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MARKETWATCH

Deeply Rooted in the Community | First Quarter 2017

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Clyde Butcher

Dear Clients, Friends, and Colleagues,

A new year brings a clean slate – the chance to start fresh with the goals that are most important to you and the enthusiasm to tackle them. The end of 2016 had people around the world riveted and wondering. Now that the race for the White House is behind us, 2017 anticipates new global endeavors and opportunities.

This is the perfect time to sit down with your advisors to discuss your investment and estate planning goals to assure they are on track for you and your family. In that same vein, we can help business owners in evaluating long-term and short-term strategies to make the most of their years of dedication and growth – and be prepared when opportunity knocks. We have the pleasure of helping all kinds of clients realize their dreams every day.

In this New Year, if you are not already a member of The Trust Company family, we invite you to visit one of our offices to get better acquainted. Happy New Year.

Sincerely,

S. Albert D. Hanser
Founder & Chairman

Richard E. Pyle, CFA
President

The Trust Company's Asset Management Committee (AMC) meets regularly 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 or are interested in attending an AMC meeting, we welcome your call at the number below.

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Current Outlook

Andrew Vanderhorst, CFA, CFP®, CLU®
Senior Vice President, Senior Portfolio Manager, The Tampa Bay Trust Company

In retrospect, the theme for 2016 was 'expect the unexpected.' The British vote to leave the European Union (EU) was greatly discounted by the 'smart money.' The surprise election of Donald Trump to the U.S. Presidency took almost all pollsters by surprise. The Federal Reserve Board (Fed), meanwhile, fell woefully short of its goal of raising interest rates four times. These events will continue to play out in 2017 as the British initiate the two-year process to leave the EU, president-elect Trump is inaugurated, and the Fed continues on its path of tightening monetary policy. The latter two events deserve the most focus.

Trump has an ambitious agenda for his first-term: immigration reform, corporate and personal tax reform, infrastructure stimulus, health-care reform, and renegotiating trade agreements were among his top campaign priorities. As of this writing, we have seen little written detail from Trump and his advisors to definitively opine on how his policies may affect the markets. What we do know is that he will have a Republican-controlled House and Senate to help push through many of his policies, but we suspect that the focus of Congress will be on the low-hanging fruit of infrastructure stimulus and corporate tax reform. Both should be net positives to U.S. economic growth and stocks. On the other hand, should Trump pursue unconventional trade policy or initiate a trade war with China, we will likely see retaliatory actions that may dampen the global economic recovery and act as a headwind to multinational companies' earnings. Our investment team will continue to research the impact of Trump's policies as they become more certain.

In December, our data-dependent Fed increased short-term interest rates by 0.25% to a range of 0.50% – 0.75%, as expected. While the Fed has begun the cycle of tightening monetary policy, we should keep in mind that this marks only the second rate increase in the eight years since they lowered interest rates to 0%. Obviously, we still have a ways to go before we reach 'normal' interest rates. The Fed will continue to monitor the status of their dual mandate: maximizing employment and stabilizing prices. The current unemployment rate stands at 4.6%. Inflation has picked up slightly, but still remains below the Fed's 2% target. Both data points suggest future rate increases may be on the horizon.

However, the Fed will likely watch for any continued strength in the U.S. dollar, as a stronger dollar can have similar negative effects on economic growth as a rate increase. The continued easy monetary policy by global central banks may continue to weigh on the Fed's ability to quickly raise our short-term rates. Recently, the European Central Bank announced that they would extend their quantitative easing program (i.e. bond purchases) until the end of 2017, although their monthly purchases would decline from €80 billion to €60 billion. Meanwhile, the Bank of Japan offered to buy unlimited 2-year and 5-year Japanese government bonds, effectively pushing those yields further into negative territory. Given the likelihood of continued easy global monetary policy, we expect two small rate increases by the Fed in 2017.

In summary, we see continued steady U.S. economic growth and modest inflation going into the New Year. We prefer selective stocks over bonds in such an environment.

Riches to Rags in Three Generations

Steven V. Greenstein
Executive Vice President, Wealth Services, The Sanibel Captiva Trust Company

We've all met entrepreneurs who have built a successful business and then sold it or left it to their children, so their families can reap the rewards of a lifetime of hard work. No doubt, these business owners envision leaving a legacy to their heirs that will last for several generations. But, dating as far back as biblical times, the tale of riches to rags in three generations highlights how difficult it can be to make inherited money last.

Usually, a business is most productive and successful while the founder is alive and involved. But by failing to take time to share information with their family about the business during their lifetimes, founders often leave their heirs without an understanding or appreciation of the values of hard work and thrift that made the business thrive. In addition, flawed estate plans can fail to adequately define who exactly will inherit the wealth and how it will be protected and controlled. These very issues have extinguished great wealth in short periods of time.

Today, sobering statistics continue to show that the children and grandchildren of their fortune-building parents will lose 65% of the wealth in the next generation and 90% by the following generation. Contributing factors can include taxation, divorce and marital claims, misappropriation, mismanagement and family strife. But often, it boils down to the negative personal effects of inherited wealth. Second and third generations often inherit without critical prior guidance about the purpose and objective of money. Seldom do they take the time to understand the values that created their inheritance in the first place, values that are essential to maintaining a healthy relationship with their newly obtained wealth.

But there is hope. An estate planning attorney is a vital member of the high net-worth business owner's advisory team. It is the attorney's responsibility to create the documents that will protect the wealth from taxation and destruction from creditors, spendthrift heirs, matrimonial claims, and future legal assertions. Of equal importance, the estate attorney assists siblings in creating "family governance," a means of regulating the involvement of the entire family structure that highlights the vision of the "founder" and the original wishes of how this wealth should benefit heirs in the future. Ultimately, the plan must ensure that the wealth is protected, properly managed, and that the family members will lead healthy, happy and meaningful lives for generations to come.

A key planning tool being utilized today by high net-worth business owners is the use of a Family Office Services group. These advisory team members have the cumulative expertise to assist the founders in establishing and executing proper succession planning, family governance, investment management, estate and tax planning, family foundations and other philanthropic designs for their future heirs.

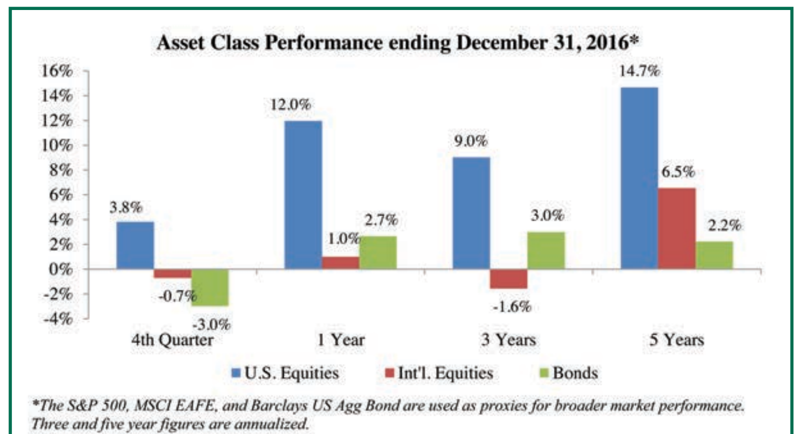
History has taught us that it is hard to create wealth, harder to keep it, and hardest to give it away prudently. As King Solomon warned, "An inheritance gained hastily in the beginning, will not be blessed in the end."

Visit The Trust Company website for more information on Family Office Services under SERVICES.

Portfolio Review & Strategy

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

The fourth quarter of 2016 was far more eventful than most would have anticipated. Though election years typically bring some level of uncertainty, most predicted that divided government would continue, meaning the status quo in Washington would remain. The surprising November election results prompted a level of speculation among global markets that had not been experienced in many years. U.S. stock markets moved considerably higher immediately following the presidential election. However, the overall increase has largely masked the underlying volatility within the market. Speculation around government policy shifts and the eventual impact on particular industries and companies have sent select segments of the market considerably higher – and lower. The movement in bond markets, which is far less publicized (but just as important) has been quite remarkable as well. Bond yields soared higher, sending bond prices markedly lower as investors began to believe for the first time in many years that interest rates would begin to rise more consistently. The decision by the Fed to raise rates 0.25% in December became a foregone conclusion.



Our clients have been served well over the years by having an investment team that avoids overreacting to short-term movements in the market. With that said, we are not ignoring the fundamental impacts that a Trump presidency, along with Republican control of both houses of Congress, means for the broad U.S. economy and, more specifically, individual companies. For example, a lower corporate tax rate certainly portends higher equity valuations. Infrastructure spending and health care reform would have real impacts on select businesses that we follow. However, instead of speculating, we always base our investment decisions on hard data, most of which are still unknown as it relates to government policy. With that said, our investment team will be focused heavily on sourcing new ideas and avoiding pitfalls as the dust begins to settle and real conclusions emerge in 2017.

The core of our client portfolios will remain high-quality U.S. stocks. Economic data, company fundamentals, and valuation levels continue to support our thesis. Readers of this newsletter will recall that we have largely avoided most traditional fixed-income (bond) investments for our clients who require income. Instead, we have favored high-quality income stocks, preferred stock, real estate investment trusts (REITs), and master limited partnerships (MLPs) as a primary source of current income. While value remains in the aforementioned areas, corporate and municipal bonds are beginning to look more attractive following the recent surge in interest rates. Though valuation levels still favor stocks over bonds by a considerable margin, it is encouraging to think that we may be able to once again utilize bonds within client accounts to achieve income needs and reduce volatility.

The Active/Passive Debate

Timothy P. Vick
Senior Vice President, Senior Portfolio Manager, The Naples Trust Company

As 2016 was beset with surprises in financial markets, the chorus of voices – from Main Street to Washington – challenging industry practices grew louder. Highly decorated fund managers posted below-average returns yet again while the entire hedge fund industry limped through its biblical seventh lean year of performance. Investors responded by removing tens of billions of dollars from these "active managers" and sought refuge in the lowest-cost packaged products such as index funds and exchange traded funds (ETFs).

Indeed, the investment industry so often gets evaluated on short-term raw statistics – just like a batting average – that little emphasis gets placed on why the batting average might temporarily have dropped or was elevated.

Cause and effect, however, is not so clear, and the debate over industry performance misses a bigger point. In 2015, renowned strategist Jeremy Grantham analyzed returns of active managers since 1989 and discovered that the industry's performance was directly linked to managers' desire to diversify portfolios. It was not due to managers' dwindling skills, computerization, or to heightened competition, but instead may have arose out of a growing culture of protection. The typical manager, his firm wrote, does not hold a portfolio of 100% U.S. large-cap stocks that mimics the S&P 500, but intentionally spreads clients' assets into a combination of cash, bonds, small-cap stocks, and international investments to spread risks. In years when U.S. large-cap stocks outperform most asset classes (such as 2014, 2015, and 2016), the majority of professional managers lag the index. Conversely, in years when international investments or bonds shine, the study found that the majority of managers can beat the index.

What Grantham inadvertently discovered was that parts of our industry have slowly been adapting to the times. Back in the 1970s and 80s, for example, few investors were obsessed on beating a benchmark; they willingly held their stocks for years, and by and large obtained pleasing returns. Slowly, the pendulum completely shifted. Today's investors are armed to the teeth with free information and can be overly obsessed with indexes and short-term performance – and to such an extent that they trade stocks, trade ETFs, and trade managers, at a near-record pace to chase returns.

The irony is, these same investors are getting older, and their financial plans now must take into account many factors that will influence asset allocation – such as the possibility of living past 90, the inability to absorb prolonged losses, tax and estate matters, and needing continuous income from their portfolios. To be sure, low-cost products such as index funds or ETFs can serve a role in managing a family's balance sheet. But they remain the means, not the end.

In our work with hundreds of families, we've found that the active vs. passive debate is mostly moot. A passively managed indexed portfolio that may have served risk-taking investors in their 40s has little practical relevance for retirees with complex income and wealth-preservation needs. For those folks, advisors can add value by decoupling the portfolio from a static, "one-size-fits-all" model and instead custom-tailor solutions as the family's needs change. We've found it best to develop "absolute-return" goals for a client, rather than try to chase the moving target of indexes. Setting an absolute goal – then hitting that goal over a multi-year period – is often more crucial to the client than whether the portfolio beat an index 30% of the time, or 50%, or 70%. Consider where you are in life and discuss what is best for you with your advisor.

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