GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

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William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary

Real GDP rose at 4.2% in the second estimate for Q2 vs. 4.1% in the advance estimate. The data is not likely to change in final revisions as the story remains the same. The consumer is employed and confident. Business fixed equipment investment is bolstering consumer spending, and while inventories have contracted, so too has the trade deficit thereby offsetting one another. Some of the particulars may change in Q3, but the overall impact is likely to be the same.

The US and Mexico announced that they agreed in principle to a "New NAFTA" trade agreement the week prior to Labor Day. The details of the agreement are yet unknown; however, the talking points were focused on "win-win" approaches to tariffs on the flow of production parts that cross the border several times in the production cycle of domestic autos sold in both countries. If the political objective was to keep US auto jobs in the US, it is unclear that the trade agreement was successful. Further details will give us the evidence we need to judge that outcome. Canada seemed caught off guard by the announcement and Canadian representatives wondered aloud how there could be a legitimate North American Free Trade Agreement without Canada being included. Clearly this was not a communication snafu, but rather a trade policy strategy to place the Canadians in a position they had not expected. The question of reason for the strategy is unclear at this writing, and as we often are left to say with the administration's actions, strategies and tweet announcements: more to follow.

Corporate profits, personal income, personal spending, disposable income and the PCE Index all rose for the quarter; however, there was little impact upon the Fed's mandate of 2% inflation. Jobless claims fell to the lowest level since 1969 and the Consumer Confidence Index rose to the highest level since October of 2000. Housing prices took a breather for the third consecutive month, and new, as well as existing, home sales softened for the same duration of time. Auto sales slowed, but not outside the industry's forecast and not enough to slow production schedules.

The Fed meets September 26 and is expected to raise rates yet again to affirm its previous commitment to doing so. There appear to be two camps among Federal Reserve governors, those that expect inflation to ramp up due to a very tight labor market and those that fear increasing the tightening of credit will

Commentary, continued

dampen growth. The election cycle is growing near and the September meeting of the FOMC will be the last meeting prior to the November elections. The President has already voiced his displeasure at interest rate hikes, Yet, those announcements are not likely to restrain the Fed. There are those that would like to think that there is a political bias to the Fed, and from time to time Fed chairs have come under political scrutiny and questioning from legislators when providing testimony to Congress. What each chair has been able to demonstrate in their actions and testimony responses is their commitment to the Fed's mandates with respect to employment and price constraints even if their answers weren't the ones that the legislators were hoping to hear. Ahead of the September 26 meeting will be economic data releases that check all the boxes with respect to our economy's health, inflation and employment. The Fed's mandates remain certain, but their decisions are a good deal more complicated.

"September 15 is the ten-year anniversary of the infamous Lehman Brothers failure that symbolized the beginning of the largest recession in our country's history..."

Anniversaries are important, some more important than others. September 15 is the ten-year anniversary of the infamous Lehman Brothers failure that symbolized the beginning of the largest recession in our country's history and the start of a globalized banking, credit and liquidity crisis that would grind our economy as well as that of many other developed economies to a halt. The reasons for the banking crisis are well known to readers of this column as we have done extensive writing about them during the crisis and for many months after. Why revisit the crisis now? Beyond the anniversary date, there are many who ask me "What has changed? Can the crisis that created the Great Recession of 2008 be repeated today?" As my wife often retorts whenever someone references that one is "preaching to the choir" well… sometimes the choir needs practice. In the spirit of that sentiment and because it is the tenth anniversary of Lehman's collapse, let us look back on some compelling and often dramatic causes of the bubble that burst and evaluate if the conditions continue to exist today.

Leverage

In the decade prior to 2008, the financial industry went through tremendous consolidation that resulted in the commercial side of the enterprises (syndication, brokerage, investment banking) being merged in corporate ownership with the deposit and lending side of the enterprises whose assets were guaranteed by government-backed agencies such as the FDIC. Unknown, at least in the order of magnitude, was that the commercial side of the largest banks in our country were highly leveraged to enhance return, but also to greatly accelerate risk. Many regulations were created in the post cataclysmic 2008 recession that made leveraging, or borrowing against assets by banks, much more difficult. The regulations did so by requiring the banks to deduct the leverage from their total capital structure making common ownership of the commercial and deposit side of the business less profitable. The low borrowing rate that the Fed has maintained since the Troubled Asset Recovery Plan (TARP) has also served to improve the asset quality of most banks. Lastly, the reluctance of bank regulators to issue new national bank charters has greatly reduced the number of troubled banks throughout the country.

Syndication Meets Investor Greed

Much of the legacy of the financial crisis of 2008 was created by investment bankers syndicating and selling mortgage-backed securities. While mortgage-backed securities had been in existence since the late 1970s, the demand for high yield guaranteed securities went through the roof. As the demand increased, the investment banking need for product also accelerated and the fundamentals of the syndicated product deteriorated. New housing was created to meet mortgage demand not to satisfy true and valid market driven demand for new homes. Renters were induced to buy rather than rent through a variety of mortgage products sold through an increasing number of newly created mortgage companies, many of whom were created by the very investment banking firms that were syndicating the mortgage-backed securities. Asset quality of banks, retirement plans, pension plans, municipality and sovereign funds deteriorated as the risk within the pools of mortgages being sold and bought increased dramatically. Today, asset quality is intensely audited by state bank regulators as well as by independent auditors employed by banks and the state and national regulatory agencies. New financial accounting standards have been created and new audit standards by the Office of the Comptroller of the Currency have been adopted by state and national regulators. My personal experience is that every instance of investor loss and fraud almost always includes syndicator and investor greed coming together to form the "perfect storm." To be certain, the "perfect storm" can and will be repeated at some time, but the components that allowed for it in the run up to 2008 will be hard to replicate given the regulation that is now in place.

Federal Reserve vs. Treasury

Monetary policy did not create the fuel and accelerants of the housing bubble that popped in 2008. It was the post-deregulation era of the late 1980s through late 2000s that allowed for the consolidation of larger and larger commercial banks that also included the integration of risk and risk-free assets to exist for the first time since 1929. While this risk has been somewhat reduced through regulation on leverage, there has been nothing of consequence done to reduce the risk of the payer of last resort that guarantees both deposits and many government guaranteed loans. Today 80% of all deposits and loans are still on the balance sheets of only five banks. The regulatory responsibility of that much risk is enormous and remains today the single largest opportunity, if not managed well, to repeat the mistakes that created 2008. "Too big to fail" still exists and we (taxpayers) remain the payer of last resort.

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Chris A. Middleton, CTFA
Executive Vice President
Director of Retirement Plan Division

Lawsuits Driving Fee Reductions

Few things get more attention than mass lawsuits based on a resounding issue. In recent years, retirement plans have been the target of many individuals and law firms seeking to cash in for what some have claimed to be excessive investment-related fees within retirement plan mutual funds.

The debate about internal expense ratios within mutual funds is nothing new. Historically mutual fund families such as Fidelity and American Funds have set their annual expense ratio at a competitive market rate, and it was up to the investors and advisors to determine their interest in buying those mutual fund products. Mutual fund behemoth Vanguard stood as the main anti-fee, low cost option for investors looking to gain market return exposure without the additional fees charged for active management.

It is generally understood that the administrative costs and effort to manage $10,000 is not much different than the cost to manage $100,000, though few people complain about the fees assessed in relatively smaller balances because even higher fees on lower amounts of invested capital don't trigger significant revenue for fund companies. But what about on the other end of the spectrum--when millions turn to billions, or even trillions? Even a small percentage fee on billions can start to be perceived as "excessive" in the eyes of the public, and especially for opportunistic and/or altruistic lawyers who realize the courts may want to weigh in on the question of "how much is too much?"

"As market leaders reduce their fees in response to litigation and public scrutiny, other competing mutual fund families are following suit. Ultimately this is good for investors…"

So it is the situation with the recent glut of higher education litigation that began in 2016 and continues to weave through the court system today. And these aren't the obscure or small institutions being targeted. We are talking about Yale, MIT, Princeton, Cornell, Duke, Georgetown, USC, Vanderbilt, Johns Hopkins, Northwestern, Brown and several others. Large private sector companies have also been in the crosshairs. Home Depot, Oracle, Northrop Grumman, AT&T and others are being netted into similar litigation. In a splash of irony that can't be made up, even financial institutions and mutual fund companies themselves are being sued for offering investments with excessive fees within their own retirement plans! For instance, Fidelity settled their own 401(k) lawsuit for $12 million.

To be fair, several of these cases are being dismissed, at least in part, and even those companies offering settlements are often still denying "any fault, liability, or wrongdoing." Regardless, the results of these lawsuits are having a few notable effects in the marketplace.

Firstly, there is a well-documented race to the bottom in mutual fund internal expense ratios. As market leaders reduce their fees in response to litigation and public scrutiny, other competing mutual fund families are following suit. Ultimately this is good for investors as they are able to maintain access to reputable mutual fund investment options at lower and lower costs. Never have mutual fund fees been lower (based on a percentage of assets) than they are today.

Additionally, employers offering retirement plans are becoming more diligent in reviewing the investment options provided to their employees. This is one of the many ways Greenleaf Trust helps our retirement plan clients. As a fiduciary for all our retirement plans, Greenleaf Trust has a vested interest in making sure the investment lineup within our clients' retirement plans are best in class. The result is strong peer compared performance at very competitive costs.

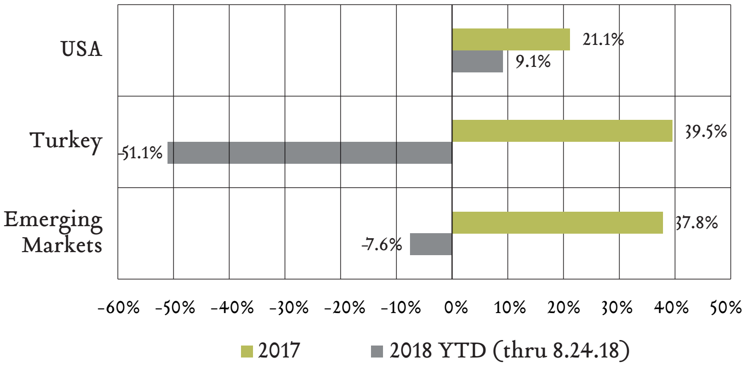
Nobody wants to find their name listed as a defendant in a lawsuit. Unfortunately, many institutions find themselves in that exact situation today. Thanks to our independent, open architecture investment approach, our clients can rest assured they will probably never deal with such a nightmare for their retirement plan.

Turkey in Context

Lucas W. Mansberger, CFA, CAIA
Investment Strategist
Senior Manager Selection Analyst

On the heels of a banner year, 2018 has been challenging for emerging market stocks. In August, the nation of Turkey was in the headlines as the value of its currency and stock market fell significantly. This result contrasts with 2017 when emerging market equities gained more than 37% and Turkish equities returned nearly 40%. Thus far in 2018, the broader emerging market stock index is down 7.6%, while the Turkish stock market has contracted more than 50%. In this article, we offer insight into problems affecting Turkey and thoughts on the potential impact for emerging market financial assets.

Equity Market Returns



* USA = S&P 1500 Index, Turkey = MSCI Turkey Index (in USD), Emerging Markets = MSCI Emerging Markets Index. Source: Bloomberg

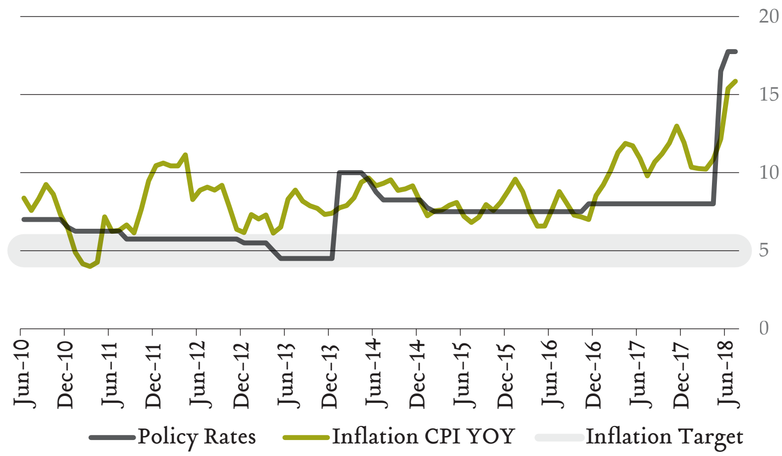
Double-digit inflation, devalued currency, and debt.

Over the past five years, Turkey's central bank (TCMB) has kept interest rates low to support the country's economic recovery. Over that time frame

Turkey in Context, continued

inflation was consistently above the TCMB's target of 5%. In 2017, inflation accelerated to double-digits. Nevertheless, policy rates were kept at only 8%.

Inflation and Interest Rates in Turkey



"We believe the risk of a contagion to emerging markets from Turkey's troubles is muted. Many of the largest emerging markets countries are more fundamentally sound than in the past."

Low interest rates and rising inflation began to cause Turkey's currency, the lira, to depreciate. In an emergency meeting in May, after the lira had fallen by more than 20% against the dollar in 2018 alone, TCMB raised rates dramatically to 16.5%. They acted again in June, raising rates to 17.75%.

In late July, TCMB met and chose not to increase interest rates. Investors interpreted the decision as a sign that Turkish President Recep Erdogan was asserting undue control over the Central Bank, which led to a sharp sell-off in the lira and in Turkish government debt. Through August 24th, the lira had depreciated by over 58% against the dollar in 2018.

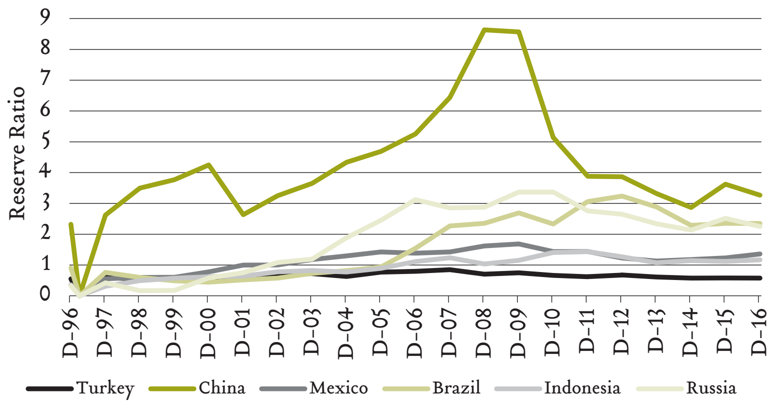
This is particularly problematic because borrowers in Turkey have a significant level of US dollar and euro-denominated debt. These liabilities now require meaningfully more lira to service. If increases in policy interest rates slow economic growth, corporate borrowers could also be less profitable. As a result, investors have grown concerned about nonperforming loans and potential defaults on Turkish debt obligations.

Risk of contagion remains low in our view.

We believe the risk of a contagion to emerging markets from Turkey's troubles is muted. Many of the largest emerging markets countries are more fundamentally sound than in the past. They appear to have the resources to weather currency-driven debt crises.

A key measure of their resilience is improved reserve ratios. The reserve ratio represents the total estimated external currency reserves of a country divided by the amount of externally-denominated debt coming due in the next twelve months. Turkey stands out among large emerging market borrowers for having a low reserve ratio. Our estimates of the reserve ratios of the other largest issuers of externally-denominated debt have all gone up considerably over the past twenty years.

Reserve Ratios Have Improved



Source: Bloomberg, data from IMF, World Bank, author's calculations.

There is concern that Turkey's issues may precipitate a banking crisis within Europe. It is estimated that around $140 billion of Turkish debt is held by banks in Spain, Italy and France, with attention focused on the banks BBVA, UniCredit and BNP Paribas.[1]

While a default cycle in Turkey would be painful, it appears that Turkey's situation is more manageable than, for example, Greece's in 2010 or 2012. In particular, the financial linkages between Turkey and the European banks appear to be less complex, the Turkish and European economies stronger, and the European Central Bank and other European financial institutions have healthier balance sheets than was the case for Greece.

"... the poor performance of emerging markets during 2018 is a reflection of many of the same factors that have harmed Turkey."

Turkey's performance should not dictate emerging market returns.

Until late July, Turkey's issues had not been the cause of significant emerging markets equity volatility. It should be noted that the country itself constitutes a small portion of global GDP and of the investable markets.

- Its GDP, around $900bn, accounts for 1% of global GDP[2],
- Its equity market cap, around $228bn, represents about 0.2% of the global equity universe.[3]
- Turkish hard-currency government debt represents a larger proportion of emerging markets debt at 4.2%, but Turkey is still only the seventh-largest country in the JPMorgan Emerging Markets Government Bond Index.

As a result of its size, Turkey's poor performance is not the largest direct contributor to underperformance in emerging market assets.

Instead, the poor performance of emerging markets during 2018 is a reflection of many of the same factors that have harmed Turkey. The US dollar has appreciated against many other currencies as the Federal Reserve has increased interest rates. Dollar appreciation directly detracts from emerging market stock returns. Additionally, many emerging markets countries are net importers of oil and have struggled with the sustained increase in oil prices from the low $50s during much of 2017 to the high $60s today. Finally, shifting US trade policy, particularly with respect to China, is

Turkey in Context, continued

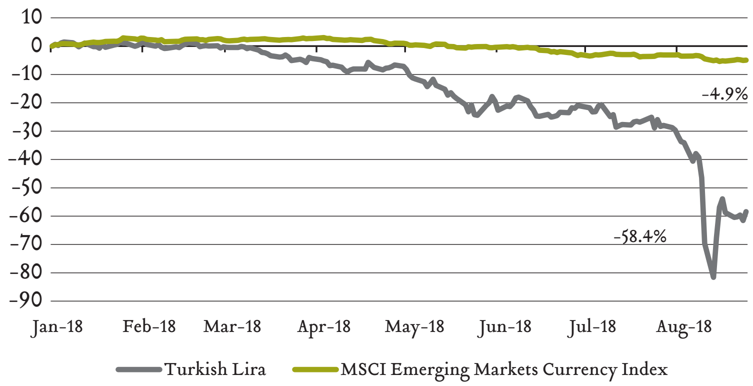
leading to heightened risk aversion as investors attempt to understand and adjust to the ramifications.

“We continue to believe emerging markets offer attractive return opportunities for long-term investors and that clients should maintain their exposure.”

We recommend continued exposure to emerging markets.

We continue to believe emerging markets offer attractive return opportunities for long-term investors and that clients should maintain their exposure. We create strategic allocations to major asset classes based on expected risk and return over the long-term. On that basis, our view of the relative attractiveness of emerging markets as a whole has not changed.

Currencies Depreciating vs USD



Valuations of emerging markets equities remain attractive relative to the US, while expected growth over the intermediate-term is expected to be higher as well. We also anticipate higher risk relative to developed markets, which we manage through prudent position sizing and portfolio diversification. We will continue to monitor developments in Turkey and in the broader emerging market investment landscape and adjust client portfolios accordingly.

References:
1. www.ft.com/content/51311230-9be7-11e8-9702-5946bae86e6d
2. www.imf.org/external/datamapper/NGDPD@WEO/OEMDC/ADVEC/WEOWORLD
3. data.worldbank.org/indicator/CM.MKT.LCAP.CD?view=chart

Save Your Receipts!

Jeff T. Pauza, CFA
Wealth Management Advisor

Health savings account participation has increased dramatically in recent years. Industry surveys have shown more than 80% of eligible employees are now enrolled in a health savings account (HSA) through their high-deductible healthcare plans. The popularity of these accounts can be attributed to several well-known, tax-advantaged uses for accumulated savings such as paying for qualified healthcare expenses, reimbursing drug prescriptions, covering COBRA insurance premiums and funding long-term care insurance premiums. Few investors are aware that health savings accounts are also an effective method to accumulate emergency savings for non-healthcare expenses.

The basic concept of an HSA is to serve as a tax-advantaged savings account for out-of-pocket medical, dental and vision expenses. These accounts have evolved since their 2003 inception into unique saving and investing tools. Families that can pay for current medical expenses from other sources have the freedom to invest their HSA funds and build greater wealth from tax-free compounding.

A health savings account is the only savings structure that enjoys triple tax benefits; contributions are tax-deductible, income and capital gains grow tax-free and qualified distributions are tax-exempt. Funds can be accessed in two penalty-free ways: 1) withdrawals can be taken from an HSA to cover qualified healthcare expenses and 2) non-qualified distributions are taxed as ordinary income for those over the age of 65, essentially turning an HSA into an IRA.

"A health savings account is the only savings structure that enjoys triple tax benefits…"

As long as your qualified healthcare expenses occurred after your HSA was established, your withdrawal will be tax-free if the funds pay for a current health related expense or reimburse a prior years' expense (even from many years earlier). This allowance from the IRS has created a unique emergency savings feature through health savings accounts. Qualified reimbursement can be pursued many years after the expense occurred. When a non-medical emergency arises and you need access to funds, you can seek reimbursement for past healthcare expenses sufficient to cover the current emergency. An HSA allows access to pre-tax funds equal to qualified healthcare expenses that you've already paid. In other words, savings to an HSA can be invested, grown tax-free for decades, and finally distributed after many years of compounded, tax-free growth to pay for current expenses. It is crucial to have proper documentation to justify the reimbursement.

The additional accessibility of HSA funds compared to other retirement accounts makes them a valuable tool to maximize retirement savings. While you likely have other available funds to pay for non-healthcare expenses, health savings accounts have superior tax savings compared with other retirement accounts while also offering earlier and broader access to funds.

Maximizing the value of your HSA requires accurate documentation and organized recordkeeping. By saving medical, dental, and vision records you will be prepared to access your HSA funds to seek reimbursement for expenses that

Save Your Receipts, continued

occurred decades ago.

The earlier you begin storing your qualified healthcare expense records, the better off you will be when you start withdrawing from your HSA. There are many resources available online to consult with to ensure a medical, dental or vision expense is qualified. You can also reach out to a member of your client centric team and they can help determine if an expense is a qualified item. At a minimum, you will want to keep the following documents with your healthcare records:

1. Receipts for items/services related to qualified medical, dental or vision expenses
2. Documents explaining items/services you've paid for
3. Employer contributions made to your HSA
4. Health savings account statements

"The earlier you begin storing your qualified healthcare expense records, the better off you will be when you start withdrawing from your HSA."

As with any important document, you have options for how to save personal information: physically, electronically, or both. It can be painful to constantly maintain detailed records, especially in physical storage. Keeping electronic files for healthcare related documents will save you precious time as well as valuable space. Greenleaf Trust's mywealth platform grants clients access to a personal and secure document storage vault that would be a terrific home for these confidential documents. With mobile access to mywealth, you can even take a picture of your documents from your phone and quickly upload these images directly to your mywealth profile.

Any member of your client centric team is prepared to help you upload, save and store documents in your private digital vault. For assistance with deciding the best method to store your private documents, please reach out to your client centric team.

Unclaimed Property – is it Yours?

Judy Grace
Vice President
Senior Trust Relationship Officer

Is the State of Michigan holding money for you that you do not know about? Michigan currently holds hundreds of millions of dollars in unclaimed property, some of which could belong to you. Unclaimed property is any property, mostly intangible property, but occasionally tangible personal property, that has been turned over to the state of the owner's last known address. What this could mean for you is that a financial institution or other corporation held money for you, lost track of you, and then turned the money over to the state to get those funds off of their books.

In the 1950s, the Uniform Law Commission enacted the first Unclaimed Property Act to create a uniform process to address the problem of abandoned intangible property and to keep companies honest with regard to the property that they held. Without some kind of uniform law in place, there was little motivation for companies to attempt to locate owners of unclaimed property. The Act has been amended over the years, but its basic framework remains the same. The Act defines when property is deemed unclaimed and sets requirements for the holder of the property to report that property to a state's unclaimed property administrator. The holder must make a formal attempt to notify the owner about the property. If the holder is unable to locate the owner, the property is turned over to the state. The state then becomes the custodian of the property until the owner is found.

Unclaimed property can include uncashed checks, dormant bank accounts, insurance policy benefits, stocks, bonds, apartment rental refunds or utilities refunds. Sometimes the items can be coins, stamps, jewelry or other items from safe deposit boxes that were not maintained. The State of Michigan takes control of this unclaimed property from banks, insurance companies, utilities companies and other corporations and holds it for the property owner until it is claimed. The State of Michigan will hold on to tangible personal property such as the coins and stamps for three years. If the items are not claimed within that time frame, the State will auction the items and hold the proceeds in the name of the owner until those proceeds are claimed.

According to the National Association of Unclaimed Property Administrators, in 2015, over $7.7 billion was collected by the states of which almost $3.3 billion was returned to the rightful owners. With decades of accumulation of unclaimed property, there are tens of billions of dollars remaining unclaimed in the United States.

The biggest concern with states holding this money is that most people do not know that this money is out there. As reported in a WNEM-TV interview with the Unclaimed Property Manager for the State of Michigan, over one million properties are currently unclaimed in Michigan. In the last three years, the State of Michigan has paid out over $270 million in unclaimed money, but hundreds of millions of dollars still sit with the State waiting to be claimed.

Finding out if you have unclaimed property with the State of Michigan is quite easy. Go to The State of Michigan's Department of Treasury website, www.michigan.gov/treasury and follow the link to the unclaimed property search. Type in the name of the person you are searching for and see if there is a match. If your name is not there, try spending a few minutes typing in the name of family and friends; most likely, you will find a match. If a match is found, there is a link to the Unclaimed Property Inquiry Form that can be downloaded and filled out. The form asks for all former Michigan addresses for the property owner. If the property owner is deceased, additional information will need to be submitted, but instructions for the documentation needed are attached to the form. The form needs to be signed, dated and notarized before being submitted to the Michigan Department of Treasury. Getting a response back from the state can take several weeks. The website lists the names of the property owners, but not the amount of the property. However, any property listed is worth at least $50.

If you have lived in other states, make certain to check the unclaimed property sites for those states. You can use the site www.missingmoney.com to help you connect with other states' unclaimed property sites.

It may not be a windfall nor change your life, but why let the state keep something that belongs to you?

"It may not be a windfall nor change your life, but why let the state keep something that belongs to you?"

Stock Market Pulse

Index	8/31/18	Total Return Since 12/31/2017
S&P 1500	672.97	10.10%
Dow Jones Industrials	25,964.82	6.73%
NASDAQ	8,109.54	18.32%
S&P 500	2,901.52	9.94%
S&P 400	2,044.70	8.67%
S&P 600	1,098.36	18.27%
NYSE Composite	13,016.89	3.50%
Dow Jones Utilities	726.41	2.85%
Barclays Aggregate Bond	106.41	-1.11%

P/E Multiples	8/31/18
S&P 1500	21.3x
Dow Jones Industrials	18.4x
NASDAQ	24.2x
S&P 500	21.0x
S&P 400	22.5x
S&P 600	27.3x

Key Rates

Fed Funds Rate	1.75% to 2.00%
Tbill 90 Days	2.07%
T Bond 30 Yr	3.02%
Prime Rate	5.00%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	672.97	21.3x	1.78%
S&P 500	2,901.52	21.0x	1.81%
Dow Jones Industrials	25,964.82	18.4x	2.12%
Dow Jones Utilities	726.41	18.2x	3.25%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.24%

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