GREENLEAF TRUST

Perspectives

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2018 Review and Outlook

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In our 2017 year-end seminar, we recapped a period characterized by:

- ◊ Exceedingly low volatility,
- ◊ Stronger-than-expected returns across major asset classes, and
- ◊ A compelling economic backdrop heading into 2018.

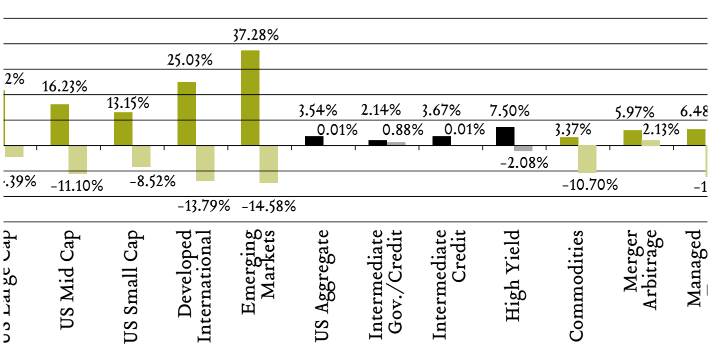
Despite an auspicious start, the 2018 experience unfolded to include:

- ◊ Higher Volatility,
- ◊ Lower-Than Expected Asset Class Returns, And
- ◊ Questions about the economic backdrop heading into 2019.

In 2018, every major asset class posted disappointing returns. Whether it was stocks around the globe, government debt, corporate bonds or commodities, negative investment returns were the norm this year. We have been communicating our expectation that future returns might be lower, as the combination of high stock valuations and low interest rates dampen the prospects for future growth. Still, 2018 was uncommon in the lack of bright spots on the investment landscape.

Asset Class Performance

(2017-Dark; 2018-Light)



Source: Bloomberg

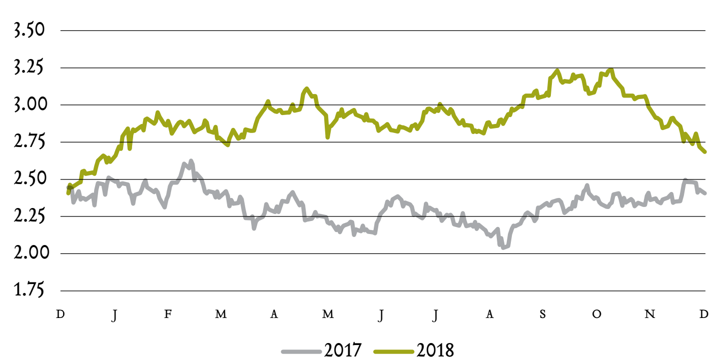
In 2017 the S&P 500 gained more than 20% and had its first ever perfect record, advancing every month on a total return basis. 2018 was very different, with more volatility, four down months, and a near 20% drawdown from the late September high. When all was said and done, domestic stocks were 6% lower to close the year, netting -4% total return after accounting for dividends. These returns belie the 20% growth in earnings for S&P 500 companies, an estimated 7% of which came from cuts to the corporate income tax rate in the United States. This is the fastest growth rate for earnings in eight years.

S&P 500 Price

Source: Bloomberg

Bonds fared well in 2017 as key rates spent much of the year below their starting points, supporting low single digit returns across most indices. In 2018 rates were largely on the rise. From a starting yield of 2.40% on the US 10-year treasury, rates peaked at 3.24% in November and closed the year at 2.68%. As a result, bond returns were either flat or negative in 2018.

US 10-Year Yield



Source: Bloomberg

Throughout the year, but particularly in the 4th quarter, investors became increasingly anxious about the prospect of a recession, reacting sharply to any data point or headline that could signal a slowdown. Key sources of angst included Federal Reserve Policy and US/China trade negotiations among others.

Federal Reserve

The Federal Reserve accelerated the pace of rate increases to once per quarter in 2018 following three hikes in 2017 and one hike in 2016. Generally speaking, rate increases, or other approaches to tightening monetary policy, can be an indication of economic health for a Fed tasked with maintaining a balance between full employment and target inflation of approximately 2%. However, investors are concerned that continued rate hikes will cause economic growth to stall.

At the December meeting, the Federal Reserve raised benchmark interest rates 0.25% (bringing the range to 2.25%-2.50%) and lowered the median projection for 2019 rate hikes from three to two. In addition, Fed Chairman Jerome Powell indicated that the Fed would stand firm on plans to allow bonds to roll off of its balance sheet (considered tightening), and noted that the Fed will react to financial conditions (market volatility) only if/when they were to impact the actual economy.

We make two key observations. First, despite an acceleration in rate increases, real interest rates remain near zero (after inflation) and would remain historically low even at the Fed's projected long-term rate of 2.75%-3.00%. It seems unlikely that real interest rates of 0%-1% would trigger a recession. Second, while we acknowledge that potential missteps by the Fed present a risk, we believe the Fed is operating with a disciplined focus on the dual mandate, despite criticism received from some observers.

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Trade Policy

Evolving U.S. trade policy and its reception by trading partners introduced uncertainty and fears of an all-out trade war between the U.S. and China in 2018. Early in the year, the Trump administration announced tariffs on steel and aluminum as well as plans for a 25% tariff on up to $50B of goods imported from China specifically. In response, China's commerce ministry proposed reciprocal tariffs on $3B of imports from the U.S. By late September, the US announced that a 10% tariff on $200 billion worth of Chinese goods would go into effect by the end of the month, increasing to 25% by the end of the year. Further, the Trump administration threatened tariffs on an additional $267B worth of imports if China were to retaliate, which it promptly did. So far, China has either proposed or implemented tariffs on $110 billion of U.S. goods, representing most of its imports of American products.

On December 1, Trump and China's Xi Jinping agreed to a truce, prompting the White House to delay for 90 days the tariff increase from 10% to 25% on $200B in annual imports from China. The agreement called for talks to get underway in earnest in January and postponed the increase until at least March 1. A U.S. delegation is expected to meet with Chinese officials in January to hold talks, but what comes after that is unclear. The moratorium could be extended if the two sides are making progress in negotiations, though to date the dialogue has proven more unpredictable than not.

Recession Monitor – Data Suggest Not in 2019

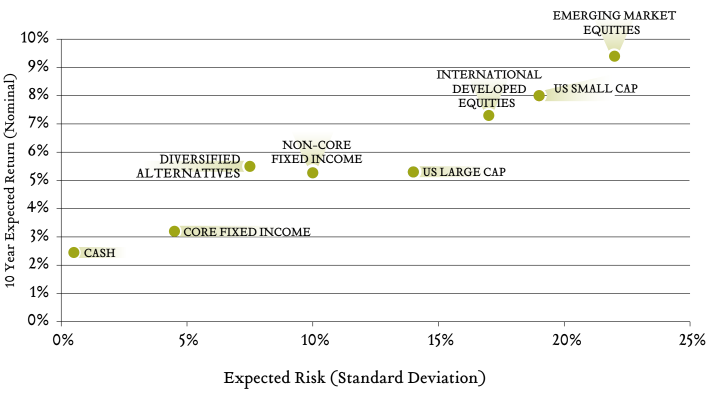
We expect the implications of Fed policy and global trade negotiations to continue to carry significant influence as we head into 2019. From our perspective, both have the potential to compromise what is an otherwise healthy economic backdrop today. Indeed, as we evaluate the economic data, it is hard to argue with 3.9% unemployment, 2.0% real retail sales growth, and strong corporate profits benefitting from muted wage inflation and favorable pricing of commodities.

All in, real US GDP will likely have grown 2.9% in 2018, up from 2.2% in 2017 and 1.6% in 2016. It would be unrealistic to expect the economy to sustain 3.0% growth in 2019, which by definition, means that we expect growth to slow this year. Specifically, we believe real US GDP growth will decelerate to something on the order of 2.0%-2.5% - slower than 2018, but not unhealthy and far from a recession. Looking to 2020 and beyond, the risk of an economic recession begins to rise as we are late in the business cycle.

Capital Market Assumptions

As for the market experience going forward, we share our updated capital market assumptions below. Our forecasts represent our expectations for average annualized returns for each asset class over the next ten years. Over the next decade, there will be years where returns exceed our expectations and years where returns trail our expectations. We believe any attempt to pick and choose which years to participate is a fool's errand. Said another way, we encourage our clients to stay disciplined in a year like 2018 so as not to miss out on a year like 2017.

Long-Term Capital Market Assumptions



Source: Greenleaf Trust

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Asset Class	10 Year Expected Return (Nominal)	10 Year Expected Risk (Std Dev)
US Large Cap	5.3%	14.0%
US Small Cap	8.0%	19.0%
Developed International Equities	7.3%	17.0%
Emerging International Equities	9.4%	22.0%
Core Fixed Income	3.2%	4.5%
Non-Core Fixed Income	5.3%	10.0%
Diversified Alternatives	5.5%	7.5%
Cash	2.5%	0.5%

Source: Greenleaf Trust

Overall, we recommend most of our clients hold a full weight to global equities in accordance with their individualized risk profile, and we remain marginally more constructive on international equities. Concurrently, we are less enthused by the outlook in fixed income markets and believe a modest underweight in favor of an allocation to diversifying strategies (alternative assets) is prudent at this juncture.

Despite an ever-changing landscape, our disciplined approach and long-term orientation serve us well in our quest to create comprehensive investment solutions that help our clients reach their financial goals. Investment decisions are made in alignment with our documented investment philosophy and always with the intention of serving our clients' best interests. On behalf of the Research Division, I wish you all a safe and prosperous 2019.