Trust Company Oklahoma

INVESTMENT PERSPECTIVES

April 2020

Outlast the Storm

"The only thing we know about the future is that it will be different."
– Peter Drucker

We are experiencing an unprecedented reality as a result of COVID-19. Thousands have died. Social distancing, sheltering in place and a host of other measures to curtail the spread of the virus have radically transformed workplaces and homes across the globe. The changes are occurring at a dizzying pace, with little time for anyone to adjust to the harsh new reality.

The reaction in the financial markets has been equally abrupt and painful. The longest bull market in history—lasting just over 11 years—unceremoniously collapsed on March 12, when the S&P 500 closed down 27% below its February peak. Thus, the longest expansion ended with the fastest decline, taking a mere 16 trading days to decline 20% or more, which is the traditional definition of a bear market.

At historic moments like this, the future looks uncertain at best, and dire at worst. No one can foretell precisely how or when the current crisis will be over.

But here is a bold prediction: **it will eventually be resolved**. Rather than focusing on the uncertainty of *when* the storm will be over, the best response as an investor is to control your own behavior until it does.

Many investors, our firm included, had long expected a pullback. Admittedly, this forecast required little imagination: bear markets historically occurred every six years, yet the market had been grinding higher for over a decade. Furthermore, the stellar 31% returns of 2019 came almost entirely from expansion of the market's price-to-earnings ratio rather than earnings growth, also suggesting that stocks were primed for a correction. But, as is the case for every bear market, no one could have accurately predicted the catalyst for the sell-off.

WHERE DID THIS STORM COME FROM?

Two major factors combined to drive stocks down.

The first, and most obvious, has been the worldwide spread of the novel coronavirus. At this point, a virus-induced recession seems all but certain, with many early economic indicators

JIM SAVAGE, CFA
Senior Vice President

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MARKET **RECAP**

Equity markets were down sharply in the first quarter due to coronavirus and substantially lower oil prices. The market experienced the fastest bear market in history. International stocks were down even more due in part to a strengthening dollar.

	YTD	Past 6 Months	Past 12 Months
S&P 500	-19.6%	-12.3%	-7.0%
EAFE (International)	-22.8%	-16.5%	-14.4%

VIEWPOINT

A Message From the Desk of Tom Wilkins

Your family and your business can rely on us during this challenging moment. The COVID-19 pandemic continues to devastate communities, and it is hard to wrap our arms around its impact at this point. All we can do is support each other and come together towards a common goal.

Our professional team continues to work tirelessly on your behalf. In a very short period of time, our team transferred most of our operations to a remote structure.

I appreciate every one at TCO for their collective effort to make this happen while ensuring the health and safety of our clients and staff. Because of their dedication we have been able to maintain operational integrity with no significant disruption in service.

Our company and our professionals have experienced many bull and bear markets, and each bear market is different and unprecedented. This is significant and has created uncertainty for many, including our health professionals.

But I can assure you that this too shall pass. We will be here for you, to guide you through the turmoil, to assist you with your plans, and to manage your investments through these volatile markets .

Trust Company of Oklahoma remains open and our services continue uninterrupted. Please contact us via email or call (918) 744-0553 in Tulsa and (405) 840-8401 in Oklahoma City.

Thank you for your continued confidence in Trust Company of Oklahoma.

THOMAS W. WILKINS, Chairman & CEO

reflecting this possibility. An important indicator is unemployment claims, which skyrocketed in late March, signaling extremely high unemployment is already affecting the economy. In addition, retail and food service sales were negative in February, and that was at a time before most people had even heard of the term “social distancing.”

Secondly, after Saudi Arabia could not reach an agreement with Russia and other OPEC countries, it announced the Saudi Kingdom would lower the price it charges for oil in key markets by 20% or more. In order to support this action, it would increase production — at a time when global demand continued to plummet. On the day of Saudi Arabia’s announcement, oil prices declined roughly 25% and, in turn, U.S. equities continued their decline.

WHERE IS IT TAKING US?

As of this writing, COVID-19 continues to spread all over the world. Forced business closures and self-quarantine measures have likely tipped the U.S. into a recession, but the depth and breadth of the slowdown are still unclear.

Oil prices will probably remain low for the foreseeable future, as the Saudis appear committed to their new strategy as a means to drive marginal U.S. producers to shut down their wells. These two factors will likely lead to continued volatility in the equity markets for a while longer.

MEASURES TO CONTAIN THE TURMOIL

In response to the stock market decline and the significant slowdown in consumer spending, the Federal Reserve (the Fed) has cut the target for Fed Funds to a range of 0.0% to 0.25%. These monetary actions should certainly help stimulate the economy, but they left the Fed with few levers to pull going forward.

Using one of those remaining levers, the Fed has committed to massive—and unlimited—purchases of bonds to provide liquidity to the credit markets. Fed Chair Jerome Powell said in late March, “we will not run out of ammunition,” implying even more bond purchases are likely.

Fiscal stimulus (aka federal spending and tax cuts) came quickly in the form of a $2.2 trillion stimulus bill that was passed in late March. The Coronavirus, Aid, Relief and Economic Security (CARES) Act includes financial relief for corporations, cash payments and delayed tax filing for individuals, and increases in unemployment benefits.

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Also included is increased spending on healthcare programs and federal departments that are dealing directly with the virus outbreak. This legislation worked its way through Congress very quickly, as the government came to grips with the seriousness of the situation.

REASONS TO STAY POSITIVE

Thankfully, the U.S. financial system appears significantly stronger and better capitalized going into this bear market than in the past. In 2008, many previously solid banks and investment firms teetered on the verge of bankruptcy, with Lehman Brothers and Bear Stearns and many others companies ultimately failing. There were also several moments when markets were not functioning properly.

Due to the paralysis in the markets, bonds were thinly traded and companies with good balance sheets could not find buyers for their commercial paper and other short-term bonds at reasonable rates. This time around, banks are on solid footing and markets have (so far) been able to handle the daily swings in prices and volume.

There have been eight bear markets since World War II. The worst bear market was the 57% decline during the 2007 – 2009 financial crisis, which lasted 17 months; the shortest was only three months. The average bear market has declined by 33% and lasted 14 months.

Where our current decline fits into history has yet to be determined. An analysis of previous bear markets shows that stock prices are higher one year later almost three out of four times.

Bear markets are painful, but history shows that markets do rise over the long term.

HOW TO NAVIGATE THE CURRENT STORM?

Most of our clients have a meaningful allocation to bonds in their accounts. This has been an important shock absorber that helped portfolios maintain some of their value.

As the Fed has cut rates and investors have sought the safety of U.S. Treasury bonds, the yield on the 10-year U.S. Treasury declined from 1.92% on December 31, 2019 to 0.67% on March 31, 2020.

The decline in interest rates has driven increases in bond prices, leading to strong total-return numbers for client fixed income portfolios over the last few years.

Bonds have not gone up nearly as much as stocks have gone down, but the fixed income portion of a balanced portfolio has provided the dampening effect that we expect when the stock market declines.

YOU CAN'T CONTROL THE PANDEMIC NOR THE STOCK MARKETS. WHAT CAN YOU CONTROL?

- Going forward, we recommend that you revisit your long-term goals and objectives. If nothing has changed, then history tells us that it's best to stay the course and wait for the market to recover. Once it does, a re-examination of your long-term stock/bond asset allocation may be appropriate.
- Although it is tempting to get out of the market now to avoid additional losses, doing so can be dangerous since you might miss out on a strong rebound. In fact, approximately 50% of the best days in the market come during bear markets and another 30% of the markets best days happen in the first two months of a recovery. **Most telling, more than 95% of market returns come in less than 5% of the trading days.**
- Avoid checking the market value of your account on a daily basis. This can significantly increase your stress level during this volatile period. Furthermore, studies show that investors who review their investments frequently earn lower returns than those who don't.

Please know that we are here for you: to manage your assets, to analyze what we see in the markets and, most importantly, to make sure you are comfortable with how your portfolio is structured to achieve your long-term objectives.

Thank you for your continued confidence in Trust Company of Oklahoma. Please call us if we may be of service to you in any way possible.

CARES Act Impacts to Retirement Plans

The Coronavirus, Aid, Relief and Economic Security (CARES) Act was signed by President Trump on March 27. The bill represents a historic $2 trillion stimulus package for American workers, businesses and industries. It includes a few provisions in Sections 2202 and 2203 that affect retirement plans for qualified individuals, defined as someone who:

- Has been diagnosed with COVID-19;
- Has a spouse or dependent diagnosed with COVID-19; or
- Experiences adverse financial consequences as a result of being quarantined, furloughed or laid off or having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business owned or operated by the individual due to COVID-19, or other factors as determined by the Secretary of the Treasury.

Tax-Favored Withdrawals: The Act permits a qualified individual to withdraw up to $100,000 from their retirement plan on or after January 1, 2020 and before December 31, 2020. While the distribution under the Act is taxable income, the distributed amount would not incur the 10% early withdrawal penalty ordinarily applicable to someone under age 59-1/2. In addition, the individual making the distribution can elect to spread the taxable income ratably over a 3-year period. This is not an eligible rollover distribution; however, CARES also allows the individual to repay some or all of the withdrawal at any time during a 3-year period from the date on which the distribution was received.

Plan Loans: For retirement plans that allow participant loans, the Act doubles the amount available for a loan, increasing the limit to the lesser of $100,000 or 100% of the participant's vested account balance for a qualified individual. Qualified individuals with an outstanding loan in the plan with a repayment from the date of the enactment of the Act through December 31, 2020 can delay the repayment for one year and disregard the 5-year maximum repayment limit if applicable.

Plan Amendments: Retirement plans are now allowed to operate in accordance with these provisions prior to the required plan amendment, even if hardship distribution or loans are not currently allowed. Plan documents must be formally amended by the end of the plan year beginning on or after January 1, 2022 or such a later date as the Secretary of the Treasury may prescribe.

Required Minimum Distributions: The SECURE Act recently increased the age in which an individual is required to begin distributions (RMDs) from a retirement plan or IRA to age 72. The CARES Act waives RMDs for calendar year 2020 for retirement plans and IRAs.

While the CARES Act does provide flexibility for those impacted, it is important to remember as plan sponsors that qualified plan assets are retirement savings. It is important to discuss them with one of our Retirement Plan Solutions team members.

BEN REYNOLDS
Senior Vice President

SPOTLIGHT

The **Homeless Alliance** is dedicated to rallying Oklahoma City to end homelessness through collaboration with service providers, government agencies, and the community. It operates several housing programs for families with children, veterans, people who are HIV-positive, and the chronically homeless. In 2019, the nonprofit helped 754 people work their way out of homelessness.

The organization owns and operates the Westtown Homeless Resource Campus, which includes offices for multiple nonprofit and government agencies, a housing complex, and the Day Shelter serving an average of 350 people each day. The Day Shelter serves breakfast and lunch, provides showers, access to computers, phones, mail, and access to needed services including mental and physical healthcare, budgeting assistance, legal support, and multiple classes and programs. The shelter also welcomes those who have a companion animal, so that people with pets aren't shut out of the system of care. It served 6,950 individuals in 2019 alone.

HOMELESS ALLIANCE

The Homeless Alliance has several programs to employ the population it serves and provide them with financial literacy. Learn more at **HomelessAlliance.org**.

The End of the Stretch IRA


Credit: iStock

On a particular Christmas morning, I learned a valuable lesson: not everything is as I think it is. That year, I asked Santa for Gumby, a green clay figure who starred in his own television show, and Gumby's sidekick Pokey, a talking orange clay pony. When I watched Gumby's show as a young child, I believed that Gumby and Pokey were alive and extremely stretchy. However, after Santa dropped off my very own Gumby and Pokey, they simply were not alive and not very stretchy.

IRA owners are now facing a similar dilemma. With the passage of the SECURE Act, Congress concluded that the IRA "stretch" provisions were too good to be true, changing the rules that made them among the most favored generational wealth transfer tools.

As Michael Hopper reviewed in the last Investment Perspectives, the Act largely eliminated the popular stretch IRA, which permitted inheriting IRA beneficiaries to stretch the withdrawals over their life expectancies.

THE NEW RULES

Under the old rules, a beneficiary could choose to take only the required minimum amount each year and enjoy a lifetime of continuing tax-deferred growth on the majority of the account balance.

Under the new rules, however, most beneficiaries must now fully withdraw the balance of the inherited IRA by the end of the 10th year after inheriting it.

This new, compressed withdrawal timeline presents a possible complication. Since distributions from traditional IRAs are fully taxable as ordinary income, beneficiaries of retirement accounts may now face substantially higher tax burdens than in the past, especially if the additional income pushes them into a higher tax bracket.

When passing assets to the next generation, taxable assets (like those held in a revocable trust) are now much more tax-efficient than IRAs because of the IRS basis "step-up." When inheriting a taxable asset, the IRS allows beneficiaries to "step-up" the basis of the inheritance to its market value as of the decedent's date of death.

Speaking of toys, that Hasbro stock you bought at $3 in the 1980s today trades near $60. If you sell that stock, you will pay capital gains tax on $57 of profit. If you leave it to your children, however, they inherit it with $60 basis. Thus, they can sell the stock and enjoy its proceeds without any capital gains or income tax.

ADVANTAGES OF DONATING TO CHARITABLE ORGANIZATIONS USING YOUR IRA

So, what do we do now that the IRAs don't work the way we thought they would?

For the charitably-inclined, IRAs should now be at the top of the list for annual charitable gifts because of the Qualifying Charitable Distribution (QCD), which is made from an IRA directly to a qualifying charity. The IRS entirely excludes these distributions (limited to $100,000 per year starting at age 70-1/2) from the donor's income.

If you are planning to give some portion of your estate to charity, consider making the charity a beneficiary of your IRA instead of using taxable assets.

These gifting techniques can reduce the proportion of an estate that will be subject to ordinary income tax for the next generation and efficiently satisfy charitable intentions.

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Senior Vice President

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FORWARDING SERVICE REQUESTED

Thank You

We at Trust Company of Oklahoma would like to thank doctors, nurses, first responders, scientists and the entire medical community working around the clock to save lives during this health crisis. You are true heroes.