Q&A with Becky Frank

Becky Frank, Tulsa Metro Chamber Chairman & CEO of Schnake Turnbo Frank| PR recently visited with two of Trust Company of Oklahoma's portfolio managers, Michael Abboud and Cameron Turner, to get their perspective and opinions on investments in the world today.

Becky Frank (BF): The economy has grown very slowly since we have come out of the recession in 2009. Will we continue to see sluggish growth, in your opinion? Why or why not?

Cameron Turner (CT): I expect a significant period of time where we do see slower growth - some have termed this "the new normal." We came out of the last recession with slower growth than a typical recovery, and we will continue down this path. However, slower growth is not necessarily bad. It is an oxymoron in that yes, it is slower, but still it is growth. And, there is a lot to be said about the slow and steady race. Having an economy growing slower is not inherently bad because it is growing. Some of this slower pace has to do with what is going on internationally with developed and emerging markets. This is typical of a market cycle.

Michael Abboud (MA): Many people may not be aware that between 1999 and 2011, our gross domestic product (GDP) has averaged just 2 percent, whereas, historically, GDP has been around 3 percent and 7 percent coming out of a recession. But one of the big differences with a financially induced recession like we just experienced as opposed to another type of recession is that you have lower growth rates. In this environment of deleveraging, re-regulation, and de-globalization, we are going to be at that 2 percent trajectory in the U.S. But remember, 2 percent is growth—it's not a negative 2 percent. Investors can't think in terms of quarters, but rather think in terms of years as we get back to a normal trend line for the economy.

BF: In 2011, Standard and Poor's downgraded U.S. government debt. This was on the front page for several months, but no longer.Should we still be concerned?

MA: This was a warning shot across the bow. The downgrade formally put pressure on Congress to address these long-term fiscal challenges. It was focused on the level of debt and trajectory relative to other AAA sovereigns per S&P's comments when they downgraded the debt. However, the U.S. is still the bastion of safety for world markets.

CT: S&P downgraded our debt because we are not taking care of our fiscal house and not reducing our long-term debt. But six months down the road after the downgrade, we still have not made any progress on reducing the debt. Congress is still not making headway on correcting our fiscal house. The problems are still there and at some point, we as a nation will have to address them.

MA: If we stay on this same path and legislators keep kicking the can to the other side of the aisle, debt will hit 600 percent of GDP in 75 years. Studies show that once debt becomes greater than 90 percent of GDP, it will trim at least 1 percent of GDP with an average reduction of 3 percent. Right now our GDP is $15 trillion and we have $14.3 trillion in debt.

BF: What is the number one risk for U.S. investors over the next year? Over the next five years?

CT: Over the next year, the greatest risk would be something geopolitical, either a shock to the economy or a shock to the world. On a one-year basis, something of a global magnitude is always the biggest risk. Those risks are difficult to plan for, but markets do correct themselves even after this type of event, often in three to six months following the event.
Over the next five years, inflation, which has been on the minds of individuals for three to four years, will continue to be a risk. In this low interest rate environment, if inflation takes hold, investors who have fixed income portfolios could have no return or even be eating into their principal.

MA: Over the next year, a serious risk for U.S. investors is the near-term sovereign debt crisis in Europe as well as the unrest in the Middle East, such as the rioting in Egypt. Another risk is what is going on with Iran, especially because of the Suez Canal. To give perspective on the importance of the Suez Canal: every day, 2.5 percent of the world's oil supply flows through it.
One of the concerns I have over the next five years is deleveraging. Deleveraging is unwinding the monetary stimulus, not only in the U.S. but globally as well, and addressing debt issues both in the U.S. and Europe. The Federal Reserve (Fed) is financing 40 percent of the U.S. deficit and is the largest holder of U.S. Treasuries. Long term, the challenge will be how the Fed will unwind that amount of debt without upsetting our fragile U.S. recovery.

BF: Unemployment is still really high—even though we are in a recovery. What will it take to turn employment around?

MA: Things have been looking up on the unemployment front. Employers added 284,000 jobs in January, the most in nine months. Unemployment dropped to a three-year low with those job additions. Due to what is going on with the retirement rates of the baby boom generation, we need 75,000 to 100,000 new jobs to keep the labor market steady today. This number is much lower than it has been historically. I believe that unemployment may decrease much quicker than the consensus has projected. Right now, unemployment is 8.3 percent, but by year end, it may be 7.8 percent.

CT: Until small businesses get clarity on what their taxes will be and what their healthcare costs will be, smaller employers will be reluctant to hire more employees. With more clarity, you will see unemployment decrease much more.

BF: Last year, U.S. stocks did much better than most international stocks. Do you think that will continue this year?

CT: If you historically look at how U.S. stocks have done versus international, you go through a period where U.S. stocks outperform for a couple of years then international stocks outperform for a few years. An investor should be more global oriented, but if one really wants to put things into baskets of U.S. versus international, I think U.S. will do modestly better.

BF: Should investors consider getting out of international stocks and invest here, given all the problems in Europe?

MA: It seems like the obvious choice, but if you would have pulled out of international stocks this year, you would be disappointed today because international is up 10.5 percent whereas U.S. is only up about 8 percent (as of early March). With Europe in a recession right now, as with any recession, it is the time to swim against the stream and put money into equities. There are a lot of good values internationally, particularly in the European space, given the contagion concerns with the sovereign debt crisis.

CT: There are obviously companies within Europe whose growth will significantly slow because of the issues they are having, but there are also good companies that have been beaten up, their valuations are ripe and they are good buys. You do have to be very, very selective, especially if you are looking at any kind of European fixed income because a lot of it is sovereign debt, which means debt of the countries. I would be very cautious there.

BF: What is the future of Greece? Of Europe in general?

MA: The way the winds are blowing, Greece is trying to stay in the Eurozone. The numbers are very unfriendly for Greece to generate enough economic growth and pass enough legislation to raise the retirement age from 50 to something more realistic. Greece's debt to GDP will still be 120 percent by 2020. I do applaud Greece's efforts to stay in the Eurozone, but the country is at a competitive disadvantage because Greece's economy does not grow as fast as a country such as Germany, but Greece spends as much as the faster growing economies. It has been proposed that countries in the Eurozone with deficits to GDP greater than 3 percent will be sanctioned. But how do you impose that on a Greece or Portugal when there is no way they can meet those requirements? So, I don't see the math working out for that to succeed. This bad situation was bound to happen from the beginning because there was only a monetary union, and not a fiscal union, as well.

BF: Is China overtaking us economically? Should we be investing there now?

CT: Investors should always have some piece of their portfolio allocated to China, although I would say a relatively small piece. China is a very big country that is economically growing the lower income base more than its middle class. I would be more inclined to look at U.S. or international companies with exposure in China. I am very leery of Chinese companies given the fact that the Chinese government has the propensity to take companies over or severely restrict them. You can get China exposure through Wal-Mart, McDonald's and a lot of other companies who are expanding their presence in China.

MA: China is going through a lot of what the rest of the world is. The Chinese are trying to curb property speculation. In China, there are cities that have row after row of empty highrises as far as the eye can see, with many of these built in the last decade. Some investors try to latch on to who has the fastest GDP growth, but remember growth does not necessarily relate to stock performance.

BF: Gasoline prices have been rising sharply in recent months. Should investors be concerned?

CT: Consumers are always concerned about gas prices because they hit our pocket books immediately and have significant impact on almost all other cost of goods. As gas prices rise, every other cost of goods rise. And, the more you have to spend on gas, the less you have to spend on other goods. Gas prices impact spending significantly and impact our economy with a big multiplier effect so gas prices are always a concern for investors.

MA: We are pretty close to a tipping point in terms of the effect oil will have on global GDP. What matters more for the economy is how fast the price of oil changes rather than its actual price level. For example, while oil has surpassed levels seen last year, over the past 6 months oil has moved up by 15 percent versus the 40 percent move in the six months leading up to last April. Similarly, gasoline prices have moved up 10 percent from $3.40 to $3.80, versus the 40 percent move from just below $3 to $4 leading up to last April. In addition, the U.S. by the end of the decade will be almost self sufficient in energy. Presently, we import nine million barrels of oil per day, but that should drop to two million by the end of the decade. We can easily get the two million barrels from Canada and Mexico so the U.S. will keep $250 billion annually that we currently send abroad. That is a huge plus which will insulate us from the current ramifications of unrest in the Middle East.

CT: The higher oil and gasoline prices, the more push we will have to turn more toward natural gas vehicles. From an energy policy standpoint, oil has to get to a certain level before we start wanting to buy more natural gas. When it does reach that level, you will see more semi-trucks and cars being converted to natural gas, and, of course, that will have a positive impact on Oklahoma.

BF: Cameron & Michael, thank you so much for your time and an enlightening conversation on the state of the markets and economy worldwide.

Michael Abboud *Vice President* | Becky Frank *CEO, STF |PR* | Cameron Turner *Vice President*