TRUST
INVESTMENT PERSPECTIVES
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# The Markets: Past and Future

As we flip the calendar to 2016, it's a great opportunity to think about the future. Or maybe we want to think about 2016 simply because 2015 wasn't a great year for the markets. Unfortunately, the S&P 500 was basically flat for the year. The average stock actually decreased in value while the S&P 500 index was buoyed by a few large tech companies (particularly Amazon, Netflix, Google and Facebook).

For bond investors, treasury yields changed little during the year (hovering around 2.3%), meaning that investors were left clipping small coupons which resulted in a below-average total return. Almost all commodities, including oil, dropped in value and there was no relief gained from investing overseas since most markets were weak. Even the overseas markets that had positive returns saw their gains wiped away when converted back to the appreciated dollar.

The markets spent much of the year waiting for the Fed to finally start increasing rates. In late 2014, Fed officials suggested they would raise rates by mid-2015. As summer arrived and the Fed's rate increase didn't, the markets started to anticipate a September rate increase. Labor Day came and went, as did Halloween and Thanksgiving – still no increase in rates. That all changed in December when the Fed finally raised rates after seven years of a zero-interest-rate policy.

Clearly, we are at an inflection point with Fed policy. While some observers try to diminish the importance of the Fed, we're reluctant to do so. It's hard to deny the impact of quantitative easing and the Fed's accommodative monetary policy when you examine the chart on page 3. As you can see, the Fed borrowed money (from 2008 to 2014) so it could buy additional bonds in order to keep interest rates low. The chart shows a strong correlation between stock prices and the Fed's balance sheet.

With that quick summary of 2015, let's turn our attention to some of the issues to keep in mind as we enter 2016.

**Interest rates –** According to the Federal Open Market Committee participants (the decision makers at the Fed), the Fed funds rate will be in the 1.25% to 1.50% range by the end of 2016. Yet, the market (based on the Fed

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James F. Arens II
*Executive Vice President & Chief Investment Officer*

## MARKETRECAP

*Even with a strong fourth quarter, most markets were weak in 2015. U.S. stocks outperformed international stocks for the third straight year.*

| | Fourth Quarter 2015 | Past 12 Months |
|---|---|---|
| Dow Jones | 7.7% | 0.2% |
| S&P 500 | 7.0% | 1.4% |
| EAFE (Int'l) | 4.0% | -0.8% |

# VIEWPOINT

*A message from the Desk of Tom Wilkins*

In the first month of 2016, we – at Trust Company of Oklahoma – are celebrating our **35th anniversary**. Chartered by the Oklahoma Banking Commission in December 1980, we opened our doors in January 1981. What started as a service to small local banks that didn't have a trust department has grown to be Oklahoma's largest and oldest independent trust company.

In the last 35 years, we have successfully expanded and diversified the services we provide. We have grown to our current three offices and over 73 employees, but we have remained committed to our sole purpose: to serve individuals, families and businesses in our communities, basing our recommendations solely on our clients' interests. It is because of you, our clients and friends, that TCO has reached this milestone. I speak for everyone in the organization when I say how thankful we are to share another year with each of you.

As each year begins, I enjoy the privilege of recognizing colleagues who have earned well-deserved promotions. 2016 is no exception. Please join me in congratulating six employees who earned promotions the last quarter of 2015.

Zac Reynolds, a senior vice president, is now director of investments for our OKC Region as well. Zac joined TCO in 2012 and provides invaluable expertise to our clients. I would also like to recognize Michael Hopper, who has been promoted to vice president. Michael advises clients on insurance and estate planning. Two employees were promoted to assistant vice president. In the Retirement Plan Services Division is Vicky Brown. She joined the company in 2007 and focuses on compliance for employee benefit plans. Jared W. Buchan has also been named assistant vice president. He came to TCO in 2014 and serves in the Investment Division.

Our newest trust officers are Trena Person and Katherine Chandler. Trena works at Tulsa's Yale office. A native Tulsan, she joined TCO in 2015 and has almost 15 years of banking experience overall, including 11 years of experience directly involved in trust administration and operations. Katherine works in the OKC office. She has served the company for almost three years in our Real Estate Division. Congratulations to all for the accomplishments!

Finally, as we begin 2016, thank you to our clients and friends for allowing Trust Company of Oklahoma to serve you.

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

funds futures contract) is expecting the Fed funds rate to be in the 0.75% to 1.0% range by the end of 2016. Regardless of who is right, interest rates should remain low by historic measures.

Our view tends to be more consistent with the Fed funds futures. The current low unemployment rate (5%) is a sign of significant improvement in the labor market from the 10% peak in 2009, but it's also misleading. We've seen a tremendous drop in the labor participation rate, and we still have an unusually high number of people who are working part-time even though they want full-time jobs.

More importantly, inflation has been weak. The Fed's primary gauge of inflation (the PCE Price Index) is the lowest that it's been in the past 50 years, with the exception of a brief period during the Great Recession. Even when oil prices stabilize and we lose that deflationary influence on the index, inflation will likely be below the Fed's 2% target. This will make it difficult for the Fed to raise rates quickly.

While low inflation may sound like a good thing to those of us who remember the problems caused by high inflation in the 1970s and early 1980s, it's not. First, remember that prices are the best indicator of demand, meaning that low inflation is typically an indication of a weak economy. Second, when inflation is low, it creates the risk of deflation. Lower prices mean that employees don't get meaningful raises, home prices stagnate and consumers defer consumption ("why buy today when it will be cheaper tomorrow?"). The Fed also loses its ability to influence the economy since the Fed doesn't want to take the Fed funds rate below zero.

**Credit spreads –** Interest rates on high-yield debt have increased significantly in the past year while U.S. Treasury rates have been flat. This is particularly onerous for highly leveraged energy firms as there is a fear that low oil prices will make it difficult for industry participants to repay debt. Higher rates will make it difficult for some companies to roll over their debt and will also make acquisitions more expensive. Of course, while many people expect significant acquisition activity in the energy sector, it's difficult to put a deal together when buyers value a target company based on $35 oil, but sellers value their company based on $60 oil.

**The rising dollar –** The dollar has appreciated more than 20% over the past 18 months versus most foreign currencies. The higher dollar has hurt our ability to export since it makes our products more expensive when sold overseas, lowers the dollar value of foreign profits and makes foreign imports more competitive. The majority

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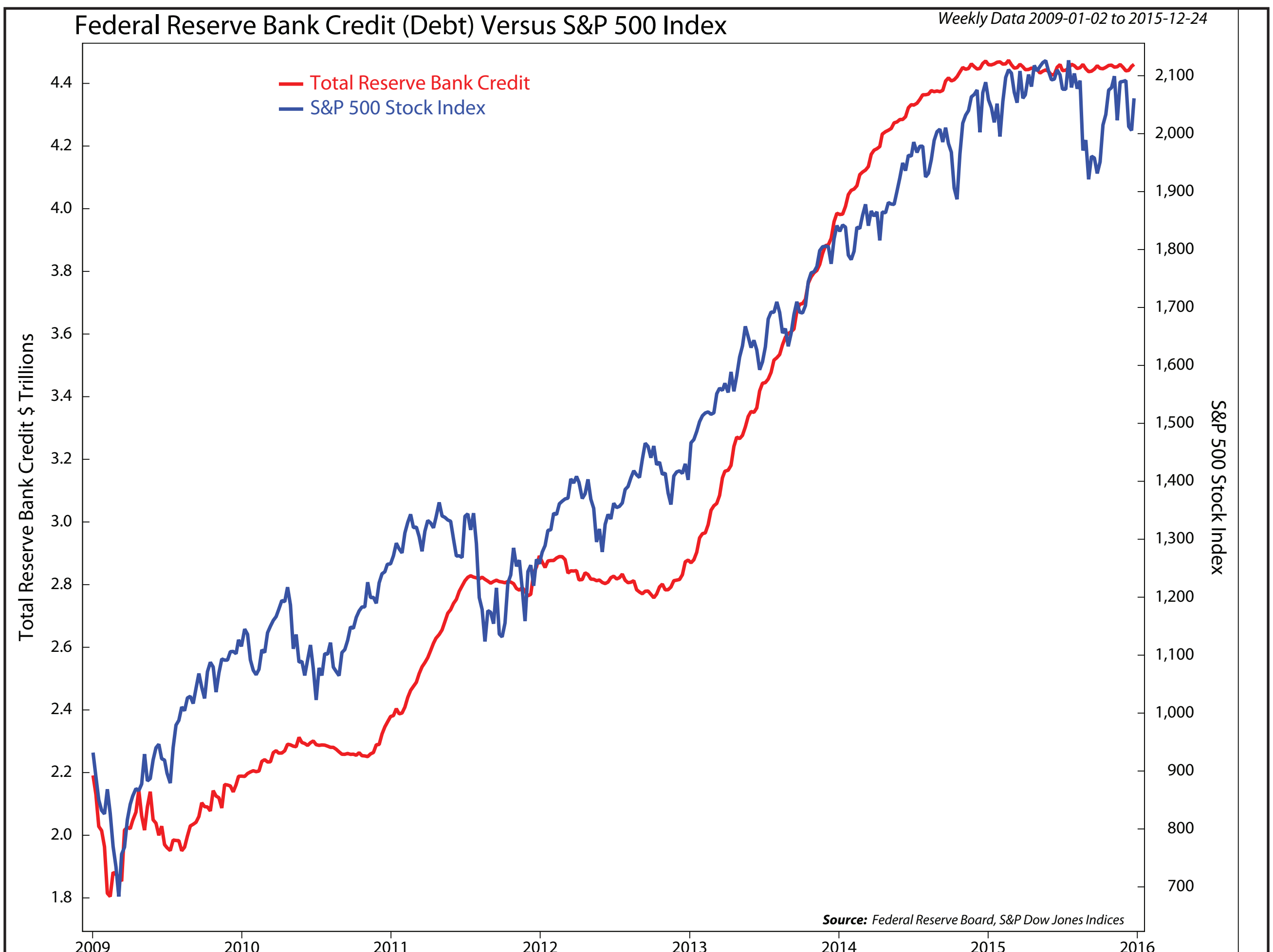
of the dollar's upward move is likely behind us as the market has been anticipating higher U.S. interest rates.

**Wage growth is below average** – Wage growth is just above 2%. And, after excluding inflation, it is even lower with the result that it's difficult for consumption to grow. Low wage growth is likely attributable to low productivity growth and the increase in service related jobs (i.e. retail and restaurants) versus manufacturing.

**Low oil prices** – In 2014, the price of oil was well above $100. As everyone knows, oil traded below $35 in December 2015. Many factors have resulted in this price decline, including increased supply (due to the use of fracking and other technologies), slow worldwide growth (below average demand) and the appreciating dollar. While many economists have argued that $35 oil would spur consumer spending, that hasn't had much of an impact from an aggregate perspective since some of that money has been saved or used to pay off debt. More importantly, lower oil prices mean that we're losing many high-paying jobs and creating fear in a sector that has been responsible for much of our growth over the past few years.

**Equities** – Equities are currently trading at 18 times trailing earnings. While this is higher than the historic average of approximately 16 times trailing earnings, multiples are typically higher during periods of low interest rates. As described above, we expect rates to remain low which should be favorable for equity markets going forward. We're also hopeful that oil prices will stabilize at higher levels and that the dollar's appreciation is complete. Finally, we're optimistic that investors are not complacent and will use pullbacks in the market as an opportunity to buy additional stocks.

These are some of the issues that we at Trust Company are thinking about as we look at the market today. Many of these issues have the potential to create bouts of short-term volatility: situations that will likely give us the opportunity to increase our allocation to equities at more attractive prices over time. We will continue to monitor the markets and adjust portfolios to best position you for whatever the market and the Fed send our way.



# Big Changes With Social Security

Last November, Congress passed, and President Obama signed into law, the Bipartisan Budget Act of 2015, which included changes to Social Security benefits. While these changes are not sweeping, a few popular strategies to maximize social security benefits have been eliminated—one of those relates to married couples and divorcees seeking spousal benefits through the use of what is known as file and suspend.

**Social Security Benefits for Individuals**

Social Security retirement benefits, at least for individuals, are simple to understand. An individual is eligible for benefits after working 10 years and may begin to receive benefits as early as age 62. The amount received is a calculation based on one's earnings history and the age at which benefits start.

Individuals will receive 100% of their benefit at what Social Security deems Full Retirement Age (FRA), generally between age 66 and 67. Any age at which the benefit is claimed prior to (or after) an individual's FRA will reduce (or increase) the benefit. Importantly, once an individual reaches age 70, increases cease so one should always file for benefits by age 70.

**File and Suspend Before and After Budget Act**

Benefit options become more complicated when another individual is added to the decision by way of marriage or divorce. Prior to the Budget Act, when a married couple or divorcee evaluated benefit options, it was necessary to consider such options not merely as an individual, but also with an eye on the rules available to married couples or divorcees in order to maximize benefit amounts, such as the spousal benefit. The spousal benefit is calculated not on the individual's earning history, but on that of his or her spouse (or ex-spouse in the event of divorce).

*"Removal of popular Social Security tactic will cause many couples to further evaluate plans for retirement"*

One technique retirees could use prior to the Act in order to leverage the spousal benefit is commonly referred to as file and suspend. This methodology for claiming Social Security benefits, often confusing to retirees and advisors alike, is eliminated in the Budget Act.

Before the Act, a spouse could file for his benefit at FRA, but immediately suspend receipt of payment. This allowed the second spouse to claim and receive the spousal benefit, while the first spouse's suspended benefit continued to increase.

Ideally, the suspended benefit of the first spouse would be delayed until age 70 to receive the maximum payment under the law.

After the Budget Act, when a spouse suspends his benefit at FRA, all benefits tied to that wage earner (i.e. the spousal benefit) must also be suspended. In other words, the second spouse cannot receive a spousal benefit while the benefit of the first is in suspense, and the first spouse cannot receive a spousal benefit either.

Furthermore, after the Act, anyone filing for benefits will automatically receive the larger of their own benefit or their spousal benefit irrespective of the filing age.

Fortunately, like a good legislative body, Congress wrote in "grandfather" language to allow individuals a six-month grace period to elect this strategy or, if already elected, continue receiving payments according to the law prior to the Act. In that regard, so long as an individual turns 66 before May 2, 2016, she can leverage this Social Security strategy by acting on or before April 29, 2016 (the Friday preceding the deadline). For individuals that requested to file and suspend prior to the Act, government will honor the strategy and continue payments as prescribed.

Albeit complex, file and suspend was a useful tactic to maximize Social Security for many retirees, and the removal will cause many couples to further evaluate plans for retirement and Social Security benefits.

The Act provides other changes to Social Security beyond file and suspend. If you would like to discuss how these changes might affect your retirement plans, please give us a call.

Jared W. Buchan
*Assistant Vice President*

# Real Estate Tech Trends

## How technology and online platforms impact the market of buying and selling property.

Recently I read an article outlining how Airbnb, the website that allows homeowners to list their homes – or portions of them – for short-term rental, has teamed up with Realtor.com, the National Association of Realtors website, to let you sleep overnight in a house you may be interested in purchasing. This real estate "try it before you buy it" initiative makes me consider all of the enormous improvements in resources that home buyers, sellers and real estate professionals have at their disposal today because of technology.

The long-promised electronic signing of real estate documents is really just now coming into widespread use, even though E-sign legislation was passed in 2000. E-signing is very popular for real estate contracts, but not so much in the closing process. For some reason, lenders seem to want that mortgage signed in the old fashioned way: ink.

Searching real estate listings has progressed from the "phone-book-like" Multilist (which was available only to realtors and hopelessly out of date as soon as it was printed) to a multitude of websites that now allow prospective homebuyers to view pictures, do virtual tours and even get drone footage of potential homes. And to think that all of this can now be done from our mobile devices!

Zillow is another real estate mobile tool driving changes and profoundly impacting the industry. It has advanced significantly in recent times. Beginning as a real estate advertising website, its "Zestimates" (estimates of home values) were only fairly accurate. Sometimes, if not a lot of public information was available, they were wildly inaccurate. Today, with data on 110 million homes across the U.S., mobile platforms and strategic partnerships, Zillow has become a powerful tool to gather accurate information on current listings, sales history and even rental property.

Through the many recent advancements, information in the real estate market is power for both buyers and sellers. Even so, buying (and selling) a home is still basically an emotional process.

Careful decision making and word of mouth are as important today, even with all of the fancy apps, as ever. Some things, as they say, will never change.

Jim Bloomfield
*Vice President*

# SPOTLIGHT

With over 11,000 children in foster care in Oklahoma, not nearly enough foster families to care for the children in need, and one of the lowest foster family reimbursement rates in the nation, Oklahoma's child welfare system is in crisis. These children are in state custody and get little support. All Kidz was founded in 2013 by Oklahomans who want to help foster families, already stretched thin, provide much-needed experiences and extracurricular activities to the children in Oklahoma foster care.

Extracurricular activities build social skills, teamwork and self-confidence. All children, especially foster kids, need an outlet to grow and nurture these qualities. All Kidz promotes and sponsors enrichment activities by paying for enrollment fees for sports and music lessons, providing assistance with extracurricular uniforms and equipment and by holding community events that the entire foster family can attend together.

All Kidz has sponsored foster children in activities such as dance lessons, cheerleading, gymnastics, football camps, karate, guitar lessons and soccer. The organization funded birthday parties for many children who never celebrated a birthday before.

The nonprofit organization has also hosted a number of community events including renting out the Paramount Theatre in Oklahoma City for holiday movies, hosting families in the suites of the Chickasaw Bricktown Ballpark for a Dodgers game and organizing a back-to-school basketball skills camp. Kids and families who benefit from these events are thankful for the opportunity to participate in activities that they may not be able to afford otherwise.

AllKidz is based in Oklahoma City. Katherine Chandler, trust officer at Trust Company of Oklahoma, is a founding member of the organization.

To learn more about AllKidz, please visit **www.allkidz.org**

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