COCONUT GROVE BANK

TRUST & WEALTH MANAGEMENT

July 2016

Market Outlook

Keep Calm and Plod Along

To think we are only halfway through the year – we have had so many ups and downs during this brief time. The good news is we emerged no worse for the year and staying invested has produced a positive, albeit unspectacular, return thus far this year. The bad news is there is no shortage of uncertainty out there in the world: slow global economic growth, Brexit, terrorism, and upcoming U.S. elections, among others, are leading to great investor angst. We firmly believe in remaining invested in the markets but continue to choose our spots carefully.

Dividends have paid dividends

Stocks of quality companies that pay significant dividends have been the big winners thus far this year, and our dividend stock strategy is up 15% year-to-date at the time of this writing. In a U.S. stock market that has seesawed and recovered but is only up slightly over 2% for the year, we are pleased with the performance of this strategy.

Its success can be attributed to a few factors, among them the search for yield in a very low interest rate environment and a longing for safer, less volatile equities. This state of affairs and accompanying performance of the strategy will not last forever, but for now it persists.

Interest rates, and when they will go up, is front and center in investment discussions. The Federal Reserve, which had once signaled that 2016 would likely bring four interest rate hikes, has noticeably changed its tune in light of recent soft economic data and events around the world. In March, the Federal Reserve's Open Markets Committee convened and subsequently downgraded the number of anticipated rate hikes this year to two. After Brexit, it is looking like one rate hike this year would be an accomplishment.

For those of you living off of interest income (and for those of us tasked with producing it as investors), this turn of events only makes the challenge more difficult and prolongs the suffering of savers. The yield on a ten year U.S. Treasury bond is now barely above 1.4%; the yield on government bonds from a number of countries around the world is actually negative as central banks desperately try to stimulate economic activity. This means if you buy a German ten year government bond today, when the bond matures you will get less money than you invested. In short, you are paying for safekeeping of your money, while its purchasing power gradually erodes over time, and are guaranteed to end up with less than what you started with! Perhaps in recognition of this madness, in Japan there has been a run on sales of safes as people have bought them to keep their cash "under the mattress," where at least they know they will have the same amount of money that they first deposited on the day they decide to open the safe.

Fear and lack of opportunities, but mostly fear, is driving these trends and intensifying them as of late. The sudden rise in gold prices is another manifestation of this fear.

We continue to do our best to navigate this difficult income environment, but we are not taking what we consider outsized risks with our clients' funds in order to eke out a higher yield with low credit quality or long maturity instruments. In our view, that would provide a temporary solution with negative long-term consequences.

Brexit, Elections, Terrorism, and Other Factors

The laundry list of items causing investor angst is a long and growing one.

The latest is Brexit, the decision of the United Kingdom to leave the European Union. Concerns about sluggish growth abroad, already significant, were amplified by the outcome of the British referendum. The vote was close, at 52% for leaving and 48% for staying. The judgment of the market was swift, with $3 trillion in global equity values wiped away in two trading days. But then, just as quickly, the stock market came roaring back, recording the best week it has had in some time. As we write, this, the U.S. markets are hovering near all-time highs again (although international markets remain well off their peaks). Markets dislike uncertainty. They respond with volatility. Brexit is merely the latest disruptive event, and it will not be the last. Though Brexit has economic consequences (particularly for Britain), events such as this and geopolitical risks such as terrorism and the outcomes of political elections are near impossible to accurately forecast; though we do not mean to diminish their significance, we do not set our investment framework around them, either.

We do, however, make modest adjustments to our investment strategy as economic and market conditions warrant. Our focus has been on high quality, less volatile stocks, and high quality bonds with a reasonable duration. That has not changed. Uncertainty does tend to create some opportunities, and we have been well positioned to capitalize on panics when they occur, working from a position of strength. Rather than join the crowd in panic induced selling and be forced to sell out of positions at depressed prices, we are inclined to add to our investment positions when the market puts attractive assets "on sale" you can be certain that there will always be something to be worried about. A major part of our job is to make dispassionate decisions based on economic fundamentals and take the emotion out of investing.

Economic Growth or Stagnation?

First quarter GDP growth in the U.S. disappointed, coming in at an annualized rate of just 0.50%. Clearly, an economy growing at one-half of one percent per year is not a robust one. The past few years have started in the same sluggish manner and then improved. Nevertheless, we expect growth to pick up somewhat going forward and hit the 2% annual level that has been its recent trajectory. It is certainly uninspiring, but not stagnant. On the employment front the news is better, as the U.S. has continued to create over 200,000 jobs per month, and wages are ticking up modestly.

Just because the U.S. economy is growing mildly, that does not mean corporate earnings are growing along with it. We have experienced four consecutive quarters of earnings declines reported by U.S. companies. So for a year now, corporate profits have been declining. This is what is meant by the term "earnings recession."

So far, earnings have been a little better than expectations, and that has helped buttress the market. Exceeding depressed expectations, though, is not something to cheer much about; the fact is corporate earnings are down about 6% year over year, and reported revenues are down about 1.6%. Of course, a sharp decline in earnings for companies in the energy sector is weighing on earnings overall. Even excluding the energy sector, however, earnings are still down.

A significant factor has been stagnant global growth, which has hurt American multinationals that get significant revenue overseas. Finally, currency issues – in the form of a strong U.S. Dollar – also took a toll. A more valuable dollar makes products sold overseas more expensive, and it erodes revenue earned overseas when those euro or yen or other currency is translated back into American currency. As a result, American multinational corporations that receive significant revenue from overseas have gotten a double whammy from lackluster global growth and a strong dollar. While the currency trend has abated somewhat, slow global growth persists.

China, which has been crowded out of the headlines by recent events, is a case in point. While China claims year-over-year growth of between 6-7%, no one believes these official figures. Since the financial crisis, China has taken on substantial debt, and its debt-to-GDP ratio has ballooned. China is now paying the price for past malinvestment in projects that resulted in empty apartment buildings, unused highways, and excess industrial capacity. These projects yielded temporary GDP boosts during construction, but are now unable to generate the cash flow necessary to service underlying debt.

There is no question the world economy is being weighed down by too much debt, and there is not enough economic demand to absorb the slack in the world economy. These things will take time to sort themselves out. We have faith in the ability of free markets to rectify these issues over time. In the interim, investing may feel like one long slog, but rewards those with the patience to maintain a long-term view.

Regards,

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About Us

About Coconut Grove Bank

Founded in 1926, Coconut Grove Bank (CGB) is the oldest continuously operating bank in Miami-Dade County. CGB is a full service financial institution offering personal and business banking, lending, trust and wealth management services to clients desiring a personalized level of service. An independent and privately owned bank, CGB has five offices located in Aventura, Coconut Grove, Coral Gables, Palmetto Bay and South Miami.

Trust & Wealth Management Approach

CGB's Trust & Wealth Management team provides comprehensive wealth management and fiduciary services tailored to meet the needs of successful individuals and their families. We focus on preserving wealth through risk management, diversification and goals-based investment planning while addressing the qualitative aspects of wealth.

Trust & Wealth Management Capabilities

Serving as a trusted advisor, CGB prides itself in the deep relationships we forge with successful individuals and their families. Our approach is a unique planning experience designed to give a better understanding of the purpose of wealth and clarify personal objectives for our clients and their families. We assist clients by taking a 360-degree look at personal and financial circumstances. This process is designed to involve wealth planning and investment experts, as well as a client's own legal and accounting professionals, to proactively implement a dynamic action plan in this constantly evolving environment.

Each client portfolio is customized for each particular investor. Through our "open architecture" investment platform, we select managers on a "best of strategies" basis. We believe in proper asset allocation given the facts and circumstances, appropriate diversification and goals-based investment planning. We utilize portfolios that consistently deliver the highest possible net return (fees and taxes) for a given level of risk and seek the lowest level of risk for a desired expected rate of return.

Our investment philosophy includes:

- Customized strategies to meet each client's needs and objectives
- Strategically planned, tactically managed and monitored
- Focused risk management
- Extensive due diligence process

Additional Capabilities & Services

- Institutional-quality portfolio management
- Well diversified portfolios among and within asset classes
- Tax-efficient portfolios
- Investment Management accounts
- Revocable, Grantor, and Living Trusts
- Foundations and Endowments
- Irrevocable and Testamentary Trusts IRAs, Rollover IRAs, SEP IRAs and Simple IRAs
- Pension plans
- Profit sharing plans
- Traditional banking services, including competitive rates on interest-bearing accounts
- Commercial mortgage financing
- Conflict free advice and counsel
- Trust and estate administrative services, trustee and personal representative services
- Commercial loans, including loans secured by wealth management accounts
- Guardianship accounts
- Special Needs Trust
- Charitable Trusts
- Custody accounts
- Life Insurance Trusts
- Financial Planning
- Estate plan and document review and counsel

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