Trust Company Oklahoma

INVESTMENT PERSPECTIVES

January 2020

Doing the Limbo

What a year for stocks, bonds, oil, and pretty much anything else you could invest in. Stocks, as measured by the S&P 500 Index, were up 31% in 2019. The Barclays Aggregate Intermediate Bond Index was up 9%, while the price of oil increased 26%. Yes, it was a great year, but 2019's returns may be a bit misleading.

Last year's numbers look so strong because the fourth quarter of 2018 was so bad. In other words, stocks are only up around 13% since September 20, 2018. A lot of 2019's gains merely reflect a recovery of what we lost in the fourth quarter of 2018 (market declined 14%). Oil offers the most extreme example: while oil is up 26%, it's actually 16% lower than its October 3, 2018, price of $72.22.

HOW LOW CAN YOU GO?

If the stock market's climb defied expectations, so did the bond market's game of limbo – lowering interest rates so low, in some cases, investors wondered if it was still worth playing the game. The 10-year Treasury yield dropped from 3.2% in late 2018 to a low of 1.5% in September 2019. Fortunately, yields for the 10-year Treasury improved, closing the year at 1.9%.

After raising rates nine times between 2015 and 2018, the Federal Reserve (Fed) seemed to change course in January 2019 when Fed Chair Jerome Powell indicated that it would stop raising rates. In August 2019, the Fed jumped fully into the game, lowering rates three times in 2019.

If you think U.S. rates are low, you should compare them to other developed countries. You will see that our rates are attractive. In fact, the 10-year yield for sovereign debt in countries like Germany, France and Japan is currently negative. Shorter-term yields for sovereign debt in these countries are negative as well. As result, depositors are effectively paying banks to hold their cash. Hard to believe, but true.

As you can see from the **chart on page 3**, worldwide, negative yielding debt peaked at $17 trillion earlier this year. With negative rates, some investors are guaranteed to be worse off in nominal terms by the time their bonds mature. Assuming investors lived in a country with a positive inflation rate, their real return will be even worse.

ALL AROUND THE LIMBO WORLD

The fact that U.S. interest rates are positive leads to strong foreign demand for our bonds, which means the U.S. dollar remains strong. Unfortunately, the strong dollar constrains our ability to export, since a strong

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President &
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MARKET **RECAP**

The S&P 500 posted its strongest annual return since 2013. While not as strong, international stocks also posted solid returns for 2019. These returns contrast with 2018, when the best performing asset class was cash equivalents.

	Fourth Quarter	YTD	Past 12 Months
Dow Jones	6.7%	25.3%	25.3%
S&P 500	9.1%	31.5%	31.5%
EAFE (International)	8.2%	22.0%	22.0%

VIEWPOINT

A message From the Desk of Tom Wilkins

If you were alive in 1999 (back when I still had dark hair) you remember the panic surrounding the approaching new millennium. So much talk and so much fear about 9 becoming 0 and the unknown territory of the 21st century. It's hard to believe that it's been 20 years and we are now stepping into 2020.

At TCO, we always start the new year sharing great news about our professional team so it's my pleasure to kick off this decade with this tradition. Two dedicated and experienced professionals have recently joined our team. Please help me welcome **Ben Reynolds** and **Jessica Hendrix**.

Ben is leading our Retirement Plan Solutions Division. Jessica, as a member of our Oklahoma City team, helps families, businesses and foundations achieve their financial goals.

In addition, help me congratulate **Michael Hopper** and **Michael Hairston** for being promoted to executive vice president. They also have joined our Board of Directors. Congratulations!

Emily Crain's dedication to clients earned her a promotion to senior vice president. And, **Rebecca Mitchell** and **Lindsay Bivin** are now assistant vice presidents. Last, but not least, **Sean Connolly**, who has been working in the Property Management Division for almost two years, is now a trust officer.

Please join me in congratulating these exceptional employees.

Once again, thank you for your business. Here's to a happy, healthy and prosperous New Year!

THOMAS W. WILKINS, Chairman & CEO

dollar makes our exports more expensive.

All of this negative yield debt has led many investors to ask the question: **how low can rates go**, especially in international markets? We have never seen a negative yielding rate environment like this and hopefully never will again. With negative rates, investors *need to be nimble, they need to be quick to make much money under the limbo stick*.

THE THREE DRIVERS OF STOCK RETURNS

As mentioned earlier, stock returns were very strong last year, up 31%. In fact, 2019 was the best year since 1997. Back then, the market was up 33%. As we consider how we got here and where we are going, let's break stock returns down further.

Stock returns can be thought of as coming from three factors: earnings growth, earnings multiples (how much you are willing to pay for a dollar of earnings), and dividend yields.

In other words, if the multiple doesn't change (e.g., the market is trading at 20 times $1 of earnings), your return will come from earnings growth and the dividend yield. Of course, multiples do change and that can have a tremendous impact on returns. In fact, in 2019, earnings were flat while dividends yielded approximately 2%. As a result, the remaining 29% of stock market returns came from multiple expansion. The fact that 2019 returns were primarily driven by multiple expansion leads us to these questions: why did multiples expand? And can they expand more?

There are some basic reasons why an investor may be willing to pay more for a dollar of earnings. Investors are willing to do so if earnings are expected to grow at a higher rate, if those earnings become less risky, or if interest rates are lower.

When you examine those three factors, earnings growth had little impact. By far, the biggest impact came from lower interest rates. Low interest rates drive multiples higher in many ways. Low rates mean lower interest expense and a lower cost of capital for companies.

Most importantly, when investors are faced with lower interest rates, they are willing to pay higher prices for stocks and the dividend yields they offer. The bond market's limbo game becomes less and less attractive.

The third factor that drives multiples is risk or uncertainty. Overall, uncertainty lessened during the year. It now appears likely the U.S. will reach a partial trade deal with China.

Secondly, our fears of recession have faded away over the course of the year as the U.S. economy continues to generate below average, but stable 2%-type economic growth. And most importantly, the Fed seems to be increasingly attentive to the stock market by keeping interest rates relatively low for the foreseeable future.

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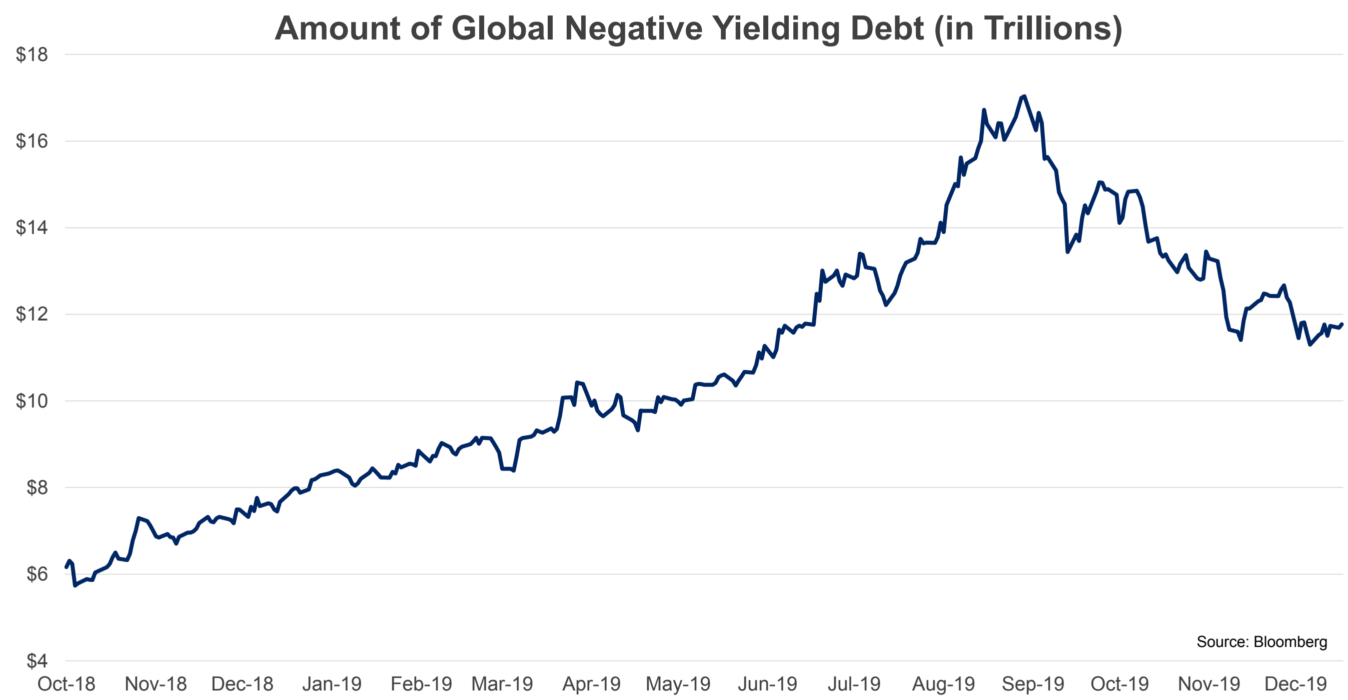

LOOKING AHEAD

While it's always easier to look backward than forward, I suppose it's time to look ahead. Let's start with stocks and return to our framework of earnings growth, multiple expansion (or contraction), and dividend yield. While earnings are currently forecast to grow 10% in 2020, those estimates almost always come down significantly.

In a low growth economy with limited trade, it's unlikely we would have the potential for earnings growth higher than 5%. The second factor, the dividend yield, is relatively steady at 2%. Simple math puts us at a 7% return before considering the issue of multiple expansion or contraction.

The arguments for higher multiples are limited. Certainly, rates could go lower and this could drive more money into stocks. In addition, the trade conflict with China could get resolved and that could help multiples.

On the flip side, multiples could be hurt by a significant increase in wage inflation that would lead the Fed to engage in more restrictive policy (i.e. raise rates), the trade war could re-escalate, political uncertainty over the upcoming election could increase, and the market could become increasingly focused on the record-setting length of this expansion (10 years and counting).

Long-term risk is also heightened by the fact that fiscal and monetary policy may be limited in the next recession. Currently, federal deficits are widening in a time of near full employment and it will be politically and financially difficult to run even larger deficits during our next recession. At the same time, expansionary monetary policy will be constrained since the Fed Funds rate is already below 1.75%. In past recessions, the Fed has lowered rates by an average of 5% to stimulate the economy.

With respect to bonds, the limbo bar is quite low. The 10-year Treasury yield isn't keeping up with inflation. As a result, current yields are not particularly attractive. Below-average economic growth and the gravitational pull of low foreign rates are holding our rates down.

Unfortunately, moving out the risk continuum into corporate bonds isn't much help either. Riskier corporate bonds are offering very low risk premiums, further evidence that investors seem to feel very confident in today's economy.

For now, enjoy the above-average returns we experienced in 2019. Then fasten your seat belt for what may prove to be a bumpier, but positive, ride in 2020. While there will likely be unexpected twists and turns along the way, it is helpful to remember that it is more about the destination than the journey (stay focused on the long-term, not the short-term).

As always, thank you for allowing us to help you achieve your financial goals.

A *Beneficial* New Year's Resolution

When you set up your retirement savings account maybe 3 or 30 years ago, you listed who will be the beneficiaries of your savings. A lot may have changed in your family since then, such as divorce or remarriage. Would you want your ex to inherit the sum of money you saved for retirement? That is why it is important to review the beneficiary forms of your retirement accounts, to ensure your beneficiaries are in accordance with your wishes by the time of your death. How about making this your #1 New Year's resolution?

SETTING THE BENEFICIARY RECORD STRAIGHT

Funds in a retirement account – such as IRA, 401(k), or 403(b) – pass to beneficiaries designated when you opened the account (unless you changed them since). Transfers to these beneficiaries go into effect at your death and, contrary to popular misconception, will not normally pass under the terms of your will.

The exception is if you simply forget to name a beneficiary or if your beneficiary predeceases you. If that happens, your IRA will be a part of your estate and must go through probate before it will pass to your heirs. This could be costly, time consuming, and your loved ones could get much less than you planned. Even if your beneficiaries are still alive, reviewing who you designated is a good exercise. Family situations change, so it is wise to verify that what you put down on paper, say 5 years ago, matches your wishes today.

DO YOU HAVE A BACK-UP BENEFICIARY?

Typically, married people will choose to name their spouse as the primary beneficiary. But what happens if you both pass away in an accident? Do you have an alternate beneficiary listed should something like this happen? Don't stop at listing a primary – your back-up or contingent beneficiary can be just as important. Some may opt to have a trust serve as the beneficiary when asset protection is a major objective, or if there are concerns an heir could squander the inheritance. If you selected this option, ensure your trust contains the necessary language to make this work. If in doubt, consult with your attorney.

A big curve ball retirement account owners face in 2020 is the recently signed SECURE Act (read Michael Hopper's article on page 5). The act eliminates the ability for most non-spouse beneficiaries to stretch out distributions over their lifetimes. Instead, they have to take the payouts over a maximum 10-year period. This change impacts IRAs whose owners die after December 31, 2019, and may affect your beneficiary selection as well as the attractiveness of naming a trust in some cases.

Make it a priority to review your forms; make sure they outline your most recent wishes, and verify that they are properly on file with the custodian. Check this item off your resolutions list first, then move on to that junk drawer or the always awaiting treadmill.

WHITTNEY STAUFFER, CFP®
Vice President

SPOTLIGHT

It's a weekday morning and volunteers with **Operation School Bell®** (OSB) eagerly anticipate the arrival of their guests. As a yellow school bus pulls up, the volunteers gather to greet students coming in to receive new uniforms, shoes, coats and the personal items needed to attend school with confidence.

Since 1970, Assistance League® Tulsa, an all-volunteer non-profit organization, has been helping meet essential needs of students in grades Pre-K to 12. Last year, the program served more than 25,000 students in 108 schools from 12 area school districts.

Tulsa Public School students must wear uniforms, but providing the appropriate clothing for growing children is often a hardship for families. Because of this, uniforms, shoes, coats and underwear can be barriers to education for many children. In 2018-19, OSB provided support to approximately 56% of Tulsa Public Schools students.

Participants in OSB are identified by school counselors and teachers. Selected students are transported to the Assistance League building for a personal shopping experience. They receive a full school wardrobe of new items. TPS middle school, junior high and high school students receive needed items through OSB's school-site clothes closets.

The program is financed by the fundraising efforts of AL Tulsa's 283 volunteers. OSB's largest income stream is from Bargains Thrift Shop, which is open for business five days a week and run by volunteers. Bargains sells gently used items donated to AL Tulsa. Learn more at **altulsa.org**.

SECURE Act Significantly Impacts Your Retirement Planning


Credit: iStock

Last month Congress passed one of the most sweeping changes to retirement law since the George W. Bush administration. That's right: somehow in the midst of impeachment proceedings, another looming government shutdown and typical Washington dysfunction, the Setting Every Community Up for Retirement Enhancement (SECURE) Act passed through Congress with bipartisan support and was signed into law by President Trump. The passage of the SECURE Act under such difficult circumstances should underscore the pressing need for retirement reform.

The bulk of the SECURE Act deals with employer-sponsored retirement plans – such as 401(k) plans –with the aim of increasing employee participation. Although these changes are potentially substantial, there are simply too many to adequately discuss in a couple of pages. Instead, what follows is a description of the changes likely to impact most readers. Some of these impacts appear positive, others negative, and even more remain uncertain. But it is worth paying attention to all of them.

THE END OF THE STRETCH IRA

Let's get the bad news out of the way first: the "Stretch IRA" is dead, at least for beneficiaries inheriting an IRA beginning in 2020. For anyone unfamiliar with the term, prior to SECURE, non-spouse beneficiaries (kids and grandkids for instance) of IRAs and defined contribution plans could stretch their required distributions over their own life expectancies. This popular feature allowed assets to remain inside of IRAs, growing tax-deferred over multiple generations.

However, beginning in 2020, most IRA beneficiaries will be subject to the 10-Year Rule, which requires that beneficiaries withdraw their *entire* inherited IRA balance by the 10th year following the year of inheritance. Since distributions from traditional IRAs are fully taxable as ordinary income, beneficiaries of retirement accounts may now face substantially higher tax burdens than under the prior rules, especially if the additional income pushes them into a higher tax bracket.

Notably, under the new rules, there is no requirement that beneficiaries take distributions in equal amounts over the 10-year distribution period — they simply must withdraw the entire account balance by the end of the 10th year. Thus, prudent beneficiaries could strategically plan to distribute more inherited IRA assets in years when their other income is lower and take less when their other income is higher.

Some IRA beneficiaries are unaffected by the new 10-Year Rule. Inheriting spouses will continue to have

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the option to roll a deceased spouse's IRA assets into their own IRA. Other beneficiaries, such as disabled persons, the chronically ill, individuals not more than 10 years younger than the decedent and certain minor children may still stretch distributions over their own life expectancies. In the case of minor children, the stretch option will apply only until the child reaches the age of majority; afterward, the 10-Year Rule will apply.

Clearly, the elimination of the stretch option may pose challenges to existing estate plans. Specifically, retirement accounts which name an existing trust as a beneficiary may be adversely affected. Many trusts historically included language mandating only required minimum distributions from inherited IRAs be disbursed to the trust each year.

Retirees who do not want to take distributions may now enjoy an additional year and a half of tax-deferred growth on their full retirement account balances.

But since the new rule does not require *equal* distributions over the 10-year period, trusts with a minimum distribution requirement would not make any distributions from the IRA until the 10th year, at which point the *entire* IRA would be distributed. Especially for larger inherited IRAs, this scenario could prove disastrous because it would force all of the income from the IRA to occur in a single year, rather than spreading it out.

REQUIRED MINIMUM DISTRIBUTION (RMD) INCREASED TO AGE TO 72

Thankfully, the SECURE Act also introduces a number of positive changes. In particular, it delays the age at which Required Minimum Distributions (RMDs) must begin from traditional IRAs and qualified plans.

Beginning in 2020, taxpayers may now wait until age 72 to begin RMDs, rather than age 70 1/2 as under the previous rules. Retirees who do not want to take distributions may now enjoy an additional year and a half of tax-deferred growth on their full retirement account balances.

There are a couple of details worth noting here. First, similar to the old rules, individuals can technically wait until April 1 of the year *after* turning age 72 before taking their first RMD. However, anyone considering delaying an initial RMD should be warned that a second RMD must be taken in the year they reach age 73, which could result in unnecessarily high incomes (and correspondingly higher taxes) in the second year of RMDs.

It is worth pointing out that the age 72 beginning date for RMDs only applies to those persons turning 70 1/2 on January 1, 2020, or later. Therefore, a taxpayer who turned 70 1/2 on December 31, 2019, would begin RMDs by April 1, 2020, whereas a taxpayer born one day later could wait until April 1, 2022, before beginning RMDs.

TRADITIONAL IRA CONTRIBUTIONS ALLOWED AFTER AGE 70 1/2

Prior to SECURE, individuals age 70 1/2 and older were prohibited from making contributions to Traditional IRAs, even if they were still working. Beginning in 2020, anyone of any age may make contributions to Traditional IRAs. The only caveat is that, just as before, taxpayers must still have earned income (i.e., must be working) in order to make a Traditional IRA contribution.

QCDs STILL ALLOWED AT 70 1/2

Although the SECURE Act extended the beginning age for RMDs to 72, it did not delay the ability to make Qualifying Charitable Distributions (QCD) from IRAs. A QCD is a distribution from an IRA directly to a qualifying charity. Because the distribution is excluded from an IRAs owner's income, the QCD has been a popular, tax-efficient gifting technique.

Prior to the act's passage, the law allowed for these distributions beginning at age 70 1/2, which coincided with the RMD beginning date. Although RMDs will no longer start at age 70 1/2, IRA owners can continue to make QCDs up to $100,000 per year beginning at their actual age 70 1/2. So, if your charitable giving goals included QCDs, your plans are unaffected by the new law.

IN CONCLUSION

While the new Stretch IRA limitations are certainly ugly news for beneficiaries, the news isn't all bad. The most important conclusion is that the SECURE Act provisions do two things: create new planning opportunities and hamper existing plans. Because every situation is unique, the new law should be viewed as an opportunity to revisit your specific circumstances with your TCO planning team as well as your tax and legal advisors.

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FORWARDING SERVICE REQUESTED