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FOURTH QUARTER | 2022

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Current Outlook & Portfolio Strategy

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The recurring narrative in U.S. equity markets this year has been 'expect more volatility,' and the third quarter showed markets continue to read from the same script. U.S. equity markets experienced a nice rally from the market lows in June only to give back some of those gains late in the quarter. Why? Market participants are coming to terms with stubbornly high price inflation and the U.S. Federal Reserve Board's determination to dampen it through interest rate increases.

We remain confident that the U.S. economy will recover and persevere, but it may take time.

Market participants helped drive U.S. equity markets higher with expectations that the U.S. economy had already reached peak inflation and that the Fed would soon abandon its well-advertised policy to continue raising interest rates. In fact, some investors strongly believed that the Fed would soon start cutting interest rates to avoid a recession. Given that we have had a few months of declining inflation readings and positive economic reports, such views may have seemed warranted, but they may be slightly premature. The August Consumer Price Index (CPI) report showed a continued decline in headline inflation to 8.3% year-over-year, thanks largely to declining oil and fuel costs. However, the Fed is largely concerned with core inflation prices, which exclude the impacts of volatile food and energy costs. The same August report showed core CPI prices increased to 6.3% year-over-year, which broke the downward trend from prior months. This led to a sharp correction in equity markets late in the quarter and a lesson to market participants to remember the long-standing mantra: Don't fight the Fed.

Fed governors returned from their August recess and demonstrated their continued resolve to reduce inflation. During their September meeting, the Fed raised short-term interest rates again by 0.75% and continued to remark that inflation will not decline organically yet. This decision brings their target range of short-term interest rates to 3.00% – 3.25%. After the meeting, Chairman Jerome Powell reiterated the Fed's intention to continue raising interest rates based upon its assessment of monthly inflation reports and other economic data. Market participants immediately saw a greater likelihood of the Fed increasing rates too much, leading to a more severe economic downturn. Hence, the continued market volatility. A positive effect from these higher interest rates, however, is that bonds now appear more attractive than they have in years. A 1-Year U.S. Treasury Bill is yielding about 4%, which may appeal to investors seeking a short-term, risk-free investment, while a 10-Year Treasury is yielding about 3.5%. Yields this high have not been available since before the Great Financial Crisis of 2008-09.

Our outlook for the fourth quarter is to expect market volatility to continue. Investors will be monitoring the monthly economic reports (such as inflation readings and jobs growth) and quarterly company earnings reports as they seek answers to such questions as, "Will the Fed adjust its interest rate policy by ceasing rate increases?" and "Will company earnings decline as they face continued inflationary headwinds?" These data points can and do change month-to-month and quarter-to-quarter, so equity markets may fluctuate as the information is digested and acted upon. We remain confident that the U.S. economy will recover and persevere, but it may take time. For now, these volatile periods are best handled by understanding your near-term cash flow needs and ensuring those needs are met through an appropriate allocation to high-quality dividend stocks, short-term bonds, and cash. This will allow you to maintain an appropriate allocation to high-quality U.S. stocks (both growth and dividend stocks), which continue to look very attractive for patient, long-term investors.

Selling the Family Business – Putting All the Pieces Together

Hood Craddock, CPA
Director of Family Office Services

Values of all asset types have risen significantly in the past 10 years. Nowhere is this phenomenon more obvious than in the world of private company valuations and sales. With the introduction of private equity buyers into the market, combined with massive amounts of liquidity in the economy, multiples for private companies have continued to increase. In fact, more capital has been raised in the private markets than in the public markets each year for the past decade.

If you have been contemplating a sale of your family business, you should make sure each of the following factors are addressed:

Our experiences have shown that the best results come from coordinating all the professionals early in the process.

1. What is the right time for exiting the business, and how long could that take? Aside from family considerations and sale price, there are a host of other factors to consider. Many times, the company's financials may need to be "cleaned up" to enhance business value before going to the market. This could take up to two years. Once the business goes to market the timeline to closing could be another year. Following a sale, many buyers may want you to stay on in some capacity for an extra 1-5 years. Although many businesses may sell in as little as a year, you should consider a total timeline of up to eight years before you eventually exit.

2. Put your team together early in the process. A successful transaction will be enhanced by having the right players assembled including an investment banker, transaction attorney, certified public accountant, estate attorney and investment advisor. Each of these professionals has a critical part in the sale process, and their ability to work as a team is crucial. You will need a single point of contact to bring them all together. That advisor should have deep experience in helping business owners through a complex process that has many steps.

3. Obtain a value of your company, and see if it's enough to accomplish your goals. When interviewing an investment banker to sell your business, ask for an estimation of value. The right banker will be familiar with your industry and the approximate multiples being paid in today's market for your type of company. Though it's only an estimate, this will allow your financial advisor and your CPA to estimate true after-tax dollars for you and your family. The investment advisor can then approximate the earnings potential of these funds for retirement and estate planning purposes.

4. Plan for income and estate taxes prior to sale. Income taxes will take a significant bite out of your sales proceeds, and estate taxes may well do the same from what is left of the proceeds (and the rest of your assets) at your passing. To minimize the impact of these taxes your CPA, estate attorney, and investment advisor should consider certain tax deferral techniques and, for estate tax purposes, gifting of company stock prior to the receipt of any offers. Any gifting will most likely require an outside valuation firm to establish the value of the company stock prior to the sale process. Many owners miss these opportunities by not having these advisors involved in the sale process from the beginning.

Our Family Office Team at the Trust Company is fortunate to have helped many of our clients with the sale of their business. Our experiences have shown that the best results come from coordinating all the professionals early in the process. If you are considering selling your business, now or in the future, we welcome the opportunity to help you from start to finish.

The Benefits of Passing On Your Wealth Now

Jeffrey A. Muddell, CFP®
Sanibel Office President

The number is staggering to comprehend: $60 trillion. For the record, that's $60,000,000,000,000 – a 6 with 13 zeroes. That's how much money is expected to be passed down to various generations over the next 25 years in what is simply being called the Great Wealth Transfer.

Members of the Silent Generation (born between 1925 and 1945) and Baby Boomers (born between 1946 and 1964) will leave this collective amassed fortune to children, grandchildren, other heirs, and charities. But how and when they do so is a multi-trillion-dollar topic of great importance – one your family should be discussing.

Americans are living longer – life expectancy is now nearly 80, and the fastest growing demographic in our country is those aged over 100. In many cases, this also means that wealth transfer to the next generation could be significantly delayed. Only a few decades ago, adult children typically received an inheritance from their parents in their 40s or 50s when those extra funds helped pay off a mortgage, sent grandchildren to college or allowed for family vacations and other lifestyle benefits. But with longer lifespans, the next generation often receives an inheritance in their 60s and 70s, well past when it could have been of the most benefit.

For high-net-worth families, this is the time to discuss whether it makes sense to begin passing assets onto children, grandchildren, or charities before death while both you and they can witness its rewards. Also, getting assets out of your estate now and letting the future appreciation of those assets accrue to beneficiaries rather than to you, can result in sizable estate tax savings someday.

It is likely you have a long life ahead, so now is the time to consider these objectives:

- Clearly state and communicate to your family members and wealth advisors, your goals and values, as they relate to money and family. Make sure everyone is on the same page.
- Your values can be conveyed through a family meeting. Our team has facilitated dozens of these for client families and this strategy may be just right for yours, as well. The conversations can be delicate at times, but it is usually best to have them while you are still living, so your intentions are clear.
- Consider skipping a generation. Many parents are now skipping their aging adult children, and instead are creating plans to help their grandchildren and great-grandchildren get started in life.
- Create and regularly update your estate documents to reflect your choice of heirs or beneficiaries, as well as the timeframe for asset transfer.
- Help your family understand the challenges that lie ahead for you as you age. What do you expect if you fall ill or incapacitated? Do you prefer to receive care at home, a senior living community or full-skilled nursing? Answers to questions such as these will prepare them for the responsibilities and circumstances in your later years.
- Make it a point to introduce your heirs to your wealth advisors, so they know where to turn for help when needed, resulting in a more seamless and less stressful transition after passing.
- Encourage your heirs to begin their own estate and financial plans to make them better prepared to accept their future inheritance.

You are not alone! All successful families have complex dynamics across multiple generations with diverse values, views, and social circumstances. It is always the goal to create a wealth transfer strategy that does what is best for all involved.

Our team at The Trust Company can help you navigate this process and develop your wealth transfer plan. Start today by contacting our experienced team of wealth advocates and trust officers.

Family Loans as a Cash Flow and Estate Strategy

Kelly Ritrievi
Trust Services

Your neighbors - let's call them the "Conners-" own a successful restaurant supply business and are nearing retirement. Their son has worked in the business for more than 20 years and is well known among clients. But his children are in private school, and he has a home mortgage. Taking out another loan to buy the business may be burdensome. The Conners' youngest daughter, a schoolteacher, hopes to buy a townhouse in the city but cannot qualify for a loan because of her modest salary and poor credit. These scenarios could have a common solution: **The Intrafamily Loan.**

An intrafamily loan can be an ideal strategy for both borrowers and lenders alike, if structured properly. Intrafamily loans are made at the minimum interest rate allowed by the IRS for private loans – the Applicable Federal Rate (AFR) – to provide borrowers with a lower lending rate when compared to other private lenders. The current AFR of 3.14% on a long-term loan compares very favorably to the current national average of around 6% for a 30-year mortgage. With an intrafamily loan, there is no need for credit approval, and you (the lender) get to establish the payment terms for the loan.

For families like the Conners, the intrafamily loan can enable family members to meet personal goals. Parents can make a direct loan to a child or, if the request is large, a loan to a trust. Regardless of whether an individual or a trust receives the loan, diligence is required in collecting and tracking payments to ensure that the loan does not look like a gift in disguise, potentially triggering a gift tax and reducing the lender's lifetime exemption.

An intrafamily loan can be designed to fit individual circumstances. For borrowers like the Conners' son, this could mean using income from the family business to repay the loan if the rate of return from the business is greater than the interest rate on the loan. If the loan is made to a trust, the trust becomes the borrower, which relieves the individual from repayment obligations. If the trust is a grantor trust, the individual may avoid paying taxes. In the case of the Conners' daughter, her limited cash flow might necessitate setting up an interest-only loan with a final balloon payment. Or her parents could make annual exclusion gifts to her to use for repayment or to excuse the loan. In any case, there are multiple strategies for structuring an intrafamily loan to help ease the debt burden, ensure repayment, and comply with IRS guidelines.

Complying with the IRS, however, is crucial. Borrowers may be able to deduct the interest if they use the loan to make investments or buy a home or business, but can't deduct interest if the loan is used to pay off a credit card or for personal consumption. Lenders may likewise have to declare the interest income on their tax return. And if the lender charges less than the AFR rate, the IRS may deem the loan to be a gift that is subject to estate exemption limits.

Consider family dynamics before deciding to lend money. Relationships can be strained when a loan is made to one child to the exclusion of others. Parents should also be conscious of their own liquidity needs before making a loan. A defaulted loan could cause you to make budget or lifestyle changes and create other estate and income-tax consequences. So, while the transfer of money between family members can be a win-win, it is not without its pitfalls.

This is not an exhaustive account of the structure and function of intrafamily loans. Discuss your situation with your legal and tax advisors as well as with family members before deciding whether this strategy is right for you.

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