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The Sanibel Captiva Trust Company

The Naples Trust Company

The Tampa Bay Trust Company

Divisions of The Sanibel Captiva Trust Company

FOURTH QUARTER | 2020

Current Outlook & Portfolio Strategy

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Current Outlook & Portfolio Strategy

Ian N. Breusch, CFA
Chief Investment Officer

Global capital markets continued to rally through much of the third quarter, rebounding from the March lows we experienced when investors aggressively sold assets in response to the significant unknowns related to Coronavirus (COVID-19). Clearly, investors have responded to the swift and aggressive actions taken by major central banks and governments all over the world. The monetary and fiscal stimulus was substantial enough that investors were willing to purchase assets now with an eye towards a future economic recovery, which most believe will not be in full swing until a vaccine is widely distributed. Although we believe COVID-19 will continue to weigh on economic activity until a vaccine is approved and disseminated, we have undoubtedly made substantial economic progress since our self-imposed shutdown.

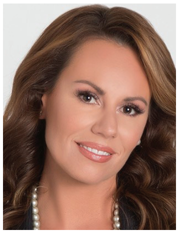
At the latest meeting in September, the Federal Reserve Board announced its intention to keep the federal funds rate at the current level (0-0.25%) for the foreseeable future. In fact, the voting members of the Federal Open Market Committee (FOMC) almost unanimously agreed that rates will stay in this range through 2023. Moreover, they intend to keep rates low until maximum employment is achieved and inflation has risen to 2% and is on track to moderately exceed 2% for some time. The Fed will also continue to purchase Treasury bonds and agency mortgage-backed securities to sustain market functioning and help support the flow of credit. The aforementioned Fed policies, coupled with a willingness by Congress and the President to pass another relief package at some point (before or after the election), does indeed create one of the most accommodative environments we have ever experienced.

The upcoming U.S. elections in November are quickly approaching. Given the constant rhetoric from the two primary political parties, it is easy to lose sight of what really matters to successful long-term investing. We remain adamant that meaningful shifts in portfolios need not be made because of who controls the White House or Congress. While we may experience some short-term volatility around the election itself, don't make the mistake of over emphasizing politics when making investment decisions. There are simply more important things to consider such as:

- Your own long-term goals and constraints
- Fundamental characteristics of asset classes and individual investments
- Valuation levels across asset classes and individual investments
- Underlying economic landscape

Given the backdrop of continued economic weakness related to COVID-19 (albeit slowly improving), and unprecedented fiscal and monetary stimulus, we will remain methodical in our investment approach. We will focus on the things we can control, such as our clients' asset allocation among high-quality stocks, bonds and cash, as well as our ongoing research efforts. Our research process will continue to emphasize high-quality investments trading at attractive prices relative to the overall opportunity set. These efforts are most meaningful to ensure we continue to achieve (and hopefully exceed) each client's long-term investment goals. Given the amount of speculation we are seeing in certain areas of the stock market, we believe it is more important than ever to be mindful of company fundamentals when making investment decisions. To the extent fixed-income securities (bonds) are appropriate, we are intentionally favoring shorter-term bonds with good credit quality. Interest rates will remain historically low for the foreseeable future, diminishing expected returns for most bond investors.

Gifting to Heirs During Your Lifetime



Jeannine Hagedorn, CTFA
Wealth Services

Building a strategic gifting plan for your children and perhaps your charities can not only benefit them, but you as well.

Over the last few generations, Americans have been living longer and longer due to advances in medicine, their environment and lifestyle choices. In the 1940s the average life expectancy for a man was 61 years and 65 for the average woman. In the 1970s it was 67 for men and 75 for women. Today it is 76 for men and 81 for women! What does this mean for the timing of the inheritance we plan to pass onto our heirs?

Keep in mind that the timing of life's milestones hasn't changed. Children still go to kindergarten at around age 5 and start college on average at 18 years of age. They often enter expensive extracurricular activities throughout their educational careers, such as sports, dance and so on. They marry a bit later than they did in the 1940s and 1970s, but the average age is still in the mid to late twenties.

Just a couple of generations ago, adult children usually inherited the proceeds from an estate of deceased parents in their forties and fifties, often boosting their personal wealth and quality of life for the overall family. This supplemented college tuition, a better home, paid down debt during these expensive years and added to their own nest egg for retirement. Today, this is usually not the case unless the matriarch/patriarch choose to begin gifting during their lifetime to their children.

Many individuals and couples have built successful businesses and had lucrative careers, worked and saved appropriately to see them through their lifetimes in comfort. Many have accumulated such wealth that they will never spend it all and so have an opportunity to make a difference for others now instead of after death. Only you know your children and if they have the wisdom and discipline to manage such a gift.

Building a strategic gifting plan for your children and perhaps your charities can not only benefit them, but you as well. For your children and other heirs, decreasing the size of your estate now may reduce future estate taxes and leave your heirs with a larger inheritance, while giving to charities today provides current tax deductions that could reduce your tax bill in the spring.

At The Trust Company we have the ability to model gifting scenarios to project how implementing such a strategy would affect your wealth management plan over your lifetime. Effective wealth plans can include not only the financial portion but can impart your values to your family, as well. These inform and guide the actions and decisions that the family makes around their wealth and how it will be used and stewarded in the next generation.

Having conversations early and often about the opportunities and responsibilities of having wealth will help to ensure that heirs are well prepared to make a lasting impact with their inheritance. If you don't have a wealth plan or are considering a gifting plan to your heirs during your lifetime, we are happy to assist.

The Growth Tide Rolls On - For How Long?

Briana L. McDougall, CFA
Senior Portfolio Manager

Historical returns in the market have validated that value stocks outperform growth stocks over long periods of time. Yet, there have been many periods over which leadership has rotated, persisted for a while, and challenged the patience of investors with exposure to value stocks. In the past 14 years, for example, growth stocks have outperformed value stocks by 6.3% annually. This is the longest and perhaps largest divergence between the two equity styles seen in at least 40 years.

As the period of divergence from normal patterns lengthens, investors and researchers look for rationales, for catalysts that would drive stocks back to their historical trends, or for clues that the shift may be permanent. During the late 1990s, many were asking whether technological innovations could explain the divergence. Sound familiar?

As you may recall, growth stocks outperformed value from 1994 to 2000, averaging 10.5% in excess compounded annual returns. Not only was performance well outside of the norm then, so too were valuations. A study in the Financial Analysts Journal in the summer of 2000, just after tech stocks peaked, attempted to evaluate the various rationales. The study revealed that, rather than positive surprises in growth or innovation driving higher stock price multiples, it seemed that the most plausible explanation was behavioral. Actual growth in sales and consensus forecasts were within normal historical ranges, yet price-to-sales ratios doubled in just two years leading up to the rotation. Other measures of relative valuation likewise confirmed prices seemed disconnected from fundamentals.

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Currently, growth stocks are trading at 4.6x sales (more than twice their historical average and persistently above the 15-year average for the last five years). At the same time, the 5-year average sales growth rate of these stocks has declined from 9.3% to 7.4%. Consensus estimates are that sales growth will remain near 7.4%. So, if the outlook for growth doesn't justify the high multiples, what could?

The most cited explanation has to do with sector exposure of the indices. The growth index is dominated by large weightings to technology and healthcare, both sectors that seem poised to benefit from secular trends that have been accelerated by the pandemic. Conversely, the largest sector weight in the value index is financials, which have faced headwinds since 2008 from declining interest rates and increased regulation.

While sector weightings seem a reasonable explanation, we can't help but wonder whether investor sentiment has gotten carried away again, a situation that in the past has led to significant reversals. Positive information and a hopeful outlook can certainly drive up prices, leading to positive momentum and creating a feedback loop. This time may be just another example.

All of this has meaningful impact on portfolio strategies and short-term performance. While it may be tempting to shift exposures to capture the momentum, there is no way of knowing when the tide will roll out. Rather than make directional bets, we adhere to our disciplined approach to equity exposure. We firmly believe there is a place in the portfolio for both growth and value styles, that client circumstances matter in this equation, and that trying to time the exposure tends to produce inferior results. Finally, valuations tend to be good predictors of forward returns, with high valuations suggesting lower expected future returns for growth stocks. Therefore, those able to exercise patience with value-oriented investments should eventually stand to benefit.

Life Insurance As An Asset Class

Krista J. Hinrichs
Wealth Services

Reviewing your policies on a regular basis can keep you on track to meet your goals.

Life insurance is one of the simplest and most powerful forms of financial protection. But like other assets within your estate, your policies need attention. Left unattended, a policy bought years ago in a different economic climate and while your estate was considerably smaller (or larger) may not be meeting your original planning objectives. As interest rates have fallen over the past two decades, life insurers' investment portfolios have experienced lower returns than were projected years ago. As a result, many insurers have reduced the performance on their cash value, whole life, and universal life products by lowering dividends and, in some situations, raising premiums or other fees. Any of these changes can affect a policy's long-term performance and if not addressed, can have harmful results.

A policy review starts with your insurance agent or consultant ordering in-force illustrations from the insurer to evaluate how the policy is performing against expectations. These illustrations assess existing interest rate risk and will reveal the outcome if the policy remains in place versus revising the terms of the policy.

When some policies underperform, or a scheduled premium is not paid, an "automatic premium loan" provision within the policy will be triggered to pay the missed premium. The long-term consequences of the loan, and loan interest requirements, could become detrimental to your planning objectives. These loans may not have an immediate tax impact. However, if the policy is permitted to lapse or terminate with a loan that exceeds premiums actually paid with cash, the policy owner will have an income tax liability for the difference between the total loan and the actual premiums paid. A policy review is an opportunity to address this situation and to identify other potential issues.

Whole and universal types of cash value life insurance are commonly purchased for estate and wealth transfer planning goals. Both types of policies rely upon a rate of return on a cash value set by the life insurance company and guaranteed for a set amount of time. Even though rates have fallen over recent history, volatility is reasonably low, and performance is considered to be relatively stable. It is this stability that can aid in long-term planning, particularly when the death benefit is counted upon to meet future estate liabilities or to provide protection to a family or business due to an unexpected death.

Additionally, because a policy's death benefit or cash value can be a meaningful part of your net worth, life insurance should be considered a separate asset class in that life insurance proceeds will be received tax free, and can be arranged to be received outside of your estate for estate tax purposes. The same stability counted upon for long-term planning allows life insurance to be easily analyzed and strategically added to a diversified investment portfolio. The death benefit and cash value of an insurance policy have a lower risk level compared to stocks or private equity and therefore can serve to balance a portfolio's performance.

Reviewing your policies on a regular basis can keep you on track to meet your goals. As part of our wealth management services, we will evaluate your performance history and work with your agent or a life insurance consultant. Please contact us at the Trust Company if you would like a review of your existing life insurance policies.

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