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MARKETWATCH

Deeply Rooted in the Community | Second Quarter 2016

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Current Outlook

Richard E. Pyle, CFA
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Lower for longer. This short three-word phrase probably best describes three of the major determinants of the world's economic health in 2016 and 2017 – interest rates, the real economic growth rate, and inflation. Seven years into an economic expansion that began after the jarring financial crisis, interest rates remain, on balance, at historical lows. Real economic growth is tepid compared to the average of the post-World War II period. Pricing power is so limited that inflation fears have morphed in some regions of the world into deflation fears. Lower for longer means that these three factors will most likely continue to produce an economic reality more like the last few years rather than anything drastically different.

In our view, there are two main factors driving this conclusion. In less than 10 years various forces have combined to alter the long-term outlook for both banking and energy. These two major sectors of the world economy have seen their traditional business models implode – one by new regulations and one by a bounty of supply. Their lower growth rates, as well as those of their suppliers, have created a drag on normal activity for the entire economy. Add to this the reluctance of fiscal authorities around the world to stimulate as they have in the past and you have a prescription for slow growth, less inflation, and resultant low interest rates.

We continue to expect monetary authorities around the globe (central banks) to take a cautious approach toward reversing their accommodative policies. Even our own Federal Reserve Board appears less hawkish than they were in December when they instituted the first short-term interest rate increase in nearly 10 years. Despite the fact that progress toward their dual mandate of full employment and stable prices has been substantial, their concern about global developments has caused them to lower their expected rate increase path going forward.

We think the equity market will show encouraging, though sometimes volatile, results over the coming months. This is despite the occasionally unnerving headlines from China, Russia, ISIS, Syria, Iraq, and energy markets. Fears of a Chinese economic hard landing have re-surfaced as a result of the poorly managed plunge in their equity markets.

We also are highly attentive to the political landscape, but do not think much has changed in the makeup of Washington's decision-making process. Some compromises are possible in 2016 on minor issues, but nothing that would materially change our outlook. And, of course, we are watching the "long slog" to the November election that is in full force. As the delegate count shapes up for the leading candidates, it appears to us that divided government will be the norm for some years to come.

We think that we could be pleasantly surprised by the improvement in equity prices in 2016 given the relatively low valuations compared to fixed-income alternatives. Stabilization in both the value of the U.S. dollar and the price of oil will go far in 2016 to act as a tailwind to profit growth after their negative impacts in 2015. As always, we are being careful but not fearful. We remain comfortable in our outlook for moderate economic and profit growth as well as for relatively low inflation and interest rates. This is generally a prescription for rising demand for equities.

Strawberry Fields... Forever

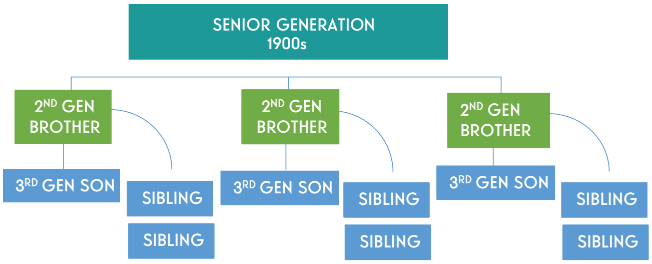
F. Hood Craddock, CPA
Director of Family Office Services, The Tampa Bay Trust Company

Learn how our Family Office Services helped three generations of farmers transfer the family business to the next generation and come to a happy conclusion. This story may resonate with your family.

A century-old agricultural business comprised of strawberry farms was founded by the family patriarch in the early 1900's. When the Trust Company was hired to serve the family, the business already had been passed to the second generation, comprised of three brothers (all over 65 years old) who owned 100% of the business. The strawberry farms were the major asset in each of their estates.

Each brother had an adult son (third generation) who already was involved in the business and planned to become an owner. However, other third-generation siblings were not involved in the business at all, which led to our challenge: **How do the second-generation brothers (the current owners) leave the business to their sons, while at the same time, treat their other children fairly in each of their estate plans?**

Our job was to devise a comprehensive plan to 1) transfer ownership of the business from the second-generation brothers to their sons in a tax efficient manner, 2) provide equal economic value to the remaining siblings, (who do not own the business), and 3) provide the second-generation brothers with retirement income, as they were losing control of the business.



Working with the family's estate planning attorney and tax accountants, we developed a plan that achieved the objectives at minimal tax and transaction costs to the client. In a nutshell:

1) We hired a business valuation firm to produce an independent valuation of the business, providing unbiased evidence to all third-generation children of the business's value.

2) Each second-generation brother gifted his shares in the business equally to ALL of his children in a tax-safe manner.

3) Immediately after the gifting, the strawberry company repurchased the shares of all third generation siblings not involved in the business and issued them installment notes. This gave 100% control to the third-generation sons and provided an income stream to the other siblings based on the current value of the business.

4) Working with the Company's business attorney, we structured employment agreements for the second-generation brothers to give them "post-sale income" from the company for retirement.

Here's the happy ending: Each third-generation son involved in the business now owns one-third of the company; each sibling not in the business owns a Note equalizing their inheritance from their respective fathers; and each second-generation brother has retirement income via an arrangement with the Company.

Our Family Office Services (FOS) team created a plan to solve a generational business issue by coordinating with all of the client's advisors to fine tune the plan and oversee its implementation. How can we help you?

Portfolio Review & Strategy

Ian N. Breusch, CFA
Vice President, Portfolio Manager, The Naples Trust Company

U.S. equity markets began 2016 by selling off rather dramatically. In fact, there were periods during both January and February where markets had declined more than 11% before rebounding to higher levels by month's end. The last time we experienced an intra-month decline of the same magnitude was 2008, leading some to worry that we were on the brink of another recession. However, volatile energy markets and dire prognostications of many "experts" have since diminished following the strong stock market rally in March. Positive global economic data, particularly surrounding employment, and generally solid corporate earnings helped propel markets upward.

As a firm, we intentionally stay away from speculating on short-term market movements. Periods of heightened volatility are usually the worst times to make wholesale portfolio changes. Nonetheless, absent any substantive economic or company-specific news, we are happy to continue purchasing high-quality U.S. businesses for our client accounts in the face of a declining market, which is what we did for many clients holding excess cash.

*The S&P 500, MSCI EAFE, and Barclays US Agg Bond are used as proxies for broader market performance.

At this point it seems rather clear to us that global markets have no real appetite for higher interest rates. The Federal Reserve Board's modest federal funds increase (from 0% to 0.25%) in December caused global equity markets to sink and bond markets to rally – pushing interest rates down even further. In March, the Fed adjusted its outlook for 2016, and hinted there would be two more rate increases this year (down from four). However, based on the pricing of global assets, the market is expecting no more rate hikes in 2016. Regardless of what actually transpires this year, we continue to believe that historically low rates will persist over the near term.

For this reason, we continue to avoid most traditional fixed-income (bond) investments for our clients who need current income. Instead, we are buying high-quality dividend stocks, preferred stock, REITs, and master limited partnerships (MLPs) for those clients. The first few months of 2016 have served as a reminder that dividends can provide a thick layer of protection against share-price fluctuations because dividends are paid based on the number of shares you own, not on the value of your stock at a particular point in time.

Midway through 2015, we exited our emerging markets positions in growth-oriented accounts in light of the increased uncertainty surrounding China and many of its trading partners. The economic landscape, earnings expectations, and currency and commodity price movements began to outweigh the seemingly attractive valuation levels in many emerging economies. More recently we have significantly reduced our developed international exposure as well. However, our decision to lower our developed market exposure was less a call against Europe and other developed areas of the globe, and more about the attractive opportunities we see domestically. Our U.S. growth strategy appears quite attractive from a valuation standpoint, and we feel confident we can achieve our client's long-term growth goals by staying with high-quality U.S. companies.

Finding Growth in a Slow-Growth World

Craig J. Holston
Chief Investment Officer, The Sanibel Captiva Trust Company

With global Gross Domestic Product (GDP) estimated to grow only about 2% in 2016, a common question we hear from investors is: "Why should we expect our equity portfolios to grow in this kind of slow-growth economy?" This is a fair question, especially if you consider that price-to-earnings (P/E) ratios have increased from 13 times 2008 depressed earnings to the current P/E of 16 times 2016 earnings estimates. The answer really depends on two factors: stock selection and investment goals.

Investors who are not relying on their portfolio to fund living expenses should focus on finding exceptional companies with a long track record of increasing profits at a rate in excess of global economic growth. Even if P/E ratios remain unchanged, we feel that over time stock prices can increase as company-specific earnings increase. The table below highlights three companies that have shown consistent earnings growth despite the current stagnation in the world economy:

COMPANY NAME	TICKER SYMBOL	EARNINGS 5 YEAR HISTORIC GROWTH RATE	2016 EARNINGS ESTIMATED GROWTH
ALPHABET	GOOGL	12%	17%
LOWE'S	LOW	18%	21%
NIKE	NKE	14%	9%

In the case of Alphabet (formerly Google), actual earnings have grown by an average of 12% per year over the last five years and are expected to increase another 17% in 2016. Long-term investors in exceptional companies like these have been amply rewarded as stock prices have risen in tandem with the earnings.

For those investors who need current income, finding companies with a history of not only paying out dividends, but actually increasing them, is a more conservative way to increase value in a portfolio. Unlike a traditional bond, where the interest payment remains constant from issuance until maturity, an equity that increases its dividend becomes ever more valuable to the investor. The table below highlights three companies, with an average dividend yield of nearly 3%, that have raised dividends 10 consecutive years:

Dividend Growth Rates 2006 -2015

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Cumulative
Procter & Gamble	+11.0%	+12.4%	+14.3%	+10.6%	+9.6%	+9.1%	+7.5%	+7.0%	+7.0%	+3.9%	+141.5%
Microsoft	+15.6%	+10.8%	+12.2%	+13.0%	+5.8%	+23.6%	+22.1%	+16.9%	+18.6%	+12.2%	+303.1%
Johnson & Johnson	+14.1%	+11.3%	+10.8%	+7.5%	+9.3%	+6.6%	+6.7%	+7.9%	+6.6%	+6.9%	+131.4%

Of particular interest is that these companies actually increased their dividend payouts in 2008 and 2009 in the midst of the financial crisis, even as corporate earnings of S&P 500 companies decreased 24% during the same period. This consistency of dividend growth speaks to the underlying quality of companies we can select when building an income-oriented portfolio for an investor.

The bottom line is that if an investor wants to increase portfolio value in a slower growing economy, start by choosing higher-quality growth companies with a track record of increasing intrinsic value. Earnings and dividend growth are two ways that history has shown can accomplish this goal.

Source for both charts: Thompson Reuters Baseline

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