Trust Company Oklahoma

INVESTMENT PERSPECTIVES

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THE FED'S WAR ON INFLATION

Is an economic "soft landing" possible with historically high inflation?

With the invasion of Ukraine in February, Russian President Vladimir Putin has rewritten the European order established at the end of the Cold War. His actions have resulted in thousands of casualties and millions of displaced Ukrainians.

As the conflict settles in and appears that it will persist, world financial and commodity markets have begun adjusting to these events. Since the beginning of the year, U.S. stocks experienced a 10% correction, with most of that decline occurring prior to the invasion. At one point in March, the S&P 500 had experienced the fourth-worst start to a calendar year in its history.

The situation in Ukraine is certainly worth following for many reasons, including both its humanitarian cost and its geopolitical ramifications. But from a market perspective, it is unlikely to be the primary determinant of market outcomes for 2022. Instead, the greater story for the remainder of the year will be historically high inflation and the Federal Reserve's response.

James Savage
CFA
Senior Vice President

Sources of Inflation

There are many contributors to today's inflation, but one of the most pronounced has been in the energy sector. In this instance, the conflict in Ukraine has contributed to rising global energy costs. Many countries in Europe rely on natural gas from Russia, and natural gas prices have increased in anticipation of these supplies being taken off the market through sanctions and the development of new wells. Much of Europe's gas actually travels from Russia through Ukraine, and this has added to the uncertainty surrounding the state of the European energy markets.

Both West Texas Intermediate (WTI) and Brent crude have seen increases of approximately 50% so far this year. This has resulted in much higher gas prices here in the U.S., with the national average price for a gallon of unleaded fuel rising by similar percentages. While higher energy prices are beneficial to many here in Oklahoma, other parts of the country only feel the bite of higher gas prices without the economic benefits that we experience here at home.

Another driver of today's inflation is wage growth. Currently, the ratio of unemployed persons per job opening is about 0.6. There are over 11 million job openings in the U.S. and about 6.2 million people who are unemployed. In other words, if each and every unemployed person in the U.S. accepted a job, there would still be nearly 5 million open positions. Looking at those numbers it is easy to see why employers are increasing wages to attract new employees.

Undoubtedly, this labor market has been beneficial to employees, providing them with bargaining power over their employers. However, the corresponding increase in wages is not necessarily good news for everyone. For starters, not all industries have benefited from these wage increases equally. Compensation in some industries, such as retail and leisure and hospitality, have increased at a much greater rate than in others, such as construction or manufacturing. Furthermore, wages tend to produce a particularly "sticky" form of inflation. When unemployment eventually increases, wages will likely remain the same or slowly increase, rather than decline in response to changing economic conditions. Put simply, higher wages are likely here to stay.

In addition to wage and energy inflation, lingering pandemic supply chain issues have also produced price increases. In particular, shortages of semiconductors have continued to cause

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MARKET RECAP

Stocks globally had a challenging quarter as interest rate rises and war in Ukraine sent shockwaves through markets. At its worst, the S&P 500 was down 13%. However, March was stronger and most equity indices recovered somewhat.

	YTD	Past 6 Months	Past 12 Months
S&P 500	-4.6%	5.9%	15.6%
EAFE (International)	-5.9%	-3.4%	1.2%

VIEW**POINT** A Message From the Desk of Jim Arens

Jim F. Arens II
CFA

Chairman, President & Chief Executive Officer

Spring brings with it images of renewal and a time of new beginnings. In that same vein, it gives me great pleasure to announce the upcoming opening of our new Oklahoma City office. Our new office will be located in the Waterford complex in Northwest Oklahoma City close to Nichols Hills.

We are excited to move into our new office. The space has been remodeled to meet our Oklahoma City staff's and, more importantly, our clients' needs.

Our Oklahoma City team is looking forward to welcoming you to this new location, to which they've dedicated countless hours of preparation and planning to make it a space that works well for our clients and employees for many years to come. We hope you find it to be a comfortable place to meet with our team.

I also want to take the opportunity to laud one member of our Oklahoma City team, **Senior Vice President Emily Crain**. Emily has been named one of *The Journal Record*'s 2022 Achievers Under 40.

Emily joined Trust Company of Oklahoma in 2017 and is a member of the Oklahoma County Bar and the Oklahoma Bar Association. Many of our Tulsa clients may recognize Emily, as she moved from our Tulsa office to our Oklahoma City office in 2018 and has been a great asset to the entire TCO team during her tenure. Please join me in congratulating Emily for this major accomplishment.

We take great pride in celebrating our Oklahoma City team and their new office. Our target opening date is May 2nd.

many global supply chain problems. Much of the global supply of these computer chips originates from countries that have experienced strict COVID lockdowns, which has limited the ability of manufacturers to meet surging demand.

Although the semiconductor shortage has constrained the production of many consumer goods, it has had an especially outsized impact on automobile production. Modern vehicles contain over 3,000 chips, controlling parts including the engine and blind-spot detection. Without semiconductors, there is little auto manufacturers can do to increase the supply of new vehicles other than wait for these supply chain constraints to ease.

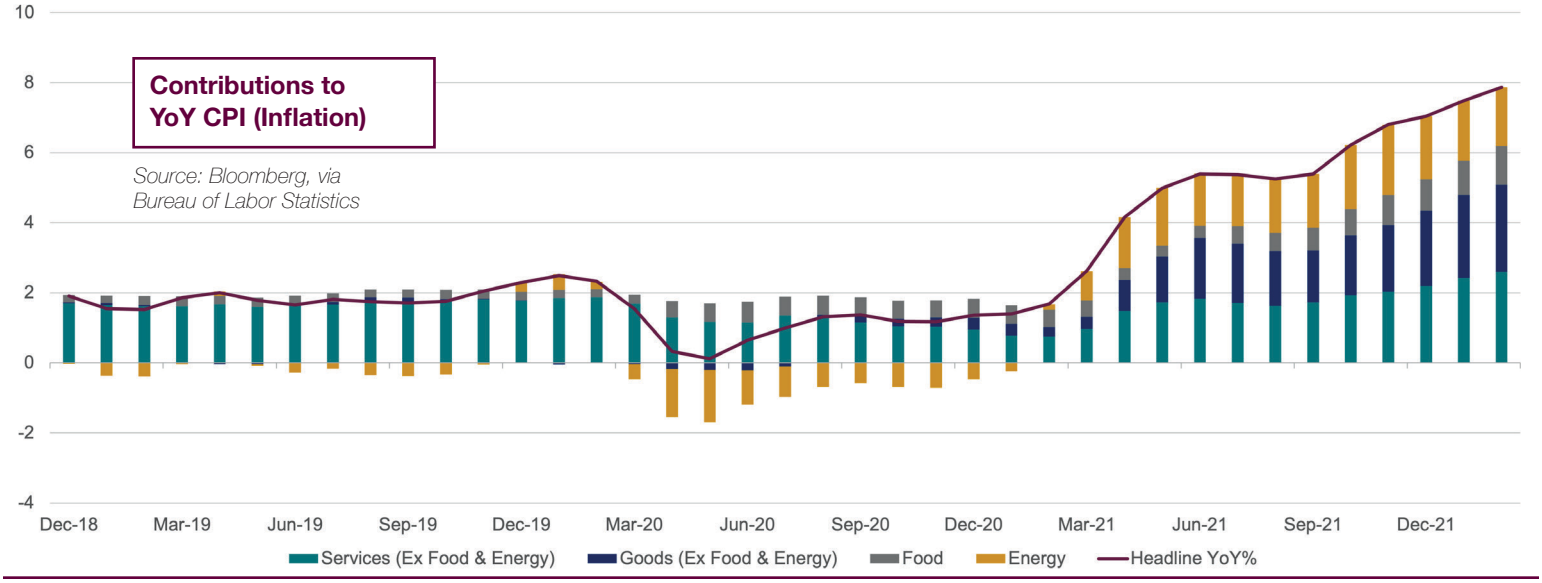
As anyone who has read or watched the news knows, home prices are also increasing dramatically. According to the Federal Reserve Bank of St. Louis, the median price of a home has increased an astounding 25% over the past two years. Higher home prices have in turn produced similar increases in rental costs, especially as more potential home buyers become priced out of the housing market and become renters instead.

Interestingly, due to nuances in how the government calculates inflation, increases in home prices have not been fully incorporated into official inflation numbers yet. The government's official inflation calculation requires that these price increases be amortized over 24 months. As a result, much of the increase in rent and housing prices has not been reflected yet in the official government statistics. If housing inflation were immediately accounted for the same as other input prices, current inflation would actually be much worse than reported.

The Fed's Offensive Playbook

In response to this historically high inflation, the Federal Reserve has finally begun to raise short-term interest rates. At its March meeting, the Fed raised its target for the Fed Funds discount rate by 0.25 percentage points, bringing its stated target to a range of 0.25% to 0.50%. Furthermore, the Fed also indicated that they intend to increase rates six more times during 2022, effectively raising rates each time they meet for the remainder of the year. If they follow through with this plan, the discount rate would increase by an additional 1.5 percentage points from now until the end of the year.

The Fed also announced that it expects to reduce its bond holdings at future meetings. This tactic, dubbed "quantitative easing," has been used for several years to provide liquidity and price support in the bond market and has been an important tool in keeping interest rates low here in the U.S. The Fed currently holds over $8 trillion in



bonds, including Treasuries, agency debt, and mortgage-backed securities. While this has been beneficial in keeping the plumbing of U.S. financial markets working correctly, reversing this and selling bonds back to the market will have the effect of adding additional upward pressure on interest rates.

Chairman Jerome Powell and the Fed's Board of Governors certainly have ample justification for their proposed actions. In its last announcement, the Fed acknowledged that it no longer considers inflation "transitory," the term originally used to indicate that it was expected to be temporary. For several months now, inflation has greatly exceeded the Fed's long-term inflation target of 2%. The other principal objective of the Fed is to maintain maximum employment, which by most definitions has been achieved given the aforementioned surplus of job openings compared to job seekers.

Despite the obvious need for some action on the part of the Fed, the current situation is fraught with risk. Should the Fed raise rates too aggressively, they could stall consumer demand too abruptly and effectively send our economy into recession. Should the Fed raise rates too conservatively, inflation could persist for years.

Ultimately, the Fed will try to engineer a "soft landing," meaning a reduction in inflation that avoids tipping the economy into recession. This has been extremely difficult for past Federal Reserve chairs to pull off, but the Fed's March statement emphasized that it will "continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals."

Reassessing 2022's Outlook

The bond market has already begun to adjust to the Fed's announced tactics. The yield on the 10-year U.S. Treasury bond has increased from 1.51% at the end of 2021 to 2.34% at the end of March. Thirty-year fixed-rate mortgages have climbed above 4%. However, despite the fact that rates on most portions of the yield curve have risen significantly, the yield on the 30-year U.S. Treasury bond has only increased slightly *(see chart below)*.

In other words, yields on midterm treasuries such as a five-year U.S. Treasury now pay nearly the same interest as a 30-year U.S. Treasury. At the end of March, key rates in the market moved such that the two-year Treasury has a higher yield than the 10-year Treasury, producing an inverted yield curve. Longer-term debt generally pays more in interest than shorter-term, but when that flips and near-term debt pays more interest, it is a warning signal for the economy. It is worth noting that each recent recession has been preceded by a yield curve inversion. However, not every yield curve inversion has resulted in a recession.

While many of these factors could turn out to be negative for the markets, there are some positives to consider. Job growth in the U.S. has been very strong, with the unemployment rate falling to 3.6% as the economy rebounds from the pandemic. Workers have benefited from wage increases as employers adjust to the tightness of the labor market. Many consumers have also seen their net worth increase as housing prices and stock prices climbed strongly during 2021, with corresponding increases in consumer spending and retail sales.

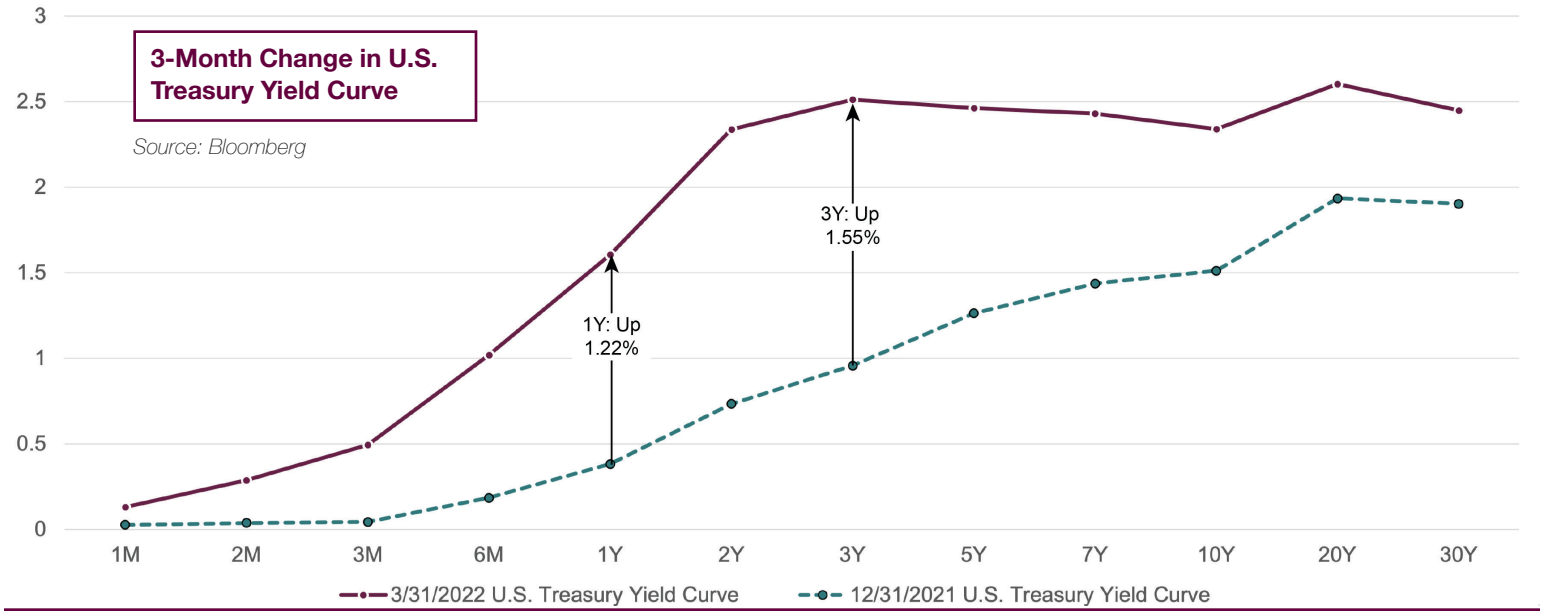
Corporate profits, which bounced back dramatically from the recession of 2020, continue to grow at a healthy clip. Earnings per share for the S&P 500 are currently predicted to grow by about 9% in 2022, and 10% in 2023 (both numbers are year-over-year). Although the U.S. stock market experienced a correction (defined as a decline of 10% or more) in early 2022, longer-term returns have still been very strong. As of Dec. 31, 2021, the S&P 500 had returned an average of over 16% per year for the last 10 years.

Put simply, the past decade has been a phenomenal time to be invested in stocks. While we do not expect returns for the next 10 years to be as strong, we do believe that stocks will provide growth in portfolios over the decade to come.

Higher interest rates will also eventually provide better yields for investors and savers. Money market funds have had virtually no yield for the past two years. If the Federal Reserve raises rates as much as it has indicated, then cash balances in investment accounts could be earning much better interest by the end of 2022.

Your Port in the Storm

As we go forward into the rest of 2022, please be assured that we are paying attention to the markets and working to help our clients preserve and grow their wealth. We greatly appreciate the trust that our clients have placed in us. We wish everyone a peaceful and prosperous remainder of the year.



IS THERE A PILOT ON BOARD?

Carefully Consider Your Successor Trustee to Prevent Turbulence for Your Trust and Beneficiaries

Andrew King
Assistant Vice President

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Isn't it exciting that you could wake up tomorrow and catch a flight to Los Angeles and be back in time for dinner? If things are operating smoothly, you as the passenger won't see the effort it takes to get you there and back. You are in the good hands of the captain, and if the captain should fall ill, the trusty co-pilot is there to step in and get you to your destination safely. All of this occurs with you being none the wiser that any issue has occurred. Now imagine there is no co-pilot and the flight attendant comes over the intercom asking, "Is there anyone on board who knows how to fly a plane?" If I'm on that plane, I surely hope a trained pilot raises their hand instead of the taxidermist in seat 32B.

When you establish a revocable trust, you take your seat in the captain's chair as trustee, but have you given any thought to who your trust has appointed as your co-pilot? When a trustee dies or becomes incapacitated, it becomes the successor trustee's turn to take a seat in the captain's chair with all of the same powers and responsibilities that the original trustee had upon the trust's establishment. This includes gathering and protecting the trust assets, paying creditors and expenses, valuing and appraising assets, filing taxes, and ensuring the beneficiaries are provided for consistent with the plan and goals outlined in the trust.

In a recent conversation with a new client, I was informed that the couple's estate plan, like many estate plans, named one of their siblings as the successor trustee. The couple went on to tell me how overwhelmed the sibling felt with the knowledge that she would eventually step into the trustee role. "Do I have to go to court?" "How do I know who gets what?" "What if someone disagrees with the trust?" And of course, "What in the heck do I do about taxes?" Ultimately, the sibling felt too burdened with the responsibility she had been given. TCO answers these questions every day, and we were happy to step in for this couple to serve as their successor trustee.

One difference between a bona fide aviator stepping in as co-pilot and the successor trustee you name in your trust document is that you have the ability to name as many backup trustees as you wish. If you do choose to name a loved one to serve as your successor trustee, it is always recommended to name contingent successor trustees in the event this person cannot serve or does not want to serve as your trustee. Back to our example with the sibling as trustee: Had this couple already named TCO as contingent successor trustee, then if their sibling felt overwhelmed she could simply resign from her position, allowing TCO to step in as trustee. Taking care to plan for these possibilities in advance can save you and your loved ones a lot of unnecessary work and stress.

Choosing a successor trustee with the necessary skills to step into the captain's chair should be the priority for any pilot who wants to ensure his/her passengers reach their destination. Whether you choose an individual or a corporate successor trustee, you want to choose someone you can trust to take the time during your life to learn how you want your specific trust to operate. This way they can ensure the passengers (your assets) arrive safely to their rightful destination (your beneficiaries). When naming your successor trustees, you should also select individuals you have the confidence in to accomplish the goals set out in your estate plan. At the very least they should know where to look when questions arise.

You would never trust a co-pilot who couldn't land the plane safely, so don't appoint a successor trustee who doesn't have the skills necessary to administer your trust consistently with the plan you laid out for your assets. If you aren't sure who your successor trustee is or if you want to look into contingency planning if your successor trustee cannot take on this responsibility, contact us to ensure your assets arrive at their intended destination.

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FINDING PEACE WITH YOUR POSSESSIONS

You Love Your Things – but How Do Your Heirs Feel About Them?

It's no secret that Americans love their stuff. When it comes to accumulating things, we are truly professionals. This stuff, also known as personal property, includes cars, boats, planes, motorcycles, jewelry, clothing, trinkets and home furnishings. Simply put, it is any property except real estate.

Accumulating mountains of stuff is all fun and games until a loved one dies. Cleaning out a loved one's home and distributing their personal property presents a truly challenging and often miserable task. While it is easier to divide and distribute financial assets, personal property is a completely different animal.

Part of the problem stems from the unique nature of personal property. It tends to be relatively low in market value but high in sentimental value. Many families have ferocious fights over the silliest things – a favorite trinket or a painting of no value. Not only can these fights divide a family, they can also slow

Jennifer May
Assistant Vice President

down the process of settling an estate. Not to mention, these clashes often create large and unnecessary costs.

Don't let the distribution of your personal property be the cause of frustration, anger or resentment among your loved ones. Careful planning is the best way to avoid family feuds after your death.

When it comes to personal property, consider the following suggestions:

1. Make your wishes and desires known and easily understood by providing clear directions on how and to whom your personal property shall be distributed;
2. Communicate verbally with your family about your final affairs and wishes; and
3. Gift the items during your life, rather than at your death.

The Swedes have a word for the process of getting rid of possessions toward middle age: döstädning, which translates to "death cleaning." The idea isn't as morbid as it sounds: Many people use springtime to clean out closets, attics and garages. The Swedish Death Cleaning practice takes this one step further. Paring down one's possessions helps to declutter and streamline your living space, and it also creates an opportunity to reminisce as you go through things you might have not seen for many years.

Dealing with the death of a loved one is hard enough. If you plan ahead, you can lighten your loved ones' burden by having less "stuff" to deal with upon your passing.

SPOTLIGHT

To learn more about this organization and how to assist in its mission, visit **NVOklahoma.org**.

newview OKLAHOMA

NewView Oklahoma is a 501(c)(3) nonprofit organization that has been helping empower those who are blind or have low vision since 1949. NewView helps individuals of all ages to achieve independence through low-vision rehabilitation services, employment opportunities and community programs.

Originally named Oklahoma League for the Blind (OLB), the organization changed its name to NewView Oklahoma in 2009 for its 60th anniversary. With a mission of "It's not what you can see, it's what you can be," NewView operates clinics in Oklahoma City and Tulsa, with its headquarters located in Oklahoma City. Aside from assisting clients in all 77 Oklahoma counties, as a national service provider, NewView serves clients in 16 other states.

Among other services, NewView assists people in finding employment, providing nearly 150 jobs in the areas of administrative, manufacturing, management and rehabilitation specialists.

Besides helping individuals who are blind or have low vision, NewView also assists businesses and communities create more accessibility for those with significant vision loss.

Trust
Company Oklahoma

P.O. BOX 3627
TULSA, OK 74101-3627

FORWARDING SERVICE REQUESTED

TCO MOBILE — IS ON — ANDROID!

The TCO app provides a safe and secure way to access your TCO account information. You can easily view market values, holdings, and even transaction details while on the go.

For more information on how to download and log into TCO Go, please contact your account administrator.