TRUST
INVESTMENT PERSPECTIVES
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All Eyes On The Fed

What a year for stocks! The equity markets were up 32 percent in 2013. Since it's only appropriate to give thanks at the end of the year, let me be the first to say, "Thanks, Chairman Bernanke." And, like any spoiled child would do, let me ask incoming Chairwoman Yellen, "What are you going to give us in 2014?"

If you have ever doubted the importance of the Federal Reserve or the adage "Don't fight the Fed," just look at the performance of the markets since March 2009. As you can see from the chart on page 3, in less than five years the Fed has added massive liquidity to our financial system (by purchasing more than $2 trillion in bonds), while the stock market has increased by more than 200 percent.

Dictating monetary policy is not easy. The Fed's decisions sometimes result in redistributions where there are both winners and losers (e.g., borrowers love low rates; savers hate them). But possibly the most difficult part of any decision made by the Fed is the length of time it takes to see the impact.

The Fed's primary lever is to raise or lower the Fed funds rate. It lowers the rate to stimulate the economy (to boost growth), and it raises the rate to slow the economy (to fight inflation). Of course, when the Fed changes the funds rate, the economy does not immediately change. It takes time. This reminds me of taking a hotel shower. The water is too cold so you turn the knob to a hotter level. Still too cold. Turn it hotter. Not warm enough yet. Turn it up some more. Suddenly, the water is absolutely scorching. Turn the knob sharply back to cold. The temperature is great for just a moment, and then it turns ice cold!

So like navigating the hotel shower, the Fed has to anticipate when it needs to turn its levers to make the temperature perfect for our economy – not too hot or too cold. To do this, the Fed has to forecast six to 12 months out. In fact, that's what the Fed is doing right now.

Reflecting upon the 2007-09 financial crisis, you may recall that home prices were down more than 30 percent nationally and over 50 percent in several states. Equity prices also were down more than 50 percent. Lehman failed, other large investment banks were in trouble and the government had to bail out AIG, Fannie Mae, and Freddie Mac.

The Fed responded to this chaos by instituting a series of interest rate cuts over a 15-month time period that dropped the Fed funds rate from 5.25 percent in September 2007 to a target of 0 to .25 percent. Of course, at

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James F. Arens II
Executive Vice President

MARKET RECAP

U.S. equity markets posted strong gains in 2013. Most international markets posted double-digit returns as well.

	FORTH QUARTER 2013	PAST 12 MONTHS
Dow Jones	10.2%	29.7%
S&P 500	10.5%	32.4%
EAFE (Int'l)	5.7%	22.8%

VIEWPOINT

A Message from the Desk of Tom Wilkins

If you are like me, the New Year serves as a marker for both beginnings and endings.

Let me begin with a Trust Company (TCO) ending. Both officers in our Muskogee location, Sr. Vice President Ed Thornley and Asst. Vice President Janet Metzger, retired December 31. And with their departure, our office in Muskogee also retired. We wish them well in their retirement, and know our friends in the Muskogee community will miss seeing them. TCO will continue to serve the Muskogee area with the same level of dedication and commitment that Ed and Janet brought to their profession these past 30 plus years.

I also have some beginnings to share, in the form of promotions. Jamie O'Shields has been promoted to vice president in our Oklahoma City office. A former OU basketball player, Jamie is an attorney who specializes in estate planning and trust administration. She joined TCO in 2012 and has been providing superior service to her clients ever since.

I'd also like to recognize Stacey Curtis and Christina Gruszeczki. Stacey was promoted to trust officer. She administers our clients' life insurance trusts as well as working with many of our other clients on their trust and estate needs. Christina was promoted to marketing officer. She coordinates all of our marketing and advertising efforts including marketing campaigns and events. As with all TCO officers, Stacey and Christina have worked hard to earn this recognition.

Finally, as 2013 ends and 2014 begins, my gratitude for the long-standing relationships we have with you, our clients, certainly is not ending. Thank you for your continued confidence and friendship.

Thomas W. Wilkins *Chairman, President & Chief Executive Officer*

that point, rates could not go any lower so the Fed turned to non-traditional tools. It engaged in quantitative easing where the Fed bought Treasury bonds and mortgage-backed securities. The idea was to push rates lower through these purchases and to add liquidity in the form of bank reserves. In addition, the Fed wanted to push investors into riskier assets such as stocks. As stock prices increased, we all started feeling better. This was "the wealth effect" in action. The Fed also pledged to keep rates low and monetary policy accommodative for the foreseeable future.

In recent months, all of the talk has been about tapering (i.e., lowering the amount of bonds the Fed purchases each month). On December 17, the Fed announced that it will reduce its monthly purchases from $85 billion to a "paltry" $75 billion. Just in case this small tweak to the bond buying bonanza upsets the market, the Fed also announced that there is no set schedule to completely stop buying bonds and that its monetary policy will continue to be accommodative (i.e., keeping the Fed funds rate low), even after the bond buying is done. The stock market rallied even further after this announcement.

The question on the minds of many investors is when will the quantitative easing program stop and when will the monetary policy become less accommodative (i.e., the Fed starts raising rates). None of us can predict the answer, but our guess is that there are several reasons why the Fed will remain very accommodative during 2014:

- **The unemployment rate is still high.** While the unemployment rate has fallen from 10 percent in 2007 to the current rate of 7 percent, much of this decline is the result of people dropping out of the labor force. If the participation rate had not decreased so much, the unemployment rate would still be above 9 percent.

- **Fiscal policy is not accommodative.** Normally when economic growth slows, fiscal policy expands. But, as we continue to run large deficits and our debt levels increase, it is very unlikely Congress is going to cut taxes or increase spending in a significant way. To some extent, the Fed is trying to counteract the impact of fiscal policies, including Congress' current standstill.

- **The Fed is fearful of spooking the equity markets and the housing market.** Much of the economic confidence that has returned can be traced back to rising stock prices and a bounce in home prices. The Fed fears a restrictive monetary policy could put an end to these rallies.

- **Inflation is far below expectations.** Of the reasons I've listed, inflation is the most important issue to watch. Many commentators believe the Fed's accommodative policy will cause inflation. You see, when the Fed buys these bonds, it is simply creating money! That's right; the Fed credits the accounts of the financial institutions that sell these bonds. The worry is that this accommodative policy will cause inflation *if* these reserves are loaned out.

The reality is that these reserves are *not* being loaned out. However, the other reality is that the Fed's favorite measure of inflation (the PCE Price Deflator) is showing inflation just above 1 percent and trending down. The

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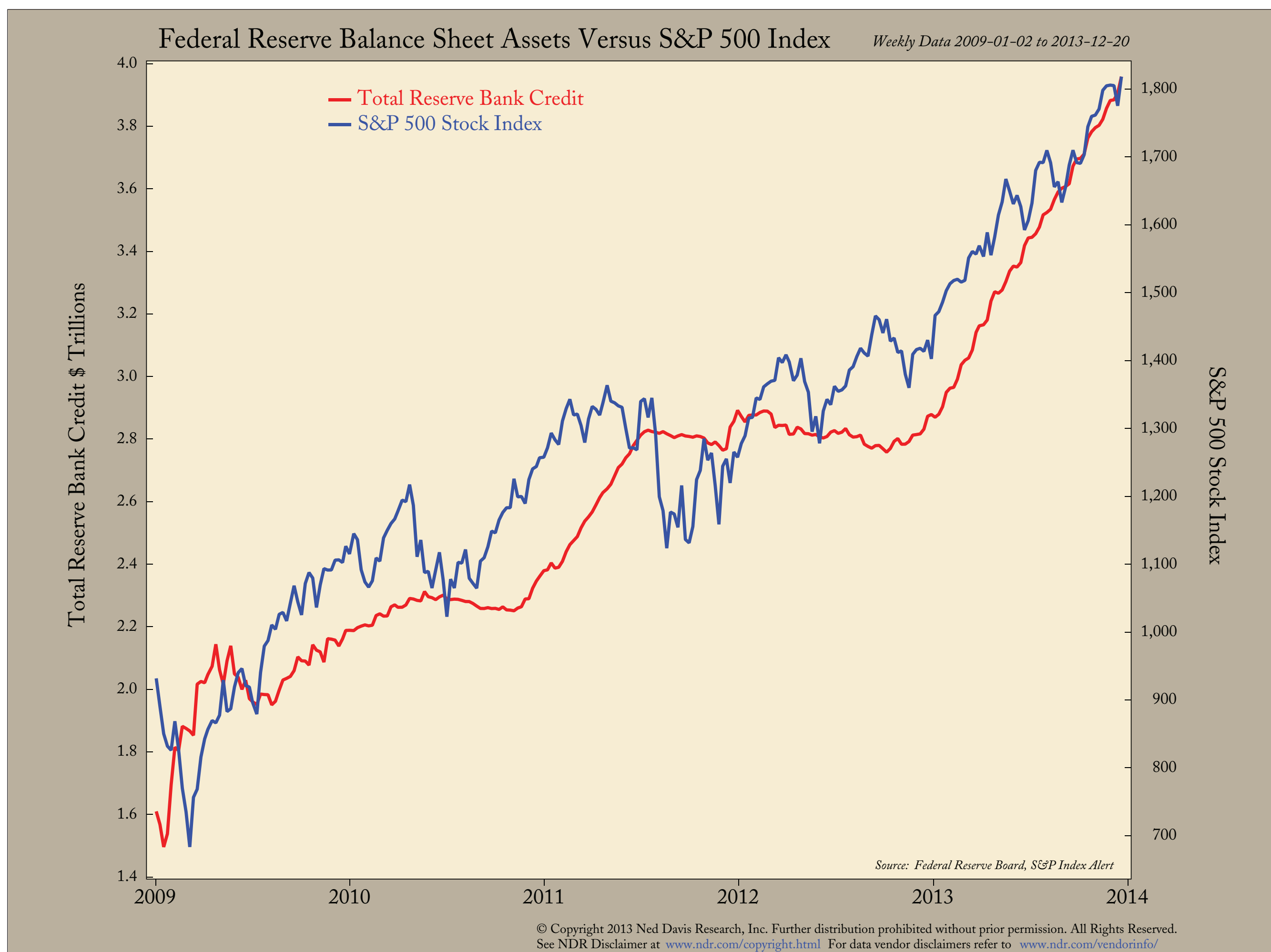
Fed's greatest fear is living through Japan's recent 20 year nightmare of deflation. One of the lessons the Fed learned from Japan is that its accommodative policy should not stop too soon. It would be a terrible sign if the Fed slowed its accommodative policy and was then forced to restart it. Our conclusion from this analysis is that the Fed will continue to remain accommodative.

Next, we must ask if the stock market is currently overvalued, given the significant rally over the last five years. The market is not cheap, but we would not judge it to be extremely overvalued. The market is currently trading at 17 times earnings compared to a historical average of 16 times earnings. If the market moves much closer to 20 times earnings, we might examine valuation further.

It is evident that there is still plenty to worry about. We are overdue for a stock market correction (a 10 percent drop in the market). On average, the stock market has experienced a correction every 10 months. However, we have not experienced a correction in over 20 months. We all know markets do not go straight up. As a result, a correction would not surprise us. But, barring any new information, such as an increase in inflation or a significant drop in profit margins, we would view a correction as an opportunity for investors to increase their equity allocation if they are below their target allocation range.

With respect to the bond market, interest rates have risen dramatically this year with the yield on the 10 year Treasury increasing from 1.6 percent in May to 3.0 percent currently. We think it is likely interest rates will continue their upward trend over the next several years. However, given our views on inflation and the Fed, there's nothing to say that this will happen soon. We feel investors should avoid the temptation to stretch for yield by investing in longer-term bonds. Ultimately, the increase in interest rates should be viewed as a positive for bond investors since this will create an environment where you can once again earn a real positive return on your bond investments.

In sum, we expect the Fed to continue to be accommodative. We're not going to fight the Fed or the market, nor will we try to time the market. We'll continue to monitor changes in inflation, profit margins and money flows. At Trust Company, we will work hard to help you, our clients, be in the best position for whatever the market and the Fed have in store for us.



It's Better To Be Safe Than Sorry!

As Ponzi-like scandals (Bernie Madoff, etc.) periodically make national headlines, investor concern with the safety and security of their money understandably rises. Yet, the world of investment firms is multi-faceted, and the rules that apply to different types of firms vary as widely as the players in this field. As we discuss our services with prospective clients, a question that often surfaces concerns the processes we have in place to protect clients from a Madoff-type situation.

Earlier in my career, existing or potential clients would never ask specific questions about how operations or compliance functions work as related to the safety of their investments. But, in today's climate, this is a question that is asked often. With this in mind, let us turn to some helpful questions to ask your advisor and some warning signs that you should be aware of.

The first set of questions you should ask your advisor is how his or her firm is audited and regulated. There are non-regulated and regulated advisors. As a state-chartered trust company, Trust Company of Oklahoma is regulated primarily by the Oklahoma State Banking Commission. In addition, since we serve as the trust department for several Oklahoma banks, we are or have been regulated by the FDIC, Federal Reserve, and Comptroller of the Currency. This regulation includes annual in-depth on-site exams.

Other types of advisors may be regulated by the Financial Industry Regulatory Authority (FINRA). FINRA is a not-for-profit corporation that acts as a self-regulatory organization, promulgating rules that govern brokers and dealers and certain other kinds of professionals in the securities industry. FINRA itself is regulated by the SEC.

After determining if your advisor is regulated or non-regulated, you should ask: What are the checks and balances in my advisor's systems that keep widespread fraud from occurring? Are the firm's auditors independent? Your advisor should be able to answer these questions.

"Fraud and falsehood only dread examination. Truth invites it."

– Samuel Johnson

The second set of questions you should ask involves the custody and effective control of your assets and what happens in case of fraud or other misconduct. At TCO, all assets are either held at the Federal Reserve (government securities) or Depository Trust Company (DTC) for all other securities. In addition, ownership of your assets is always retained by you, the client.

Be sure to ask if your advisor is the custodian. A custodian is a financial institution that holds customers' securities and other assets, in physical or electronic form, for safekeeping against theft or loss. Also, does your advisor's firm have control over the custody of your assets? If the answer is no to either of these questions, who is the custodian and are the assets held in your name or the name of the firm?

Advisors who are not regulated should not have anything to do with the custody of the assets, including ownership interest in the custodian they are using. Additionally, you should ask to what extent the firm insures clients against loss due to employee misconduct. Lastly, pricing investments should be performed by an entity independent of the advisor so as to remove the ability to manipulate the market value of your investments.

Even among regulated advisors, it is prudent to check out who you are dealing with as an individual. Get to know your advisor and make sure the relationship is a good fit. Finally, remember there are no investment vehicles that provide high rates of return with little or no downside volatility. The investment plan and strategies offered should make sense to you. If not, ask questions until you are comfortable. You might think asking these questions is a given, but over my 25 years in this business, I have seen greed cause people to have historical and common sense amnesia.

When I sit down to discuss how we do business at TCO, I can look confidently in the eyes of my clients and prospective clients with the knowledge that our firm will only do what is best for the client. That is the essence of the fiduciary standard of investing.

It is all about alignment and trust. How you are aligned and connected with the people who manage your investments is critically important. Our company would not have the word "Trust" as a part of our name for over 30 years if we did not know how to earn it.

David T. Stanley
Executive Vice President

HEMS To Live By

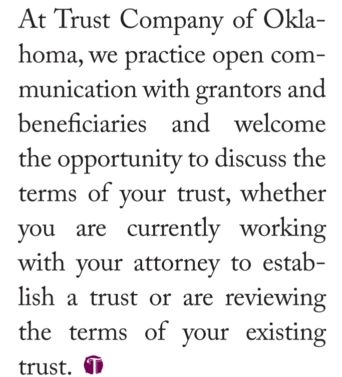
While the initial motivation for creating a trust is unique to each grantor (creator of the trust), all grantors share the common goal of wishing to provide appropriately for their beneficiaries. As a grantor, the distribution language you choose for your trust will guide your trustee on how best to use trust assets to provide for your beneficiaries.

Understanding how the trustee will interpret the distribution language is a critical step in estate planning that is often overlooked. To illustrate the importance of early and open communication with your trustee, let's discuss the distribution standard we see most often in today's trusts, the HEMS standard, and how seemingly straightforward terms may be interpreted differently by different people.

HEMS stands for "health, education, maintenance, and support." Each of the individual terms may seem clear at first glance, but they actually may be very imprecise if you do not make your wishes known. For example, it is commonly understood that the term "education" includes costs associated with higher education. But, what if you also wish for the trust to pay the costs of private tuition for high school or a semester abroad? Without additional guidance, your trustee may not interpret "education" to include these things.

Another instance where clarity is needed concerns the terms "maintenance" and "support." Generally, these are interpreted to include such things as distributions for normal living expenses such as housing, food, insurance, and taxes. However, what if you value a strong work ethic and do not want your beneficiary to rely solely on the trust for support? Without carefully crafted language and open communication with your trustee, will your trustee exercise discretion in such a way that rewards your beneficiary for being self supporting?

As you can see, even the most commonly used distribution language is subject to interpretation. Whether your trust uses the HEMS standard or other distribution language, understanding how your trustee will interpret your chosen language is critical to ensure that your trust assets will provide for your beneficiaries as you intended both now and in the future.



At Trust Company of Oklahoma, we practice open communication with grantors and beneficiaries and welcome the opportunity to discuss the terms of your trust, whether you are currently working with your attorney to establish a trust or are reviewing the terms of your existing trust.

Joanna K. Murphy
Senior Vice President

SPOTLIGHT

Healthy communities start with healthy babies. That's why Infant Crisis Services helps meet the needs of the tiniest citizens in Central Oklahoma. Infant Crisis Services provides life-sustaining formula, food, and diapers to babies and toddlers in times of crisis because no baby should go hungry.

For 30 years, our organization has strived to prevent childhood hunger and reduce health and developmental issues that can occur during the first few years of life. Between birth and age three, 85 percent of the brain is developing at a rapid rate. Immunity is being strengthened. Physical growth is occurring. Studies have shown children who miss a meal during that time are more likely to endure lifelong consequences as a result, negatively impacting a child's behavior, performance in school, and overall cognitive development. Each child who receives our services is one less child who will go to bed with an empty tummy or a soiled diaper, and one more child who will have a chance to grow up healthy.

Last year, Infant Crisis Services served more than 14,000 babies and toddlers at our main location (4224 N. Lincoln Blvd in Oklahoma City) and three branch locations. But transportation barriers prevent many needy families from receiving our services. So in October, the BabyMobile was born. The BabyMobile is a formula, food, and diaper pantry on wheels. It is the first of its kind in the state, and one of the first in the nation. Each week, the BabyMobile travels to various locations throughout Central Oklahoma serving babies and toddlers who otherwise could not get to us.

Since our first year of operation, Infant Crisis Services has remained 100 percent privately funded. Thanks to you and your donations, we are making healthy communities a reality, not only today, but for generations to come.

For more information about Infant Crisis Services and how you can become involved, visit ***www.infantcrisis.org*** *or call* ***405-230-1900****.*

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