FineMark National Bank & Trust

Fine Points

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SECOND QUARTER REVIEW & COMMENTARY

IN THIS ISSUE:

By Christopher Battifarano, CFA®, CAIA
Executive Vice President & Chief Investment Officer

We stand at the mid-point of the year, shocked that it has gone by so quickly. There have been a number of surprises, but nothing terribly alarming apart from the very low level of market volatility, which has fallen even further than what was experienced in the first quarter.

Beyond the low level of market volatility, we are also somewhat surprised at the overall returns in equity market performance. The results have exceeded our expectations at the onset of 2017 and we would not be surprised to see a market correction before the year is over. As mentioned in the last issue of *Fine Points*, such pullbacks are normal, even during secular bull markets, and are the price investors pay to earn the outsized returns that equity investing affords.

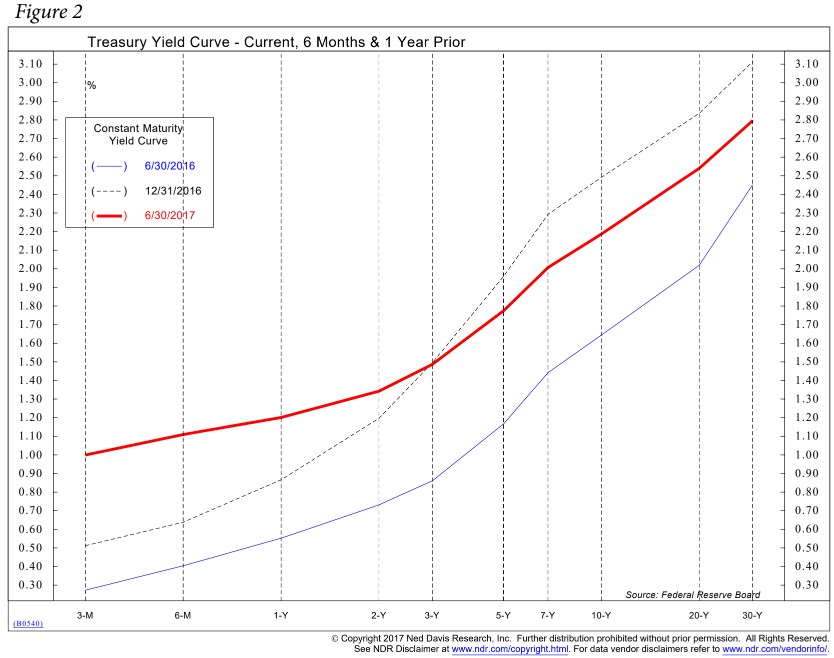
Figure 1

	YTD Returns	1 Year Returns	3 Year Returns	5 Year Returns	10 Year Returns
S&P 500	9.34%	17.90%	9.61%	14.63%	7.18%
Russell 2000	4.99%	24.60%	7.36%	13.70%	6.92%
MSCI EAFE	11.83%	17.08%	-1.53%	5.76%	-1.82%
MSCI EM	17.22%	21.18%	-1.28%	1.52%	-0.47%
Barclays US Aggregate	2.27%	-0.31%	2.48%	2.21%	4.48%
Barclays US 5 Year Municipals	3.17%	0.44%	2.02%	2.06%	4.00%
HFRX Equity Hedge	3.73%	8.07%	0.52%	3.44%	-1.52%
Barclays BTOP 50	-2.46%	-5.28%	1.06%	0.19%	1.64%
HFRX Global Hedge	2.56%	6.00%	-0.35%	1.91%	-0.95%

(continued)

We are astounded at the returns generated thus far in 2017 in fixed income. We expected the two Fed Funds rate hikes to have a more deleterious effect on bond returns. However, returns have been unexpectedly good because of a flattening in the yield curve (see Figure 2), also known as a reduction in term premium.* The Fed's recent discussions to normalize its balance sheet should put upward pressure on the long end of the yield curve later this year and make for a more normalized term premium structure than we see today.

Figure 2



One of the most notable events that took place in the second quarter was the release of President Trump's long-awaited tax plan. Considering its lack of detail, we believe this release was the first salvo in what will be a long negotiation between budget hawks on both sides of the political aisle. We continue to expect a reduction in tax rates for corporations and modest relief for individuals, however we do not expect to see something as dramatic as President Reagan's 1986 Tax Reform Act. While a number of market participants seem to have given up on the prospect of a Trump legislative agenda, we believe reducing the corporate tax burden will gain support because the US is so far behind its developed market peers. As depicted in Figures 3 and 4 below, the US dramatically lags behind the rest of the developed world as it relates to the competitiveness of our corporate tax policy. The situation has worsened significantly over the past two decades.

Figure 3

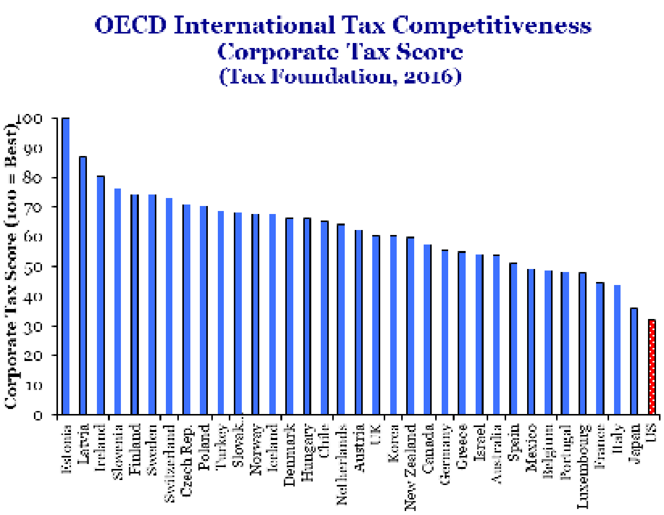
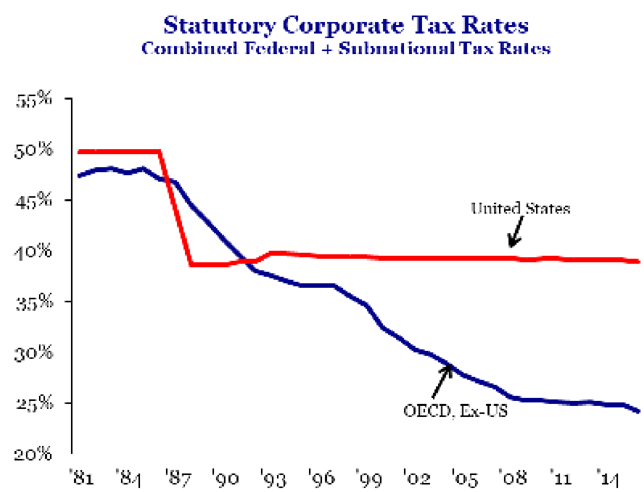


Figure 4



Organization for Economic Co-operation and Development (OECD): a group of 34 democratic member countries that support free market economies and discuss and develop economic and social policy.

We have experienced a prolonged period of positive market returns, coupled with what appears to be significant market participant complacency. Our philosophy and approach is to generate gains where we are able and to prioritize preservation of capital when times become more challenging.

*"**The goal in investing is asymmetry:** to expose yourself to return in a way that doesn't expose you commensurately to risk, and to participate in gains when the market rises to a greater extent than you participate in losses when it falls. But that doesn't mean the avoidance of all losses is a reasonable objective."*

\- Howard Marks, Chairman and Founder, Oaktree Capital Management

Marks, H. Memo to Oaktree Clients, Re: Dare to be Great II, Oaktree Capital Management, L.P., 4 April 2014.

*A term premium is the extra return that lenders demand to hold a longer-term bond instead of investing in a series of short-term securities.

We attempt to be dynamic in our client portfolio allocations through tactical asset allocation, manager due diligence and alternative assets, which have lower correlations to traditional asset classes. To generate outsized portfolio returns, we are required to have a variant perception of markets versus other market participants. It is extremely difficult to generate outsized returns without constructing portfolios that are sufficiently different than what the consensus market view dictates. This frequently puts us in the position of going against popular viewpoints, while still doing what we believe to be in our clients' best interest.

An example of this approach is a study of Warren Buffett's chairmanship at Berkshire Hathaway. His performance has been nothing short of legendary, however, as illustrated in Figures 5 and 6, there have been significantly long periods of time where the performance of Berkshire Hathaway stock (BRK-A) has abysmally lagged the passive market index performance. Buffett and his shareholders had to endure significantly long periods of uncomfortable underperformance to generate long-term, outsized returns. Quite simply, there are going to be prolonged periods of time where active management underperforms a passive benchmark.

Figure 5

Figure 6

	BRK-A	S&P 500	BRK-A Underperformance
1967	13.3%	30.9%	(17.6)%
1972	8.1%	18.9%	(10.8)%
1974	(48.7)%	(26.4)%	(22.3)%
1975	2.5%	37.2%	(34.7)%
1990	(23.1)%	(3.1)%	(20.0)%
1996	6.2%	23.0%	(16.8)%
1999	(19.9)%	21.0%	(40.9)%
2003	15.8%	28.7%	(12.9)%
2009	2.7%	26.5%	(23.8)%
2015	(12.5)%	1.4%	(13.9)%

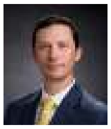
To use a baseball analogy, since we are in the dog days of summer, we can draw a corollary to pitchers who endure boos from the crowd by constantly throwing to first base. The crowd wants to see him deal to the plate, but the right, albeit unpopular, play is to keep the base runner honest. Our approach at FineMark is to always do what is right in order to generate the highest risk adjusted returns for clients, whether or not it is popular.

During the quarter we increased our rotation out of US equities and into international equities. We believe this to be prudent for a number of reasons. The most profound being relative valuation disparity, which we discussed in the last issue of *Fine Points*. US equities have enjoyed a much more resounding rerating, or increase in value, since the financial crisis and are now trading at a significantly higher valuation than their international peers.

The other major asset allocation action we took during the quarter was to increase the credit quality of our fixed income portfolios. For quite some time, we have been in an extremely difficult period to generate yield thus, we invested in areas outside of core, investment-grade fixed income to generate incremental yield. Today, we believe it is wise for us to adopt a defensive posture in fixed income and wait for more attractive yield opportunities to manifest in the future. Our timing may be early, but we prefer assuming the risk of opportunity cost to the certainty of losses in the fixed income component of our portfolios.

We wish you a great summer, wherever your travels may take you, and we thank you for your continued confidence. As always, FineMark is available to answer any investment questions you may have.

ELECTRONIC WILLS



By Read Sawczyn
Vice President & Private Wealth Advisor

One of the more recent developments in estate planning is the concept of electronic wills. Instead of signing a hard copy document in ink, an electronic will allows the testator (a person who has written a will) and witnesses to sign it electronically and a notary to notarize it electronically. Currently Nevada is the only state in the US where electronic wills are legal, but other states are trying.

Five states: Arizona, Florida, Indiana, New Hampshire and Virginia all introduced a bill this year seeking to validate electronic wills, however none of these bills passed into law.

Florida came the closest when the Florida Senate passed the controversial Florida Wills Act in May by a vote of 34 to 0. The act was expected to be signed into law by Governor Rick Scott however, on June 26, Florida's governor vetoed the bill set to go into effect July 1. In a letter, Gov. Scott said the concept of remote notarization is meant to provide increased access to legal services such as estate planning, but he did not believe the bill adequately ensured authentication of the identity of parties involved.

Those in support of electronic wills contend that electronic wills allow more people access to estate planning through online tools without the cost of hiring an attorney. While this is beneficial, others are concerned that electronic wills do not have the traditional safeguards that have been put in place to protect the elderly from fraud or exploitation. Additionally, there are concerns that estate plans are too complex to create without an attorney's assistance.

In Florida, the controversy revolves around the act's changes to the will execution procedure and the ability for a non-resident to probate a will in Florida. Currently, every will signed in Florida must physically be in writing, signed by the maker at the end of the will, in the physical presence of two witnesses. The witnesses must also sign the will in the presence of the maker of the will and each other.

The Act would have allowed the maker, witnesses and a notary to participate in the will signing from different locations as long as they were connected through live audio and video connections. In addition, only the witnesses and notary have to be physically located in Florida for the signing. A secondary, but important issue is whether probating non-resident's wills in Florida would unduly burden already overburdened courts here.

While this particular Act was vetoed, we expect to see more efforts in Florida as well as many other states, to legalize electronic wills. Stay tuned.

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10 YEARS

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