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The Sanibel Captiva Trust Company

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THIRD QUARTER | 2021

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Current Outlook & Portfolio Strategy

Ian N. Breusch, CFA
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The second quarter of 2021 essentially continued the modest progress we experienced through the first quarter of the year across global equity markets. While much of the market exuberance has dissipated, investors remain willing to invest as markets grind to higher levels. To be clear, there is still good reason to be optimistic. Global economies are rebounding quickly as COVID-19 vaccination levels increase around the world, particularly across developed nations. Coupled with improving labor markets, rising prices, and exceedingly accommodative monetary and fiscal policies, we should expect robust economic growth through the remainder of this year and well into 2022. However, we also understand capital markets are forward looking and much of the aforementioned good news is being priced into stocks and bonds today. For that reason, we are being ever vigilant in our valuation work to safeguard against systematically overpaying for the stocks and bonds we purchase on clients' behalf.

Global economies are rebounding quickly as COVID-19 vaccination levels increase around the world, particularly across developed nations.

Given the expectation for strong growth across global economies, investors have become increasingly wary of inflation concerns, particularly in the context of the Federal Reserve Board's exceedingly accommodative monetary policy stance. On June 16, the Fed's Open Market Committee (FOMC) met and revised its forward assumptions. The FOMC addressed the inflation landscape, which is key to understanding when and how the Fed plans on tightening its policies as we work our way out of the 2020 recession. While the FOMC did indeed revise higher its own inflation expectations for the year, members remained willing to allow inflation to run ahead of their long-term target of 2% to ensure the economy and labor markets continue to heal. While we still expect no change in the Fed Funds rate before 2023, we do anticipate the Fed will address their bond purchase program sooner than was expected just a few months ago. Changes in Fed policy often cause additional short-term volatility across capital markets; however, let's also recognize that normalizing our monetary policy is a healthy and necessary step towards achieving longer-term economic stability.

Fed decisions certainly impact equity markets, but they also carry significant sway over fixed-income (bond) markets. Given historically low bond yields and the expectation of rising rates on the back of inflation, we would rather keep our bond exposure primarily to short term maturities. Given the inverse relationship between interest rates and bond prices, we want to limit our risk when buying and holding bonds for clients. Subsequent to interest rates rising, we will be ready and willing to extend our duration across our bond holdings for those clients where bonds are appropriate.

Throughout prior articles, we have highlighted the differences between growth and value stocks over the past several years. Last year, as the pandemic took hold, growth stocks' outperformance continued as interest rates were lowered and free money was made available to businesses and consumers. We saw a sharp reversal in this dynamic during the first quarter of 2021 as inflation expectations increased. Interestingly, growth stocks are beginning to perform relatively better again despite expectations that interest rates will move higher. We continue to believe that value and dividend-paying companies offer slightly better forward return prospects than many of their growth counterparts – due to the valuation disparity that exists between these types of companies. However, we certainly recognize the futility in timing such shifts in market sentiment, which is why we will continue to advocate for a well-balanced diversified portfolio for our clients.

Financial Vulnerability of Seniors

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

Sadly, one in five older Americans becomes the victim of financial exploitation each year. Annual losses run about $3 billion, with an average loss totaling more than $120,000. According to the AARP Public Policy Institute, older adults are targeted not only because they have accumulated more than $18 trillion in assets (about 67% of all U.S. wealth) but also because they are more likely to be suffering from problems with memory and judgment, making them quite vulnerable to fraud.

The reality is that as we grow older, we become more dependent on others for day-to-day care and assistance with financial affairs. Unfortunately, family members become the most frequent financial abusers, followed by others in positions of trust, including caregivers and friends. When family members are involved in the financial exploitation, they often have substance abuse, gambling, or financial issues of their own that influence their deceitful actions.

So, for family and friends who do have the best interests of loved ones at heart and want to protect them, it is important to keep an eye out for warning signs of financial abuse. Red flags can include: large or unexplained withdrawals from bank accounts; new "friends" accompanying loved ones to the bank; notices of insufficient funds or unpaid bills; checks written as gifts or loans; bank statements being sent to a third party; a caretaker or friend conducting financial transactions without proper documentation; changes in ATM withdrawal patterns; and closing CDs or bank accounts without regard to penalties. If possible, it is always a good idea to establish a relationship with a local banker to enlist their help in stopping any criminal activity and to prevent its occurrence.

For seniors who want to protect themselves and their assets, some tips include: locking up your checkbook, account statements and other sensitive information when others will be in your home; shred store receipts, financial documents, and credit card offers before throwing them away; never give personal information – including social security numbers and passwords – to anyone over the phone or on the internet unless you initiated the conversation and you trust the other party; and trust your instincts since abusers are often very skilled, charming and forceful in convincing you to give up control of your assets.

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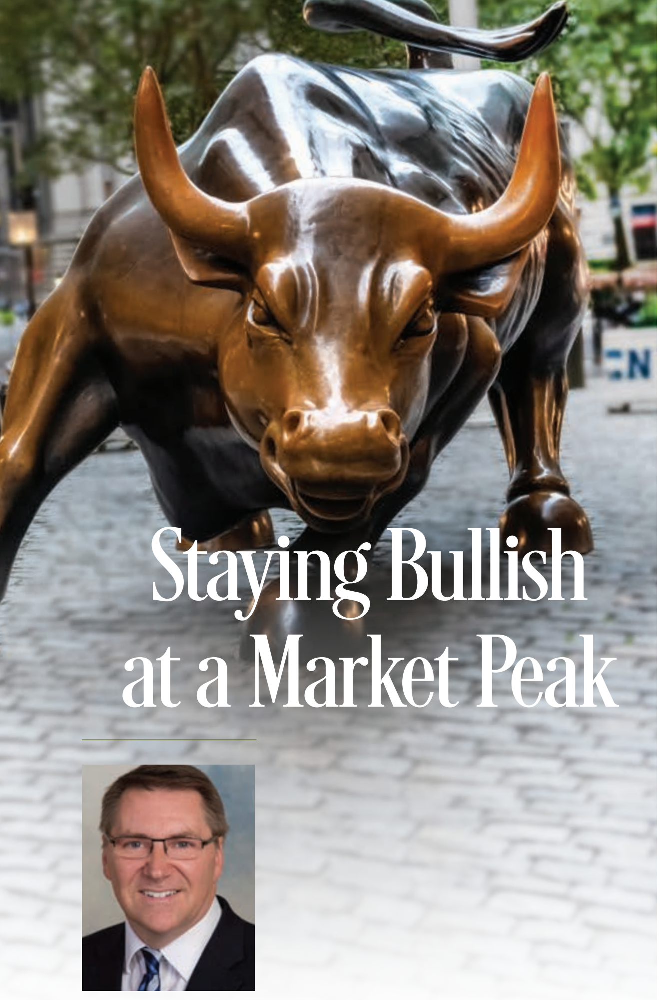
As a result of the dramatic increase in financial abuse among seniors, there are more resources available from local law enforcement agencies and State and Federal regulators. In Florida, both the Adult Protective Services Division of the Department of Children and Families and the Florida Office of Financial Regulation have added telephone hotlines and online access for filing complaints and reporting senior fraud crimes. Federal financial regulators, including the Consumer Financial Protection Bureau, have done the same and are devoting additional personnel for prevention and investigation to help seniors stay safe, secure, and protected. Over the coming months, The Trust Company will host online and in-person presentations by experts who can further educate all of us on the latest pitfalls and how to avoid them. We hope you will attend, and we always look forward to hearing from you if we can be of help.

If you think you or a family member has been the victim of financial exploitation, please reach out to your Client Advocate for information on how to contact the appropriate agency to help you find the answers you need.



Staying Bullish at a Market Peak

Take note of the past 18 months: We all just experienced one of the more confounding roller-coaster markets of our careers. No doubt, investors can wipe their foreheads in relief that stock prices not only recovered all their early 2020 losses but have touched record highs consistently since November. Undeniably, too, anxiety levels have risen in tandem with the rally. In the aftermath of any recession, investors tend to fear a relapse and naturally turn gun-shy – always on the lookout for another bubble forming, even when no bubble exists.

But before you get caught up in the hype of wondering how stock prices can be so strong today – we want to lay out a few truisms that should guide your thinking:

First, markets always should move toward new highs. That is the natural course of stock prices. As long as the U.S. economy is growing, businesses are selling more goods and generating more profits, thus making their shares more valuable. This trendline of growth gets interrupted occasionally by economic slowdowns, unexpected geo-political events, or sudden bouts of panic selling, but a market moving to new highs on the back of a growing economy and rising corporate profits is the norm.

Corrections are not to be feared. A short-term stock market correction, where prices drop 10%-20%, is always a possibility and tends to happen several times a decade. But corrections tend to be fleeting and result in the market reversing itself and pushing toward its old highs again. Corrections also have been unpredictable, not only in their causes, but in their depth and duration. Trying to anticipate the next correction often results in being underinvested at the wrong time and yields poorer portfolio results.

The U.S. stock market has been top-heavy. The 18%return of the S&P500 in 2020, followed by a more than 10% return so far in 2021 has been fueled by a handful of mega-cap technology companies that today impart an undue influence on index returns. The 10 largest stocks in the S&P500 provided most of 2020's 18% return and traded for 33x their projected earnings by Dec. 31. This gave the appearance of a stock market that was overheating and expensive, though the other 490 stocks in the index traded for just 20x projected earnings and experienced 2020 returns averaging just 4%. Top-heavy markets tend to conceal numerous less-risky opportunities below the surface.

We remain closer to the bottom of the economy than the peak. That's a key point to consider when investors worry about future returns. We are less than a year removed from the type of painful recession and bear market that occurs once every 10-20 years. If history is any guide, the economy is more likely to provide several more years of expansion now, rather than fall back into recession. Recessions tend to cleanse excesses in the economy, lead to lower interest rates and government stimulus, and prompt consumers and businesses to take more-prudent risks with capital – events that set the stage for a long recovery.

Our clients don't own "the market" but instead own a collection of companies and bonds that are hand-selected to achieve the absolute return goals we set for each client. The short-term oscillations and valuation levels of the S&P500 or the Dow Industrials may be irrelevant to your personal portfolio.

Finally, the stock market has been exceedingly "efficient" in valuing companies since the onset of COVID-19. Stocks that fell the most during COVID-19 were in the hardest-hit consumer discretionary industries such as restaurants, airlines, real estate, hotels, and cruise ships. Stocks that rose throughout the recession tended to lie in non-cyclical technology sectors where demand for products kept rising. Indeed, never before had America suffered a recession whose beginning and end, and causes and effects, were as easy to predict and quantify. That fact has removed many early-cycle "grey areas" and given us more confidence we can locate and value suitable investments for you.

Plan to Transition the Family Business

James McArthur
Family Office Services

Many family business owners contact The Trust Company for assistance as the future approaches and it is time to consider exactly how they will transfer their precious business into the hands and control of the next generation. As closely held family businesses expand over time, the needs of the families relying on these businesses are expanding as well. Growth of a business is often viewed in linear metrics – revenue and profitability. However, families can expand exponentially through generations. Such a dynamic creates demands that significantly impact culture, performance, and decision making, punctuating the need for a succession strategy that aligns the family's intentions, goals, and cash-flow requirements through multiple generations.

Protecting the longevity of a family business is essential to our global and U.S. economies. Family-owned businesses account for roughly 80% of all companies world-wide and approximately 78% of business entities in our country. According to the 2021 Family Enterprise Business Survey, approximately 40% of U.S. business owners actually have a succession plan in place and of those families, only a third believed their plan to be sufficient in terms of documentation and communication. Yet the survey revealed that many founding generation's children do not understand the fundamentals of the business including long-term goals and intentions. Nor are their financial priorities aligned between first and second generations.

For the business to support multiple generations, three key elements need to be managed throughout the life of the company: Growth, Cash Flow, and Control. Ample growth will maintain and increase valuation. Sufficient cash flow will enable owners and family members to support lifestyles. Control preserves the owner's ability to make decisions without the influence of non-family stakeholders or creditors. Environmental changes such as in politics, labor markets, generational behavior, technology, and regulation are occurring at such a rapid pace that simultaneously maintaining growth, liquidity and control may be challenging.

A well-structured succession plan will go a long way in terms of mitigating the risks of swift changes in our economic landscape. The blueprint for a family business's long-term strategy begins with four pillars:

Owners - determine the mission and define success

Governance – A board of directors directs the business as well as manages the chief executive

Management – recommends strategy and operates the company

Family – maintains and develops unity and core values for the next generation

Each pillar is tied to the other with family members creating the link. Management and leadership roles will vary and overlap to ensure that a good decision-making process is in place. When a family business experiences issues, most often it stems from a lack of governance and communication.

As the family works through the planning process, the overall mission and purpose of the business should be assessed by the fundamentals: Why does the business exist? How will the company grow to support multiple generations? Are current family members qualified and willing to lead the business? Is the current ownership structure appropriate and how will ownership be passed down to preserve capital and family control?

Often, fiduciary partners are called upon to assist family-owned businesses and family offices in planning for the transition to the next generation. When choosing a partner, the criteria of competency, experience, depth of talent, and continuity are important. Trusted advisors that invest time to learn the family's history, intentions, goals, and priorities will be vital to ensure a smooth transition of leadership and ownership for years to come. We specialize in this at The Trust Company and are here to assist you.

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