Fiduciary Perspective

FIDUCIARY™ TRUST

First Quarter 2023

2023 Market Outlook: Goodbye to All That

January 3, 2023

Every age enjoys the optimism of a new set of rules, ideas, and ways of doing things. Historically, these periods are the result of a discovery or change in societal dynamics. In the late 1800s, scientific and technological advancement accelerated societal change and ushered in the Industrial Age. Indeed, scientific advancement has been the foundational catalyst for progress over the last 150 years. The Technological Age accelerated in the 1980s and met societal change with the end of the Cold War. This period brought a considerable peace dividend and the embrace of democratic forms of government. Furthermore, productivity boomed, markets ruled, and massive wealth creation unfolded across the globe.

The economic hyper-financialization that unfolded during this period created a new order where central bankers play a dominant role. Through the administration of interest rates and the printing press, these Lords of Money have become the guardians of prosperity, the guarantors of capital, and the mitigators of risk. This alacrity to print and price money, thereby smoothing business cycles and supporting asset values at scales never seen before, facilitates risk-taking and forms of "innovation" not seen in modern times. New narratives spun by visionaries unfettered by existing rules spur new businesses, markets, securities, and supporting philosophies, culminating in an "everything bubble." Yet inevitably, old rules have the unfortunate habit of reasserting themselves like gravity, and the market/economic/societal cycle turns.

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In this Issue

Planning with the Massachusetts Millionaires Tax

Who wants to be a millionaire? Although higher household income is often something families strive for, with the passage of the Massachusetts Millionaires Tax (MMT) on November 8, 2022, having taxable income in excess of $1 million has become less attractive for 2023 and beyond. While it is estimated that only 0.6% of households will be impacted by the new tax annually, some households could find themselves subject to the tax as the result of a onetime event such as a significant Roth conversion or the sale of a home or business.

Beginning in 2023, if the taxable income on your Massachusetts income tax return is over $1 million, you will pay an additional 4% tax on the income exceeding the $1 million threshold. This is in addition to the other state tax, usually 5%, on income.

The following are a few planning ideas to potentially decrease the impact of the new tax.

Having taxable income in excess of $1 million has become less attractive for 2023 and beyond

1. Charitable Planning:

a. *Qualified Charitable Distributions (QCDs):* If you are over age 70 ½, you can gift up to $100,000 per year from your traditional IRA to a qualified charity. Done properly, the QCD amount will count towards your RMD and you will not recognize income on the amount gifted directly to the charity. For those with philanthropic goals, using a QCD can be an attractive option for lowering taxable income.

   b. *Charitable Deductions:* Beginning in 2023, Massachusetts will once again allow charitable deductions against taxable income. If you are pushing up against the MMT and charitably inclined, making charitable contributions beginning in 2023 may be attractive. Coupling that with using appreciated securities for the donation can be a double benefit by getting a full fair market charitable deduction and avoiding recognition of the embedded capital gains on the security gifted. If you will be subject to the MMT due to a onetime income event, such as a significant Roth IRA conversion or the sale of your home or company, you may wish to consider establishing a Donor-Advised Fund (DAF) and deduction bunching by gifting multiple years' worth of charitable gifts to the DAF in the current year, in order to offset your current income event. You could then request that the gifts be distributed to charities over multiple years in line with your charitable goals.

2. **Bond Investments:** If you will be subject to the MMT, changing your municipal bond strategy to be Massachusetts focused will exclude that income from Massachusetts taxable income. In addition, the interest from U.S. Treasuries is not taxable in Massachusetts.
3. **Commercial Real Estate and 1031 Exchanges:** If you are thinking of selling and replacing a commercial real estate holding, you should explore utilizing a Section 1031 exchange that allows you to exchange the properties and delay any gain recognition until the ultimate disposition of the property.
4. **Qualified Opportunity Funds:** Before January 1, 2027, capital and qualified Section 1231 gains can be deferred by investing the gain amount in a Qualified Opportunity Zone utilizing a Qualified Opportunity Fund. Under this provision, gains must be properly reinvested within 180 days of the realization event.
5. **New Hampshire Trusts:** Depending on your situation, there may be an opportunity to establish irrevocable New Hampshire trusts and avoid state income tax on ordinary income or capital gains, but not on Massachusetts-sourced income. Placing an income-producing investment or a business interest prior to a liquidity event in the trust may avoid the MMT. However, this only works if the ordinary income in a particular year is not withdrawn from the New Hampshire Trust.
6. **Is Married Filing Separately (MFS) an Option?** A couple can file their federal income taxes as Married Filing Jointly (MFJ) and file their Massachusetts income taxes as MFS. Based on the language of the constitutional amendment that is the MMT, it appears that the tax is levied on a per return, and not per household, basis. If this is not interpreted differently by the Massachusetts Department of Revenue (MA DOR), a couple may be able to have up to $2 million of income in a year taxed only at the 5% rate. This may require shifting ownership of assets between spouses to accomplish the benefit.
7. **Wealth Transfer:** If your wealth plan goals include wealth transfer to your family, you have assets you do not anticipate needing during your lifetime, and your children or trusts for their benefit will not be subject to the MMT, you may wish to consider gifting assets sooner rather than later. This may help to both remove any future appreciation from your taxable estate and avoid the MMT.

Beginning in 2023, Massachusetts will once again allow charitable deductions against taxable income

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Planning to avoid the additional tax may be time well spent

8. **Changing Domicile:** Most income will not be taxable in Massachusetts if the taxpayer is not domiciled here. For an individual, changing your domicile is not easy, but there are plenty of families that have successfully moved their domicile to Florida or New Hampshire, two states without an income or estate tax (although NH has an interest and dividend tax). It is likely that the MA DOR will continue to be aggressive in verifying that a change in domicile is legitimate, so this is not one to be undertaken lightly.

Planning to avoid the additional tax may be time well spent. It is important to consult with your tax and wealth advisors to help ensure you make the decisions in this area that best fit your individual circumstances and fulfill your objectives. ■

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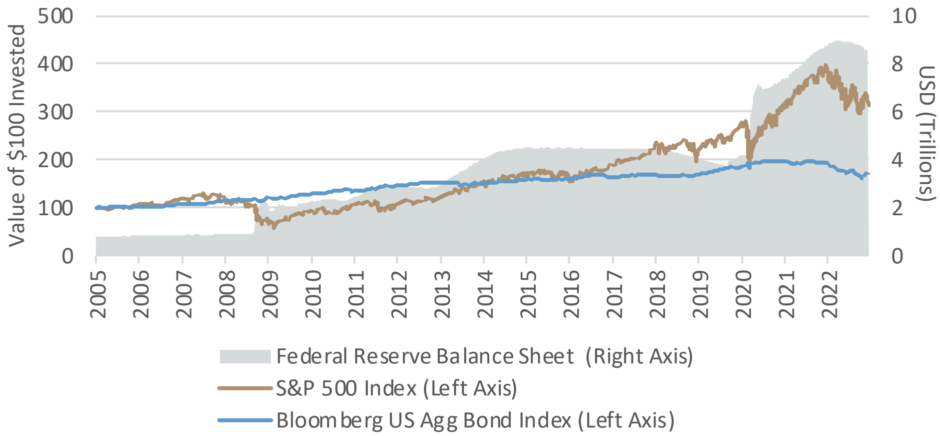
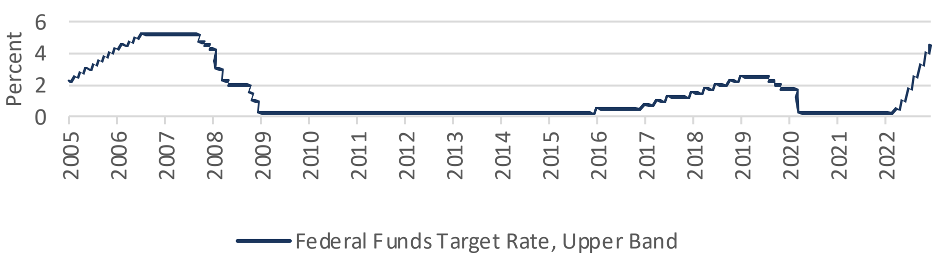
2023 Market Outlook: Goodbye to All That *(continued from page one)*

In surveying the financial and societal landscape of 2022, it is hard to overstate how the fashionable ideas of recent years have painfully collided with the reality of the old rules. Buoyed by a cost of capital so low that one needed a magnifying glass to detect it, new frontier ideas such as Modern Monetary Theory, meme stocks, Special Purpose Acquisition Companies (SPACs), China, crypto, central bank omnipotence, and high-expectation growth stocks bloomed. Easy money and easy returns fueled these confections. The synchronicity of money growth and asset inflation is hard to miss when comparing the Federal Reserve's balance sheet and administered interest rates to stock prices. (Exhibit A)

Exhibit A: Federal Reserve Policies and Asset Returns





Source: Federal Reserve, S&P Global, Macrobond, Fiduciary Trust Company. Data as of December 30, 2022.

Fashionable ideas of recent years have painfully collided with the reality of the old rules

The cycle of cheap money began unwinding in 2022. Short-term interest rates rose an eye-watering 18-fold over the course of the year.[1] While the entire term structure of money rose, the quantity of money the Federal Reserve printed since the pandemic began to shrink. Monthly balance sheet runoff from the central bank increased to roughly $100 billion a month. This shrinkage in the Fed's balance sheet will likely continue, as the oceans of liquidity injected into the economy during the pandemic were a source of the current inflation.

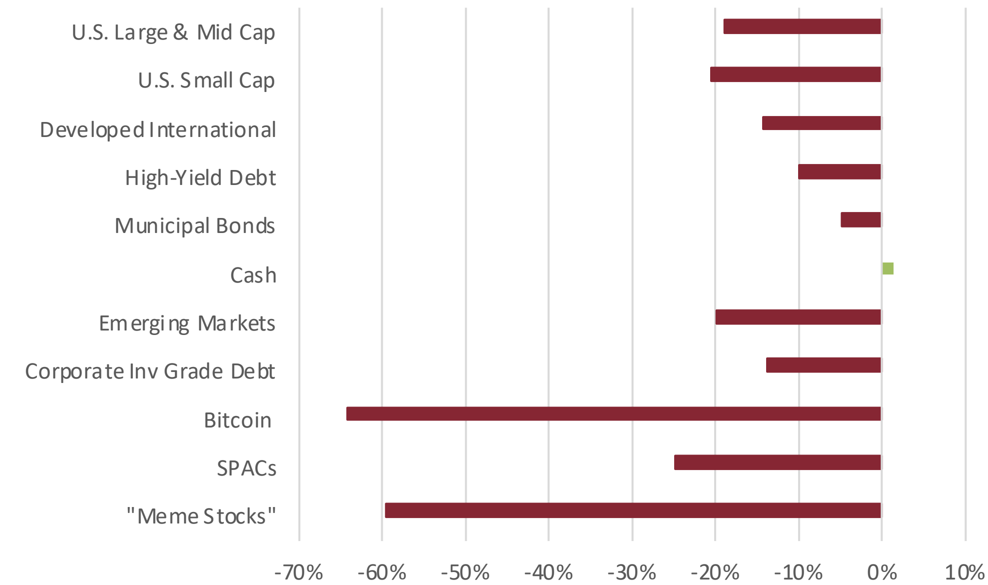
The resetting of asset prices in this new, unfolding money regime is a brutal affair. Surveying the landscape causes eyestrain as one attempts to find markets sporting gains for the year. (Exhibit B) Across markets, assets faltered, even those that conventional wisdom dictates should do well in adverse conditions. Consider the price of gold: accepted wisdom would have us believe that war and inflation are stressors that catapult gold prices higher. This "barbarous relic," the thinking

Bitcoin, the "Johnny come lately" of financial assets and the digital equivalent to gold, turned in a dreadful performance

Video:

View our market outlook webcast at:
fidtrustco.com/market-outlook
(available mid-January 2023)

Exhibit B: Total Returns by Asset Class



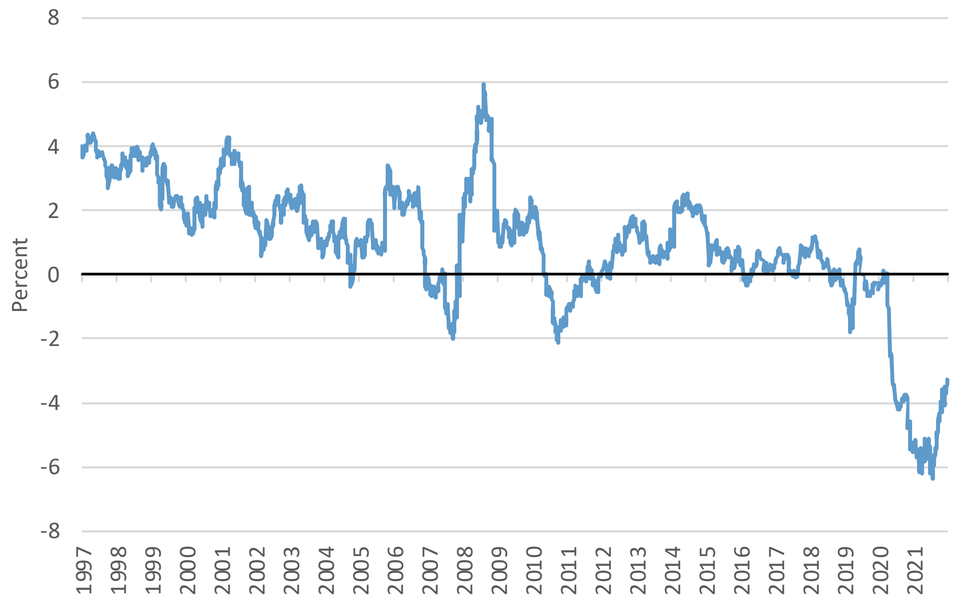
Source: Source: Bloomberg, Fiduciary Trust Company. Indices: Cash: Bloomberg Barclays 1-3M Treasury Note, High-Yield: Bloomberg Barclays US Corp HY, Corporate Debt: Bloomberg Barclays US Corporate, U.S. Large and Mid Cap: Russell 1000, U.S. Small Cap: Russell 2000, Dev. Int'l: MSCI EAFE, Emerg. Mkts: MSCI EM, Municipal Bonds: Bloomberg Quality Intermediate Muni, Bitcoin: Bitcoin / United States Dollar Cross, SPACs: The IPOX SPAC Index, MEME Stocks: Solactive Roundhill Meme Stock Index. Data as of December 30, 2022.

goes, is the bulwark against inflation and geopolitical uncertainty, both of which were abundant in 2022. Yet gold failed to follow the script, posting a 0.28% loss.[2] Bitcoin, the "Johnny come lately" of financial assets and the digital equivalent to gold, turned in a dreadful performance. Not only did it plummet 64.3%, the entire "crypto-ecosystem" was called into question as exchanges, custodial structures, and financing mechanisms appear not fit for purpose.[3] Investors have endured serial failures within the crypto architecture, some apparently fraud and theft.

Portfolio diversification failed to offer much protection in 2022. The popular 60%/40% stock-bond portfolio posted a loss of 17.3%.[4] In the United States, a fundamental repricing of financial assets is underway as the price and quantity of money normalizes, driven by inflation not seen in generations. Demonstrating this normalization is the rise in the inflation-adjusted yield on the benchmark 10-year Treasury bond. Negative for a decade, yields are rising. (Exhibit C) Investors who have been long accepting of negative interest rates are less so when inflation runs hot and central banks join the fight to arrest it. This pain process is not just a domestic phenomenon. The quantum of negatively yielding debt across the globe plummeted in 2022. (Exhibit D) Could the future new normal look like 2014?

The reset unfolding in the American equity market is driven in large part by a decline in the multiple that investors are willing to pay for profits, rather than by a large drop in profits. Multiple contraction is a traveling companion with inflation and a closer look at the relationship between the two reveals a surprising and thoroughly unsustainable state of affairs. Calculating the real earnings yield on the S&P 500 Index, essentially the same measure as Exhibit C, shows the earnings

Exhibit C: U.S. Inflation-Adjusted 10-Year Treasury Yield



Source: U.S. Department of Treasury, Bureau of Labor Statistics, Fiduciary Trust Company. Data as of December 30, 2022.

Multiple contraction is a traveling companion with inflation

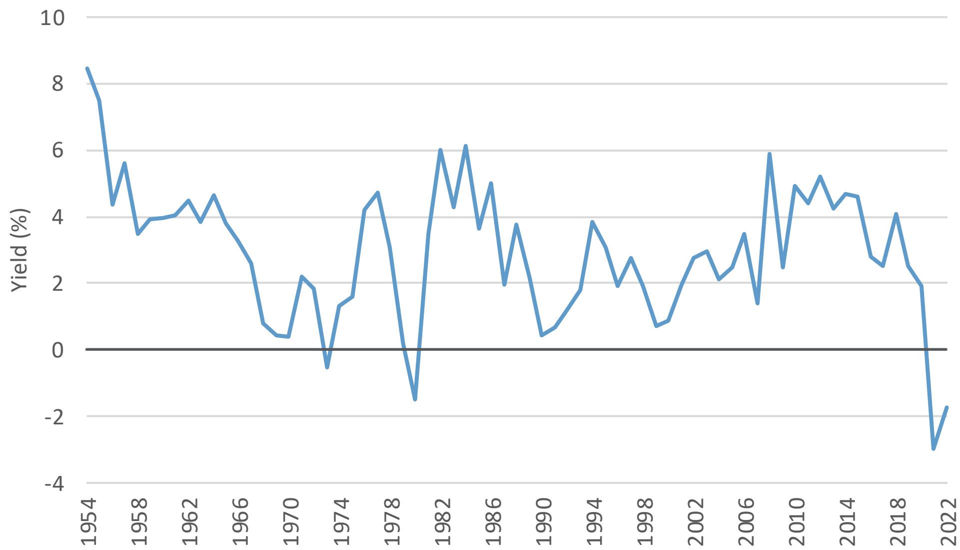
yield to be significantly negative which is exceedingly rare. (Exhibit E) Data beginning in the 1950s shows only three episodes where it appeared, two briefly in the 1970s, and now. In statistical terms, this is a three standard deviation event.[5] Considering the risks inherent in equity investing—the fact that equity investors have no senior claim on the earnings or assets of a company, they are residual

Exhibit D: Bloomberg Global Aggregate Negative-Yielding Debt

Source: Bloomberg, Fiduciary Trust Company. The Bloomberg Global Aggregate Negative Yielding Debt Index is a broad-based benchmark providing the aggregative market value of negative yielding debt across the Bloomberg database. Data as of December 30, 2022.

More often than not it's the things not mentioned in forecasts that are the most important and material

Exhibit E: S&P 500 Real Earnings Yield



Source: Bloomberg, Fiduciary Trust Company. The S&P 500 Real Earnings Yield is the Index's trailing 12-month earnings per share divided by the index's price level minus the trailing 12-month inflation rate based on the Headline CPI Index. Data as of December 30, 2022.

players in the financial order—the inability to earn an inflation-adjusted profit fails to make the investing equation balance. In short, there is too much risk and not enough return. The only way for this imbalance to correct is for inflation and p/e multiples to contract.

Perhaps the most surprising development in 2022 was not the breathtaking rise in global interest rates, a 20th-century-style war in continental Europe, or a global bear market in financial assets but the return of the long-slumbering bond vigilantes. Their reappearance occurred not in the United States but in the United Kingdom. Their stirring was the result of a shambolic policy effort from the Kingdom's shortest premiership in history. The country's government bonds and currency collapsed with stomach-turning speed. An inchoate "mini-budget," fueled by deficit spending, led to a collective "enough" from investors that quickly showed the door to the Prime Minister and her Chancellor of the Exchequer. The speed and severity of the market's response serves as a cautionary tale for policymakers in the United States to tread carefully with spending when a country is battling inflation and the decline in living standards that it induces.

The Year Ahead

Forecasting is a tricky business and invariably misses the "big" events. Predictions of a WWII-style land war in Europe; cratering currencies in Japan, the UK, and Europe; and an 18-fold increase in the policy rate in the United States were most definitely not part of the prognostications at year-end 2021, yet here we are. More often than not it's the things not mentioned in forecasts that are the most important and material. The unknown unknowns. Our crystal ball is as foggy as the next but we will try, nonetheless, to sketch out what to expect in 2023.

Inflation

Price data suggests inflation is slowing, but slowing to what remains unknown. If past is prologue, the process of working out the supply imbalances of goods and labor will take time. The labor part of the equation will be the tougher bit to resolve. As a population ages, older workers tend to be less engaged with the labor market than younger workers. An increasingly older Baby Boomer cohort is moving to a more tenuous relationship with work, therefore reducing an important source of labor. Labor-led service inflation is tougher to address than goods inflation. Since the U.S. economy is driven by services, the process of lowering inflation is likely to be messy and erratic. On the goods side, today's reshoring, restocking, and rearming trends make inflation's return to the pre-pandemic 2% level seem fanciful.

Is 4% the new 2%? Only time will tell.

Interest Rates

The eternal debate remains: "what will the Federal Reserve do?" In the short term, they will most likely raise interest rates because inflation remains too high. Market-based measures of the Federal Funds rate predict a top in the middle of 2023 of roughly 5% followed by a decline through the balance of the year.[6] This decline assumes a recession will destroy demand and eliminate jobs, forcing inflation into a state of dormancy. From our perch, this is a tidy narrative, which is a bit too easy. What if a recession fails to materialize as expected? Does this failure mean more interest-rate hikes to slow the economy and achieve the desired result? Current data fails to follow the narrative, as the economy does not show signs of slipping into recession, though a deeply inverted yield curve suggests trouble ahead.

Bond Markets

Bond prices will likely follow expectations of inflation and policy. Globally, interest rates are rising and will continue to do so well into 2023. Consequently, bond markets will struggle but not likely to the same extent as they did in 2022. Investors will watch investment-grade, high-yield bonds, and syndicated loans in order to see if any stress develops in the ability to service and refinance outstanding debt. If credit events occur, it will likely be in 2023, the result of profit impairment that accompanies a recessing economy. Default rates, which are at a low 1.6%, will likely double in 2023. Some estimates suggest default climbing as high as 5% to 10% over the next couple of years.[7]

Equity Markets

Global equities have had a rough year. It is unusual for markets to post successive years of negative returns. Indeed, the surprise in the closing weeks of 2022 has been how well European markets have held up, despite the endless ructions in the trading bloc.

Low single-digit returns led by the United States are likely to be the result. How that unfolds remains an open question. The surprise in 2023 could very well be international developed markets, not because they have sorted their respective issues, but because the companies in those markets trade with the rest of the world.

In the United States, equities will likely remain in a metronomic swing driven by perceptions and expectations of the battle to control inflation. Earnings in the U.S. will likely be lower as inflation's deleterious impact on profit margins manifests itself. If a recession does occur, we expect a peak-to-trough profit decline of roughly 20%-30%, which is consistent with a mild recession.

If the anticipated normalization of interest rates continues, the high multiple darlings of the pandemic will likely struggle while quality- and value-leaning sectors will continue to do well. Materials and energy should do well as the capital spending cycle and end demand works in their favor. High interest rates will likely bring with them a more discriminating attitude from investors, which will differentiate returns across sectors. This is welcome, as it gives more attention to the elements of good capital husbandry rather than to the siren call of story stocks that are long on narrative but short on business fundamentals.

News & Notes

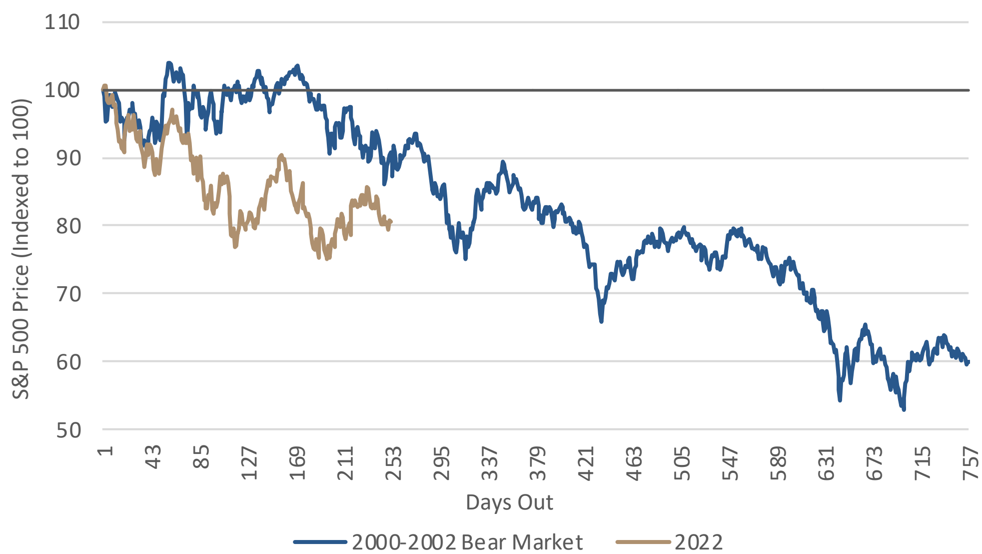
Anne Nolen joined as Chief People Officer

FTC named a finalist for five Private Asset Management Awards

Portfolio Implications

Our recommended portfolio posture ended 2022 with significantly more cash than we began the year. This additional cash came from significantly cutting our exposure to developed international and emerging market equities. We also slightly trimmed our structured credit exposure. These changes stem from our belief that the path to normalization will affect markets broadly and in waves. History demonstrates that bear markets have powerful rallies that are eventually overwhelmed by the larger downward trend. This phenomenon occurred in 2022 and we expect it to continue into 2023 as well. (Exhibit F)

Exhibit F: S&P 500 Price Change – Comparing Bear Markets



Source: Macrobond, Fiduciary Trust Company. Data as of December 30, 2022.

Looking for Opportunities

Bear markets are great opportunities for investment, whether private or public market investing. When sellers need bidders, the bidders generally win. While the valuation reset will likely continue, we are looking at opportunities in both public and private markets. Real estate valuations are falling as capitalization rates rise.[8] Similarly, if the expected rise in default rates in credit markets occurs, opportunities across the fixed income complex will materialize. Distressed credit might be a term that investors hear more of in 2023. Finally, we recently recommended adding to the natural resource space given the lack of capital invested in recent years, better capital management exhibited by the overall sector, and global structural imbalances. These are longer trends that will take time to pay off. Judging by the results of the natural resource sector in 2022, the trend is off to a profitable start.

Transitioning to What Is Next

If the epoch of the Great Moderation has ended, a new epoch has begun, one which brings with it fundamental structural changes and challenges that have been absent for 40 years. In this new epoch, a modicum of skepticism becomes an important component of investor compensation as the bar for profitable investing rises with the rise in interest rates.

Think about it as the cost of capital: the higher it goes, the higher the return on investment must be. The thematic silliness of the decade following the Great Financial Crisis seems to be drawing to a close. I hope we can say a goodbye to all that accompanied this time: billion-dollar valuation companies without revenue, crypto thingamabobs, Modern Monetary Theory, meme stocks, negative interest rates, and nosebleed stock and bond valuations. It will make for a more sustainable and profitable future.

May you and yours have a healthy, happy, and prosperous new year. ■

Exhibit G: Fiduciary Trust Asset Class Perspectives

	Asset Class	Attractiveness: Less	Attractiveness: Neutral	Attractiveness: More	Key Thoughts
Equities	U.S. Large & Mid Cap			○	Rising inflation and interest rate normalization will likely continue to fuel the rotation away from hyper-growth stocks towards higher quality, more value-oriented shares. Margin concerns have appeared and will continue as labor and material shortages persist. Market volatility and potentially significant future market drawdowns are likely as earnings estimates are revised lower. Retesting of lows is probable. The U.S. market remains the most attractive relative to other markets as interest rate normalization is further along compared to International Developed and Emerging Markets.
Equities	U.S. Small Cap			○	Profitable, high-quality small companies continue to hold attractive return possibilities. Weak market performance of small companies could change as investors reassess equity exposure in the light of higher interest rates and pivot away from hyper-growth stocks. Rising interest rates will represent a headwind that makes the sector an attractive place for active investment management.
Equities	International Developed	○			Attractive valuations and higher dividend yields give support to this market despite challenging domestic conditions. The dominant themes driving performance of Europe are the war in Ukraine, inflation, energy security, and a deteriorating fiscal position. Recession is a real possibility. Japanese equities remain, as ever, a challenge but might be the beneficiary of cheap market valuations and a reshoring of investor funds driven by a strengthening currency.
Equities	Emerging Markets	○			Emerging market returns have struggled against a backdrop of a strong dollar and rising interest rates. These markets are ideal for active management as opportunities and challenges vary significantly from market to market. Overall, modest multiple expansion could drive solid returns but these markets are sensitive to interest rate and currency changes in the United States.
Fixed Income	Municipal Bonds/ Investment Grade Corporate Debt	○			Yields on high-quality, liquid municipal bonds are generally below the inflation rate, rendering these securities less attractive in protecting purchasing power. The muni market has suffered along with the corporate market this year as yields have risen. Higher taxes remain a support for the tax-exempt market. All holdings of investment grade bonds either municipal or corporate should be kept to short durations during periods of rising interest rates.
Fixed Income	Structured Credit			○	Residential and commercial mortgages offer attractive risk-adjusted returns. Despite rising interest rates, seasoned mortgage-backed securities with low duration, significant credit support, low loan-to-values, offer an attractive opportunity for total return. This market is ideal for active management.
Fixed Income	U.S. High Yield	○			Rising interest rates, lax underwriting standards, and recession worries are forcing a repricing of high-yield bonds. Option-adjusted yields do not reflect a possible economic slowdown. This market will likely be a good candidate for investment if/when recession unfolds and yield spreads widen.
Alts	Private Assets		○		Select opportunities continue in the private asset arena. We are interested in niche opportunities where less capital is deployed. Private assets will likely be challenged in 2023 as the reset in public market valuations is reflected in private company valuations.
Cash	Cash			○	While negative real returns on cash make holding it unattractive on a longer-term basis, the war in Europe and market volatility in global markets offset the lack of inflation protection that cash provides. The overweight is tactical.

Note: These forward looking statements are as of December 31, 2022, and are based on judgements and assumptions that change over time.

[1] Federal Funds Target Rate Upper Bound from December 31, 2021 through December 31, 2022
[2] Data via Bloomberg
[3] Data via Bloomberg
[4] A generic portfolio that is constructed using 60% MSCI All Country World Index and 40% Bloomberg Barclays Aggregate Bond Index. Data via Bloomberg.
[5] Bloomberg. Fiduciary Trust Company. S&P 500 Real Earnings Yield is the Index's trailing 12-month earnings per share divided by the index's price level minus the trailing 12-month inflation rate based on the Headline CPI Index. Statistics are based on daily data from January 1, 1954 through December 27, 2022.
[6] Federal Funds via Bloomberg
[7] Defaults on U.S. Junk loans expected to climb as rate rises squeeze earnings, Financial Times, December 13, 2022
[8] Capitalization rate refers to the net income a property is expected to generate divided by the property value

A Letter From Our President & CEO

Austin V. Shapard
President & CEO

Dear Friends and Clients,

Measurement is an important component of Fiduciary's business. It is how we ensure we are on the right path, gauge progress and hold ourselves accountable. Over the course of years and decades we work with families, non-profits and other professionals to track achievement of long-term client goals. As a result, it is fundamental that each year we reflect on the Company's annual accomplishments.

Fiduciary's 137th year of operation will be measured by our distinctive client service, navigation of challenging global investment markets, transition to our hybrid operating model, and continued growth as new clients migrate to our differentiated offering.

Proactive, thoughtful, and customized service has always been Fiduciary's hallmark and this year was no different: we worked diligently during the year to exceed client expectations. While this measure of quality is hard to specifically quantify, we look to telltale signs, including our 98% average annual client-retention rate over the past decade, our next generation clients consolidating their finances with us, and strong referrals from existing clients.

More easily measurable were the challenging global stock and bond markets of 2022. Despite the broad downdraft, a majority of our client accounts had strong relative performance, outperforming benchmark returns over multiple time periods. As long-term investors, we view periods like this as opportunities to preserve capital and to prudently take advantage of market dislocations.

After two years of navigating the pandemic, 2022 was also the year that we launched ourselves into our new hybrid operating model. Leveraging the silver linings learned during the pandemic, we crafted a flexible working model that provides an attractive work/life balance for our team, includes the active mentorship of early-career professionals, and fosters collaboration across the organization.

The Company continued its string of annual growth with its second best new business year ever. The continued expansion of our New Hampshire subsidiary, along with the additions of new custody clients and comprehensive wealth management relationships, demonstrate the strength of the Company's value proposition relative to alternatives.

Most importantly, we continue to believe this is a "people business" dependent upon the identification, recruitment, and retention of great professionals. To that end, several experienced and exceptional players joined our team and we have plans to add more.

I and my colleagues are proud of the work we have done on behalf of clients during this pivotal period and we look forward to continue tracking Fiduciary's evolution and growth in the years to come.

Best,

Learn More:

For more information about Fiduciary Trust's services, please contact your Fiduciary Trust officer or Rick Tyson at tyson@fiduciary-trust.com or 617-292-6799

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