

Tulsa Estate Planning Forum

January 13, 2015

Robert A. McCormick, CFA, CAIA
Senior Executive Vice President and Chief Operating Officer

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Will the Bull Continue in 2015?

Legal Disclaimer:

“Several studies have shown that people prefer a pundit who is confident to one who is accurate. Pundits are happy to oblige.”

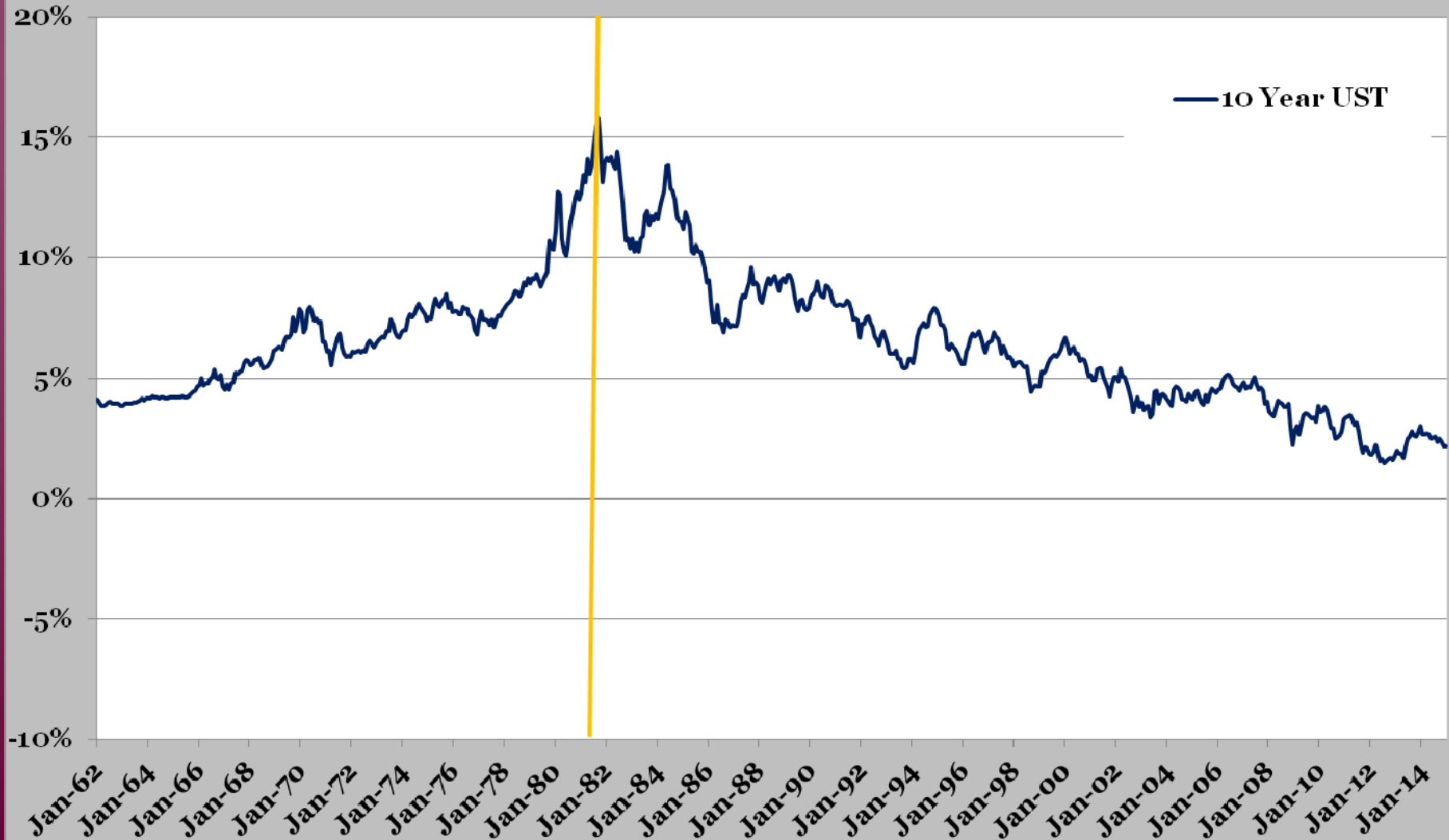
Source: “122 Things Everyone Should Know About Investing And The Economy” by Morgan Housel, Motley Fool

Surprises from 2014

- No market correction of at least 10%.
Not one since 10/3/2011.
- Interest rates went down instead of
up
- Oil prices plummeted late 2014.

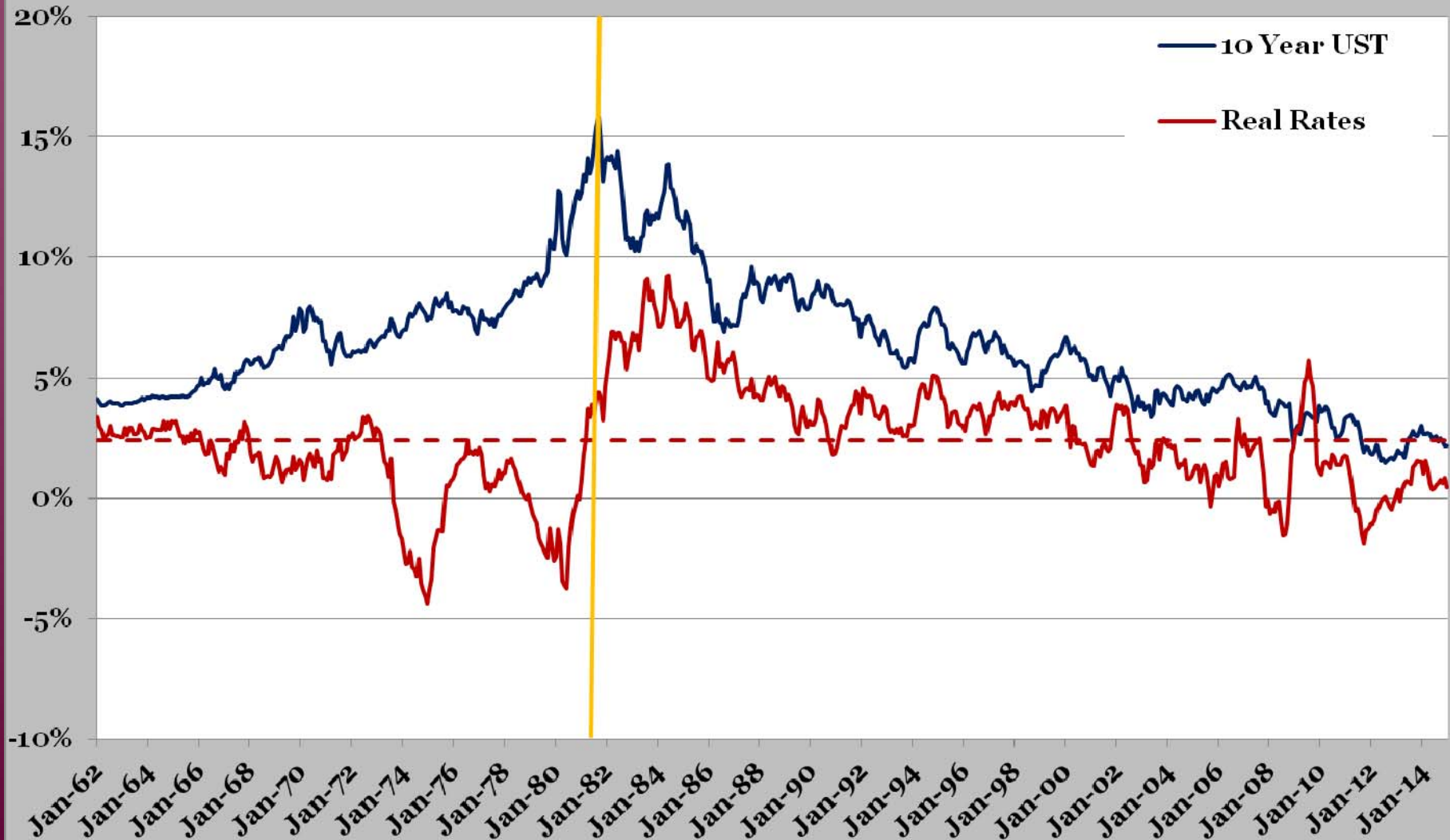
Trend Down for Over 30+ Years

Interest Rates - Nominal

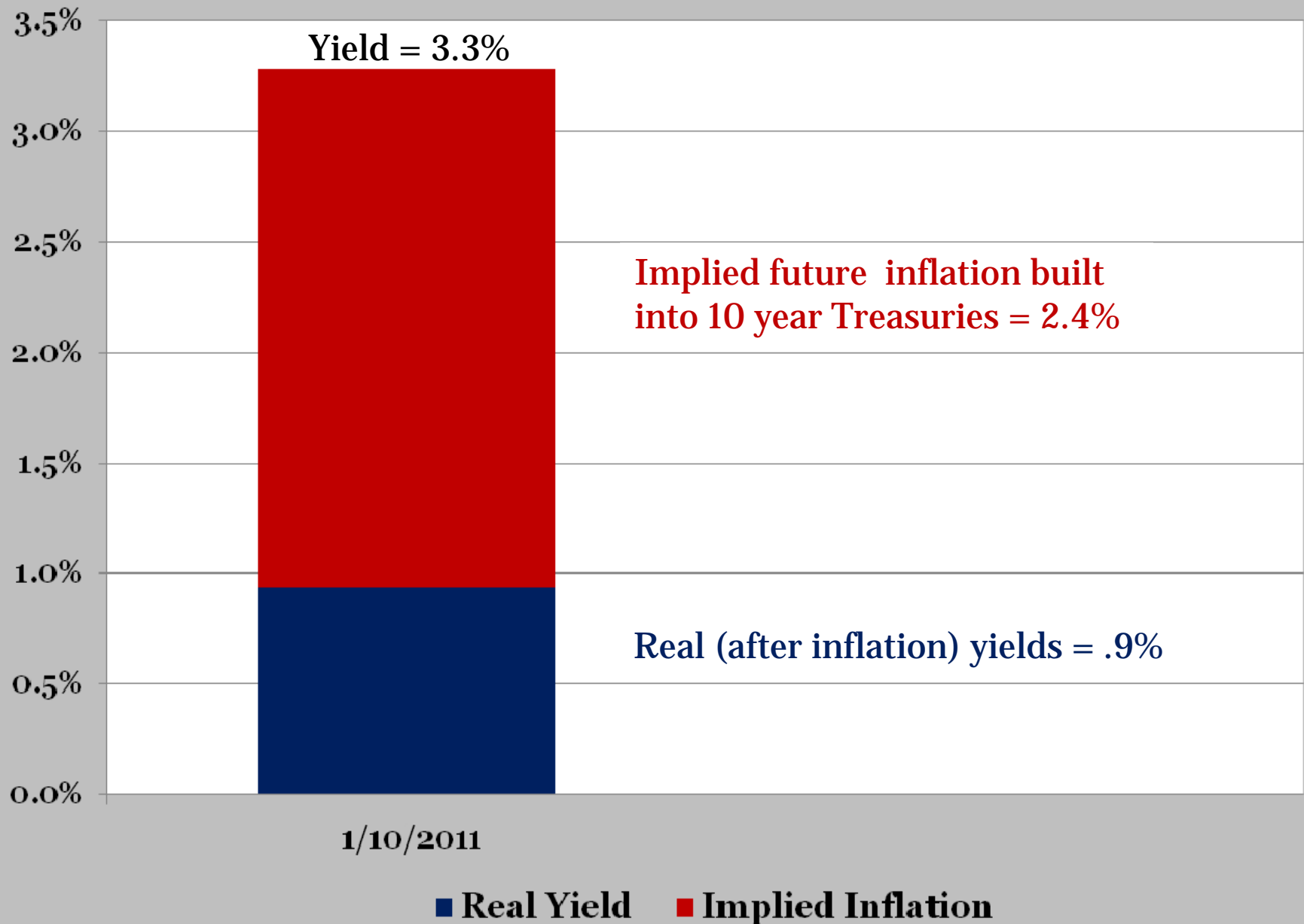


Trend in Real Rates Down Recently

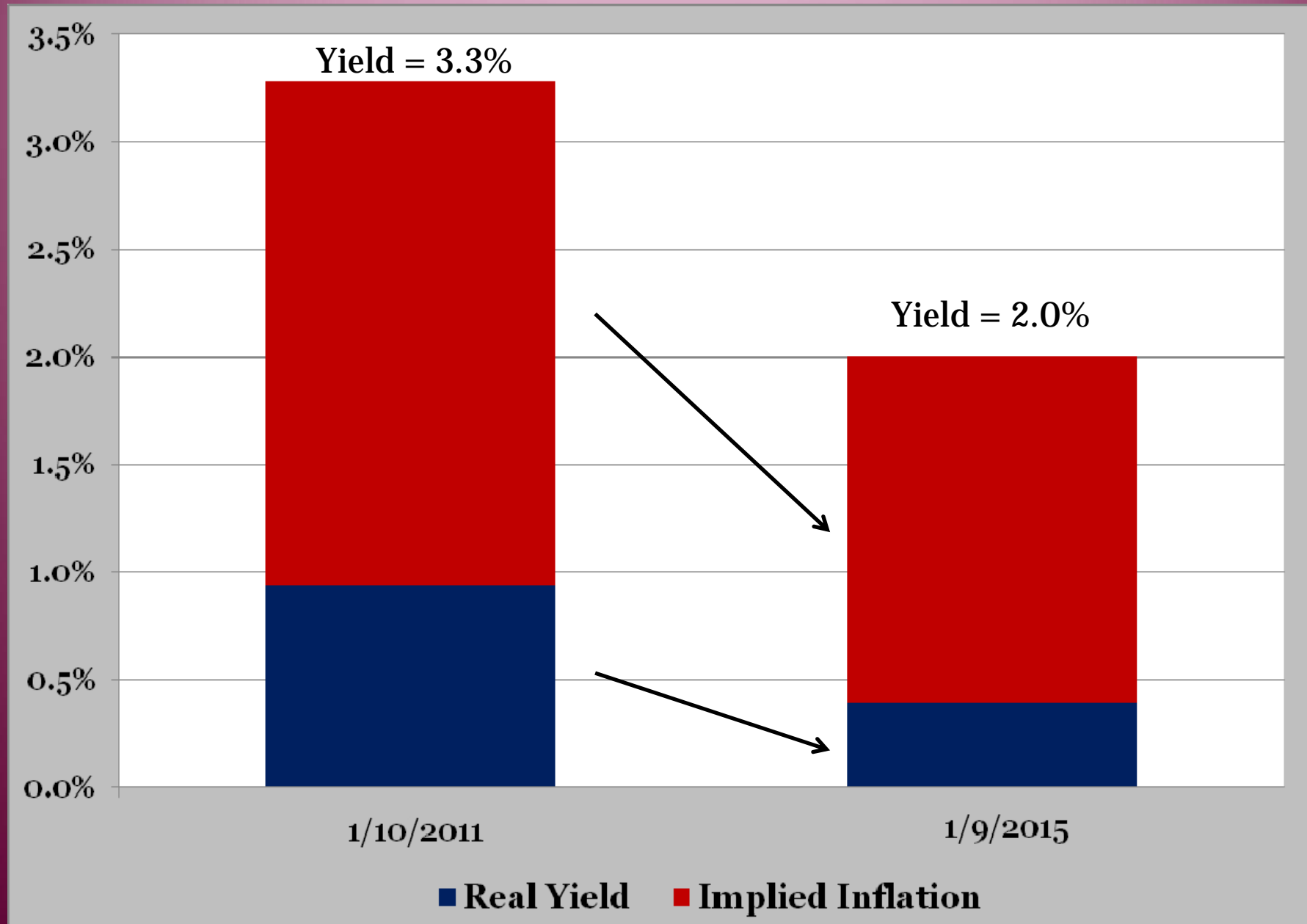
Interest Rates - Nominal and Real



Yield = Inflation + Real Return

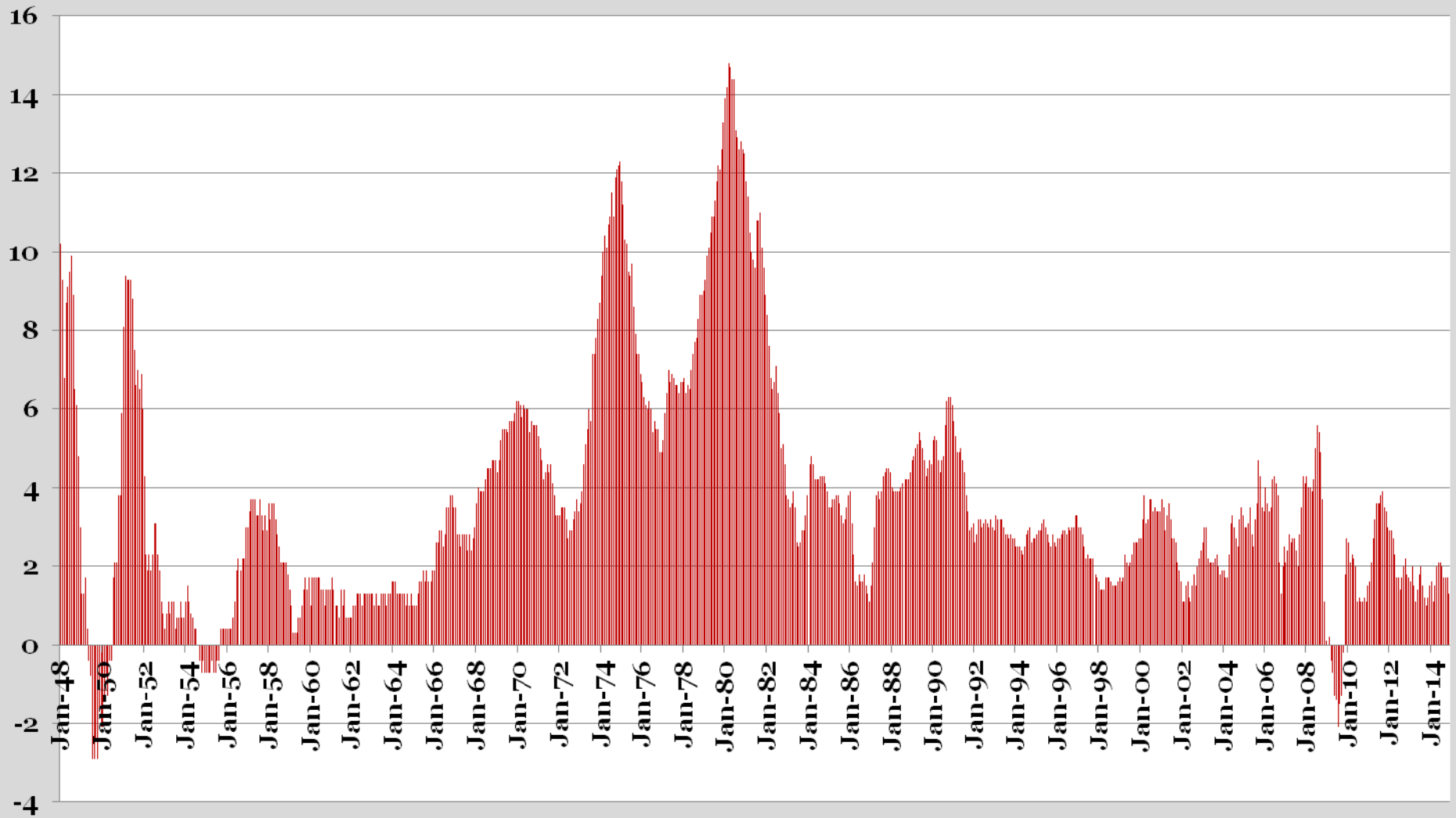


Inflation and Real Yields Down

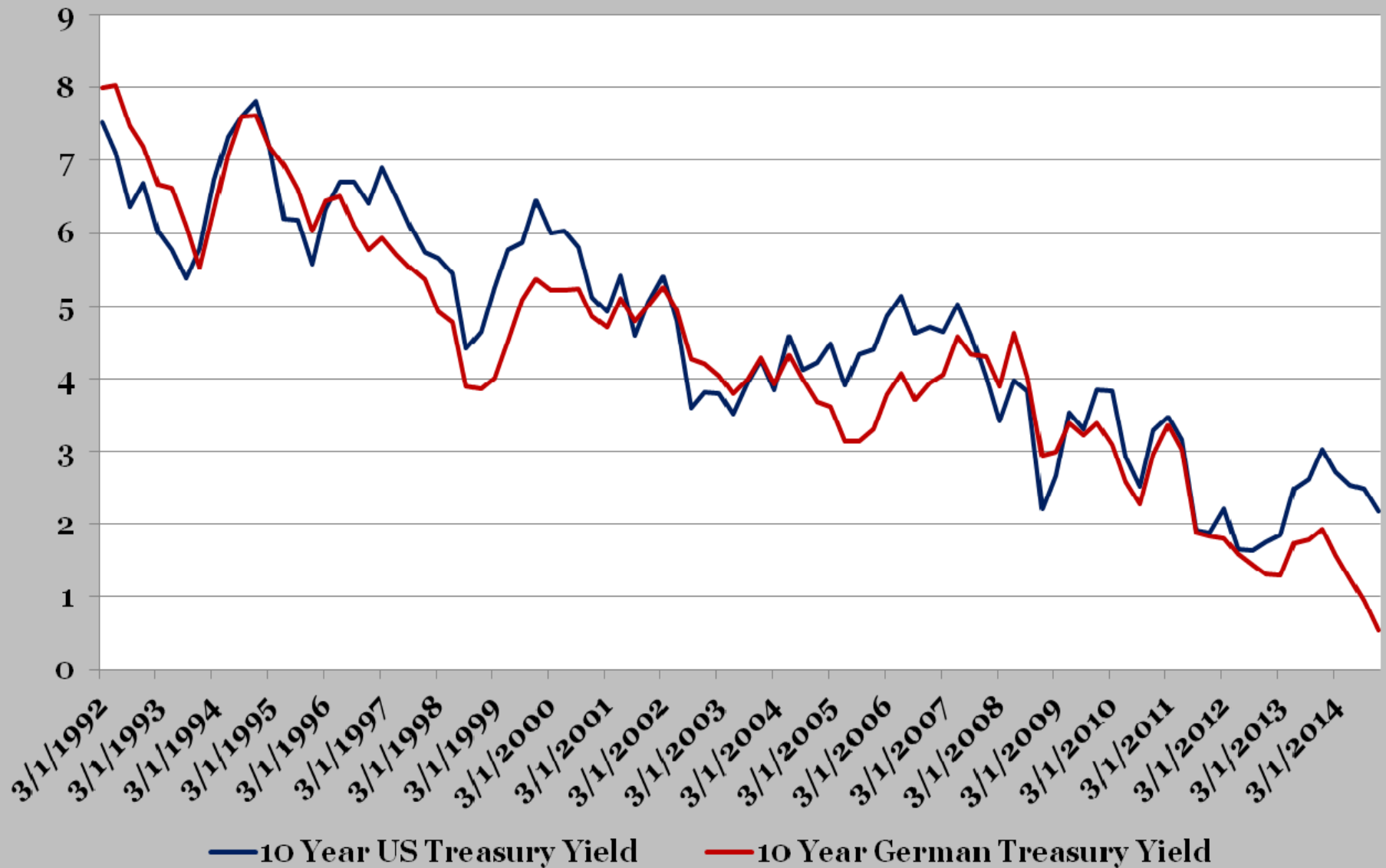


Minimal Experience With Deflation

Consumer Price Index - 12 Month Rate

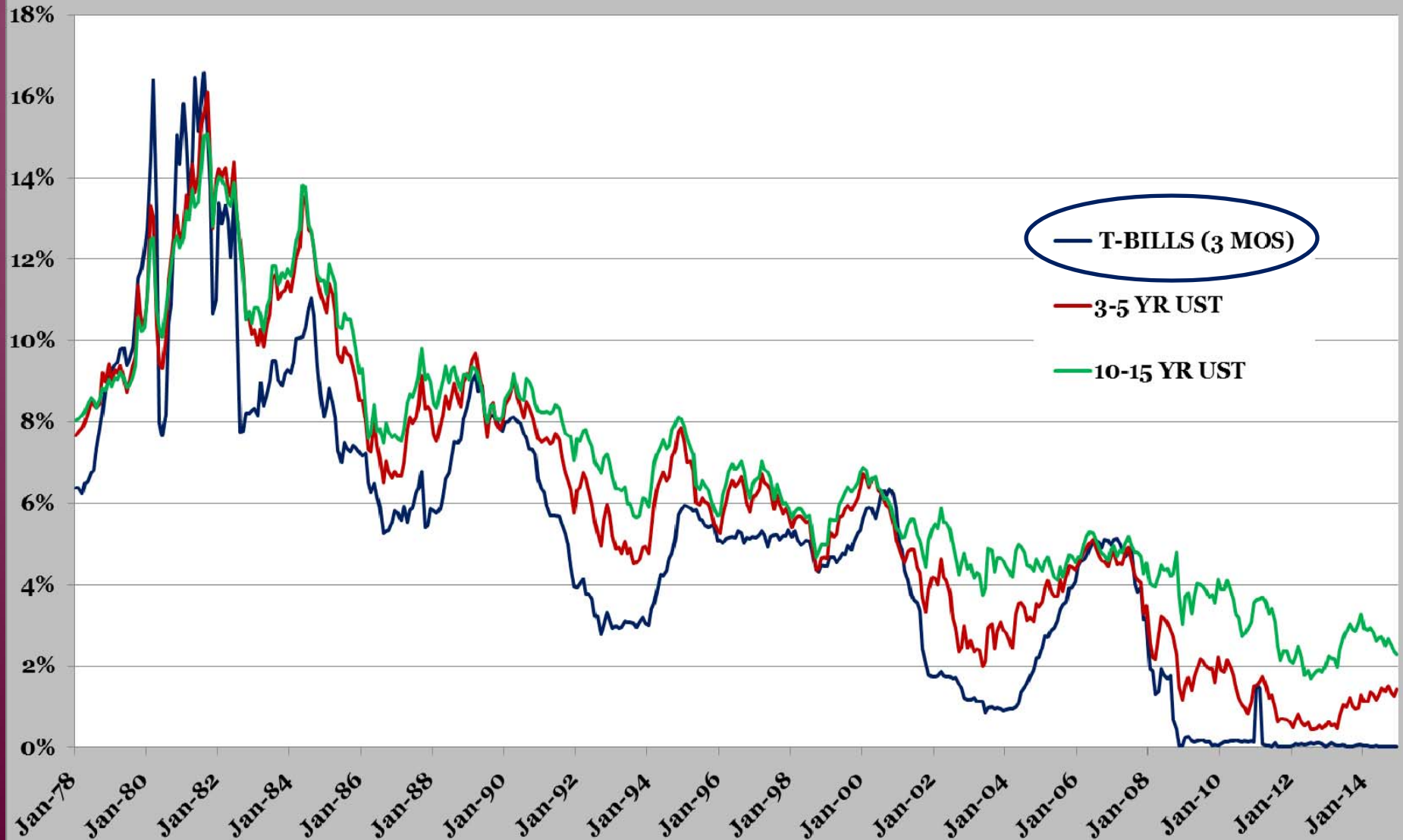


The Case for Low Yields



The Case for Higher Yields

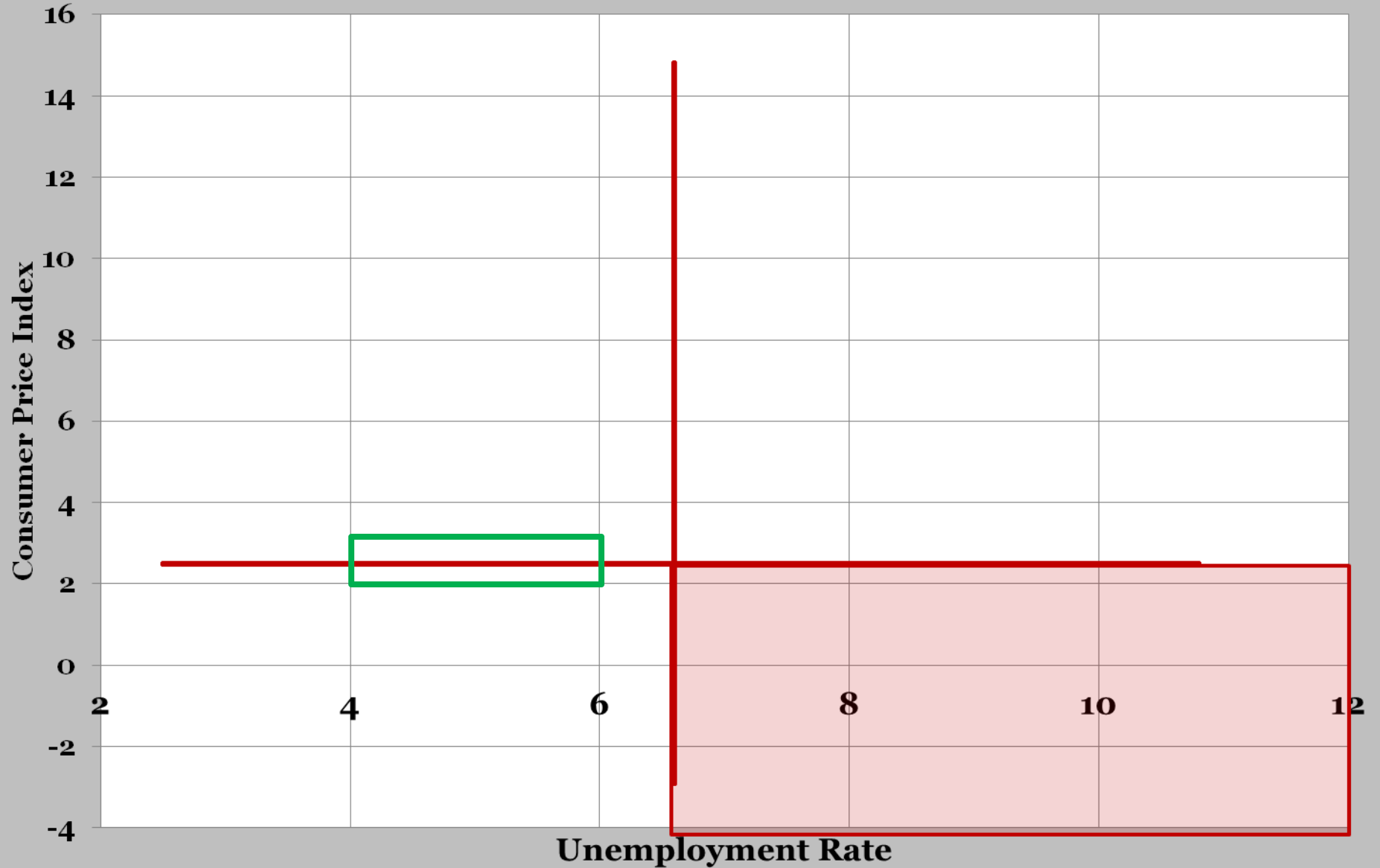
U.S. Treasury Rates - Hard to Go Lower?



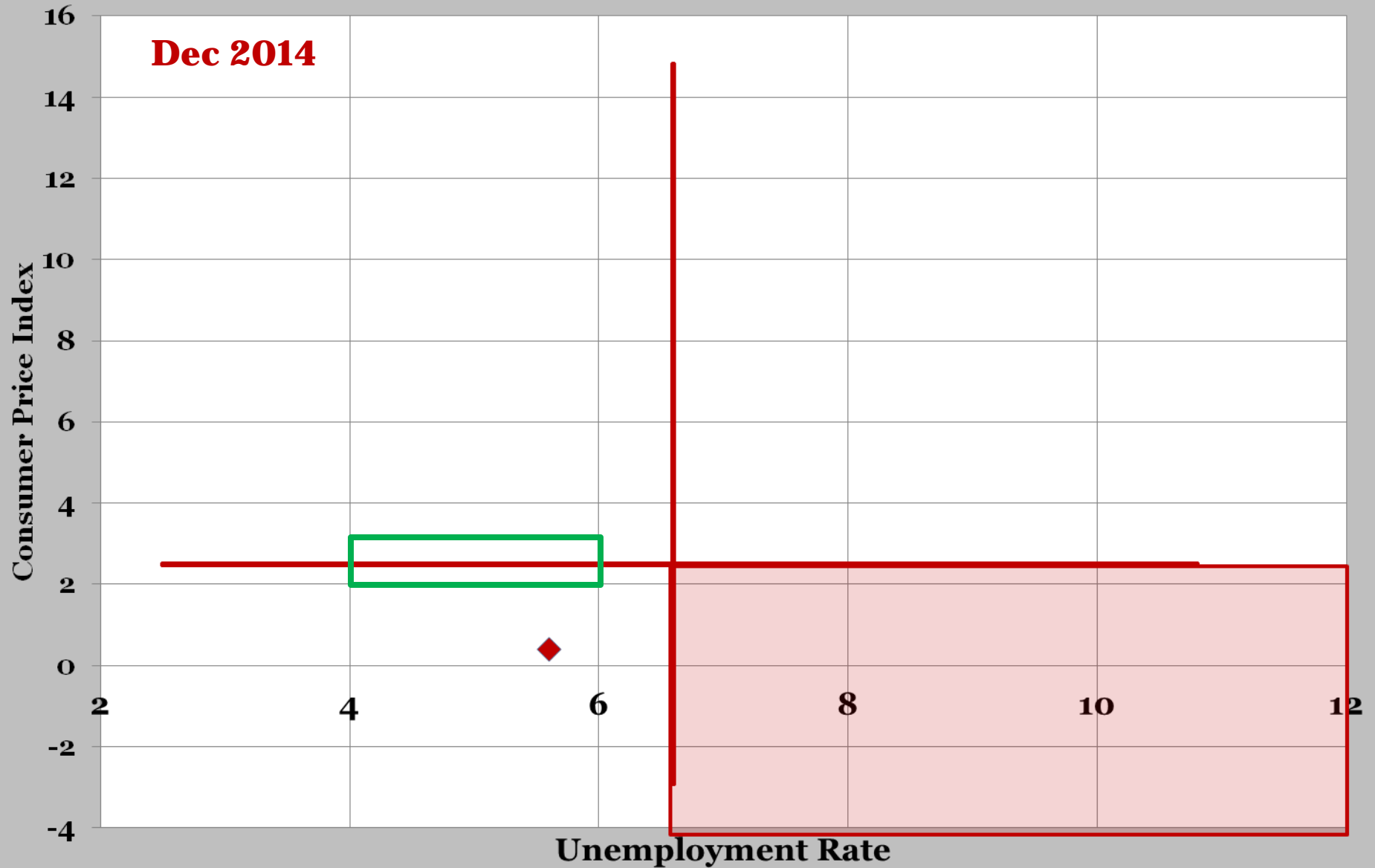
The Fed's Tradeoff



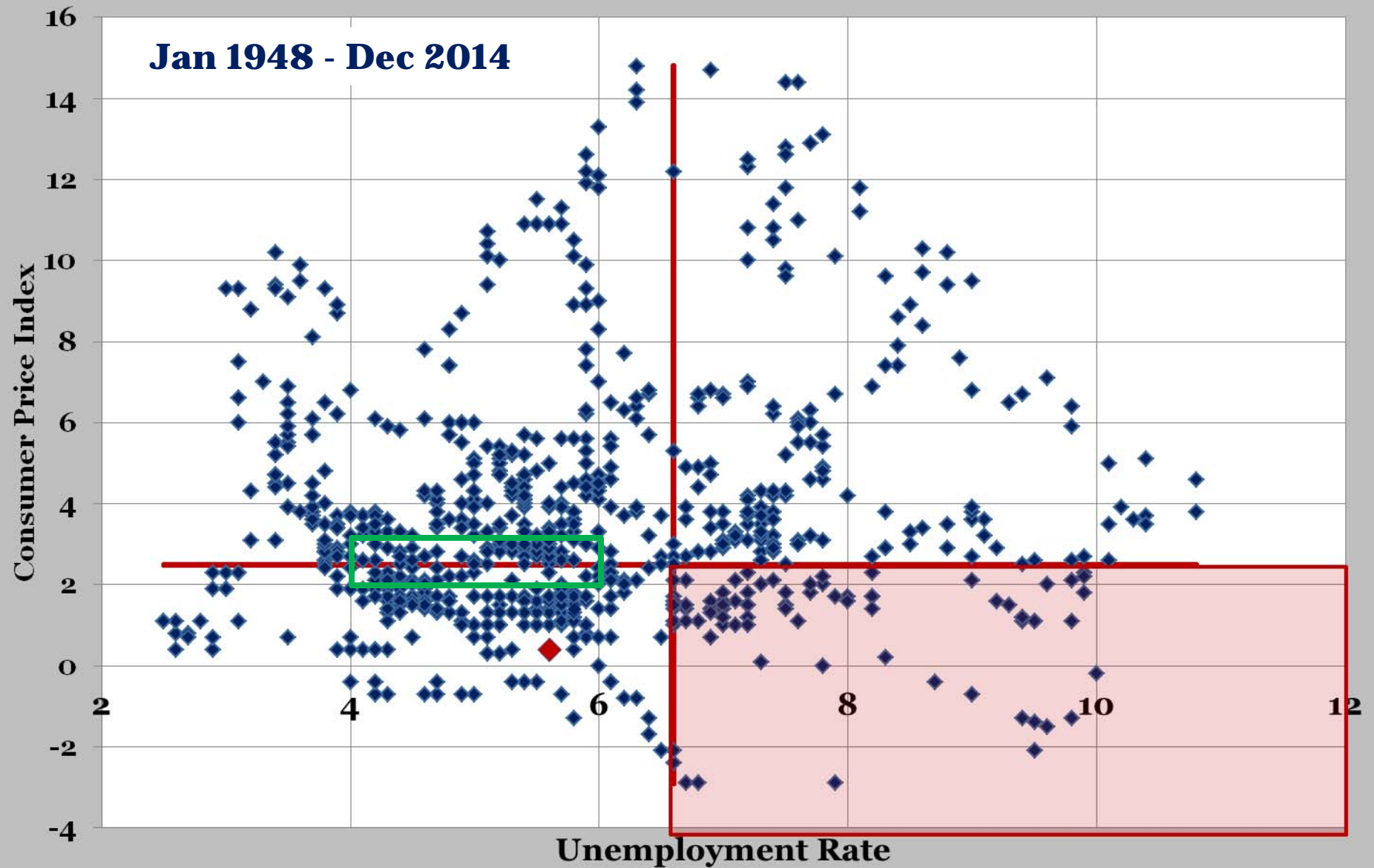
The Fed's Sweet Spot



The Fed's Opportunity



The Fed's Quandary



Breaking Down Equity Returns

- Equity returns can be broken down into **four** sources

$$\text{Revenues} * \text{Profit Margin} = \text{Earnings}$$

$$\text{Earnings} * \text{P/E} = \text{Price}$$

$$\text{Price} + \text{Dividend} = \text{Total Return}$$

A Little Math

As of 12/31/14

Earnings Growth x Price/Earnings Growth = Price Growth

1.053 x 1.058 = 1.114

**Earnings Growth
x P/E Change
= Price Change**











5.3%
5.8%
11.4%

**Price Change
+ Dividends
= Total Return**

11.4%
2.3%
13.7%

World Economies Slowing Down

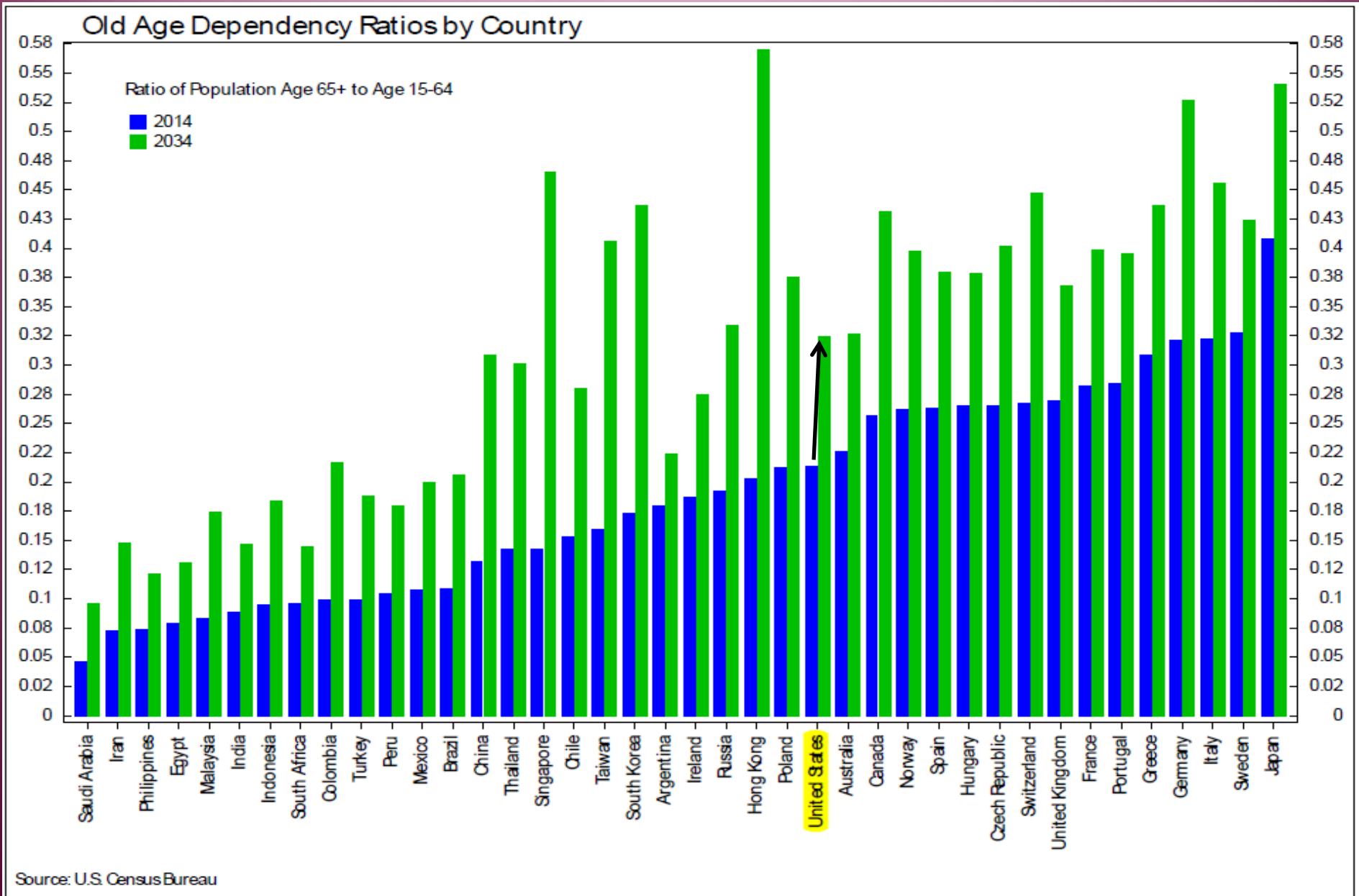
Estimated potential real GDP growth rates

	Percentage of world economy	Estimated trend growth (%)		Overall trend
		Pre-recession average (1990–2007)	Projected future (2014–2019)	
 United States	22.4%	3.0%	2.1%	▼
 Euro area	17.1	2.0	1.1	▼
 China	13.3	10.0	6.3	▼
 Japan	6.2	1.4	0.5	▼
 United Kingdom	3.7	2.9	2.1	▼
 Brazil	2.9	2.9	2.1	▼
 Russia	2.7	1.5	1.3	◀▶
 India	2.6	6.2	5.9	◀▶
 Canada	2.3	2.5	2.0	▼
 Australia	1.9	3.4	2.8	▼

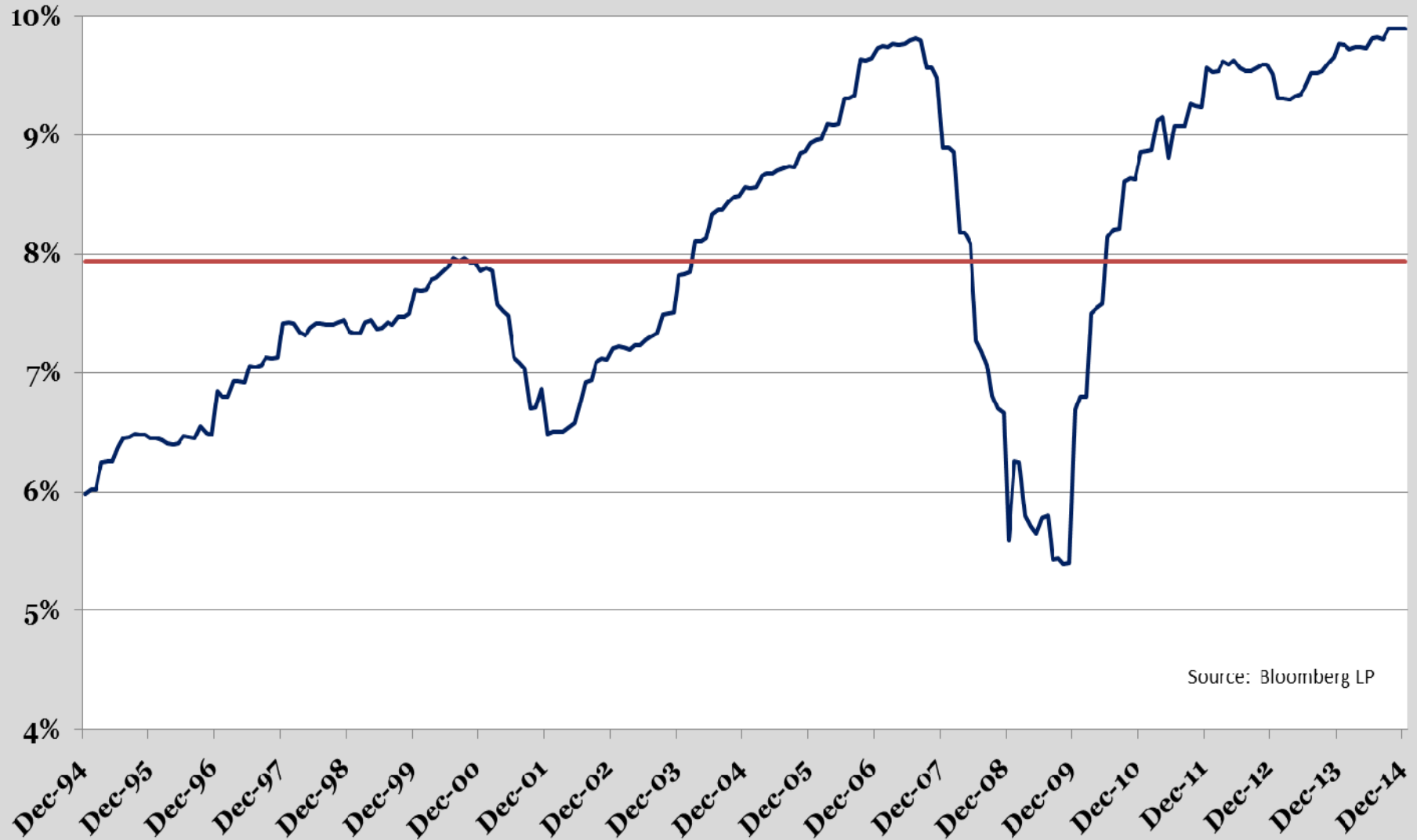
Notes: Pre-recession and projected trend are based on average annualized real potential GDP growth from IMF WEO. For developing countries, we projected the sum of ten-year annualized projected population growth and the Hodrick-Prescott trend component of real GDP per capita growth. For Australia, data available only to 2015. For euro area, data begin in 1991. For Russia data begin in 1993.

Sources: Vanguard calculations, based on data from IMF and U.S. Census Bureau.

World Population Aging

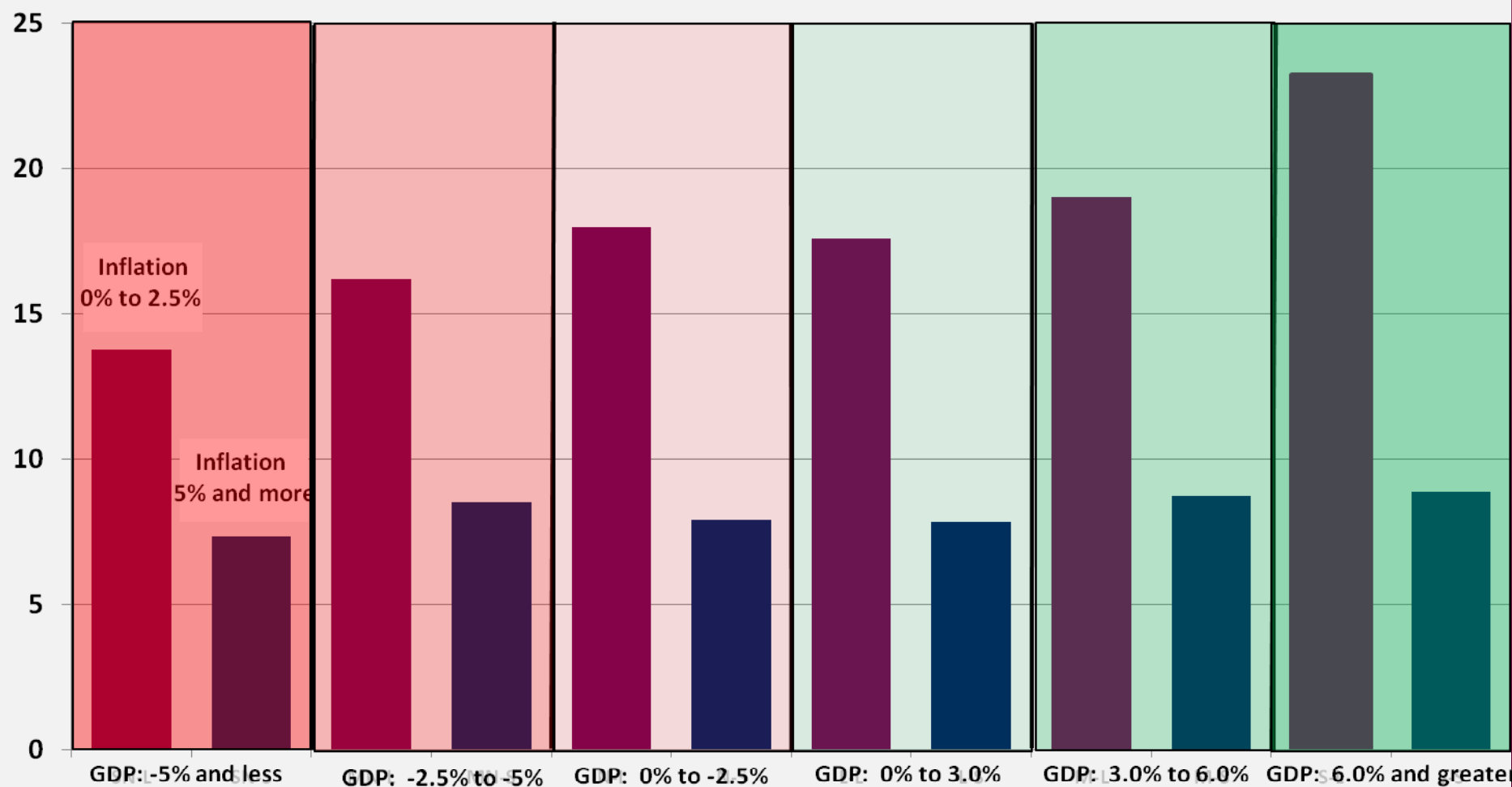


S&P 500 Operating Profit Margins 12/31/1994 to 12/31/2014



Inflation Key to Stock Valuations

S&P 500 Price/Earnings (P/E)
at Different Levels of GDP and Inflation (GDP Deflator)
January, 1978 to September, 2014



The Sources of Market Return

	As of 12/31/14		The
	<u>One Year</u>	<u>Twenty Years</u>	<u>Future ?</u>
Revenue Growth	3.9%	4.3%	4.0%
x Profit Margin Change	<u>1.4%</u>	<u>2.5%</u>	<u>0.0%</u>
= Earnings Growth	5.3%	6.9%	4.0%
Earnings Growth	5.3%	6.9%	4.0%
x P/E Change	<u>5.8%</u>	<u>0.8%</u>	<u>0.0%</u>
= Price Change	11.4%	7.8%	4.0%
Price Change	11.4%	7.8%	4.0%
+ Dividends	<u>2.3%</u>	<u>2.0%</u>	<u>2.0%</u>
= Total Return	13.7%	9.8%	6.0%

P/E Rises from 18.2 to 19.2

	As of 12/31/14		The
	<u>One Year</u>	<u>Twenty Years</u>	<u>Future ?</u>
Revenue Growth	3.9%	4.3%	4.0%
x Profit Margin Change	<u>1.4%</u>	<u>2.5%</u>	<u>0.0%</u>
= Earnings Growth	5.3%	6.9%	4.0%
Earnings Growth	5.3%	6.9%	4.0%
x P/E Change	<u>5.8%</u>	<u>0.8%</u>	<u>5.5%</u>
= Price Change	11.4%	7.8%	9.7%
Price Change	11.4%	7.8%	9.7%
+ Dividends	<u>2.3%</u>	<u>2.0%</u>	<u>2.0%</u>
= Total Return	13.7%	9.8%	11.7%

P/E Drops from 18.2 to 17.2

	As of 12/31/14		The
	<u>One Year</u>	<u>Twenty Years</u>	<u>Future ?</u>
Revenue Growth	3.9%	4.3%	4.0%
x Profit Margin Change	<u>1.4%</u>	<u>2.5%</u>	<u>0.0%</u>
= Earnings Growth	5.3%	6.9%	4.0%
Earnings Growth	5.3%	6.9%	4.0%
x P/E Change	<u>5.8%</u>	<u>0.8%</u>	<u>-5.5%</u>
= Price Change	11.4%	7.8%	-1.7%
Price Change	11.4%	7.8%	-1.7%
+ Dividends	<u>2.3%</u>	<u>2.0%</u>	<u>2.0%</u>
= Total Return	13.7%	9.8%	0.3%

Market Outlook Summary

- Interest rates – once Fed begins to raise short-term rates, longer term rate pressures build. Deflation is the ?
- U.S. equities – positive but below average. Economic backdrop modestly positive; demographics not good but better than Europe, Japan; valuations appear full

2015 is Not 2008



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"I THOUGHT WE WERE JUST BUYING A HOUSE!"

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ND: 2.7% unempl,
30.8% job gains

Net Job Gains or Losses Since the Start of the Recession and November 2014 Unemployment Rate by State



Note: The figure above excludes North Dakota, which has a current unemployment rate of 2.7% and net job gains totaling 30.8% since the start of the recession.

Yellow: 10 richest oil states per WSJ

Prepared by the Vice Chair's Staff of the Joint Economic Committee