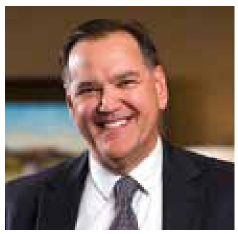
Trust Company Oklahoma

INVESTMENT PERSPECTIVES

TrustOk.com October 2024

Economic Anomalies

Why the Rules Don't Apply Anymore



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Economic, fiscal, monetary, and market conditions never align completely with history, making comparisons with the past imperfect. There was never a "last time" in which:

- The global economy was effectively shut down due to fears of a pandemic,
- Supply chains were stressed to the breaking point,
- Massive stimulus payments were made to reduce the impact of these shutdowns,
- Government debt ballooned by trillions of dollars, and
- Inflation spiked dramatically.

Some historically reliable economic indicators broke down in the face of this assortment of highly unusual circumstances.

A Recap of Actions

Massive stimulus and supply chain disruption unleashed inflation to levels the U.S. economy had not seen since the early 1980s. The Federal Reserve's aggressive response to that inflation began in earnest in March 2022 when the Fed boosted its Fed Funds Rate (FFR) from its highly stimulative Covid-era 0% lower bound. Over the ensuing 16 months, the Fed ratcheted up the FFR to 5.50% by July 2023. After holding steady for 14 months at that very restrictive level, the Fed eased rates by 0.50% in mid-September 2024.

Restrictive monetary conditions were accompanied by an ongoing refrain of recession predictions. In the past, high inflation and the Fed raising interest rates in response, more often than not, led to recession. Tightening was usually followed by overshooting, leading to widespread labor market turmoil.

Fast forward to now, when the U.S. economy has avoided a broad-based decline in economic activity. Consumers who were flush with savings from pandemic-deferred spending and better-than-usual personal balance sheets were not affected as much as expected by higher borrowing costs. Supply chain normalization also helped to ease inflationary pressures. Several indicators softened, but none to a worrying degree, concurrent with continued GDP growth.

Failed or Untimely Indicators?

Inversion of the yield curve has been a relatively reliable and often-cited indicator of imminent recession. The yield curve is the difference in yields between two maturities of U.S. Treasury securities, typically the 10-year minus the two-year (or the 10-year minus the one-year). When that difference is negative, the yield curve is said to be inverted.

Investors expect the Fed to cut interest rates when longer-term yields are below short-term yields – often the Fed's response to a weakening economy. Historically, an inverted yield curve was followed by a recession within 12 to 24 months. However, the yield curve was inverted between July 2022 and September 2024, but a recession has not occurred.

Several unique Covid-era factors have caused the yield curve signal to fall short in the recent past:

1. Massive monetary policy intervention distorting bond market pricing;
2. "Fed-subsidized" labor market skewing consumer spending behavior;
3. Global push toward U.S. Treasuries driven by low (or negative) rates in Japan and Europe; and
4. A massive support of businesses and consumers in response to global supply and demand disruptions.

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MARKET RECAP

The path to a U.S. economic soft landing remained intact during Q3 with economic growth above trend, and the Fed embarked on its first of a series of steps from a restrictive monetary policy toward a more neutral stance.

	YTD	Past 3 Months	Past 12 Months
S&P 500	21.2%	5.6%	36.3%
EAFE (International)	12.9%	7.02%	24.7%

U.S. Economic Indicator Roundup

SUGGESTING CONTINUED GROWTH	LEANING POSITIVE	NEUTRAL	LEANING NEGATIVE	SUGGESTING ECONOMIC DOWNTURN
• Narrow **corporate bond spreads** (signal benign credit risk/continued growth) • **Equity market** rally (with increasing breadth) • **AI** promising massive growth opportunity	• Lower short-term **interest rates** (Fed easing to ~3.5% by mid- or late-2025) • **Initial jobless claims** – slight uptrend but well below recessionary levels • **Manufacturing** showing early signs of improvement (good interest sensitive indicator) • **Corporate earnings** double-digit growth outlook for 2024 and 2025 • **Corporate balance sheets** are relatively healthy • **China stimulus** – likely to boost global growth; China deflation helps U.S. and rest of the world	• **Inflation** – progress made, but it's too early to declare victory (second wave?) • **Labor market** – numbers are cooling, but they're not weak • **Consumer Spending** (services > goods) • **Hourly earnings** (real, inflation adjusted) • Purchasing manager survey (**services**) • **Housing** starts and home prices • **Business investment** except for commercial real estate • **Net exports** (inventories/ domestic and international demand balance)	• **Supply shocks** (U.S. port strike) • **Fed surveys and interviews** are signaling growth concerns (anecdotal) • **Consumer confidence** weakening/continued price consciousness (rotation to cheaper/necessities) • Weak **manufacturing purchasing surveys** for two years • No longer a **buffer of excess cash** in consumers' pockets; consumer credit balances increasing • **Credit card delinquencies** have increased (highest in 13 years) • **Slowing growth in the rest of the world** impacts U.S. companies • **Geopolitical environment** • **Federal budget deficits**/ crowding out concerns/ expected big Treasury bond issuance	• **Inverted yield curve** for two years (until recent "de-inversion") • **"Sahm Rule" triggered** related to recent unemployment rate increase • **Gold rally** typically accompanies economic weakness/inflation fears

Source: Trust Company of Oklahoma

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The recent inflation spike was partly self-correcting as businesses recovered from supply chain disruptions and dramatic changes in customer behavior. The businesses were able to boost output to meet burgeoning, pent-up customer demand.

Whatever the cause, the sharp decline in inflation with only a small uptick in the unemployment rate has encouraged investors toward a soft-landing thesis.

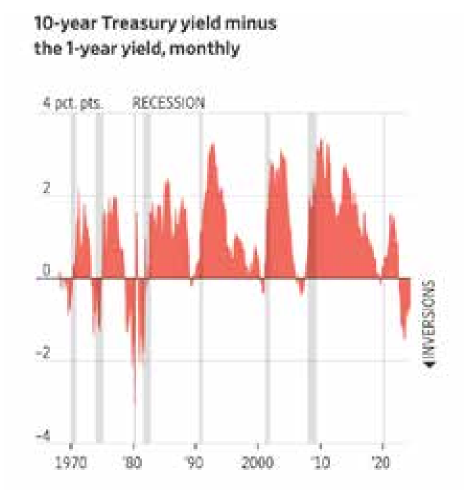
In addition, the U.S. economy has added far more jobs than any comparable period that followed an inversion. Perhaps the underlying strength of the U.S. economy has stalled any recession that the yield curve may have predicted.

Additionally, as banks' plentiful deposits have made them less reliant on borrowing Fed funds, inverted yield curves are less relevant/effective in transmitting financial conditions to the real economy.

Bottom line: The inverted yield curve has not been reliable as a recession indicator in this instance.

Additional Indicators

The "Sahm Rule" recession indicator was triggered in mid-2024. It signals a recession when the three-month moving



Source: Federal Reserve Bank of St. Louis

average of unemployment rates rises by 0.50 percentage points or more from its low in the previous 12 months.

The rule has been reliable in the U.S. since the end of World War II. However, many economists (including its namesake, Claudia Sahm) have questioned its reliability in today's economy due to several distortions, including growing household income and consumer spending and business investment remaining resilient even with restrictive monetary policy.

Add those to swings from labor shortages, with people dropping out of the labor force, to large immigrant inflows, to a spike in new job seekers, all causing material disruption to labor market statistics and perhaps a false signal from a historically reliable labor market recession indicator.

Gold prices, a traditional safe-haven asset, provide valuable insights. A gold rally typically reflects growing global economic uncertainty, concerns about inflation, or low real interest rates. It can signal that investors are seeking a haven because of a loss of confidence in more traditional investments like stocks or bonds or in the value of the U.S. dollar itself. A number of central banks have boosted their gold buying in a meaningful way, pushing up prices.

Conclusion

We are aligned with the "soft landing" consensus, which expects the U.S. GDP to soften later this year and in early 2025 before rising in the second half of 2025. Softening is driven primarily by the delayed effect of monetary tightening and the depletion of household excess savings.

The accompanying table (above) shows our view of economic indicators and the signals they are currently exhibiting. Readers are encouraged to contact their TCO representatives to discuss our constantly evolving views on these indicators and how those views inform our approach to investment management.

VIEW**POINT** A Message From the Desk of Michael Hopper

Michael Hopper
CFP®, CTFA

President & Chief Executive Officer

As the days grow shorter and the nights grow longer, there's nothing quite like curling up on the couch with a warm beverage, watching some football, and enjoying the comforting aroma of a crackling fire. But while the autumnal atmosphere may be inviting, it's also an excellent opportunity to harken back to the great Deion Sanders and recognize that this is the Prime Time for year-end tax planning.

Just as the Kansas City Chiefs strive for an elusive three-peat championship, you can aim for a financial victory by maximizing your tax deductions and credits toward the end of the year. You can significantly reduce your tax burden by considering the key areas to focus on and leveraging the available opportunities.

Consider charitable gifts, retirement contributions, business expenses, capital gains and losses, and tax-loss harvesting. Each presents unique opportunities to optimize your tax situation.

Remember, the key to successful tax planning is to be proactive. Starting early allows you to gather the necessary documents, explore available deductions and credits, and make informed decisions about your financial strategy. Don't wait until the last minute to scramble — start now and harvest the benefits.

As your team hits the gridiron, our team at Trust Company would love to coach you to a successful year-end. We are here to help you tackle your financial future with the same precision and strategy as your favorite team. We have a playbook with tactics to fit your financial goals. We will team up with your other advisors to ensure you score a touchdown come tax season.

SPOTLIGHT

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

The Oklahoma Hall of Fame, founded in 1927, is well known for its annual ceremony honoring notable Oklahomans. However, the organization is much more than a hall of fame. From its inception, it has provided educational programming for all ages.

The Oklahoma Hall of Fame's mission is to tell the story of Oklahoma through its people. Since 2007, the Hall of Fame has been housed in the former Mid-Continent Life Insurance building in Oklahoma City, and the Gaylord-Pickens Museum opened shortly after. The museum educates the public on the Hall of Fame members and the history of Oklahoma through the perspective of some of the lives that shaped it.

The museum houses several permanent exhibits open year-round to visitors. One exhibit, the Oklahoma Hall of Fame Gallery, displays stories of the more than 700 Hall of Fame members and the current class's portraits. Additional portraits and their subjects' stories rotate through the Story of the Portraits exhibit.

The Hall of Fame also hosts many rotating exhibits that highlight specific state stories and Oklahomans, and the exhibits are available to view virtually.

The Oklahoma Hall of Fame has educational programming designed specifically for families and educators. Their free family programs are provided year-round and include on-site arts, crafts, and story time, as well as free at-home activities for children during school breaks and holidays.

Beyond the Hall and Fame and the museum, the Oklahoma Hall of Fame Publishing has been involved with the production and distribution of more than 200 titles. These stories tell the story of Oklahoma's people, institutions, and movements, winning regional, state, and national awards. The Library Distribution Program donates copies of these titles to schools and public libraries across the state.

Source: oklahomahof.com

In further support of education, the Hall of Fame offers at least $770,000 in scholarships annually. Cash scholarships or tuition grants are available to students each spring, offering at least 10 scholarships available in all 77 counties.

The Hall of Fame's programs and scholarships are supported by donors. Donation opportunities are available through the Oklahoma Born & Brewed annual event, held each August, for a unique tasting of Oklahoma breweries. Donations are also accepted in traditional ways. For more information, visit **OklahomaHOF.com**.

Roth Retirement Savings Strategies

As we head into the year's final quarter, many people will reflect on 2024 to make resolutions for the new year. Instead of waiting until December to reflect, now is a good time to take stock of your retirement game plan.

Some popular strategies might be familiar to you, and you might be using them already. Because of their potential for tax-free income in retirement, after-tax Roth IRA contributions inside a retirement plan and to a Roth IRA are attractive retirement savings strategies.

But did you know there are additional strategies that could help you maximize tax-free income in retirement?

Enter the backdoor Roth IRA and mega backdoor Roth IRA options: powerful savings strategies that might offer significant benefits.

Backdoor Roth IRA

A backdoor Roth is a savings strategy that allows high-income earners to contribute indirectly (through the "backdoor") to a Roth, **even if their income level exceeds the IRS limit for Roth contributions**. Yes, you read that correctly … high-income earners CAN contribute to the Roth source within their 401(k) and indirectly to a Roth IRA.

To make contributions to a Roth in 2024, a single tax filer must have a modified adjusted gross income of less than $161,000, and a married couple filing jointly must have a modified adjusted gross income of less than $240,000. Note that the IRS may adjust these income limits for 2025.

A backdoor Roth is an option when individuals:

- Contribute *deductible* (pre-tax) contributions to a traditional IRA and convert the funds to a Roth
- Contribute *nondeductible* (after-tax) contributions to a traditional IRA and convert the funds to a Roth

When assets transfer from a traditional IRA to a Roth, you must pay taxes on any deductible (pre-tax) contributions and any earnings that have not been taxed at the time of conversion. Once converted, the principal and earnings can grow tax-free, provided you follow the IRS rules for a qualified withdrawal.

Even high-income earners can make Roth contributions inside a retirement plan and indirectly through the "backdoor" to a Roth IRA.

Holly Ferguson
ERPA, QPA, QKA®
Senior Vice President

Mega Backdoor Roth IRA

Mega backdoor Roth is a savings strategy that occurs inside a 401(k) plan and has the potential to allow individual contribution amounts significantly higher than the Section 402(g) limit, also called the employee contribution limit. The 2024 employee contribution limit is $23,000 for those under age 50 and $30,500 for those age 50 and older.

By making mega backdoor Roth contributions, individuals can potentially defer up to the IRC Section 415 limit, also called the annual contributions limit.

The total annual contributions limit of $69,000 for those under age 50, and $76,500 for those age 50 or older, in 2024 includes ALL contributions to a retirement plan. These include individual pre-tax contributions, individual after-tax contributions, employer matching as well as employer nonmatching contributions.

(Note that it's important to coordinate any voluntary after-tax contributions, defined in the next section, with all other employee and employer retirement plan contributions for the year to avoid exceeding the total annual contributions limit.)

Steps to Implementing a Mega Backdoor Roth Maneuver:

1. Maximize your pre-tax and Roth contributions inside your 401(k) plan.
2. Make voluntary after-tax contributions inside your retirement plan. Voluntary after-tax contributions are different from Roth deferrals. They are an "old-school" type of after-tax contribution in which the earnings do not grow tax-free. Participants may be able to make voluntary after-tax contributions up to the total annual contributions limit rather than the employee contribution limit.
3. Convert your voluntary after-tax contributions to Roth contributions via an in-plan Roth conversion.
4. A 1099-R will indicate taxes owed on any earnings generated from the voluntary after-tax contributions converted to Roth.
5. Your contributions plus earnings converted to Roth will grow tax-free, provided you follow the IRS rules for a qualified withdrawal.

For the maneuver to succeed, your retirement plan must pass required testing, allow voluntary after-tax contributions, and allow in-plan Roth conversions.

Because the plan must pass nondiscrimination testing, including all after-tax contributions, the maneuver works in limited circumstances:

- Solo plans, also known as "owner only plans" and "owner and spouse only plans," are ideal candidates because the owners are the sole participants. Thus, the plan automatically satisfies nondiscrimination testing requirements.
- Plans consisting solely of Highly Compensated Employees (HCEs), as defined by the IRS, are also ideal. These plans automatically meet nondiscrimination testing requirements. For 2024, HCEs include individuals who own more than 5% of the company and employees who earned more than $150,000 in 2023. The compensation threshold increases to $155,000 for earnings in 2024.
- It's unlikely the maneuver will work in a retirement plan consisting of both HCEs and Non-Highly Compensated

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Employees (NHCEs), as defined by the IRS, as these plans will likely fail required nondiscrimination testing.

Additional Considerations

Roth contributions and conversions are taxable in the year they are contributed or converted. Converting any amount of pre-tax contributions and could increase your taxable income, which may result in a higher tax bracket.

Additionally, the IRS imposes two rules to consider. The first is the pro-rata rule, which impacts the taxation of conversions, and the second is the five-year rule, which affects the timing of tax-free withdrawals.

The pro-rata rule prevents individuals from selectively converting, or "cherry picking," only after-tax amounts to Roth.

Suppose your IRAs include pre-tax and after-tax contributions and you elect to convert only part of your contributions to Roth. In that case, the taxable amount will be proportional to the ratio of your pre-tax and after-tax balances in ALL of your IRAs combined. However, within a 401(k) plan, the pro-rata rule generally doesn't apply, though this depends on the plan's specific terms.

The five-year rule requires any withdrawal of funds from Roth conversions to meet a five-year waiting period to avoid penalties. Each conversion is generally subject to a separate five-year waiting period. Inside a retirement plan, the five-year waiting period begins the year you first make Roth contributions or a Roth conversion occurs, whichever happens first.

From time to time, Congress considers changes in legislation that could alter or eliminate backdoor and mega backdoor Roth savings strategies. For now, both strategies remain permissible by the IRS.

Due to their complexities, these backdoor Roth strategies require careful planning and execution. Working with a financial or tax advisor like those at TCO is crucial to avoid unintended tax consequences.

If you are a high-income earner and wish to maximize your retirement plan savings, these strategies could allow you to make significant Roth savings. Make the most of the year and talk with a TCO advisor today.

IRA Stretch: A Special Needs Trust Solution

Emily Crain

Senior Vice President, Director of Marketing

"The Yellow Wallpaper" is an unsettling short story by Charlotte Perkins Gilman. Narrated by an unnamed woman suffering from postpartum depression, it explores themes of mental illness, confinement, and the oppressive societal expectations placed on women in the late 19th century.

The woman is confined to a nursery room with peeling yellow wallpaper, described by the narrator as containing "sprawling flamboyant pattern[s] committing every artistic sin." As her mental health deteriorates, she becomes convinced that a woman is trapped behind the wallpaper, a symbol of her entrapment and desire for freedom. The story culminates in the narrator's belief that she is the woman trapped in the wallpaper.

This story is often cited as an example of gothic fiction exploring themes of mental health and powerlessness. The American author Alan Ryan once said it "may be a ghost story. Worse yet, it may not."

The feeling of powerlessness is a common challenge faced by those living with mental illness. A special needs or supplemental needs trust is a legal tool designed to provide financial support for individuals with disabilities while preserving their eligibility for government benefits. For individuals with mental health disorders, these trusts can be particularly valuable in ensuring a stable and fulfilling life.

One of the primary benefits of a special needs trust is that it allows individuals to benefit from resources without jeopardizing their eligibility for government benefits. These benefits are often crucial for individuals with mental health disorders, as they may require ongoing support for medical expenses, housing, and other essential needs. Individuals can receive additional financial resources by establishing a special needs trust without losing eligibility for these vital programs.

Furthermore, a special needs trust can provide flexibility in asset management. Unlike government benefits, which may have strict rules regarding how funds can be used, a special needs trust allows for greater control over how assets are spent. This can be especially important for individuals with mental health disorders who may have unique needs or preferences. For example, a trust can fund specialized therapies, assistive technology, or recreational activities that can improve quality of life. When describing how a special needs trust can improve a beneficiary's life, I often liken governmental benefits to the "cake," or the foundation for a beneficiary's care, and that a special needs trust can pay for the "frosting," providing an extra layer of support for the beneficiary.

In addition to financial benefits, special needs trusts can also provide peace of mind for families of individuals with mental health disorders, knowing that their loved one's financial future is secure. Moreover, a special needs trust can help ensure the family's wishes regarding the care and legacy of the beneficiary are respected.

The Secure 2.0 legislation passed in 2022 offers several provisions that can be strategically utilized to maximize contributions to a special needs trust.

One of Secure 2.0's key provisions is making it less cumbersome for special needs trusts to qualify for lifetime "stretch" distributions. Under this law, a special needs trust with a primary beneficiary who is a qualified, eligible designated beneficiary can receive distributions from the qualified account based on their life expectancy. This technique allows the assets in the qualified account to grow tax-free over the beneficiary's lifetime.

"The Yellow Wallpaper" serves as a poignant illustration of the isolation, confinement, and powerlessness often felt by individuals with mental health disorders. The narrator's struggle to break free from her oppressive surroundings mirrors the challenges faced by many individuals who seek to overcome the limitations imposed by their mental health conditions. A special needs trust can allow individuals with disabilities to live with a little more freedom, just as the narrator ultimately seeks to break free from the confines of the yellow wallpaper.

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