The Sanibel Captiva Trust Company | The Naples Trust Company | The Tampa Bay Trust Company

Divisions of The Sanibel Captiva Trust Company

MARKETWATCH

Deeply Rooted in the Community | First Quarter 2019

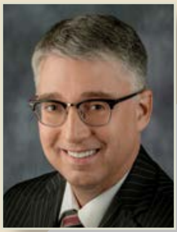
In This Issue:

Current Outlook

Technology Provides Planning Advantages

Reflections Over the Long Term

Portfolio Review & Strategy



Current Outlook

Gary W. Dyer, CFA
Senior Portfolio Manager

Now that 2018 is in the books, it's time to reflect on the year just ended and look forward into 2019. As we all know, financial markets were on a roller coaster in 2018 with investors focusing on positive news in the first nine months of the year then turning their attention to political and economic uncertainties in the fourth quarter.

For most of the year, the market focused on several constructive items including: low U.S. unemployment (between 3.5% and 4.0% all year), tame inflation of around 2%, and soaring corporate profits (S&P 500 companies registered a nearly 25% gain vs. 2017).

However, during the fourth quarter, equity investors became increasingly anxious about the potential impact of several items. For example, the decision by the U.S. government to initiate tariffs on some of its trading partners created growing concern that U.S. companies will pay more for their input costs and that the growth rate of the entire global economy would slow.

Actions by the Federal Reserve Board also have increasingly worried investors. Short-term U.S. interest rates rose throughout the year as the Fed implemented several rate hikes. However, longer-term interest rates increased a more modest amount, which created a nearly flat yield curve as 2018 ended. If short-term interest rates ultimately rise above long-term rates – a phenomenon called an "inverted" yield curve – recession fears will rise. It bears noting that the last seven U.S. recessions were preceded by an inverted curve. At the very least, the bond market seems to be signaling that the U.S. economy may have already experienced its peak growth rate during this economic cycle.

The potential for a moderate global economic slowdown has also unnerved investors. Recently released data from the Eurozone and China indicates both are experiencing a deceleration. Eurozone real GDP grew only 1.7% in the third quarter, while China reported 6.5% growth in the quarter (figures we always view as suspect). Even so, China's quarterly growth was its slowest since 2009.

Finally, the results of the November U.S. mid-term elections did not appear to cheer investors. A split Congress, with the House controlled by the Democrats and the Senate by the Republicans, will likely result in legislative gridlock like it has so many times in the past.

While it is likely some of these issues (tariffs, global economic slowdown, etc.) will continue into the new year, our outlook for 2019 is cautiously optimistic. Corporate profit growth will slow considerably from 2018, since a great deal of the growth in 2018 was due to the recent tax bill. But we still estimate healthy corporate profit growth in the mid-to-high single-digit range. When 2018 and 2019 corporate profit growth is combined with a relatively flat stock market, stock valuations are suddenly more attractive now than they were when we began 2018 – that is, price-to-earnings ratios (P/E) have declined. We also foresee the Fed modifying or halting its rate hike plans, if necessary, so as not to throw the U.S. economy into a recession.

As always, portfolio construction is paramount in determining a client's long-term return. While the volatility we have experienced is certainly unpleasant, we do not advocate changing one's asset allocation due to short-term market swings. Our goal is always to own top-quality, blue-chip companies in your portfolio and use pullbacks as opportunities to add to current positions or place new holdings in your portfolio at sale prices. Here's to a Happy, Healthy and Prosperous 2019.

Reflections Over The Long Term

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

As my retirement is now just weeks away, my colleagues have asked me to share with you some of the professional life lessons I have learned over these past five decades as an investment analyst, portfolio manager and Chief Investment Officer. Developing an investment philosophy and process that can guide the direction of one's work is perhaps the foundational aspect of any lesson learned.

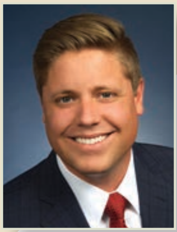
For me, this development started with my first full-time job as an investment analyst for a large trust company. When I arrived at the job, the first thing I tackled was the iconic *Security Analysis* textbook by the famed Benjamin Graham and David Dodd. This assignment would lay the groundwork for the development of my personal investment philosophy and process. While the textbook spent a lot of time discussing value investing, I became more interested in the growth investing style. Both styles could be effective money makers over time, but at the time the growth style was very popular. The growth style differed from the value style in one major way. The value style tried to find decent businesses that were priced relative to balance sheet and income statement ratios such as book equity and cash flow from operations. The growth style emphasized absolute revenue growth—the faster the revenue growth the greater the value.

The growth style morphed in 1972 and 1973 into what was called "Nifty Fifty" investing – find the fastest growers and pay any price to own them. When the government put in wage and price controls in 1971 in response to inflationary pressures the economy began to teeter. The excessively priced "Nifty Fifty" ultimately collapsed, and the stock market dropped nearly 50% between early 1973 and late 1974. **First lesson learned – pay attention not only to growth but use a price discipline as well.** While equity markets eventually rebounded from the "Nifty Fifty" debacle by the end of the 1970s, the economic environment continued to challenge businesses with above-average inflation and eventually sky-high interest rates. Economic policy makers in Washington finally decided to address the malaise. The Federal Reserve in 1979 began to raise interest rates in order to kill inflation. This action brought about a severe decline again in equity valuations. By 1982 the most severe recession since the 1930s had reduced corporate profits and laid the groundwork for an unprecedented gain in these equity valuations. **Second lessoned learned – pay attention to the direction of interest rates.**

Between 1982 and 2000 the equity markets and the fixed-income markets feasted on a "Goldilocks" environment of generally strong economic growth, falling inflation and declining interest rates. Wealth creation occurred nearly everywhere. While I had hoped to never have to deal with "Nifty Fifty" valuations again after the experience of the 1970s, another bubble was created by the end of the 1990s. Growth at any price was the general rule and, as happened in the 1970s, we subsequently experienced nearly four years of losses in the equity markets ending in 2003. **Third lesson learned – if the valuation of an asset class appears above average, it probably is.**

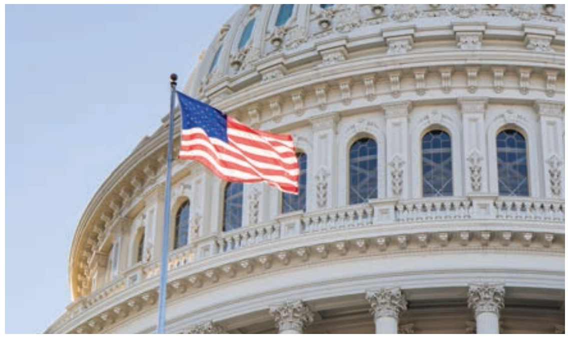
Right now, we are experiencing a pause in normally rising equity valuations and continued high prices for fixed-income securities after 10 years of positive results from both asset classes. **Fourth lesson learned – valuations will fluctuate but over the long-run equities of high-quality enterprises, appropriately monitored, will build investor wealth.**

These lessons learned formed the basis of our investment philosophy and process when I joined the Trust Company nearly 16 years ago. In building our "in-house" investment team over these past several years we never lost sight of these lessons. It is with this knowledge that the investment team confidently moves forward – and I transition to retirement.



Portfolio Review & Strategy

Ian N. Breusch, CFA
Chief Investment Officer

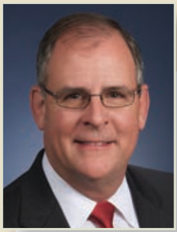


The fourth quarter of 2019 was marked by volatility as global equity markets sold off in response to a number of issues that concerned investors. Stock markets began to move lower following the Federal Reserve Board's interest rate hike in late September. U.S. bond yields moved considerably lower over a short period of time as investors aggressively purchased bonds (while selling stocks). Uncertainty surrounding market conditions and future prospects for the economy and corporate profit growth were the primary culprits. Increasing trade and tariff posturing between the U.S. and China certainly fueled the concerns. However, let's put some things into context. For one, corporate earnings growth was rather strong coming out of the third quarter. And while we expect GDP growth and corporate profit to slow some in 2019, we still anticipate positive numbers across both metrics. Unemployment remains very low, inflation is subdued, and most of the companies we own are executing quite well.

Since the beginning of 2018, we highlighted interest rate movements as one of the more important market risks to heed. We highlighted this at our annual outlook events in January and February, and we discussed it throughout our newsletter articles this year. It was our belief that interest rates would move higher on the back of Fed decisions to hike rates periodically; however, we were unsure how the market would react to these Fed decisions and how quickly and smoothly the interest-rate changes would take effect. In December, we saw the first inversion in the Treasury yield curve take place as yields on 2-year government bonds rose above 5-year bond yields. After stock markets rebounded higher in November, markets moved lower again in December following this inversion. On December 19th, The Fed announced another quarter point increase in the federal funds rate, which we expect will keep the yield curve fairly flat in the near term.

To be clear, inversions in the yield curve are a bearish market signal – all else being equal. The next obvious question that our clients ask is what we are doing (or will do) if this market correction turns into a recession at some point. Very simply, we will continue building portfolios that we believe will meet our clients' return goals over the long term. This involves building an asset allocation mix between high-quality stocks and bonds that makes good sense in any market environment (good or bad) and that ties back to our clients' long-term return goals. The investment objectives we implement on behalf of our clients already assume we are going to have periods of time that are uncomfortable. In fact, we know corrections and recessions are going to occur; it's a matter of when, not if. It's the long-term average rate of return we shoot for, not the avoidance of short-term volatility.

Once the broad asset allocation has been discussed and agreed upon, we spend our time selecting investments that we believe offer the best risk-adjusted return potential. We continue to believe that stocks offer a better risk-adjusted value than bonds; therefore, we are only using bonds to mitigate volatility. We welcome the day when bonds can add to, rather than subtract from, long-term returns. As long as rates stay low, however, bonds will continue to serve primarily as a risk reduction vehicle.



Technology Provides Planning Advantages

West McCann, CFA
President, The Naples Trust Company

Wealth Management encompasses so much more than just implementing an investment strategy. In recent years, evolving technology has enabled us and our clients to consider a bounty of options in developing a focused investment plan and meeting spending goals that coincide with your lifestyle.

Responsible wealth managers guide fruitful discussions that include taxes, wealth transfer, philanthropy, complex family needs, and estate structure, as well as answer the vital question: Do I have enough? Wealth managers today often sit with clients and utilize investment technology tools that demonstrate quickly and efficiently how a small change to their lifestyle goals, or a tweak to their portfolio, can make a major difference in the success of meeting those goals.

At the core of so many of our client conversations are the questions: “Can I afford health care, gifting, and philanthropy?” “Is my current spending sustainable or can I consider spending more?” “What are the chances that I outlive my savings?” Financial planning tools that we incorporate make the experience of investigating these options more impactful, convenient and even enjoyable. That’s because the solutions are uniquely honed to a client and provide easy-to-digest numerical and visual projections of the probability of success.

Assessing goals and itemizing a client’s available resources are the cornerstones of the process. We consider how much a client wishes to spend annually; the frequency of durable goods purchases; changes of residence; gifting to heirs, major repairs and expenses, as well as the timing of these expenses. These unique goals, whether one-time or recurring, have a direct cost against the assets available to fund those goals. Understanding and modeling for inflation is likewise important to make sure the portfolio keeps pace with increased future outflows.

Today, the Wealth Management technology we use allows a client to model and test a variety of scenarios to see whether there are sufficient assets to meet goals as well as prioritize goals based on needs, wants, and wishes. Most importantly, the experience instills a greater confidence that “your plan” is going to work.

Our clients have found that such technology offers robust, instantly generated scenarios that we can hone over time to keep improving outcomes for you. A significant added bonus to a technology-based planning experience is that often the partner who is less concerned with a portfolio of stocks becomes more engaged when seeing the bigger, long-term picture. It means so much more when you see how your spending choices impact children, grandchildren, and charities.

We believe that the effort dedicated to your lifestyle and investment plan is of utmost importance as you age, and that reviewing your plan regularly with your advisor is vital. Goals change over time, and investment returns will vary from estimates, so spending time with your advisor and portfolio manager helps them offer more tailored solutions, and provides you the confidence in the choices you’ve made. If we can assist you with your wealth management needs and demonstrate how The Trust Company has integrated technology into the planning process, we invite you to contact one of our offices. www.sancapgroupinc.com

Corporate Leadership

S. Albert D. Hanser
Founder and Chairman

Terence M. Igo
Chief Executive Officer

Portfolio Management

Ian N. Breusch, CFA
Chief Investment Officer

Gary W. Dyer, CFA
Senior Vice President, Senior Portfolio Manager

Craig J. Holston
Chief Operating Officer, Senior Portfolio Manager

Joel A. Johnson
Vice President, Investments

Richard E. Pyle, CFA
President and Senior Portfolio Manager
The Sanibel Captiva Trust Company

Andrew Vanderhorst, CFA, CFP®, CLU®
Senior Vice President, Senior Portfolio Manager

Timothy P. Vick
Director of Research, Senior Portfolio Manager

Trust & Estate Services

David F. Port, J. D.
Executive Vice President

Family Office Services

F. Hood Craddock, CPA
Director of Family Office Services

Louis N. Pappas
Vice President
The Tampa Bay Trust Company

Allison Constant
Vice President
The Tampa Bay Trust Company

Client Services

Beth Weigel
Director of Client Services & Trust Operations

Wealth Services

Harriett S. Bankston
Vice President
The Tampa Bay Trust Company

Carol B. Boyd
Regional Corporate Director
The Naples Trust Company

Robin L. Cook
Executive Vice President
The Sanibel Captiva Trust Company

Michael R. Dreyer, CPA
President
The Tampa Bay Trust Company

Steven V. Greenstein, J.D., CTFA
Executive Vice President
The Sanibel Captiva Trust Company

West McCann, CFA
President
The Naples Trust Company

Cherry W. Smith
Executive Vice President
The Naples Trust Company

Board of Directors

William L. Bolster
John Brabson
Stephen R. Brown
Cheryl Giattini
S. Albert D. Hanser
George Heisler
Terence M. Igo
Charles H. Ketteman
James R. Lozelle
Linda D. Marcelli
Frank Morsani
F. Fred Pezeshkan
Dolph W. von Arx
Donald A. (Chip) Lesch, Emeritus
Richard A. Botthof, Emeritus
John W. Burden III, Emeritus
Ginny L. Fleming, Emeritus
John D. Schubert, Emeritus

www.sancaptrustco.com