

TRUST

INVESTMENT PERSPECTIVES

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Cautiously Optimistic

Money managers are supposed to be cautiously optimistic over time. If we're not optimistic, we risk becoming "perma-bears" – investors who don't invest in the market because they're always fearful. On the other hand, if we're not cautious, at some point in the economic cycle we will wish that we had been a perma-bear.

In reality, cautious optimism is likely the appropriate state of mind 80% of the time since the market historically goes up three out of every four years. And, 10% of the time, when the economy and markets appear to be in dire straits and the majority of investors are scared, we need to be aggressively optimistic. The remaining 10%, when there is far too much optimism in the market, we need to embrace the cautious component of cautiously optimistic.

Warren Buffet summarized it best: investors should "buy when others are fearful and sell when others are greedy."

So, where are we now? Since the market bottomed on March 9, 2009, stocks have increased almost 380%. The only bull market that had a greater run was the technology bubble in the late 1990s. That's a scary comparison, but not one that's altogether fair.

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The current rally started after a deep recession that lowered stock prices by more than 50%, giving stocks plenty of room to run. At this point, it feels as if we are on the border between cautiously optimistic and cautious. With that in mind, let's examine how the markets are performing.

BOND MARKET

The Barclays Intermediate Bond Index increased approximately 3% for the year, a fair return in what continues to be a low-interest-rate environment. Bond returns are a combination of interest income and price changes. Bond coupon rates remain low and prices haven't changed much in 2017. Of course, we all want to know when interest rates will increase. That is why credit markets pay close attention to the actions of the Federal Reserve (Fed).



JAMES F. ARENS II
Executive Vice President &
Chief Investment Officer

MARKET RECAP

Equity markets worldwide posted strong returns in 2017. Since beginning in March, 2009, the current bull market is now nearing its 9th anniversary.

	FOURTH QUARTER 2017	PAST 12 MONTHS
Dow Jones	11.0%	28.1%
S&P 500	6.6%	21.8%
EAFE (Int'l)	4.2%	25.0%

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VIEWPOINT

A message from the Desk of Tom Wilkins

The new year comes marching in. Welcome to 2018, friends. I hope that 2017 was a great year for you and your family. For us at TCO, it was a wonderful year. I would like to share with you some good news about our valued employees.

Our colleague and friend **Jim McKinney** retired at the end of the year. Jim was a member of our board of directors and an executive vice president. His retirement closes a cycle of 37 years serving our clients (Jim was a founding member of the company). We were fortunate to work alongside him and I would like to thank Jim for almost four decades of service.

Now allow me to recognize the TCO employees who received promotions in 2017. Let me begin with our newest executive vice presidents and members of TCO's Board of Directors: **Lesla Creveling** and **Zac Reynolds**. Congratulations!

Our newest senior vice presidents are **Michael Hopper** and **Nick Gallus**. Six employees have been promoted to vice president: **Alex Kaiser**, **Rhonda Kerr**, **Philip Mock**, **T. Raylene Rogers**, **Ryan Short** and **Marcia Brookey**. In addition, **Trena Person** is now an assistant vice president.

Join me in congratulating these professionals for an exceptional job and well deserved promotions.

I would also like to take this opportunity to acknowledge an important achievement: **Ryan Short** and **Doug Castle** passed a rigorous process and earned the Certified Financial Planner designation. Outstanding!

Finally, on behalf of everyone at Trust Company of Oklahoma, I would like to wish you a joyful and healthy 2018.

We feel privileged to serve you, clients and friends, and hope that our relationship continues for many years to come. Thank you for allowing us to work on your behalf.

Thomas W. Wilkins Chairman, President & Chief Executive Officer

Currently, the Fed is making progress in its rate tightening cycle, having raised rates three times in 2017. The market is predicting the Fed will increase rates two to three times in 2018. Most analysts agree that the Fed would like to raise rates at a faster pace. However, it appears the Fed doesn't want to raise rates too quickly and risk slowing down economic growth that has been trending, until recently, at a pace of only 2 to 2.5% per year.

The Fed is also very sensitive to the fact that most major countries aren't raising their interest rates. Each time the Fed raises rates and other countries don't, the dollar strengthens, which hurts the competitiveness of U.S. company exports (since a strengthening dollar increases the price of U.S. products sold overseas). As a result, we believe the willingness of foreign countries to raise their rates will influence how aggressively the Fed raises our rates over time.

Given our forecast for below-average interest rates over the near term, we expect bonds will continue to generate below-average returns over the next several years. While our outlook for below-average bond returns over the near term is disappointing, the only way bond returns can get back to their historical 4 to 6% annualized returns is for interest rates to increase over time. Although painful in the short term, we should view increasing rates as a necessary step toward a normalized interest rate environment.

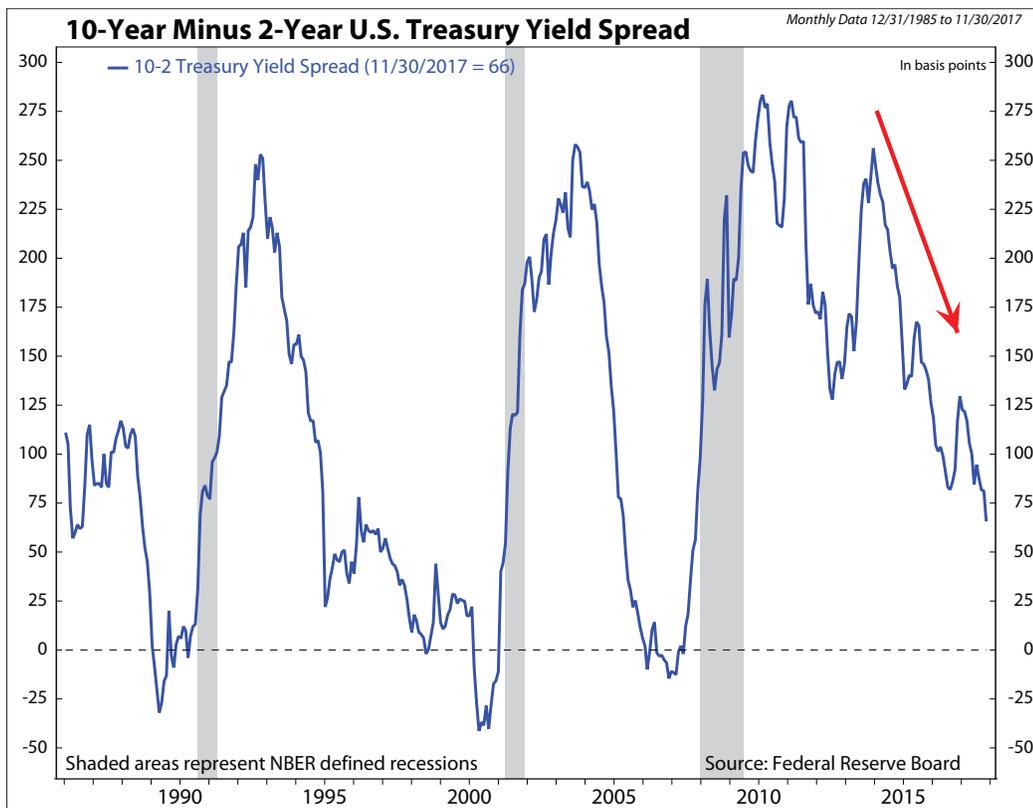
Interestingly, when the Fed raises rates, they only directly impact the short end of the yield curve. As the Fed increased rates over the last year, the two-year Treasury yield increased from as low as 1.1% to 1.8%. Longer-term yields tend to reflect investor outlook for future economic growth and inflation. Despite the fact that the Fed raised short-term rates, the 10-year Treasury yield actually decreased last year, from as high as 2.6% to as low as 2.0%.

The fact that we saw short-term rates rising and longer-term rates declining explains why we have seen a flattening of the yield curve. One measure of the steepness of the yield curve is the difference between the 10-year and two-year Treasury yields (i.e. the 10-2 spread).

When the 10-2 spread tightens, it signals the economy may be softening. At the end of November 2017, the 10-2 spread was approximately .70% (70 basis points) with the 10-year Treasury yielding 2.4% and the two-year Treasury yielding 1.7%.

As you can see from the **chart on page 3**, historically, anytime the 10-2 spread has gone negative by more than 10 basis points (i.e. inverted yield curve), the U.S. economy has entered a recession 12 to 18 months later (the grey area on the chart reflects historical recessions).

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As a result, the 10-2 spread is worth monitoring since the batting average of a negative 10-2 spread predicting a recession since 1987 is 100%. Fortunately, the yield curve is still upward sloping (i.e. positive 10-2 spread), meaning longer-term rates are currently higher than short-term rates.

STOCK MARKET

The stock market continued its great run in 2017, up 28% since the presidential election, and up 16% per year over the last five years. As we move closer to full employment and the Fed continues to raise rates, we are exercising caution due to our belief that we're likely in the later innings of this business cycle.

In 2017, the market moved higher primarily due to higher earnings and investor willingness to pay more for a dollar of earnings. Earnings increased 18% in 2017 and are expected to increase 16% in 2018.

While earnings have caused more of a market increase than the increase in the multiple that investors are willing to pay for earnings, we are starting to see rampant speculation in risky markets that concerns us. For example, at its high in 2017, Bitcoin increased 1,900% for the year!

While it's fun to talk about, Bitcoin is not an "investment" that we recommend. Bitcoin has no intrinsic value and

is only worth what the next person is willing to pay. Beyond that, there is significant risk that a more popular digital currency comes along that could cause the value of Bitcoins to fall out of favor with investors. In my opinion, this is a high stakes game of musical chairs. We'll see who's the last man standing.

TAX REFORM

The recently passed tax cuts should help stimulate the market over the next several years. Historically, the market has reacted favorably to tax cuts over the near term, averaging a gain of more than 10% in the 10 months following a tax cut. Fortunately, this

tax-reform package includes both corporate and personal tax cuts.

The corporate tax cuts should improve the profitability of American companies and will hopefully stem the tide of U.S. companies relocating overseas to save taxes. Companies with significant cash on their balance sheets stored overseas will receive favorable tax treatment if they transfer the cash back to the United States. Hopefully, this incremental cash will be used to increase capital spending, hire employees and pay down debt over time.

As it relates to individual tax cuts, most Americans will benefit from the proposed tax cuts, admittedly some more than others. The hope is that tax cuts for the average American will increase consumer discretionary spending, which should benefit the U.S. economy over time. This tax reform package is front loaded with many of the individual tax cuts expiring after 2025. These individual tax cuts may help extend this market cycle, which was likely in its final innings, without the implementation of the tax bill.

In closing, 2017 was another great year in the market. Earnings should continue to rise in 2018 as a result of tax cuts, low interest rates and overall economic strength. As this bull market nears the all-time record for longest in history, we recognize that the time for caution is coming soon. 📉

New Year's Resolution: Revisit Your Estate Plan

Now that the holidays are officially behind us, many of you are revisiting that final vestige of the season: the resolution list. Before you lace up your running shoes and dedicate the next 365 days to celery and lean protein, let me suggest a new resolution this year: tackle your estate plan.

A complete and updated estate plan gives you and your family guidance in a crisis. Your family, loved ones and care takers will have clear instructions on how to deal with both your assets and your healthcare in the event of your incapacity or your death.

A complete estate plan contains a key document: a durable power of attorney, which assigns a person to act for you, during your life, if you become incapacitated. This person is called your attorney-in-fact. It is not uncommon that attorneys create two separate powers of attorney; one to manage your finances and one to manage your healthcare decisions. Absent such a document, someone may have to petition a court for a guardianship over you. Guardianship is monitored by the court and requires accountings annually. As you can imagine, guardianship is costly and time-intensive.

Your estate plan should contain an advance directive for healthcare, often shortened to "advanced directives." This is a document created by the State of Oklahoma that allows you to make decisions about your care in an end-of-life situation. This document deals with life sustaining treatment and the decision to receive artificially administered food and water if you cannot eat and drink on your own.

And of course, your estate plan should include a will and possibly a trust. A will is a document that becomes effective upon your death, after it is admitted into probate court. As an aside, the word probate comes from the latin probare, meaning "to prove." A will must be "proved" to be your will and must be administered in court. Some states have shortened probate administration procedures, colloquially called simplified probate. Oklahoma is not one of these states, and probate matters can take months to conclude. A trust is administered outside of

the purview of the court, making a trust both private and not constrained by the timelines dictated by the courtroom.

Both a will and a trust can clearly outline who you want to inherit, and what you want the individuals or non-profits to receive. If you want to disinherit someone, you need to clearly spell that out in your will or in your trust.

Likewise, if you would like to leave something to a charity or to someone who is not a relative, you need to clearly spell that out in your will or in your trust. If you have minor children, your will should nominate a guardian to care for them. Absent your nomination,

a court will make that decision for you.

Remember to review your beneficiary designations. Proper beneficiary designations are an essential, but often overlooked, element in estate planning. An asset that has a beneficiary designation will transfer to that beneficiary outside of your will or trust. A flurry of accounts, including retirement accounts, banking accounts, vehicles, and even real estate can pass to a beneficiary through designations in Oklahoma. Designating a beneficiary can be deceptively complicated, as spouses often have certain rights and benefits with respect to certain retirement accounts and real estate.

NEW YEAR, FRESH START

Whether you are reviewing already established estate plans or meeting with an estate planning attorney for the very first time, resolving to get affairs in order is one resolution we should all make and keep. Our professionals at Trust Company of Oklahoma are here to help you make this the year that you keep your resolutions! 🎯



EMILY CRAIN
Assistant Vice President

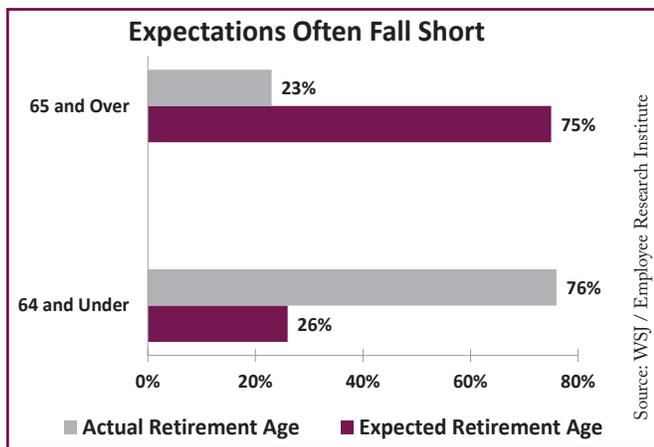


TAKING SHORTCUTS ON RETIREMENT

Deciding when to retire is a very important financial decision. Some choose to retire later in life. Others, however, end up retiring earlier than they expected, which can dramatically affect their financial position in retirement.

A recent Wall Street Journal article explored the differences between the actual and expected retirement ages of Americans. The article examined data collected from the Employee Benefit Research Institute. According to the research, about 75% of those polled expected to retire at 65 or later, but only 23% actually met that goal (see chart below).

It may not sound like taking a shortcut of one or two years would make a big difference, but it does.



Let's consider a hypothetical family: Ben and Nancy. They expect "average" social security benefits, have \$1 million in retirement savings with a balanced portfolio, and plan to spend \$100,000 per year in retirement. Nancy has already retired and Ben, 63, plans to retire at 67. He is saving \$20,000/year for retirement. Let's assume they both live to age 95. If Ben indeed retires at 67, based upon certain expected market returns, there's a 75% chance of retirement success for the couple (i.e. a financially secure retirement).

However, should Ben decide to retire earlier than 67, the chances for a successful retirement decline rapidly. If he retires at age 66, the couple has a 64% chance of success. If Ben retires at 65, the rate falls to 50% (a one-third drop from retiring at 67). That's a dramatic difference, and it is not an impossible scenario, as the research shows.

Since many retire earlier than expected, it is equally important to consider if your goals are realistic. Consider an emergency fund to accommodate extenuating circumstances, such as your health, that may prevent you from working as long as you plan. Now, back to work!



PHILIP MOCK
Vice President

SPOTLIGHT

Unfortunately, Oklahomans are all too familiar with the following data:

- Over 70% of Tulsa Public Schools students live at or below the Federal Poverty Level.
- Oklahoma leads the country in cutting funds for education.
- Oklahoma pays teachers less than any other state in the nation.
- Tulsa teachers spend an average of \$500 annually on school supplies—out of their own pockets.

Families struggling to make ends meet, underfunded schools, and underpaid teachers cannot afford the tools required for learning. This is where **The Pencil Box** comes in. The Pencil Box is a nonprofit free store that provides the necessary supplies students must have to learn.



Teachers from eligible schools visit The Pencil Box and select supplies specific to the needs of their students. Schools eligible to participate are pre-K through grade 12 public schools where over 70% of students live at or below the Federal Poverty Level. After the teacher's visit, both the school and school district superintendent receive detailed reports.

Access to supplies has made a significant impact at participating schools. It has improved student interest in learning by 100%, class participation by 99%, student preparedness by 100%, homework completion by 86%, self-esteem by 97%, student attendance by 80%, and student behavior by 96%.

The nonprofit relies on businesses, foundations, and individuals for donations of materials and/or funds to purchase discounted supplies from its partners. If you are interested in helping The Pencil Box positively impact our schools, teachers, students, and ultimately our community, visit pencilboxtulsa.org.

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