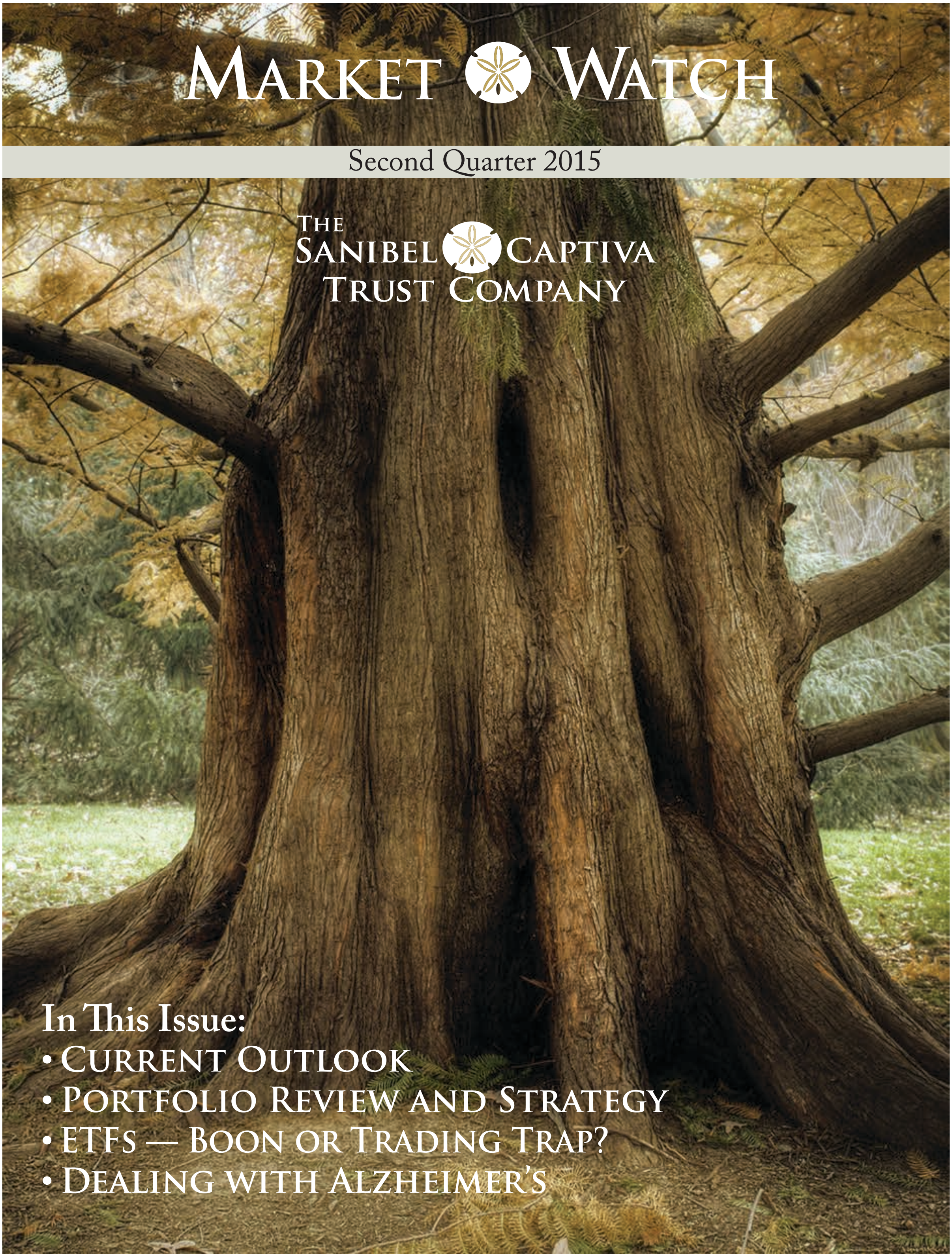
Market Watch

Second Quarter 2015

The Sanibel Captiva Trust Company



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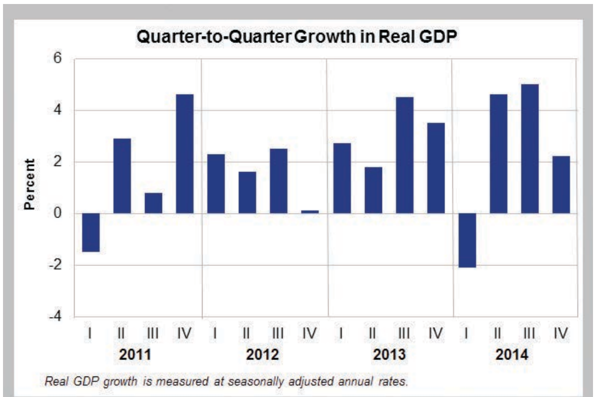
CURRENT OUTLOOK

Is this déjà vu all over again? As spring arrives we seem to be experiencing another economic growth swoon similar to a year ago. Not only have weather and the depressed energy patch created a softer outlook for Gross Domestic Product (GDP), but the rapid rise in the value of the dollar verses other world currencies has put pressure on sales and profit growth of all multi-national and export-related companies. After two quarters of 5% annualized GDP growth in the middle of 2014, the first quarter of 2015 likely experienced growth closer to 1%. Despite the expectation that consumers would use their savings at the gas pump to buy discretionary items, the reality, so far as we have seen, is that savings rates have increased. Initial expectations for 5%-10% profit growth in 2015 have become much more tenuous as currency translation losses hit corporate America's bottom line.

Defying the incessant drumbeat from prognosticators that interest rates are bound to go up in the next year, the Federal Reserve Board continues to confound the consensus and has avoided a rate hike for a ninth year. Other "data dependent" central bankers around the world continue to expand money supply, "pushing on a string" hoping for better economic growth. So-called quantitative easing has ended in the United States but is continuing in Japan and just beginning in the Euro-Zone, China, and India. As long as capital is free to move about the globe without the fear of old-time capital controls, it is hard to see how interest rates will do anything but stay historically low.



U.S. Bureau of Economic Analysis

We continue to expect the equity market to show encouraging, though sometimes volatile results over the coming months. This is despite the occasionally unnerving headlines, including Greece, Russia and Ukraine (and also ISIS, Syria, Iraq, and oil prices). Both the Euro-zone debt crisis and fears of a Chinese economic hard landing have receded, but growth there remains slow.

Many of the domestic fiscal and monetary issues that were vexing markets two years ago have been constructively resolved. These include the Federal budget debates as well as initial actions of Federal Reserve Chair Janet Yellen. We also note the recent Congressional elections, but at present do not think much has changed regarding the makeup of our political scene. Perhaps we can look forward to some compromises on issues, but we foresee nothing that materially changes the political outlook we had prior to the casting of ballots.

We still expect that we could be pleasantly surprised by the improvement in equity prices in 2015 given their relatively low valuations compared to fixed-income alternatives. As always, we are being careful but not fearful. Despite the first quarter soft spot, we remain comfortable with our 2015-16 outlook for moderate economic and profit growth as well as for relatively low inflation and interest rates – both here and abroad. Generally, that's a prescription for stable-to-rising demand for equities.

ETFs – BOON OR TRADING TRAP?

The 40th anniversary of the launch of the first index fund passed recently, and we noted with irony that the leading proponent of indexing – Vanguard's founder John Bogle – seized the opportunity to chastise an industry that took indexing to a marketing extreme. "My idea in creating that original index fund was the essence of simplicity: Buy the stocks representing the lion's share of the U.S. stock market, weigh them by their market capitalizations, (and) hold them forever," Bogle wrote in March.

But that's not what happened. Wall Street affixed on Bogle's brainchild, and index funds proliferated (they now account for 32% of all equity mutual fund assets). Their popularity eventually gave rise in 1993 to the Exchange Traded Fund (ETF), pooled baskets of stocks linked to indexes that can be traded minute by minute – unlike mutual funds that post their values once a day. More than 1,700 ETFs now list on U.S. exchanges, giving investors a chance to buy their favorite baskets of stocks (representing more than 1,000 distinct indexes) and to reap excess portfolio returns from adroit buying and selling. In one of the most disturbing financial trends of the past decade, investors have moved nearly $2 trillion in common stocks out of their portfolios and replaced them with ETFs.

Count us among the continued skeptics. The more the ETF industry proliferates, the less incremental value these products offer investors, and the more harm they seem to be bringing to sensible investing strategies – not to mention that investors who use ETFs perform worse than those who don't. In a word, individual ETFs have largely replaced individual stocks as "products" that are created, packaged, and sold by legions of brokers who promote them for rapid-fire timing of sectors and indexes.

The chart on this page is most telling. The largest, most-popular ETFs today sport turnover rates far in excess of 1,000%, meaning their shares are held by investors, on average, just days. Indeed, investors who ostensibly try to capture market-beating returns in oil, emerging markets, small-cap companies, Asian stocks, or in technology quickly become enticed into ruinous trading behavior. As an example, shares of the largest companies within the S&P 500 are being held an average of nine months (see table). Yet the shares of the S&P500 SPDR ETF, which allow investors to own little bits of all 500 index stocks, turn over every 8 days, according to recent trading data. Which group of investors would outperform over the long-term; the group buying and holding the S&P leaders, or the group trading that same package of leaders every 8 days?

We have always espoused a back-to-basics, "take-control" approach to investing. Since ETFs were not packaged with our clients' unique interests in mind, our use of them in accounts has been sparing. We strive instead to own strong, growing companies that we know intimately, and let the companies' growth increase portfolio value over time at rates that can satisfy your financial goals. With ETFs, or baskets of stocks, you have given up all control of risks, the purchase price, the sale price, security selection, and ultimately your returns.

TURNOVER RATE OF THE LARGEST ETFs AND STOCKS

ticker	description	avg. vol. (mil.)	avg. holding period (days)
SPY	S&P500 SPDR	125.2	8
EEM	Emerging Markets Index	52.1	16
GDX	Gold mining stocks index	48.6	8
VXX	VIX volatility futures	45.9	1
UWTI	Crude Oil Futures --3X Long	45.5	6
XLF	Financial Sector index	34.2	23
USO	Crude Oil Futures	33.2	4
EWJ	Japan stock index	31.9	37
IWM	Russell 2000 index	30.7	7
UGAZ	Natural gas futures -- 3X Long	30.7	6
QQQ	Nasdaq 100 index	27.0	13
FXI	FTSE China index	15.5	9
AAPL	Apple Computer	57.9	100
MSFT	Microsoft	38.1	217
GE	General Electric	37.4	270
WFC	Wells Fargo	16.4	313
XOM	Exxon Mobil	15.1	278
WMT	Wal-Mart	7.0	455
DIS	Walt Disney	6.7	250

DEALING WITH ALZHEIMER'S

More than 5 million Americans, age 65 and older, have Alzheimer's disease; a progressive and irreversible brain disorder that destroys memory and other cognitive skills. The time from diagnosis to death in Alzheimer's patients can vary – from as little as three years if diagnosed at age 80 and above, to as much as 10 years or more for those diagnosed in their 60's. Early warning signs to look for are poor judgment, unusual behavior, difficulty remembering things, withdrawal from social activities, mood changes, and disorientation.

Financial, legal and medical experts all encourage those who have been recently diagnosed with Alzheimer's disease to update their estate documents as soon as possible. Complications from the disease will gradually affect a person's ability to participate meaningfully in the decision-making process, making early estate and financial planning even more important.

Advance directives for financial and estate planning must be created while the person still has legal capacity, and everyone should move quickly to update or prepare some or all of these financial and estate documents:

- *A Will, to provide for distribution of assets upon death*
- *A Durable Power of Attorney for finances, to help avoid future court actions*
- *A Living Trust, to hold title to property and assets for the beneficiaries*

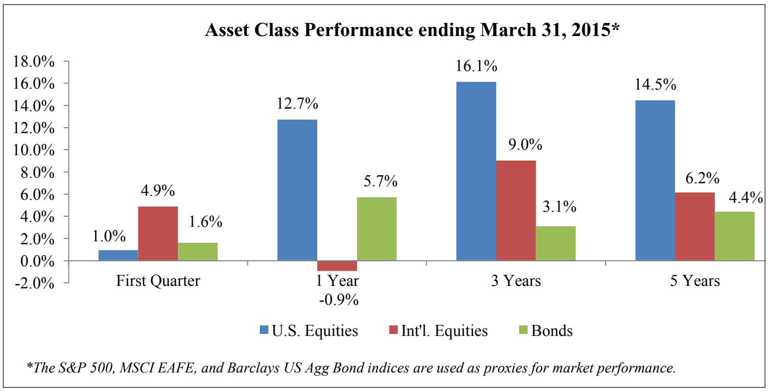
Advance directives for financial and estate planning must be created while the person still has legal capacity, and everyone should move quickly to update or prepare some or all of these financial and estate documents: a will, to provide for distribution of assets upon death; a durable power of attorney for finances, to help avoid future court actions, and; a living trust, to hold title to property and assets for the beneficiaries once a person can no longer manage his or her own affairs. There are also advance directives for health care, including such documents as: a living will, to record a person's wishes for medical treatment near the end of life; a durable power of attorney for health care, to designate a person to make health care decisions, and; a "do not resuscitate" (or DNR) order, instructing health care professionals not to perform CPR if the heart or breathing stops. Access to private medical information is closely regulated by the federal Health Insurance Portability and Accountability Act, so a person must clearly state in writing who is authorized to see or read their personal medical records.

Paying for care is also a big concern as Alzheimer's disease progresses, and involves ongoing financial planning and consultations with your advisors. Common-care costs can include continuing medical treatment and doctor visits, medical equipment, home safety modifications, prescription drugs, and eventually in-home care services or full-time residential care services outside the home. Many of these costs are not covered by Medicare. The average cost of caring for an earlier-stage patient at home is $56,800 per year, plus an average of $7,000 per year to family members who are also providing care-giving services. For late-stage patients, in-home round-the-clock health aides or assisted living facilities, combined with other ancillary costs, can easily exceed $100,000 per year.

Alzheimer's is a terrible, degenerative and fatal disease that can rob an individual of a lifetime of memories… and a lifetime of savings. With the help of financial, legal and medical professionals, having a plan in place for the future can ease some of the family's agony, stress and uncertainty.

Portfolio Review and Strategy

The beginning of 2015 has been more volatile than what we have experienced over the past several quarters. Despite the price movements, U.S. equity markets are generally trading near where they ended in 2014. Speculation about the future of energy prices and interest rates has caused much of the short-term volatility. Though we monitor broader economic data, we remain focused on the long term and the underlying fundamentals of the investments we own for our clients. Generally speaking, we view equity markets as "fairly valued," meaning we expect the majority of our equity positions to appreciate at rates commensurate with their underlying companies' business results, but without the added benefit of valuation expansion. We remain comfortable with our equity allocations across our client accounts.



The Federal Reserve Board has continued to hint toward increasing interest rates at some point this year, but has been very careful to avoid being pinned down to a particular date. We expect markets to be particularly volatile around each Fed meeting this year. Historically, equity markets will tend to trade lower immediately following an announcement of an increase in the Fed Funds rate. However, we encourage our clients to remember that rising interest rates are generally a very positive long-term sign for an economy. Considering we expect interest rates to rise eventually, we believe fixed-income (bond) investors will find themselves earning meager (and in some cases negative) real rates of return as rates slowly move higher. We have avoided traditional fixed-income investments and will continue to do so until interest rates and yields rise to an acceptable level. In the meantime, we are using our high-income strategy, which is our alternative to traditional fixed-income for many of our clients requiring current income. Our strategy focuses on securities with consistent (and growing) distributions and utilizes high-quality dividend stocks, preferred stock, REITs, and – in taxable accounts – energy master limited partnerships (MLPs).

International equity market results have been stronger than in the past several quarters. Though Europe still has a long way to go to restore GDP growth and increase inflation, stocks there have generally behaved better since Europe's own "quantitative easing" program began. From a fundamental standpoint, equity valuations remain quite attractive across the international landscape, particularly in "emerging" markets, where we continue to allocate capital for clients desiring long-term growth. Moreover, our active approach toward international investing continues to add value.

Volatility may continue through much of 2015, as the timing around interest-rate increases becomes more apparent and energy prices stabilize. However, we also believe there remains fundamental upside for markets, in general, considering that slowly rising interest rates and lower energy prices are net positives for consumers and for businesses tied to consumption.

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Dear Investors,

As the largest independent trust company serving Southwest Florida, we combine personal service with world-class investment management to create a superior client experience. The Sanibel Captiva Trust Company seeks consistently to provide our clients with experience and vision grounded in results. Preserving and building wealth are fundamental to our investment philosophy and process. We know that your portfolio should be as individual as you are. That is why each portfolio is separately managed and uniquely tailored to meet the total return and cash flow requirements for each of our clients.

On the first Thursday of every month, the Trust Company's Asset Management Committee (AMC) meets to discuss investment strategy and how current events may be affecting the securities we own in our client portfolios.

If you would like to learn more about our investment approach and/or would like to attend one of our AMC meetings, we welcome your call at (239) 472-8300.

Warm Regards,

S. Albert D. Hanser
Founder and Co-Chairman

Richard Pyle
President

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