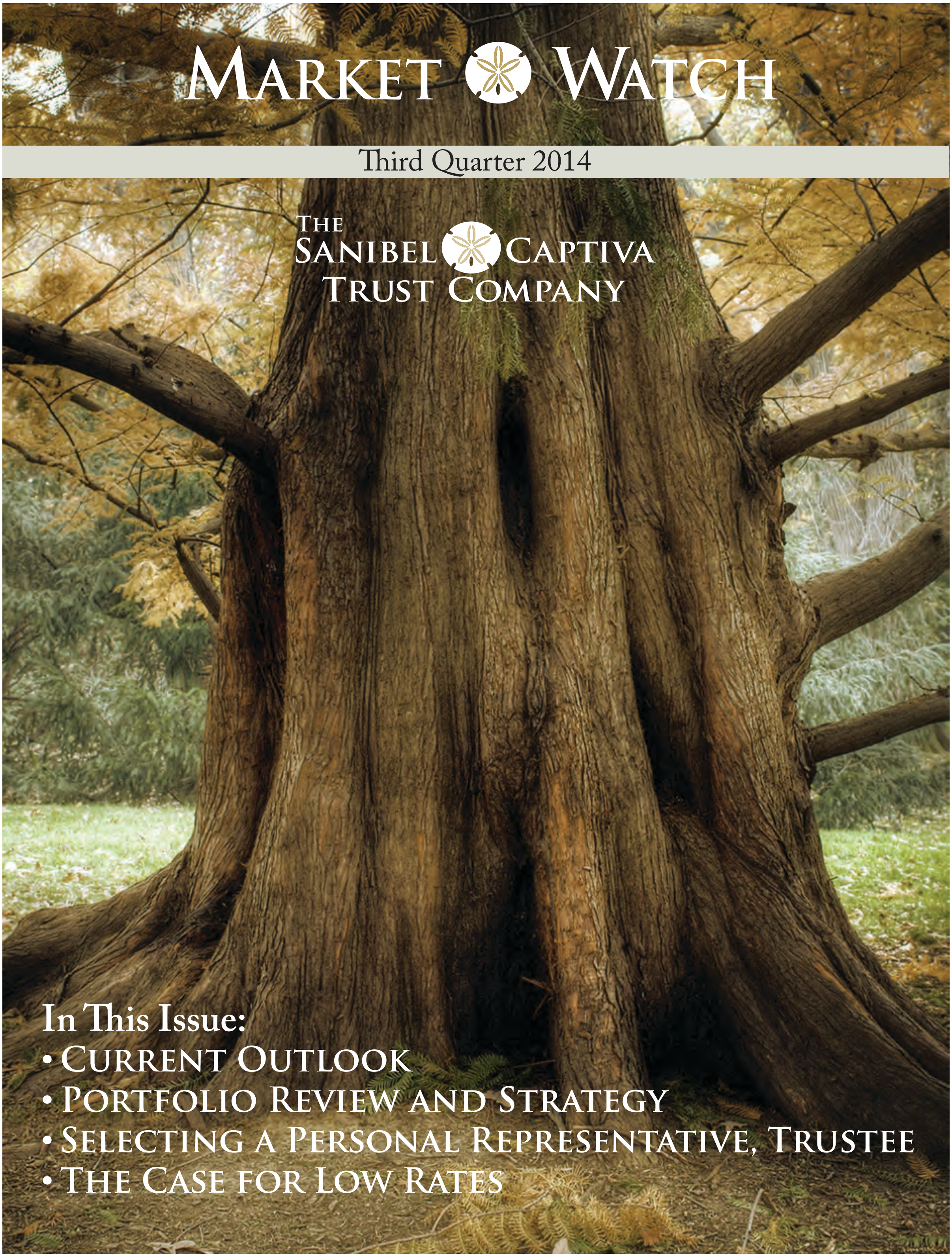

Market Watch

Third Quarter 2014

The Sanibel Captiva Trust Company

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Current Outlook

More signs that the U.S. and the world were showing overall economic improvement greeted investors as the second half of 2014 got underway. After the weather-induced decline in U.S. Gross Domestic Product (GDP) in the first quarter and a subsequent rebound in the second quarter, the outlook for the balance of 2014 suggests higher consumer and business spending.

However, the rate of growth of that spending will continue to be below historical averages due to the lingering effects of the financial crisis of 2008 and 2009. Housing and auto sales are showing improvement from unusually low levels during the "Great Recession" but are nowhere near the previous peak. Bank lending is improving but, again, remains below the absolute levels experienced in 2006-07. Employment levels have improved from 2008 lows, too, but it has taken nearly six years to return to pre-recession levels, while the population has grown more than 5% during that time. Thus, today's unemployment rate (6.3%) still far exceeds the 4.6% rate of 2007.

Similar to the environment from 1982-2000… we may be seeing a sustained period of moderate economic growth, relatively benign inflation and below-average interest rates.

Likewise we are seeing tentative signs of economic recovery in Japan and the Euro-Zone after many months of little-to-no growth. In an interesting turnaround in financial markets from the bleakest days of 2010-11, Euro-Zone countries now can borrow money at rates actually below those of the U.S. government. Easy money and a pledge by the European Central Bank to do "whatever it takes" to preserve the Euro currency has led to this stunning rebound in the European bond market. In contrast, the "BRIC" countries (Brazil, Russia, India and China), formerly the most reliable growers across the globe, face slower growth trajectories. This has prompted both the World Bank and the International Monetary Fund recently to reduce their expectations for world-wide growth to below 3% for this year and to 4% in 2015.

While the worldwide recovery from the economic shocks in the U.S. and the Euro-Zone progresses (and notwithstanding the growth slowdown for the emerging economies), corporate profits are hitting record levels. By reducing headcounts and costs, fostering improved productivity, and taking advantage of reduced raw materials and energy prices, corporations continue to boast record profit margins. Corporate balance sheets, too, are improving as companies take advantage of unusually low interest rates and relatively high equity valuations to raise capital for spending, mergers, acquisitions and share buybacks.

Similar to the environment from 1982-2000 (which included many phases of a not-too-hot, not-to-cold "Goldilocks" economy) we may be seeing a sustained period of moderate economic growth, relatively benign inflation and below-average interest rates. Both fiscal and monetary policy are likewise reverting to a more normalized regimen. Consumer balance sheets have improved as a result of higher portfolio valuations and lower debt levels. As mentioned earlier, businesses have also improved their cash flows, balance sheets and business models – all which imply stable-to-rising corporate profits for the foreseeable future. While this scenario is not meant to be as much a projection as a reasonable probability, it does foresee the potential for further valuation improvement in the equity market. But as always, we are data driven and will continue to monitor economic news going forward and make adjustments to our outlook and asset-allocation strategy as the data dictates.

Selecting a Personal Representative, Trustee

The terms "personal representative" and "executor" are interchangeable when referring to the management, administration and disbursement of estate assets. The term personal representative (or "PR") is commonly used today to replace the gender-specific terms executor (male) or executrix (female). Personal representative duties include gathering and valuing all probated property, contacting named beneficiaries, giving adequate public notice to creditors, and paying all valid claims. Before final disbursement of estate property, the personal representative must file final tax returns and pay any federal and state income and estate taxes. While estate assets are under the personal representative's control, he or she is legally responsible for any losses and can be held personally liable by the court.

Often, family members or close friends seem to be the logical choice as your personal representative because you might assume that they will perform their duties with the best interests of the family in mind and serve without compensation. You need to consider more than a caring personality and a good heart when naming a personal representative. Financial skills and the ability to make unbiased decisions are also essential, and individual personal representatives often find they need to hire professionals to help, which can eliminate any planned cost savings.

To qualify to serve as a personal representative in Florida, an individual must be either a Florida resident or, regardless of residence, a spouse, sibling, parent, child or other close relative of the decedent. An individual who is not a Florida resident and who is not closely related to the decedent cannot serve as a PR.

Sometimes a trust agreement displaces the will as the primary legal instrument that communicates the decedent's wishes for disposition of property at death. To avoid the potential expense and delays of probate, people establish revocable living trusts to hold title to their property. Trusts can also benefit families by providing a successor trustee that can manage financial affairs during incapacity. Trusts can even be a tool to address special needs and protect assets from creditors, undue influence and spendthrift concerns. At death, the trust becomes a "testamentary trust," and the successor trustee named in the original revocable trust is responsible for management of the assets as specified in the trust agreement.

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Trust companies are equipped to perform the required tasks of trust or estate administration that individuals can find so daunting. They are experienced in investing, and when dealing with the beneficiaries they are not distracted by emotional ties and can act impartially. They can serve as "co-trustee" with a family member to ensure that all duties are handled properly. Trust companies also offer perpetual service, which means there will be continuous estate administration after the death or incapacity of an individual.

The selection of a personal representative or trustee is a vital part of your estate planning. While no two plans are alike, and the considerations and complexities will vary, you can make your plan work best by ensuring that your personal representative or trustee has integrity, experience, sound judgment and your absolute trust.

The Case for Low Rates

Inflation, or deflation? Rising interest rates, or falling? Pundits continue to make the case daily for both scenarios to develop, and the answers will no doubt impact asset prices the next few years. Five phenomena, however, tell us that the likely course for interest rates is to rise modestly, but to generally stay at historically low levels.

More demand than supply – It may seem counterintuitive that bond investors would crave U.S. Treasuries yielding 0.2% - 2.5%, but there's no doubt that their continued appetite has helped push up bond prices, and push rates back down, in 2014. Exacerbating the decline in rates has been a steady improvement in the finances of the federal government, whose yearly deficits are one-half their recessionary peaks – hence, there is less supply of new Treasury bonds for yield-starved institutions to bid on.

Continued slack in the economy – The level of interest rates prevailing in an economy will, of course, correlate to the rate of inflation. Those looking for a surge of inflation from the recent flood of cheap money forget that even during the commodity boom of 2006-07, when most raw materials prices hit simultaneous peaks around the world, the Consumer Price Index (CPI) in the United States was rising at just 3% annual rates. It is unrealistic to expect 3% inflation today when commodity prices are far below 2007 peaks, wages are rising at just 1% annual rates, American industries still operate at just 78%-79% of capacity, and several million workers remain jobless.

"Beggar Thy Neighbor" export pressures – With the U.S., Japanese, and Euro-Zone economies mired in sub-par growth, central banks and policy makers have sought to grow their nations back to prosperity by emphasizing exports. Keeping currency values low relative to trading partners' currencies has been a means to that end and has incentivized central bankers to keep rates low to discourage foreign investment. We frankly see this downward pressure on currencies continuing, as China, Brazil, South Korea, and the European Central Bank all recently have sought to push down their currencies and in the process "export deflation" to their trading partners.

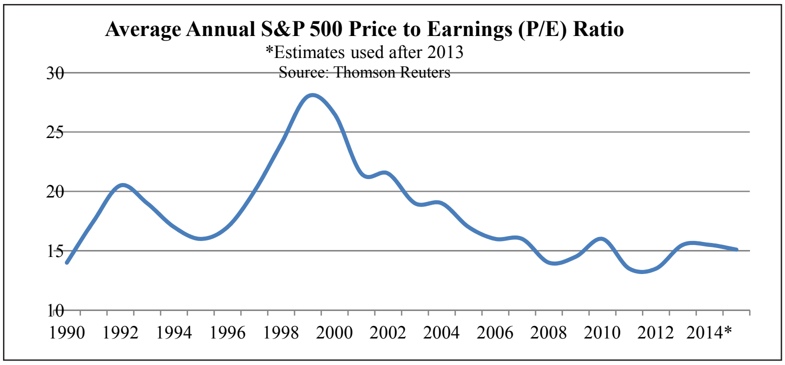
Low turnover of money – In classic economics, the size of the economy roughly equals the money supply multiplied by the turnover rate of money. Starting in 2008, the turnover rate ("velocity") plummeted, and continued to plummet into 2013 -- long after the recovery began. Simply put, all the injections of stimulus since 2008 did little to bolster consumption and investment, but were used instead by businesses, banks, and individuals to pay down debt and create large cash cushions. As long as this defensive behavior persists, economic growth will remain stalled.

Government balance sheets need more repairing -- Finally, we can't overlook the intense pressure policy makers in Washington are under to keep rates very low for the foreseeable future – whether that policy is the correct course or not. Allowing rates to rise could imperil rebounding, rate-sensitive industries such as housing, autos, and construction whose participants have levered their balance sheets to low-cost funds. More ominous, a rise in rates by just 1-2 percentage points would have huge impacts on government budgets by swelling interest costs on debt and crowding out spending on politically popular programs. Just as worrisome, rising rates would impair the face value of some $22 trillion of federal and municipal government bonds held on the balance sheets of institutions and banks around the world, causing huge mark-to-mark losses that could force these firms to contract their activities.

Portfolio Review and Strategy

Performance across most major asset classes was positive during the second quarter of 2014. Domestic and international equities continued to appreciate across various sectors and market capitalization ranges. Considering the overall equity market's appreciation – now several years in the making – it is reasonable to question valuation levels. While we focus most of our attention on the individual businesses we buy on behalf of our clients, we also consider broader market metrics to help inform our asset-allocation decisions. One way to gauge broad equity market valuation is by comparing today's price-to-earnings ratio (P/E) relative to historical averages. As the chart below reveals, though equity markets have appreciated substantially over the past several years, the upward movement in price has been justified by growth in earnings, which has kept the P/E ratio in the mid-teens.

While equity markets are no longer broadly inexpensive, they are not overvalued either compared to long-term historical averages. Rather, we view equity markets as "fairly valued." The businesses we buy are increasing their revenues and earnings and either reinvesting for further growth or distributing cash to shareholders via dividends, share buybacks, or debt retirement. We will pay more for a company with above-average growth potential, but overall we generally purchase these companies in client portfolios at valuation levels below that of the broader market. Going forward, we expect equities to appreciate at rates commensurate with their underlying business results. In other words, a reversion to long-run average rates of return seems reasonable, meaning we should expect stock market performance to average closer to 7%-9% per year, as opposed to the above-average returns we were pleased to earn over the past several years.



Fixed-income investments also moved modestly higher during the first half of the year, as interest rates held near historical lows. Our longer-term thinking regarding bonds remains unchanged, but is worth repeating. Though the timing is difficult to predict (perhaps sometime next year), it remains inevitable that interest rates will rise. It is also inevitable that *when* (not if) interest rates rise, fixed-income investments will drop in price. As rates move higher, bond prices fall so that the coupon payments and current yield stay competitive with newly issued securities. We expect fixed-income investors will find themselves earning meager (if not negative) real rates of return as this occurs. For this reason, we have largely avoided fixed-income investments and will continue to do so until interest rates rise, which will lower the inherent price risk and improve bonds' total-return characteristics. In the meantime, we continue to use high-quality dividend stocks, preferred stock, and master limited partnerships (MLPs) for many clients requiring current income.

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Vice-Chairman

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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.

Every Thursday, 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
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