TRUST
INVESTMENT PERSPECTIVES

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Tough Love?

With the stock market's quick and negative reaction to a possible change in Federal Reserve (Fed) policy later this year, you would have thought that (Uncle) Ben Bernanke sat the market down for a straight talk on the dangers of easy money addiction and the importance of living within one's means. Neither a borrower nor a lender be. Shape up or ship out.

Well, if that were the lecture, Bernanke and the whole Fed would pretty much be out of a job. While Bernanke himself does indeed appear to be out of a job next year, I am pretty sure the Fed, and other central bankers around the world, will still be here. I don't think they are quite ready to tell their respective financial markets that it is time to close the books on the easy money addiction the banks themselves have created. After all, when investors nickname the third round (QE3) of easing "quantitative easing infinity", it doesn't really suggest that the path to frugal living is just around the corner.

Of course, I could be wrong. But I will believe it when I see it. Don't get me wrong, I do think interest rates will continue to go up as the Fed tapers off its buying. The 10-year US Treasury has gone from a 1.6 percent yield in early May to 2.5 percent recently. As you and I start to set interest rates again on US Treasury securities, we should demand, at the very least, a return that covers the expected rate of inflation plus an additional amount for the time value of money. The Fed's goal has been to force rates down, not make money on its investments. So, ending QE3 will be easier said than done. However, I do not think the Fed is saying QE3 is ending quite yet. But let's assume for the sake of argument, the Fed is indeed signaling QE3 is finished.

Before the market and economic meltdown of 2008, the Fed held just over $800 billion in largely short-term US Treasury securities. Just what does the Fed do with the $3.4 trillion in bonds it currently owns, some much longer term in maturity than it has historically held, including mortgage-backed bonds supporting the housing market? Reduce these holdings too fast and the Fed risks both a very sharp spike in interest rates and an economic slowdown as it potentially shrinks the supply of money used for loans. Too slow and easy money persists long past when it should. My bet is the Fed is slower to respond as a result. If the Fed were to sell bonds at the same rate it is now buying bonds, it would take about two and one-half years to get back to the pre-meltdown level. Importantly, even without QE3, the Fed has targeted the Fed Funds rate at .25 percent. Most Fed governors and the market itself expects this rate to continue for at least the next 12 months. That is still easing in my book.

BREAKING THE CYCLE

Other central banks are aggressively easing so there may also be some pressure on the Fed to keep easing as well, even if not to the current extent. Yet, our easing has likely encouraged easing overseas. If we can not break the cycle, we should at least put the brakes on it. Japan is now easing to a degree that makes it hard to tell if we are witnessing a slow motion train wreck or brilliance never seen before. Only time will tell. The European Central Bank has ramped up their easing in recent months as well.

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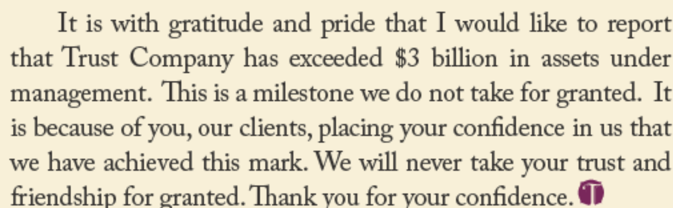
Robert A. McCormick
Senior Executive VP & COO

VIEWPOINT

A Message from the Desk of Tom Wilkins

Before I write about our company's second quarter of 2013, I must acknowledge those affected by the May tornadoes that swept through Shawnee, Moore, and El Reno. All of us at Trust Company of Oklahoma stand with our state in remembering the lives lost, the lives displaced, and the lives forever altered from these tornadoes. We also know the strength of Oklahomans and look forward to seeing lives, homes, and families rebuilt stronger and greater.

Now, it is my privilege to share news from our company. First, two new members have joined the Trust Company team: Melissa Taylor, Vice President, and Julissa Medina, Assistant Vice President. Melissa earned her law degree from the University of Tulsa and specializes in personal trust administration, as well as tax and estate planning. Julie, who received her Master's degree from the University of Oklahoma, is responsible for compliance and tax reporting in our retirement plan services division. Melissa and Julie are both knowledgeable and client focused, making excellent additions to our company.



It is with gratitude and pride that I would like to report that Trust Company has exceeded $3 billion in assets under management. This is a milestone we do not take for granted. It is because of you, our clients, placing your confidence in us that we have achieved this mark. We will never take your trust and friendship for granted. Thank you for your confidence.

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

But, is all of this easing truly extraordinary or run-of-the-mill lever-pulling for these bankers?

The Bank of England (BOE) is instructive from an historical perspective. Since 2009 its Bank Rate, similar to our Fed Funds Rate, has been set at .5 percent. This is the lowest rate it has set - ever. Prior to 2009, the lowest rate was 2 percent. Our Fed has been around since 1913 and has survived recessions, depressions, world wars, and upset politicians. The BOE was established in 1694. It has survived the South Sea Bubble of 1720, numerous wars in the 1700's (including the American Revolution), the Panic of 1873, the depression of 1919 that followed World War I, and so much more--including much worse unemployment than currently exists. Throughout both the 1920's and 1930's, Britain's unemployment rate consistently averaged in the double digits. The lowest interest rate over this entire time period? *Two percent until 2009*. Maybe the current policy is superior to actions taken over the past 300 plus years. However, is keeping rates at or near zero percent during periods of modest growth and relative calm the smart thing to do? What will our central bankers do during the next crisis?

Chart 1

S&P 500 Return & Sources

10/31/2008 to 6/30/2013

Sales Growth	1.6%	
x Profit Margin Change	6.6%	
= Earnings Growth	**8.3%**	
Earnings Growth	8.3%	
x P/E Change	2.9%	(13.7 to 15.7)
= Price Change	**11.4%**	
Price Change	11.4%	
+ Dividend Return	2.5%	
= Total Return (Average Annual)	**14.0%**	

* *above figures are each component's contribution to total return, calculated as compound annual growth rates. Source: Bloomberg*

ARE INTEREST RATES DRIVING STOCK PRICES?

Interest rates are certainly important to the stock market. The stock market has rallied when the Fed signaled it would start a new round of QE. It has gone down when QE1 and QE2 ended and hints that QE3 will be tapered back. Lower interest rates and the Fed buying large quantities of bonds can lead to higher equity valuations, such as price/earnings (P/E) ratios. Conversely, if rates rise too far too fast, stock valuations will shrink and stock prices will go down. Historically, the early stage of a rise in interest rates, in *normal* recoveries, is not damaging as the increase reflects a strengthening economy. Of course, this is not a normal environment with interest rates rising from a Fed-induced historically low level. No one can really say with much confidence how this plays out, not even the Fed.

Interest rates have not been the only driver of good stock market returns. Since the Fed started with QE1 in November 2008, the market has returned 14.0 percent per year through June 30 (see Chart 1). Starting from the top of the chart, earnings increased by 8.3 percent per year on average. The majority of this growth was not due to companies selling more (1.6 percent annual growth) but due to higher profit margins (6.6 percent "return"). Expanding profit margins were the biggest single driver of returns and margins are now at historically high levels. The changing level of valuations as measured by the P/E ratio over this time period

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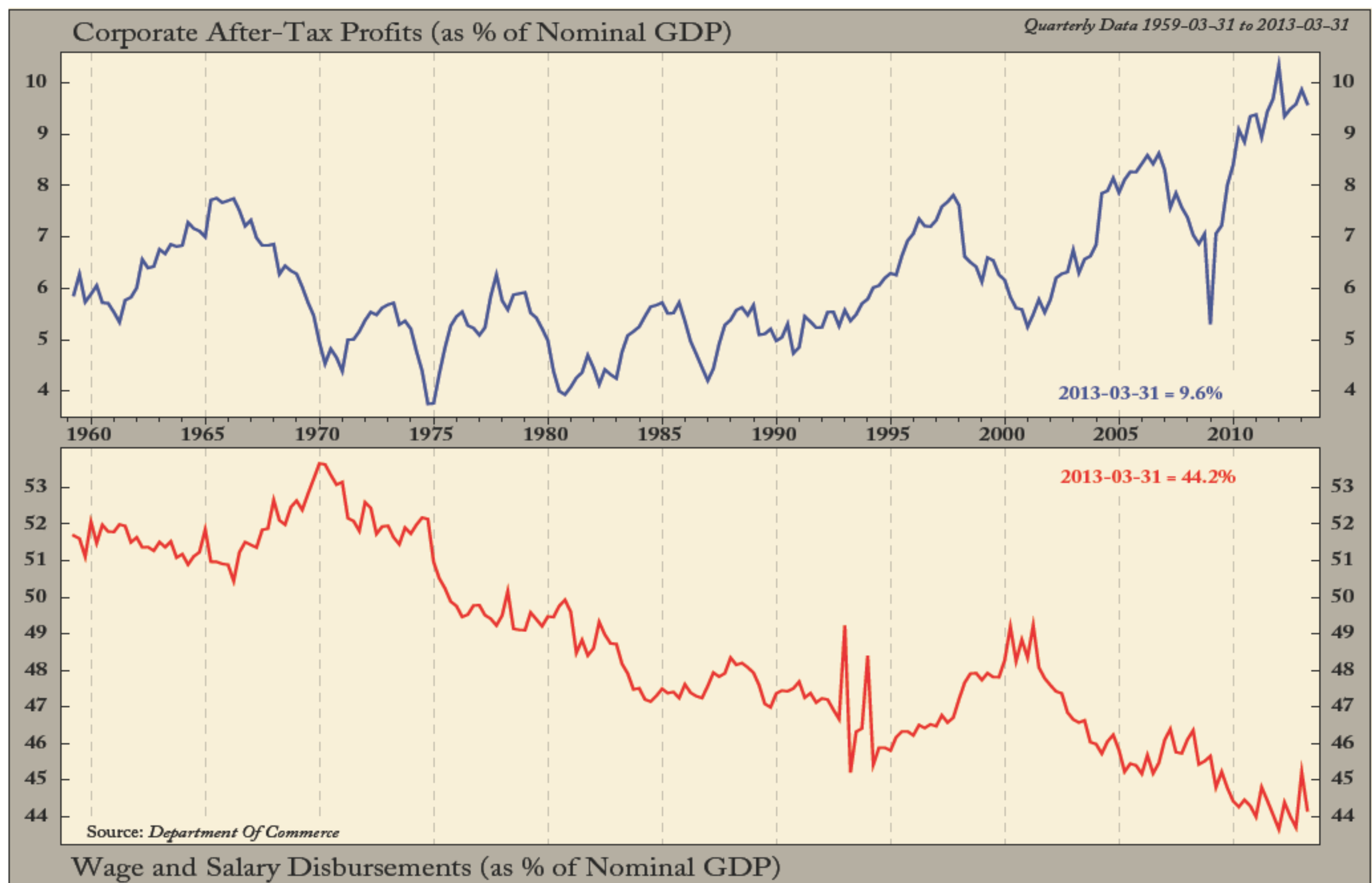
has contributed roughly 2.9 percent of the return per year. Why have margins expanded so sharply?

EMPLOYMENT IS GOOD

Below, Chart 2 shows how corporate profits are taking an increasingly greater share of what we produce while the allocation to wages is shrinking (both as a percent of GDP). The fact that this relationship is both strong and negative is not surprising. Employee compensation is generally the largest expense of the average company and in many cases most of the expense. So, with weak employment growth and weak wage growth, margins have taken off. Where do margins go from here? It seems to me that margins will no longer provide the gas for the market. There is only so much cost control possible before companies end up not having any customers, or at least happy ones. Due to fewer people generating a paycheck that allows them to buy goods and services produced, most companies have seen a modest sales increase. Ultimately, employment and wage growth need to pick up. This is the way the economy should work - the consumer buys goods and services from companies which allows companies to pay their employees to produce the goods and services. This cycle breaks down when too few consumers are employed. When employment picks up, margins may go down, but company sales should increase (along with GDP), thus allowing us to achieve a better balance in the economy. What is the evidence that margins have actually peaked? Modest signs of strengthening in the labor markets.

If this strengthening does not continue, we will further "hollow out" and become more dependent upon the Fed and other parts of our government for our economy. For most people, this is not a prescription for good, only for the privileged few. I do not think our destiny is a downward path. It is too easy to draw a straight line to Armageddon when times are bad. Our pendulum has always swung back into balance, and we will get there again. First, we need to get to the point where the Fed is off the front page every day. This starts with the Fed tapering its buying and getting out of crisis mode. As equity investors with a time horizon longer than a few months, we applaud this move. We continue to look for buying opportunities while some in the market think they have just heard the worst news ever. Now, the next step is to adopt fiscal policies that support and encourage Main Street growth and risk taking. But, that is a topic for another day.

Chart 2



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A Legacy of Wealth *and* Purpose

I like a good plan. More than that, and in the words of Colonel John "Hannibal" Smith of the A-Team, "I love it when a plan comes together." Planning is one of the many reasons I became an estate planner.

Recently, I have found a new appreciation for estate plans that not only pass along a family's hard-earned wealth, but also make room for understanding a family's legacy: a family's history, ideals, and values. Sixty percent of families waste their wealth by the end of the second generation, and 90 percent have little or nothing left of the money received from their grandparents. The goal of legacy-focused estate planning is to stop the wealth destruction cycle of "shirtsleeves to shirtsleeves in three generations." This approach is based on a philosophical belief that if you love them, you should pass more to your descendants than just your assets.

In the words of Tim Voorhees, "The availability of money tends to undermine the pursuit of higher purpose." If money becomes the focus, it is unlikely that the legacy creating it can be sustained. It's like an architectural engineer who creates blueprints to build a bridge but does not share the design with the individuals needed to keep it strong for generations. These blueprints are your estate and financial plans coupled with your legacy. Together, they enable your family to not only enjoy the wealth you pass on, but to pursue its higher purpose.

A legacy is the collection of values, memories, morals, contributions, and achievements that make up who you are and what your family stands for. I like to think of it as passing along the family identity. Like a tapestry, it changes with the addition of each new thread, but it is bound together by an overarching theme that stands the test of time. Family history, values, and ideals are the plans that allow your family to take their inherited wealth and invest in a bright future.

Your legacy is about more than just your balance sheet

If you have not created a plan that communicates your legacy, you are not alone. A 2011 survey by U.S. Trust noted that 52 percent of wealthy baby boomers who were parents had not fully disclosed their wealth to their children, while 15 percent had disclosed nothing about the family wealth. When asked why, 31 percent of respondents said they had just never thought about it.

I encourage you to carefully think about your family legacy and share it with your family and your wealth planning professionals. In the 2011 U.S. Trust survey, 84 percent of parents responded that their children would benefit from discussions with a financial professional, yet 60 percent had never introduced their children to their professional advisors. In today's age of hyper electronic communication, face-to-face meetings still matter. Help your estate planning professionals understand your family dynamics by bringing the younger generation along.

Prepare your family to receive its inheritance. Don't fall into the group of people who have never discussed legacy goals with their financial professionals either. If you have substantial wealth, you need a trusted group of professionals around you. Instead of relying on these professionals solely for investment, tax, or legal advice, rely on them to protect your wealth and your family by sharing your values on how your wealth was accumulated and how you hope to see it pass to future generations.

The best start for ensuring the younger generations are ready to adopt the family legacy as their own is to first provide the guidance needed for your children to manage their own financial affairs properly. As they build the skills and confidence needed to handle their own funds, they will be better prepared to someday handle yours and be ready to pass along the legacy to the next generation. It is natural for parents to be reluctant to share their plan with their children. Comfort to do so is increased when seeing your children acting responsibly with their own funds. Your children should be working with a financial advisor long before being called on to take a role in your estate plan.

One of the worst things we see is family wealth being diminished by subsequent generations due to their lack of understanding the family story. Far too often as we settle estates I hear an adult beneficiary say, "That's not how mom would have wanted it." Unfortunately, what the child thinks mom wanted is often not what she specified in her estate planning documents. Open dialogue about family legacy goals can prevent this. The professionals at Trust Company would be honored to start the discussion to ensure your family's legacy plan comes together.

Jamie O'Shields
Asst. Vice President

Fees Matter!

401(k) plans have received a lot of attention lately in the media relating to the fees employers (sponsors) and employees (participants) are paying. Rightly so. Whether you are an employer or an employee, you need to understand the fees assessed against your plan balance as they can dramatically impact your retirement savings.

Fees can be paid by either the employer or the employee. Fees can be outright charges or wrapped up in the cost of the investments. Until now, many fees were never disclosed clearly to employers and employees.

The Department of Labor (DOL) recently issued new rules which require disclosure of all fees in a complete and understandable format. The plan sponsor and plan participants should receive an annual written fee disclosure detailing the fees, and, if the plan is participant directed, include fees associated with the investment choices. In addition, the quarterly participant statements must detail the fees charged.

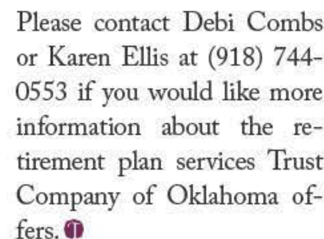
Fees do matter. The DOL estimates that an employee with $25,000 in a 401(k) account earning 7 percent per year and being charged a fee of 0.5 percent annually would have $227,000 after 35 years. But if that same plan charges 1.5 percent in fees, the employee's balance drops to $163,000, or 28 percent less than the lower-fee plan.

Fees can vary greatly from plan to plan. According to one industry source, smaller 401(k) plans have fees typically ranging from 0.4 percent to 2 percent. That is a wide range.

Sometimes comparing fees is like trying to compare apples to oranges and maybe even a watermelon or two. Services provided, as well as fees, must be considered. While I would advise that the highest bidder is rarely the best option, the lowest bidder is not always the best option either if cut-rate or no service is provided.

Determining what fees are reasonable and who should be your 401(k) provider can be a very daunting task as most employers are in the business of running their companies, not becoming 401(k) plan experts. So where should you begin? Start by reviewing the annual notices and reports and asking questions of your plan provider if the fees are not clear.

Please contact Debi Combs or Karen Ellis at (918) 744-0553 if you would like more information about the retirement plan services Trust Company of Oklahoma offers.



Debi Combs
Vice President

SPOTLIGHT

Community Food Bank of Eastern Oklahoma

Oklahoma is the fourth hungriest state in the nation. More than 660,000 Oklahomans don't know where or how they'll get their next meal.

Through a network of 450 Partner Programs, the Community Food Bank of Eastern Oklahoma helps distribute more than 247,000 meals each week to those struggling with hunger in Eastern Oklahoma. Partner programs include food pantries, soup kitchens, emergency shelters, low-income after-school programs, and senior citizen centers.

While the Food Bank works with partners in communities throughout Eastern Oklahoma, it also coordinates various programs to address specific hunger issues. The Food for Kids Backpack Program provides a weekly sack of shelf-stable food to children who are at risk of not having enough food during the weekend. Last year, the program served more than 7,000 students at 195 sites in Eastern Oklahoma and continues to expand.

This year, the Food Bank launched Senior Servings, a program specifically designed with senior nutritional needs in mind. Senior Servings currently distributes shelf-stable food, produce, and bakery items to more than 300 low-income seniors at 10 locations in Eastern Oklahoma. By partnering with low-income senior housing complexes, senior centers, and congregate meal sties, the program provides independence and dignity for clients.

The Mobile Pantry Program creates a farmers' market style of food distribution in rural communities with limited access to a full-service grocery store. Fresh produce, bakery items, and non-perishable food items are distributed to food insecure families in the 24 counties of Eastern Oklahoma. Since the program began in 2010, more than 2 million meals have been distributed through the Mobile Pantry.

The Food Bank's vision is food security, with dignity, for all Eastern Oklahomans. Thanks to the support of the community, the Food Bank is able to fight hunger and feed hope in Eastern Oklahoma.

For more information about Community Food Bank of Eastern Oklahoma, visit okfoodbank.org or call 918-585-2862.

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DID YOU KNOW?

The first Girl Scout cookie was sold in Muskogee in 1917

The nation's first parking meter was installed in Oklahoma City in 1935

The nation's first traffic "Yield" sign was erected in Tulsa on a trial basis in 1959