Fiduciary Trust International

2020 OUTLOOK

Finding Financial Peace of Mind in the Decade Ahead

WHAT'S INSIDE

Letter from the CEO

Our Outlook for the Economy and Markets

Wealth Planning Strategies for 2020

JOHN M. DOWD
CHIEF EXECUTIVE OFFICER

What does it mean to have financial peace of mind? For many of our clients, it is the reassurance that comes along with knowing they are in control of their wealth—their wealth does not control them.

Of course, life doesn't come with guarantees. The world is changing rapidly, often in ways that are difficult or impossible to anticipate. But despite these uncertainties, Fiduciary Trust has been helping families and individuals like you take control of their wealth and face the future with confidence for almost 90 years. In simple terms, we start by bringing your entire financial life into focus. Then we develop a personalized wealth strategy aimed at moving you closer to your unique goals, whatever life brings your way. Our mission is to leverage every resource at our disposal to protect and grow your wealth for today and for the generations ahead, providing you with financial peace of mind.

To that end, we continue to look for new ways to enrich your experience with Fiduciary Trust today and build your confidence in the future.

On the investment side, we're broadening our lineup of alternative investments, which can reduce volatility in your portfolio and reveal new opportunities for growth, especially when traditional stock and bond markets are in flux.

We are also making it more convenient for you to connect with Fiduciary Trust, whether that means a face-to-face meeting with your team of advisors or accessing your account information online. Our offices in New York, South Florida and Northern California have been expanded to make your advisors more easily accessible and our client website has been refreshed and redesigned to improve security and make it easier to navigate. With the support of our parent company, Franklin Templeton, we are on track to invest more resources in technology in 2020 than ever before.

In the year ahead, my sincere wish is that you enjoy the same degree of confidence about your financial future as I have about mine—not only as CEO of Fiduciary Trust, but also as a client.

Wishing you health, wealth and peace of mind in 2020 and beyond.

John M. Dowd
Chief Executive Officer

Will risk be rewarded in 2020?

The economy and markets suggest a more cautious approach

2019 was another robust year for risk asset returns and another weak year relative to historic standards for economic growth. In this sense, it was a microcosm of the entire decade. Markets persistently outperformed despite a plodding, muddle-through type of economy.

The scars from the Great Financial Crisis (GFC) remained never far from investors' minds as the least loved stock rally in living memory continued for a decade.

Looking back to look forward

As we approach 2020, it may be helpful to recall some of the past decade's highlights. Coming out of 2009, the world was still racked by the GFC. Although US economic growth had returned, it remained mired at a slower pace than its pre-crisis peak. Terms such as "quantitative easing (QE)," "zero interest rate policy (ZIRP)" and "Troubled Asset Relief Program (TARP)" were heard with an increasing frequency as policymakers sought to mitigate the global downturn via new monetary policy tools. A bottom had, with the benefit of hindsight, been reached by the S&P 500, but to shell-shocked investors, the next downturn never felt too far away.

Economic fallout provided seeds for rebirth

Despite the economy feeling closer to recession than growth, the economic slack created by the recession provided the fuel for the ensuing recovery. At the time, with unemployment near double digits, the precariousness of the

situation masked the vast amount of idle potential existing within the economy, which would drive innovations in everything from labor to automobiles to houses.

The move toward energy independence led by the US shale revolution helped contain and even depress oil prices. More than just a boon to consumers, this also proved helpful to the Federal Reserve's ability to maintain lower interest rates longer than previously thought possible. Global conditions also contributed, with anemic growth in Europe and a slowing China dampening inflationary pressures.

Outperformers for the past ten years

The shift from a nascent recovery beginning in 2009 to today's mature environment was characterized by three key macroeconomic themes: a lack of global growth, a lack of inflation, and a lack of yield combined with accommodative monetary policies.

The confluence of these factors produced a not-too-hot, not-too-cold (Goldilocks) economy which, perhaps surprisingly, provided an enormous boost to a host of financial assets (CHART 1). A robust returns environment arose for both "risky" stocks and "safe" bonds. A typical portfolio mix of 60% stocks and 40% bonds proved to be ideal as both asset classes delivered returns well in excess of their historical averages.

The weaker global growth trajectory caused investors to place an ever-increasing premium on the regions, industries and companies capable of exponentially increasing revenues. That kind of revenue growth was in short supply and the few firms, mainly in the US, that offered it were outsize winners. Investors became so accustomed to discussing these US technology highflyers that they were colloquially termed "FAANG"—Facebook, Amazon, Apple, Netflix and Google—as these companies provided a large portion of the S&P 500's return advantage versus the rest of the world.

While investors increasingly searched for growth, they also sought safety and income via global fixed income markets. As interest rates neared 0%, investors looked beyond government bonds to augment yield. Central banks, via QE policies, had purchased massive amounts of fixed income securities, effectively encouraging investors to purchase riskier assets while the low absolute level of yields encouraged a stronger appetite for credit risk and a further reach for yield (CHART 2).

Fixed income performed on par with non-US equity markets, while US Treasuries produced

CHART 1: THEMATIC VIEW OF THE GOLDILOCKS DECADE

a comparable return to emerging markets equity with considerably less risk. The search for yield went beyond fixed income and also impacted the pricing of the highest quality income-oriented equities. For instance, Procter & Gamble, perhaps the gold standard for high quality, dividend-paying stocks, saw its valuation advantage relative to its peers remain in place, even as low interest rates helped the broader index move toward higher price-to-equity (P/E) levels. These higher valuations occurred within an environment of greatly lower volatility, as steady though uninspiring growth met investor demand for US equities.

Diversification wasn't rewarded

Dips and corrections in equity prices seemed to all but disappear, as consistent strength in domestic equity markets became the norm (CHART 3). This dearth of volatility challenged traditional investment orthodoxy which argues that outperformers will vary from year to year and, as such, provide an incentive to diversify an overall portfolio. However, over the decade, asset class winners did not rotate, but simply kept on winning. For example, large-cap equities ranked as one of the top three performers for five out of the last six calendar years. That singularity of success is largely contrary to the market's performance during prior market cycles.

Will Goldilocks keep her charm?

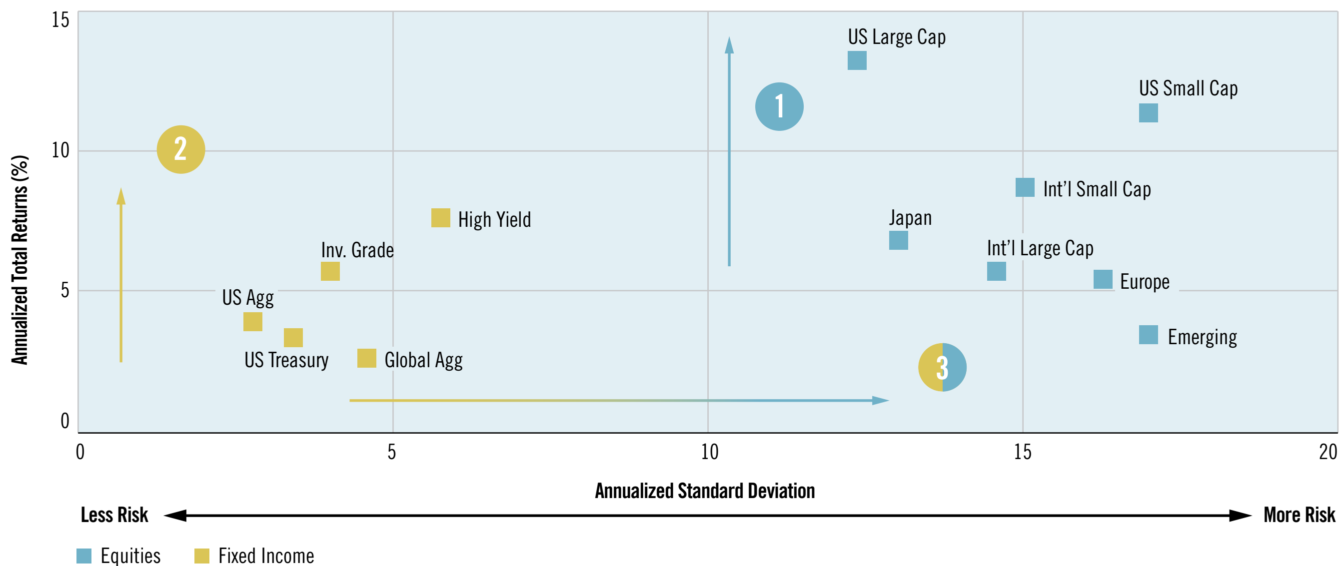
With 2020 on the horizon, the US economy finds itself in its tenth consecutive year of expansion, the longest period on record. The country's unemployment rate stands at its lowest level in modern history and there are indications that workers may finally be gaining bargaining power regarding wages. Yet, inflation has largely proved absent and interest rates seem poised to hover at multi-generational lows.

From a market perspective, the S&P 500 is currently near all-time highs. As volatility has remained contained near its lows, P/E levels have richened considerably and are now near levels that are considered full to slightly overvalued. Investors' unrelenting appetite for growth and technology companies is being challenged by the next generation of IPOs struggling to move from high-growth, high cash-burn business models to sustainable, investable ones. While a continuation of the same Goldilocks economic backdrop seems likely, more of the same does not seem capable of generating the same return profile as the last decade.

CHART 2: A SNAPSHOT OF THE PAST 10 YEARS

The 10-year risk/return profile reflected the macroeconomic backdrop

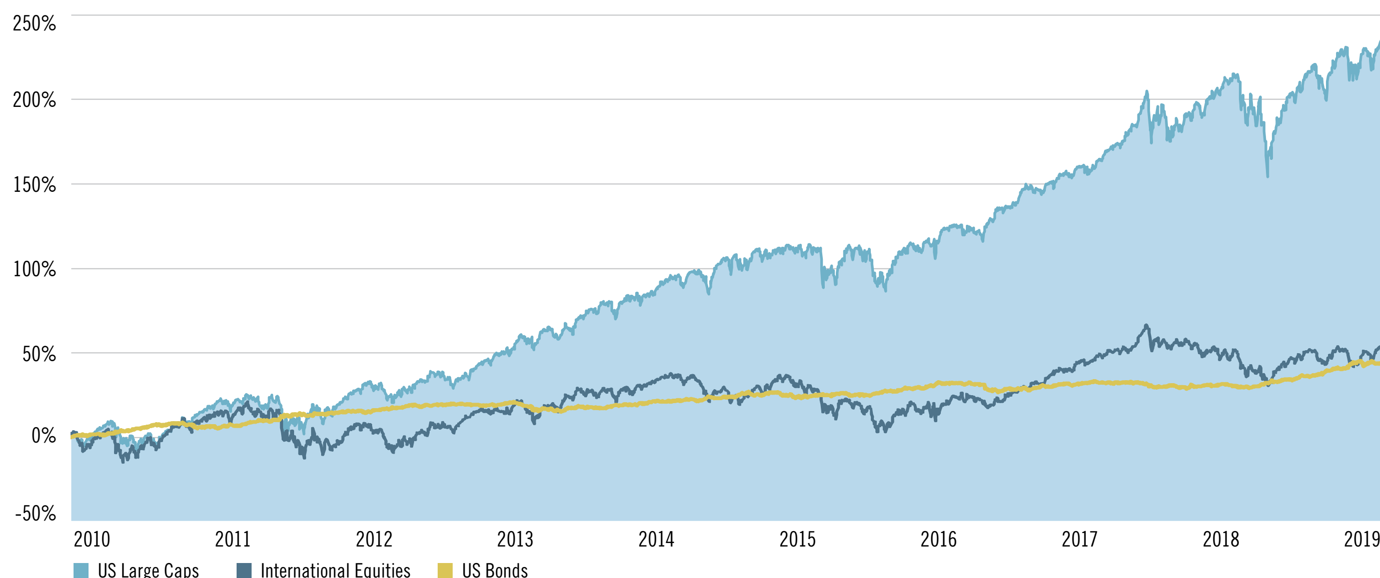
1. US equity led on an absolute and risk-adjusted basis. 2. High-income assets were in favor. 3. Non-US equities underperformed fixed income on a risk-adjusted basis.



Source: Bloomberg.

CHART 3: US EQUITY RETURNS OUTPACED GLOBAL EQUITIES AND FIXED INCOME

Trailing index performance (January 2010–October 2019)



Source: Bloomberg.
US Large Caps represent S&P 500 Index, International Equities represent MSCI All Country World Index and US Bonds represent Bloomberg Barclays US Aggregate Index. Chart shows total cumulative return.

In search of catalysts

We believe these factors add up to a world without obvious catalysts. In our opinion, the peak effects of monetary policy are likely in the past. The trajectory of global growth seems lower, pulling inflation and interest rates lower with it. While the drivers were hard to see 10 years ago as we emerged from the recession, the valuations were palatable. Now, with near all-time highs in US equities and lows in global interest rates, the lack of new catalysts makes us more wary about the year ahead.

A time to reassess risk

Given the economic backdrop, we believe that risk management, while always of the utmost importance, must become an even larger focus for investors. We no longer foresee a world in which the balance of risks is unambiguously tilted to the upside and must adjust our expectations accordingly.

We still believe that the economy will keep growing in 2020, albeit more slowly than in 2019. We believe that if GDP growth in the US hovers around 2%, coupled with equities trading near all-time highs, market participants could start to reassess the Goldilocks economy. Relatedly, both low interest rates and accommodative monetary policy support equity prices only so far. If such a tipping point were reached, falling rates, instead of supporting higher stock prices, could signal a darkening growth outlook.

In our opinion, the best way to manage through this environment is with a more cautious approach to portfolio construction. While we acknowledge that this has been a remarkably long cycle, we feel it will continue through the near term, despite current market valuations that seem stretched, economic growth and policy that leave much to be desired, and an absence of obvious change drivers in the marketplace.

We note the present policy uncertainty regarding trade in particular as a potential (though we believe unlikely) boon to equities.

Our assessment of the risk backdrop views the current situation as part of the investment foundation for the foreseeable future. It is always challenging to predict the future. It felt difficult to commit to an equity bull market 10 years ago and it feels equally hard to commit to one now. We are cognizant that a high-return, low-risk Goldilocks environment is not the norm. The fact that it was the hallmark of the last decade makes it a hard act to follow.

RONALD J. SANCHEZ, CFA®
CHIEF INVESTMENT OFFICER

Is 2020 a year to be prudent?

Awaiting opportunities as risks remain

With continued policy uncertainty, trade tensions and a presidential election ahead, we expect financial markets to remain volatile in 2020. These challenges suggest a cautious approach when navigating through an environment that could bring more risks than opportunities.

Equities: Risks outweigh rewards

In the US, we are underweight large-cap equities. With more evidence of a negative spillover from the downturn in manufacturing trickling into services, we feel it is appropriate to remain underweight this asset class. While US consumers and employment levels continue to appear strong, we think large-caps may face challenges if signs of global weakness impact their earnings and growth outlooks.

Given that much of the trade and manufacturing slump has heavily impacted international developed markets, we remain underweight stocks in these countries. With Brexit risks pushed into 2020 and limited scope for monetary and fiscal policy, the headwinds facing overseas markets could continue.

In emerging markets, we maintain a neutral view. While many of the factors that have weighed on international large-cap equities have also weighed on emerging market equities, we believe a supportive liquidity backdrop could help offset some of the challenges emerging market stocks face.

Fixed Income: A flight to quality

Interest rates have plummeted around the globe, driven by fears of a global recession and heightened risks surrounding trade policy. Central banks have made a renewed push toward more accommodative policies but concerns about the economic and policy backdrop have led to heavy demand for bonds, causing a record amount of sovereign debt to drop into negative-yield territory. We believe the long end of the curve can still rise in the medium to long term, especially in the US, but are more cautious about short-term rates.

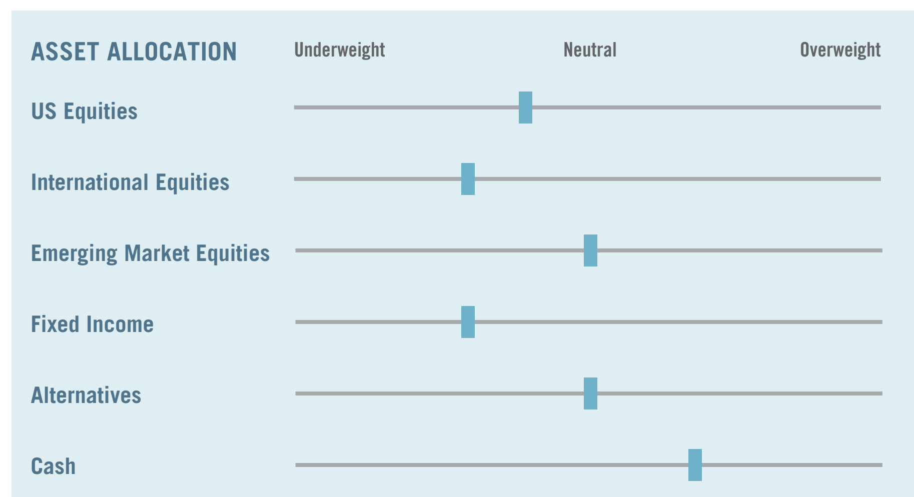
Alternatives: A hedge against the unknown

In this so-called "Twitter economy" with its near-daily market gyrations, alternatives can be an effective tool to reduce volatility within a portfolio. Therefore, we continue to recommend a strategic allocation to this asset class.

Cash: Keeping some powder dry

Given the high level of market sensitivity to headlines, we believe cash provides the flexibility needed to capture attractive investment opportunities as they arise.

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



Where are the growth opportunities in 2020?

Demographic shifts, new technologies drive consumer spending and capital outlays

Lower interest rates helped keep consumer spending levels above water in 2019, but they weren't enough to actually be stimulative.

Overall, personal consumption expenditures in the US slipped to an annualized growth rate of 2.9% in the third quarter, down from 4.6% in the second quarter of the year, even as personal savings increased steadily during the months of July, August and September.

In general, consumers are spending less and saving more. But a deeper dive into these numbers shows that while some industries have been hit especially hard by this trend, there are also pockets of the economy that are growing—consistently capturing a larger share of the discretionary income consumers have at their disposal. A look below the surface also reveals specific catalysts that are driving these spending patterns, offering investors a glimpse into the dynamics that are likely to discourage or encourage growth for certain market sectors in 2020 and beyond.

Healthcare services for old and young alike

Americans are getting older. Data from the US Census Bureau shows that the population of individuals over the age of 65 is expected to almost double by the year 2060 and the number of Americans over the age of 85 could triple. While these older consumers tend to spend less on consumer goods than other groups, they spend significantly more on their health. In fact, a report published by West Health in April 2019 estimates that seniors spent $22 billion on out-of-pocket medical expenses over a recent 12-month period.

More surprisingly, perhaps, is the fact that younger consumers are following a similar path, spending less on apparel and major purchases such as automobiles and allocating more of their budgets to the bare necessities such as food, utilities, paying down debt and healthcare. The Federal Reserve estimates millennials spend nearly twice as much on healthcare as baby boomers did at their age, accounting for 6.2% of their budgets compared to just 3.5% for boomers.

This shift in spending has broad implications for industries and investors alike. In addition to opening up new opportunities for the pharmaceutical industry and manufacturers of medical devices, it is also likely to spark demand for senior living facilities and at-home health care services. As millennials focus on their health, it is also pushing food providers to offer more

natural and organic products, and it has given rise to a broad array of wearable electronic devices used to monitor health and fitness.

Consumers need professional financial advice

Outside the healthcare arena, the aging of America also offers the potential to drive demand for income-producing investments and wealth-management services among older Americans, as well as financial planning services for millennials. This generation is saving more for retirement than other generations at comparable ages, their incomes are rising faster, and they are in line to inherit a sizeable portion of the estimated $30 trillion that will pass down from baby boomers over the next 30 years.

Experiences take precedence over material possessions

Older Americans have another important spending habit in common with millennials—they are dedicating more of their disposable incomes to "experiences" such as attending sporting events and concerts, visiting amusement parks, dining at restaurants and traveling to exotic locations. According to Eventbrite, an online event management company, spending on personal experiences like these has increased 70% since 1987, and research conducted by McKinsey & Co. shows that spending on experience-related services is increasing at nearly four times the rate of spending on consumer goods.

One of the most prominent catalysts fueling this trend is the desire among millennials to share their experiences and express themselves online. Nearly three-quarters of the millennials surveyed by Eventbrite said attending a live event is the best way to show other people what they are interested in, and almost half said they attend live events just so they have something to share on social media.

Businesses that are ahead of this curve, evolving to meet the growing demand for unique experiences and technologies for sharing them with friends, could have significant competitive advantages in the coming years.

Innovation leads to investment opportunities

One of the most rewarding investment themes we have pursued in recent years is finding companies that are leveraging the power of innovation to capitalize on these emerging trends and capture a larger share of the market. Our enthusiasm for this investment theme rests primarily on four convictions:

1. Innovation is creating value, fueling rapid advancements in areas such as e-commerce, genetic engineering, self-driving vehicles and artificial intelligence.

2. It is necessary to look beyond traditional growth metrics to spot innovative companies with the vision and skill to thrive in this environment—trailblazers in markets where penetration rates are low and the prospects for growth are strong. For example, we focus on high-quality companies with forward-thinking management teams, strong business models and exposure to the secular tailwinds that encourage sustainable growth.

3. Innovators are making breakthroughs across a broad variety of industries in the US and abroad, pioneering everything from single-serve coffee makers to personal concierge services.

4. As equity valuations rise, finding growth at a reasonable price becomes more challenging. Identifying attractive entry points requires patience and taking advantage of buying opportunities requires agility and nimbleness—especially during bouts of market volatility.

With the likelihood of more frequent market volatility ahead, we believe carefully balancing opportunities against risks will be critical as we evaluate companies that are breaking new ground in 2020 and beyond. We will continue to look for growth at a reasonable price by taking a measured approach to owning stocks that may come under pressure in the short term but offer the potential for stronger long-term growth.

CARIN L. PAI, CFA®
HEAD OF PORTFOLIO MANAGEMENT

What's ahead for fixed income investors?

Volatility, new muni supply and a focus on credit quality

Fixed income investors can expect a fair bit of uncertainty as we head into 2020. The good news is that the issuance of municipal bonds, which are in strong demand, is expected to increase next year and corporate debt service ratios should remain healthy, aided by lower interest rates.

The ongoing trade war with China, weaker manufacturing data, slowing global GDP growth and more modest expectations for future growth have captured the attention of the Fed and central banks around the world. To confront these challenges, boost economic activity and move inflation closer to targets, global policymakers have made it clear that the possibility of easier monetary policy and lower rates is still on the table for 2020.

More easing on the horizon?

The classic response to economic slowdowns is to reduce rates and introduce other monetary stimulus measures. In fact, the Fed spent most of 2019 transitioning from a neutral monetary policy to a dovish approach in response to a weaker economic outlook, cutting rates three times in the second half of the year. That followed a period of eight rate hikes between 2016 and 2018.

However, there is a good deal of skepticism among policymakers regarding how effective monetary policy easing will be in the year ahead. One reason for this cynicism is that the outlook for growth and inflation could be dramatically changed by geopolitical developments such as the impeachment process and 2020 elections in the US, Brexit and trade war concerns.

The uncertainty surrounding these issues has encouraged investors to pile into fixed income over the past year, driving yields down and flattening yield curves. With trillions of dollars' worth of negative-yielding debt across the globe, investors are demanding very little compensation in return for lending capital in the current environment. Investors are reaching for yield in an environment characterized by expectations for slower economic growth and mounting concerns about the resolution of geopolitical tensions. We believe this sets the stage for periodic bouts of volatility in the fixed income market as these situations play out over the course of the year.

A pickup in municipal bond supply

Demand for tax-advantaged income should continue to be strong in 2020, especially in high-tax states that have a $10,000 cap on state and local tax deductions. While the 2017 tax code did away with municipalities' ability to "advance refund" bonds and replace them with new tax-exempt debt, lower interest rates in 2019 allowed municipalities to issue taxable bonds and reduce their interest costs compared to previously issued debt. In general, taxable bonds are more

expensive for municipalities to issue versus tax-exempt debt. But taxable bonds can offer attractive advance-refunding opportunities if overall rates move low enough.

With this in mind, we believe the issuance of taxable municipal bonds should continue to rise in 2020 unless rates unexpectedly move higher. This, combined with an uptick in the issuance of traditional tax-exempt bonds, should provide a pickup in both gross and net supply for the first time in recent years—good news for investors looking to put money to work in 2020.

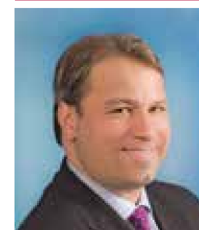
Because we do not foresee a US recession in the near term, which would reduce tax receipts and make it more difficult for issuers to service their debt, we prefer high-quality revenue bonds in the year ahead. While we are active investors in the general obligation (GO) sector, underfunded pension liabilities may represent challenges for some GO issuers, including the possibility of a worst-case scenario in which bondholders are not made whole in a restructuring. Therefore, we remain very selective with respect to credit quality in the GO market.

Corporate bonds: Quality matters

Corporate bonds posted very strong returns in 2019. Investment grade and high yield bonds were two of the top-performing asset classes, taking advantage of lower interest rates and tightening spreads. At the same time, corporate earnings growth slowed from the double-digit rates seen in 2018. While earnings growth appears likely to be muted throughout 2020, we believe most companies should be able to meet their payment obligations because debt service ratios remain healthy, aided by lower interest rates.

In the corporate bond market, credit quality also remains solid. But we are cautious about certain areas of the market such as investment grade bonds, as several issuers struggle with deleveraging and reorganization efforts. Within high yield, the highest-quality issuers within the lower-rated BB sector are at historically high valuations, representing an unattractive entry point. In addition, a slower-growth environment raises concerns about CCC bonds because their credit quality and default rates are highly sensitive to US GDP growth.

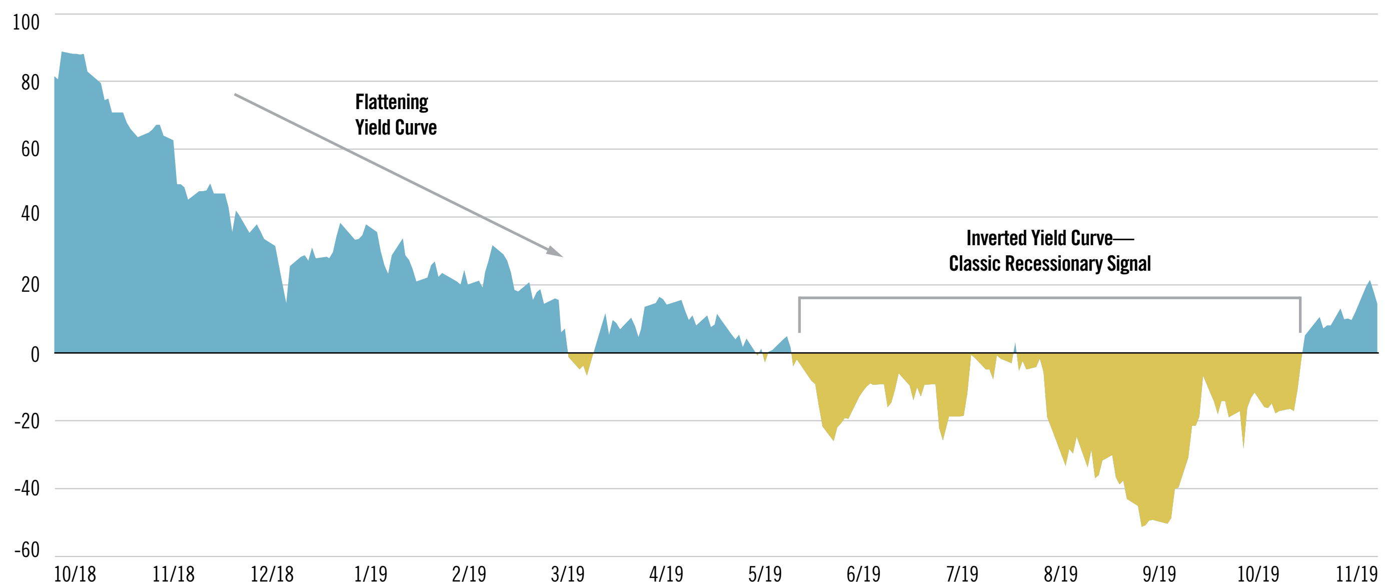
In summary, we recommend taking a more cautious stance against expected periods of elevated volatility in 2020. In our view, corporate bonds may offer value compared to other sectors of the fixed income market. And since we anticipate more volatility on the horizon, we prefer bonds with higher credit quality that mature in 10 years or less.



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

HAVE WE SEEN THE END OF YIELD CURVE INVERSIONS?

10-year Treasury yield minus 3-month Treasury yield (basis points)



Source: Bloomberg.

Have private markets peaked?

A crowded market demands a high degree of selectivity

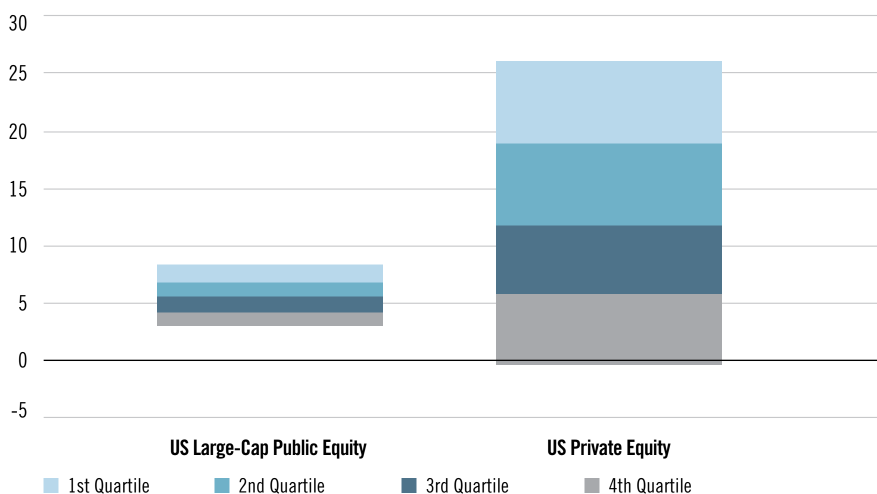
In an environment of unprecedented low yields since the financial crisis, investors have shown a stronger appetite for risk assets—and private investments are no exception.

A proliferation of new private investment strategies has sought to meet investor demand, creating new opportunities for everyday investors. In fact, the level of dry powder* committed and waiting to be invested now stands at $1.6 billion in the North American and European private markets, 40% higher than 2007 levels.[1]

At the same time, strong demand has attracted a crowd of competition and lifted valuations. This, along with worries about an economic slowdown, has some investors wondering if the good times for private investments are coming to an end.

RETURN DISPERSION IS MUCH GREATER IN PRIVATE EQUITY THAN IN PUBLIC MARKETS

The average IRR by performance percentile for US private equity funds (vintage years 1996–2014) on December 31, 2018 and the average 10-year annual returns by performance percentile from US mutual funds at year-end 2006–2018



Source: Lipper and PitchBook. US Large-Cap Public Equity represents the average of the 10-year annualized returns as of calendar year-end from 2006–2018 for the Lipper US Large Cap Equity universe of public equity funds. US Private Equity represents the average IRRs for US Private Equity Funds with vintage years from 1996–2014 as of December 31, 2018; 10-year annualized returns are used for the public equity universe to match the common 10-year fund period for private equity investments.

1. As of June 30, 2018. PitchBook, 2018 Annual Private Fund Strategies Report Summary.

*The total dollar amount of capital pledged by investors to a private fund, less the amount of capital "paid in" to finance underlying investments.

A wider range of outcomes

We believe the key to successful investing in private markets going forward will be the ability to choose experienced and knowledgeable portfolio managers and the right types of investment vehicles. The wall of capital allocated to private equity investments continues to grow, increasing the odds of less attractive returns in the years ahead. So, investors must be highly selective at this stage of the private equity market cycle.

Returns tend to vary much more dramatically across the universe of private investments and managers than they do in the public equity market. Therefore, while gains from private equity investments can exceed public equities by a wide margin, so can the losses. Private market investors must also be comfortable with lock-up commitments that can tie up capital for as long as 10 years.

New investments are on the rise

In the wake of the financial crisis, regulators placed restrictions on banks that limited their ability to lend. The private markets stepped in to lend capital and create private debt investments that have become increasingly popular with investors. The private debt market has returned roughly 10% each year since 2008 and offered higher yields than the public market. In this time, the universe also expanded to include investments such as real estate debt, venture debt, direct lending, credit special situations, and other strategies that help investors to fine-tune their exposures.

Evaluating the opportunities

Our approach to private investments is to evaluate opportunities over the long term and, when appropriate, take a contrarian view, recognizing that durable and sustainable investment themes often outperform today's "hot" investments. This perspective helps us avoid getting swept up by the early enthusiasm for novelties like 3D printing, which lost its initial traction and is still struggling to become profitable.

We are also highly selective when evaluating private equity portfolio managers. Our rigorous selection process favors experts who offer a clearly identifiable value-add component as part of their core competencies, prudent governance practices and an established track record of building businesses. We are not interested in private equity managers who generate returns through financial engineering.

In 2020, we will continue to focus our efforts on taking advantage of skill disparities in the private market and finding general partners who demonstrate a high degree of investment discipline.

WAYNE A. SPRAGUE
HEAD OF STRATEGIC ADVISORY

Achieving financial peace of mind with the modern three-legged stool

Knowing the right questions to ask

To achieve financial peace of mind, it is important to identify immediate concerns as well as challenges that may be on the horizon. Only then can you begin to build a truly solid foundation for the future and put your mind at ease.

Financial anxieties often stem from near-term events—like paying this year's taxes, selling a business, getting divorced or even a joyous event like getting married. But longer-term concerns can also become a source of stress, especially if you are asking yourself important questions such as: Will I be able to afford a comfortable retirement? How much is the right amount to leave to my children, grandchildren and charity? What happens to the money after I die or make gifts?

Look beyond retirement

Decades ago, financial security was said to be grounded on a three-legged stool: your pension, Social Security and personal savings. In theory, the three legs would support you from different directions and provide you with the strength and stability you'd need for your financial future.

In today's complex world, this image of a three-legged stool remains useful. But we would argue that the three legs of the stool have changed, expanding beyond sources of retirement income to three broader areas of concern that can lead you to financial peace of mind.

Today's three-legged stool

Making sure these three legs are squarely in place can go a long way toward calming your anxieties and helping you feel confident about your financial future.

1. **A clear understanding of your financial picture.** It is impossible to achieve peace of mind without first assembling a clear picture of where you stand today.
2. **A detailed financial plan.** This involves identifying your financial goals for your lifetime and then making sure your finances, spending patterns and asset allocation strategy are aligned and moving you in the right direction.
3. **An estate planning strategy.** Your plan should address your legacy after you die and how you might accelerate those plans during your lifetime through gifting. You also need to plan for the unpredictable challenges of disability or incapacity and the financial uncertainties they might create for your heirs and others you might benefit.

Asking the right questions

Since your finances aren't static, maintaining financial peace of mind requires vigilance. Whenever your serenity starts to fade, you can identify the source of the problem by exploring the right questions with your family and advisors. Identifying your options, finding a course of action and revisiting the questions on a regular basis keeps you on the right track and keeps each leg of your stool planted firmly on the ground.

BRYAN D. KIRK
HEAD OF ESTATE AND FINANCIAL PLANNING AND TRUST COUNSEL

THE MODERN THREE-LEGGED STOOL FOR FINANCIAL PEACE OF MIND

YOUR FINANCIAL PICTURE

Balance Sheet

- What are your current assets and liabilities?

Cash Flow

- How much money are you saving or spending annually?
- What are your income sources and main factors influencing your annual tax bills?

Legal and Tax Structures

- What are the tax characteristics of your assets, such as 401(k) accounts, IRAs, life insurance policies, and 529 college savings accounts?
- What are the legal structures around your assets, including LLCs, LPs and trusts?

Relationships

- How are your family's personal relationships affected by financial circumstances?
- Do you have a relationship with an accountant and estate planning attorney?
- Are your professional advisors properly coordinated with each other?

YOUR FINANCIAL PLAN

Lifetime Goals

- What are your financial goals (e.g., retirement, paying for education for children or grandchildren, purchasing a home, gifting or expenses)?

Spending Plan

- What is your spending plan?

Asset Allocation

- Is your asset allocation strategy optimized to meet your goals and coordinated across all your accounts?

Tax and Transaction Strategy

- Do you understand your options for mitigating taxes during your lifetime?
- Do you have a plan for any anticipated financial or major life events?

Stress-Test

- How likely are you to achieve your goals based on your current plans, and what steps can you take to improve these odds?
- Have you stress-tested your financial plan for issues (e.g., inflation, recession, health care expenses) and developed a plan to address them?

YOUR ESTATE PLAN

Legacy Goals

- What are your goals for leaving assets to family, friends, charity during your lifetime and at death?

Disposition of Assets

- Do you have a plan for gifting during your lifetime?
- How will your estate be divided among your family, friends, charity and others at death?
- Have you made plans for unique property such as real estate, art collections or a family business?
- Is your estate prepared for the taxes it may owe at your death?
- Are you taking advantage of the tax benefits of charitable giving?

Your Fiduciaries

- Have you designated an executor and trustee to handle your property after death?
- Who will make financial and healthcare decisions for you if you are unable to make them yourself during your life?

Family Education and Governance

- Are your beneficiaries prepared to receive your assets?

What does it mean to be a trust beneficiary?

Understanding how a trust fits into your financial picture

Whenever a trust is established, there are three main players: the grantor who creates the trust, the trustee who will oversee and administer the trust, and the beneficiaries who will eventually receive property from the trust.

The terms of the trust, including details about the relationship among all three parties, are spelled out in a legal document called the trust agreement.

The trust agreeement provides directions to the trustee, including the parameters for when and how the trustee exercises discretion over investment decisions and distributing assets. The trustee is subject to a variety of fiduciary duties to the beneficiaries, but most important is the trustee's duty to follow the terms of the trust.

If you have been named a beneficiary of a trust, understanding exactly what you are entitled to, now or in the future, can be confusing. Here, Director of Trust Administration Theresa McGinley explains how best to work with your trustee to receive the full benefit of being named a beneficiary.

Q: I've been named beneficiary of a trust. Where do I begin?

THERESA: The starting place for any beneficiary is to get a copy of the trust instrument. Trust instruments sometimes require assistance to understand. Your trustee or, when necessary your attorney, will help you understand your rights as a beneficiary and what those provisions mean.

At a basic level, the trust agreement contains four key elements:

1. A description of any current distributions you might be entitled to.
2. An explanation of any additional distributions you might receive, either when certain conditions are met or at the trustee's discretion.
3. Details about whether those distribution provisions will change in the future.
4. Notice of when the trust will terminate and what happens to the remaining trust property when it does.

Of course, there are many other provisions in the trust agreement that are likely to be relevant. But if you understand these four items you will have a general understanding of the distributions you are entitled to receive.

Q: What does it mean for distributions to be made under "certain conditions"?

THERESA: As a beneficiary, it's important to keep in mind that your trustee's actions are governed and guided by the terms of the trust agreement. The trustee is not free to do whatever he or she wants. In addition, the trustee has general fiduciary duties which include prudently managing (investing and monitoring) trust assets, dealing fairly and impartially with beneficiaries, acting in the best interests of current and future beneficiaries when it comes to both investments and distributions, and furnishing beneficiaries with information. The overarching goal of the fiduciary standard is to ensure that the grantor's intent is followed and the interests of all beneficiaries are protected.

The phrase "under certain conditions" refers to language in the trust agreement that restricts distributions, typically specifying that the funds must be used for specific purposes—such as a down payment on a home, seed money for a business, education or health care expenses. Distributions may also be permitted for broader categories like "maintenance," "support," or even "reasonable luxuries."

The trust agreement might also include language authorizing the trustee to make distributions at his or her discretion. But even if the trustee has sole and absolute discretion, he or she must always balance the desires of current beneficiaries (usually, distributions today) with the interests of future beneficiaries (growth of assets today and distributions in the future). As a result, the trustee must always

be prepared to demonstrate that each distribution is aligned with the grantor's intent and the terms of the trust instrument.

Q: What does it mean to receive distributions for "support"?

THERESA: Standards like "health" and "education" are fairly clear, and there is usually little controversy over what they cover. Even a vague term like "maintenance" is easy to understand (it typically refers to a beneficiary's current standard of living).

"Support" is a more relative term. Determining what constitutes a reasonable level of support typically takes various factors into consideration, including the beneficiary's age and the size of the trust as a whole. Your need for support changes as you grow older and your financial situation evolves. Some trust instruments are very explicit about which circumstances should be considered and how a trustee should determine an appropriate level of support, as well as lifestyle decisions and behaviors that should not be supported financially.

When the trust document does not offer explicit guidelines, we often look at the trust's income as a guideline for appropriate distributions. That helps balance the interests of current beneficiaries, ensuring the trust remains available for the remainder of their lives, and the interests of future beneficiaries. We encourage all of our clients to sit down with a trust officer, review the terms of the trust and, importantly, discuss how the trust will be managed and administered.

Q: What are my responsibilities when I request a distribution?

THERESA: Some trustees require beneficiaries to provide various documents—including their personal budgets, tax returns, and sometimes even a "statement of purpose"—when considering a distribution request. Then the information is presented to a committee, which decides whether the distribution should or should not be made.

At Fiduciary Trust, we prefer a more personal approach. The conversation begins by discussing your goals, assets, cashflow and financial plan for assets you hold outside of the trust. Then we initiate an open and honest discussion about the trust's assets, asking questions such as: "How do you plan to use assets you receive as distribution?"

If you don't have a formal plan for your financial future, or your vision is not as clear as it could be, we can help you to firm it up. We typically ask about your financial goals and needs over the long term, not just for one particular distribution.

The bottom line is that when you open up and start discussing your entire financial life with our wealth advisors, a real relationship starts to take root. Then your long-term financial plan becomes much clearer, including the role of the trust over the long term.

Q: Do you use modern technologies to collaborate with beneficiaries?

THERESA: Absolutely. Today, it is very easy to build a model that illustrates the impact distributions can have on a trust and on your financial situation. Over the long term, for example, we can show how significantly the financial picture improves if you withdraw 3% of the trust's assets each year instead of withdrawing 5%. When we provide these types of visual graphics, it becomes very easy for a beneficiary to understand the implications of various withdrawal patterns.

The same is true when we look at your "big picture" financial life, including assets you own outside of the trust, your income and your expenses. Depending on the terms of the trust agreement, it may be appropriate to include trust property as an asset on your balance sheet. Or it may be more appropriate to include the trust as a source of income.

This is where the guidance of our trust officers pays dividends. They can help you find the most appropriate withdrawal rate, identify any gaps in your financial plan and ensure you remain on track toward achieving your long-term financial goals.

THERESA MCGINLEY
DIRECTOR OF TRUST ADMINISTRATION

How can I make the inheritance process as smooth as possible for my family?

Eight ways to make life easier for everyone involved

Conventional wisdom tells us that there are several steps you can take to prevent your estate from being a mess after you die. Have an estate plan, make sure your assets are properly titled, update your beneficiary designations and keep your documents in a safe place where the right people can find them. Unfortunately, many people fail to cover these basic items, and even fewer take additional steps to make the inheritance process as smooth as possible for family members and other beneficiaries.

In every stage of life, whether your estate is modest or sizeable, these eight steps can help simplify the process of administering your estate and make life easier for everyone involved.

1. Consolidate your accounts

When your estate is settled, one of the first tasks an executor or successor trustee is responsible for is gathering your assets. Typically, this involves consolidating your accounts. Whether you have two bank accounts or 12, your estate will likely have only one. The same is true for brokerage or investment accounts and may apply to retirement accounts as well.

The more accounts you have when you die, the longer it takes to gather them and the greater the chance funds will not be immediately available if needed. Having numerous accounts also makes it more difficult for your executor or trustee to manage your assets in an efficient manner. The easy answer to these concerns is to not maintain more accounts than you need during your lifetime.

2. Keep important documents together

Are your important documents mixed in with the holiday decorations in your garage? Are your second sets

of house and car keys in the back of your sock drawer? Is your desk and filing cabinet a mess? Make it easy on your family and designate a safe, well-organized, easily discoverable place to store your important paperwork and physical items like keys.

Such documents include your will and trust. They also include statements (or at least a list of institution names and account numbers) for your bank and investment accounts, and proof of ownership for your other property interests (and whatever you may need to access them). The goal is to make it as easy as possible to determine what you own and take control of everything.

Rather than storing these items in your house, it's often a good idea to open a safe deposit box, assuming you keep the key in a safe place that is easy for the right people to find.

3. Authorize access to digital assets

Keep in mind that your assets are not only physical but also digital. Make a list of all your online accounts and email addresses along with usernames and passwords, especially for any digital currencies like Bitcoin or Ether.

Consider using a "password manager" on your computer and cell phone. There are several programs that allow you to automatically and securely store passwords in a digital wallet maintained by an online service provider.

But allowing access to your digital assets requires more than just providing an executor or successor trustee with a list of accounts and passwords. Your estate planning documents generally should include provisions formally authorizing your fiduciaries to access and manage your digital assets upon death or incapacity. You also need to coordinate your estate planning document with any online password manager you may have set up with specific providers, like your email or social media accounts.

4. Don't leave small percentage gifts

Some people find it easier to leave each beneficiary a percentage of their estates rather than a specific dollar amount. It's not uncommon to see people leaving the balance of their estates to a list of friends, family members and charities, each with a specific percentage.

The problem with this approach is that a lot needs to happen before those percentages can be paid out. Even if the amount is relatively small, your beneficiaries will need to wait until the administration process is fully complete before they receive their entire inheritance. In the meantime, the executor or successor trustee will need to keep them informed of everything happening in the administrative process, because every dollar spent and received ultimately impacts their gifts. This can place a heavy burden on your bequests.

As a general rule, if a bequest is going to be less than 20% of your estate, consider making it a dollar amount. You may need to update that dollar amount as circumstances change, but that's much easier than the burden that would come with the gift by making it a percentage.

"Nothing causes family strife like people's stuff."

5. Consider collectibles carefully

There's an old adage in estate planning that says nothing causes family strife like people's "stuff." That stuff can include sentimental items, priceless collectibles and even items you may view as worthless. Your plan for the distribution of tangible personal property (the technical term for "stuff") does not need to be complex. But it should be well-thought-out.

Having a realistic sense of value, both financial and emotional, is essential. It is also critical to keep important documents such as purchase receipts, sale records, authentication and provenance documents, appraisals and insurance contracts. If certain items of value are left to specific individuals, make sure your wishes are expressed clearly in your will and trust documents.

If you plan to leave all items to your children and also want them to pass along certain items to other people inside or outside of your family, think carefully about how that process will work. Contact any charities, museums or other institutions to determine what items they'll accept and how they will be used. Finally, for items that have significant financial value, make sure you consider the tax implications of your gifts.

You don't need to fully embrace the practice of Swedish death

cleaning (rigorously organizing your belongings before you die), but sorting out your "stuff" typically results in fewer headaches for your loved ones.

6. Plan for your pets

Legally, pets are also considered tangible personal property. But for many people, pets aren't property—they're members of the family.

If you feel that way about your pets, you should probably plan for them as well. Your will or revocable trust should specify who will receive your pets and those documents should also include a back-up plan to prepare for the possibility of someone's ability or willingness to take your pet changing over time.

You may also want to leave a sum of money to the person who receives a pet and request the funds be used to take care of your pet. This request typically is not legally binding, so the recipient could theoretically use those funds for other purposes. But it makes the point clear. It's also possible to establish a "pet trust" to hold funds dedicated specifically to animals. These trusts generally make the most sense for animals that are expensive to care for, such as horses, or if you have a particularly pampered puppy.

7. Donate your IRAs to charity

If you are planning to leave part of your estate to charity, use your traditional IRA. While charities can receive the IRA proceeds tax-free, distributions to an individual will be taxed as ordinary income at rates as high as 37%. And that's on top of any estate tax that might be due. Ultimately, an individual who receives IRA assets may receive less than 50 cents on the dollar, while a charity will receive the entire amount.

Leaving your entire IRA to charity can also largely remove those assets from the estate administration process, which can become especially cumbersome when IRA proceeds are funneled through an estate or revocable trust.

8. Be smart about what and when to give

Gifting is great. It can have significant tax benefits if your estate is subject to estate tax when you die. More importantly, it can have a meaningful impact on the lives of your beneficiaries, and it allows you to see how your gifts are being used.

But gifting can also have a downside. From a tax perspective, a lifetime gift sacrifices the "step-up" of income tax basis at death. If your estate isn't subject to estate tax when you die, this can be a big tax mistake. Beneficiaries who receive appreciated property during your lifetime will have to pay capital gains taxes when they sell that property. But capital gains taxes disappear if you pass along the property upon death.

If you have concerns about how a gift is used, irrevocable trusts can be very useful. They specify the purpose of your gift and establish parameters for how and when it should be used.

KEVIN DUNCAN
DIRECTOR OF ESTATE ADMINISTRATION

How can 'hyper-coordination' help me manage my wealth?

When financial advisors work in lockstep with one another, great things can happen

To achieve the best and most tax-efficient outcome for your wealth, seamless coordination between planning and execution is required. At Fiduciary Trust, we focus on all three elements of efficient wealth management: planning, trust and estate services and investment management. We bring these three disciplines together in an approach we call 'hyper-coordination' to provide you with our best thinking.

Here's how our integrated teams aim for the best outcomes, as explained by Gerry Joyce, National Head of Trusts and Estates, and Carin Pai, Head of Portfolio Management.

Q: Why is hyper-coordination across disciplines so important?

GERRY: When setting up a trust, it's critical for the investment strategies, administrative process and your big-picture financial plan to fall into alignment. And it is just as important at every transition point in the trust's life, such as a change in your family's situation; whether it is personal, financial, or both. These events generally prompt a review of your family's wealth plan.

For example, we often see scenarios such as divorces, employment changes or even a child starting college trigger the need for more income, or reduce a person's tolerance for risk. Portfolio adjustments—including your asset allocation strategy and the selection of individual investments—are almost always necessary to make sure your investment plan is keeping up with your family's needs.

CARIN: One example of hyper-coordination, which happens on a regular basis, is how we use your desire to make gifts to drive discussions about your portfolio. When grandparents create trusts for their grandchildren, for instance, funding these trusts requires the guidance of a portfolio manager.

We help these grandparents find the best method for making contributions, whether it involves liquidating assets to make a gift of cash or gifting securities directly. We consider which assets are most appropriate to give away, depending on your tax situation, and how your gift will affect your remaining portfolio.

GERRY: Terminating a trust is also a great example of a time when we help clients reevaluate their investment strategies because a substantial amount of assets usually changes hands. When there's a change in control, we help make sure the investment plan is aligned with those changes. If a trust terminates due to the death of a grantor, there's usually an immediate need for cash to pay expenses like funeral costs and taxes. We also have

conversations with beneficiaries, bringing in our investment and trust experts, to help them understand their investment goals.

CARIN: In most cases, the investment plan we develop for trust beneficiaries is not the same as it was for the trust or the grantor. We seek input from our investment management, trust and planning professionals to determine which assets should be used for the distribution and identify the most efficient way to make that distribution, whether it involves liquidating the trust or distributing assets in kind.

Q: How do you resolve the tensions that often arise among beneficiaries?

GERRY: In any trust administration process, conflicts can arise. Sometimes they involve current beneficiaries and remaindermen (future beneficiaries), and sometimes they arise among current beneficiaries who are concerned about being treated fairly and equally.

We help resolve conflicts between current beneficiaries and remaindermen by using our strategic asset allocation strategies to help bridge the gap. Together, a trust professional and a portfolio manager can show each beneficiary how their interests are being served within the dynamic interaction of investment and distribution strategies. That helps relieve the tension by showing how the trust is supporting all beneficiaries as a group.

CARIN: It also helps to manage trusts in a tax-efficient manner. We make sure everyone understands the terms and provisions of the trust agreements and we make sure all distribution decisions and investment strategies consider the tax treatment of trust income. Is the trust exempt from transfer taxes? Who pays taxes on capital gains? How do distributions shift the tax liabilities of the trust? Answering these questions helps us build an effective investment strategy and overall plan for managing and administering the trusts.

For example, if I have a situation where I need to raise money, the first thing I do is consult with a trust officer to see which trust has the longest life and which one we should tap into first, versus which one we should leave alone because it's most protected from estate tax.

GERRY: As fiduciaries, we must apply the prudent investor rule, consider taxes, maintain our duty of impartiality and uphold the intentions and directives of what are often very complex trust documents. So, it's critical for our trust officers and investment professionals to get together, clearly understand the requirements and recognize all the options that are available to build the most appropriate investment program.

CARIN: The key is that our teams offer their best thinking by combining the expertise of our trust and investment professionals. This addresses both sides of the equation and helps us develop a comprehensive and holistic plan for managing trust assets efficiently.

Q: How has this hyper-coordination helped clients reach their goals?

GERRY: One great example is the work we do with Grantor Retained Annuity Trusts (GRATs). The IRS allows you to place assets into the trust and pass any appreciation that exceeds the IRS's "hurdle rate" to beneficiaries tax free. Since the grantor is considered the owner of the trust, he or she pays taxes on its income. In effect, paying those income taxes is an additional tax-free gift.

CARIN: The key to success with GRATs is investing in securities that appreciate in value over time, usually two years or more. That means we need to be extremely thoughtful about the investments we select, targeting those we believe have the potential for significant growth.

For example, let's assume we move shares of stock valued at $1 million from your investment account into your GRAT. If those shares appreciate by 10% over the two-year term, at the current hurdle rate of 2% (December 2019), about $132,000 would transfer to your heirs free of gift and estate taxes. Even if assets were to appreciate by just 5%, you would still pass down $50,000 as a tax-free gift.

GERRY: And a GRAT can be structured in a way that treats your original contribution as a very small gift (or not a gift at all) for tax purposes. That makes the only downside of a GRAT the cost to prepare the trust instrument and administer the trust, which together may be nominal in comparison to the potential tax savings.

GERARD F. JOYCE
NATIONAL HEAD OF TRUSTS AND ESTATES

CARIN L. PAI, CFA®
HEAD OF PORTFOLIO MANAGEMENT

Managing Your Account Online Just Got a Whole Lot Easier

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