GREENLEAF TRUST

Perspectives

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William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary

There certainly has been a great deal of economic news lately, most of which revolves around the issues of trade deficits and tariffs. It makes sense to spend some time talking about these related topics, but first, we should examine the state of the current economy.

The first quarter's GDP growth of 2018 could best be described as moderate with solid expansion in employment and continued inflation adjusted growth in consumer spending as well as incremental advances in wage growth. Moderate first quarter GDP growth has been missing during the past six years and was explained away by weather disasters and other factors that bordered on excuses rather than data driven reasons. Consumer, as well as small business confidence, remains at high levels suggesting that the conditions that drove moderate economic activity in the January through March timeframe continue to be in place.

Consumer spending rebounded in February from the decline registered in January and is now tracking at a 1% year over year advance rate adjusted for inflation. While it is not unusual to observe some monthly and even quarterly unevenness in economic data, we do note that Q1 of 2018 consumer spending will fall well below the fourth quarter of 2017 level of +4%.

Inflation adjusted wage growth grew incrementally during the quarter though specific in-demand skill sets and geographically labor pool challenged areas showed stronger than average wage increases. Labor turnover rates increased during the period reflecting the "moving up" phenomena that evidences itself in fuller employment cycles. Employers become more aggressive in recruitment by offering sign-on bonuses and other benefits to lure the existing employed to new and better-paying jobs. While these moves don't impact average hourly wages, the employment moves for those accepting the positions do result in higher discretionary income, and therefore, more confidence and greater spending.

Average duration of unemployment and U-6 unemployment both registered progress during the quarter as unemployment was last reported at 4.1% while U-6 unemployment was measured at 8.2%. Both measures are nearing 20-year lows, suggesting that further progress in both categories will be harder to achieve. The gap between both measures is also at levels achieved during

Commentary, continued

"full" employment cycles which are normally recorded during strong economic growth periods.

Housing data, as well as the manufacturing and non-manufacturing purchasing managers index, pulled back slightly, but were still at the levels of moderate growth rates. Auto sales came in above the consensus expectations. In the categories that are most telling — employment, wage growth, consumer confidence, consumer spending, small business confidence and Purchasing Manager Index — the quarter is shaping up to be very solid, and momentum is in place for sustainability.

"As you can imagine, I have had quite a few questions from clients about deficits as a result of the President's bully pulpit messages about trade and tariffs."

Of course, sustainability requires that conditions don't change. The recent hyper focus on trade, trade deficits and tariffs gives rise to the notion that conditions could change. It is good to remind ourselves that consumer confidence drives economic activity. Consumer confidence is all about expectations of the future set of conditions. What can drive either increased or decreased expectations of the future? Beyond employment and the employment of those around you, consumers tend to focus on prices and personal economic conditions. Simply put, is it getting better or worse for me as well as those around me? If it is getting better, I act accordingly, buy more and save less. If my conditions aren't improving, I do the opposite.

As you can imagine, I have had quite a few questions from clients about deficits as a result of the President's bully pulpit messages about trade and tariffs. Political theatre is separate functionally and intellectually from reality, yet it is naive to think it does not matter. The following is what I have come to know of economic theory and data analysis over the past 35 years.

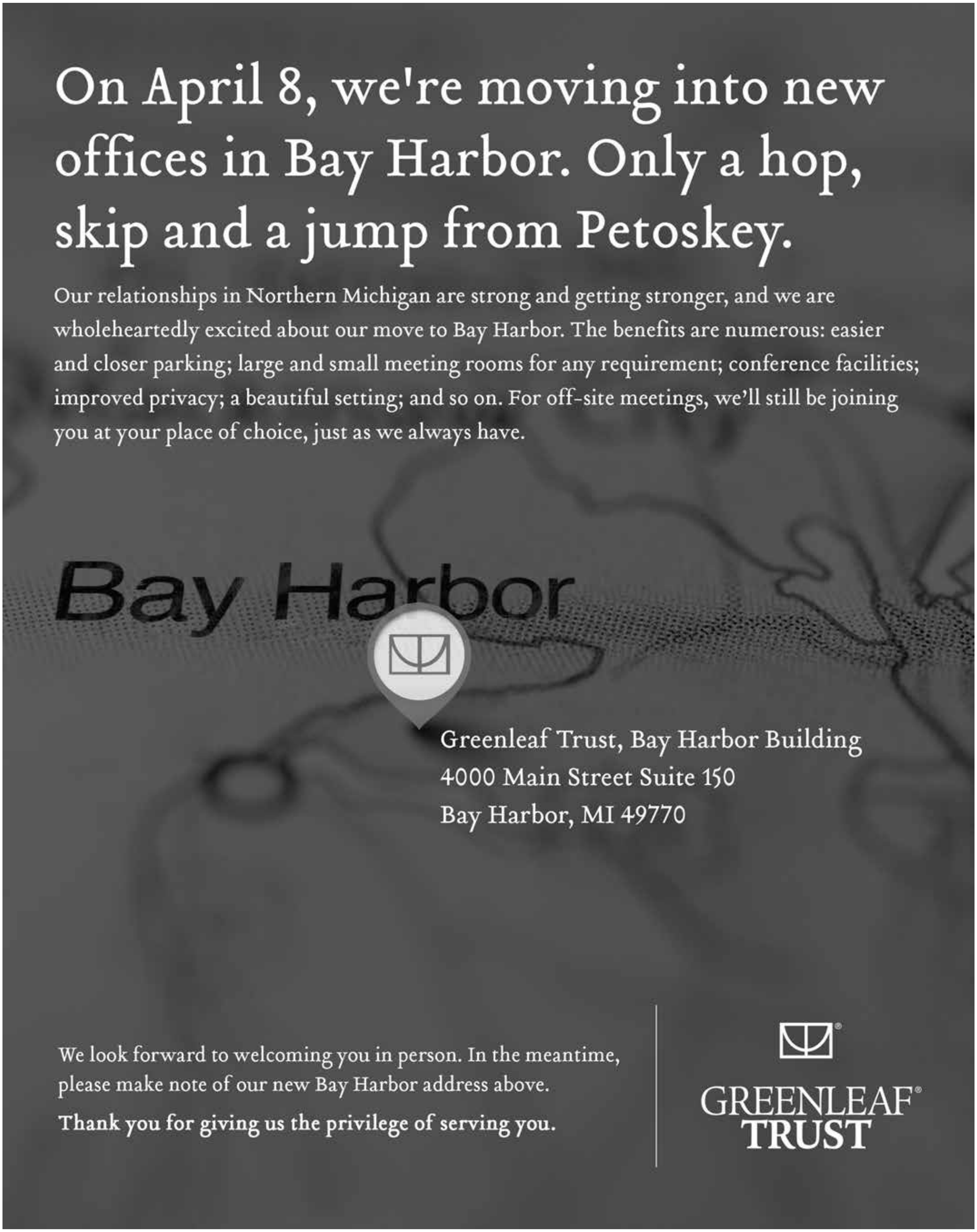
DEFICITS: There are several, but the one that we should be most concerned with (fiscal budget) is the one we hear almost nothing about yet has the most to do with our economic and national security in the long run. Trade deficits are now the deficit that those orchestrating political theatre have on center stage, so let's try to add some clarity to the discussion.

For any nation, a trade deficit with a trading partner occurs when you import more goods and services than you export to that partner accounted for in the currency of the country in question, in our case dollars. For every dollar we import into our country, a dollar is paid to that trading partner and is accounted for as such. Conversely, for every dollar we export to a trading partner we receive a dollar in return and it is accounted for as such. The difference between the two will result in either a trade deficit or surplus. A country's total trade deficit will be the aggregation of all of its trading partners, and again, the calculation of all trading will either result in a surplus or a deficit in total trade. China is our largest trading partner, followed by Canada and then Mexico, and China represents the largest portion of our trading deficit, though currently both Canada and Mexico also maintain a surplus trade gap with the US.

The dollar amount of the trade gap has grown substantially over the past two decades; however, we must account for the aggregate growth of our GDP as well as the growth of total global GDP. It is easy and unfortunately common for politicians attempting to perpetuate an ideological view to speak in terms of aggregate dollars. It makes their argument, or point, seem noteworthy and more critically important. Our current aggregate trade deficit is projected to be nearly $700 billion in 2018. Isolated, that aggregate number seems huge, and therefore, seemingly bad. When that same politician rails on that the trade deficit is the highest it has been in nine years, it implies a sense of urgency to do something about that condition. If we ask a few questions, we might gain some perspective. What is the size of our total GDP? The answer is that in 2018 US GDP will be approximately $20 trillion. As a percent of GDP, has our trade deficit grown dramatically over the past twenty years? No, our long term average trade deficit as a percentage of GDP has remained at 2.5%, and has ranged between 1.8% and 3.4% depending upon strength of the US economy. Currently, our trade deficit is forecasted to be within the upper end of that historical range. Why are we at a nine-year high in our trade deficit? Trade deficits are highly correlated to the economic activity of the trading partners. When the US has experienced recession, our trade deficits shrink, and when our economy grows, our deficits expand. Simply put, trade is a function of supply and demand. When a country cannot meet the supply demanded by its consumers, that supply will be met by imported goods and services.

When countries such as China export greater amounts of products to our country, is that bad for the US? The answer is both yes and no. Let's take the Apple iPhone as an example. Many in the US assume that the Apple iPhone is manufactured in China and exported to the US. That assumption is only partially true. There are seventeen components of the iPhone that are necessary to complete the production process, only four of which are completed in China. The remainder are completed in the US with product components that are manufactured inside as well as outside our country. The device's design, engineering, intellectual property, research and development, marketing and logistical sales distribution are all dominated by US operations. The aggregate US GDP that results from the total scope and breadth of the iPhone device far outweighs the trade deficit contribution accounted for in the importing of the partially completed iPhone when it passes through our country's borders. The same could be said for many products conceived, designed, engineered, produced, marketed and sold by US companies that utilize components manufactured and partially assembled in other countries.

The point of the iPhone illustration is that in a global economy the trade deficit analysis is reported in archaic fashion that often misses the total economic impact, because we account for imports and exports the same way we have for decades. Political theatre and demagoguery will have some believe trade deficits are always bad, or perhaps never bad — when the real story is that they can sometimes be both — but they are, at their core, tied to global consumer demand, which changes rapidly, and therefore, is responded to rapidly. The digitization and technology transfer of the global economy is powerful and real and cannot be the proverbial genie to be put back in the bottle. Tariffs don't change consumer demand, but they can slow it by making products more expensive and exports less competitive. Tariffs have never saved industries whose global demand for their products fell due to pricing, quality or innovation. Does that mean governments can't and shouldn't be vigilant of trade policy? Absolutely not. Trade policy should not isolate or disadvantage a country's own commercial universe, and trade policy should also not penalize segments of that universe while simultaneously benefiting others.


On April 8, we're moving into new offices in Bay Harbor. Only a hop, skip and a jump from Petoskey.
Our relationships in Northern Michigan are strong and getting stronger, and we are wholeheartedly excited about our move to Bay Harbor. The benefits are numerous: easier and closer parking; large and small meeting rooms for any requirement; conference facilities; improved privacy; a beautiful setting; and so on. For off-site meetings, we'll still be joining you at your place of choice, just as we always have.
Bay Harbor
Greenleaf Trust, Bay Harbor Building
4000 Main Street Suite 150
Bay Harbor, MI 49770
We look forward to welcoming you in person. In the meantime, please make note of our new Bay Harbor address above.
Thank you for giving us the privilege of serving you.
GREENLEAF® TRUST

Human Capital: The Soft Side of Estate Planning

George F. Bearup
Senior Trust Advisor

Estate planning is much more than signing a will or a trust, or making lifetime transfers of assets to reduce the size of an individual's taxable estate. Estate planning is usually viewed as the transmission of wealth, dealing with what and when wealth is transmitted with the least amount of disruption (e.g. probate or estate taxes). The soft side of estate planning focuses on the sudden impact of inherited wealth on the beneficiaries of an estate plan and their ability to cope with the responsibilities that go along with that inheritance. This soft side is frequently reflected in trust provisions that are intended to change the behaviors or the values of the trust beneficiaries, using the inheritance as a reward for acceptable behaviors, or the direction to withhold the inheritance as a form of punishment for bad behavior or to induce behavioral changes. Sadly, all too often those beneficiary behaviors that the decedent's estate plan either fears, or hopes to modify, are so entrenched that carrot-and-stick provisions in a will or trust will fail to address the root of the behavioral problem.

The goal of estate planning should be far more than signing a will or trust to transmit wealth with the mitigation of taxes or to avoid the expense and publicity of probate. Estate planning should also be about enabling the beneficiaries of an individual's wealth to find fulfillment in life and peace of mind. Unfortunately, we seem to live in an era when many family members feel that they are entitled to an inheritance. Yet at the same time these family members do not possess the ability to appreciate, let alone competently manage, what they will receive as an inheritance. This often manifests itself in the parents' concern that their children who inherit their wealth will become unmotivated, continue with immature lifestyle decisions, and possibly continue to live with low self-esteem. Those parents understand that leaving too much wealth too quickly can rob their children of their own identity and self-worth, confirming the famous Andrew Carnegie quote: "The parent who leaves his son enormous wealth generally deadens the talents and energies of the son and tempts him to lead a less worthy life than he otherwise would." [Carnegie, The Gospel of Wealth and Other Timely Essays, The Century Com. (1900).]

> "Estate planning should also be about enabling the beneficiaries of an individual's wealth to find fulfillment in life and peace of mind."

What often is lacking in the wealth that is to be inherited by the next generation is human capital. Human capital is often defined as the collective skills, knowledge and other intangible assets of individuals, such as habits, personality attributes and creativity that embody the ability to perform in the world to provide economic value, that is, skills and experience unique to that individual. An estate plan should consist of far more than transmitting

The Soft Side of Estate Planning, continued

tangible assets and investments to family members. A successful estate plan should also be viewed as the transfer of human capital wealth — meaning values, skills, and life experiences — to family members and more remote heirs. Human capital also includes the transfer of learning skills, knowledge, and experience that prepares the next generation of family members to perform in the world to produce economic value both for themselves and for others.

The transmission of human capital is not a 'one and done' task, but a journey over a lifetime, with the goal to teach family members to understand the responsibilities associated with ownership of wealth. It means establishing a dialogue among family members about wealth, involving family members in philanthropic plans, and possibly involving members even at a young age in the operation of the family business. The goal is to engage the younger family members in what is decision-making which provides the opportunity for those younger family members to gain human capital from the previous generation through exposure before it is too late. Transferring human capital does not merely take place on the death of senior generation member with conditions or incentives buried in their will or trust that attempt to modify the behaviors of their heirs. It is a lifelong endeavor that prepares the next generation to appreciate the wealth that they will inherit and to fully understand the responsibilities that go along with that wealth.

"... do the younger generation family members possess the needed skills, the experience or exposure to decision-making, i.e., the human capital, to deal with those challenges when they arise?"

When the development of human capital is ignored, the challenges that confront children on the death of their parents can be overwhelming. Family conflicts and sensitivities will always be present in any family, but often childhood resentments and sibling rivalries come 'out of the closet' after a parent's death, while other children (or grandchildren) maintain "scorecards" of who got more when their parents were alive, who demand that disparity be rectified from the parent's estate plan, regardless of the plan's terms. Emotions beyond the grief over the death of a parent cloud judgments and often lead to bad decisions. Thus, it is highly unlikely, given these circumstances, that an incentive trust or a conditional gift that attempts to change a beneficiary's behavior will be well received. The development of human capital, which manifests itself in maturity and respect for others, can go a long way to overcome these emotional responses on the death of a parent.

Thus, the question is: do the younger generation family members possess the needed skills, the experience or exposure to decision-making, i.e., the human capital, to deal with those challenges when they arise? Estate planning documents like wills and trusts cannot make family members respect one another, nor can those documents make heirs happy and satisfied with what they will, or will not receive, as an inheritance.

While trusts can be drafted to incent behavioral changes in trust beneficiaries, all too often the trust is viewed with resentment or with the erroneous conclusion that the parent did not love or respect the child-beneficiary equal to their siblings. Incentive trusts and conditional bequests, while attractive in theory, often backfire and become counter-productive and produce the wrong emotions and reactions. Conditional bequests to heirs, or incentive trust provisions, are usually too late to accomplish much other than cause more resentment.

Education and preparedness that lead to the development of human capital in beneficiaries needs to start at an early age. While it is never too late to expose family members to the required skills and maturity to deal with wealth and its responsibilities, it may be too late if those family members are already well into their adulthood. Better to start them young. And most important of all is for parents to start the process of investing in human capital by leading by example in their daily lives. Children learn important values when they observe how their parents function, make decisions, and display informed judgment in the most basic decisions of everyday life. Exposing children and young family members to how decisions are made with regard to the management of wealth, and equally important why a decision was made, cannot be underestimated in the development of their human capital.

The success of an estate plan is dependent upon the existence of the beneficiaries' human capital to manage and fully appreciate their good fortune to receive an inheritance. The role of human capital in an estate plan enables the next generation of family members to become self-sufficient, productive, grateful, self-fulfilled, and loving members of a cohesive family unit. Only then will the financial inheritance that they receive be put to productive use for their lives and the lives of others. This soft side to the estate planning process is often overlooked. A family's human capital can appear in a family mission statement, in an ethical will, or in a legacy letter that explains not only personal values but the parents' life lessons, which can help to explain to the next generation why or how the decedent chose to leave his or her assets. Human capital, the hidden asset, starts with the family identifying and transmitting its intrinsic values, not with the attorneys who draft the estate planning documents.

"The success of an estate plan is dependent upon the existence of the beneficiaries' human capital to manage and fully appreciate their good fortune to receive an inheritance."

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Nicholas A. Juhle, CFA
Vice President
Director of Research

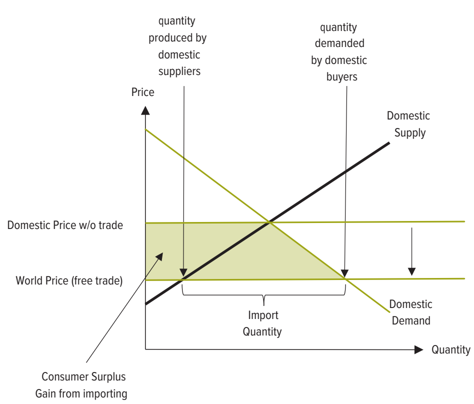
"From an economic perspective, tariffs make imported goods more expensive, and therefore less attractive to consumers. In turn, demand for domestically-produced substitutes should increase."

On Tariffs and Trade Policy

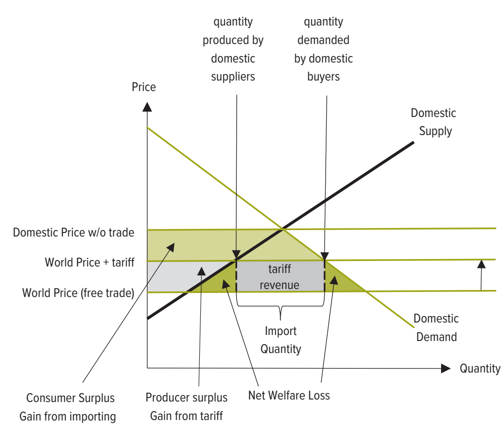
The first quarter of 2018 was exciting if nothing else. Stock market strength in January was followed by a correction in February sparked by inflation concerns and monetary policy uncertainties. Stocks rebounded into March until tariff announcements from the White House and speculation over a possible trade war pushed markets lower again. Evolving U.S. trade policy begets uncertainty and could have far-reaching implications for the global economy. We believe the probability of an all-out trade war remains low at this time, but offer some perspective on the recent announcements and their potential implications.

In recent weeks the Trump administration announced tariffs on steel (25%) and aluminum (10%) imported from around the globe, with temporary exemptions granted to a handful of trading partners including Canada and Mexico. The administration also announced plans for a 25% tariff on up to $50B of imported Chinese goods. In response, China's commerce ministry has proposed reciprocal tariffs on $3B of imports from the U.S. Based on their magnitude and scope, these measures represent more aggressive trade posturing and a departure from international norms established in recent decades.

Governments typically impose tariffs to raise revenue or to protect domestic industries and jobs from foreign competition. The Trump administration is citing national security as the grounds for the tariffs imposed on industrial metals — protecting domestic steel and aluminum industries because our defense capabilities depend on their health. Tariffs can also be used as an extension of foreign policy as a means of exerting economic leverage. In this vein, the Chinese tariffs were levied in response to a seven-month investigation into intellectual property (IP) theft – a longstanding point of contention in US-China relations. Here, tariff proceeds (approximately $12.5B) are viewed by the administration as compensation for the alleged IP violations.



Free trade generates value (surplus) for consumers



Tariff creates net welfare loss

From an economic perspective, tariffs make imported goods more expensive, and therefore less attractive to consumers. In turn, demand for domestically-produced substitutes should increase. Higher prices translate to lower sales volume for foreign producers, or lower profitability if they can absorb the added cost of the tariff. This interference with what would otherwise be considered free trade results in an economic inefficiency known as “net welfare loss” or “deadweight loss.” Benefits to domestic producers (more volume, higher prices) and the government (tariff revenue) do not offset the reduction to consumer surplus otherwise supported by free trade.

While their use can be tactical and targeted with specific intentions, tariffs can also cause a range of negative side-effects. For example, tariffs can:

- Reduce competition making domestic industries less efficient
- Increase prices and degrade purchasing power for domestic consumers
- Create tension (even at home) by favoring certain industries and/or regions over others

Perhaps most importantly, global tensions and retaliatory responses from trading partners can quickly escalate into a counterproductive policy exchange or trade war. Taken to an extreme, higher prices and reduced demand for goods and services can erode global GDP growth, perhaps contributing to a global economic recession and/or market downturn. Speculation about this type of escalation is likely the reason investors responded so strongly to recent announcements from the Trump administration.

As observers of the economy and markets, we prefer the economic efficiency of free trade, though we acknowledge the rationales provided for these specific tariffs. The economic impact of the announced tariffs should be modest, as many of our important trade partners are exempted, and the initial scope is small relative to our overall trading relationship with China. We think the likelihood of escalation into a full-fledged trade war remains low, though the risk of such an outcome is elevated amidst an evolving stance on trade policy and dynamic relationships with global trading partners.

“This interference with what would otherwise be considered free trade results in an economic inefficiency known as ‘net welfare loss’ or ‘deadweight loss.’”

Achieving Success in a Family Business Succession

Daniel L. Baker, J.D., CTFA
Vice President
Director of Business Development
Trust Relationship Officer

"... only 30% [of family businesses] actually make it to the second generation, only 12% to the third generation and only 3% to the fourth."

Owners of family businesses will one day exit their businesses. As sure as death and taxes, it is one of life's certainties. Another certainty is that business owners have the power to heavily influence how that exit happens. Nonetheless, many business owners fail to exercise that power in what might be considered a successful way.

If a business has value which outlives its founder, there will be a "business succession" in some form when the business ownership changes hands. Succession is defined as "the coming of one thing after another in order, sequence or in the course of events." Success, on the other hand, may be defined as "the accomplishment of one's goals." As you can see from the definition of succession, it can happen in a planned and orderly manner or be purely serendipitous. A successful succession, however, is by definition one tied to the current owner's goals. So, how should a family business owner maximize the chances that the business will transition to new ownership in an orderly way consistent with the owner's goals and objectives? The simple answer to a more complex question (and process) is to have a plan. We'll talk about obstacles to creating a successful plan, how to overcome such obstacles and the building blocks of an effective plan in the paragraphs below, but let's first look at the findings of some widely cited studies to provide context:

- In the United States, there are about 24 million family businesses. These account for over 89% of all business tax returns, employ 62% of the workforce and generate 64% of annual gross domestic product.
- Well over half (56%) of family businesses in the US are expected to experience a leadership change in the next ten years as baby boomers retire.
- Over two-thirds of small business owners in a Wilmington Trust survey acknowledged that it is important to have a business succession plan as they approach retirement. However, almost 60% of small business owners do not have such a plan.
- While approximately 50% of family business owners want to keep their business "in the family," only 30% actually make it to the second generation, only 12% to the third generation and only 3% to the fourth.

Given these sobering statistics, one wonders what is keeping family business owners from creating succession plans. When business owners are surveyed on why they do not have such plans, the number one answer is "time." Other reasons given include: that it is too early to plan for succession, that they can't find adequate advice or tools to start, and that such planning is too complex. There are also the emotional and psychological issues around the owner's mortality and fear of conflict with family members and employees which create inertia.

To ultimately devise a transition plan with a high probability of success, it is helpful to gain a better understanding of why transitions often fail. Roy Williams and Vic Preisser studied 3,500 wealthy families over a 20-year period to identify what differentiated those families who successfully navigated intergenerational transitions from those that did not. The results published in Preparing Heirs, a leading authority on the topic, identified four primary factors which led to failures: breakdown of communication and trust within the family unit (60% of failures); inadequately prepared heirs (25% of failures); absence of a clear vision or mission to align family members (12% of failures); and failure by advisors to correctly interpret or anticipate taxation, governance and wealth preservation issues (less than 3% of failures). While the study focused on the transitions of family wealth generally, the findings may be extrapolated to family business transitions.

So if we know what leads to failure, what are those best practices utilized by families and family owned businesses which lead to successful transitions and can provide the framework for a successful succession plan? Here are six (6) tried and true practices:

"So if we know what leads to failure, what are those best practices utilized by families and family owned businesses which lead to successful transitions...?"

1. Start the Process Early

Many professional advisors recommend starting the succession process no less than three years before the anticipated transition. Others adopt the Steven Covey (*The 7 Habits of Highly Effective People*) approach and suggest "beginning with the end in mind"—a belief that an exit strategy should be contemplated in an initial business plan. Given the enormity of the task and the countless moving parts that go into a successful plan, the clear takeaway is that the plan should be started as soon as is practicable.

2. Create and Articulate the Vision

Vision is a long-term concept that lays out where the business intends to be in the future. It almost always comes from the top, be it from the founder or current owner. A clearly articulated vision statement provides long-term guidance to everyone in the organization and the family. It can also serve as the family's North Star when disagreements arise over any of a multitude of issues surrounding the business transition.

Family Business Succession, continued

3. Enlist Experienced Professional Help

Given the historically high probability of an unsuccessful transition and the consequences of that, it would seem to that no one should try to transition a business without professional help. Unfortunately, that is not the case. Many family businesses change hands after the premature death or disability of the owner without having put a plan in place. Other businesses are sold for far below optimal values because no plans were in place for the viable continuation of the business. An experienced advisor can assist in ensuring that the owner's goals and objectives are carried forward in a detailed succession plan. Such a plan will ensure that the legal and tax structures are consistent with the owner's wishes and provide for the owner's retirement needs. In many cases, a skilled advisor will also be invaluable in serving as a facilitator to help lead family discussions throughout the process.

> "Given the historically high probability of an unsuccessful transition and the consequences of that, it would seem to that no one should try to transition a business without professional help."

4. Get All Stakeholders Involved in the Process

Perhaps the toughest (and likely most emotional) decisions to make in the succession process is who will own and lead the business going forward. If there are no family members with the interest or aptitude to run the business, a decision must be made to either sell the business or bring in outside management. These decisions should ultimately be made after discussions with family members (both those actively involved in the business and those who anticipate future benefits from it) and key management personnel. These are often tough conversations due to complex emotional issues involved in transitions. Whatever the future ownership and management decisions, it is imperative that all stakeholders are as engaged as possible in the ongoing process and fully apprised of the resultant decisions.

5. Formalize the Succession Plan as Part of the Ongoing Business Plan

Ultimately the succession plan should become part of the business plan. The plan should outline who is going to do what and when. Oftentimes founders look for a single successor or "heir apparent" to replace them, when in reality there is no single person capable of stepping into the oversized shoes of the founder. In these cases, a governance structure might involve multiple people fulfilling different roles within an integrated framework. Such a system does not result from happenstance and takes time to put into practice. As with business plans, succession plans often get relegated to the back burner under the crush of day-to day business operations. Business owners may struggle with the emotions of leaving their life's work and such feelings usually result in a desire to maintain control. When this happens it is difficult to effectively train next level leaders and provide them meaningful opportunities to grow into their future roles. A successfully implemented plan will almost always include expressly stated timelines and tasks to ensure new leaders are ready to assume their new roles when the transition takes place.

6. Communicate, Communicate, Communicate

As stated above, a breakdown of communication and trust within the family is the culprit in 60% of intergenerational family wealth transfer failures. It is not easy to deliver a message to a family member that his or her ongoing role in owning and managing the family business is not what they hoped or expected it to be. For many family members, the business is part of their identity or even a perceived birthright. If the role of those members is going to change, it is best to address these matters as soon as possible. Conflict often arises when family, money, ego, self-worth and entitlement issues all intersect. However, open and ongoing discussions allow for dialogue which can help resolve conflict and build trust in the process.

With appropriate time, vision, discipline and communication, family business owners can beat the odds and ensure that success is paramount in a business succession.

> "Oftentimes founders look for a single successor or 'heir apparent' to replace them, when in reality there is no single person capable of stepping into the oversized shoes of the founder."

Nicole E. Asher, CFP®, CPWA®, ChFC®
Vice President
Senior Wealth Management Advisor

What Would You Like on Your Sandwich?

According to legend, the sandwich dates back to the 1700s and was named after The Earl of Sandwich. As the story goes, The Earl was a bit of a gambler who hated to be bothered to leave the card table for the dinner table. He instructed his staff to make him something that he could eat with only one hand, so he could continue to gamble. He was thrilled to enjoy a slice of meat between two pieces of toast and, Voila, the sandwich was born! More recently, the word sandwich has taken on another meaning in the form of the Sandwich Generation. The Sandwich Generation is made up of people, like myself, who care for their parents and their children and are "sandwiched" between them.

> "The Sandwich Generation is made up of people, like myself, who care for their parents and their children and are 'sandwiched' between them."

As a member of the Sandwich Generation, I am responsible not only for the support of my two sons, but also for the daily care of my 93-year-old father. I am fortunate to share this responsibility with my siblings, and my dad loves the change of scenery as he travels between our homes. He also loves to embarrass us all by telling anyone that will listen that he "sleeps around" and is "homeless." Caring for an elderly parent, in my opinion, is more challenging than that of a toddler, especially if the parent is no longer able to live independently. Taking care of my dad requires me to act as his bookkeeper, nurse, counselor, chauffer, maid, day care provider, chef, and, most importantly, social director. My kids are easier; for them I am simply therapist and banker. I need to sometimes be there to listen, but always need to have my checkbook ready. Sounds like a bunch of bologna, right??

For many families, becoming a "sandwich" can take a toll on their finances, time, health, and career. The Sandwich Generation is having to financially care for three generations, all at the same time. On average, 48% of adults are providing some sort of financial support for their grown children and 25% are financially supporting their parents as well.

Your retirement can also be thought of as its own sandwich. Like a BLT, your "retirement sandwich" can't exist without the key ingredient of bacon. For your retirement, your contributions are the bacon. Lots and lots of bacon!!! It is important that we not neglect our own retirement savings as we care for our loved ones. With lifespans increasing, the risk for outliving our retirement nest egg is real. Because of this, we, as the Sandwich Generation, need to avoid neglecting our own retirement. Maxing out retirement plans is a great start. If you can't max it out but have an employer match, take advantage of this at the bare minimum as this is "free money." Like they say on airplanes, "put your oxygen mask on first before assisting others." While it is a difficult decision to make, be sure to fund your own retirement before providing additional support for your parents or adult children. Additionally, under no circumstances should you raid your retirement funds. I've heard many times of parents pulling money from retirement funds to help their kids buy a home; sometimes even paying a penalty to do so. This never makes sense. This might tug at your heart strings, but know that the only person who can save for your retirement is you. If you need to, trim a little fat out of the sandwich: take fewer vacations, buy cheaper cars, downsize your home, etc. Scaling back on current expenses to save for retirement can turn a nest egg salad sandwich retirement into a Monte Cristo retirement. On that same note, if your children are younger, and you want to start a college fund, again don't do this at the expense of your own retirement. Fund your retirement first, and their college second.

It is critical to have an open dialogue about finances with both your parents and children, especially adult children. For our parents, it can be difficult to open up about their financial health, as that generation is often guarded when it comes to money. We encourage our older clients to share their finances with children, whenever appropriate. Difficulties can arise when the senior generation's retirement is not properly funded or they require care that is depleting most of their savings. Have a conversation with your parents to find out where their income is coming from, what their expenses are, and if you will need to add a little extra mustard to make it more palatable. It's important to note that this may require some give and take on everyone's part. Your retirement may be delayed a year — be flexible.

"While it is a difficult decision to make, be sure to fund your own retirement before providing additional support for your parents or adult children."

Another difficult conversation we need to have with our parents and children is about estate planning. It's a tough conversation to have as you don't want to come across as wanting to know who gets mom's diamond ring and dad's gold watch, or for our children to think that our days are numbered. A well-orchestrated plan not only spells out our wishes for "who gets what" when we pass, but it also chooses an executor to carry out important tasks. It includes a delicatessen full of important documents such as wills, trusts, advanced health care directives, and medical and durable powers of attorney that are vital for everyone's peace of mind. It's not just about the money. It's important that we know our loved ones' wishes should they pass or become incapacitated.

Additionally, help your parents to consolidate accounts. Many older adults have a smorgasbord of accounts scattered across multiple financial institutions. Find out which ones they use most frequently and why and assist in consolidating. You would be surprised at the number of accounts your loved ones may have opened to earn an extra half percent of interest

211 SOUTH ROSE STREET, KALAMAZOO, MI 49007 269.388.9800

The Sandwich Generation, continued

and a free umbrella.

Some of us have parents who don't live nearby. Managing their care from a distance can be overwhelming. Researching organizations that specialize in elder care can be critical. Fortunately, the need has been recognized and there are many apps and services that can be used nationwide.

> "It's important that we know our loved ones' wishes should they pass or become incapacitated."

Sandwiches are a staple of the American diet, and while they may seem plain and mundane to some, others find them to be one of their favorite foods. In fact, the cover story of the March edition of *Bon Appetit* is dedicated to the art of building a better sandwich. As the Sandwich Generation, it's not all peanut butter and jelly, and it may feel like there is a panini press on your time and money. The best way to handle the stresses of the Sandwich Generation is to have a well-thought-out financial plan for you, your parents, and your children. It's important to plan ahead and not let the ice cream melt in your ice cream sandwich. That coupled with open-faced and honest communication will help create a sandwich worthy of the Earl of Sandwich.

Tax Acts Lead to Changes in Qualified Retirement Plans

Michelle M. Gray
Participant Services Specialist

Over the past few months, there have been two tax acts signed into law, the Tax Cuts and Jobs Act and the Bipartisan Budget Act of 2018, that contain provisions related to Qualified Retirement Plans ("QRPs").

Suspension of Contributions When Taking Hardships:

Currently, if a participant takes a hardship distribution, they are suspended from contributing to the plan for 6 months from the date of the distribution. Effective January 1, 2019, that suspension will no longer be in effect. A participant will be able to continue to make contributions to their plan immediately after their distribution.

Hardship Distributions Can Be Taken from More Sources:

Currently, when participants take a hardship distribution, they are only allowed to withdraw their accumulated contributions, not the earnings on their contributions. Effective January 1, 2019, participants will be able to withdraw the earnings on their contributions, as well as Qualified Matching Contributions and Qualified Non-Elective Contributions from their employers as well as earnings on those accounts.

> "...there have been two tax acts signed into law, the Tax Cuts and Jobs Act and the Bipartisan Budget Act of 2018, that contain provisions related to Qualified Retirement Plans."

The Hardship "Last Resort" Rule:

If a QRP allows for loans, current laws require a participant to take a loan prior to accessing hardship distributions. Because there was no reporting mechanism to enforce this rule, the new law eliminates this last resort hardship distribution rule. Therefore, loans are no longer required before a hardship distribution can be taken.

More QRP's Will Permit Hardship Distributions:

Currently, not all QRP's can permit hardship distributions. With the recent change in law, more types of QRP's will be authorized to permit hardship distributions.

Extending the Amount of Time Participants Have to Rollover an "Offset" Loan:

Beginning with distributions occurring on or after January 1, 2018, participants will have until the due date of their tax return (including extensions) to roll over a loan that has been offset. What does this mean? Under the old law, when a participant terminated with a loan outstanding and took a distribution without first repaying the loan, the plan would reduce (or

Changes in QRPs, continued

offset) the value of the participant's account by the outstanding loan and only distribute the net difference. The entire distribution, including the value of the loan offset, was taxable. If the participant wanted to roll over the account to avoid paying taxes, they could roll over the net cash payment and they then had 60 days to come up with additional funds equal to the outstanding loan amount and make an equivalent contribution to the rollover custodian of the loan value. Under the new law, the 60-day deadline for contributing the loan offset amount has been extended to the filing due date (including extensions) for the participant's tax return for the year in which the loan offset arises. This change only applies to loans that are being distributed. If a loan goes into default because no loan payment has been made within the default cure period (usually the end of the quarter that begins after the quarter in which the default arises), then the loan will continue to be treated as a taxable distribution to the participant.

"For tax years beginning after December 31, 2017, taxpayers are no longer allowed to reclassify a Roth conversion."

Roth Conversion Reclassifications:

For tax years beginning after December 31, 2017, taxpayers are no longer allowed to reclassify a Roth conversion. Under old law, individuals were allowed to convert a pre-tax account to a Roth account and pay taxes at the time of the conversion. If the individual later changed his/her mind, they had until October 15th of the year following the conversion to "undo" the conversion. Under the new law, the individual may no longer change their mind about this decision. If they transfer money from a traditional IRA to a Roth IRA or from a pre-tax contribution source in a 401(k), 403(b) or 457 retirement plan to a Roth IRA, they will not be allowed to "undo" that transaction.

I'm sure we will learn more about these changes as 2018 comes to a close. In the meantime, if you have any questions, please feel free to contact Greenleaf Trust's Participant Call Center at (866) 553-8400. We would be more than happy to answer any questions you have.

Technological Unemployment: Why Universal Basic Income is Being Considered

John Graham
Guest Contributor

A recent study by The McKinsey Global Institute [1] has projected that by 2030 as many as 800 million jobs worldwide will be lost to automation. Between 39 an 73 million of those jobs will be in the United States while China faces the prospect of losing up to 100 million jobs to technological unemployment. Of the US workers who face the prospect of unemployment from advancing technology, between 16 and 54 million can move to other jobs provided economic growth remains strong, labour market fluidity is increased, retraining and skills development is significantly increased and if income and transition support is available.

For some, the increasing pace of technological change is not a significant worry. Quite the contrary, in many respects it presents a huge opportunity for mankind. Automation has the capacity to make us more productive, free us from tedious repetitive labour and usher in a cleaner and greener world. However, just like globalization created more income equality globally at the expense of inequality in certain places, the Digital Revolution has the capacity to make our lives better at the expense of workers in certain sectors. The argument is that, just like in the Industrial Revolution, certain workers will be displaced, but will migrate to other sectors and find new jobs — some of which do not even exist today. Indeed, if you are a parent of older children, some of them may already have jobs which didn't exist 30 years ago.

"... the pace of change in the Digital Revolution is much faster than in previous eras of technological change."

The "it's just like last time" scenario misses some important points, however. First, the pace of change in the Digital Revolution is much faster than in previous eras of technological change. Second, the types of workers and skill affected are different as well. Third, the retraining of workers required is significant both in terms of scale and complexity.

In their book, *Race Against the Machines*, McAfee and Brynjolfsson tell the often-cited legend of the reward for the inventor of chess. Evidently the king of the country where the game was invented was so delighted that he offered the man anything he desired. The inventor requested that the king place a grain of rice on the first square of the chess board and then double the amount of rice on each subsequent square. The king was mystified by this request until it became apparent that this doubling would produce a mountain of rice the size of Everest on the last square.

Similarly, the authors point out that computational power in computers doubles each 12 to 18 months (Moore's Law). They cite 1958 (the dawn of the Information Age) as the first square on the chess board meaning that we are now only a little over halfway through the Digital Revolution. This calculation does not factor in

Universal Basic Income continued

quantum computing or artificial intelligence (AI). They also pointed out that in the recent past, teams of humans and computers working together were more effective at playing chess than programs like IBM's Deep Blue alone. The authors argued that humans and computers, working in teams toward problem-solving, might be one path forward. However, in the last few months, after their book was published, a computer using AI was, given only the rules of chess, able to teach itself the game and beat everyone and every program on the planet in four hours!

Given this pace of advancement and the global scale of change, it is reasonable to assume that the disruption to our economies due to technological advancement will not only continue, but increase in scope and impact.

This might be fine were it not that the kind of technological change we face is much different than workers faced in the 19th century. Then, change raised the productivity of lower-skilled workers (agrarian labours) and lowered the productivity of some higher-skilled workers (artisans).[2] Overall, average standards of living rose, but some highly skilled workers were worse off. Worst off of all were horses. In 1920, there were 20 million horses in the United States and by 1960 there were around 3 million. Horses, as a labour force, just disappeared.

"Technological innovation has raised the value of skilled workers and globalization has increased the rewards for their skills... Others, less skilled, have seen their employment replaced by machines and will continue to do so."

Coming back to the Digital Revolution, the technological change we face is skill-based technological change. Workers in "routine-intensive" occupations are being replaced by machines; indeed, whole occupations are being eliminated or reduced.[3] Technological innovation has raised the value of skilled workers and globalization has increased the rewards for their skills. Those involved in problem-solving, creative roles, working in unpredictable environments (health care, servicing jobs, gardeners, etc.) and abstract thinkers are increasingly valuable as workers. Others, less skilled, have seen their employment replaced by machines and will continue to do so. In fact, one could argue that the old division between labour and capital has become blurred. In the future, if robots and machines do most of the manual work, labour will be capital. Marx would be surprised!

If we accept that what we are facing is skill-based technological change, how does society prepare its unskilled labour for what lies ahead? On this, all observers are agreed. Training and retraining of workers needs to be increased in breadth and depth. However, as the McKinsey study points out, over the past few decades "investments and policies to support the workforce have eroded. Public spending on labor-force training and support has fallen in most member countries of the Organisation for Economic Co-operation and Development (OECD)." Yet, they continue: "Income support and other forms of transition assistance to help displaced workers find gainful employment will be essential." In today's political environment, such an uptick in spending on training seems unlikely, but as Walter Reuther is supposed to have said to Henry Ford II when showed shining new machines replacing workers, "will these machines buy your cars?." Indeed, the question is not just how we will employ people in the future, but how we will

Figure 3a: Share of Jobs with High Probability of Automation by Occupation's Median Hourly Wage

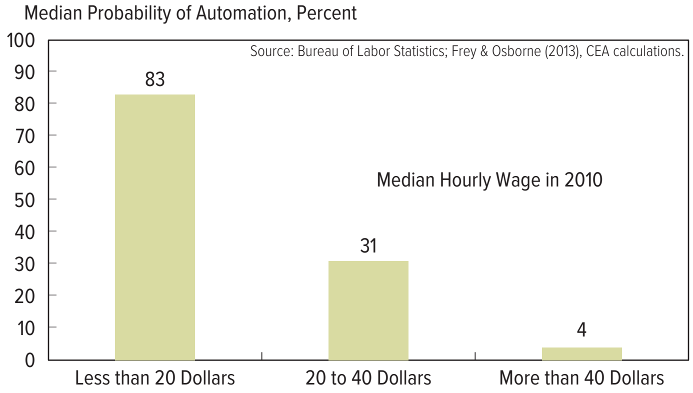
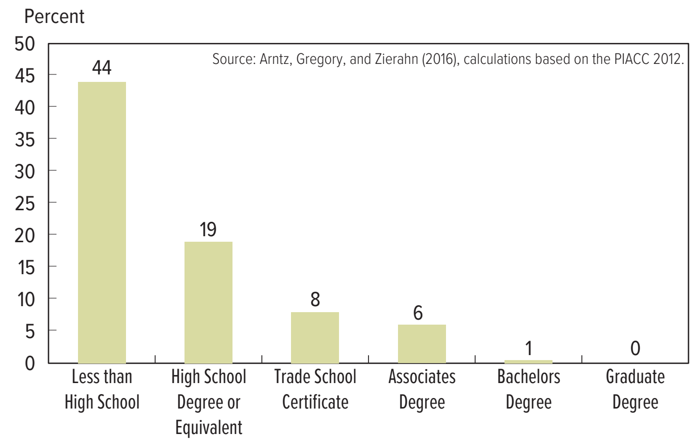


Figure 3b: Share of Jobs with Highly Automatable Skills, by Education



> "If we accept that what we are facing is skill-based technological change, how does society prepare its unskilled labour for what lies ahead?"

employ them with incomes large enough to buy houses, cars, cell phones, and flat screen TVs?

The idea of providing everyone with a basic income was first proposed 500 years ago by Sir Thomas More (*Utopia*). Universal Basic Income (UBI) is now, however, seeing renewed interest. Experiments on a worldwide basis, largely as a mechanism for supporting recipients while retraining to get back to work having become unemployed, are underway. Small scale programs have been tried or are underway in several different countries including Finland, Germany, Holland, and Canada. The state of Hawaii has recently passed legislation mandating that the State Government investigate how best to launch UBI reasoning that the state's largest industry, tourism, could be hit hard by technological change. The state of Alaska has, since 1982, run a program of giving a yearly dividend to each resident from the investment of oil revenues.

Proponents of UBI, defined as giving either everyone or a defined set of people in the economy a fixed amount of money, come from all parts of the political spectrum. Conservatives favour it because it has the potential to eliminate expensive, complicated and often politically charged bureaucracy, putting the

Universal Basic Income continued

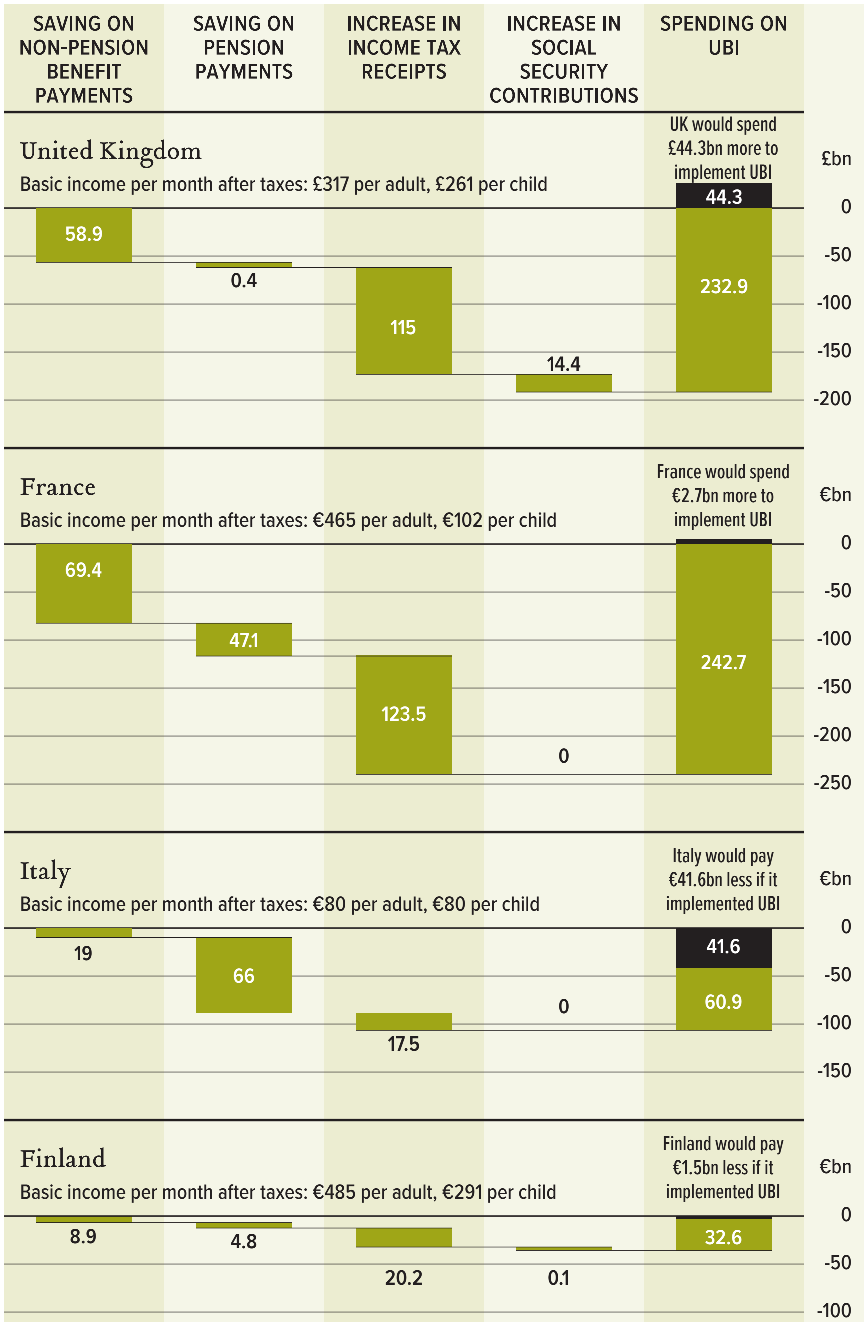
unemployed in charge of their own economic life. Liberals like UBI because it can help modify some of the harsher necessities of capitalism, i.e. the need for some to lose out in the process of creative destruction. Even Keynes argued for a type of UBI (pay people to dig holes) as a way of providing stimulus during economically difficult times. The key problem with universal basic income, however, is the cost.

Estimates for the cost of a universal basic income for all vary widely.

> "The idea of providing everyone with a basic income was first proposed 500 years ago by Sir Thomas More (*Utopia*). Universal Basic Income (UBI) is now, however, seeing renewed interest."

How Affordable is a Modest Basic Income?

Budget savings and cost of Universal Basic Income (UBI) at existing minimum social assistance levels. Annual amounts in local currency (bn).



Adapted from a a graphic by Cleve Jones; source: OECD calculations.

Researchers estimate that the cost to give $10,000 to each person in America would be between 2 and 3 trillion dollars. Such a sum would replace the current entitlement system, so the net cost would be much lower, but it would still be larger than the current outlay for existing welfare programs (see calculatons for various European countries above). Clearly, some sort of targeting system could help. However, the more narrowly targeted the system, the more of today's current welfare bureaucracy remains, undermining UBI's appeal to conservatives, libertarians, and pragmatists. Nonetheless, some buffer for the technologically unemployed would seem to be necessary if current estimates of the pace and scale of technological unemployment are to be believed.

The question for us as long-term investors is how to think about these ideas. Here are some things which emerge from the discussion above which we clearly should think about.

1) TECHNOLOGY. Technology and its associated sectors will clearly be important to have as investments in our portfolios. While these sectors can be volatile and individual investments can either disappear or become unicorns, the rise of technology will continue. It should remain firmly among our long-term investments albeit in diversified form.
2) PURCHASING POWER. The purchasing power of consumers may come under pressure. One could argue that the lack of inflation (demand pull) in recent years bears this out. With incomes for wide swaths of workers stagnant in real terms, we need to be realistic about the ability of mass consumer industries to grow, at least at rates comparable to the technology sector.
3) TAXES. Taxes will likely rise either on individuals or corporations or both. These taxes may take the form of a government tax to fund income stabilization or transition programs for workers. Or, barring government willingness to assume this role, taxes may come in the form of training costs borne either by the corporate sector or, in line with their ability, workers themselves.
4) SOCIAL DISRUPTION. Even if transition programs for workers become a reality, if demand overwhelms supply, the possibility for social disruption and political instability exists. It could be argued that the electoral dissatisfaction currently being expressed both in Europe and the US over immigration is the first wave of this phenomenon.

"The question for us as long-term investors is how to think about these ideas."

At first glance, the concept of universal basic income might seem counter to the social contract in Western societies. However, given the pace and scope of the coming economic and social changes in the Digital Age, UBI may well come to play a significant role in a successful transition from today's world to tomorrow's.

(1) What the future of work will mean for jobs, skills and wages, The McKinsey Global Institute, November 2017.

(2) Artificial Intelligence, Automation, and the Economy, The Executive Office of the President, December 2016.

(3) Ibid

Stock Market Pulse

Index	3/29/18	Total Return Since 12/31/2017
S&P 1500	611.70	-0.72%
Dow Jones Industrials	24,103.11	-1.96%
NASDAQ	7,063.45	2.59%
S&P 500	2,640.87	-0.76%
S&P 400	1,878.77	-0.77%
S&P 600	938.46	0.55%
NYSE Composite	12,452.06	-2.20%
Dow Jones Utilities	692.63	-3.40%
Barclays Aggregate Bond	107.25	-1.47%

P/E Multiples	3/29/18
S&P 1500	21.5x
Dow Jones Industrials	19.5x
NASDAQ	21.6x
S&P 500	21.2x
S&P 400	23.4x
S&P 600	27.2x

Key Rates

Fed Funds Rate	1.50% to 1.75%
Tbill 90 Days	1.71%
T Bond 30 Yr	2.97%
Prime Rate	4.75%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	611.70	21.5x	1.93%
S&P 500	2,640.87	21.2x	1.98%
Dow Jones Industrials	24,103.11	19.5x	2.29%
Dow Jones Utilities	692.63	NA	3.84%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.04%

MAIN OFFICE:
211 South Rose Street
Kalamazoo, MI 49007
office: 269.388.9800
toll free: 800.416.4555

TRAVERSE CITY OFFICE:
125 Park Street, Suite 495
Traverse City, MI 49684
office: 231.922.1428

GRAND RAPIDS OFFICE:
25 Ottawa Avenue SW, Suite 110
Grand Rapids, MI 49503
office: 616.888.3210

BIRMINGHAM OFFICE:
34977 Woodward Ave., Suite 200
Birmingham, MI 48009
office: 248.530.6202

BAY HARBOR OFFICE:
4000 Main Street, Suite 150
Bay Harbor, MI 49770
office: 231.439.5016

DELAWARE OFFICE:
4001 Kennett Pike, Suite 226
Greenville, Delaware 19807
office: 302.317.2163

GREENLEAF TRUST®
e-mail: trust@greenleaftrust.com
www.greenleaftrust.com