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TRUST COMPANY of NORTH CAROLINA

WEALTH MANAGEMENT
UPDATE

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The once and future living trust

The "peace of mind" strategy for wealth management

You've probably heard about living trusts, the modern marvels of estate planning. At a person's death, a trust established during life can eliminate probate delays and serve as a ready source of income for beneficiaries. Estate administration expenses may be reduced.

Most of our living trust customers value these estate-planning advantages. But they didn't set up their trust *primarily* for that reason.

Generally, our living trust customers come to us because they seek responsible, capable assistance in managing and organizing their assets. In the words made iconic by *Star Trek*, they hope to "live long and prosper." Our job is to help them do it.

Here's how our living trust service is helping them . . . and *could* help you.

Disinterested investment guidance

Take a good look at that adjective, "disinterested." You don't see it much any more. It means "free from selfish motive or bias." As trustee, we have no securities for sale nor any interest in encouraging frequent transactions. When you place cash, securities or other assets in trust with us and we develop an investment program for your trust account, our sole concern is to meet your requirements and protect your prosperity.

. . . a trust established during life can eliminate probate delays and serve as a ready source of income for beneficiaries.

A convenient way to organize your financial life

With a typical living trust, we invest the funds you place in our care, tend to all details relating to ownership of securities, maintain accurate records, collect dividends and interest, and pay the income to you. In short, we do much to save you time and worry. In addition, you can shape our services to meet your own needs in any number of ways.

Perhaps you'll want us to receive and invest your deferred compensation, or installment payments from the sale of real estate or a business. Perhaps you'll wish us to make regular income payments to another member of the family, or to a charity to which you have pledged support. Our procedures are readily adaptable to your special instructions.

Checklist of living trust benefits

- ☐ Professional asset management
- ☐ Uninterrupted family financial protection
- ☐ Probate avoidance
- ☐ Family financial privacy
- ☐ Minimizing identity theft
- ☐ Protecting aging retirees
- ☐ Serving disabled loved ones
- ☐ Asset protection in divorce

Comprehensive assistance with your financial planning

Although not a formal element of our living trust service, our financial planning assistance has proven to be much appreciated. Our aim is to help you protect your prosperity, and your family's, in every way we properly can.

To that end, your account officer will work with you, your attorney and other advisors in updating your will, reviewing your life insurance program, setting aside education funds for your children and grandchildren, or developing ways to safeguard the future of a family business.

Planning charitable gifts? Here again, a trust officer's insights may prove helpful.

If you can't act, we will

In your living trust agreement, you and your attorney may include instructions empowering us to pay out income and principal for your benefit and do whatever needs to be done, for yourself and even for your dependents, if you should be unable to act on your own because of illness or disability.

Summing up

People who have found it productive to explore the money-management benefits of a living trust include busy executives, the recently retired, young heirs and surviving spouses with investment worries, professionals and business owners who don't have time for researching securities.

The *estate administration* advantages of a trust, as mentioned earlier, are becoming well known. Discuss them with your attorney and with us. One of the most useful facets of a trust, we find, is the way it can be used to *organize* a diverse estate. Additions to a living trust may be made by will, and by making life insurance policies payable to the trust. This approach can facilitate tax-wise estate planning.

Does a living trust promote long life and prosperity? We know of no scientific studies demonstrating that proposition. But people with trusts have reduced stress, because they have greater confidence in their financial future—maybe they do live longer! Whether or not our services actually increase the *quantity* of your life, there's a good chance we can help you improve the *quality*. We will be pleased to meet with you at your earliest convenience to tell you more. ☐

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Five reasons to take advantage of our living trust service

Planning to set up a living trust? Already have a trust of the self-trusteed variety? Here are good reasons to place your trust in our care:

1. Reliability. We understand the special responsibilities of a trustee. All trust funds in our care are safeguarded by both internal and external audits.

2. Experience. Trusteeship is our business.

3. Responsiveness. Financially successful individuals and their families expect personal attention and responsive service. We deliver.

4. Objective investment guidance. Unlike investment advisors who are compensated mainly by sales commissions, we earn our reasonable trustee's fee by providing our trust clients with unbiased, personalized guidance.

5. Convenience. From bill-paying to retirement planning, we can provide or obtain just about any convenience or special service that our trust clients desire.

How low can stocks go?

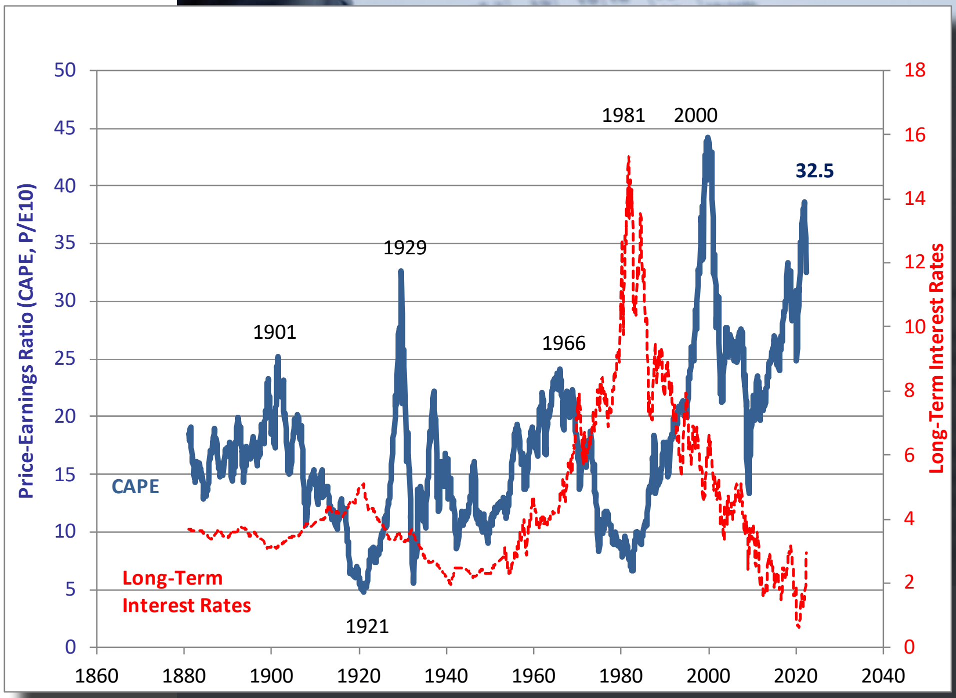
Considerable uncertainty remains about the health of the economy in 2022. The Federal Reserve has quickened the pace of interest rate increases, but the outlook for inflation remains cloudy. The consumer sentiment index created by the University of Michigan hit a record low in June. Drops in consumer sentiment have been associated with the onset of recessions.

Despite the pullback of stock prices into bear territory, equity prices remain high relative to earnings. The price to earnings ratio is a measure of what investors are willing to pay for the future stream of earnings from a share of stock. As 2022 began, investors were willing to pay quite a lot indeed.

Yale Professor Robert Shiller popularized the cyclically adjusted price to earnings ratio (CAPE ratio), which smooths the earnings data over ten-year periods. The graph below plots the CAPE ratio for the S&P 500 index over time, together with long-term interest rates. A peak of 32.56 in the CAPE ratio was reached in 1929, before the stock market crash that preceded the Great Depression. The ratio stayed below 25 throughout the prosperity of the post-War period, until 1996. It rose sharply at the end of the century, spawning the term "irrational exuberance" and topping out at 44.20 in 1999. Then came the dot-com crash.

In more recent times, the ratio reached 33.31 in 2018, responding perhaps to the corporate tax reforms enacted at the close of 2017. It fell to 24.82 in 2020 during the pandemic, before recovering to 33.74 at the start of 2021. The ratio peaked at 38.58 in November 2011, and has fallen steadily during 2022, reaching 32.51 in May (latest data available as this is written).

As the graph shows, low interest rates make bond investing relatively less attractive, while higher interest rates depress stock prices. When interest rates were very high in the 1970s, the CAPE ratio fell to low levels. Regular double-digit payouts from bonds were more enticing than the uncertainty of dividend distributions or the unknown potential for price appreciation. The historically low interest rates that prevailed until quite recently have had the opposite effect, boosting stock prices and making them quite expensive by historic measures. That suggests that as the Fed continues to raise interest rates to try to tame inflation, the attractiveness of stocks could diminish, bringing prices and the CAPE ratio down even further.



Source: http://www.econ.yale.edu/~shiller/data.htm

The answer to the headline question is that no one really knows how low stocks can go. But in uncertain times such as these, investors may benefit from professional investment counsel, such as we offer. ☐

The Fiscal 2023 "Greenbook"

Each year a "Greenbook" is prepared by the Treasury Department to explain the thinking behind the budget proposals for the next fiscal year. On the income tax side, the Biden administration hopes in 2023 to:

- restore the top tax rate of 39.6%;
- tax long-term capital gains and dividends as ordinary income for those with taxable income greater than $1 million;
- treat transfers of appreciated property by gift or at death as realization events, triggering capital gains taxes; and
- impose a new minimum tax of 20% for those with wealth of $100 million or more, to be applied to total income *and unrealized capital gains.* Such gains would only be taxed once.

Proposed changes in the estate and gift tax arena include:

GRATs. Grantor Retained Annuity Trusts would be required to have a term of at least ten years, and the minimum value for gift tax purposes would be the greater of 25% of the value of the assets or $500,000 (but not more than the value of the assets transferred). If the grantor acquired a trust asset in an exchange, gain or loss would have to be recognized for income tax purposes.

Grantor trusts. One of the useful tax benefits of a grantor trust is that the payment of the trust's income tax obligations by the grantor is not a taxable gift, even though the trust beneficiaries enjoy an economic benefit (and the grantor's taxable estate is reduced). This rule would be reversed, and such payments of income tax would be taxable gifts unless reimbursed by the trust.

Promissory notes. The administration is concerned that taxpayers may rely upon IRS-provided interest rates on promissory notes for gift tax purposes, but then look to market rates for valuing the same note after a death. A new consistency requirement would head off such strategies.

GST trusts. When the generation-skipping transfer tax was adopted, all the states had rules against perpetuities. That has changed, creating the possibility of a private trust that is shielded from the estate and gift tax for many generations, perhaps permanently in some cases. To combat such forward-looking tax planning, the proposal would limit the availability of the GST exemption.

The sunset of the Tax Cuts and Jobs Act is fast approaching. Unless Congress acts, the amount exempt from federal estate and gift tax drops roughly in half on January 1, 2026. Tens of thousands of families who need not be concerned today about federal transfer taxes could suddenly have some major new tax issues to confront. ☐