



Trust Company Oklahoma

INVESTMENT PERSPECTIVES

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AN END TO THE DRAMA

As the curtain falls on 2022, what can we expect from 2023?

For equities and fixed-income markets, 2022 certainly had its share of drama. Like the ghost in Shakespeare's Hamlet, record-high inflation numbers frequently appeared throughout the year. And just as in the play, their appearance sowed confusion and fear in markets.

The longer this inflation-induced uncertainty persisted, the greater the odds of loss became. The bull market that arose out of the pandemic abruptly ended when investors were forced to grapple with a massive reversal of financial conditions. As a product of this struggle, stocks and bonds delivered their worst combined performance since 2008.

We gladly draw the curtain on 2022 and find reasons for optimism and opportunity in the new year. The following roadside markers offer a historical perspective on the current bear market journey.

Consecutive Annual Declines Are Rare

The classic "60/40" portfolio has long been considered the gold standard for investors with moderate risk tolerance. Its 60% allocation to equities has historically offered investors exposure to capital



Michael Abboud
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Chief Investment Officer
& Senior Vice President

appreciation, and its 40% allocation to fixed income has provided income and a reduction in the portfolio's overall risk. Yet despite its enduring popularity, over the past year, many pundits have questioned whether the 60/40 portfolio might be dead.

The reason? In 2022, the 60/40 posted its greatest decline since 2008, falling by approximately 16% (see chart on page 2). In fact, 2022 marked the fourth-worst year on record since 1926. However, when the 60/40 portfolio has fallen by greater than 10%, there have only been two instances in which the following year's return has also been negative, specifically, during the Great Depression and the Great Recession – periods associated with profoundly greater economic stress than today.

Even if you consider bonds and stocks separately, history is equally encouraging. This past year bonds posted their second

negative return year in a row, a dismal record not seen since 1958-59. Bond markets have never registered three consecutive years of negative returns. As for stocks, since 1928, they have only declined two years in a row on four occasions, with each down year three times as likely to be followed by an up year.

Nothing Lasts Forever

The current bear market has dragged on for 12 months, with the S&P 500 dropping by approximately 25% at its lowest point. Yet as painful as the past year has been, it's worth putting these numbers in context. Since 1942, the average bear market has only lasted around 11 months, with an average loss of 32%. There may be more volatility and further declines ahead, but history suggests that much of the damage has already been done.

Is Recession Inevitable?

The Fed and other central banks have sent a clear message that they will sacrifice economic growth on the altar of price stability to avoid the policy mistakes of the 1970s. To that end, the key macroeconomic question is no longer when inflation will peak but whether the highest inflationary environment in 40 years can be tamed without a recession.

Despite the Fed's less-than-stellar track record at engineering a "soft landing" and avoiding recession, many economists believe this tightening cycle could be different. In particular, they cite several

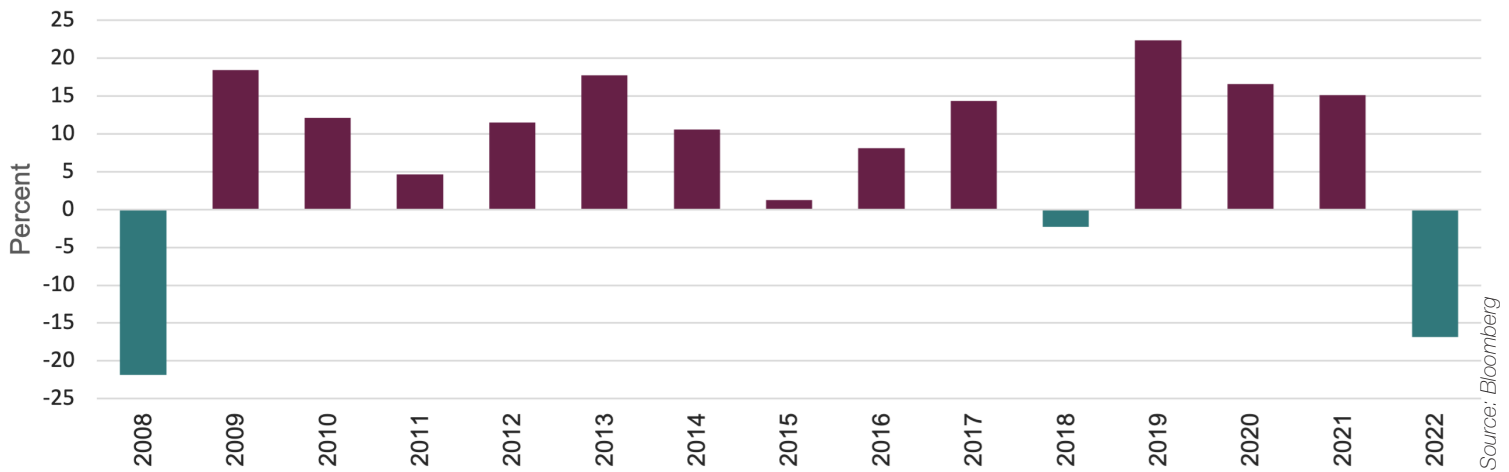
MARKET RECAP

It was a historically rare bear market for both equities and bonds in 2022, with the average 60% stock/40% bond portfolio having its fourth-worst return on record since 1926.

	Fourth Quarter	Past 12 Months
S&P 500	7.5%	-18.1%
EAFE (International)	17.4%	-13.9%

Continued on page 2

Worst Year for 60/40 Portfolios Since 2008



factors, including: a belief that current inflation mostly reflects pandemic supply imbalances that will eventually self-correct, an employment-to-population ratio that is not excessively high, and longer-term inflation expectations remain reasonable.

The case for a soft landing is built on the premise that the U.S. economy will have an extended period of positive but below-average growth. That slower growth will eventually help alleviate an overheated labor market, bringing down wage inflation and, in turn, headline inflation. There are currently six million more job openings than unemployed workers, which should provide the Fed with room to cool the labor market. The slack in the jobs market could allow the Fed to bring wage growth in line with levels compatible with their 2% inflation target.

If the Fed is successful in this endeavor, inflation as measured by the core Personal Consumption Expenditures (PCE) index should decline from the current 4.7% annualized rate to roughly 3% by the end of this year. This decline would be due to softer wage growth and goods inflation continuing to moderate as supply chains continue to heal. Services inflation could fall meaningfully, as the official data catches up with real-time numbers, particularly in areas such as shelter and health care costs.

History sides with those who contend that a recession is likely. Eleven of the last 14 tightening cycles have ended in a recession. Furthermore, recessions have always occurred following periods when inflation was greater than 5% and when the unemployment rate has risen by 1% from its lows, which the Fed forecasts will occur later this year.

There are many other signals that

indicate a recession is likely. Longer-term bond yields peaked in late October, and now most of the yield curve is inverted, which has historically been one of the best recession indicators. Furthermore, real-time economic data, including manufacturing, housing, and consumer confidence, are all already at recessionary levels.

Even if a recession occurs in the first half of 2023, there are many reasons to believe it will be relatively shallow, especially when compared to the hard landing of 2007-09. The U.S. economy as measured by GDP expanded by a 2.6% annualized rate in Q3 2022, and unemployment remains near historic lows. Overall, the financial system is in much better shape, with strong corporate and consumer balance sheets serving as buffers to economic weakness.

Final Thoughts

The economy and markets have acted like a ship trying to right itself from the macroeconomic waves left in the wake of the pandemic. Given the extreme monetary and fiscal stimulus undertaken to stabilize the economy in 2020, this past year could be viewed as an adjustment to those measures.

Despite initially being slow to react, the Fed has ultimately responded to the highest inflation in four decades with an equally aggressive rate tightening cycle. As a result of this “rip the Band-Aid off” approach to monetary policy, it appears the Fed may have avoided the stop-and-go monetary policy mistakes of the 1970s, thus also averting a potential double-dip recession and a protracted period of below-average equity returns.

The war on inflation may not be over yet, but it does appear that the Fed is winning.

In June, annualized inflation peaked at 9% and currently stands at 7%.

A closer analysis of the underlying inflationary components of the Consumer Price Index (CPI), reveals that the Fed may be closer to achieving its 2% inflationary target than the current headline 7% number would suggest. With the annual rate of growth in the CPI over the past five months at 2.45%, the Fed is already close to its 2% target.

Using current numbers for the CPI shelter category (versus the official data, which is known to lag), would have resulted in month-over-month inflation declining last month as measured by core CPI. Consensus estimates for inflation in the year ahead recognize this progress and forecast inflation to be roughly 3% by the end of this year based on the Personal Consumption Expenditures price index (PCE), the Fed's preferred measure of inflation.

To engineer a soft landing, the Fed must get the glide path correct. It would not be surprising for the Fed to run out of runway as in 1974 when it continued to tighten after the recession began. However, policymakers have a more sophisticated understanding of both inflation dynamics and their policy tools, as well as better real-time data, than they did 40 years ago. Because of this, the economic picture should give the Fed the justification to pause by Q2, then begin to pivot policy.

Given the stock market historically bottoms four months after the last rate hike, equities could start to recover by this fall. Until then, inflation may haunt markets a few more times through the final acts of this bear market, but these visits should not provoke an overreaction as the threat of inflation continues to decline in the new year.

VIEWPOINT

A Message From the Desk of Jim Arens



Jim F. Arens II
CFA

*Chairman, President &
Chief Executive Officer*

When I look back on 2022, the one word I would use to describe world events would be “turbulent.” We’ve witnessed rampant inflation, Russia’s invasion of Ukraine, continued COVID-19 uncertainty, and still more inflation. Even though the world is a stormy place, the clients and employees of Trust Company of Oklahoma give me a sense of peace and calm.

As we ring in the new year, I’m pleased to share with you the news that **Baylor Cashmore**, **Michelle Alvarado**, and **Kathy Turner** each recently earned promotions. Baylor was promoted to Officer within our Operations Group, and Michelle was promoted to Officer within our Oil & Gas Division. Kathy is our newest Trust Officer.

I’m also excited to announce two new employees who have joined our team: **Garrett Guinn** and **Stacey Curtis**. Garrett has joined our

investment team in Tulsa as an Assistant Vice President. A Texas native and graduate of the University of Oklahoma, Garrett comes to TCO from PricewaterhouseCoopers. Stacey might be a familiar name for some of our clients. She previously worked at TCO as a Trust Officer from 2010-15. She most recently served as a business development officer in Bank of Oklahoma’s Kansas City office. She returns to TCO as a Senior Vice President and the manager of our Retirement Plan Services group.

I also wanted to let you know of the retirement of **Kathy King**. Kathy joined TCO in 1985 and retired as Vice President. We are grateful for Kathy’s many loyal years of service and wish her a happy and healthy retirement.

Thank you for being part of our Trust Company of Oklahoma family. May each of you have a calm, healthy, and prosperous 2023.

IS CASH STILL TRASH?

With the Fed’s rate hikes, it might pay to move your money from your bank.

Billionaire investor and hedge fund manager Ray Dalio once proclaimed that “cash is trash.”

Until recently, few people would have disagreed with that sentiment. Yields on bank accounts and money market funds have hovered near zero for so long that many investors have probably forgotten that they were even capable of producing a return. However, with the Fed raising rates at an eye-watering pace, suddenly cash looks a lot more attractive.

That is, assuming you’re keeping it in the right place.

Unfortunately, higher short-term interest rates have not translated to higher yields on all cash equivalents. Despite the Fed raising short-term interest rates by 4.25 percentage points over the past nine months, the average yield on bank savings accounts has barely budged. According to a weekly survey of banks conducted by Bankrate.com, the national average yield for savings accounts is still a measly 0.20%. Average CD rates are only slightly better, with Bankrate’s



Michael Hopper
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*Executive Vice President
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**... the national average
yield for savings accounts
is still a measly 0.20%.**

national average for one-year CDs yields still only a paltry 1.38%.

So what accounts for the difference? Why are bank yields lagging so far behind interest rates?

The short answer is this: It has been a loooong time since banks have been able to earn a decent rate of return on the cash you deposit with them. Now that short-term interest rates have finally risen to a reasonable level, banks aren’t exactly eager to cut into their profits to give

depositors a share of those higher returns. And until consumers start withdrawing those deposits and moving them elsewhere, banks won’t have much incentive to offer their customers higher rates.

So if you are sitting on a dragon’s hoard of cash at your local bank, now might be the time to move it somewhere else. Where, might you ask? A good starting place for your consideration would be money market funds. As of Dec. 31, the Crane 100 index of the largest money market funds was yielding a whopping 4.05%. The primary money market fund used in Trust Company of Oklahoma investment portfolios is performing even better, yielding 4.42% as of Dec. 31. That’s a substantial improvement over the 0.20% yield offered on the average bank account.

How long the Fed maintains interest rates at their current levels — and how long these higher money market yields last — is anyone’s guess. If you want to cash in on these higher rates, you might want to move quickly.



OFF TO A GOOD START

Three Ways to Gift Money to Children and Grandchildren



Joanna K. Murphy

Senior Vice President

One of the most joyous moments in life is learning that you are to be a parent — or, even better, a grandparent. Soon enough, hopes for the new child's future will motivate parents and grandparents to think about saving for that hoped-for future. There are many ways to save and invest for a child's future needs and security. In this article, we will look at a few of the more common techniques.

Uniform Transfer to Minors Accounts (UTMA)

Many people have had personal experience with the Uniform Transfers to Minors Account. More commonly referred to as a UTMA, this account has a designated custodian (the individual who controls the account) who is responsible for managing the funds for the benefit of the minor child. Opening a UTMA is as easy as walking into your nearest bank, brokerage, or ...trust company. While funds gifted to a UTMA must be used only for the benefit of the minor child, there are no restrictions on the types of expenses these funds can pay. It is the simplicity and flexibility of these accounts that make them popular.

That simplicity and flexibility does, however, come at a cost. At age 18 (or age 21 if the agreement specifically states this), control of the funds shifts to the child. The inability to delay the distribution of the funds is the most significant disadvantage of the UTMA. Especially for those who plan to make more substantial gifts, this restriction can make these accounts unappealing. In addition, because the UTMA is owned by the minor, assets in these accounts can negatively impact a child's eligibility for financial aid.



iStock.com/mphillips007

529 Plans

Another popular method for saving for a child's future is the 529 plan. These state-sponsored investment plans are designed to encourage savings for education. While 529 plans are most commonly used for college expenses, in recent years, the definition of qualified expenses has expanded to include K-12 education tuition. A limited amount may even be withdrawn to pay student loans without penalty.

Like the UTMA, opening a 529 plan account is straightforward. Once the account is open, gifts may be made each year and the funds invested to grow for future education expenses. The funds in a 529 plan may only be used for qualified education-related expenses and so lack the flexibility of the UTMA. However, if the child does not use the funds for education,

the owner may transfer the unused funds to another child or certain other relatives without penalty. These plans also have tax advantages that the UTMA does not. Contributions to a 529 plan may provide a state income tax deduction for the contributor, and the assets grow tax free and can be withdrawn tax free as long as all withdrawals meet the specified criteria. Unlike UTMA's, funds in a 529 plan have a lesser negative impact on the child's eligibility for financial aid.

Gifting Through Trusts

While the UTMA and 529 plan are both useful savings vehicles for minors, especially because they are simple to establish and administer, many parents and grandparents choose to create a trust as the savings vehicle for a minor child. A properly drafted trust can provide the needed flexibility and the desired control over when and under what circumstances the minor can access the funds, a feature both the UTMA and 529 plan lack. Two types of trusts are commonly used in these situations. Both are irrevocable, meaning that once established, the terms of the trust cannot be easily altered. Both have certain rules that must be followed to ensure that gifts made qualify for the annual gift tax exclusion (\$17,000 per donee in 2023).

The first type of trust is the 2503(c) minor's trust, named after the Internal Revenue Code section that created it. This type of trust can have only one beneficiary. Until the beneficiary turns 21, principal and income may be used for the child's benefit. At age 21, the child must be given the unrestricted right to withdraw any funds remaining in the trust. This one-time right of withdrawal allows gifts made to the trust to qualify for the annual gift tax exclusion. The trust must be drafted to provide that, should the child choose not to withdraw the funds, the trust income will be distributed to the child periodically. The trust principal will continue for the child's use under whatever terms the

Continued on page 5

trust's grantor (generally a parent or grandparent) determines. This mandatory withdrawal right, and the fact that income accumulated in the trust prior to age 21 is taxed at less favorable trust rates, are the two biggest drawbacks of this type of trust.

The second type of trust commonly established as a savings vehicle for minor children is the Crummey trust. The Crummey trust gets its name from the court case that created it. This type of trust is much less restrictive than the 2503(c) minor's trust in that there is no mandatory withdrawal at age 21 and trust income need not begin distributing to the child after age 21. Also, unlike the 2503(c) minor's trust, a Crummey trust may have multiple beneficiaries. While the Crummey trust may allow the grantor broad latitude in how the trust is drafted, it does bring with it additional administrative burdens that can make it a less attractive option. For contributions to the trust to qualify for the annual gift tax exclusion, the child beneficiary must be allowed to withdraw the newly contributed funds for a limited period of time. If the child chooses not to exercise this right of withdrawal, the contributed assets will become a permanent part of the trust. The trustee of a Crummey trust must keep careful records to document that the beneficiary, or beneficiaries, of the trust were given the opportunity to exercise this withdrawal right.

A carefully considered saving plan using any one, or more than one, of the above techniques can be the start of a long-term, financially secure future for a minor child. At Trust Company of Oklahoma, we have years of experience in administering and overseeing accounts for minors. If you have questions about saving for a child or grandchild, we would welcome the opportunity to talk with you.

THE TIME FOR GIFTING

Making gifts to family and charity doesn't have to be a year-end chore.

With the new year comes new gift tax exemptions. Though the gift-giving season has just ended, it is never too early to start planning for the upcoming year. The IRS has increased the annual gift tax exemption from \$16,000 per person to \$17,000 per person in 2023. The lifetime gift exemption has also increased from \$12.06 million to \$12.92 million, meaning you can give up to these limits without tax consequences. Giving during your lifetime allows you to witness the recipient enjoy their gift. Additionally, making annual gifts can reduce the amount of your taxable estate at your death.

Giving to family and friends is not the only strategy to lessen your taxable estate. Charitable gifts are not subject to the gift tax. At the end of the year, charitable giving is at an all-time high. One-third of philanthropic donations are given in the last quarter of the year, with most contributions made in December.

Although many people rush to complete year-end gifts for tax purposes, research shows that tax benefits are generally not a prime motivation for giving. Donors usually give for more personal or philanthropic reasons. Yet, one of the most significant challenges is identifying what causes donors care about and where to donate. If you fall into this category, now is a great time to explore what you are passionate about and what organizations align with your values.



Madelaine Hawkins

Assistant Vice President

If you have already identified a favorite charity, speaking with the organization about getting more involved or setting up a planned gift are ways to become more intentional with your contributions. Being thoughtful about where and how you give can impact the charities you choose to support and influence your family. Parents' charitable contributions tend to affect their adult children's philanthropic contributions. Giving throughout the year allows loved ones to observe your contributions and ignite their giving spirit.

Whether you are motivated by tax benefits or sharing your wealth, there is no need to wait for the end of the year. You can start now and enjoy the effects of your generosity. It is important to speak with your financial advisor about your desire to give to your loved ones during your lifetime and your philanthropic intent, so they can assist you in giving most advantageously.

Madelaine Hawkins works in TCO's Oklahoma City office and is pursuing the Chartered Advisor in Philanthropy designation, which will benefit our work with charitable organizations and their donors.

SPOTLIGHT



Sharing Tree, a 501(c)(6) organization previously known as Christmas Connection, was founded in 1984 with a goal of providing families a dignified, no-cost shopping experience. Located in Moore, Sharing Tree now offers four programs, Community Connection, Crisis Connection, Classroom Connection, and Christmas Connection, each providing low-income families the ability to select items they need at no cost to them.

Through its four programs, Sharing Tree serves

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

central Oklahoma parents in need of Christmas gifts and winter clothing for their children, families affected by total loss from a disaster such as fire or tornado, Oklahoma City Public Schools students in need of school uniforms, and families in need at other times of the year.

Sharing Tree relies on donors and welcomes assistance from the public in the form of volunteers to work the store and warehouse, financial contributions, and donations of items.



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