Trust Company Oklahoma

INVESTMENT PERSPECTIVES

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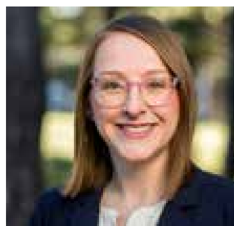
RETHINKING PORTFOLIO DIVERSIFICATION

S&P 500 Concentration and Tech Growth Have Changed the Landscape of Investing



Rebecca Mitchell
CFA
Vice President

There is a well-known phrase, used inside and outside of investing: "Don't put all of your eggs in one basket." What if you thought you disbursed said eggs quite well, only to find out more of them were in one basket than you thought? In an age of mutual fund and ETF investing, many investors find themselves in that situation. We are in a time when a few stocks take up a more significant portion of the market than many investors realize.

The S&P 500's Impact on Diversification

One of the primary reasons investors choose investment vehicles like mutual funds and ETFs is the benefit of diversification. You purchase one share of a fund, and your portfolio immediately holds dozens, if not hundreds, of stocks. A market capitalization weighted fund is the most popular, where each stock is given a weight in the fund based on its size. An equal weighted fund is the other option, where each stock is given equal weight.

Arguably, the most popular funds track the S&P 500 in some way, and for good reason. The S&P 500 encompasses about 80% of U.S. market capitalization and about 50% of the global market. This is why the response to "How is the market doing?" is often related to how the S&P 500 is performing.

Top 10 Stocks in Control

Historically, the top 10 companies have made up a larger portion of the S&P 500, averaging between 15% to 25% over the past few decades. That total has reached new highs in the past few years with several large technology companies taking off and surpassing over $1 trillion in value. As of the end of August, the top 10 stocks in the S&P 500 are 32% of the index! The S&P 500 is especially concentrated in Apple and Microsoft, making up almost 15% of the index. *(See the chart "Top 10 Holdings of S&P 500" on page 2.)*

... since the positive performance of these mega-technology companies had such an enormous impact on the performance of the S&P 500, there is the risk that any negative performance would also carry that weight.

Stock performance this year has added another layer of complexity to S&P 500 market concentration. Apple, Microsoft, Alphabet, Amazon, NVIDIA, Meta, and Tesla are the largest holdings in the S&P 500 and the largest contributors to positive performance this year.

Part of that makes sense. Because they are a larger portion of the S&P 500, their positive performance would affect total market performance more than a smaller constituent's would. However, as of the end of June, these seven companies, along with three other companies (Broadcom, Eli Lilly, and AMD), were responsible for about 70% of the positive performance this year. If someone had created a market-cap-weighted portfolio of these 10 stocks, it would have returned 60% through June! *(See the chart "Mega-Cap Growth Stocks Dominate U.S. Market Returns" and the chart "Weight of the top 10 stocks in the S&P 500" on page 3.)*

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MARKET RECAP

Stocks and bonds gave back gains in the recent quarter as markets adjusted to the Federal Reserve's "Higher for Longer" message in the face of a resilient economy.

	YTD	Past 3 Months	Past 12 Months
S&P 500	13.0%	-3.2%	21.5%
EAFE (International)	7.0%	-4.1%	25.6%

VIEWPOINT A Message From the Desk of Michael Hopper

Michael Hopper
CFP®, CTFA
President & Chief Executive Officer

I'd like to take this opportunity to inform you of changes at Trust Company of Oklahoma.

Effective Aug. 2, Jim Arens resigned from his position as CEO. We want to take this moment to express our deep gratitude for Jim's nearly 25 years of dedicated service to our company, and to you, our valued clients and partners in the community.

Jim was a meaningful part of the growth that TCO has experienced over the last two decades. Beyond his professional contributions, he has been a cherished friend, a trusted colleague, and a mentor to many within our organization. We extend our best wishes to Jim as he seeks new adventures, and we are confident that his legacy will continue to resonate within our company.

I am deeply honored and humbled by the decision of TCO's Board of Directors to appoint me as the new President and CEO.

During my time with TCO, I have watched as our talented team has grown and dedicated themselves to the growth and success of our clients. Our unofficial mission statement remains steadfast: to deliver excellent customer service to our clients. That mission continues to be the focus of each employee.

For those of you I have yet to meet, allow me to introduce myself. I joined Trust Company of Oklahoma 10 years ago. During this time, I have worked with clients in trust administration, wealth management, and financial planning. My passion has been using these skills to assist individuals and families in crafting their legacy.

My wife, Shelly, and I are native Oklahomans. We cherish quality time with our two sons. When we are not working, you can often find us enjoying live music, cheering on our boys at their soccer and football games, or exploring our beautiful national parks. Each year, I set aside some time for a hiking trip to Colorado, where I reconnect with friends.

As only the fourth CEO in our 42-year history, I am filled with a profound sense of gratitude for being entrusted with the leadership of a company that makes a difference in so many lives. I have never been so confident in the future of this company.

Thank you for your continued partnership with and trust in TCO. I look forward to a bright future together.

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Tech's Growth Potential

So, what does this mean for the market and your portfolio? One question is: How long can these large technology companies' outperformance continue? Apple became a $1 trillion company in 2018 and broke $2 trillion in 2020. By itself, Apple is worth more than all the small-cap companies in the Russell 2000 Index. In the last five years, Microsoft also reached $1 trillion and $2 trillion in value.

Can these firms keep up this pace? I think it is possible, and they have an excellent catalyst for growth: artificial intelligence. Goldman Sachs economists believe AI could potentially drive $7 trillion in global economic growth over 10 years, and AI software has a total addressable market of about $150 billion. For more on AI, I highly recommend reading my colleague Garrett Guinn's article from last quarter, "AI: The Next Revolution?"

TOP 10 HOLDINGS OF S&P 500 ‡	WEIGHT
Apple Inc.	7.72%
Microsoft Corporation	6.81%
Amazon.com Inc.	3.13%
NVIDIA Corporation	2.82%
Alphabet Inc. Class A	1.91%
Tesla Inc.	1.90%
Meta Platforms Inc. Class A	1.71%
Alphabet Inc. Class C	1.66%
Berkshire Hathaway Inc. Class B	1.64%
UnitedHealth Group Incorporated	1.20%

Source: SPDR® S&P 500® ETF Trust Fact Sheet | ‡ Subject to Change | As of 6/30/2023

Growths Vs. Risks

While there is a significant catalyst for growth for these companies, there are also headwinds, one of the biggest being the current level of interest rates. Growth-focused companies tend to have higher P/E valuations and are more sensitive to increases in interest rates. Investors also have more options for where to invest, especially investors who prefer to take less risk.

Investors also need to remember that

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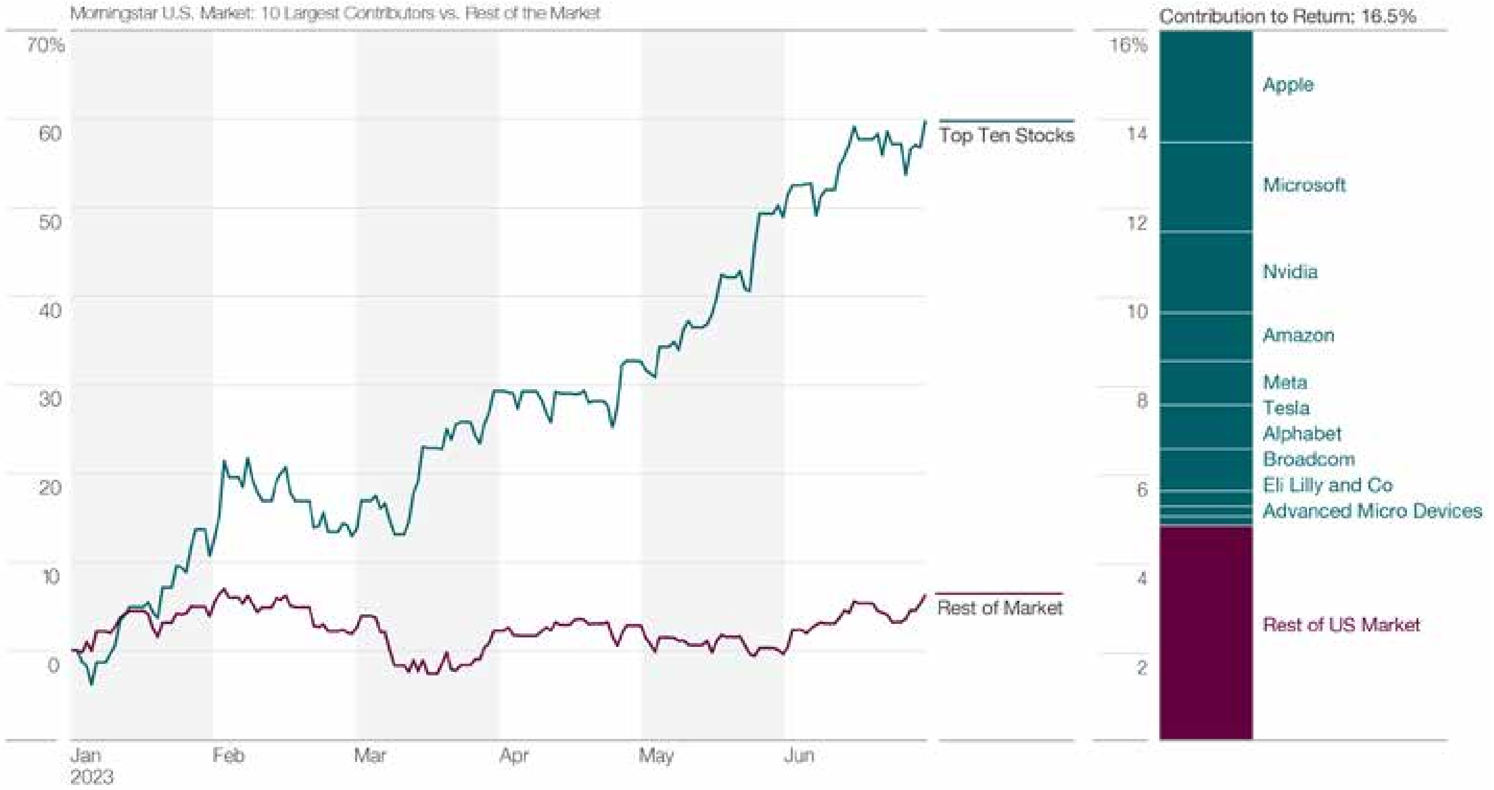

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since the positive performance of these mega-technology companies had such an enormous impact on the performance of the S&P 500, there is the risk that any negative performance would also carry that weight.

Importance of Active Management

Another result of the current market performance is most active managers are lagging the S&P 500 this year. This is especially true when you consider that a well-diversified portfolio also includes holdings in U.S. mid-cap, U.S. small-cap, and international stocks, which all have booked positive returns for this year but are lagging behind the S&P 500.

An additional issue that arises is most investors are attracted to passive investments because they help with diversification, but we are to the point where solely investing in the index can actually hinder diversification. This is where active management can add value, even in years of underperformance. Active management can create a more diverse portfolio when the market only rewards a few companies.

Active management also allows investors to take advantage of times like these where some stocks are performing better than others, both by adding more exposure to those stocks if it is warranted and, conversely, buying companies who have underperformed but have great potential.

Looking to the Future

It has been a much better year for stocks than most investors expected New Year's Day 2023. The competing forces of innovation and quantitative tightening have been at the forefront, and there is still much of the story that needs to play out. No matter how many people on the internet may claim that they can predict the future and know which 10 stocks will outperform everything else, there is no one out there who only picks winners and never picks laggards.

These 10 companies have performed well this year, but there are hundreds of other companies out there that have potential as well. The good news is, many of them are on sale when compared to this year's leaders.

USING QUALIFIED CHARITABLE DISTRIBUTIONS TO SUPPORT CHARITIES

Emily Crain
Senior Vice President

iStock.com/bob_bosewell | TCO Photo Illustration

Philanthropy is the engine that drives charitable institutions, allowing entities to create and sustain good in a community. One lesser-known but highly advantageous strategy for charitable giving is the Qualified Charitable Distribution (QCD). This tax-efficient tool allows retirees to combine their philanthropic goals with their retirement planning, offering a unique way to give back to charities.

Understanding Qualified Charitable Distributions (QCDs)

A Qualified Charitable Distribution is a provision in the U.S. tax code that permits individuals aged 70½ or older to donate money directly from their Individual Retirement Accounts (IRAs) to eligible charitable organizations without incurring federal income tax on the distributed amount. This provision was established as part of the Protecting Americans from Tax Hikes (PATH) Act of 2015 and has been a powerful tool for retirees seeking to support charities while minimizing their tax liability.

How a QCD Works

Eligibility: To make a QCD, you must be at least 70½ years old. The IRS mandates this age requirement to encourage retirees to use their retirement savings for charitable giving.

IRA Account: The donation must come directly from your traditional IRA account. Roth IRAs are not eligible for QCDs.

Annual Limits: The maximum annual QCD limit is $100,000 per individual. If you are married and both spouses have separate IRAs, each can make QCDs up to the annual limit.

Qualified Charities: QCDs can only be made to IRS-qualified charitable organizations. This includes 501(c)(3) public charities, religious institutions, educational institutions, and certain private foundations. Donations to donor-advised funds, supporting organizations, and most private foundations do not qualify.

Tax Exemption: The distributed amount is not included in your taxable income, reducing your Adjusted Gross Income (AGI) on your tax return. This can have a positive impact on your overall tax liability.

Benefits of Qualified Charitable Distributions (QCDs)

Now that we understand what QCDs are, let's delve into the benefits they offer:

Tax Efficiency: One of the primary advantages of QCDs is their tax efficiency. When you make a QCD, the donated amount is excluded from your taxable income. This means you don't have to report it as income on your tax return, which can help reduce your overall tax liability. Lowering your AGI can also affect the taxation of Social Security benefits, Medicare premiums, and other deductions that are tied to your income.

Fulfilling Required Minimum Distributions (RMDs): For many retirees, taking Required Minimum Distributions (RMDs) from their traditional IRAs is a mandatory annual obligation. These withdrawals typically begin at age 72 and are subject to taxation. QCDs count toward satisfying your RMD for the year in which they are made. This means you can use your QCD to meet your RMD obligation while avoiding the associated tax liability.

Maximizing Your Charitable Impact: QCDs allow you to maximize the impact of your charitable giving. By donating directly from your IRA, you ensure that 100% of the donated amount goes to the charity of your choice. In contrast, if you were to withdraw the funds and then make a donation, you would have to pay income tax on the distribution before giving it to the charity.

Simplified Record-Keeping: Using QCDs simplifies your record-keeping. Since the distribution goes directly from your IRA to the charity, there's no need to track the donation separately. This can make your financial management more straightforward, especially if you're making multiple charitable contributions throughout the year.

Potential State Tax Benefits: While QCDs primarily provide federal tax benefits, some states may offer additional incentives for charitable giving. Retirees should check with their state's tax authorities to see if there are any state-specific advantages to making QCDs.

Tips for Making Qualified Charitable Distributions (QCDs)

To make the most of QCDs, here are some important considerations:

Verify Charity Eligibility: Ensure that the charity you wish to support qualifies for QCDs. Most reputable charitable organizations fall under this category, but it's always a good idea to double-check.

Work with a Tax Professional: Tax laws and regulations can change, so it's wise

to consult with a tax professional or financial advisor to ensure you're making QCDs correctly and maximizing their benefits.

Plan Your Giving: Strategically plan your charitable giving and RMDs to make the most of QCDs. This might involve coordinating with other sources of income to minimize your overall tax liability.

Document the Donation: Even though QCDs simplify record-keeping, it's still essential to keep a copy of the acknowledgment letter from the charity as proof of your donation.

Potential Drawbacks and Limitations

While QCDs offer numerous advantages, they may not be the best option for every retiree. Here are some potential drawbacks and limitations to consider:

Age Requirement: You must be at least 70½ to make QCDs. If you want to support charities before reaching this age, other giving strategies may be more suitable.

Annual Limit: The maximum annual QCD limit is $100,000 per individual. If your charitable intentions exceed this amount, you may need to explore other giving methods.

No Tax Deduction: Since QCDs are excluded from your taxable income, you won't receive a charitable deduction on your tax return for the donation. If you itemize deductions, this might be a consideration.

Roth IRA Limitation: Roth IRAs are not eligible for QCDs. If your retirement savings are primarily in Roth accounts, you'll need to consider alternative ways to support charities tax-efficiently.

Conclusion

Qualified Charitable Distributions are a valuable tool for retirees looking to align their philanthropic goals with their retirement planning while minimizing their tax liability. By enabling individuals aged 70½ and older to donate directly from their traditional IRAs to eligible charities, QCDs offer a win-win solution that benefits both retirees and the charitable organizations they support.

Before making QCDs, it's essential to consult with a tax professional or financial advisor to ensure you meet all the requirements and take full advantage of this tax-efficient giving strategy.

BUSINESS HEALTH AND EMPLOYEE FINANCIAL WELLNESS

Companies increasingly support employees' financial wellness, leading to improved well-being, productivity, and loyalty among workers.

Stacey Curtis
Senior Vice President

In working with business owners and human resource professionals, I have witnessed a significant trend in companies offering financial wellness resources to their employees over the past few years.

A 2022 Bank of America study found 97% of employers feel responsible for employee financial wellness (up from 95% in 2021 and 41% in 2013) – with two-thirds (62%) going as far as to say they feel extremely responsible (up from 56% in 2021). Employees agree with this sentiment, as 82% say employers should support their financial wellness.

Financial health is a crucial element of overall well-being and extends beyond the amount of money in someone's bank account. A financially secure workforce produces numerous benefits for employers and employees, including improved productivity and enhanced job satisfaction.

Advantages to the Employer

Greater productivity and engagement: Employers who invest in financial wellness programs have reported higher levels of engagement and a more dedicated workforce. When individuals have the tools and resources to manage their finances effectively, they are better equipped to focus on their work.

Reduced absenteeism: Financial woes often lead to absenteeism. According to a 2022 Ramsey Solutions survey, more than one-third of employees reported missing work because of a financial problem.

Lower turnover: By providing resources to help employees with retirement savings, employers contribute to their workers' long-term financial security, promoting loyalty. In addition, financial stability reduces the risk of individuals seeking higher-paying opportunities elsewhere.

Positive company reputation: Job seekers find companies that offer financial wellness resources more attractive. Companies that prioritize their employees' financial health tend to have a better reputation and are viewed as more desirable workplaces, which can draw in top talent seeking stability and support beyond their salary.

Employees can retire when eligible: Laying the groundwork early for a secure future allows employees to retire once they are eligible. Delayed retirement can have unintended consequences on the organization, such as higher compensation rates and increased health and disability claims.

Advantages to the Employee

Reduced stress: Financial stress is a leading cause of anxiety and depression. Financial security leads to peace of mind and an improved sense of stability.

Greater quality of life: Achieving financial wellness involves planning for major life events such as saving for emergencies, retirement, and other long-term goals. With the right tools and guidance, employees can pursue goals such as buying a home and saving for their children's education.

Empowerment through knowledge: Providing financial literacy training during the employment onboarding process is one approach companies have taken to educate their employees. In addition, employers often organize lunch-and-learn sessions on various financial wellness topics, including the benefits of their 401k plan and matching contributions – encouraging employees to save early and consistently. Programs such as budgeting, debt management, and investment education empower individuals to take control of their financial futures.

Long-term financial security: Individuals who fail to lay the groundwork for a secure future often face large amounts of debt, are forced to work until later in life, and leave their families with financial and emotional stress.

By investing in employees' financial health, companies secure a stable and motivated workforce, and contribute to the overall well-being of their organization.

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