TRUST

INVESTMENT PERSPECTIVES

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Learn to Love the Pullbacks

"In the short run, the market is a voting machine, but in the long run, it is a weighing machine."
– Benjamin Graham

After four long years without a 10% pullback, the S&P 500 finally experienced a correction in late August. Hooray! If you are puzzled by my excitement, allow me to try and persuade you to embrace the pain. While it's contrary to human nature to feel happy about a decrease in wealth (however temporary), doing just that can help one become a better investor, or at the very least, avoid making costly mistakes.

Everyone says that they want to buy low and sell high. Yet when Morningstar studied the performance that actual investors earned in various mutual funds by looking at asset flows (the timing of purchases and sales) versus the average return for a dollar bought and held over a 10-year period, it found that mutual fund investors cost themselves on average 2.5% per year through timing decisions. In other words, people tend to buy high and sell low.

While that difference may not seem like much in any one year, over a 30-year period an investor giving up 2.5% a year would end up with less than half as much wealth. Such wildly different outcomes for people invested in the exact same funds is remarkable and all thanks to the human emotions of fear and greed.

About those emotions, Warren Buffett famously said to be "fearful when others are greedy and greedy when others are fearful." He made his fortune by focusing on his long-term horizon and buying at low prices in times of uncertainty. It's important to remember that there are two sides to every trade: someone was selling low and giving up future gains to Buffett. Don't be that seller.

In fact, pullbacks are often great times to be a buyer. Most investors have portfolios that are a mix of stocks, bonds and cash. Periods of unrest in the stock market are often accompanied by a decrease in interest rates (and therefore an increase in bond prices), making it a great time to rebalance portfolios by trimming bonds at higher prices and using the proceeds to buy stocks at lower prices.

This strategy worked well in 2008 and 2009, for example, when U.S. Treasury bond

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Zac Reynolds
Senior Vice President

MARKET RECAP

The S&P 500 posted its first quarterly negative return since the fourth quarter of 2012. Most other market indices were down as well.

	Third Quarter	YTD	Past 12 Months
Dow Jones	-7.0%	-7.0%	-2.1%
S&P 500	-6.4%	-5.3%	-0.6%
EAFE (Int'l)	-10.2%	-5.3%	-8.7%

GET TO KNOW US

A closer look at one of our team members

Trena Person is a dedicated, cheerful and loving employee. But these are not the only character traits associated with her. She's also known for being a problem-solver, a "Gadget Gal" and a fun-lover. Trena works in our Yale office managing the process of new accounts and their assets coming in to TCO. She also takes care of processing all mergers, spin-offs and other corporate actions. A native Tulsan, she joined the company in May 2014. Trena answered a few questions so that our readers could get to know her.

What do you like to do when not working?
Trena Person: I've been married to my wonderful husband for 31 years and we have two daughters, ages 19 and 22. I love to spend time with family and friends, travel and watch movies. I'm currently training to participate in the MS150 Bike Ride. I enjoy reading all kinds of literature and learning new things about various subjects.

What is your favorite aspect of your job?
Everyone at TCO is so good to show appreciation toward one another.

How would your friends and family describe you?
My friends would say I'm up for new challenges, detail oriented, considerate and analytical. They would also say that I love to laugh and hear about other people's interesting life experiences. My family would say that I'm a loving, encouraging, determined person and a problem solver.

What might someone be surprised to know about you?
I have several things people may not know. About four years ago, I was a member of a speed skating team. And, I used to co-own the oldest Lotta Burger in Tulsa. Also, at age seven, I began taking years of piano lessons from a Tulsa Philharmonic Orchestra cellist. He taught me to play cello and clarinet, too, so I taught piano and served as church organist in Jenks for eight years. In addition to all of that, I taught a Vietnamese lady friend how to speak English.

If you were not living in Oklahoma, where would you rather be?
I would be in a northern coastal state like Oregon, next to the ocean or on a cruise. I just love castles, palm trees and being near the ocean.

prices spiked as investors sought safe assets amid the financial crisis and stock market crash. A portfolio that was rebalanced to buy stocks as they declined and sell appreciated bonds didn't have to time the bottom exactly right to significantly outperform a portfolio that simply held tight, or worse yet, sold stocks out of fear. The transfer of value to patient, long-term investors from "Nervous Nellies" is thanks to market pullbacks like we saw in 2009 and (to a lesser degree) in August.

In addition to providing opportunities for rebalancing, corrections are healthy for markets. They prevent bubbles from growing too large and force market participants to examine fundamentals. Markets can't move straight up forever, a lesson the Chinese government is learning right now, despite their efforts to the contrary. The correction in August ended a 1,417-day run that was the second longest period of time between 10% pullbacks in the S&P 500 since World War II. On average, the S&P 500 experiences such a pullback slightly more than once per year, so the market was statistically overdue for a move down.

"In addition to providing opportunities for rebalancing, corrections are healthy for markets."

So now that we've gotten the long-expected correction, where do we go from here? While predicting short-term returns is notoriously difficult, a look back at history can be instructive. For example, since 1940 there have been 10 instances of 10% or greater declines over four trading days like we saw in August (see chart on page 3). Returns after such quick, sharp moves down have been quite strong. In fact, nine out of the 10 instances saw positive returns in the S&P 500 one year following the correction, with an average gain of more than 20%.

The fourth quarter has also been historically quite good for stocks. Over the past 25 years, for example, the market has gained more on a total-return basis in the fourth quarter than the previous three quarters combined.

Of course, there is no guarantee that history will repeat itself this time around. But also in the positive column, the U.S. economy appears to be gaining strength. Unemployment in the U.S. is now 5.1%, a level not seen since before the Great Recession. Wage growth, while still historically low, is trending higher. The housing market continues to improve, and American corporations have strengthened their balance sheets and are enjoying profit margins near all-time highs.

Like always, there are some potential storm clouds on the horizon. The Chinese economy is weakening and has weighed on other emerging-market economies and stock markets. European countries are suffering from high unemployment and

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on the receiving end of mass exodus from troubled areas in the Middle East. Commodity prices continue to fall, which is good for consumers but painful for the energy and materials sectors of the economy and those who work in those industries.

Last but not least, the Federal Reserve's decision in September to leave short-term interest rates at 0% muddies the economic outlook further. Given the U.S. economy's continued strength and the low unemployment rate, about half of economists surveyed before the decision expected the Fed to increase the benchmark Fed Funds rate above the emergency level of zero it has maintained since late 2008.

The Fed has a dual mandate of full employment and stable prices. While it has clearly succeeded on improving the employment front, the Fed pointed to inflation that has been persistently below its long-term target rate of 2% in its statement explaining why it decided to leave rates unchanged.

There is no consensus view on what the Fed's decision means for the economy and given the unprecedented length of time and degree of market intervention (Quantitative Easing I, II and III), history is no guide. Some worry that the Fed's refusal to raise rates indicates that the decision makers on the Federal Open Market Committee (FOMC) see signs of weakness in the economy that other market participants have missed. I find this argument rather unconvincing as the Federal Reserve does not have a good track record of predicting recessions. Even in October 2008, for example, the Fed was still predicting the U.S. economy would avoid a recession even with obvious turmoil in the housing market.

Despite having only two months left in the year, the Fed missed the forecast terribly as the U.S. plunged into recession, recording its worst GDP number since 1946.

Perhaps a more reasonable concern is the possibility that keeping the cost of money so low for so long can create unintended consequences such as asset bubbles. As Benjamin Graham noted, stocks and bonds may go up or down in the short run based on fads, emotions and "animal spirits." But in the long run, the market weighs fundamentals and aligns asset prices with underlying values.

Certainly both stocks and bonds have appreciated to a greater degree than they would have without such loose monetary policy. But what happens when interest rates normalize and the market begins weighing fundamental values in an environment without Fed intervention is still an open question.

One thing is for sure though: at some point there will be another recession or even just another sharp market drop, and it will take many people by surprise (maybe even the Federal Reserve!). Some investors will panic and decide to sell at any price. Savvy buyers will keep their emotions in check and use the opportunity to make long-term purchases at low prices.

So the next time volatility strikes, remember to embrace the pain. Or at least take some aspirin and try to ignore it. Your future self will thank you.

S&P 500 returns following similar declines of at least 10% over four trading days

Date	After 5 trading days (1 week)	After 20 trading days (≈1 month)	After 250 trading days (≈1 year)
5/14/1940	-11.1%	-3.8%	-7.0%
5/21/1940	0.5%	9.7%	4.6%
5/28/1962	3.7%	-5.7%	26.2%
10/19/1987	1.3%	9.7%	22.4%
8/31/1998	6.9%	9.6%	40.8%
7/23/2002	13.2%	17.5%	22.7%
10/7/2008	0.2%	1.0%	4.4%
10/24/2008	10.5%	-8.8%	24.7%
11/19/2008	10.1%	9.8%	37.7%
8/8/2011	7.6%	4.1%	24.3%
Average	4.3%	4.3%	20.1%
08/2015	2.5%	3.8%	?

Source: Barclay's Research, FactSet and Bloomberg as of Sept. 23, 2015.

That's What Trusts Are For

Why should I have a trust? The most touted answer to this question is to avoid probate. However, there are many other reasons for creating a trust that often do not get the attention they deserve. One of those is to avoid some future federal estate taxes.

Generally, if an irrevocable trust provides income for the life of a beneficiary and, upon the death of that beneficiary, specifies a new income beneficiary or terminates, the trust corpus value will not be included in the taxable estate of the lifetime beneficiary. This is commonly referred to as a generation skipping trust when the trust benefits several generations of the grantor's descendants. If done properly, this type of trust can avoid federal estate taxes that would otherwise be imposed on each generation.

A trust also provides a grantor a way to leave property to a beneficiary without the beneficiary's creditors having access to the trust property. For example, a grantor can leave property in trust for a beneficiary who has a job that exposes him to liability (e.g., a doctor) in order to protect the property from the beneficiary's potential creditors. In other words: a grantor can provide a beneficiary with an asset protection trust.

This also works well if the beneficiaries are spendthrifts or already have creditors. By leaving the estate in trust, the property can actually benefit the beneficiary rather than the beneficiary's creditors. It also protects the estate from a beneficiary's ex-spouse in the event of a divorce.

The Silver Spoon Syndrome

Yet one more reason to leave property in trust is to avoid the so-called "Silver Spoon Syndrome," in which one generation earns the money and later generations spend it all. The grantor who earned the money can leave the property in trust and specify the conditions that must be present before a beneficiary receives a distribution. This can help prevent beneficiaries from squandering the estate and safeguard the property for future generations. It also permits the grantor to continue to control his estate even years after his death.

For example, if it's important to the grantor that his beneficiaries work and not be reliant on the trust fund, he can specify that no distributions be made to a beneficiary in excess of wages earned. Or if a grantor is concerned about drug or alcohol abuse, he can provide that no distributions be made during the time such abuse is taking place. And the list goes on and on. However, there are some limitations. One of those is the rule against perpetuities, which limits the amount of time a trust can be in existence. The current version in Oklahoma provides that an Oklahoma trust can only exist until the end of the life of a currently living beneficiary plus 21 years.

Thus, if an Oklahoma grantor has only children and grandchildren living when establishing a trust, the trust can provide for each of the children and grandchildren as well as the grandchildren's children, but only for 21 years after the death of the last grandchild living at the inception of the trust. The trust cannot provide for the great-grandchildren past this age or for any later generations.

Rule Against Perpetuities

Recently in Oklahoma and many other states, there has been a push to abolish or modify the rule against perpetuities. Effective Nov. 1, 2015, the Oklahoma Trust Act will provide that this rule is only violated if no one has the power to sell, exchange or otherwise convey the property owned by a trust.

In other words, as long as someone like the trustee has the power to sell trust property, the rule is not violated, even if the terms of the trust do not provide for a termination date. Thus, the trust can stay in place in perpetuity.

There are some exciting implications of this change in Oklahoma. Going back to the examples mentioned above, the common denominator is that the grantor wants to protect her estate—from creditors, taxes and the beneficiaries themselves—and benefit her descendants in the method she prescribes for as long as possible.

Beginning next month, as long as grantors do not prohibit the sale, exchange or conveyance of assets in their estates, they can do this for potentially limitless future generations of beneficiaries while also controlling, for years after their deaths, how and when their estates can be spent. And, to boot, they can also avoid probate!

Melissa Taylor
Vice President

A Better 401(k)

We can all agree that a traditional 401(k) plan is a good way to start saving for retirement, even during the years when saving is the last thing you want to worry about. But what is a Safe Harbor Plan and why should you choose it for your business?

A Safe Harbor Plan generally allows all participants to save more money for retirement because it lets an employer offer a retirement plan that benefits all eligible employees regardless of salary.

Non-Safe Harbor Plans are subject to a variety of nondiscrimination requirements intended to ensure the plans do not unduly favor highly compensated individuals such as executives and business owners (those who earned over $120,000 in 2015). In these plans, highly compensated individuals are limited to defer only about 2% more than the average of all the employees who are not highly compensated. This means that in Non-Safe Harbor Plans, business owners are not capitalizing the full potential of a 401(k) because they are reducing their own accounts by the limitations associated with the nondiscrimination requirements.

On the other hand, because a Safe Harbor Plan fulfills select IRS requirements, a business owner can contribute the maximum deferral ($18,000 for 2015 or $24,000 if age 50+) regardless of other employee contributions without the fear of a refund for failing to meet the nondiscrimination requirements.

This table illustrates the difference a Safe Harbor Plan can make by bypassing the nondiscrimination tests to allow business owners and employees alike to save for retirement.

Hypothetical Savings from a Safe Harbor Plan

		Total Contributions	
	Compensation	**Non-Safe**	**Safe Harbor**
John Doe (owner)	$265,000	$17,077	$25,950
Jane Doe (spouse of owner)	$130,000	$13,027	$13,900
Alice Smith	$90,000	$7,700	$7,700
James Dean	$45,000	$0	$1,350
Adam Clark	$65,000	$3,000	$3,450
Total		$40,804	$52,350
Increased savings			$11,546

In the scenario presented, the business owner maximizes his deferral without having to worry about a refund.

Less tax regulation on your company's 401(k) is always a simpler and cheaper choice for small employers. A Safe Harbor Plan may also be the right choice for large employers with substantial differences in pay between hourly employees and executives. Big or small, a Safe Harbor Plan may be the right choice for you.

Julissa Uriarte
Assistant Vice President

SPOTLIGHT

TULSA CAMPAIGN TO PREVENT TEEN PREGNANCY

Teen pregnancy rates in Oklahoma are third highest in the nation. To put this in perspective, more Oklahoma teens have become pregnant in recent years than have entered the freshman classes of OU and OSU combined. Without a doubt, it is at a crisis level for our state. Teen pregnancy is connected to multiple social issues, including education, child well-being and poverty. It costs Oklahoma over $190 million every year.

In November 2013, the Tulsa Campaign to Prevent Teen Pregnancy, a collaborative agency of the Tulsa Area United Way, launched. Its mission is to implement strategies and solutions to reduce teen pregnancy. By 2020, the agency aims to reduce teen birth rates in Tulsa by 30%.

Why is this goal so important? Children from unplanned pregnancies are more likely to experience adverse health and developmental consequences. And, teen mothers are more likely to deliver early and have babies with a low birth weight. It's not surprising that children of teen parents suffer higher rates of abuse and neglect than children of mothers who delay childbearing. Preventing teen pregnancy reduces poverty and improves overall child and family well-being.

The Tulsa Campaign to Prevent Teen Pregnancy is the only organization in Tulsa using a coordinated approach to address teen pregnancy prevention on a systems level. The non-profit provides teen pregnancy prevention training and resources for physicians, business leaders, faith leaders, non-profit administrators and school professionals. It works closely with partner agencies like Tulsa Public Schools and the Tulsa Health Department to address the issue where it matters most – in the lives of teenagers.

To learn more about the organization and how you can help, visit **tulsacampaign.org**.

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