

A MATTER OF TRUST

THIRD QUARTER 2018



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Mills



Chris
Klemme



Todd
Wetsel



Alisa
Scott



Terry
Wright



Terri
Wright



Bryan
Limmer



Jason
Carter



Kevin
Rider



Buffy
Haden



Shannon
Van Campen



Brooks
Smith



Hunter
Vagrosky



Scott
Richardson





THIRD QUARTER INVESTMENT UPDATE



Todd Wetsel

Todd has 15 years of trust and banking experience. He started his career with Bank of America while attending West Texas A&M University. After graduating with a Bachelor of Business Administration, he went to work for the trust department at Herring Bank where he served as an Assistant Trust Administrator. Todd enlisted in the United States Army in 2005 and served two tours of duty in Iraq. In 2010, he joined Happy State Bank, where his principal duties include market research and portfolio management. Todd has attended the Texas Trust School and Texas Graduate Trust School offered by the Texas Bankers Association. He is a member of the Amarillo East Rotary Club and serves on the board of the Wesley Community Center Foundation.

Many of the themes from the second quarter carried over into the third. Interest rates continued to rise, however the yield curve did not invert as many had feared. Tariffs and trade concerns still linger, but corporate earnings continued to rise, pushing the markets higher.

The U.S. Economy and Markets

The U.S. economy grew at 4.2% in the second quarter while expectations for the third quarter are 3.4%. Many economic indicators continue to tell a positive growth story; however, some indicate that growth may be slowing a bit.

While still at an elevated level, the manufacturing growth rate declined slightly in September; however, expectations are that it will continue to expand in the coming months. U.S. consumer confidence hit an 18 year high, while small business optimism is at the highest levels on record. Unfortunately, some concerns remain about the housing market. Inventory is building as it appears that new home sales may have peaked in August.

The S&P 500 Index was up 7.4% during the quarter, hitting an all-time record high on September 20th. The Nasdaq crossed the 8,000 mark for the first time in history, with Apple and Amazon becoming the first stocks to ever reach \$1 trillion valuations. Lower taxes, increased economic growth, and consumer spending have boosted corporate earnings throughout the year. The earnings of small company stocks jumped by over 35% in the second quarter. This has been reflected in the stock prices as small cap stocks have lead the way year-to-date. Some of this can be attributed to the fact that small companies (represented

by the Russell 2000 Index) generate only 21% of their revenue from foreign operations, compared to companies in the S&P 500 that earn approximately 30% overseas.

U.S. equities are trading at the highest premium to international stocks in years. While the Eurozone and Asia seem to be struggling, America is doing well and investors are flocking to the U.S. market.

Interest Rates

The Federal Reserve raised the Fed Funds rate to 2.25% in September (third hike this year) and signaled that there could be one more increase in 2018. The 10 year Treasury yield climbed above 3.0% in September. Longer rates also moved higher, causing the entire curve to shift upward. The recent increase in rates could be an indicator that investors are less concerned about trade wars and have higher hopes for future economic expansion. Conversely, higher rates could cause difficulties with borrowing costs and cause the economic expansion to stall out.

Overall, the bond market hung in there against rising rates with a relatively flat return. Bonds with shorter durations and mid- to lower-quality performed slightly better. Investors were rewarded for taking more credit risk.

Unemployment & Wage Growth

The unemployment rate fell to 3.7% in September. While wages are improving, economists are still searching for those larger gains that are expected with such a tight labor market. Hourly earnings rose 2.8% in August, but that is well below the rate expected at this point in the economic cycle.

INDEX RETURNS

	U.S. Stock Market	International Developed	Emerging Markets	Global Real Estate	U.S. Bond Market	Global Bond ex U.S.
Q3 2018	STOCKS				BONDS	
	7.12%	1.31%	-1.09%	-0.03%	0.02%	-0.17%
						

Interestingly, the improved labor market is allowing for more unions to approve strikes if negotiations with employers fail to achieve their objectives. There have been more strikes and days of work missed due to strikes so far year-to-date than in all of last year.

Trade

Throughout the quarter, the market rose and fell based on the most recent headlines regarding tariffs. There have been glimmers of hope that the U.S. and China will reach a deal, but so far every effort has fallen short and additional tariffs have been implemented. While the trade tiffs between the U.S. and China continue, the U.S. did reach separate deals with both Mexico and Canada, easing investor’s concerns.

Final numbers for the full third quarter are not yet available, but, according to indicators, it appears that the trade gap (the difference between exports and imports) widened during the quarter, causing a drag on U.S. growth. This reverses a trend from the second quarter when the trade gap narrowed, adding to U.S. economic output.

International and Emerging Markets

The markets in the rest of the world had mixed results. International developed markets were slightly positive; however, emerging markets were down. China, a significant component of any emerging market index, was one of the worst performing

markets for the quarter. Emerging markets are feeling the pressure as the Federal Reserve raises rates here in the U.S., increasing the borrowing costs of countries with dollar-denominated debts.

Thoughts

Since the end of the third quarter, we have witnessed long-term rates rise to levels not seen in a long time. This has caused some significant concern and volatility in the markets. However, long-term rates are a gauge of where the market believes growth and inflation are headed. So, with better economic growth and higher inflation projections, the Fed is moving forward with its stated interest rate hikes. This increase in rates, while causing some short-term angst, could be what we need for the long-term.

Intuitively you may be thinking that if current economic growth is better, the stock market should rise, however the stock market is always forward looking. Investors are now attempting to determine how they should account for the possibility of higher inflation and the almost certainty of higher interest rates and what that will ultimately mean for future earnings. This is a re-adjustment period and those are rarely smooth and orderly. We believe that the best thing to do at a time like this is to hold steady and not make a reactionary decision at a really bad time. Stick to your long-term plan and you will be rewarded.

HAPPY Investing!

What is your Risk Number?

RISK
1

RISK
?

RISK
99

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Have you ever wondered how much risk you are really taking in your portfolio? Many investors take the advice of a financial professional but never really know how much risk they are taking. Happy Trust is now able to analyze your investment portfolio and give you a risk score based on the market risk. We are also able to provide you with a quick investment questionnaire that will give you your personal risk score. This analysis is important because many times the two scores don’t match up and you may be taking more market risk than you should be. To take our 5 minute questionnaire, simply go to happytrust.com and click on the [Does your portfolio fit you?](#) button. Once completed, our staff will reach out to you to discuss further.

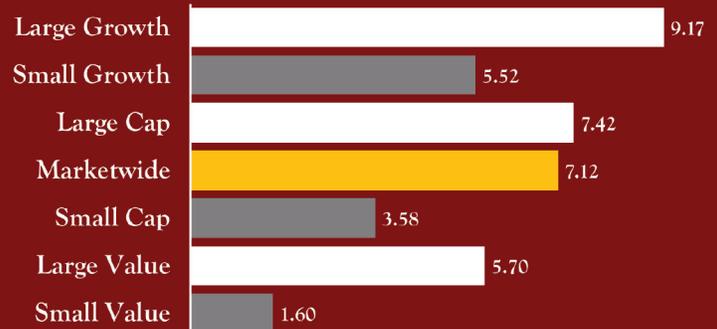


MARKET SUMMARY

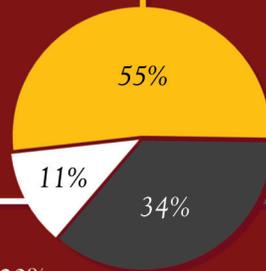
In the third quarter, U.S. and international developed markets were positive, while emerging markets fell slightly. Growth stocks led the way in both the U.S. and international develop; however, value significantly outperformed in emerging markets. Small cap stocks underperformed in all markets globally. Bond markets were relatively flat, while commodities overall declined marginally. For a more detailed quarterly report please see the publications tab at www.happytrust.com.

US STOCKS

RANKED RETURNS FOR THE QUARTER (%)

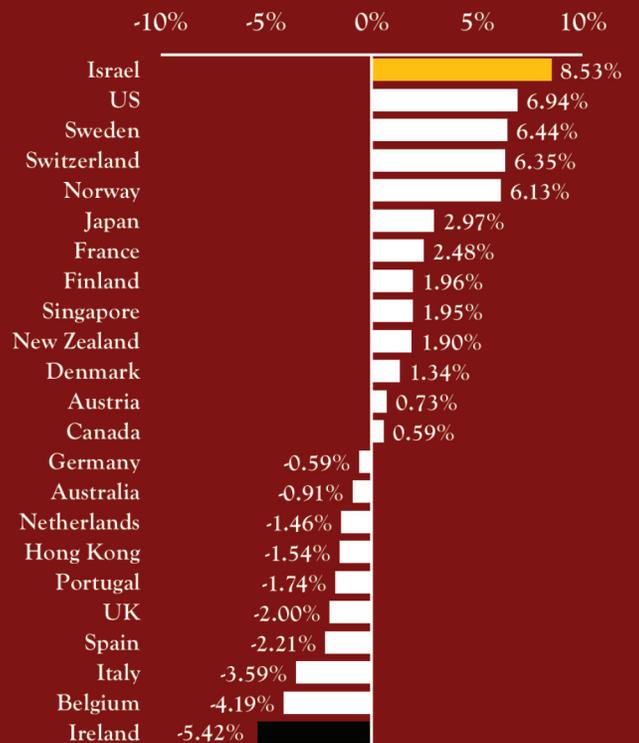
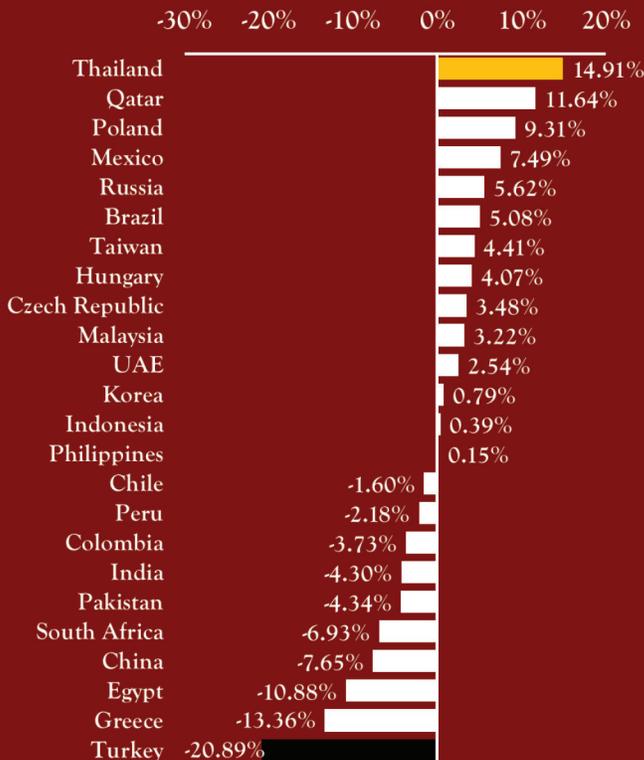


WORLD MARKET CAPITALIZATION



EMERGING MARKETS STOCKS

INTERNATIONAL DEVELOPED STOCKS



MEET THE TEAM



Terry Wright
Oil & Gas Manager
Amarillo Office

Terry has more than 35 years of Trust experience, including residential and commercial real estate, farm and ranch, and oil and gas management. He began as a farm and ranch manager and over the years advanced to Senior Trust Officer prior to joining Happy State Bank. Terry became a member of the team with Happy Trust Company in 2015 where his primary duties include oil and gas management and business development.

Having grown up in Happy, Texas, Terry graduated from West Texas State University (now West Texas A&M University) earning a B.S. in Agriculture Business and Economics. Terry is an avid football fan and you will often see him at WTAMU sporting events.

Terry is married to Terri (yes, Terry and Terri Wright). They have a daughter, Kristen, son-in-law, Butler, and a grandson, Quint.

Terry is well known throughout the community for all the numerous civic and social boards he has served on. He is currently serving on the Executive Committee with the Tri-State Fair and as President of the Amarillo-Potter Events Venue District and President of the Coors Cowboy Club, Inc.



Bryan Limmer
Senior Vice President
Senior Trust Officer
Lubbock Office

Bryan has 25 years in the trust banking industry. He spent the first 6 years of his banking career as the trust officer and department manager for City National Bank in Colorado City, Texas. In 2000, Bryan moved to Lubbock and began working for American State Bank, now known as Prosperity Bank, where he was a trust administrator and the department's real estate assets manager. Bryan has been with Happy Trust Company since December 2014, where he serves as the manager of the Lubbock region.

Prior to becoming a banker, Bryan worked for the Texas AgriLife Extension Service for 6 years as a County Agriculture Agent. He is a Texas Tech University graduate with a degree in Animal Science.

Bryan has furthered his education through the Texas Bankers Association Trust School and Graduate Trust School as well as the Cannon Trust School. In his role with Happy Trust Company, Bryan is the administrator for trust, estate and investment agency accounts as well as IRAs. Both Bryan and his wife Cari are natives of Snyder and have three adult children and one granddaughter. Bryan is Vice President of the South Plains Trust and Estate Council and is the Chairperson of the Leadership Board for the Lubbock Area American Diabetes Association.



SPECIALTY ASSET MANAGEMENT



Kevin Rider

Kevin has 12 years of Specialty Asset Management experience with an emphasis on Farm and Ranch Management. Earning his Bachelors of Science in Agriculture Economics from Texas Tech University, Kevin spent the first 9 years of his career in the Sorghum Seed Industry before beginning his banking career. At Happy State Bank, his primary duties include managing all specialty assets including farm, ranches, homes, commercial properties, and oil/gas interests.

Wealth is achieved in many different ways. One of those ways, particularly in Texas, is through owning real estate and mineral holdings. One of the hardest decisions our clients face when going through their estate plans involves who has the skills necessary to manage those assets. Happy Trust Company can help you with the management of specialty assets as a part of your overall investment portfolio. Whether these assets consist of farms, ranches, homes, commercial properties, and royalty or working mineral interests; our group has the expertise to help manage, grow, and maintain these assets for future generations. With over 50 years of combined experience in specialty asset management, we can explain all of the options to manage your specialty assets now or in the future.

Our real estate management team is familiar with surface leases and agreements. One of our roles is to vet and hire the best tenants for each particular property. The most common agriculture lease and surface agreements include crop-share, cash, wind, solar, sand/gravel leases along with surface damage and easement agreements. Commercial and residential leases are typically either triple-net or monthly cash lease agreements. Our goal is to generate the greatest amount of income with fully vetted tenants who are able to pay the agreed upon rental rates and take care of the rental property.

During the course of the year, all of the real properties managed by Happy Trust Company have an on-site inspection by our real estate manager. While we ensure all properties are inspected once a year, we typically inspect the properties on multiple occasions throughout the year, which allows us to maintain accurate knowledge of the property conditions. During inspections we visit with the tenants, look at the property, improvements, and crops. We also work with the tenants to ensure all repairs and environmental issues are addressed. Our main focus during the inspections includes inspecting crops, pastures, homes, or buildings to ensure that these properties are being taken care of appropriately. Finally, we are able to get a feel of what is really going on with these properties, and are better able to determine the quality of the asset and work to maximize the potential of the property.

“ Our goal is to generate the greatest amount of income with fully vetted tenants... ”

Day to day management generally includes collecting income through cash rents, marketing crops, or insurance proceeds. The real estate manager reviews the income for accuracy while paying and monitoring expenses. Our other duties include making sure properties are properly insured, and working with insurance companies when claims are needed. We annually monitor tax appraisal districts and determine whether or not to protest property valuations.

“We will work with the tenants and contractors to make sure all improvements are done correctly, up to code, and completed in a timely fashion.”

There are times when capital improvements or major repairs are needed, which could include installing a new center pivot irrigation system or overseeing a roof replacement after a hail storm. We will work with the tenants and contractors to make sure all improvements are done correctly, up to code, and completed in a timely fashion. Finally, we work closely with the Farm Service Agency to make sure all agriculture properties are in compliance with government regulations.

Happy Trust Company can also help when it comes to selling or buying real estate for our clients. Depending on the needs of the client, there are times when a real estate asset needs to be liquidated in order to generate funds to care for that client. Our department can help with selling real estate either through private treaty or usage of brokers. We also help those clients who are interested in purchasing real estate assets for their trust or agency accounts when it fits their investment needs.

Most clients who have mineral interests have owned these assets in their families for generations. These legacy assets likely have and continue to generate a good source of income for our clients. Happy Trust Company mineral managers negotiate leases and bonuses on the owned mineral tracts. Our expertise and knowledge allows us to determine what types of mineral leases and bonuses are best for our clients. Our lease documents, which are reviewed and regularly updated by legal counsel, allow us to further benefit our clients with the most current trends in mineral management.

Our mineral managers receive and review each working or royalty interest income check for accuracy. We monitor all mineral expenses and notify producers when discrepancies occur. As with real estate management, our team reviews the annual ad valorem taxes charged against the mineral interests and determines whether there is a need to protest those valuations.

Oftentimes, specialty assets have more meaning and sentimental value than other types of investments such as stocks and bonds. As part of your estate planning process, it's important to ensure your entire portfolio will be protected and managed with expert care. We can assist you and your family in managing not only traditional investments, but also specialty assets, to ensure they remain an important part of your family's legacy for generations to come.

“...it's important to ensure your entire portfolio will be protected and managed with expert care.”

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