our guest: non-US citizens with assets or family in the United States

If you are a non-US person with assets or family in the United States, you may be focused on just your personal situation—that is, what are the US income tax consequences of your US connections? However, you may not be aware of gift and estate taxes that may apply to the assets you own.

As a non-US person, you are not generally subject to US gift and estate taxes unless you own assets that are treated as "US situs" or US-based. The US situs rules vary between the US gift and estate tax, but the type of assets subject to the federal estate tax include US real estate, US stocks and mutual funds, cash, tangible property located in the US and certain debt obligations.

Establishing a trust can preserve your legacy to US recipients for generations to come

If you are a non-US person who wishes to leave a substantial legacy to US persons, the best option in our view is to use an irrevocable trust. If the trust is designed correctly, the US estate tax is never triggered, even though the trust benefits US persons.

Conversely, if you were to leave significant assets directly to a child or another US citizen or resident without the use of a trust vehicle, these assets would become part of the recipient's US taxable estate. Even though the assets were held outside the US, they may become subject to US federal estate tax.

A word of caution when using trusts: It is important to ensure the trust is not funded improperly with US assets to cause the property to be deemed to be included in your estate for US estate tax purposes. And, location of the trust is also important. Many non-US citizens establish their trusts in the state of Delaware for the privacy, tax benefits and estate-protection features these trusts can offer. Home country laws and US estate tax treaty provisions can significantly impact your planning, so it is important take a coordinated approach.

Lastly, even if you use a foreign holding company to avoid US estate tax, this technique will not work over the long term for your US family members as they will then own the foreign company (or its underlying assets) and be subject to the US estate tax, which applies to a US person's worldwide assets.

The challenges in owning and transferring US real estate

One of the most common challenges is transferring US real estate, which is subject to both US income tax and to federal estate and gift taxes. Non-citizens can often eliminate the estate tax exposure by setting up a trust or non-US holding company to buy the property and name family members as beneficiaries.

Capital gains tax on the sale of the US real estate cannot be avoided in the long run. However, many clients structure the ownership through a US LLC that is, in turn, owned by a non-US company. This helps avoid the "FIRPTA withholding" which is 10% of the sales proceeds rather than a tax on the actual gain, if any.

There is no one-size-fits-all solution. You need to weigh a variety of factors, such as how long you plan to live in the US and whether or not your US children will use the US real property. The longer you own the property and the longer the property will be held by US persons weighs in favor of funding a US trust to purchase the US real estate. This way, there should never be a US gift or estate tax, and the capital gains rules apply only when the property is sold. In addition, the FIRPTA rules are avoided because the US real property is not "foreign owned" since the US trust is the owner.

Another factor to consider is whether the property is for personal use or commercial property. Commercial properties may warrant very complex vehicles to avoid US estate tax and to minimize US income tax on the property's income. You should understand whether the benefits from your planning warrant the cost or whether another option, such as purchasing insurance, can more efficiently fund any US estate tax obligation.

Bon voyage? Relinquishing US citizenship or long-term green card status

If you are a US citizen who gives up US citizenship (or a green card holder for eight out of the last 15 years who terminates his or her status), your assets could still be effectively subject to US income and estate taxes. The IRS has established income tax rules in the form of an "exit tax" that is specifically for high-income and high-net-worth expatriates, as well as a so-called "phantom" estate tax on legacies passing to US persons. Generally, these rules apply if your net worth is greater than $2 million or if your average annual US income tax (not income) is greater than $165,000. The tax cost of these rules should be seriously evaluated before expatriating.

Delaware trusts help avoid estate taxes

Many non-US citizens establish Delaware Trusts for the privacy, tax benefits and estate-protection features they offer. Often, families prefer to keep information about their international holdings private—not to avoid tax obligations, but to manage the risk of political instability in their home country and prevent the release of private financial information that could put their personal safety at risk.

The rules that govern Delaware Trusts for non-US citizens are complex, but one of the most popular strategies among non-citizens is setting up a foreign grantor trust in the state of Delaware. When funded entirely with non-US assets, the trust is not subject to the US federal estate tax.

Unfortunately, when the person who created the trust (the grantor) dies, most other tax benefits associated with a Delaware foreign grantor trust do not extend to beneficiaries. But there are strategies that can help mitigate this problem, including converting the foreign trust to a domestic trust, essentially bringing it back onto US shores.

Benefit from a professional

If your estate plan is complicated by multiple citizenships or international assets, we always recommend seeking guidance from our professionals who can help navigate the nuances of the laws and rules surrounding cross-border planning.

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

Advice for the Next Generation

Preparing for the journey ahead

Throughout our history, one of Fiduciary Trust's top priorities has been educating future generations. Our goal is to help young people lead productive lives and manage wealth wisely.

As part of this commitment, CEO John M. Dowd addressed a group of graduate students who are members of the Fortis Society, an organization that provides networking opportunities based on merit rather than privilege. In John's guidance on financial and professional success, summarized here, one message comes through loud and clear: Success requires planning.

Successful investing begins with a plan

Q: When is the best time to start investing?

JOHN: There's an old saying that the best time to start investing was 10 years ago, and the second-best time is right now. And I think there is some truth to that, assuming you have money to invest.

Everyone has different financial needs, but the general rule of thumb is that 50% of your after-tax income should be reserved for essentials like food, clothing and shelter; another 30% goes toward travel, entertainment and other things you want but don't necessarily need; and the remaining 20% should be saved or invested.

Assuming all your bills are paid and you have adequate savings (six months of living expenses as a buffer), it is usually best to start investing as early as possible. The earlier you start, the more likely you are to benefit from compound interest—a force so powerful that Albert Einstein called it the eighth wonder of the world. When you continuously reinvest the income earned by your investments, time can be a powerful ally.

Q: If I'm ready to start investing, where do I begin?

JOHN: First, it is important to have a plan. Put your personal goals in writing and sketch out a strategy for how you expect to accomplish them. And, be sure to take advantage of your company's 401(k) retirement plan, especially if your employer makes matching contributions.

Professional guidance may also be helpful, especially if you could use more discipline in your financial life or want more guidance on investing. For example, you may have heard that you can estimate how much of your portfolio should be allocated to stocks by subtracting your age from the number 100 (meaning that a 25-year-old should have 75% of his or her portfolio in stocks). While this rule of thumb is helpful, a professionally developed financial plan will tell you exactly how your investments should be allocated.

Q: What are the most common mistakes made by younger investors?

JOHN: Not having a financial plan—and then making emotional decisions when markets are rocky. Over the last 20 years, an investor who stayed fully invested in the

S&P 500 would have received close to a 10% average annual return. However, if they missed the 10 best days of the market, their return would have fallen to 6%.

I often think about investors who headed for the sidelines during the global financial crisis in 2008 and locked in their losses, only to see the US stock market fully recover by the end of 2009. We often tell our clients to focus on "time in the market" rather than "timing the market."

Q: If I am an active investor, what should I know about the economy?

JOHN: There is so much information out there that it is critical to build a framework to make sense of what you are seeing and hearing in the news.

It took me a long time to develop my own framework, but I generally take six key economic factors into consideration when investing:

- The strength or weakness of the dollar, which influences so many investments.
- The direction of interest rates and the policies of central banks like the Fed.
- Inflation, which affects the consumer's purchasing power.
- Corporate earnings growth, which reflects the general health of the economy.
- Employment rates, which influence personal consumption (responsible for 70% of our economy).
- Gross Domestic Product, which is our country's economic scorecard.

Best practices for your personal finances

Q: Do you have any advice on how to manage my personal finances?

JOHN: Build financial discipline early. Read the book *Titan: The Life of John D. Rockefeller*, by Ron Chernow. It explains how Rockefeller became the first billionaire in history through a life of discipline, determination and meticulously recording every financial transaction he made.

If you are an investor, avoid the wisdom of the crowd. As Warren Buffett said, "Be fearful when others are greedy and greedy when others are fearful."

Leadership and intellectual curiosity

Q: What are the most important skills I should develop for a successful career?

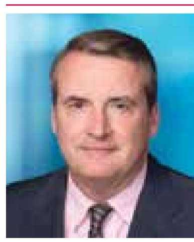
JOHN: Curiosity and creativity. In this fast-changing world, with so many day-to-day "work problems" that need to be addressed, it is important to maintain a sense of intellectual curiosity and continue learning throughout your career.

I find it extremely helpful to study business leaders in other professions and apply the lessons they have learned to wealth management. Yes, it is important to have drive, ambition, talent and self-confidence. But I think it is equally important to admit that you don't have all the answers to life's questions.

Q: What is the most challenging aspect of running a business?

JOHN: I am responsible for moving this company forward by leading broad initiatives and discussions that can sometimes continue for months, or longer. The challenge is to stay sharp, keep my energy levels high and remain fully present and engaged in the tasks that are in front of me 100% of the time while those broader discussions are moving along.

Managing people can also be challenging and rewarding at the same time. When I am coaching and mentoring in the office, I have to make sure I am not only encouraging and rewarding people but also challenging them to step outside of their comfort zones. This can be risky because you never know how an individual is going to react. Everyone has different strengths and weaknesses. Finding a way to leverage those strengths and then watching them shine is especially gratifying to me.



JOHN M. DOWD
CHIEF EXECUTIVE OFFICER

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The Latest on Tax Reform: Planning for the Changes Ahead

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Fiduciary Trust International

fiduciarytrust.com

Fiduciary Trust International Offices

New York, NY
(877) 384-1111

Arlington, VA
(703) 647-4132

Boca Raton, FL
(561) 988-8460

Coral Gables, FL
(800) 618-1260

Fort Lauderdale, FL
(561) 988-8460

Los Angeles, CA
(800) 421-9683

San Mateo, CA
(877) 284-2697

St. Petersburg, FL
(800) 618-1260

Washington, DC
(888) 621-3464

Wilmington, DE
(866) 398-7414

London
(44) 20-7073-8500

Fiduciary Trust Company of Canada Offices

Calgary
(800) 574-3822

Toronto
(800) 574-3822

FTCI (Cayman) Ltd.

Grand Cayman
(877) 384-1111

(212) 632-3000
(calling from outside the US)

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