Tolleson Wealth Management

Quarter-End Snapshot

Q4 2017

FIRM UPDATE

from ***J. RICHARD JOYNER, PRESIDENT***

Even though we rang the bell to kick off 2018, I can't help but take a minute to talk about some of the amazing things that happened in 2017: massive changes to income and estate tax rules, financial markets that exceeded almost everyone's expectations and a U.S. economy that seems stubbornly committed to continued expansion. Who would have guessed this 12 months ago? 2017 was a notable year here at the firm, too:

- Executing our long-term leadership strategy, Carter Tolleson became Chief Executive Officer and I was named President, while John Tolleson became Executive Chairman – and remains very involved in the company.
- We welcomed Eric Bennett back as our Chief Investment Officer. Eric was our first CEO, left for a time to pursue non-profit goals, then returned in a different role. He's been a member of our Board of Directors and Investment Committee continuously since 1997, and will continue to add an experienced voice to our investment decision-making.
- We upgraded our financial reporting and bill payment services, and have almost completed a major improvement in our investment reporting system. Upgrades like this are designed to help our client families add clarity and context to their financial decision-making.
- The Tolleson Donor Advised Fund, created to facilitate sophisticated and sometimes complex charitable giving strategies for our client families, doubled in assets.
- In 2017, Tolleson Wealth Management was named to the Financial Times list of the 300 Top Registered Investment Advisors in the U.S., named a Top Wealth Manager by D Magazine and listed among top the 50 firms in the Registered Investment Advisors Ranking in Financial Advisor Magazine. Carter Tolleson

was also recognized as one of the 500 most influential business leaders by D CEO Magazine and I was grateful to be named one of Barron's Top 100 Independent Advisors in 2017.

We never forget, however, why we are here. This year will bring its share of financial and family challenges as well as opportunities. No one is better positioned than we are to work with you, side by side, to make your family stronger and more successful. No matter how you define success, that's our commitment and our passion, every single day.

INGREDIENTS FOR INVESTING

"Food is about making an interaction with ingredients. If you talk to them, they will always tell you a story." – Chef Jose Andres

The financial markets told us quite a story in 2017! As with any great meal, you need all the right ingredients to bring it to the table. Similarly, 2017 was a tasty and highly unique year for investors as the economic and financial climate blessed us with many favorable ingredients: low interest rates, low volatility, steady inflation, pro-business government sentiment and dramatic tax reform optimism, strong corporate earnings growth, improving job markets and synchronized global growth.

The confluence of these factors created unusually broad and strong investment returns. In fact, 2017 was the first time in history that the S&P 500 recorded positive returns in all 12 months of the calendar year. The mixture of all these "ingredients" in the same calendar year is rare, and investors were rewarded.

Like with any good meal, ingredients do not stay fresh forever. People may start to take all this good momentum for granted. Two key economic factors that could become possible headwinds are interest rates and inflation. As the U.S. Federal Reserve continues to move forward with raising the Federal Funds rate and unwinding the unprecedented bond-buying program, we wonder if – or when – this might put pressure on economic growth. If the U.S. unemployment rate remains low (4.1%), higher wages may result, causing inflation to rise. Even though inflation is a sign of a healthy economy, the financial markets historically do not respond well to unexpected inflation.

In addition to the factors above, there are two key questions on our mind: 1) are prices too optimistic today, and 2) when will the optimism around the economy end? We will not try to predict the timing of when we might see a market downturn, but we believe there lies inherent risks to this level of optimism. Thus, we manage portfolios to still provide yield and upside as our investments benefit from the fresh ingredients of 2017 while we also provide downside protection in the event of a downturn.

A key tenant of our investment approach is in designing balanced portfolios that invest in a variety of asset classes. These asset classes don't always move in the same direction at the same time, providing a smoother ride for the broader portfolio over longer time periods. Within equities, we own stocks with valuations that are lower than the market, avoiding "hot" stocks like Netflix, Facebook and Amazon, which trade at unsustainable valuations. We also own more floating rate securities and fewer traditional high yield corporate bonds than our bond benchmarks, which protects against rising interest rates and inflation. By purposefully differentiating our portfolios from the general market approach, we have designed a strategy intended to give clients more peace of mind by taking less risk to achieve their goals.

Although we are thrilled with how 2017's recipe came together to support the economy and markets, we look to identify how other ingredients – or lack of – may affect the portfolio. Just like any great chef, we constantly challenge the status quo and seek new investment opportunities to help craft a portfolio for the ever-changing market environment.

TAX

from ***AMY ARMSTRONG, MANAGING DIRECTOR OF TAX***

The Tax Cuts and Jobs Act was recently signed into law by President Trump and is effective with the 2018 tax year. While the law will simplify the tax system for numerous Americans, wealthy families' tax returns will become increasingly complex.

The most significant tax law changes impacting wealthy individuals include the decrease in maximum tax rate from 39.6% to 37% and the elimination and/or significant limitation of several itemized deductions. With the elimination of these deductions, it is unlikely taxpayers will be subject to the Alternative Minimum Tax (AMT) of 28% and, thus, may pay a higher marginal tax rate going forward.

There was also a change in methods of taxation for the following categories of income:

- A deduction is now allowed against a new category of income, the qualified business income (QBI). This is also referred to as the pass-through deduction. At most, a 20% deduction is allowed to offset business income from partnerships, s corporations or sole proprietorships. The calculation of this deduction is quite complex and numerous limitations and exclusions from this treatment exist depending on the type of income and industry generating the income. Application of this deduction will need to be determined on a taxpayer-by-taxpayer basis.
- Active trade or business losses were previously unlimited. Beginning in 2018, these losses are only allowed to offset up to $500,000 of non-business income on a married filing joint tax return
- Future net operating loss carryforwards (NOLs) will only be allowed to offset up to 80% of ordinary taxable income.

The nuances of the tax law changes are complex and impact individual taxpayers in unique ways depending on the individual's primary source of both income and deductions, with some seeing tax savings and others experiencing increases. We are currently studying each client's tax situation in order to identify opportunities for tax planning under this new evolution of tax law.

TRUSTS & ESTATES

from ***CHRISTINE FINN, SENIOR VICE PRESIDENT AND DIRECTOR OF PRIVATE TRUST***

To continue the discussion around the Tax Cuts and Jobs Act, there are several changes to the federal gift and estate tax in the Act. Beginning in 2018, the Act doubles the estate and gift tax exclusion amount from $5 million to $10 million. The $10 million amount is indexed for inflation and is expected to be approximately $11.2 million per individual, or $22.4 million per married couple, in 2018. Generation-skipping transfers should also see an increased exemption amount.

In 2026, the exclusion amount will revert back to the $5 million base, indexed for inflation. Even though the future return to 2017 amounts makes these changes temporary, individuals should review their estate plan to ensure that it will achieve the desired result during the next eight years. Individuals should also consider taking advantage of the temporary increase in the gift tax exclusion amount.

For those who wish to pass wealth to their children or grandchildren, the best plan is to make additional irrevocable gifts to one or more generation-skipping trusts. This type of gift will shift future appreciation and lock in the use of the added exclusion amount and GST exemption. This is also the time to think about additional funding of life insurance trusts and forgiveness of intra-family promissory notes. For individuals who live in high income tax states, this is an opportunity to re-evaluate grantor versus non-grantor status of current and future trusts.

TOLLESON
WEALTH MANAGEMENT

FAMILY EDUCATION & GOVERNANCE

from ***JEFF STRESE, CHIEF TALENT AND LEARNING OFFICER***

With the New Year upon us and resolutions beginning, it's the time of year when people set goals and habits for themselves and their families. It's also a great time to start talking to your children about money.

We are often asked two questions as it relates to parenting and navigating the complexities of wealth:

1. When is the best time to start talking to our children about money?
2. How do we educate them in a way that reduces the probability of entitlement and overspending?

We advise starting the conversations early and investing in fun and creative ways to teach them about financial responsibilities. Just as many of us set personal and business goals at the first of a calendar year, it is also a good time for parents to help their children do some goal-setting that reflects their family values. Financial well-being starts with values and proceeds from there.

Creating some focused time and fun exercises to emphasize the important sequence of giving, saving and then spending, paves the way for responsible money skills prior to adolescence and young adulthood – minimizing the allure of overspending, materialism and, ultimately, entitlement. Remember, children emulate what we do more than what we say. Resolve to walk the walk, talk the talk and ask others to assist in the process.

Awards & Recognition: InvestmentNews partnered with Best Companies Group, an independent research firm specializing in identifying great places to work, to compile the inaugural survey and recognition program. The list is a first of its kind for the financial advice industry. Tolleson Wealth Management was chosen as one of this year's top-50 based on employer and employee surveys delving into everything from company culture, benefits, career paths and more. Barron's Top Advisor rankings are based on data provided by over 4,000 of the nation's most productive advisors. Factors included in the rankings: assets under management, revenue produced for the firm, regulatory record, quality of practice and philanthropic work. The Private Asset Management Awards recognize and reward top investment professionals, wealth advisors and other key service providers operating within the private asset management industry. Tolleson Wealth Management was named the 2018 Private Asset Management (PAM) Award for Best Multi Family Office - Overall among wealth managers with more than $2 billion in assets under management. The judging process, using an independent panel made up of industry experts, is based on a mixture of qualitative and quantitative performance indicators. They are based on data provided by over 4,000 of the nation's most productive advisors. Factors included in the rankings: assets under management, revenue produced for the firm, regulatory record, quality of practice and philanthropic work. To learn more about rewards and recognitions, please click here.