TRUST

INVESTMENT PERSPECTIVES

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It's All About Europe... For Now

What a year 2011 has been for the U.S. stock market. For the first four months of 2011, the market was up 9 percent. This rally was followed by a 19 percent selloff over the next five months. Since early October, the market has rallied 15 percent through year-end. We have certainly covered a lot of ground to end the year, up only 2 percent for the year.

For better or worse, much of the volatility in the market over the last six months has been driven by the daily news out of Europe. To oversimplify the situation, positive news flow from Europe has led to rallies in the U.S. while negative news has resulted in down days. In addition, the news flow from Europe has caused the U.S. markets to be quite volatile. In 2011, there have been 14 trading days in which the S&P 500 Index has moved up or down by more than 2 percent in a single day.

As we all know, the European Union (EU) countries are struggling to address the sovereign debt crisis that many are now experiencing. Throughout the year, Greece and Italy have dominated the European news. Greece's debt-to-GDP ratio is currently 165 percent and Italy's ratio is 112 percent. Germany, in contrast, has a debt-to-GDP ratio of only 43 percent.

While Italy's debt-to-GDP ratio is not as severe as Greece's, we worry about Italy even more. Italy is the fourth largest country in the EU, while Greece is only the 12th largest. As a result, many analysts consider Italy as "too big to fail" because the repercussions of an Italian default could be tremendous. In addition, the European Central Bank (ECB) probably doesn't have the resources for a large bailout and German politicians don't have the desire to support the weaker EU members.

In the interim, the bond market has certainly demonstrated some concern. The yield on 10-year Greek bonds has increased from 10 percent in February to as high as 33 percent in December, while the yield for 10-year Italian bonds has increased from 4.5 percent in February to as high as 7.5 percent in November. In other words, Greek bonds are priced for default while Italian bonds are signaling risk.

Given the debt levels in both countries, yields at these high levels are not sustainable. The numbers just don't work. Think about the simple math: if Italy is paying 7.5 percent interest on its debt (assume that its debt is 100% of GDP), Italians are paying interest that is 7.5 percent of GDP. Italy's tax revenue is only 22 percent of GDP. In other words, more than one-third of its tax revenue will be used to pay interest!

Recent news out of Europe has been more encouraging. The EU countries met in early December and announced that they agreed on a long-term plan requiring each EU country to effectively balance their budget each year. If an EU country violates the balanced budget measure, automatic sanctions (yet to be determined) will be imposed.

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James F. Arens II
Senior Vice President &
Chief Invetsment Officer

VIEWPOINT

A Message from the Desk of Tom Wilkins

As we head into a new year, I would like to take this opportunity to thank you, our loyal customers, for giving us the opportunity to work with you and help you achieve your financial goals. The markets continue to overreact to news on a daily basis. Since our politicians in Washington, Republican and Democrat alike, are not helping us achieve any kind of financial stability, markets may continue their rollercoaster ride in 2012. However, through well conceived plans and strategies, together we have stayed the course and are achieving our desired results.

I would also like to extend my deepest gratitude for the outstanding officers, directors and employees of Trust Company of Oklahoma. All of us here know that our responsibilities to you, our customers, deserve our best efforts on a daily basis, and we strive to do just that. I would like to recognize two officers that were recently promoted to Assistant Vice President: Jennifer May and Corey Redington. If you have had the opportunity to work with either Jennifer or Corey, you know they are very deserving of their promotions.

I wish all of you a safe and prosperous 2012.

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

While this agreement sounds ideal in theory, this plan has many potential obstacles that must be overcome in order for this plan to work. These obstacles include:

- It is unlikely that all EU countries will be able to muster the political support for a balanced budget.
- Even if countries do agree to balance their budgets, it will be politically difficult to implement austerity measures. These measures will likely result in government layoffs, cutting retirement benefits and a significant recession.
- Even if all countries agree to balance their budgets, it is uncertain whether the EU will actually impose sanctions on those countries which violate the terms. As we have seen with Greece, even a small violator can cause huge problems since much of their sovereign debt is owned by banks throughout the EU.

There is tremendous uncertainty with the obstacles described above. This could eventually lead to some countries exiting the EU so that they can return to their own currency (and devalue it). There will be serious repercussions if a small country does this. But the repercussions would be tremendous if a larger country, such as Italy, were to exit the EU.

With all this said, the European Central Bank (ECB) has done its part to ease the current tension. The ECB has made significant below-market-rate loans to EU banks. The assumption is that these banks will buy sovereign debt and temporarily ease the problem. Of course, loaning money to an over-spender is only a temporary fix.

The bottom line is that these are long-term problems. It took a long time to arrive here and they're not going to exit this situation quickly. Ultimately, a few countries will most likely get kicked out of the EU (i.e. Greece). This may be a good thing since it could give the markets some clarity as to how the European sovereign debt crisis will stabilize itself. Until that time, the news out of Europe will likely continue to affect the U.S. markets more than we would like.

Attention May Shift to the U.S.

As described above, much of the market's focus is on Europe for now. However, once there is some clarity concerning Europe's debt situation, the market's attention may turn to our deficit/debt situation. Obviously, we have our own debt problems in the U.S. This fiscal year, our government incurred a $1.3 trillion deficit and next year's deficit is expected to be more than $1 trillion. Our federal government's debt-to-GDP ratio is currently 100% and increasing. While we are not Greece, this trend is a concern and will only get worse until our elected officials begin to make some difficult decisions.

Earlier this year Congress agreed to reduce our deficit spending by $2.4 trillion over the next 10 years. When this bill was passed, $900 billion of the $2.4 trillion in cuts were agreed upon. A debt "super committee" was then appointed to identify how to cut the remaining $1.5 trillion from the deficit. As we all know, this "super" committee was unable to reach an agreement.

This result was a huge disappointment. First, we simply kicked the can down the road once again. Second, it's particularly disappointing that our elected officials can't

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find $1.5 trillion of savings OVER 10 YEARS, when we have incurred a $1.3 trillion deficit for this year alone. Finally, the likelihood of a significant agreement in a major election year (2012) seems unlikely as partisanship is intense.

However, the U.S. continues to be fortunate from a fiscal perspective. We are able to borrow huge sums of money at low rates. As a result, we still have time to solve our problems.

Currently, Japan and China continue to buy more than 50 percent of our federal government's new bond issues. If Japan or especially China stops buying our debt, even incrementally, the only way we could entice other buyers to the table would be to offer higher, possibly much higher interest rates. Such an increase would likely spook the bond market. As we have seen in Greece and most recently Italy, spooking the bond market can be dangerous since the bond markets can take on a life of their own in a panic environment. Hopefully our politicians won't let us get to that point.

In the interim, the Federal Reserve (Fed) is doing everything it can to help. The Fed has effectively cut interest rates to 0 percent. Unlike the ECB, our Federal Reserve has the flexibility to print additional money to finance a portion of our debt. Over the past four years the Fed's balance sheet has increased by approximately $2 trillion from $800 billion four years ago to $2.8 trillion today. There is likely a limit to how much the Fed can leverage its balance sheet before global investors object. As a result, this financing approach may have reached its limit.

While we have time to act, the time is not unlimited. It is encouraging that our debt situation is becoming an issue that ordinary citizens are discussing. Obviously, this puts pressure on our politicians to act. The decisions that must be made concerning our entitlement programs (primarily Medicare and Social Security) are very difficult and will impact everyone. Will our politicians have the courage to make changes? It will be a lot less painful if we make these changes before the markets force us to make changes.

We think market conditions will continue to improve through 2012.

Where We Go From Here

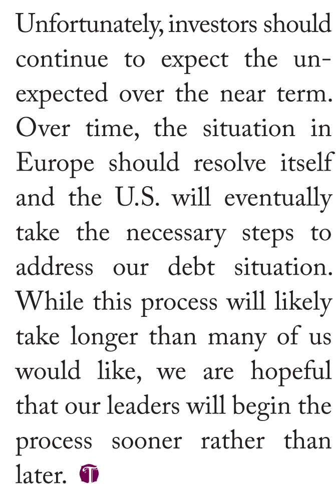
While the U.S. clearly has long-term fiscal issues which need to be resolved, our economy and markets are fortunately in better shape than Europe's economy and markets. Some of the positive news about the U.S. include:

- First, most economists are forecasting below average but positive GDP growth for 2012, in the 2.0 percent to 2.5 percent range. While this is significantly below the long-term average of 3.5 percent, it is certainly better than the negative growth (recession) that is expected in Europe.
- Second, earnings growth for the S&P 500 companies is expected to be approximately 10 percent in 2012. While this is slower than the 16 percent growth that is expected for 2011, it is much higher than the long-term average of 6 percent earnings growth.
- Third, for better or worse, our federal government continues to have the ability to stimulate our economy with continued deficit spending. It is likely that the 2 percent payroll tax cut and the expanded unemployment benefit program will be extended for all of 2012. The cost of extending both of these programs is approximately $200 billion which analysts believe will add at least 1 percent to their 2012 GDP forecasts.
- Fourth, recent employment trends are encouraging. Over the last year the unemployment rate has decreased from 9.8 percent to 8.6 percent. Unfortunately, these numbers are a little misleading due to the fact that a significant number of Americans have quit looking for work and don't count as unemployed. But, we are moving in the right direction, even though it will be several years before we get our unemployment rate back below 6 percent.
- Fifth, most encouraging is the overall valuation of the market. The S&P 500 Index is currently trading at a price to earnings ratio of 13 based on 2011 earnings. That is well below the historical price to earnings ratio average of 16.

Given the trends outlined above, it is reasonable to expect the stock market to generate positive but below average returns in 2012. There will be more tail winds than head winds in the market. Assuming the U.S. avoids a double-dip recession (which it should) and the situation in Europe is contained, market conditions will continue to improve as we progress through 2012.

As it relates to the bond market, with interest rates at all-time lows, investors need to be particularly careful. Given our debt situation, it is likely that interest rates will begin to slowly increase in coming years. Given that outlook, investors should avoid stretching for yield by investing in longer-term bonds.

Unfortunately, investors should continue to expect the unexpected over the near term. Over time, the situation in Europe should resolve itself and the U.S. will eventually take the necessary steps to address our debt situation. While this process will likely take longer than many of us would like, we are hopeful that our leaders will begin the process sooner rather than later.



Yes, We Can!

I cannot tell you how many times I have had a prospective client say to me, "I did not realize that Trust Company could manage my investment account."

It is apparent from the word 'Trust' in our name that we manage trusts, estates and retirement funds. But, a service we offer that may not be apparent from our name is that of an investment money manager. In fact, we now manage more money for individuals in traditional investment and retirement accounts than in trusts, estates and guardianships combined.

Through massive advertising and aggressive sales, the brokerage community has positioned itself as the place to have your money invested while you are alive. We see this as being true for people who want to be aggressive with their investments and/or would like to direct what investments are purchased in their account on a day-to-day basis. For more conservative, long-term investors who do not have the inclination to make all the decisions required, professional portfolio management by Trust Company is a perfect fit.

It might help to discuss a few of the differences between our asset management structure and the typical brokerage relationship. First of all, under our trust company umbrella, we have a fiduciary obligation to each of our clients for all accounts, not just trusts. This means that our ultimate duty and loyalty is to our clients. Our obligation is to do what is in the best interests of our clients. The brokerage world does not have this mandate. That is not to say that there are no brokers who take care of their clients' business in a very honorable and effective way. The point is that the brokerage industry as a whole does not operate within a fiduciary standard.

"Rule One: Preserve the principal. Rule Two: When in doubt, see rule one." Warren Buffett

Another difference is compensation. The brokerage world is primarily compensated through commissions on investment products they sell to their clients. We are fee-based money managers. Since our fee is based upon the market value of the relationship, our compensation is aligned with our clients' financial success. In addition, we do not receive any money from any mutual fund we invest in for our clients. This allows us to remain objective and independent in our analysis and judgment.

Because of our fiduciary standard and non-commissioned structure and independence, we are never faced with a moral "Y" in the road where we pause to consider what is good for us versus what is good for our clients.

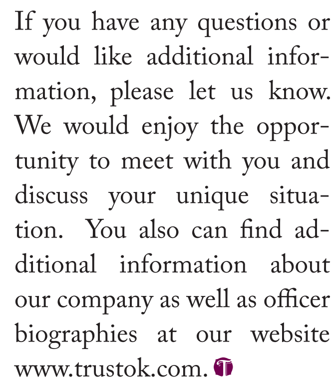
One last consideration is the level of investment expertise. At Trust Company, we have six full-time, professional portfolio managers on staff actually investing our clients' life savings. Five of these positions are staffed with people who hold the designation of Chartered Financial Analyst (CFA). The CFA designation is the investment industry's recognized standard for asset management and is earned only after several years of experience and examination. In addition, five of our portfolio managers have advanced degrees in business. This investment expertise can be especially advantageous during unsettling markets.

We certainly are in a time when it is critical to have money managed in a way that is completely consistent with long-term tolerance for risk and need for income. It is also so very important given the return environment we have experienced and may continue to experience that clients understand the fees they are paying. Our transparent fee structure offers value to our clients and is easy to understand.

Conservative money management is certainly in vogue with the market turbulence that has become the new normal in a global economy. We at Trust Company are disciplined money managers who believe in diversification. We purchase quality and conservative securities within asset allocations that are uniquely tailored for each client. Our in-house team of investment professionals are creating and maintaining investment plans that are practical and achievable.

We have learned through many market cycles that neither panic nor greed are effective strategies for building long-term wealth. We provide a road map that helps our clients establish an appropriate asset allocation, which typically determines most of an investor's returns.

If you have any questions or would like additional information, please let us know. We would enjoy the opportunity to meet with you and discuss your unique situation. You also can find additional information about our company as well as officer biographies at our website www.trustok.com.



David Stanley
Senior Vice President
Manager Oklahoma City Region

IRA's: Why, When & How Often?

A Traditional IRA is the term for a regular IRA available to those under age 70 ½ who have earned income (i.e., wages or self-employment income). Earnings within the traditional IRA grow tax-deferred until withdrawal.

You may be asking when you can withdraw funds from your IRA. The short answer is – anytime. This answer may surprise you, but it's true. You need to be aware, however, of potential tax and penalty ramifications.

Age 59 ½ is the earliest you can begin taking distributions from your IRA without worrying about any penalties, just the taxes. There are some exceptions to the penalty rule if you are not yet 59 ½:

- Disability
- IRA Owner's death
- First-time home purchase
- Medical expenses that exceed 7 ½% of adjusted gross income
- Medical insurance premiums if you are unemployed
- Higher education expenses for you or your eligible family members for the current year
- Back taxes because of an IRS levy
- Qualified Reservist Distributions while on active duty
- Conversion to a Roth IRA
- A series of "substantially equal periodic payments" made over your life expectancy

At age 70 ½ withdrawals must begin and will be taxed. These Required Minimum Distributions are due to begin no later than April 1 of the year following the year you reach age 70 ½ and are made annually based on a life expectancy factor. The IRS rules give you several choices for calculating the minimum you must take from your IRA. If required distributions are not taken at that age, a 50 percent excise tax penalty will be assessed on the amount not taken. If you have more than one IRA when you reach 70 ½, you must calculate the required minimum distribution amount for each separate IRA, but you can withdraw the entire sum from one account.

Remember, you always can withdraw money from your IRA, but you need to know the rules and regulations to determine when a distribution will be right for you.

Karen Ellis
Vice President

LET US KNOW

Each quarter Trust Company of Oklahoma publishes our newsletter "Investment Perspectives." Our Professionals write informative articles on topics we think would be of interest to you. But we want to know what you think. What are some topics that you would like to read about? Send your thoughts to Marketing@TrustOk.com and we will do our best to include your interests throughout the upcoming year.

Junior Achievement of Oklahoma

Junior Achievement's (JA) purpose is to inspire and prepare young people to succeed in a global economy. JA gives young people the knowledge and skills they need to own their economic success, plan for their future, and make smart academic and economic choices.

Through a series of volunteer-led, interactive programs which span kindergarten through 12th grade, JA of Oklahoma will impact 46,000 students during the 2011-12 school year.

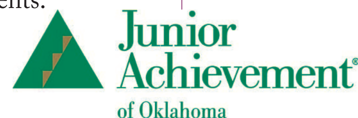
In Oklahoma, 266 schools in 55 school districts participate in Junior Achievement. JA's programs are made possible by businesses and community organizations who provide both financial and volunteer resources. For example, over 2,000 employees of local businesses volunteered to teach JA programs last year. In addition to the classroom-based programs, the JA of Oklahoma headquarters in Tulsa houses the JA BizTown program. Tulsa is one of only 30 cities in the nation to provide this site-based learning experience for students.

"Today my class went to JA Biztown. I worked as the attorney in the professional office. It was really cool! I had to do a lot of work and now I know why parents come home tired. We had a lot of fun."
– Mason D

JA programs empower students to make a connection between what they learn in school and how it can be applied in the real world – enhancing the relevance of their classroom lessons and increasing their understanding of the value of staying in school.

Focusing on education, economic and youth development, JA contributes to the vitality of communities like ours. To learn more about Junior Achievement of Oklahoma, please visit www.jaok.org.

"Yesterday, I had my first day in my college business intro class and my professor told me that a business plan will be our final! YES! I already know how to do this because I had Junior Achievement (JA) in high school. JA has made such a difference in my life; I want everyone to experience how I feel now!"
– Gabbie G



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Trust Investment Perspectives is a quarterly publication written and produced by Trust Company of Oklahoma. It is intended to provide insight and investment perspectives to the company's clients and associates.

If you have any questions or comments regarding this publication please call 1-800-411-2843 or visit us online at TrustOk.com.

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