

# The Compass

First Quarter 2018

## Executive Summary

- ❑ Politics took the spotlight in 2017, but equity markets reaching new highs stole the show.
- ❑ Synchronized global growth and strong corporate earnings contributed to strength in the equity markets.
- ❑ December's rate hike brought the Fed Funds rate to the 1.25-1.50% range.
- ❑ The S&P 500 was up 7.59% in the most recent quarter. Revenues posted solid gains. Energy surprised on the upside.
- ❑ Expectations for a strong finish to 2017 were realized, with the S&P 500 up 22.46% for the year.
- ❑ The 10 year U.S. Treasury yield closed the quarter at 2.41%, a modest increase over the previous quarter.

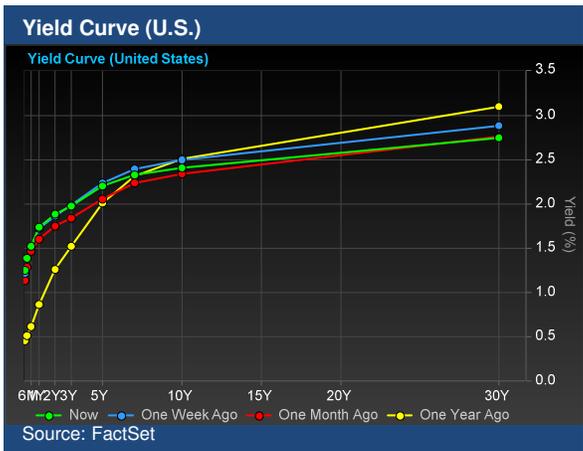
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## Cypress Trust Company Investment Committee

Brian Skarbek, Chief Investment Officer  
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Dorothy "Dee" Giannotti  
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## Overview

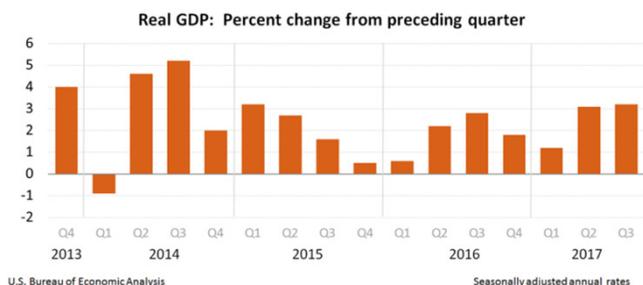
Politics took the spotlight in 2017, temporarily upstaged by natural disasters, but equity markets reaching new highs stole the show. Synchronized global growth and strong corporate earnings contributed to strength in equity markets. Even with 3 interest rate hikes by the Fed during calendar year 2017 (in March, June, and December), monetary policy is still easy, while inflation persists at relatively low levels. We are seeing elevated consumer and business confidence, perhaps at least partly attributed to the success of tax reform. Volatility remains remarkably low.

2018 is expected to be a repeat of 2017, at least in the direction, although perhaps not the magnitude. That goes for all segments of the world, most notably financial markets and geo-political environments.

There was also the excitement around a newish asset (call it what you will at this point) – crypto currencies. Its place in the global financial system is still yet to be determined.

## Economic Backdrop

As anticipated, the Fed raised rates in December, bringing the Fed Funds rate to the 1.25%-1.50% range. This is the 5<sup>th</sup> rate hike since 2015. Inflation topped the Fed's 2% target rate primarily due to energy costs, bringing the inflation rate to 2.2% at the end of November. Consumer prices inched higher. Unemployment remains low at 4.1%. GDP increased at an annual rate of 3.2% in the 3<sup>rd</sup> quarter (3<sup>rd</sup> estimate), up 10 bps over the prior quarter, reflecting positive contributions from personal consumption, private inventory investment, non-residential fixed investment, and exports. Imports decreased slightly. Fourth quarter estimates will be released in January 2018.



## Equities

In the most recent quarter, the S&P 500 was up +7.59%, led by Consumer Discretionary, Technology and Financials. Consumer Staples, Utilities, and Health Care lagged. Energy continued to gain traction.

Revenues again posted solid gains with a 6.9% increase, overshadowing the previous quarter's 5% increase. Energy surprised on the upside, followed by Technology, Materials and Utilities supporting that strong number. Telecom and Financials lagged. All sectors reported positive revenue growth in the 4<sup>th</sup> quarter.

S&P 500 earnings posted another double-digit gain of 11.9%, slightly below last quarter's 12.3%. Energy reported triple-digit earnings growth. Materials, Technology and Financials followed with double-digit gains.

Expectations for a strong finish to 2017 were realized, with the S&P 500 returning 22.46% for the year, led by Technology, Materials, Consumer Discretionary, Financials, and Health Care.

## Fixed Income

The 10 year U.S. Treasury closed the quarter at 2.41% which was only a modest percentage increase over the last quarter (closed last quarter at 2.33%). Yields have been on a steady rise since the early September level of 2.03%. Yields bounced off that almost 2% level, as investors and traders alike moved past any concerns of economic slowdowns and started to prepare for inflation, whether from monetary policy (shrinking the balance sheet and raising rates) or fiscal policy (tax reform).

## Outlook

The outlook for 2018 is generally positive, but cautious given that the unknowns are always lurking about. In the U.S. we continue in the late stages of a bull market. Steady expansion should support continued earnings and revenue growth. The impact of tax reform will unfold. We watch the yield curve for indication of recession, as well as signs of excess demand that may form bubbles. Always vigilant, our commitment to you is to navigate your portfolio through both calm and turbulent times in an effort to meet your goals and objectives.

*We don't have to be smarter than the rest. We have to be more disciplined than the rest. – Warren Buffett*



## Directed and Delegated Trusts: Embracing Vision in a Pragmatic Environment

By Joseph C. Pauldine  
Cypress Trust Company

Families are demanding more flexibility and control over their estate plans – a trend that we feel will continue to develop. The growth in popularity of bifurcating administrative duty and investment responsibility in revocable and irrevocable trusts has encouraged corporate fiduciaries such as Cypress Trust Company to expand beyond traditional service offerings. Directed and delegated trusts, of course, are nothing new – affluent and successful families have been using these concepts for more than a century and today, all but a handful of states have some form of directed trust statute.

So, it's easy – right? Not so fast!

When it comes to trust code, not every state is created equal. Although Florida has made progress toward defining the responsibilities (translated to mean "liability") between administration and investment management, the Sunshine State still has a long way to go before its trust statutes are on par with those of, say, South Dakota and Delaware as it relates to division of duties. Although there is nothing stopping the parties involved (grantors, beneficiaries, trust companies and investment managers) from "making it work," the underlying concern of accountability gives all of the above reason to pause.

And therein lies the conundrum. How does a firm go about embracing a visionary position when it's mired in the pragmatic reality of statutory framework? Although Florida does not currently have a "pure" directed trust statute, there are some creative ways to accomplish the goal of separating responsibilities using the existing trust code.

**Directed vs. Delegated:** In a directed trust, the trustee is directed in the actual document to have another party manage the assets. In a delegated trust, the trustee is merely delegating the function of investment management to a third party.

Let's start with directed trusts.

The cleanest way to implement this bifurcation is, of course, at the beginning. When drafting initial trusts and restatements, clients should be encouraged to incorporate language in support of FS § 736.0808 which states that if "the terms of a trust confer on a person other than the settlor of a revocable trust the power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust."

Essentially, this statute gives the grantor an up-front opportunity to identify responsible parties as part of the terms of the instrument. However, even here the trustee is still faced with liability – after all, what constitutes a "serious breach of fiduciary duty?" We have found that a good practice during the drafting process of sections permitting directed trusts is to include language that provides clear indemnification of parties for the actions of the others.

The process becomes a little more involved with delegated trusts. Typically we run across these scenarios after a trust has become irrevocable. FS § 736.0807 provides that a "trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances, including investment functions pursuant to § 518.112. The trustee shall exercise reasonable care, skill, and caution in:

- (a) Selecting an agent;
- (b) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust;
- (c) Reviewing the agent's actions periodically, in order to monitor the agent's performance and compliance with the terms of the delegation."

In terms of administrative fiduciary duty, this means that the corporate trustee may choose to delegate the investment management to a third party, but still retains the responsibility (again, translated to "liability") to monitor and review all of the activity for compliance. Investment oversight still lies with the trustee. In some instances while working with delegated trusts, we have found that giving consideration to approving the investment management firm as a sub-advisor has afforded us the ability to consolidate some of the oversight/monitoring requirements at the enterprise level, thereby freeing up time that would otherwise have been spent at the individual account level.

The opportunity in the administrative trust space is gaining momentum. Trust companies and investment advisors that can embrace finding ways to implement and support these clients together will be in the best position to offer the most comprehensive solutions. Until Florida trust statutes are revised, supporting directed and delegated trusts will require an investment of time and effort from everyone involved...but the benefits can be immeasurable.

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Joseph C. Pauldine is a Senior Vice President of Cypress Trust Company. Mr. Pauldine assists successful individuals and their families with custom investment management solutions and trust administration services. He received his B.S. in Business Administration from Old Dominion University.

Cypress Trust Company is a boutique corporate fiduciary that focuses exclusively on creating customized investment strategies, serving as a corporate trustee, personal representative or agent during estate settlement, and as an administrative trustee for clients already committed to an investment plan.

## A Warm Welcome to Our Jacksonville Team

In December, Cypress Trust Company completed its acquisition of the personal trust business of CenterState Bank, N.A. The transition will occur over the next several months. "We are excited to acquire a personal trust business that began in the 1960's to serve clients in the greater Jacksonville area," stated Dr. Jay Chigurupati, Chairman and CEO of Cypress Trust Company. "The transaction also enables us to serve potential clients in significant markets in the state of Florida."

The former CenterState Trust Department team – Allen Reid, Christine Bell, Becky Belt, and Tia Johnson – are now employees of Cypress Trust Company and will continue to operate from their offices at 1234 King Street in Jacksonville. They bring with them a vast wealth of experience and expertise in trust administration. We welcome them to our Cypress family.

Shown left to right:  
Patrick Dillon, Tia Johnson, Allen Reid, Dee Giannotti, Jack Kuhn, Becky Belt, Christine Bell, Dr. Jay Chigurupati, Theresa Strickland, Joe Pauldine, Charles Weir, Brian Skarbek.



## Debunking Some Common Cybersecurity Myths

By Jim Parry, Vice President IT Services  
Cypress Trust Company

**Myth:** *Anti-virus software and firewalls are 100% effective.*

**Truth:** Anti-virus software and firewalls are important elements to protecting your information. However, neither of these elements are guaranteed to protect you from an attack. Combining these technologies with good security habits is the best way to reduce your risk. Further, vendors may release updated versions of software to address problems or fix vulnerabilities. You should install the updates as soon as possible; some software even offers the option to obtain updates automatically. Making sure that you have the latest virus definitions for your anti-virus software is especially important.

**Myth:** *There is nothing important on your machine, so you do not need to protect it.*

**Truth:** Your opinion about what is important may differ from an attacker's opinion. If you have personal or financial data on your computer, attackers may be able to collect it and use it for their own financial gain. Even if you do not store that kind of information on your computer, an attacker who can gain control of your computer may be able to use it in attacks against other people.

**Myth:** *When computers slow down, it means that they are old and should be replaced.*

**Truth:** It is possible that running newer or larger software programs on an older computer could lead to slow performance, but you may just need to replace or upgrade a particular component (memory, operating system, or update to a SSD hard drive). Another possibility is that there are other processes or programs running in the background. If your computer has suddenly become slower, it may be compromised by malware or spyware.

Source: US-CERT Security Tip ST06-002



Cypress Trust Company is a boutique corporate fiduciary that focuses exclusively on providing customized trust and investment management services for successful individuals and their families, non-profit organizations, foundations and endowments. As an independent Florida-chartered trust company, we are governed by an elected board of directors and regulated by the Florida Office of Financial Regulation. Cypress Trust Company maintains full-service offices in Palm Beach, Naples, Vero Beach, Winter Haven, and Jacksonville, with additional representation in Sarasota and The Villages.

### Important Notes

This does not constitute an offer or solicitation. Opinions expressed are current opinions as of the date appearing in this material only. This information should not be considered investment advice or a recommendation to buy or sell any particular security. While every effort has been made to verify the information contained herein, we make no representations as to its accuracy. The information in this material and specific securities mentioned are not representative of all securities purchased, sold or recommended for clients. Actual portfolio holdings will vary for each client and there is no guarantee that a particular client's account will hold any, or all, of the securities identified. It should not be assumed that any of the securities or recommendations made in the future will be profitable or will equal the performance of the listed securities. Past performance does not predict future results.

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