GREENLEAF® TRUST

Perspectives

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Chairman, Greenleaf Trust

Economic Commentary

The Senate and House Tax Bills are fresh off the voting floor and into conference committee which is an abbreviated description of the traditional legislative process. Prior to the year 2000, the normal legislative process included bipartisan agreement on a legislative calendar followed by leadership assignment of senior Senators and Representatives to co-sponsor and author legislation. The legislation would then head to, and eventually be reported out of, the respective committee to the legislative floor for debate, amendments and ultimately an up and down vote. If the legislation was approved in the House, it then made its way to the senior body, the Senate, where a similar process took place. Almost always, the two legislative bodies authored and passed legislation that, while similar, contained important differences that would be resolved through the negotiation process of the "conference committee" structure. This legislative process was meant to be slow and deliberative. The result was that neither party achieved all of what they desired, but both parties achieved the important goal of being in the room and at the table. It was a time period when legislative relationships were richer and extreme ends of both parties routinely felt unheard and impotent.

The debate about how the above described legislative process was lost, and how we have landed on single party governance, can go on for hours, weeks and months — but it is safe to say that both political parties had equally important roles in its demise. Blame who you will, the fact remains that in today's political order, single party majorities will craft and pass single party policy and if unable to do so on the legislative floor they will do so via administrative executive orders. For each party, the need to gather coalitions is within their respective party and not across the aisle. Legislative victories now are clearly owned by the party in power which can be both good and bad. Tax reform of 2017 when reported out of the conference committee was authored and passed by the Republican majority in both the House and Senate and will be signed into law by a Republican president. No other tax reform legislation has had this thumbprint. Most of its provisions won't be in effect before 2019 at the earliest and thus whatever reform and economic impact was intended by the legislation won't be felt prior to the mid-term election cycle of 2018 and thus both parties will be running on the yet unseen promises and perils of it. It

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Commentary, continued

might be productive to first spend some time on what is agreed in principle upon by both the House and Senate bills and therefore not likely to change.

Reduction in Brackets

Both bills include the reduction from five to four brackets though each bill has slightly different rates for each bracket. The emphasis of the bill was to simplify, yet the rates of the brackets were not significantly lowered.

Standard Exemptions

The largest change to the code was the increase in single and married credits as well as child care credits all which doubled allowing for a substantial increase in income that will not be subject to any income tax. Within the new legislation, as authored, the first $50,000 of earned income will not be subject to any income tax. This change was specifically targeted at the campaign promise to simplify tax returns and allow for the filing of tax returns on a postal card. Bureau of labor statistics reveal that the doubling of the standard deduction will mean that 60.1% of households will not be subject to income tax at all.

"Student loan interest and medical expense deductions also were eliminated from deductibility without much rationalization."

Itemized Deductions

At this writing, the difference between bills must still be worked out but in general the SALT deduction (deductibility for state and local income tax) will likely be preserved but capped at $10,000. Several high tax states continue to lobby to uncap the deduction but the Senate seems to be holding firm at the cap level. Likewise, the deductibility of mortgage interest will be capped at a mortgage level of $500,000. This is the first attempt in post-World War Two history to remove the deductibility of mortgage interest from itemized deductions. Many economists debate the value of the deduction on home ownership participation and this attempt will provide at least some benchmark for evaluation of the premise. Student loan interest and medical expense deductions also were eliminated from deductibility without much rationalization. Neither cost that much to federal coffers and it's hard to see the political dogma interest in the elimination but none the less the deductions have been eliminated.

Alternative Minimum Tax

A very unpopular tax at both the individual and corporate level, the alternative minimum tax forced a percentage of high net worth individuals and most C corporations to spend time and resources creating two tax calculations. The Alternative Minimum Tax is exactly what it states. If in the calculation of your return your owed amount falls below what the AMT return rate would be, then your tax would be the AMT calculated amount. While this tax only impacts about 2% of individuals, it became a campaign promise and thus appeared in the bills. Whether it survives the conference committee remains a question.

Corporate Tax Rate

The legislative goal was to shift to a territorial tax policy (be taxed where you earn the income) and to lower the rate from 35% to 20% and eliminate most deductions. The conference committee is struggling to find a pathway for a rate reduction to a level between 22 and 28% as well as a repatriation of cash held in foreign locations by multinational US registered companies. Both of these negotiations are essential because at the proposed 20% corporate tax rate, the legislation doesn't meet the "Byrd rule" which prohibits adding in excess of $1.5 trillion to the deficit without regular order legislation or, in other words, bipartisan legislation.

Pass Through Rate Reduction

The overwhelming number of corporations in the country are what are termed Sub S corporations which refers to an IRS code section. Income earned by Sub S corporations is taxed on the owner's individual income tax return at whatever rate the individual owes depending upon the level of income that the owner enjoys. Reducing the rate of tax of C corporations meant that the legislation would need to provide a similar reduction to Sub S corporations. Current versions of the House and Senate bills retain the reduction of pass through income to 20% however if the conference committee compromises and increases the proposed corporate rate to between 22 and 28% you can assume the Sub S rate would follow suit.

Estate Tax

The taxable level of estates subject to tax has been doubled to $22 million for a husband and wife. There is language in the Senate bill to phase out the tax altogether, though no such language is in the House bill. The conference committee will decide the final result. The tax impacts one tenth of one percent of the population and raises inconsequential revenue for the treasury yet remains a very politicized issue. My sense is that the Republicans view this as their last best hope at repealing the estate tax and have thrown it at the proverbial wall to see if it can stick.

Important, It All Sunsets In 2025

That's right folks, this legislation will not be permanent. Congress must re-authorize the legislation in 2025 or… the act reverts to the existing code that we currently employ. The conference committee pledges to report out the final language that will be codified prior to December 22nd and, while we don't expect major changes, we will continue to watch and pass on what we learn.

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Talking to Your Children about Family Wealth, Values and Legacy

Five years ago, I wrote a *Perspectives* article entitled "The Holidays—Time to Have 'The Talk' With Your Children." The proposed "talk" centered around family wealth. A central premise of the article was that money conversations with children were generally uncomfortable, that most of us could use some help in getting the ball rolling and that family time over the holidays might provide the opportunity to move that ball. Fast forward five years and while many of our readers and clients are the same, many readers are new, and largely due to the second longest bull market in history, most of you reading this article today have more money to talk about than you did in December 2012. The earlier article prompted a number of inquiries from clients looking for more information or help in starting a conversation with their children. However, I would not be so presumptuous as to think that reading that article led most of you having that talk with your children in any meaningful way. So let's talk about why this conversation (in perhaps a broader context) remains important for you and your family and how you might approach it this holiday season or anytime thereafter.

"... virtually all wealthy parents believe it is important that their children receive a solid financial education, but less than one in four of these parents feel their children are adequately prepared for wealth."

Studies show that virtually all wealthy parents believe it is important that their children receive a solid financial education, but less than one in four of these parents feel their children are adequately prepared for wealth. They are probably right to have those feelings. Despite most families' best intentions, most fail to sustain wealth across generations. "Shirtsleeves to shirtsleeves across three generations," is the old saying describing the trajectory of most family fortunes. A recent study by the Williams Group (a respected firm focusing on the transition of family wealth) points to the certitude of the old proverb. The study found that 70% of wealthy families lose their wealth by the second generation, and 90% by the third. Perhaps surprisingly, this failure to sustain wealth is rarely due to improper estate planning, but rather to lack of communication and trust and improper preparation of heirs. With baby boomers expected to receive nearly $12 trillion from their parents, and in turn to leave $30 trillion to their children over the next several decades, it would seem that a well-thought-out conversation is in order.

So what is keeping you from having the conversation? For most people it's fear. Many parents fear that informed heirs will feel entitled to the wealth and lack incentive to lead otherwise productive lives. Others fear that disclosure will trigger sibling rivalry or that disclosure today will limit their flexibility to make changes in the future. While these fears are not entirely unfounded, they are outweighed by the consequences of failing to have open and honest discussions about family wealth and the values surrounding it.

So how do we begin the conversation? We have found that the conversation is easier, more effective and rewarding if it begins and focuses on legacy and values, rather than money. The conversation invariably leads in a different (and better) direction. One can argue that money is value neutral—its value is defined by how it is applied and the purpose for which it is applied. If we begin the conversation around money, we miss the important part: its purpose. By centering the conversation around values and legacy, parents often gain a better understanding of their own underlying attitudes about wealth and how their intentions may affect the broader family. The knowledge, values and leadership skills employed in building your family's wealth are what is most important to your children in successfully protecting, preserving and enhancing your family's wealth and legacy for future generations.

"We have found that the conversation is easier, more effective and rewarding if it begins and focuses on legacy and values, rather than money."

To Live Now or Later?

Quinn C. McCormick
Participant Services Coordinator

This is always a dilemma. You want to prepare for the future by saving, but you also want to enjoy today which often comes with a price tag. Although tomorrow is not guaranteed, you don't want to reach retirement and realize that you celebrated one too many todays and have nothing left for tomorrow. So how do you navigate this treacherous path?

I've recently been hit head-on with this question. I always had a "prepare for the future" mindset, and then my father prematurely passed away earlier this year and I started to re-evaluate my financial plan. I realized that I was diligently preparing for a future that I may never enjoy. My father passed shortly after he retired; what if the same happens to me? Will I regret skipping out on things earlier in life? I don't want to completely throw out my saver tendencies and miss out on a relaxing retirement. Here are some suggestions that helped me to move through this difficult area and determine what to do.

"Although tomorrow is not guaranteed, you don't want to reach retirement and realize that you celebrated one too many todays and have nothing left for tomorrow. "

Know your cash flow

Understand how much income you have and what you spend currently. If you want to have more money now or later, you will need to know what funds you have coming in and where those funds are being spent. Review your spending each week and make adjustments accordingly. If you overspend one week, it is easier to cut back the next week rather than waiting to review on a monthly basis and allowing the overspending to continue.

Prioritize

Certain expenses are necessities and others are luxuries. Eating is a necessity. Eating out every other day is a luxury. Learn to distinguish between the two so that you ensure all "must haves" are covered first and then you can decide

Live Now or Later, continued

what "wants" are most important. You may love eating out and, for you, that is something that is worth spending money on. Enjoy today by going out to eat but set a limit on the frequency so that you don't break your budget, maybe once or twice per week. By incorporating this expense into your budget, you are able to indulge guilt-free.

Figure out the "why" behind your spending

Maybe the reason you enjoy going out to eat so often is because you go with friends and family. The food is good but the social aspect is what truly fulfills you. Try planning to have people over to your house and have everyone bring a dish to pass. Eating in can be healthier and far more cost effective than overspending at restaurants, yet you still satisfy your "why." This allows you to live now, but also maintain your budget so that you can save for later.

Automate whenever possible

Set up automatic deductions for your retirement savings and your regular savings account. Treat these as monthly bills so that they are prioritized above all discretionary expenses. This takes the emotion out of transferring the money over to a savings account and being tempted to spend it on other things. I personally use auto bill pay as another routine. For me, it ensures that everything is done on time. I review my accounts regularly to make sure everything is functioning properly.

"Creating a plan and sticking to it is important for living life to the fullest now and in your future retirement years."

Expect the unexpected

None of us know what the future holds. As a result, it is important to save for a rainy day so that one unexpected expense doesn't completely derail your financial future. It is important to keep an emergency fund with 3–6 month's worth of living expenses. Additionally, it is helpful to factor incidentals into your budget so that you have a bit of wiggle room. With a bit of preparation, you can avoid a major financial setback. This will help you in the present and the future.

Review your plan regularly

Creating a plan and sticking to it is important for living life to the fullest now and in your future retirement years. Things don't always go according to plan, so review your plan regularly so that you can make adjustments. Maybe your new priority for discretionary funds is a big vacation or a home remodel. Those are great things that need to be incorporated into your budget. There is give and take that goes along with financial planning and it is important to change your budget to meet your needs.

Life is a constant balancing act. Each day you will be faced with decisions on where to spend your money. Having a plan and your priorities in place will make it easier to face those decisions knowing that you can enjoy your life now and still have a great retirement in the future.

The New Head of the Fed

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

The Senate began confirmation hearings on the nomination of Jerome Powell to Chairman of the Federal Reserve this week. In this article, we will examine Mr. Powell's background, the current state of the economy, and the potential financial market implications of his confirmation.

Who is Jerome Powell?

Mr. Powell has served on the Board of Governors and the Federal Open Market Committee (FOMC) of the Federal Reserve since 2012. Over his tenure, he has served as chairman of the Committee on Supervision and Regulation and has voted, without exception, along with the policy recommendations of former Chairman Bernanke and current Chair Yellen. Unlike prior chairs, Mr. Powell does not have an academic background. He is an attorney and spent time in investment banking and at a public policy think tank prior to his nomination to the Fed.

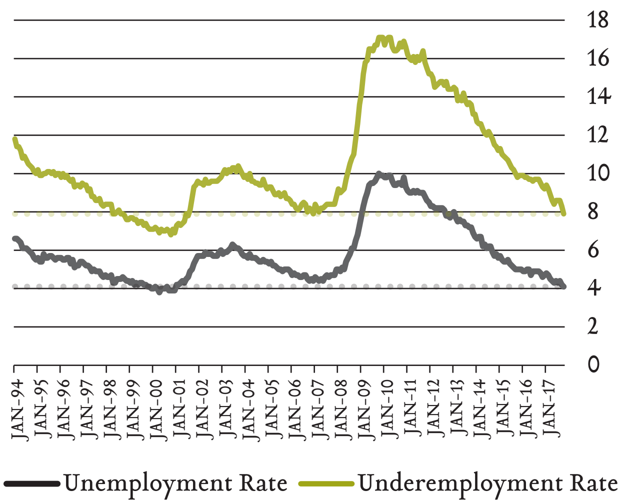
What is the current state of the economy and monetary policy?

The Federal Reserve has two goals when conducting monetary policy:

1. Maximum employment, and
2. Price stability.

In plain language, that means a low unemployment rate and moderate inflation. Let's examine some of the primary indicators the Federal Reserve cites when explaining their monetary policy stance:

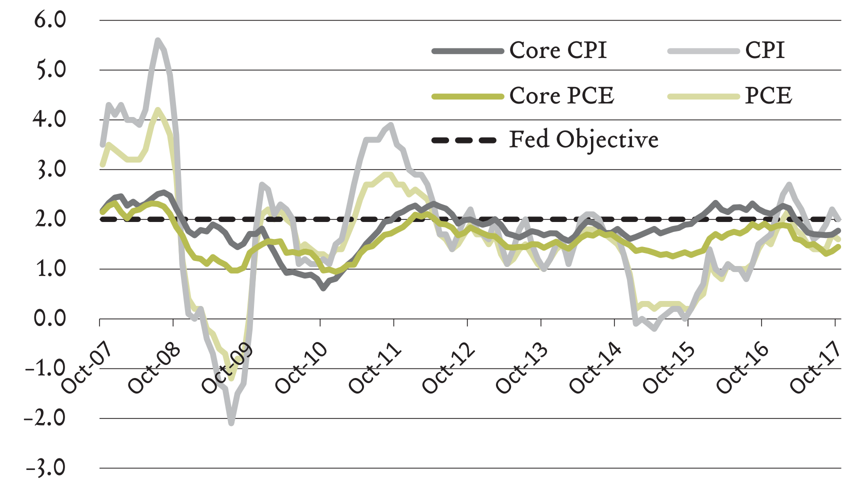
Unemployment



"Unlike prior chairs, Mr. Powell does not have an academic background. He is an attorney and spent time in investment banking..."

New Head of the Fed, continued

Inflation



"So, if confirmed, Mr. Powell will be leading policymaking at a time when... inflation continues to measure below the Fed's 2.0% target."

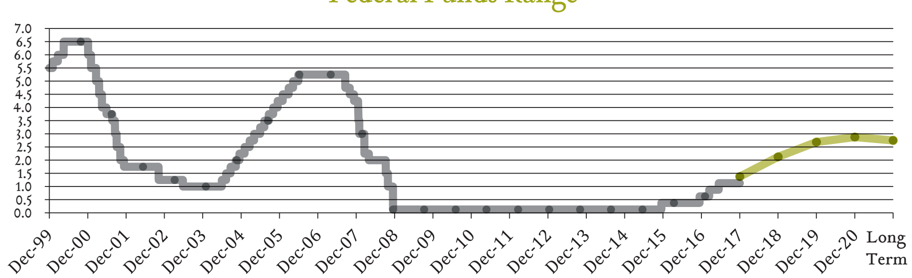
The headline unemployment rate is currently 4.1% and the Fed's preferred measure of inflation, changes in the personal consumption expenditure (PCE) index, is currently 1.6%.

Objective	Current	Target	Deviation
Maximum employment	4.1% unemployment	4.6% – 5.0%	Above full employment
Price stability	1.6% PCE change	2.0%	Below target inflation

So, if confirmed, Mr. Powell will be leading policymaking at a time when the labor market is operating at tight levels, but inflation continues to measure below the Fed's 2.0% target.

Monetary policy is currently accommodative, with the target federal funds rate range at 1.00%-1.25%. FOMC participants have communicated an expectation of increasing interest rates once more in 2017, and three more times in 2018, with a long term objective between 2.50% and 3.00%.

Federal Funds Range



What are some potential implications if Mr. Powell is confirmed?

We view Mr. Powell's confirmation as a continuation of the current policymaking process at the Fed. We believe his views to be slightly more hawkish than outgoing Chair Yellen's, but differences are on the margin. As a result, here are some of our expectations for the Fed under a potential Chair Powell:

- Normalizing the federal funds rate and the Fed balance sheet as economic conditions warrant. Importantly, Mr. Powell emphasized the need for policymaking to be responsive to economic conditions, so we do expect the Fed to change course if the economy does not respond as anticipated to monetary policy changes.
- Potential changes in Fed communications. Over the most recent decade, the Fed has taken steps to increase transparency around their monetary policy deliberations. We expect Mr. Powell to continue, and perhaps, enhance this communication, which has the benefit of reducing market surprises from the Fed.
- Potential decreases in banking regulation. Most of this article has focused on monetary policy, but the Fed serves an essential role in supervising the banking system. Mr. Powell has noted an openness to reducing some regulation on the banking sector, with a particular focus on the impact of regulation on small and regional banks.

Mr. Powell is a respected figure at the Fed and was a responsible choice as its next Chair. We expect continuity, strong communications, and thoughtful policymaking under his leadership. He is stepping into the role after a period of modest, but sustained, economic expansion, low inflation, and stability in the banking system. These conditions allow for the incremental removal of monetary policy accommodation and we will evaluate the pace and magnitude of these changes while Mr. Powell guides the Fed.

“We view Mr. Powell’s confirmation as a continuation of the current policymaking process at the Fed.”

Sources:
Federal Reserve: https://www.federalreserve.gov/aboutthefed/bios/board/powell.htm
Bureau of Labor Statistics. Unemployment Rate = U3 Unemployment, Underemployment Rate = U6 Unemployment, Core CPI = US CPI Urban Consumers Less Food & Energy, CPI = US Consumer Price Index, Core PCE = Personal Consumption Expenditures Less Food & Energy, PCE = Personal Consumption Expenditures

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Planning vs Emotion

As I write this, it is unseasonably warm outside here in Michigan. The sun is shining, and it's close to 60 degrees. Having grown up in Michigan, I'm used to unpredictable weather. Having been in finance for 27 years, I'm also used to unpredictable markets. For those of you who read my article earlier this year about becoming a Quinquagenarian, I recalled the winter of 1967 where the weather went from 60 degrees to 30 inches of snow in only two days. How quickly we forget that we live in Michigan and the combination of snow and cold is part of living here. As investors, we have also seen sudden drops and major falls, but it's been since 2008 that we have experienced a major decline in the markets. In fact, many investors have been lulled into complacency about stock market volatility. We seem to forget that while temperatures rise, both outside and in the markets... they also fall.

Last month, my colleague, Jeff Pauza, quoted Ned Stark from the Game of Thrones and his warning for battles ahead with the words "Winter is Coming." While Jeff spoke of how we can prepare for the next downturn, many investors have forgotten that this is a possibility. A very wise man said to me recently that "a bull market gives you amnesia," and I couldn't agree more. As we meet with our clients, who are thrilled with market returns, I often have to remind them of the cold outside and the reason we wear jackets in February. A well-diversified portfolio married to a prudent investment objective based upon your goals, time horizon, risk tolerance and unique circumstances is your portfolio's winter jacket.

"A very wise man said to me recently that 'a bull market gives you amnesia...'"

Current market volatility is lower than average historical levels. Historically we have seen on average 17 days per year when the S&P 500 goes up or down greater than 2% in a trading session. Year to date in 2017 we have seen zero +/- 2% days. While volatility is normal, we haven't seen it in so long that many investors have stopped worrying about it. Few want a market pullback, but like Michigan winters and negative wind chills, we have to be prepared for that to happen. It's important to have conversations about market volatility. How would you feel if your equity position went down 10, 15 or even 20%? Could you weather the storm, hunker down, stay inside? Or would you bail – sell out of your stocks and jump on the first plane bound for the Caribbean?

Behavioral finance tells us that most individual investors without a written plan routinely make decisions based on emotion and often fall prey to their own inherent biases. Paradoxically, these biases can even be at odds with each other. Given today's market environment, this is most evident when considering the duality of the Recency Bias and Loss Aversion. Recency Bias places too much emphasis on recent events. With the lack of market volatility this year, many investors have forgotten that it even exists. The market low of March of 2009 is just a foggy memory. Feelings of disappointment and trepidation have long since dissipated. Fears of losing money have been replaced by fears of missing out on the next leg up. However, just like with the weather, Recency Bias tricks investors into ignoring the wise aphorism, "this too shall pass" and instead pushes them to believe "this time is different." The natural consequence is an imprudent overreaction to both storms and sunny days alike.

While Loss Aversion is quite different from the Recency Bias, it can be equally dangerous. Loss Aversion studies have shown that the pain of losing money in the market is twice as agonizing as the joy of making money, which is very similar to when we complain more about bitter cold days than we rejoice the beautiful summer ones. In contrast to the Recency Bias, with Loss Aversion, investors have trouble believing that this euphoric bull market will continue. The pain of the financial crisis of 2008, when they lost money, is still fresh on their minds. While trimming gains is perfectly in order, the investor who falls prey to Loss Aversion, will take such extreme measures as selling all of their equities to avoid a potential loss. Unfortunately, this is ill-timed and these investors miss most of the upside (imagine if you had gone to cash on January 1st of this year and missed out on a 15% gain). Investors with Loss Aversion bias tend to gauge gains and losses on different scales. People with this bias will try twice as hard to dodge a loss than they will to achieve a comparable gain.

So how does one avoid the traps of behavioral biases? We believe that the best strategy is to design a portfolio that meets your long-term goals and focus on those goals despite the weather in the markets. When investors react to their biases, they tend to sell out of the market at inopportune times and buy back into the markets at the wrong time. Helping our clients avoid making emotional decisions adds long term value to their portfolios.

In fact, many of us aren't afraid of the snow storm once it hits… we are at home, cozy by the fire with our hot cocoa. What panics us the most is the forecast, the threat of bad weather. We head to the stores; we stock up on necessities. Snow storms can pass without concern… if we are well prepared.

As I look outside and see how beautiful and sunny it is, I am reminded that, while it may be unseasonably warm now, there is surely snow and freezing temperatures in the forecast. Like cold weather, there will also be market downturns. However, just as we know that spring follows winter, bears eventually give way to bulls. Emotional biases are the blizzards that cripple investors and can damage long-term returns. A disciplined financial plan is required for investors to stay calm in the face of a storm. Warren Buffett said it best, "To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework. You must supply the emotional discipline."

"In fact, many of us aren't afraid of the snow storm once it hits… we are at home, cozy by the fire with our hot cocoa. What panics us the most is the forecast, the threat of bad weather."

Stock Market Pulse

Index	11/30/17	Total Return Since 12/31/2016
S&P 1500	613.67	19.93%
Dow Jones Industrials	24,272.35	25.69%
NASDAQ	6,873.97	29.09%
S&P 500	2,647.58	20.49%
S&P 400	1,899.18	15.97%
S&P 600	942.94	13.80%
NYSE Composite	12,627.80	17.00%
Dow Jones Utilities	770.39	20.58%
Barclays Aggregate Bond	109.08	3.07%

P/E Multiples	11/30/17
S&P 1500	22.7x
Dow Jones Industrials	20.4x
NASDAQ	24.5x
S&P 500	22.3x
S&P 400	25.4x
S&P 600	29.4x

Key Rates

Fed Funds Rate	1.00% to 1.25%
T Bill 90 Days	1.20%
T Bond 30 Yr	2.82%
Prime Rate	4.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	613.67	22.7x	1.97%
S&P 500	2,647.58	22.3x	2.03%
Dow Jones Industrials	24,272.35	20.4x	2.45%
Dow Jones Utilities	770.39	NA	3.45%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.91%

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