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Divisions of The Sanibel Captiva Trust Company

THIRD QUARTER | 2022

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Current Outlook & Portfolio Strategy

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To say that investors experienced a roller-coaster ride in the markets during the second quarter was an understatement. We witnessed the S&P 500 close 20% down from the benchmark's January highs to officially enter bear market territory in June. Meanwhile, yields on 10-Year U.S. Treasury bonds more than doubled from the beginning of the year, recently reaching 3.36%. To what can investors attribute this volatility? The biggest culprits are concerns and uncertainty over inflation, both in the U.S. and globally.

The June Consumer Price Index (CPI) report posted a headline inflation reading of 8.6%, which marked an increase over the prior months' report and exceeded economists' consensus estimates. While everyone may not purchase the exact basket of goods measured by the CPI survey, most of us have likely experienced the uptick in the price of gasoline and groceries. Even if we remove those volatile elements of gasoline (energy) and groceries (food) from the report, inflation still measured a 6% year-over-year increase. This level is well above the Federal Reserve Board's inflation target of 2% and increases investors' concerns that the Fed will have to take more aggressive measures that potentially result in a recession.

Pinpointing the exact origins and causes of current U.S. inflation generates significant debate and disagreement among economists. However, it is reasonable to consider some key drivers that likely explain most of the situation. First, the unprecedented shutdown of the global economy led to significant fiscal and monetary stimulus as governments and central banks worked to avoid a protracted global recession. Central banks have started to withdraw that monetary stimulus by raising short-term rates and reducing their balance sheets (quantitative tightening). Following higher-than anticipated inflation readings, our Fed raised interest rates by 0.75% June 15, and remarked that "ongoing increases…will be appropriate" to wrest inflation back to the Fed's 2% target.

Second, the four-month long Ukraine war has cut global supplies of both wheat and oil. Europe recently implemented sanctions against some purchases of Russian oil, which will lead to less overall supply of oil available to the market and, hence, keep oil prices elevated. Although the U.S. does not import Russian oil, we are not immune to the marketplace dynamics. While a definitive conclusion to the war is not in sight, a relatively amicable solution will provide energy and food markets a much-needed reprieve and dampen inflation.

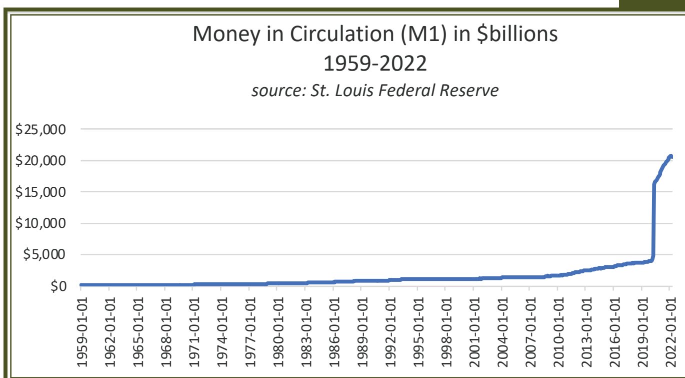
Finally, China's President Xi continues to implement a zero-COVID policy forcing massive shutdowns of entire cities, especially those that are key to global supply chains. Such a policy can worsen inflation as fewer goods are produced and delivered relative to surging consumer demand. During the pandemic, many companies acknowledged the hard lessons learned in concentrating supply chains around China, yet moving manufacturing facilities and establishing new vendors in the supply chain take time. Unfortunately, China's zero-COVID policy is unlikely to be rescinded and will continue to negatively impact supply chains and inflation.

We will likely continue to face uncertainty and volatility in the markets as the above variables shift over time. Naturally, this will lead investors to react positively or negatively to monthly data points as they try to glean a glimpse into the future. As in times past, we expect the roller coaster to bottom and begin its inevitable climb up. Long-term investors who allocate to high-quality companies will be rewarded during the recovery, but only if they stick with their long-term asset allocation. For clients who wish to reduce their risks, having modest allocations to short-term bonds or cash for upcoming lifestyle expenses may be prudent.

Get Paid to Wait: A Prescription for Handling Uncertainty

Logan Webb, CFA, CFP®
Senior Portfolio Manager

Ever since the Federal Reserve and governments around the globe simultaneously went to full-blown accommodation mode, all market corrections have been swiftly followed by a sharp "V-shaped" recovery sending stocks to new all-time highs. "Buy any and all dips" became the mantra of retail and institutional investors alike, and equities - like clockwork – responded. Fast forward to 2022: Accommodation has turned restrictive, the Fed is unwinding its balance sheet and is beginning to hike interest rates in the face of a looming recession to combat the very inflation that surprised them. Inflation is a direct result of money supply growth, and American history has never witnessed money supply growth like this:



A V-shaped recovery is no longer a sure thing in a restrictive, slower growth environment. To where can investors turn for returns in the meantime? The answer: Get paid to wait. Consider high-quality dividend-paying equities that will pay a consistent income stream as this bottoming process plays out. The U.S. economy will recover, and income-generating securities can help bridge the gap until it does. This strategy has several benefits that ultimately lead to something this father of young children is unfamiliar with: sleeping well at night.

High-quality dividend-paying equities are historically less volatile and provide more downside protection than their growth counterparts. For example, the Russell 1000 Value Index of dividend payers has fallen about 13% year-to-date vs. the Russell 1000 Growth Index, which has fallen about 30%. Dividends appear to be insignificant on the surface, but compounded over time they play a meaningful role in wealth accumulation. Dividends have contributed 32% of the total return for the S&P 500 going back to 1926. During the 10-year period ending June 2021, the S&P 500 price return was +113%, but +191% when you reinvested dividends -- nearly double the return in just a decade! There are pitfalls to avoid, however, when chasing income-generating securities:

1. There is no free lunch with high yields. Avoid that temptation to chase yields of 7% or more. It is very difficult for a company to grow if it pays out all its profits to shareholders. A high yield further signals that investors fear a dividend cut in the future. Yields between 2% and 4% have been a sweet spot.

2. Don't overplay the style box. While we're highlighting income here, long-term investors should own growth as well. The pendulum swings back and forth between growth and value, and it's good to have something working in the portfolio all the time. Don't chase past performance of growth or dividend stocks either. Remain diversified and simply own both.

3. Don't give up on dividend stocks to chase excitement. Slow and steady can still win the race in investing.

Equity valuations have recently reset to dramatically lower, and more-attractive, multiples, but not all companies have deserved the reset: Select companies continue to produce consistent growth in cash flows and earnings and continue to increase their dividends. It is more important than ever to be selective and to emphasize quality companies that trade at reasonable fundamental valuations relative to their growth. This methodology aligns perfectly with our philosophy here at the Trust Company.

Lastly, on the topic of income, don't ignore the now-unpopular bond market. High-quality short-term bonds look more attractive today than they have in several years. Premiums have come down substantially thanks to the recent spike in interest rates, and that in turn has boosted the yield to maturity. For the first time in more than a decade, select fixed-income securities are showing positive attributes as a part of a broadly diversified portfolio. Equities will continue to be the primary driver of long-term growth, but bonds are no longer as undesirable as advertised.

Planning to Make Your Wealth Last

Ann Pankow, CFP®, CTFA, ChFC®
Trust Officer

When stock markets exhibit the type of volatility we're seeing today, it's natural for investors to extrapolate recent results and worry about their futures. Indeed, the question, "will we run out of money?" is relayed to us more often today than any other. Even when clients don't ask the question directly, their outward concerns often seem to be built upon a fear that their wealth might not outlive them. As wealth advisors providing comprehensive financial planning, it is incumbent upon us to model financial plans that help clients prepare not only for volatile financial markets that almost certainly will occur but also for major life events that rarely occur – such as marriage, divorce, retirement, purchasing or selling property, selling a business, illnesses, and disability.

Specifically, clients need to know not only what decisions or events allow their plan to succeed, but under what circumstances their plan could fail. Too often upon meeting with new clients, I find that the latter has not been addressed – particularly as it relates to the death of a partner or family member.

On the surface, many plans succeed when using the projected life expectancies for a husband who, say, is 62 and a wife who is 60. Yet the odds are that one spouse will survive the other for far longer than the four years that actuarial tables say will occur. When looking at the historical life expectancies for spouses, economists found there is a 62% probability that wives survive their husbands and then live an average of 12-14 years past his death. The 38% of husbands who survive their wives live an average of 9-11 more years. Given these statistics, it is important to be aware of your financial balance sheet and to work with a financial planner to review a 'worst case scenario'.

I worked with a client several years ago who lost her husband after a short battle with brain cancer. They had recently moved to Florida, established residency, but continued to run a business that included real estate in the Midwest. The widow was in her early 70s, and although she was involved in the day-to-day operations of the business, she was not privy to their overall financial state of affairs. She didn't know where accounts were located or how they were titled. She was completely overwhelmed and feared the worst, that she would run out of money. We worked closely with her CPA and estate planning attorney to discover assets that added substantial value to her balance sheet. We created a detailed financial plan that projected a cash flow that would support her lifestyle in the manner to which she was accustomed. Assets were consolidated and her financial life was simplified. She had peace of mind.

In cases like this, a financial plan that projects outcomes well into the future becomes the most important guidepost for the survivors. A proper financial plan should consider all sources of employment and retirement income such as social security and pensions and understand the survivorship provisions. For assets such as investment accounts and real estate, it is important to know not only how the assets are titled, and who will inherit them, but any income they produce that would no longer be available to the surviving family members. A good plan will also verify beneficiary designations for retirement plans, life insurance, or annuities and will confirm their disposition at the owner's passing. By gathering this information, we can assess how the household's income and assets would be impacted by the sudden passing of either spouse, and assess if those assets are sufficient to meet the needs of the surviving family members for the rest of their lives.

It is through this kind of thoughtful planning that we help our clients feel comfortable that their loved ones will have financial security after they are gone.

Traveling This Summer? Protect Yourself

Dena Rae Hancock
Wealth Services

A traveler must understand what travel insurance is, what it covers and equally as important, what it does not.

As many of you anxiously get back to normal and enjoy traveling again, the fact of the matter is that it's a different world. Travel has become increasingly risky and expensive. Inflation, the cost of fuel and increasing demand are raising the price of airfares, lodging, rental cars, cruises, and just about every aspect of travel. Likewise, COVID-19 has added protocol risks while you're at your destinations or en route. So many travelers are asking if purchasing travel insurance is a good way to protect their investment if the unexpected occurs.

Generally, travel insurance covers trip cancellation and pre-paid reservations like airfare, lodging, cruise fares and other advanced bookings; it also covers inconveniences during your travel such as lost luggage, missed connections, and trip delays; and finally, it can cover most medical expenses while traveling.

Keep in mind that many credit cards offer travel-related benefits that can cover you if your flight is delayed or cancelled, if your rental car is damaged, or if your luggage is lost during travel. American Express, Chase, Capital One, and Bank of America travel cards all offer varying levels of protection that could serve as an alternative to trip cancellation insurance. However, if you become sick or injured during your trip, travel credit cards typically do not provide coverage and your health insurance policies will generally offer medical coverage anywhere within the U.S. It is important to investigate what coverages these resources provide and under what conditions or exclusions.

The argument in favor of buying travel insurance becomes stronger when traveling to international destinations. Medicare is not likely to cover you abroad, and even if you do have private health coverage that covers you outside the U.S., foreign doctors are not likely to accept the coverage and can demand payment up-front. It is also important to note that emergency medical transportation or evacuation is usually not covered by other medical policies and must be purchased separately. Depending on where you are, emergency transportation – such as a Medevac helicopter or a private plane -- can cost well more than $100,000 to get you back home. Finally, international travel insurance can help when dealing with medical emergencies overseas, as they understand how things work and how to speak the language ~ literally!

So, do you need travel insurance? The answer depends on your budget, your destination, and your specific situation, including any pre-existing medical conditions. Most travel insurance companies offer several different policies from which to choose, with varying levels of coverage and prices. You can also buy policies that cover a single trip, multiple trips, or coverage for the entire year. Many well-known insurance companies offer these policies, and often you can get coverage through your cruise company, your travel agent, or online travel booking engines when you make the reservations.

As an extra note of caution for international travelers, stay vigilant and be aware of scams. The latest involves the use of foreign ATMs and foreign hand-held credit card readers used at many retail locations. In both cases, your transaction will give you the choice of Dynamic Currency Conversion (DCC) which you should always decline. DCC allows the merchant or ATM operator to offer their own currency exchange rate which can be more than 10% higher than current exchange rates set by banks. To compound the scam, many foreign ATMs set exorbitantly high minimum withdrawals at $500 or higher for foreigners, which subjects more of your money to higher fees and higher exchange rates and leaves you with more foreign currency than you really need. To best protect yourself overseas, be sure to carry travel credit cards that do not charge foreign transaction fees, and always decline DCC coverage when offered.

Travel is a valuable gift to yourself. Just be prepared, safe and enjoy!

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