GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

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Chairman, Greenleaf Trust

Economic Commentary

Real GDP grew at a 4.1% annual rate during Q2 of 2018 as announced the first week in August. It is important to know that this release was an advance estimate that will be revised when actual data are available. Revisions are all over the board; however, the advance estimate reflects what the expectation of Q2 GDP was in the marketplace and among analysts.The announcement also included the revision of Q1's results to 2.0% down from the original advance estimate of 2.2%.

Consumer spending was the primary driver of the Q2 estimate, although there are several confirming data points that contribute to the robust quarter results. Agricultural exports surged in advance of tariff implementation and Private Domestic Final Purchases, which is essentially GDP minus foreign trade. Additionally, government spending and inventories rose 4.3% annualized, well ahead of the Q1 rate of 2.0%.

The Federal Open Market Committee met the week of the GDP announcement and affirmed that this pace of growth was strong. In fact, they used the word *strong* four times in their post meeting summary. If there was any thought that the Fed might be wavering on future hikes given the implications of tariffs in the forward cycle, there was no evidence of that in the minutes of their meeting. While most think that the second half of the year will soften a bit, there seems solid consensus that we should finish the year at or near 3.3%, which is well ahead of what the Fed considers sustainable growth.

Let's dive a bit more into the consumer data. We know that consumers drive GDP growth, and thus, the health of the consumer determines future growth. Employment remains stable with 213,000 jobs created in the last reporting cycle keeping unemployment below 4%. Wage growth has averaged 2.7% over the trailing twelve months, still behind expectations given the current unemployment rate, but the strongest in ten years. Adjusted for inflation, real wage growth is +0.05%. While we can say that the consumer is employed and therefore able to spend, there isn't any evidence to suggest an upward trajectory in that spending level.

CPI is currently running at +2.9% and when adjusted for gasoline the core inflation number is registering +2.3%, consistent with the Fed target.

Commentary, continued

Commodity prices, both agricultural and manufacturing related, had a nice recovery in 2017; however, 2018 has seen more moderation in both. The July Producer Price Index will be released on August 9th and it is expected to be in line with June's announcement of +0.03% and annualized at 0.01%

As we entered the economic recovery cycle in late 2008, we focused on the lack of business capital investment, stating that productivity was essential to long-term economic growth.

Typical of past recessions, employers were willing to invest in labor as demand increased, because labor could be a much more temporary cost than capital investment in equipment. The economic recovery act of 2018 included attractive depreciation schedules for capital goods investment, but businesses needed orders, revenue and cash flow, and thus, for most of the last decade they were reluctant to increase business capital investment. The six-month trend in place validates that business has returned to a capital investment strategy with targeted productivity goals. It is a welcome trend reversal and one that responds to gross margin expansion. While not a near-term GDP stimulant, it will help sustain future growth.

"Typical of past recessions, employers were willing to invest in labor as demand increased because labor could be a much more temporary cost than capital investment in equipment."

Peeling away the onion on the investment categories, we see that fixed investment rose 7.1%, reflecting a continued recovery in exploration, shafts and wells in energy sectors. Intellectual property such as software and R&D increased by double digits. Information processing mirrored the trend in place while transportation equipment declined for the period. Orders for durable goods advanced and the Purchasing Managers Index registered 58.1%, down three points from June, but still at a level that indicates strong manufacturing demand especially when contrasted with the decline in the Customer Inventory Index which shrunk during the month. If manufacturing activity is strong and inventories decline, it typically signals strong demand. Interestingly, inventories are a part of GDP calculations, and thus, a shrinkage in inventories is a drag on GDP growth. If the contraction was due to demand, that could mean stronger growth results later in the cycle.

Those that like to predict Federal Reserve policy changes read much into the verbiage of the Fed Governors post meeting statements. What seems clear to my eye is that the economic recovery, while long in the tooth, remains in place, and that the strength of the recovery has ratcheted up by better than 1.3%. More people are employed and wages have grown only incrementally, while consumer spending remains robust. Is the current growth rate at, above or below the long-term growth forecasts? This is an important question for the Fed as it crafts policy to exit an “accommodative” or expansionary policy with respect to the Fed Funds rate. It is important to note that the majority of Fed Governors don’t believe that the previous rate hikes have returned us to a normal or neutral policy and that belief, when combined with the current economic data, suggests regular rate hikes are in front of us the remainder of 2018 and well into 2019.

“The number of industry lobbying groups focusing on dampening the administration’s tariff threats continues to grow.”

The number of industry lobbying groups focusing on dampening the administration’s tariff threats continues to grow. What started as tariff threats has now morphed into “trade deals.” There is an absence of detail in the results of those discussions and thus sorting out what is and what isn’t in place is quite the challenge, and therefore almost impossible to calculate implications for the economy. It took many years to get China to the table on manipulating their currency, which benefited their trade ratios of imports and exports. It took only the promise of tariffs on Chinese imports in the US to have China return to an 8% currency devaluation, thereby practically wiping out any tariff potential cost to China by US policy. If the tariff threats are morphing into “trade deals,” that’s probably a good evolution.

Michael F. Odar, CFA
President

The Dog Days of Summer

It's that time of year again. Those hot lazy days of summer at the end of July and beginning of August. The 'dog days' of summer have certainly been hot here in Michigan, but no one has been lying around at Greenleaf Trust. We have been busy assessing the progress made on our 2018 plan, getting feedback, adding teammates, and starting to look toward 2019.

At the end of June, we conducted our annual Up Periscope meetings. Because we believe in the importance of publishing goals, we feel it is equally important to periodically revisit those goals during the year. Over the course of a full day, we meet with every division leader in the company to discuss their 2018 goals. What has been accomplished? What still needs to be done? How can the other division leaders help? It was amazing how much we had collectively accomplished from our 2018 Strategic Initiatives focused on workplace culture, beingtop of mind, scaling up, and purposeful growth.

"We have been busy assessing the progress made on our 2018 plan…"

Karen Baldwin, Director of Human Resources, and I are also finishing up our annual Perspectives and Solutions meetings. Together we meet with everyone in the company in small cross functional groups to answer any questions they might have on anything going on in the company, discuss their perspectives, and seek to find solutions to challenges they may be facing. We have been conducting these informal meetings for a few years now, and as a result, have made a number of cultural amplifications related to talent development and work/life balance. These efforts make sense to us and we are extremely proud that for the eighth year in a row we have been voted a Best and Brightest Company to Work For® in both West Michigan and Metro Detroit. We know that if our teammates are engaged and supported, they will do great things for our clients.

Nurturing our culture is important especially as we continue to grow and add more teammates. So far, we have added 10 new talented teammates to Greenleaf in 2018. And, we are looking for another 10 more this year to fill open positions. Our team has now grown to 120!

Finally, our strategic planning season for 2019 is officially underway. Our Executive Council as well as other divisions are conducting off site planning meetings and soon to follow will be our company wide Strategic Planning Questionnaire in September and Executive Leadership Team Advance in October. We have a 10-year strategic vision that began in 2015 to be Top of Mind in all that we do. Each year we develop strategic initiatives like those mentioned above that are purposeful and designed to get us one step closer to our 2025 vision.

It's fulfilling doing and sharing all of this intentional meaningful work with those that we work for, our clients.

Taxes — Not If but When

Sanford C. Leestma II, CFP®
Wealth Management Advisor

Saving for retirement and income in retirement are closely related to each other. Another less welcome relative to saving and income is tax. Although more welcome than the other certainty in life, we try to avoid it while saving and in retirement. When to pay tax on retirement assets can be uncertain.

As advisors, we are often asked what accounts are most advantageous when saving for retirement. It would seem to be a simple question, though the answer depends on your situation. We can start with the easy answer. First, save up to the match within your employer plan or "max the match." Second, open a traditional IRA and/or a Roth IRA and contribute the annual limit. Third, after you "max the match" and max out your IRAs, turn back to your employer plan and contribute up to the annual limit. Fourth, save in a taxable account for things prior to and in retirement. A combination of some or all of the above could be the right answer. For your retirement assets, paying some tax now and postponing some tax until later can make sense. Not all individuals have access or the ability to use all the different accounts available. Since it depends on your situation, we recommend discussing details with your advisors.

Having assets that are taxable, pre-tax (tax-deferred), and after-tax (tax-free) provides flexibility when it's time for your assets to provide income for you in retirement. Having the three buckets to withdraw from helps, since we do not know what taxes will be or what the tax treatment of assets will be in the future. Also, not all assets are treated equal when withdrawn for income. Pre-tax retirement assets (traditional IRA and traditional 401(k)), when withdrawn from accounts, are considered income and taxed as such. Withdrawals from after-tax retirement assets (Roth IRA and Roth 401(k)) are not considered or taxed as income, since contributions to these accounts have already been taxed. Taxable assets are taxed when a gain is realized (asset with a gain is sold) and is either taxed as a long-term gain (if held longer than a year) or a short-term gain (if held less than a year). Capital gains, along with some forms of income, are included in your Modified Adjusted Gross Income (MAGI). Your MAGI determines, among other things, your tax bracket and premiums for Medicare Part B, which covers doctor visits, and Part D, which is the prescription drug benefit. Having assets in all three buckets allows you to control your taxes in retirement.

A few things to consider when withdrawing assets to keep taxes and expenses down:

Realizing substantial gains near or in retirement can significantly increase Medicare Part B and Part D premiums. Try to limit the amount of gains realized starting two years prior to retirement, if possible. Medicare uses the MAGI reported on the federal tax return from two years ago, so to determine whether you will pay higher premiums in 2018, Medicare uses 2016 MAGI. In 2018, the basic premium for Part B is $134 per month. While it varies for Part D, higher income

"Having assets that are taxable, pre-tax (tax-deferred), and after-tax (tax-free) provides flexibility when it's time for your assets to provide income for you in retirement."

Taxes — Not If but When, continued

equates to higher premiums. If your MAGI is over $85,000 for a single tax return or $170,000 for a joint return, your premiums are subject to a surcharge known as an Income Related Monthly Adjustment Amount (IRMAA). These surcharges increase with income and can more than triple what you pay for benefits. This chart shows the effect higher income has on premiums.

If your filing status and yealy income in 2016 was			
Individual tax return	File joint tax return	File married & separate tax return	You pay each month (In 2018)
$85,000 or less	$170,000 or less	$85,000 or less	your plan premium
above $85,000 up to $107,000	above $170,000 up to $214,000	not applicable	$13.00 + your plan premium
above $107,000 up to $133,500	above $214,000 up to $267,000	not applicable	$33.60 + your plan premium
above $133,500 up to $160,000	above $267,000 up to $320,000	not applicable	$54.20 + your plan premium
above $160,000	above $320,000	not applicable	$74.80 + your plan premium

Source: Medicare.gov

“A common income strategy is to make all withdrawals from taxable accounts first, so that the pre-tax assets can continue to grow tax-deferred. ”

A common income strategy is to make all withdrawals from taxable accounts first, so that the pre-tax assets can continue to grow tax-deferred. This has the potential of postponing taxes until later. The unintended consequence may be paying too much tax at that later date. It may make more sense to take from your taxable assets and your pre-tax assets in some combination to control your marginal tax rate and to reduce the balance of your pre-tax assets. Reducing your pre-tax assets effectively reduces the required minimum distribution (RMD) you will need to take at age 70½, since your RMD is based on the asset value and your age. If your RMD is more income than you need, you unnecessarily pay more income tax than is needed. More income can also potentially lead to increased Medicare premiums.

If you wish to gift to a qualified charity, a way to reduce the tax on an RMD is through the use of a qualified charitable distribution (QCD), which can be used to satisfy all or a portion of your RMD for the year, up to $100,000 per year —the amount used as a QCD is not included in income. This can reduce your income for the year and potentially your Medicare premiums two years from the QCD.

Another way to decrease future RMDs is to convert a portion of your pre-tax assets to after-tax assets (Roth conversion). The amount converted is included in the MAGI, which may increase your marginal tax bracket and Medicare Part B and Part D premiums two years down the road. Conversions close to retirement may affect premiums, but the benefit of converting may still outweigh the added expense. Reducing the asset value within your pre-tax accounts by converting some to after-tax can reduce your RMD going forward.

There are other things to consider when taking income from your portfolio, but the only thing worse than taxes is death, and I would rather not bore you to that. Unfortunately, many things have unintended consequences. It is important to know how to save for retirement and also how to withdraw income in retirement. We can help shed light on the ways that make the most sense for you.

Tax Efficient Philanthropy

George F. Bearup
Senior Trust Advisor

With the Tax Cut and Jobs Act of 2017 there will be a dramatic decline in the number of taxpayers who file itemized income tax returns. That is because the income tax standard deduction was essentially doubled for every taxpayer ($12,000 for single taxpayers, $24,000 for married taxpayers, $18,000 for heads of households, and if the taxpayer is over the age of 65, $1,300 more if married, or $1,600 more if single).

But along with that good news of increased standard deductions comes a bit of bad news in the form of the limitation on the deductibility of state and local taxes paid, which are 'capped' at $10,000 a year for a married couple who file a joint income tax return. The upshot of these tax law changes is that more individuals will become non-itemizers when they file their income tax returns. Some estimates suggest that for households with taxable income that ranges between $86,000 and $150,000, the number who itemize their income tax deductions will drop from 39% to 15%. This means that many individuals who give to charity will not obtain any income tax benefit for their charitable gifts, as their income tax liability will be based solely on the standard deduction claimed and not their itemized deductions.

"This means that many individuals who give to charity will not obtain any income tax benefit for their charitable gifts..."

But for individuals who are age 70½, a great opportunity exists to obtain both a charitable deduction and still file tax returns as non-itemizers. Fortunately, under the new tax laws, no changes were made to the qualified charitable IRA distribution rules. Those rules permit a person over age 70½ to make a direct gift from their IRA to charities of their choice in full, or partial, satisfaction of the donor's required minimum distribution for the calendar year. The amount distributed directly from the donor's IRA to a charity goes toward satisfying the donor's required minimum distribution from their IRA for the year, but that amount is not included in the donor's taxable income for the year. While a donor is not able to claim an income tax charitable deduction for the distribution from their IRA, the fact that the amount distributed from the IRA to the charity is not included in the donor's taxable income is equivalent to a 100% charitable income tax deduction, while the donor is still able to claim the larger standard deduction on his or her income tax return.

In the past, many individuals did not exploit this charitable IRA distribution opportunity because they were able to claim a charitable income tax deduction by itemizing their income tax deductions, which included their charitable gifts for the year. But now, with far fewer individuals itemizing their income tax deductions due to the increase in the standard deduction amount, more individuals with traditional IRAs

Tax Efficient Philanthropy, continued

“In sum, taxpayers who used to itemize their income tax deductions but no longer can… should seriously consider making their charitable gifts from their IRA if they are over the age 70½.”

should consider making qualified charitable gifts using their IRA.

The rules that permit a qualified charitable IRA distribution are pretty straightforward, with only a couple of surprises. Those rules include:

- The donor must be age 70½ (note: not the year in which they attain that age, they must actually be over that age when the charitable gift is made from the IRA);
- The distribution must be directly from the donor’s traditional IRA to the charity, usually by check made payable to the charity; 401(k) accounts, SIMPLE and SEP IRAs will not qualify for this opportunity, but it is easy to move funds from a SIMPLE or SEP IRA into a separate traditional IRA from which the charitable gift is then made;
- The charity must be a publically supported charity; donor advised funds, grant-making charities, and what are called supporting organizations of charities are excluded as eligible charities;
- The donor can receive no personal benefit from the charity for the IRA distribution;
- The maximum amount that can be gifted directly from the donor’s IRA to charities in a single calendar year is $100,000 (married donors could thus contribute up to $200,000 in a year);
- The donor must receive from the charity a written contemporaneous acknowledgement of the gift before the donor files his/her income tax return; and
- The donor must report on the first page of their Form 1040 income tax return (inserting the letters QCD next to line 15b) the qualified charitable distribution from the donor’s IRA.

In sum, taxpayers who used to itemize their income tax deductions but no longer can due to the increased standard deductions and $10,000 limit on the deductibility of state and local taxes they pay should seriously consider making their charitable gifts from their IRA if they are over age 70½. The qualified charitable distribution from their IRA will be the equivalent of a 100% income tax deduction for their charitable gifts during the year, and could also reduce some of their income tax liabilities, such as the 3.8% net investment income tax, if their reported taxable income is less when their required minimum distribution for the year is not added to their other taxable income.

Listen, Guide, Educate, and Serve

The Greenleaf Trust Approach to Client Service

Rosalice C. Hall
Relationship Service Specialist

At Greenleaf Trust, our founder Bill Johnston is often heard professing the fact that we have no products to sell, only a service to deliver. Like Bill, we are also very proud to share how our independence allows us to always sit on the client's side of the desk, while providing the highest level of personalized service and fiduciary excellence. More recently, one of our teammates coined the phrase, 'continuity of client care throughout complex life events,' but what does that really mean? What is it like to work with a client centric team at Greenleaf Trust? And what value do we provide our clients? While the real dollar impact of the *asset* management strategies we implement is easy to see, often the value-add from our holistic approach to *wealth* management is a bit more nuanced to quantify.

The goal of this article is to share the story of just one of our beloved client relationships and how we have been able to listen, guide, educate, and serve them through the opportunities and challenges that come with wealth. We originally met the patriarch of the family, whom we will call John, when he was a key employee for one of the corporate retirement plans administered by Greenleaf Trust. John had done very well for himself through his working career and had also inherited additional assets at the passing of his parents.

"... one of our teammates coined the phrase, 'continuity of client care throughout complex life events,' but what does that really mean?"

After listening carefully to the goals and desires of John and his wife, whom we will call Sally, our team of experienced professionals constructed a diversified portfolio to meet the couple's specific financial objectives. Our investment decisions are always based solely on the merits of the investments themselves in the context of their customized plan, which for John and Sally included the desire to pass on wealth to their future generations.

The couple has been charitably inclined for many years. After establishing wealth management accounts at Greenleaf Trust, our team identified gifting opportunities utilizing low cost basis stocks that had been inherited from John's parents. John and Sally were able to avoid significant capital gain taxes by gifting the stocks directly from their accounts at Greenleaf Trust to several nonprofit organizations. They were pleased to be relieved of the after-tax gifting process from their checking account, and that we do not charge an additional fee to facilitate the gifts.

Implementing tax minimization strategies, such as tax loss harvesting

Listen, Guide, Educate, and Serve, continued

"Implementing tax minimization strategies, such as tax loss harvesting and asset location strategies, are often identified as a couple of our key differentiators."

and asset location strategies, are often identified as a couple of our key differentiators. Specifically, our wealth management team reviews our client accounts at least annually to recognize losses within taxable accounts to offset capital gains. Additionally, an asset location strategy on top of an asset allocation strategy is another way in which Greenleaf Trust is able to add value through tax efficiency. Asset location adds tax awareness to portfolio construction, ensuring the tax-efficient asset classes are held in taxable accounts and tax-inefficient assets in tax-deferred accounts. John, having prided himself as a savvy investor, was delighted to be educated on several tax minimization strategies. He was even more ecstatic to see the tax savings quantified, which in his case had the approximate potential to add an additional 1% per year of after tax return without adding any additional risk to the portfolio.

Prior to John's retirement, his company was acquired by a larger organization with a similar focus. Our team worked with John and his attorneys to provide 'what-if' financial modeling on the purchase offer. Our recordkeeping team ensured the retirement plan was effectively terminated and our participant services team provided education to the plan participants on their distribution and rollover options.

Shortly after the completion of the business sale and start of John's retirement, his health began to decline. Like many who experience the effects of dementia, he was having some good days and some bad days of mental clarity. The couple has been married for decades and John handled all of the couple's financial matters. Realizing his days of clarity were quickly slipping away, John called on Greenleaf Trust to help educate his wife and children on their wealth and estate planning elections. We coordinated with the couple's attorney to update durable power of attorney documents and to revisit their estate plans. Our team was also happy to begin paying some of the couple's bills directly so insurance payments, real estate taxes and utility bills would not be overlooked.

If declining health was not enough of a burden, the couple also found themselves in the middle of an identity theft situation when their accountant attempted to file their personal income tax returns, only to be notified that someone had already fraudulently filed their tax returns. Given the accountant was in the midst of the busy tax preparation season, he knew he could rely on Greenleaf Trust. He notified Sally and told her to call Greenleaf Trust because he was confident our team would be willing to help her take steps to notify the credit bureaus.

Education has always been very important to John and Sally. Over the years we have facilitated annual gifts to each of their grandchildren's 529 education plans. Charitable gifting from IRA accounts has become increasingly popular for many individuals, and John and Sally are no exception. Since reaching 70½ years, we have helped each of them satisfy Required Minimum Distributions from their IRA accounts by making direct gifts to universities and nonprofit organizations that the couple has identified as being near and dear to their hearts. The Qualified Charitable Distributions allow them to thereby avoid the ordinary income tax and lower their adjusted gross income to better take advantage of the medical expense deduction floor.

Recently, Sally realized her purse containing her cell phone, credit cards, cash, and identification cards for both John and herself had been lost or stolen during a day of shopping. Feeling panicked she called her daughter on the west coast who, given the distance, was limited in her ability to help. However, the daughter had our contact information and told her mom that she would contact Greenleaf Trust. We received a late night email from the couple's daughter Sarah, who wrote, "I'm not sure if this is within your 'scope of services,' but I hope you can help." Upon receiving the email, we alerted our corporate security team who provided direction in filing a police report and assistance in ensuring the couple's credit was frozen. Our security team is composed of retired police officers, so they were able to offer reassurance to Sally and her daughter by sharing their previous experiences with purse thefts.

Over the years, it has been rewarding to learn more about Sally and John and what makes them special. It is an honor to be trusted to manage their assets, and to also provide feedback and opinions on significant financial decisions they face. Our MyWealth software platform has proven useful in providing illustrations of where the couple's assets are in relation to their goals, along with illustrations of how financial decisions can impact their long-term net worth.

Provided on the following two pages is a diagram that was created to better illustrate many of the ways in which Greenleaf Trust is providing continuity of client care throughout complex life events. I am proud to be surrounded by teammates who are committed to our work and strive to consistently serve by exceeding the wants, needs and desires of our clients. Contact us to learn more about Greenleaf Trust, and how our goals-based wealth management approach can help you live a life well spent.

"It is an honor to be trusted to manage their assets, and to also provide feedback and opinions on significant financial decisions they desire to make."

Greenleaf Trust continuity of client

Cash Flow Planning	Insurance Planning	Investment Planning	Education Planning	Retirement Planning
Income planning	Insurance needs analysis	Goal planning to align life and wealth	Education funding needs analysis	Retirement needs analysis
Expense analysis	Review of existing policies and benefits	Risk assessment and time horizon analysis	Funding strategies	Funding strategies
Debt management strategies	Life insurance planning and coordination	Portfolio Construction	Review of existing savings vehicles	Review of existing savings vehicles
One-time and planned large expenses	Disability planning and coordination	Asset allocation and rebalancing	Funding vehicle optimization (529, trust, etc.)	Funding vehicle optimization (401k, IRA, etc.)
Emergency funding	Long-term care planning and coordination	Sub-asset allocation and tactical shifts	Tax minimization strategies	Tax minimization strategies
Credit facilities	Medicare options analysis	Tax efficiency analysis	Loan coordination	Social security optimization
Net worth analysis		Select, monitor and report on investments		Roth conversion strategies
		Third-party manager due diligence		Annuity and pension review
		Concentration management strategies		RMD strategies

care throughout complex life events

Income Tax Planning	Estate Planning	Philanthropic Planning	Financial Coaching	Additional Services
Review prior tax returns	Review estate plan	Philanthropic goal clarification	Insight to avoid emotionally driven decisions	Family meeting facilitation
Asset location strategies	Estate goal clarification	Gifting strategies and analysis	Immediate access to in-house analysts	Coordination of advisory team (CPA, attorney)
Distribution sequencing	Corporate trustee services	Charitable vehicle optimization	Solutions aligned with goals	Socially responsible investing
Tax loss harvesting	Asset protection strategies	Family foundation administration	"What-if" modeling	Outside investment coordination
Dividend skip strategies	Investor location strategies	Charitable remainder trust administration	Business succession planning	Bill pay
Carry forward loss optimization	Estate tax minimization strategies	Tax minimization strategies	Asset sustainability analysis	Identity theft assistance
Gain recognition optimization	Special needs planning	Passing family values through philanthropy		Personal financial website
	Basis shifting strategies	Qualified charitable distributions		
	Estate settlement			

Christopher D. Burns, CFA, CPA
Investment Strategist
Senior Fixed Income Analyst

This Expansion Could... Go... All... The... Way!

We are living through the second longest expansion in US history. Greenleaf's research suggests the expansion is likelier-than-not to become the longest on record. This article will express our reasoning, discuss risks to our outlook, and highlight implications for our investment decisions.

The Second Longest Expansion

Recessions are inevitable. Since 1854, the average expansion (the time between recessions) has lasted three years and three months. Since WWII, the average expansion lengthened to four years and ten months. The longest expansion in history lasted exactly ten years, from March 1991 through March 2001.

In this cycle, the economy troughed in June 2009 and has been expanding for over nine years. With one year to go, we now feel comfortable projecting that this expansion is likelier-than-not to become the longest in history.[1]

"Since 1854, the average expansion (the time between recessions) has lasted three years and three months"

Projecting the start of recessions is incredibly difficult.[2] This may be a fool's errand. We may review this article a year from now and shake our heads for projecting continued economic growth. Nevertheless, when we examine the available data, we conclude that risks of recession remain low over the next 12 months.

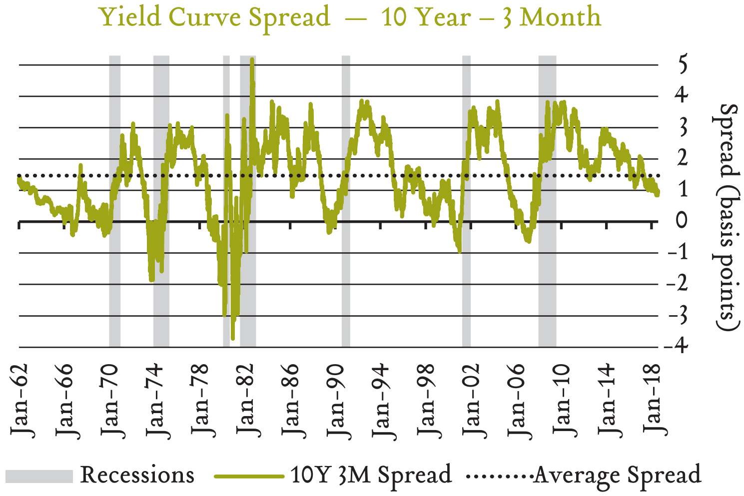
Leading Indicators of Recession Risks

There are a number of places to look to find recession risks. When setting expectations for future economic growth, we analyze many indicators rather than relying on only one or two. This section of the article will list a few of our favorites, but we consider many others in the course of our research.

Indicator 1: The Yield Curve

One of the best-known indicators is the yield curve. Researchers have found that the spread between short-term and long-term yields on treasury bonds can be a useful indicator of future economic growth.[3]

The corresponding chart and table show that the yield curve inverted prior to each of the past seven recessions. Inverting means short-term yields, in this case 3 month yields, were higher than long-term yields, in this case 10 year yields. In each case, the first inversion occurred between 4 and 24 months prior to the start of the recession. It also generated two false positives, inversions without a recession.



Inversion Date	NBER Peak	Difference between inversion month and NBER Peak
9/8/1966	No recession	False Positive
12/30/1968	Dec 1969	11 Months
6/1/1973	Nov 1973	6 Months
11/1/1978	Jan 1980	15 Months
4/6/1981	Jul 1981	4 Months
3/27/1989	Jul 1990	16 Months
9/10/1998	No recession	False Positive
4/7/2000	Mar 2001	12 Months
1/17/2006	Dec 2007	24 Months

Source: Bloomberg, dated 7/30/18

"...[the] chart and table show that the yield curve inverted prior to each of the past seven recessions."

Currently, the spread between 3 month yields (2.04%) and 10 year yields (2.98%) is 95 basis points, has been in a flattening trend, and is below long-term averages. Researchers at the Federal Reserve Bank of New York constructed a model that translates this spread into 12-month recession probabilities. This model shows a 12.5% probability of a recession in the next 12 months.[4] We consider this level to be relatively low.

If the yield curve continues to flatten at its recent pace, it might invert sometime in late 2019 or early 2020. With inversions leading recession by four to 24 months, it may be another two years or more before this indicator is predicting a recession. So, for the moment, we are not seeing major recession risks in the yield curve.

Indicator 2: Unemployment Rate Troughs

Another helpful place to look for recession risks is the labor market.[5] If employers begin cutting jobs and the unemployment rate starts rising, *This Expansion..., continued*

that can be an indication that a recession is near.

Historically, the unemployment rate hit a low an average of 9 months before a recession and rose an average of 0.3% by the time a recession started. Currently, the unemployment rate is 4.0%. That is above the recent low of 3.8% registered in May 2018.

"If employers begin cutting jobs and the unemployment rate starts rising, that can be an indication that a recession is near."

Unemployment Trough Date	Unemployment Trough Rate	NBER Peak Date	Unemployment Rate at Peak	Difference between trough month and NBER Peak
Jan 1948	3.4%	Nov 1948	3.8%	10 Months
Jun 1953	2.5%	Jul 1953	2.6%	1 Month
Mar 1957	3.7%	Aug 1957	4.1%	5 Months
Jun 1959	5.0%	Apr 1960	5.2%	10 Months
Sep 1968	3.4%	Dec 1969	3.5%	15 Months
Oct 1973	4.6%	Nov 1973	4.8%	1 Month
May 1979	5.6%	Jan 1980	6.3%	8 Months
Dec 1980	7.2%	Jul 1981	7.2%	7 Months
Mar 1989	5.0%	Jul 1990	5.5%	16 Months
Apr 2000	3.8%	Mar 2001	4.3%	11 Months
Oct 2006	4.4%	Dec 2007	5.0%	14 Months

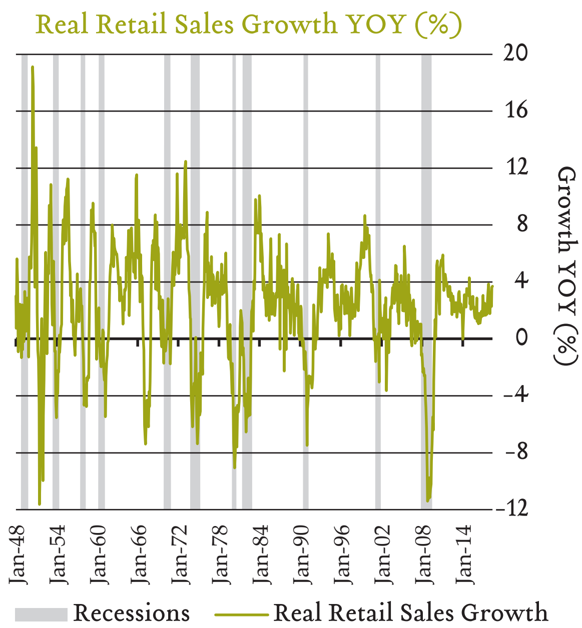
Source: Bloomberg, dated 7/30/18

The difficulty with this indicator is knowing in real-time whether you've reached a trough. Will the 3.8% rate from May 2018 be this cycle's low? Or, will there be continued improvement?

We cannot say definitively whether unemployment will rise or fall from here, but every month without continued improvement raises our assessment of the risk of recession. At this point, we do not see a material recession risk in the labor market, but we are watching closely.

Indicator 3: Real Retail Sales Growth

The last indicator we will discuss is real retail sales. Consumer spending makes up the majority of US GDP. Declines in inflation-adjusted (real) retail spending on a year-over-year basis can raise the alarm that a recession may be near.



Negative Real Retail Sales Growth Date	Growth Rate	NBER Peak Date	Difference between negative growth month and NBER Peak
May 1948	-0.9%	Nov 1948	6 Months
Apr 1951	-0.8%	No Recession	False Positive
Aug 1952	-1.0%	Jul 1953	11 Months
Oct 1956	-1.2%	Aug 1957	10 Months
Dec 1959	-1.4%	Apr 1960	4 Months
Dec 1966	-0.8%	No Recession	False Positive
Jul 1969	-0.4%	Dec 1969	5 Months
Dec 1973	-4.0%	Nov 1973	-1 Month, Missed Start
Jun 1979	-1.3%	Jan 1980	7 Months
Jul 1981	-1.1%	Jul 1981	0 Months, Concurrent
Jan 1987	-0.7%	No Recession	False Positive
Sep 1988	-2.3%	No Recession	False Positive
Dec 1989	-0.1%	No Recession	False Positive
May 1990	-0.5%	Jul 1990	2 Months
Dec 2000	-0.1%	Mar 2001	3 Months
Jun 2006	-0.1%	Dec 2007	18 Months

Source: FRED, author's calculations, dated 7/30/18

This indicator is more volatile than the yield curve or than unemployment rates. It has generated more false positives than other indicators. Nevertheless, it does provide a useful gauge of near-term growth rates for the economy.

As of June, 2018, real retail sales grew 3.8% year-over-year. It would be historically unusual to have a recession follow such a strong reading. So, we do not see risk of recession in our third indicator either.

"Declines in inflation-adjusted (real) retail spending on a year-over-year basis can raise the alarm that a recession may be near."

Risks to Our Outlook

There are several emerging risks that bear mentioning.

- Mounting trade tensions with major US trading partners may endanger

This Expansion..., continued

further economic growth. Business investment may slow due to uncertainty about the future of trade policy.

- The Federal Reserve is normalizing monetary policy. Faster increases in the Federal Funds Rate than are currently anticipated may slow economic growth.
- Mid-term elections are coming up in November 2018. Unexpected outcomes in the mid-term elections may impact business and consumer confidence.
- Growth momentum in other global economies may be slowing. This could result in slower domestic growth as well.

Portfolio Implications

It may seem obvious, but if you believe the economy is heading toward a recession you may adjust your investment strategies. On average, riskier assets like equities have generated below-average returns during recessionary periods. If you believe the economy will enter a recession, you may choose to overweight defensive assets like fixed income and underweight riskier assets like equities. The following table shows the performance of the S&P 500 during recessions, as well as one year before and after the recession.

"It may seem obvious, but if you believe the economy is heading toward a recession you may adjust your investment strategies."

Recession			S&P 500 Cumulative Total Return		
Start Date	End Date	Duration	1 Year Prior	During	1 Year After
Aug 1929	Mar 1933	3.7 Years	49.7%	-79.9%	81.5%
May 1937	Jun 1938	1.2 Years	24.0%	-23.6%	-1.7%
Feb 1945	Oct 1945	0.7 Years	19.9%	27.2%	-7.2%
Nov 1948	Oct 1949	1.0 Year	14.3%	5.1%	35.1%
Jul 1953	May 1954	0.9 Years	2.1%	25.5%	36.1%
Aug 1957	Apr 1958	0.7 Years	0.4%	-6.3%	37.2%
Apr 1960	Feb 1961	0.9 Years	2.9%	17.5%	13.6%
Dec 1969	Nov 1970	1.0 Year	-11.2%	-2.3%	11.2%
Nov 1973	Mar 1975	1.4 Years	-1.5%	-17.6%	28.3%
Jan 1980	Jul 1980	0.6 Years	18.6%	16.4%	13.0%
Jul 1981	Nov 1982	1.4 Years	18.6%	15.7%	25.6%
Jul 1990	Mar 1991	0.7 Years	16.4%	7.6%	11.0%
Mar 2001	Nov 2001	0.8 Years	-9.0%	-7.3%	-16.5%
Dec 2007	Jun 2009	1.6 Years	8.1%	-35.5%	14.4%
Average		1.2 Years	11.0%	-4.1%	20.1%
Median		1.0 Year	11.2%	1.4%	14.0%

Source: Bloomberg, dated 7/30/18

Note that returns leading into a recession have been relatively strong. On average, S&P 500 returns in the year before a recession have been up 11%. So, there may be a cost to being too early in predicting a recession. You may miss out on attractive equity returns.

Also note that S&P 500 returns during recessionary periods have not always been negative. The median observation over the past 14 recessions has actually been positive, up 1.4%. On average, though, equity returns have been below-average and relatively unattractive during recessions.

Finally, to benefit from adjusting your investment strategy, you also need to predict when the recession will end. If you don't adjust your strategies back into riskier assets when the recession ends, you will miss out on the attractive returns that are typically generated after a recessionary period. To be successful, you need to be right not just once, but twice! At this point, we believe that the risks of recession are low and we are not being overly defensive in our typical client's portfolio.

"We believe this expansion is likelier than not to become the longest in US history, lasting more than 10 years."

Conclusion

We believe this expansion is likelier than not to become the longest in US history, lasting more than 10 years. As a result, we are maintaining a healthy exposure to risk assets in our typical client's portfolio. We are mindful of emerging risks that might endanger this outlook, but most historically reliable data indicate that recession risks are low. We will continue to evaluate economic conditions on our clients' behalves and will adjust our investment strategies as warranted. Thank you for your continued confidence. Please feel free to contact a member of your dedicated client centric team if you would like to discuss our outlook in greater detail.

1. http://www.nber.org/cycles.html
2. https://www.imf.org/en/Publications/WP/Issues/2018/03/05/How-Well-Do-Economists-Forecast-Recessions-45672
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6. US Bureau of the Census, Advance Retail Sales: Retail and Food Services, Total [RSAFS], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/RSAFS, July 31, 2018.; US Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items [CPIAUCSL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CPIAUCSL, July 31, 2018., US Bureau of the Census, Retail Sales (DISCONTINUED) [RETAIL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/RETAIL, July 31, 2018.

Sharon A. Conran, J.D.
Vice President
Senior Trust Relationship Officer

Planning for the Family Pet

Having settled estates for over 20 years, I can't tell you how many times I've entered the home of a decedent and panicked when I found evidence of a pet. Be it dishes, a food mat or an empty aquarium, my first concern is always for the pet and whether or not it is still in the house hiding, hungry or worse. In most cases I find out that a neighbor or a family member has taken the pet home and is caring for the pet on a "temporary basis" until a forever home can be found.

With that in mind, when you meet with your attorney to prepare or amend your estate documents, make sure you haven't overlooked an important member of your family based on your belief that a family member or friend will step in to care for your pet when you no longer can. If you don't have a plan in place the welfare of your pet may be in limbo.

"If you don't have a plan in place the welfare of your pet will be in limbo."

When appointed Personal Representative or Successor Trustee, Greenleaf Trust has a duty to settle your estate pursuant to your estate documents. If your plans do not provide for the continued care of your pet, Greenleaf Trust, as fiduciary, must work within the terms of your document to provide for your pet. If the assets distribute outright or remain in trust for a beneficiary, the funds cannot be distributed or paid out for the care of the pet nor can the funds be paid to an individual taking care of the pet, that expense will fall to the person who has taken the pet.

If you have a pet, there are steps you should take when preparing your estate plans to ensure you have a plan in place for that special member of your family.

1. Determine the best plan for your pet(s).
   a) Will. You can establish powers in your Will which authorizes your Personal Representative to care for your pet(s) during the administration of your estate.
   b) Revocable Trust. You can establish powers in your revocable trust which authorizes the acting Trustee to care for your pet(s).
   c) Durable Power of Attorney. Should you have minor children and execute an Appointment of Guardian and Conservator you can direct that any pet(s) remains together with the child(ren) to provide continuity for both the pet and the child(ren). If your agent under your Durable Power of Attorney is the same person who will care for the pet on a temporary basis should you be incapacitated or unable to care for your pet (vacation), you can add provisions directly related to the care of your pet(s).
   d) Patient Advocate Designation. You may wish to have a pet allowed to accompany you should you need to live in an assisted living facility or if you are in a hospital, rehab facility or nursing home. If this is the case, you can incorporate that desire in your Patient Advocate Designation

keeping in mind that the facility may not honor your wish due to their existing policies.

e) Letter of Instruction. You can put a lot of information for your caretaker about your pet(s) in this document. You can compile information relating to your pet's food, medical information, schedule, likes and dislikes, relationships, quirks, habits, and any other relevant information. The letters can be updated frequently and do not require the services of an attorney.

f) Funeral Arrangements. You may want to have your pet attend your funeral or memorial service or wish to have your pet's or your remains buried or cremains scattered near each other when the time arrives. You may also wish to have your pet(s) included in your obituary. These wishes should be in writing and may involve designating a Funeral Representative in your Will. Plans such as this require additional research on your part to determine whether or not your requests will be allowed.

g) Pet Trust. A pet trust designates your pet(s) as the beneficiary of the trust. However, due to various tax implications, the trust can be structured so that the pet is not the beneficiary but still receives the benefit of the trust for its care. For a pet trust you will need to determine if the caretaker and the Trustee will be one and the same. If the caretaker and the Trustee are the same, you should be aware that the caretaker/Trustee will have complete control over the financial decisions relating to the pet which could cause a potential conflict should the named caretaker/Trustee also have an interest in the remaining assets of the trust. Naming a caregiver and a Trustee, each with separate duties and responsibilities provides checks and balances over the trust.

2. Determine the funding of the pet care plan.
   a) Funds can come from life insurance, bank accounts, annuities, pet protection agreements or provisions in a Will or Trust.
   b) The amount to fund your pet care plan will depend on your pet's care expenses for the pet's anticipated life expectancy. You should evaluate the current expenses (food, veterinary costs, prescriptions, grooming, boarding, licenses, etc.) with an allowance for rising costs as the pet ages. Consider adding additional funding to provide for expenses of transporting the pet to the pet caretaker, costs associated with the pet's end of life, such as burial or cremation arrangements, and administrative expenses if you are funding a pet trust or wish to pay the pet caretaker.
   c) Consider purchasing pet insurance to help defray the cost of future medical expenses for the pet. Be sure to plan for future payments of the insurance premiums when calculating the funding amount.
   d) Avoid leaving an entire estate or excessive funds to a pet which may result in a court proceeding to reduce the funding amount due to disputes

"The amount to fund your pet care plan will depend on your pet's care expenses for the pet's anticipated life expectancy."

Planning for the Family Pet, continued

among potential takers of the remaining funds following the death of the pet.

3. Determine who to name as the pet caretaker.
   a) A caretaker is the person who will step into your shoes to care for your pet. In effect, the caretaker is a "guardian" for your pet. Your pet will live with the caretaker and that caretaker will be the responsible person for the daily needs of your pet.
   b) If you have more than one pet, you may determine that you will need to name more than one caretaker based on the type of pets you have and the qualifications of the caretaker. For instance, if you own exotic reptiles and horses, you may need to name a caretaker who specializes in exotic reptiles and another who specializes in horses as their care is quite different.
   c) Have a contingent plan or succession plan should something happen to the named caretaker that terminates their ability to care for your pet. As the final named successor caretaker, you may wish to name a rescue or pet retirement home in the event that all other named caretakers are unable or unwilling to serve. If your pet was adopted from a shelter or rescue, check the paperwork to determine if the adoption agreement provides that the pet should be returned to the shelter or rescue agency in the event that you can no longer care for the pet.
   d) Notify the named caretaker in advance to their appointment so they are aware of the appointment and the duties involved should they choose not to accept the appointment or, if prior to your demise, the appointed caretaker's circumstances change where they will be unable to care for the pet, they will be able to notify you so you can make the necessary changes in your plan.
   e) Pick a caretaker whose interest in caring for the pet is the pet and not the financial backing for the care of the pet. Does the person bond with the pet and truly show a caring interest in the pet?
4. Determine the compensation to the pet caretaker.
   a) Avoid paying the pet caretaker compensation in a lump sum upon your demise. There would be no oversight over the caretaker and nothing to prevent the caretaker from spending the money and then resigning as caretaker for your pet.
   b) Avoid providing the pet caretaker's compensation at the end of the pet's life as there is a potential that this could incentivized the pet's early demise.
   c) A structured compensation that incentivizes the pet's longevity is preferred method of compensation. Be careful with this method as it may allow the caretaker to prolong the pet's life and create unneeded pain and suffering for your pet.

"A caretaker is the person who will step into your shoes to care for your pet. In effect, the caretaker is a 'guardian' for your pet."

d) If there is a Trustee, you may want to consider provisions in your trust which will authorize the Trustee to have discretion over the amount and structure of the compensation for the caretaker.
e) Provide an identification method for the pet such as, photos, microchips or DNA samples to prevent fraud.
f) Review your caretaker compensation plan with your attorney or tax advisor to determine whether there are tax advantages to different compensation structures.

5. Determine the disposition of the funds upon the pet(s) death. You should decide whether or not the remaining funds following the death of the pet(s) is to be distributed to named individuals, the caregiver, or donated to an animal shelter or other charity that benefits animals. Keep in mind that there is a given conflict of interest whenever the pet caretaker is a remainder beneficiary as this could create a financial incentive for an early demise of the pet(s).
6. Decisions regarding the end of the pet's life. The hardest decision for any pet owner is if and when you should end your pet's life. You should include in your plan who has the authority to make the decision and under what circumstances (veterinary recommendation).
7. Special provisions for unique or exotic pet(s). Depending on the type of pet you own, you may need to provide additional details to your plan. If your pet is exotic or statistically known to live a longer life than most animals, you may need to provide contingent plans for their care which does not involve a friend or family member. If you wish to provide for animals that are not domesticated (feral cats) you may need to discuss other options with your attorney that may involve a charitable entity.

No matter what plan you put in place for the care of your pet(s), you should always notify the fiduciary in advance that you have a pet and there are plans in place for the care of your pet upon your incapacity or demise. If you don't have funds available currently to fund a plan for your pet's care, you should still make a plan for the pet's future care. Finally, determine how you will identify your pet(s) in your estate documents as you would not want to have a plan that is determined not to cover your current pet or pet(s) you may acquire after the plan is executed. You may want to identify your pet(s) as a group such as, all pets owned by me at my death, to be sure to include pets adopted after your plan is executed.

Speaking from experience, having a plan in place for your pet(s) not only provides you with the knowledge that your pet(s) will be cared for but from an administration side, provides the fiduciary with a sense of relief knowing that the pet(s) have a plan in place for their care and comfort.

"No matter what plan you put in place for the care of your pet(s), you should always notify the fiduciary in advance that you have a pet..."

Stock Market Pulse

Index	7/31/18	Total Return Since 12/31/2017
S&P 1500	652.86	6.58%
Dow Jones Industrials	25,415.19	4.07%
NASDAQ	7,671.79	11.78%
S&P 500	2,816.29	6.47%
S&P 400	1,984.49	5.31%
S&P 600	1,048.88	12.82%
NYSE Composite	12,963.28	2.78%
Dow Jones Utilities	724.24	1.93%
Barclays Aggregate Bond	106.06	-1.67%

P/E Multiples	7/31/18
S&P 1500	20.9x
Dow Jones Industrials	18.1x
NASDAQ	22.9x
S&P 500	20.6x
S&P 400	22.5x
S&P 600	27.2x

Key Rates

Fed Funds Rate	1.75% to 2.00%
Tbill 90 Days	1.96%
T Bond 30 Yr	3.08%
Prime Rate	5.00%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	652.86	20.9x	1.81%
S&P 500	2,816.29	20.6x	1.84%
Dow Jones Industrials	25,415.19	18.1x	2.16%
Dow Jones Utilities	724.24	17.9x	3.37%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.27%

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