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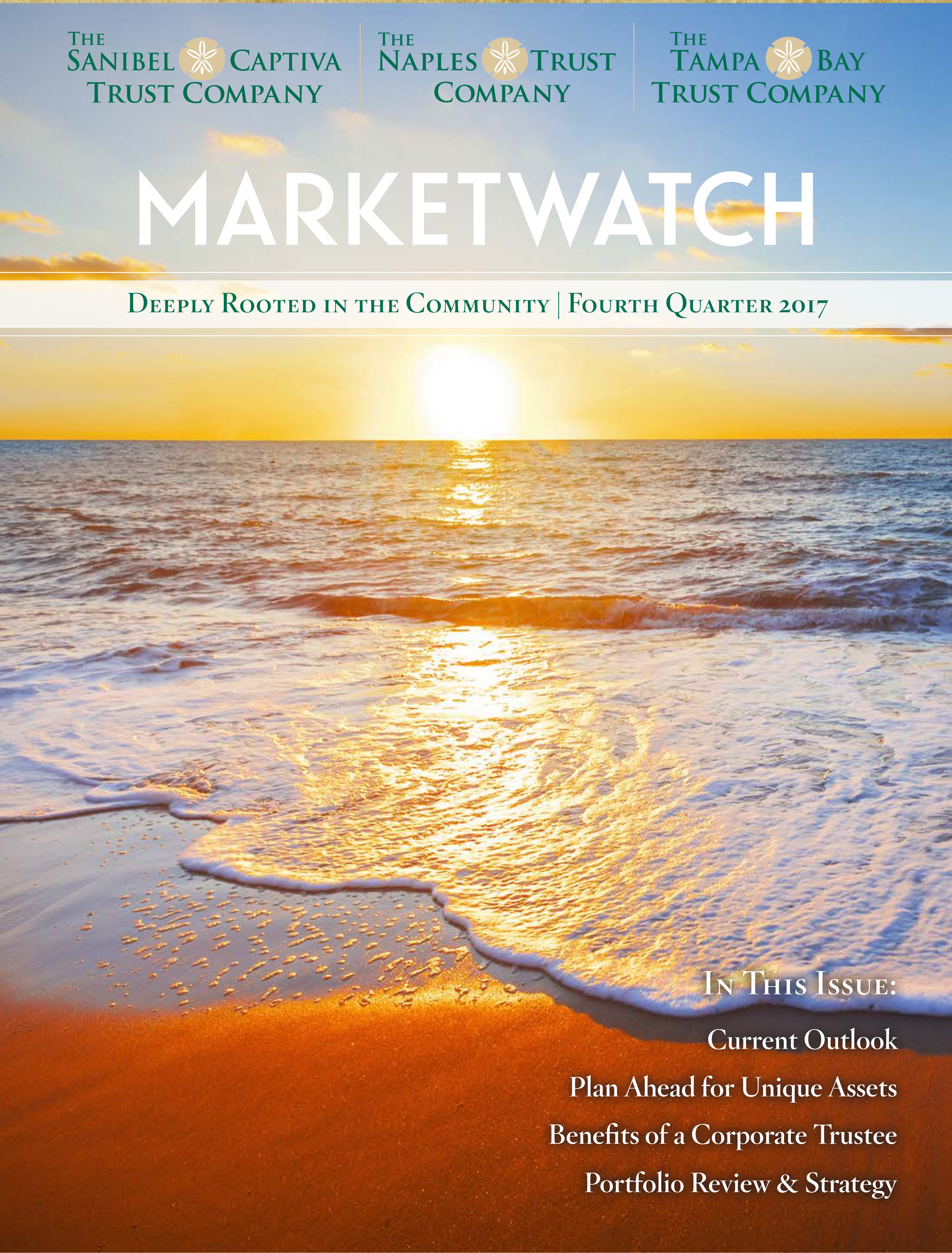
MARKETWATCH

Deeply Rooted in the Community | Fourth Quarter 2017



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Current Outlook

Richard E. Pyle, CFA
President, The Sanibel Captiva Trust Company

While the world is experiencing the first synchronized global expansion since 2003 and asset price inflation continues apace, the challenge for investors is to look somewhat in the rear-view mirror and make sure they understand the risks of euphoria. Many of the issues that we have had to deal with since the 2008-2009 financial crisis have been resolved in a positive way. Banking has become much more stable due to the revised capital requirements. While loan growth has only now started to show a healthy recovery after eight years of so-so results, investors remain cautious about the longer-term outlook. Revenue growth of businesses has been sluggish reflecting abnormally low inflation rates. At the same time, central bankers around the world are beginning the long process of "removing the punch bowl" from the investment party that has seen asset prices rise more rapidly than economic growth since 2009.

We have been suggesting to our clients to continue to be "careful, but not fearful" when looking at their asset allocations and diversification strategies. Since relative asset valuations depend primarily on economic growth rates (the higher the better), interest rates (the lower the better), and inflation (stable preferably), it is important to have a point of view on these three variables before constructing a long-term investment strategy. We have been positive on all three of these trends since 2009 as we experienced fiscal and monetary policies around the world that bolstered those forecasts. We are now seeing evidence that the future trend of interest rates and inflation will be doing battle with economic growth for the first time in a long while.

For those reasons, our current outlook becomes much more muted. The synchronized global expansion that we referred to earlier will do much to maintain the rate of economic growth (or better) that we have seen in the recent past - roughly a range of 2-3% domestically and 3-4% on a worldwide basis. This is good news. The other two variables do not show a comparable positive trend. Already economists are noting the slow, but relentless tightening of monetary conditions. It started with the U.S. Federal Reserve Board actions to cut back on purchases of government bonds. That was followed by the gradual raising of short-term interest rates. It culminated recently in the disclosure of its intention to actually start selling the stockpile of bonds that it has accumulated. These are all actions designed to raise interest rates to combat a perceived increase in underlying inflation. Even monetary authorities outside the U.S. are beginning to talk about reducing stimulus.

When combined together, the threat of rising interest rates, even slightly, should be a wake-up call to revisit asset pricing. While overall economic growth is still expected to be positive for the balance of 2017 and all of 2018, the specter of even a modest rise in inflation and interest rates could dampen returns from both equities and fixed income securities. At the same time, the performance of the economy may not be the only determinant of asset returns. We continue to monitor the changes in policy directions coming out of Washington, D.C. Whether we see the tax reform, de-regulation and infrastructure spending that was hoped for at the end of 2016 remains an open question. The impact of those possible developments on growth, interest rates and inflation must also be factored into the outlook. For the time being we maintain our cautiously optimistic stance.

Plan Ahead for Unique Assets

Steven V. Greenstein, J.D., CTFA
Wealth Services Advisor

Since 2012, the Office of the Comptroller of the Treasury has conducted an annual analysis of estates filing income tax returns, and it comes as no surprise that the dominant asset class owned by decedents was "liquid assets" such as cash, stocks, bonds, and mutual funds. What is surprising is that every year those liquid assets comprise only about half of the value of each estate. The other half of the estate is comprised of "unique assets," and there is a long list of what meets that definition. The predominant unique asset is real estate, but the rest of the list also includes closely held businesses, farms, ranches, oil, gas and mineral rights, hedge funds, wine collections, guns, intellectual property, boats, and collectibles such as cars, coins, stamps, jewels, furs, sports memorabilia, antiques, and precious metals.

The noteworthy lesson learned from that data is that for high net-worth individuals, unique assets equal liquid assets in their importance and popularity, but so often estate planning centers its focus on the liquid assets alone and can ignore the hidden half of a client's wealth. While the foundation of collecting these unique assets over a lifetime can be highly personal, so too is the process for planning for their disposition during lifetime or upon death. The fact that these unique assets are more difficult to sell than liquid assets makes it essential that you diligently plan for their transfer.

While the default position for many owners is to do no estate planning for their unique assets, it is the most expensive choice in terms of administration, and the least desirable choice in terms of finding a family member who shares your passion for those assets. For those who want to plan, the first step is to identify and talk to your potential heirs about their interest in your unique assets and then put a strategy in place for the most tax-advantaged way to transfer them.

Selling your unique assets prior to death is also an option, but bear in mind that it can include sales commissions, insurance, shipping and/or storage costs and sales tax, and is also compounded by the fact that you could incur (depending on valuations) a high capital gains tax liability. Selling the unique assets after death could eliminate the capital gains tax issues because the cost basis is "stepped-up" to the fair market value at date of death. But the tradeoff is that the entire appraised value of the unique assets would be included in your estate for estate tax purposes. In addition, sales of unique assets conducted after death can often create a lower perceived value and attract buyers looking for bargains.

Another estate planning choice is to donate your unique assets to a charitable organization during your lifetime and claim an income tax deduction of up to 30% of your adjusted gross income (AGI) based on the asset's value at the time of the gift. Donating the same assets to charity at your death provides an estate tax deduction equal to the date-of-death valuation.

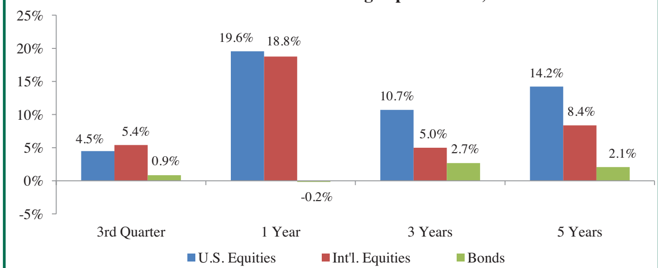
As you begin to outline strategies for the transfer of your unique assets, it is always best to consult with your estate-planning professionals to help provide guidance, expertise, tax planning, and experience to ensure an outcome that meets your individual goals. Every unique asset is, well, unique — and so is every plan to manage them.

Portfolio Review & Strategy

Ian N. Breusch, CFA
Chief Investment Officer

U.S. stock markets continued their course higher throughout most of the third quarter despite a modest increase in day-to-day volatility. Tensions with North Korea remain a concern, although market participants seem to be taking the war of words largely in stride. To the extent this continues, we feel it is important to remind our clients and readers that we do not reposition portfolios around geo-political brinksmanship and discord. These issues have a tendency of making everyone nervous in the short term, while having no long-term impact on the trajectory of the economy or the earnings growth of large U.S. corporations.

To some extent, the same can be said for political dissonance. It seems clear that most legislative items proposed by the new administration to enhance economic growth are proving more difficult to pass and implement than many expected. Corporate tax reform remains the most important item on the agenda as far as investors are concerned. A lower tax rate would impact asset prices immediately. As more money falls to the bottom line, the intrinsic value of companies is enhanced across the board. Nonetheless, we expect the growth prospects and dividend profiles of the companies our clients own to remain constructive – with or without legislative accomplishments.



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

On Sept. 20, the Federal Reserve Board announced they would be reducing the size of their balance sheet by letting their Treasury and mortgage-backed bonds mature over the next few years. This will amount to approximately $10 billion of maturities per month, which is certainly meaningful but not so aggressive considering the Fed's portfolio of bonds is currently worth $4.2 trillion. Similar to raising the Federal Funds rate, shrinking the balance sheet is another form of monetary "tightening" intended to raise interest rates and dampen inflation. We see this as a positive sign that the Fed continues to take steps toward normalizing monetary policy. We have also been pleased to see minimal volatility around recent Fed decisions, a sign the market is accepting the decisions and adjusting accordingly. We will continue to watch the shape of the yield curve. An inverted (negative sloping) yield curve generally portends poorly for economic activity, and we have seen a flattening in the curve more recently. We certainly believe higher interest rates are forthcoming, but change is not always smooth and we expect some volatility as the paradigm shifts.

Considering our expectation for higher rates, we have largely avoided traditional fixed-income (bond) investments unless clients can accept lower returns to avoid volatility. Very simply, as interest rates rise, bond prices fall. All else being equal, we continue to believe that high-quality stocks pose a better risk-adjusted value. We will wait to add bonds to client portfolios in a meaningful way until interest rates rise, which may take several years. In the meantime, income needs continue to be met by using high-quality income stocks (utilities), preferred stock, REITs, and master limited partnerships (MLPs). International stocks have performed very well throughout 2017. While we have limited our direct exposure to emerging markets due to outsized risks, we do own several individual companies headquartered abroad and have been allocating more dollars to developed markets such as Europe. As the economic landscape improves across Europe and other developed regions, we will continue to evaluate the opportunities.

Benefits of a Corporate Trustee

Robin L. Cook
Wealth Services Advisor

Over the many years the Trust Company has been in business, we have developed an understanding and appreciation for the unique family dynamics of our clients when it comes to helping with their estate plans. The selection of your trustee is the single most important decision you will make concerning the efficient execution of your will and full estate plan for your heirs. Why? Children may live in a different geographical location; have varying degrees of financial stability; possess special, medical or spendthrift needs, or be busy with their careers and family. Further, heartfelt gifts to your favorite charities or community projects are often considered, as well. These distinguishing circumstances are of critical concern when meeting with your attorney to draft your estate plans and trusts.

The selection of your trustee choices often includes a family member, friend, or a corporate trustee. The right decision can depend on the type of trust, the size and variety of the trust assets, how long the trust will last, and your relationship to the beneficiaries. Bear in mind that the trustee you choose will have a fiduciary duty to make the payments of income and principal according to the terms you specify and be required to make financial decisions guided by investment objectives that at the same time protect the trust assets and the interests of all beneficiaries.

Your trustee will also have important recordkeeping responsibilities for all investments and disbursements and will be required to file annual tax returns on behalf of the trust. They will need to stay current on the ever-changing laws of trust administration and be available in the future to provide continuity for the full term of the trust. As you weigh these responsibilities, it becomes apparent that naming a friend or family member as your trustee can burden them with undue hardship and potential liability, placing them in an awkward and emotionally charged environment with no experience and no support, and their advancing age or illness could force them to resign as trustee in the future. The solution can be the appointment of a corporate trustee or *corporate co-trustee, who can serve your family as a neutral, unbiased referee, so you can guarantee that your beneficiaries for generations to come will benefit from the professionalism, experience, objectivity and continuity that a well-established organization can provide.

It is also a key advantage if you have a prior relationship with your named corporate trustee before employing their services. If you currently manage your own investment portfolio, or work with a financial advisor who does not provide trust administration services, you might want to consider giving a portion of that portfolio to your corporate trustee now to determine if you are a good fit for each other. Your corporate trustee can also get an impression of your investment goals, risk tolerance and some background information on your estate plan and your beneficiaries' lifestyles, ages and needs for the future. It's important for a corporate trustee or co-trustee to learn the clients' desires for their legacy and their beneficiaries.

Estate planning becomes much more important as you accumulate wealth, and navigating today's financial world is an increasingly complex task. In most circumstances, a corporate trustee or co-trustee, with the resources and infrastructure already in place, can be the best choice to protect your trust assets, your beneficiaries, and your legacy. How may we help you?

*The co-trustee acts in cooperation with one or more additional trustees (a family member, attorney, or other persons selected by the decedent) of a trust. Provides professional knowledge and guidance of the trust to protect the wishes of the decedent and benefits to heirs.

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