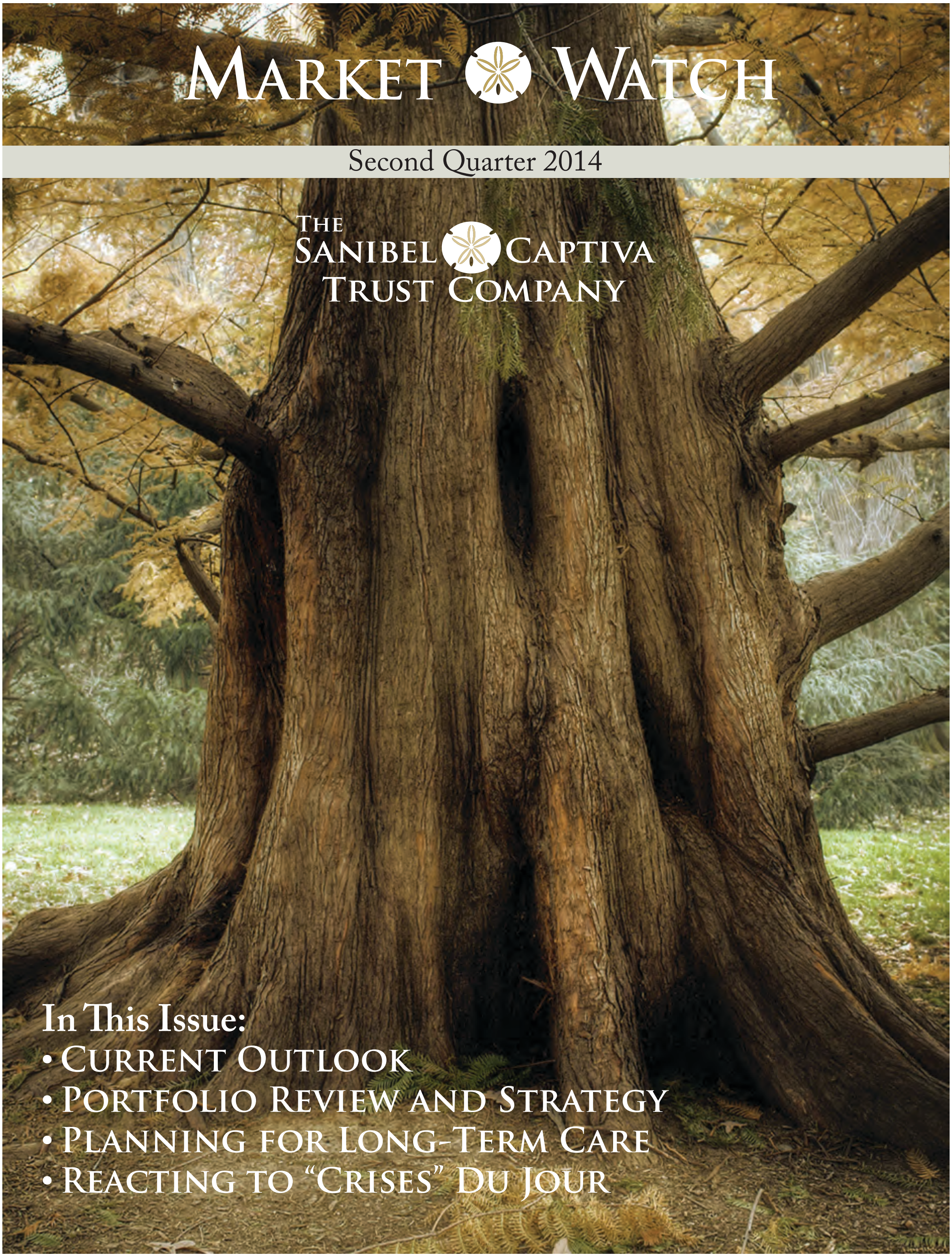

Market Watch

Second Quarter 2014

The Sanibel Captiva Trust Company

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Current Outlook

As the Federal Reserve Board continues to throttle back its unprecedented bond buying program, it raises questions regarding the economic impact of less monetary accommodation. The old adage "Don't Fight the Fed" comes into play anytime monetary policy shifts. The U.S. central bank is clearly on a path to end its purchases of Treasury and mortgage-backed securities by November of this year. The Fed also has indicated it may raise the target Federal Funds Rate (currently 0.00% - 0.25%) six months later. For worried investors, less bond buying and rising interest rates could put pressure on asset valuations.

The reason for this eventual elimination of monetary accommodation, and the expectation of a rise in short-term interest rates, is the clear evidence that the U.S. economy has finally emerged from a long period of sub-par growth and is embarking on a more sustainable growth path. Despite the fact that the financial crisis-led recession ended nearly five years ago, economic growth has been hampered by the effect of the crisis on bank lending and a contraction of fiscal stimulus. Moving forward, we expect domestic GDP growth more in line of 2.5% to 3.5% annually, rather than the 1.5% to 2.5% experience of the past four years.

At the same time, we expect more-modest economic growth in the rest of the world. With China slowing down, growth in the rest of the world will depend importantly on the strength of the rebounds in Europe and Japan. Other emerging markets besides China – such as Brazil, India and Russia – are facing their own challenges, but overall we do not see recessionary forces at work in these regions at the present time. In total, we look for world economic growth in the 3% to 4% range for both 2014 and 2015. Doubtless there will be "wars and rumors of wars" to deal with, but by and large the forces of global integration and trade will continue to favor the optimists rather than the pessimists.

We expect the equity market to continue to show encouraging, though sometimes volatile, results over the coming months despite the occasionally unnerving headlines from places such as Russia, Crimea and Ukraine. Both the Euro-Zone debt crisis and fears of a Chinese economic hard landing have receded as policy makers in both parts of the globe seem to be resolving their respective issues positively. In addition, monetary policy outside the U.S. is getting more accommodative to combat slowing growth. The housing and auto recoveries we see in the U.S. are also positive "tailwinds" for domestic economic growth that were not in the picture three years ago.

Also on a positive note, the U.S. Congress has broken through its partisanship and prevented another government shutdown by agreeing to a budget not only for fiscal 2014 ending this September but also fiscal 2015 as well. In addition, they have avoided yet another fight regarding the debt ceiling. Finally, we also know who will lead the Federal Reserve going forward – a selection we applaud.

We still expect to be pleasantly surprised by the improvement in equity valuations in 2014 and 2015 given the relatively low valuations compared to fixed-income alternatives. However, we caution investors not to expect returns in 2014 similar to last year. As always, being careful – but not fearful – is recommended. We remain comfortable with our outlook for moderate economic and profit growth in 2014-15 on a worldwide basis – which generally will set the stage for stable-to-rising equity valuations.

Planning for Long-Term Care

Among the largest threats to your financial stability and independence are the potential costs of long-term care. Since numerous studies show that more than 50% of Americans will need some type of long-term care, it is something we should all consider as part of our financial plan. There are several different ways to address this issue, and each person's individual plan should reflect their financial capacity, personal preference, and family resources.

One way you can choose to cover the costs of long term care is to "self-fund." If you plan to do this, examine your assets to determine how liquid you are, in what order you will liquidate assets, and determine if you actually have enough money to cover the costs. The costs associated with having at-home health care can easily exceed $25/hour for non-skilled care and can escalate for home health professionals.

Another way to defray the costs associated with long-term care is by purchasing insurance. Commonly, families choose traditional long-term care coverage, where they pay an annual premium – much like auto insurance. A second option is a "combination policy" that combines life insurance with a long-term care coverage rider. Many of these policies can be confusing, and the terms and features can vary widely – such as when the benefits begin, how long they last, the maximum daily payout, and which services are covered. Before you decide on insurance coverage, work with an insurance agent to determine the benefits of the various types of plans, then figure out if the cost associated with the coverage will work within your current budget. Since there are underwriting requirements for most of these plans, your age and your general level of health will drastically affect the premiums you pay.

Your family can also be a resource for assistance with long-term care needs. Often times, the healthier spouse, or even children, are able to assist with care. Even if you have those options, however, you have to ask yourself if you need additional help – and if you want to burden your spouse or children with the responsibility of caring for your needs.

You can also consider moving into a life-care retirement facility. Moving can be an emotional and stressful decision, but can oftentimes be a viable choice for long-term care. There are also tiered retirement communities and centers that can eliminate the need for any additional moves. Many have medical underwriting qualifications, so be sure to research your options as early as possible. You can progress from active retirement living, to extended care for temporary needs, to assisted living, to skilled nursing care, to dementia care and even to hospice care. There is a wide range of costs associated with various communities and centers. Try to find the one that best suits your needs and meets your budget.

Planning for long-term care can seem like a daunting task, but you can better secure your future by knowing your options, planning wisely, and taking action. Sound long-term care planning not only protects your financial stability and independence, but it may also prove to be the greatest gift you can give loved ones. Talk with your family first, as your discussions can provide the foundation for the plan you eventually craft with the advice and guidance from financial professionals.

Reacting to "Crises" Du Jour

If the past five years have taught investors anything, it's that patience and discipline matter most. On nearly one dozen occasions since 2009, investors have been induced to sell shares in a panic, often following so-called "calamitous" events that had the potential to permanently harm stock prices. As we now know, however, the Greek debt crises, the Arab Spring, civil wars in Libya and Syria, the European banking morass, the Japan earthquake, the U.S. debt showdowns, and the current Ukrainian emergency have done little to slow the sales of companies or impair their valuations.

Unfortunately, those who reacted to any – or several – of these events now live with portfolio performance below their expectations. With investors again being put on alert due to events in Crimea, we offer our prescription for countering this incessant news cycle:

Your time horizon should dictate your response – Investors who strive to be long-term oriented hurt themselves reacting to short-term events. Always try to put the news in the context of your holding period. Traders must respond to all news that may move their stocks and cause a reversal of trend – whether it's a weather event, a strike, a geopolitical occurrence, an economic data point, or a slight shift in monetary policy. You don't. Investors who desire to hold their stocks for years need to focus on issues that impact the long-term growth of the companies they hold – such as product-line development, profits margins, the strength of management, capital allocation, and competitive advantages. Don't mix your reasons for buying and selling.

The market discounts shocking news events very quickly, and moves on – After the Sept. 11, 2001 attacks, stock prices swooned for five days, losing 11.6%, but climbed back to their pre-attack highs by mid-October. When the first Gulf War began in January 1991, stock prices bottomed the day of the coalition invasion, and within six weeks had risen nearly 21%. The 2011 earthquake that damaged or destroyed 1.1 million buildings in Japan, caused a nuclear power plant meltdown, and elicited doomsday predictions from the media, prompted just a three-day sell-off on Wall Street that was fully erased within days.

Once the stock market discounts the news shock, it tends to resume the underlying trend – Events such as the Russian annexation of Crimea tend to be viewed as "sideshows to the big show," a distraction that temporarily directs traders' attention away from the more-prominent issues of the day – in this case, GDP growth, corporate earnings, and the trend of interest-rates.

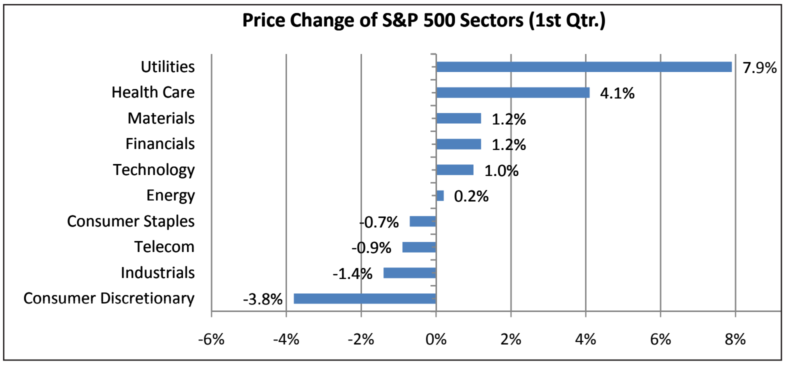
The media will certainly overhype all news events these days – Watch The Weather Channel for just a few days, and it will seem like atmospheric calamities are occurring with alarming frequency. In reality, hurricanes, tornadoes, droughts, mudslides, wildfires, and floods occur around the world just as often today as in the past, say property and casualty insurers. The difference is, these events now are televised 24/7, and the coverage feeds right into an industry that needs to induce you to trade.

You make your best profits in times of turmoil – You just don't realize it at the time. Conversely, you make your worst mistakes being enticed, for the wrong reasons, to sell your shares at cheap prices.

Portfolio Review and Strategy

U.S. equity returns modestly increased during the first quarter of 2014 following an outstanding 2013. Investors were rewarded last year with 20%+ market gains regardless of market capitalization or investment style choices. So far this year, we have seen some divergence in performance among sectors and industries, and by company size. Mid- and smaller-cap securities have performed quite well relative to their larger counterparts. Moreover, as the chart below reveals, there are discernible sector/industry differences. Last year ended with Telecom and Utilities as underperforming sectors. We took advantage of the underperformance and began to allocate dollars to some strong utility businesses trading at reasonable valuations. These companies provide stable (and in some cases growing) dividends, and are generally very well capitalized. Utilities collectively performed quite well during the first quarter.

With no notable interest rate movements during the first quarter, prices of fixed-income investments moved slightly higher. However, during her first news conference, new Federal Reserve Board Chairwoman Janet Yellen implied that the Fed may raise rates six months after it finishes its "quantitative easing" (QE) program. Those comments alone drove the 10-year Treasury price down and raised the yield 15 basis points in one day, reflecting just how sensitive fixed-income investments are to changes in interest rates.



Our longer-term thinking regarding bond investments remains the same. While the timing is unknown, it is inevitable that interest rates will rise. As rates move higher, bond prices will fall as the relative value of current coupon payments declines versus newly issued securities. We expect fixed-income investors will find themselves earning meager (if not negative) real rates of return in the meantime. 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 the total return characteristics of bonds.

International equities moved modestly lower during the first quarter. We continue to see value among international equities for investors with long time horizons – particularly in emerging markets where valuations have become quite attractive relative to their domestic counterparts.

In addition to a very strong 2013, U.S. equity markets concluded an outstanding five-year period with double-digit annualized returns. As bull markets endure over longer periods of time, the natural tendency is to believe that the next five years will look much like the previous five. While we certainly believe there is substantial upside for equity securities moving forward, it is important that we temper our expectations. For example, a reversion to long-run average rates of return seems quite plausible, meaning we should expect stock market performance to average closer to 7% to 9% per year in a healthy economy, as opposed to the above-average returns we were pleased to earn over the past several years.

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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,

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