Trust Company Oklahoma

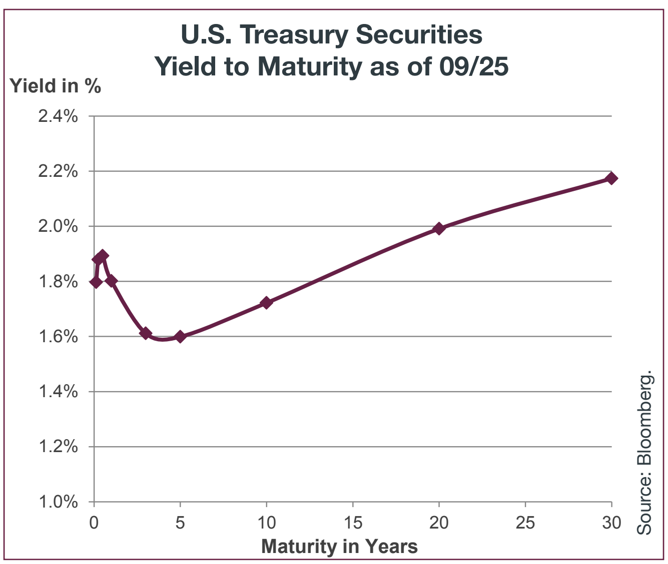
INVESTMENT PERSPECTIVES

October 2019

Upside Down

Making Sense of the Recent Yield Curve

If you have been watching the business news networks, you have probably noticed that the stories often mention the inversion of the yield curve. In finance, the yield curve is a graph showing interest rates (also called “yields”) across different maturities (two months, two years, 20 years, etc.). The curve shows the relation between the interest rate and the time to maturity. See **below** for the current curve.



MARKET **RECAP**

U.S. equities posted modest gains in the 3rd quarter. Trade and political tensions pressured stocks while economic news generally signaled continued growth. International equities posted negative returns.

	3rd Quarter	YTD	Past 12 Months
Dow Jones	1.8%	17.5%	4.2%
S&P 500	1.7%	20.6%	4.2%
EAFE (International)	-1.1%	12.8%	-1.3%

In late August, the yield on the 2-year U.S. Treasury Note was above the yield on the 10-year Treasury Note. Normally, yields are higher, not lower, as bond maturities get longer. This means the yield curve is usually upward sloping with the 2-year yield less than the 10-year yield. However, in certain market environments, the yield curve will invert with shorter dated bonds yielding more than longer dated bonds. These inversions are rare and sometimes just briefly occur before going back to normal conditions, leaving little cause for concern.

Is this inversion just an irrelevant incongruity or should we as investors adjust our portfolios accordingly? Let’s examine why inversions are anomalies and what they have historically indicated.

There are a few reasons why inversions are uncommon. Let’s begin with the concept of the time value of money. Longer term bonds typically earn a higher rate of interest because a dollar today is worth more than a dollar tomorrow. So, a dollar in two years is worth more than a dollar in 10 years. Why? Because there is an opportunity cost for tying your money up for 10 years as opposed to two years. To compensate investors for their time, a higher rate of interest is offered.

Additionally, there is the risk that inflation increases unexpectedly. Investors are usually more comfortable making an inflation forecast for the next two years as opposed

JORDAN T. HUNT, CFA
Investment Officer

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VIEWPOINT

A Message From the Desk of Tom Wilkins

The leaves will soon start falling and the cool temperatures will lead the way to the holidays. I hope that you and your family had a fun summer. At TCO, we had an important reason to celebrate this summer: ***our growth***.

Our team grows and our team members grow professionally. We are committed to supporting their professional advancement because, among other reasons, it significantly benefits our clients.

So please help me in congratulating senior vice president **Philip D. Mock** and investment officer **Jordan T. Hunt,** who recently earned the highest distinction in the investment management profession, the Chartered Financial Analyst designation. Philip and Jordan successfully passed the CFA Program, which is an extremely rigorous process. Only the most well prepared candidates all over the world earn this respected distinction.

Additionally, please help me welcome **Jim Savage** and **Tracey Sealy**. They joined the Tulsa office as senior vice president and marketing officer, respectively.

Savage has almost three decades of experience in the investment industry. At TCO, he helps clients manage their investment portfolio. Jim earned a bachelor's degree in finance from Auburn University, a master's from Georgia State University, and the CFA designation.

Tracey is an Oklahoma native who graduated from Kansas State University with a degree in public relations and a minor in leadership studies. She is focused on digital marketing, and her responsibilities include providing you with great content through our multiple online platforms.

We take pride in the strength and breadth of our professional expertise, and remain grateful for the opportunity to serve you, your family or your company.

THOMAS W. WILKINS, Chairman & Chief Executive Officer

to the next 10 years. For that matter, the further out an investor looks, the more varied the forecast because of the added risk of more volatility. Investors want to be compensated with a higher return for added volatility over longer time periods.

INVERSIONS MATTER

The markets view an inversion as a red flag, a recessionary warning. And rightfully so. An inversion has occurred before each of the last seven recessions. The reason some analysts are concerned about the most recent inversion is because this is the first such occurrence since the 2008/2009 recession. An inversion acts as a leading indicator, often before other economic indicators begin to show signs of a recession. Importantly though, an inversion has predated an economic recession by upwards of 22 months, so equity markets don't always turn down just because yields invert. A lot of events and counter-vailing forces can occur after an inversion to prevent or delay a recession from occurring.

There is always the possibility that the recent inversion may be different than past inversions. Investors are currently in a unique climate following a first-of-its-kind policy of massive quantitative easing by the Federal Reserve and other central banks where longer term Treasury yields have been forced down by the Fed. This may be distorting the message an inversion normally sends and enabling more frequent yield curve inversions without the associated risk of recessions.

There is also pressure on U.S. yields due to weakness in foreign economies and their central banks' aggressive policies. While U.S. rates are near historical lows, they are by no means the lowest on a global scale. Due to the U.S. having relatively higher interest rates compared to other developed economies, investors from foreign countries are purchasing large quantities of our bonds, thereby driving bond prices up and yields down. This foreign pressure has helped drive the 10-year yield to fall below the 2-year yield.

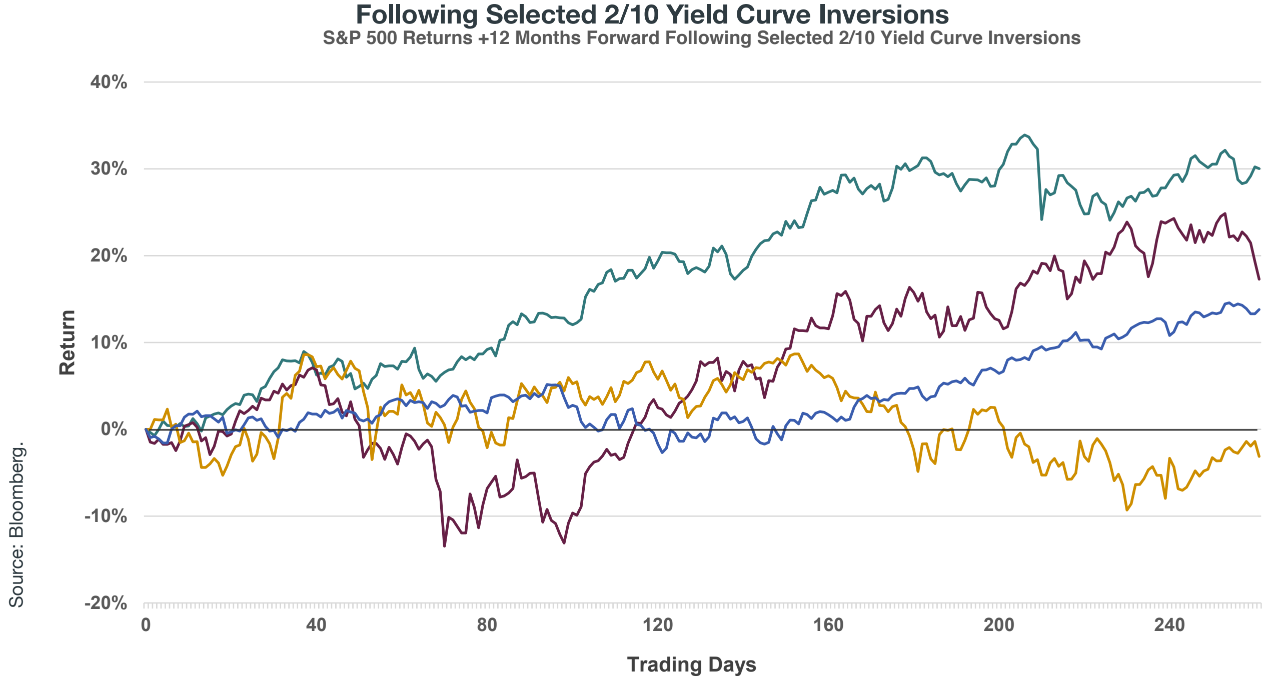
BUT MAYBE NOT SO MUCH FOR STOCKS

Regardless of whether or not the current inversion is signaling a recession, an equity investor attempting to time a recession using this inversion as a signal could easily lose out on significant returns. Not only can an inversion have a very long lead time in front of a recession, stock market returns have often been positive in the 12 months following an inversion (**see chart 1 on page 3**).

The graph shows multiple cases (1988, 1998, 2005) with positive returns in the 12 months following an inversion and one case (2000) with negative returns. The average of these four cases was a return of approximately 14%. While not shown on the graph, another instance of strong performance following an inversion occurred beginning in early 2006. After this inversion (from January 31, 2006 through October 9, 2007), the S&P 500 posted a cumulative gain of 26%. Of course, the market fell sharply after October 9th, but investors who sold out in early 2006 missed a very strong rise in prices. Even if this most recent sustained inversion signals a recession, timing the market based upon an inversion would be extremely difficult as evidenced by this graph.

Chart 1

S&P 500 Returns +12 Months Forward Following Selected 2/10 Yield Curve Inversions



Furthermore, timing the market based upon the prospect of a recession, regardless of inversion, is also risky as illustrated in **chart 2 below**. While the stock market typically turns down prior to a recession, the downturn is usually within roughly six months of the start of a recession. Again, investors who sell out too early (and especially too late) risk missing most of the market's return.

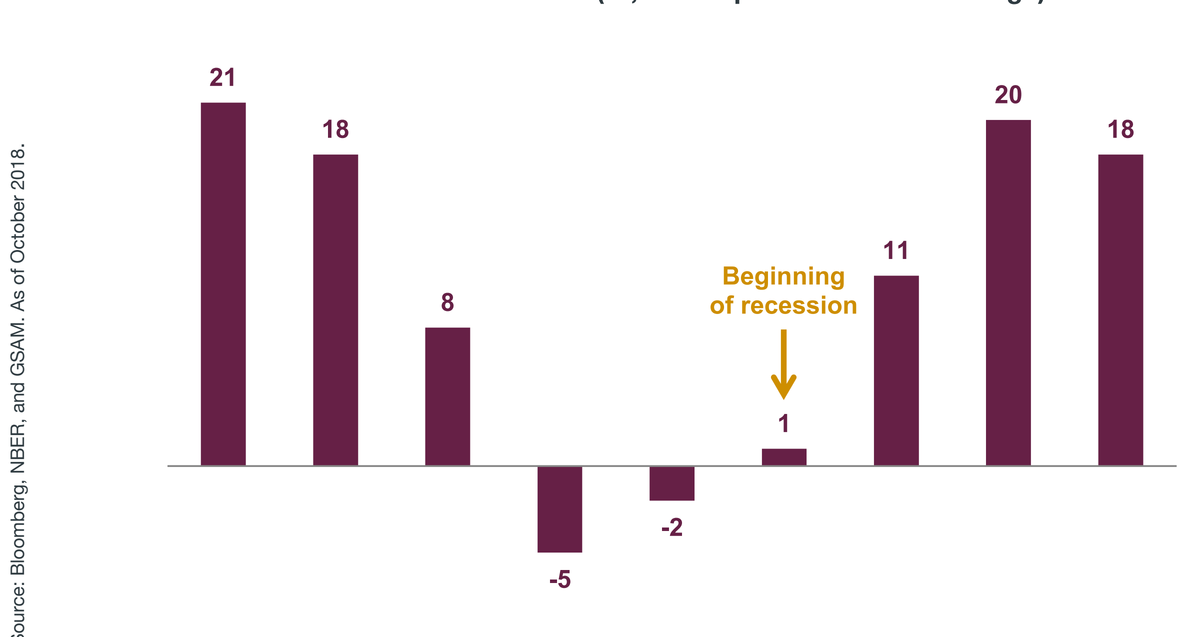
Equities have been in a strong bull market for some time – by most accounts, the longest streak recorded – and many investors may be over-allocated to stocks. A more prudent way to trade this event is to look at current allocations and, if out of line, reallocate to your long-term target. Presumably, your target allocation was set with a clear mind, understanding that you have the ability to weather any storm as long as you maintain your investment plan.

THE BIG LESSON

Timing the market and trading around a recession can be extremely difficult. To benefit, an investor would have to time selling and then buying perfectly—without a crystal ball. A yield curve inversion may make for a good news story, but the track record of using it for investing is not very appealing.

Chart 2

S&P 500 Total Return (%, Subsequent 12-Month Average)



Bob McCormick Hits the Open Road

Nestled somewhere on a dusty bookshelf in Bob McCormick's office rests a sign which reads, "No man is completely worthless; he can always serve as a bad example." As his retirement approaches at year's end, Bob jokes that perhaps serving as a bad example has been his ultimate purpose. To paraphrase a hypothetical question he often asks me, "What kind of financial professional retires early, at the peak of his career, just to travel around the country in a van?"

Retirement announcements do not typically appear in the pages of Investment Perspectives. And if Bob had his way, neither would this one. After all, why remind clients of his looming departure? And for everyone else, why not write about financial planning or anything more informative? My simple answer is this: Bob's retirement is noteworthy because TCO would not be the company it is today without the contributions of Bob McCormick.

> ***"There was nowhere to go but everywhere, so just keep on rolling under the stars."***
>
> **Jack Kerouac**
> ***On the Road: The Original Scroll***

Some of Bob's achievements are obvious. He has been a portfolio manager at TCO for 27 years, and currently serves as the Senior Executive Vice President and COO. Over that time, he has advised countless clients, helping them to manage and preserve their hard-earned wealth. Throughout his career, he also served his community in many capacities: Bob was a founding board member of San Miguel School of Tulsa and an adjunct professor at Oklahoma State University Tulsa. In 2014, Bob was even named one of the "100 for 100" graduates of OSU's Spears School of Business in honor of the school's 100th anniversary. Others who were recognized alongside Bob were Senator Tom Coburn and entertainer Garth Brooks.

Undoubtedly, any honest discussion of Bob's legacy should include all of these feats. But next year, when he is out on the open road exploring North America, none of this is what will come to mind when I think about Bob.

Instead, I will remember Bob's genuine humility. I will remember how his articles always began with the salutation, "Folks, …" I will remember how, at the outset of my career at TCO, Bob pushed my toddler up and down the halls of the office in a box, performing a move he called "The Screaming Eagle." And I will remember that, even when he was the smartest person in the room (which was most of the time), he encouraged his younger colleagues to speak up, so that they too could have their moment to shine.

I will also remember Bob's insistence on superior customer service. He has repeatedly claimed that the real mission statement of Trust Company of Oklahoma should be to provide *kickass* service to our clients, regardless of what the more politically correct version of that mission statement might actually say. I will remember the various times a question arose about the right course of action, and Bob responded, "Which way will benefit the client? Whatever it is, do that."

I will remember how unabashedly he has embraced his uniqueness (and how he encouraged others to do the same). I will remember how one Friday, March 13, he arranged a company-wide pie competition in celebration of the mathematical symbol Pi (the first digits of which are 3.14). To explain to our colleagues why the event was occurring a day earlier than the actual Pi Day of March 14, Bob wrote and performed "It's Pi O'Clock Somewhere," his parody of Jimmy Buffet's iconic "It's Five O'Clock Somewhere."

I will remember that he had me push him on a rolling office chair into a room full of TCO employees as he impersonated Elton John (while wearing a blonde wig, airplaying a keyboard and lip synching *Rocket Man*) on our firm's 35th anniversary party.

Most importantly, I will remember how Bob was a true mentor, not only to me, but to countless others at TCO; the never-ending line of people outside his door most days is proof of how much everyone values his guidance. Ultimately, Bob's greatest legacy is the tremendous professionals he hired and developed. Inspired by his passion and work ethics, we will all continue to work in our clients' best interest. I'm sure there is much more about Bob I will remember, the true extent of which may take years for me to realize.

Bob, as that sign in your office states, you are not completely worthless after all—and you have never been a bad example. Godspeed on your journey.

MICHAEL HOPPER, CFP®, CTFA
Senior Vice President

Where There's a Will...

When people share with me that they do not have an estate plan in place, I tell them that they are partially correct: they may have not prepared an estate plan for themselves, but the state of Oklahoma has. Oklahoma's state statutes outlines a generic estate plan for almost all family arrangements you might have when dying intestate – without a will. That is the good news.

The bad news? There is a good chance the statute doesn't fit your needs. For example, if you die without a will and you leave behind a spouse and children, your intestate property will be divided amongst all of them. Your spouse receives half and your children split the other half. That's assuming the children belong to both you and your spouse. If your spouse is not the parent, it's a whole different kettle of fish.

We are reminded periodically of the importance of having an estate plan by famous people who did not. They serve as cautionary tales.

FAMOUS PEOPLE WHO DIED WITHOUT AN ESTATE PLAN

President **Abraham Lincoln** died without a will, even though he practiced law. His assets at death valued $85,000. That is over $1 million in today's dollars.

Prince, who some believe was a musical genius, died in 2016 without a will or trust. His estate is worth approximately $200 million and is still unsettled.

Legendary singer **Aretha Franklin**'s estate is worth around $80 million. She never got around to preparing an estate plan.

Bob Marley's heirs were still battling the singer's estate in court 30 years after Marley's death. His estimated net worth today is around $130 million.

In its most basic form, an estate plan includes a will. Many individuals also include a trust as it has certain benefits over a will, such as greater privacy and flexibility as to how and when assets should be divided.

Trusts are also useful if you become incapacitated. Certain kinds of trusts can also help prevent litigation and provide asset protection. *You do not have to be wealthy or famous to take advantage of these benefits.*

It is said Lincoln stored important papers in his tall stovepipe hat. Too bad his will wasn't there!

KATHY KING
Vice President

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If you haven't been following us on social media, here are a few fun and helpful posts we published recently.

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Liked by and 13 others

trustcompanyofoklahoma Happy first day of graduate school to our very own, Doug Castle. We are so proud!

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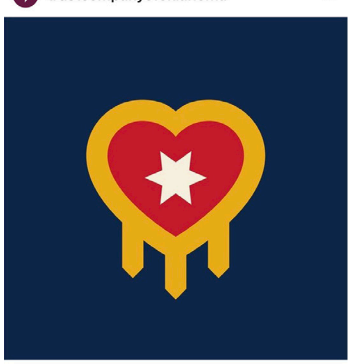
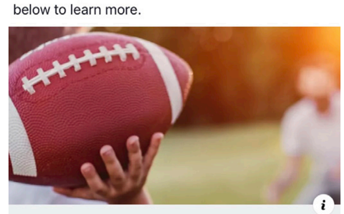


Liked by and 7 others

trustcompanyofoklahoma We love our state, but especially the 918! Join us as we celebrate #Tulsa's diversity and growth. #918Day2019

Trust Company of Oklahoma - Oklahoma City ···
Posted
Yesterday at 11:13 ·

There can be big benefits to your family knowing your estate plan. But how to communicate to your heirs who gets what without spoiling the relationships with each of them? See the article below to learn more.



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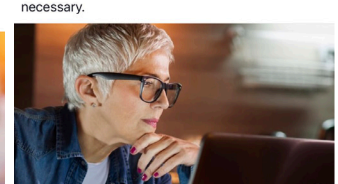
How to Talk To Your Heirs About Your Estate Plan Without Ruining Your Relationship With Them |...

Trust Company of Oklahoma - Oklahoma City ···
Posted
Monday at 09:59 ·

In the article below, Karen Ellis provides important guidance on when to withdraw funds from your IRA. While withdrawal may seem like an easy task, you may find yourself paying more in taxes than necessary.



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TULSA, OK 74101-3627

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ARE YOU LEAVING YOUR FAMILY YOUR MONEY? *OR A MESS?*

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TRUSTOK.COM
(918) 744-0553 | (405) 840-8401