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Wealth Planning Update

2021 Outlook for Business Owners

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Key takeaways:

- Thoughtful perspective coupled with an informed approach can provide a foundation for ownership decisions, and a great way to start 2021.
- Whether your business prospered through the pandemic, or is rebounding, protecting and capitalizing on your value typically is a top priority.
- Considering the balance between opportunity and risk, the economy, strong values, and gift planning are all important considerations

What this may mean for you:

- No matter what your role is in your business, there are key steps you can take to move forward with a plan for 2021 and beyond that takes into account your ownership and wealth goals.

A New Year, a new outlook. At least that's the promise of a new calendar. As we learned early last year, predictions are unreliable, but thoughtful perspective coupled with an informed approach are a foundation for ownership decisions, and a great way to start 2021.

As you think of the year ahead, first consider your objectives – for you, your business, and your personal financial position. These priorities are at the nexus of your business ownership decisions, and can shape your expectations regarding what may be your most valuable asset, your business enterprise. As a founder, shareholder, partner, spouse, potential heir, or family member, our goal for you here is simple: clarity and confidence to move forward with a plan for this year and beyond, that takes into account your ownership and wealth goals.

The pivot points

Whether your business prospered though the pandemic, or is rebounding now, protecting and capitalizing on your value typically is a top priority. Our 2021 Outlook provides observations in four key areas to factor into your ownership review:

- Business ownership risk/reward considerations post pandemic
- Economic expectations for recovery and reality
- Factors impacting markets and valuation
- Wealth Transfer action items given potential shifts in policy

Balance for the future

Business ownership success often relies on finding the optimal balance between opportunity and risk. This past year has had plenty of both. A pandemic changes everything, such as customer demand and buying patterns, pricing and cost decisions, talent and staffing, and more. Dramatic shifts in these fundamentals reveal some of the risks associated with ownership that are always present, sometimes even palpable, but difficult to measure.

An example of one of the economic impacts to the owner is the equity that they have at risk: all those hard-earned, reinvested profits may now support a great team, a new facility, and advanced technology, but is, perhaps, under-performing. That equity investment has been "stress-tested" and hopefully is rebounding. But how has that equity investment performed for you as a shareholder? What about the uncertainties relative to performance of that investment over the next few years?

Given this heightened risk awareness, many owners may reassess the reward of ownership by asking a simple question: What do I want my business ownership to do for me and those I care most about?

We advise making a list of objectives. Common objectives include: Income to support my lifestyle and fund retirement, financial security for my family, rewards for loyal employees, and benefits to my community. The next step is to ask yourself when you want to realize these outcomes, and what have you done to ensure you achieve them? Before 2021 gets too busy, asking these simple, powerful questions and sketching out a plan can help ensure you are prepared for this year's opportunities as they emerge.

The economy turns up

While 2020 is now behind us, the issues that made the year so challenging likely will continue to cast a shadow into 2021. The roll-out of COVID-19 vaccines should help slowly free the economy from the fear-induced slowdown. Wall Street's well-capitalized companies are already looking at a post-COVID world, while much of Main Street is struggling to survive and overcome the pandemic's economic costs.

Wells Fargo Investment Institute (WFII) expects the global economy may emerge from the COVID shadow in an uneven manner. In the U.S., an aggressive Federal Reserve combined with additional Federal stimulus should help create an environment for a sound economic recovery across Main Street, with the intended result being U.S. GDP growth by the end of 2021. We feel that employment conditions should continue to improve as COVID restrictions ease, with the unemployment rate projected to decline to 6.5% according to WFII. Globally, WFII anticipates the Chinese economy to rebound while Eurozone economies will be slower to return to growth.

[1] Source: **www.IRS.gov**
[2] Source: Mergermarket article "US Private Equity 3Q20 Data" October 2020

WFII's target for economic growth in 2021 is optimistic yet there are several risks that could reduce their year-end expectations. The pandemic has adversely impacted the global economy and while the creation of vaccines brings optimism, the manufacturing and distribution of billions of doses is fraught with both logistical and moral challenges.

The longer the virus circulates around the U.S. and the world, WFII believes that there is a greater chance for long-term economic damage. Additionally, the election uncertainty of 2020 will continue into 2021. New leaders in Washington, DC may have new ideas and new agendas but will face not only the pandemic but also political, financial, and global challenges. For more details on WFII's Outlook for 2021, see "Forging a Path Forward" report.

Valuations hold strong

Buoyed by Wall Street's optimism, the Mergers and Acquisition market showed resiliency through 2020. While the first half was unsurprisingly dormant, the transaction backlog eased heading into Q3, led by a 31% increase in middle-market private equity acquisition activity.[2]

While still not back to pre-COVID levels, activity has continued to accelerate in 2021, and we expect the market to remain attractive market for business owners considering an exit. Key influencing factors include the strong rebound in the equity markets, the low interest-rate environment, and a significant amount of liquidity available for investment.

Who may benefit from this market uptick?

- Sectors that have seen rapid consolidation should benefit from market trends, with bellwether transactions potentially garnering premium valuations.
- Strong valuations are likely to be seen for businesses that have a track record of past performance that help accelerate acquirers' consolidation strategies by providing exposure to new geographies, markets, and customer segments.
- Acquirers may be interested in niche, specialty businesses that provide proprietary, scalable products and services. On the other hand, acquirers will likely pay less attention to businesses without a well-defined investment thesis and transaction rationale, although many such firms have still been able to realize successful exits.

What is important to keep in mind is that each investor has unique goals and objectives and approaches the M&A process differently. M&A investors have adapted to the new normal and appear to be ready to do deals, but acquirers may be circumspect when evaluating projections that are based on the company's performance during the pandemic.

For businesses that performed well through COVID, investors may be assessing whether the performance is a one-time occurrence or if there has been a permanent change in consumer behavior. Businesses that have been negatively impacted may have to demonstrate a clear and sustainable recovery plan in order to attract M&A investor interest.

[1] Source: **www.IRS.gov**
[2] Source: Mergermarket article "US Private Equity 3Q20 Data" October 2020

Planning your gifts

Before making any ownership decisions, you should formulate a wealth plan to capture the financial rewards you worked so hard to produce. A perennial business-owner challenge centers on the question of "how much to gift now?" Currently, the individual estate gift exemption is $11.7 million, but the exemption will revert to $5 million (adjusted for inflation) in 2025.[1] Taking advantage of this exemption has two primary implications:

- The first - the headline - is most often the appreciation factor: gift assets that you believe have the potential to substantially grow in value such that the gain is outside of your taxable estate. This strategy gets significant attention, and the benefit could be significant in a recovering economy where valuations are rising.
- The second implication - the subtitle - is equally important: if you can afford to do so, using as much of the exemption now should be a consideration. Maximizing the existing highest estate tax exemption in history can be a wise strategy in many situations and yet often business owners are hesitant to utilize the full exemption. Why? Common concerns are loss of control and access to the assets or cash flow from the assets.

A popular solution to concerns about loss of access to assets or cash flow is a SLAT (Spousal Lifetime Access Trust). The donor can indirectly benefit from the gift through association with the spouse. Employing this strategy, along with others, may allow a business owner to leverage the exemption during a wealth transfer window that may not be open for long.

Effective wealth strategies are supported by attention to detail, two of which are often overlooked: Trust Protectors and Plan Maintenance. When establishing irrevocable trusts, it is a best practice to appoint a Protector in addition to a Trustee. The Protector has the authority to make changes to the trust without the interference and cost of involving the courts. In addition, these trusts, like other assets you own (such as your home, vehicles or personal property), and their operating documents should be maintained on a regular basis.

Business owners often get distracted once these instruments are established, yet periodic review is essential to performance and long-term achievement of your goals. Situations change, and these assets must keep pace to provide the protection and performance you expect. In an age of pandemic and ongoing uncertainty, attention to these tactical details can be the thin margin between smooth transitions and costly chaos.

Moving forward with confidence

This time of year is primed for reflection, looking forward, surveying the opportunities, and making an action plan. We hope these insights provide you with the impetus to set a course for achieving your ownership goals in 2021. If you would like further details, please contact your Wells Fargo relationship manager.

[1] Source: **www.IRS.gov**
[2] Source: Mergermarket article "US Private Equity 3Q20 Data" October 2020

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