GREENLEAF® TRUST

Perspectives

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William D. Johnston
Chairman, Greenleaf Trust

Economic and Market Commentary

The end of the first quarter of 2013 gives us the appropriate time to evaluate our economy’s recovery progress. Clearly financial markets have been strong for the first ninety days of the year, but what is the fundamental underpinning of those gains? Are the robust results of domestic stock market gains a predictor of future GDP growth or simply the case of no place else for investors to make money? Part of the answer lies in the data, so let’s examine it.

DATA POINTS	Q1 2010	JUNE 2010	SEPT 2010	APRIL 2011	JULY 2011	JULY 2012	SEPT 2012	FEB 2013
LABOR FORCE	153.2 million	154.4 million	154.1 million	153.4 million	153.4 million	153.5 million	154.6 million	155.6 million
EMPLOYED	138.9 million	139.4 million	139.2 million	139.8 million	139.3 million	139.6 million	142.01 million	143.5 million
INITIAL JOBLESS CLAIMS	452,000	457,000	453,000	388,000	422,000	408,000	359,006	357,000
UNEMPLOYMENT RATE PERCENTAGE	9.7%	9.7%	9.6%	8.8%	9.2%	9.2%	8.1%	7.7%
AVERAGE UNEMPLOYMENT DURATION	31 weeks	34.4 weeks	33.6 weeks	39 weeks	39.9 weeks	40.3 weeks	39.2 weeks	36.9 weeks
CONSUMER CONFIDENCE	52.3%	63.3%	48.5%	63.4%	58.5%	60.1%	70.3%	59.7%
PURCHASING MANAGERS INDEX	60.4%	59.7%	54.4%	61.2%	55.3%	51.6%	49.6%	51.7%
NON-DURABLE GOODS ORDERS	$206 billion	$226.0 billion	$216.7 billion	$245 billion	$248.9 billion	$251.0 billion	$248.0 billion	$255.0 billion
DURABLE GOODS	$179 billion	$192.0 billion	$191.2 billion	$200 billion	$195.6 billion	$201.0 billion	$198.0 billion	$232.0 billion
DOMESTIC AUTOS SOLD	165,656	189,000	146,000	195,288	198,000	199,000	199,899	203,000
CONSUMER SPENDING	$10.3 billion	$10.4 billion	$10.37 billion	$10.7 billion	$10.7 billion	$10.8 billion	$11.2 billion	$11.4 billion
NEW HOME SALES	308,000	300,000	288,000	301,000	319,000	460,000	373,000	411,000
NEW HOUSING PERMITS	650,000	574,000	569,000	517,000	612,000	620,000	803,000	946,000
NEW HOUSING STARTS	605,000	593,000	598,000	479,000	560,000	571,000	294,000	917,000
CREDIT MARKETS								
MUNI BOND BUYER INDEX YIELD	5.2%	5.17%	4.87%	5.7%	5.25%	4.23%	4.19%	4.15%
DOW JONES CORP. BOND INDEX	4.30%	4.14%	3.45%	3.93%	3.70%	2.79%	2.72%	2.58%
YIELD GAP ON DJIA TO BOND INDEX	-3.1%	-2.84%	-2.31%	-2.85%	-2.65%	-1.25%	-1.17%	-1.24%
TEN YEAR TREASURY	3.85%	2.97%	2.54%	3.47%	2.99%	2.00%	1.56%	1.83%

Commentary, continued

"The recurring theme presented in the preceding data points, as well as the thirty one additional indicators we monitor, continues to be incremental improvement..."

The recurring theme presented in the preceding data points, as well as the thirty one additional indicators we monitor, continues to be incremental improvement which, over time, adds to the sustainability structure of the economy. To be certain, one cannot make a strong case for sustainable growth when GDP forecasts remain below 3.0%; however, the consistency of incremental progress cannot be denied.

Unemployment, while still stuck in the upper 7% range, is improving, as is personal income and consumer spending. While the improvement is not dramatic, it is consistent. Duration on unemployment has taken the first significant downturn since July 2012 and coincides with sustained help wanted index strength and small business optimism index growth. We are seeing regional data showing significant growth in employment for those under thirty years of age. As expected, that data is most positive for skilled and higher educated applicants. Denver, as an example, has recently reported that for those under thirty years of age and who possess a bachelor's degree or the technical skills required for advanced manufacturing, the unemployment rate is 4%. On average, economists consider full employment to exist when the unemployment rate is 4.5%.

Currently, reported unemployment is recorded at about twelve million of the current workforce of approximately 155 million people. The gap between 4.5% unemployment or full employment and our current condition is approximately five million people; interestingly, the help wanted index currently lists slightly over five million jobs available. Several factors comprise this dichotomy. The greatest factor is the one demonstrated by the Denver regional statistics. Education and technical skills continue to be sought in large numbers by employers and the barriers to entry in the workforce continue to grow with respect to both. Compounding the issue on the lower end of the wage scale is that minimum wage combined with earned income tax credits often exceed entry level wages. The Denver region scenario is repeated elsewhere. In Michigan our official data reveals 405,000 unemployed while simultaneously we record employers with nearly 270,000 job postings. Talent, skills and education required for the jobs available are simply not in synch and the bad news for those unemployed is that the barriers to entry will get higher in the years ahead. Slow growth economies have always been difficult on the lower wage earner and this recovery isn't any different.

Housing statistics reveal a turn in the dynamic of recovery. In 2009, we wrote that it would take until 2014 and perhaps 2015 before we would chew through the excess inventory of single family homes that were built not as a result of demand during the period of 2002 to 2007 but rather the proliferation of fraudulent securitization of mortgage backed instruments. Land investment as well as new housing permit requests by large single housing developers suggest they are planning for the need that will exist in the near future as inventories are reduced gradually through population and income growth. A five year lull in building can cure a great deal. Affordability is also a huge contributing factor in renewed demand. An observation of the investment in multi-family apartment units during the period of 2010-2012 affirmed that much of the capital investment by large real estate investment trusts shifted back into large apartment projects. In essence, as homeowners left single family homes for apartments, investors did as well. Occupancy rates soared in many regions and rent increases followed, thereby rewarding the investment. While that trend will not change dramatically, the dynamic of the trend has begun to soften. There are two other components that bode well for single family homes. Rent increases have, when coupled with historically low interest rates, flipped the affordability calculation and in many regions it is becoming more affordable to own rather than rent. In hockey you are put in the penalty box for a period of time; the same is true for foreclosure. For many existing government-backed mortgage programs the duration of time on "requalifying" for mortgage backed program eligibility is three to seven years, meaning that many homeowners that lost their homes between 2008 and 2011 are returning to "applicant eligible" status for government-backed programs. Combine affordability, low mortgage rates, reduced inventory and increased applicant eligibility and you can see some of the elements for sustained housing recovery.

There are still many things to be concerned about with our economy, but most don't have to do with Adam Smith's economic theory of demand. Our population grows slowly, as does our income. On balance this will remain true in the foreseeable future because we can't change either very much. Education and skills will help the labor force but only over time and not in the near term. Housing will improve and that is good but will not impact GDP very much. The Eurozone is still very problematic and Cyprus has now introduced a new way to fund deficits, simply take depositors' money and call it a tax. Doing so only encouraged those that are or may be depositors in other Eurozone institutions to send their money to the US equity market or invest in hard assets such as land, art, New York apartments, rare collectables and isolated islands. Our original question was whether the strong gains in the equity market through March were a predictor of future economic growth or the result of a TINA market - [as in, There Is No Alternative to US stocks as a

"There are still many things to be concerned about with our economy, but most don't have to do with Adam Smith's economic theory of demand."

Commentary, continued

place to store your money, as described by Barron's Randall Forsyth]. The answer is, some of both—and how much is hard to determine though somewhat related. If the Eurozone suddenly got very healthy there would be an outflow of funds from US equities, but that scenario is dependent upon a healthy Eurozone, which is highly in doubt. The more dependable scenario is that we continue our incremental progress and justify the current valuations which are very much being supported by low interest rates and tremendous liquidity supplied by the Federal Reserve. Neither of those contributions are going to be derailed in 2013.

Michael F. Odar, CFA
President

Team Improve Processes for Clients Update

As we finish up the first quarter of 2013, I want to update clients on some of the meaningful progress we've made on our 2013 Strategic Plan. The plan is designed to help us be the best by focusing on what we do the best. What we do best is provide holistic wealth management services to clients in a spirit of continuous improvement, wrapped in honest and honorable, and with an unparalleled degree of commitment to those clients. The four primary initiatives of our plan are Process Improvement, Benchmarking, Data Collection and Analysis, and Education and Training.

At last count, our team has re-engineered and documented more than 30 work flow processes, in most cases using tools we already have, to add automation and increase efficiencies. The results are more time with and for clients. To encourage more purposeful thought in this area, we have also constructed our Efficiency Lab outside the "four walls" of our main office, where teammates can spend creative time together improving how we do things. As part of our Process Improvement initiative, we are also looking into ways to customize and communicate with clients more effectively and efficiently. A social media presence will be an obvious solution, but this is also an opportunity to remind everyone of the Go Green initiative we started a few years ago.

This is not a shameless ploy on my part to increase awareness of my beloved Spartans, but instead our effort to reduce waste, shrink our environmental footprint, and deliver information to clients more effectively, faster, and more securely. An impactful and easy way for clients to participate is to consider receiving statements electronically or changing the frequency of their paper statements. For instance, clients and retirement plan participants can stay informed by accessing their account through our secure website anytime, receive electronic statements monthly, and a paper statement quarterly or annually.

In the spirit of continuous improvement, we are also aggressively looking within as well as outside our industry to benchmark the best. We also benchmark against ourselves. Right now we are in the midst of collecting results from our most recent client survey that provides clients the opportunity with candor to let us know how we are doing and what we can do better.

As the well-known management consultant Peter Drucker once said: "If you can't measure it, you can't manage it." We think he is correct, and that's why we are quantifying as much of our business as possible. As part of our Go Green initiative, our Retirement Plan Division is using existing tools to measure electronic statement participation rates. Increased electronic statement adoption creates a cost savings, as well as accelerates information delivery and security.

Finally, if we can't figure it out, we're not too proud to call in the experts. A few of our Process Improvement initiatives require consultants to not only educate and train team members, but in some cases to do the work too, so that we can remain focused on clients. Members from every division have attended targeted conferences and seminars to increase their and teammates' knowledge of best practices in the industry. Select members are also attending courses and studying to attain advanced industry designations. For example, two of our Senior Wealth Management Advisors who have already earned their Certified Financial Planner (CFP) certifications will be entering the Certified Private Wealth Advisor (CPWA) certification program, focusing on advising high net worth clients and the life cycle of wealth.

"At last count, our team has re-engineered and documented more than 30 work flow processes… to add automation and increase efficiencies."

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

Retirement Plan Product Enhancement – 3(38) Fiduciary

Fiduciary is a very strange word. A recently popular internet video asked strangers what they thought the term fiduciary meant and several responded by suggesting that it might actually be a swear word. Perhaps. Or it simply means one who has a responsibility in certain obligations to others. It is one of those two.

A core pillar of Greenleaf Trust is fiduciary excellence. Put simply, we strive to carry out our clients' (and often times corresponding beneficiaries') desires at the highest levels. Within the Retirement Plan Division this fiduciary duty includes helping to offer prudent investment options to the employers who sponsor corporate retirement plans so their employees have access to great investment choices.

Although many retirement plan providers have attempted to side-step any fiduciary responsibility, Greenleaf Trust has always embraced it is a key role in our service to clients. And now we are looking to even expand the level of fiduciary service we provide to our corporate clients.

For the majority of our retirement plan clients, we currently serve as a directed trustee and ERISA Section 3(21) fiduciary. In this 3(21) capacity, we make recommendations to the plan sponsor (i.e. employer) of the mutual funds to be offered under the plan, and the plan sponsor makes the ultimate decision on the fund offerings. Although we perform all the due diligence work to support our recommendations, we have no actual discretion on the selection of plan investments.

To enhance the service options we will offer to serve as a fiduciary under ERISA Section 3(38). Under this arrangement we would be an "investment manager" with full discretion for the selection, monitoring and replacement of plan investment options, as well as the development of the investment policy statement for the plan. Accordingly, the plan sponsor is relieved of fiduciary risk for such actions. The plan sponsor does, however, retain the duty to prudently select the investment manager and assure the manager is carrying out its appointed duties.

There is no doubt that 3(38) is a deeper fiduciary function. However, there are still plenty of employers that will prefer to be more involved in the investment selection process and will therefore not be interested in Greenleaf Trust serving as a 3(38) fiduciary.

Going Through Withdrawal— Is the 4% Rule Dead?

Andrew L. Riker, CFP®
Senior Wealth Management Advisor

For the past two decades many retirement planners and retirees have relied on the 4% rule as a rule of thumb in determining a safe withdrawal rate from nest eggs. The concept, introduced by certified financial planner, William Bergen, states that retirees can safely begin withdrawing 4% of their retirement assets in the first year of retirement, increase the withdrawal amount by a presumed inflation rate in subsequent years, with a very small risk of running out of money during their lifetimes. The rule has been highly scrutinized lately, given sub-par stock market returns and extraordinarily low yields on fixed income securities, leading many to question whether the rule remains viable.

For illustrative purposes, we conducted a quick test of the rule by running the numbers assuming retirement in 1992, 1997, and 2002. We assumed the retiree had $1 million at retirement, withdrew $40,000 (4% of the $1 million) at the end of the first year of retirement, and increased the withdrawal amount by 3.06% (the long term average inflation rate) each year thereafter to account for inflation. Actual historical market return data from Ibbotson was used. Finally, we assumed the retiree maintained a moderate asset allocation of 60% equity, 35% fixed income, and 5% cash. The table below shows where their nest eggs would have stood at the end of 2012, and what the corresponding withdrawal rate would have been at that time.

> "...the 4% rule [is] a rule of thumb in determining a safe withdrawal rate from nest eggs."

RETIREMENT YEAR	2012 YEAR END PORTFOLIO VALUE	2012 WITHDRAWAL RATE AS A % OF MARKET VALUE
1992	$2,787,190	2.62%
1997	$1,545,602	4.07%
2002	$997,136	5.42%

Did the 4% rule work? In our example, the individuals that retired in 1992 and 1997 experienced portfolio growth and assuming they maintain the same trajectory of withdrawals past 2012 the likelihood of running out of dollars prematurely would be very unlikely. Clearly the individual that retired in 2002 would not be in as good of a position as the other two, but according to some of our most conservative internal models, it would be at least 18 more years before this individual may run out of money. Of course, we cannot rely solely on these examples, which are based on past returns, to make a

4% Rule, continued

conclusion on the viability of the rule. However, because we know that market returns from 2002-2012 have been sub-par and the rule has a good chance of holding true for someone who retired in 2002 our tests above support the notion that the 4% rule is valid.

There are many variables to consider when determining a safe retirement withdrawal rate. Common considerations are listed below:

- Age at retirement
- Desires for money after passing
- Other assets
- Discretionary versus fixed costs
- Market valuation
- Debt
- Insurance coverage
- Other income sources

When advising clients on withdrawal rates, we consider the above factors and additional unique characteristics of each client's circumstances. Depending on the client, withdrawal rates above or below 4% may be appropriate. To analyze appropriate withdrawal rates, we rely on internal probability models employing Monte Carlo probability simulations, which enable us to more clearly understand the future uncertainty associated with a particular investment strategy.

"[These] methods of examining the 4% rule support its validity. But, given the extraordinarily low current fixed income yields, will the 4% rule work going forward?"

Our probability based model simulates thousands of path dependent, hypothetical 75-year market scenarios, thereby creating a probability distribution of what could possibly happen to investment assets in the future with different levels of certainty. The dynamic assumptions incorporated into the model include historical inflation, return, volatility, and correlation (based on data from 1926-2012 provided by Ibbotson).

The above methods of examining the 4% rule support its validity. But, given the extraordinarily low current fixed income yields, will the 4% rule work going forward? To answer this question, we have developed a twenty year forward looking model to account for the current fixed income environment. We also incorporated data from the late 1950s, which represents a similar fixed income environment with low yields and potentially rising interest rates on the horizon. This model uses the following assumptions:

1. For the next four years (2014-2017) the following annual returns were assumed for equities, fixed income and cash:
   - ◊ Given the continued low interest rate environment, 0% fixed

income returns were assumed

- ◊ .06% returns for money market investments
- ◊ Below average stock market returns of 7%, 6%, 7%, and 6%, respectively

2. Returns for 2018 through 2034 for equities, fixed income, and cash, were based on actual return data from 1957 through 1973 (provided by Ibbotson), given the similar investment climate.

We tested this model by using the same example used above: a retiree with $1 million at retirement, a withdrawal of $40,000 (4% of the $1 million) at the end of the first year of retirement (2014), and increases in withdrawals by 3.06% each year thereafter. We also assumed a 60% equity, 35% fixed income, and 5% cash allocation. The table below shows where a retiree's nest egg would stand twenty years from now, in 2034, and what the withdrawal rate would be at that time.

RETIREMENT YEAR	2034 YEAR END PORTFOLIO VALUE	2034 WITHDRAWAL RATE AS A % OF MARKET VALUE
2014	$1,468,582	4.98%

The above test, which plans on no returns from fixed income investments for the next four years, and uses return data from a period with a similar interest rate environment, is a decent downside test of whether or not the 4% rule can work going forward given the current low level of interest rates. Our findings in the above table also support the 4% rule. The person retiring in 2014 in this example would have approximately $1.47 million twenty years following retirement. Assuming withdrawals continue to increase at the inflation rate past 2034, our most conservative internal models suggest it would be at least another 20 years. This means that, assuming the individual was 65 at retirement there would be little risk that they would run through their nest egg prior to age 105.

It is important to note that all of the examples in this article used a moderate asset allocation of 60% equities, 35% fixed income, 5% cash. Because yields on fixed income investments are currently very low, a portfolio that is heavily weighted to fixed income will most likely not be able to sustain a 4% withdrawal rate for the duration of retirement. Most authors that have recently argued against the 4% rule have assumed a portfolio that is primarily invested in fixed income investments. The appropriate asset allocation strategy to employ is a highly client-specific decision. However, given where

"… we believe the 4% rule can still be used as a quick reference point in estimating a safe amount to withdraw from retirement assets."

4% Rule, continued

fixed income yields are now, a primarily fixed income based portfolio for a retiree desiring a 4% withdrawal rate is most likely not advisable at the present time.

In closing, we believe the 4% rule can still be used as a quick reference point in estimating a safe amount to withdraw from retirement assets. However, the current investment and economic environment, and especially the unique considerations of each individual, play a critical part of a thorough analysis to arrive at an appropriate withdrawal rate.

Marx, Marriage and Taxes

Christopher T. Haenicke, JD, CTFA
Vice President
Trust Relationship Officer

"…husbands and wives have long had the ability to give an unlimited amount to each other… free of gift or estate tax."

I begin this month's newsletter article with Marx's observation that marriage is a wonderful institution, but who wants to live in an institution? Of course, this witty phrase is attributed to Groucho Marx, not Karl Marx. While the institution may not be as common as it once was, marriage is certainly being discussed and debated by many these days, including the Justices of the United States Supreme Court. Less contentious, and perhaps more financially significant to many, are the recent changes to the federal estate tax laws as they relate to married couples. As a result of the fiscal cliff bill passed on New Year's Day, widows and widowers can add any unused estate tax exclusion of their deceased spouse to their own $5.25 million estate tax exclusion amount. This election, commonly referred to as portability, enables a married couple to transfer up to $10.5 million free of federal estate tax. As you will read below, this benefit is not automatic, and a surviving spouse should consult with a knowledgeable estate planning attorney or tax advisor to secure the advantages of the new law.

Thanks to the unlimited marital deduction, husbands and wives have long had the ability to give an unlimited amount to each other, during life or at death (provided the surviving spouse is a US citizen), free of gift or estate tax. This deduction remains in force. While this deduction allows a couple to avoid all estate tax upon the death of the first-to-die, assets transferred to the surviving spouse become part of his or her estate, and are thus subject to estate tax at the time of the survivor's death. Relying exclusively on the unlimited marital deduction in such a situation results in a waste of the first-to-die's exclusion amount, since the deceased person's unused exclusion is not available at the death of the second-to-die. To avoid this outcome, attorneys have for decades written trusts that include both a bypass trust (also called family trust or credit shelter trust) and a marital trust. At the death of the first-to-die, the bypass trust is funded with the exclusion amount, while the balance of the estate is placed in the marital trust.

The bypass trust plan worked best when the first-to-die spouse had sufficient assets in trust to take full advantage of the exclusion amount. Since no one could be certain which spouse would die first, couples were often encouraged to transfer assets to balance their possible estate as evenly as possible. The unwillingness or inability to transfer assets, and repeated changes in the exclusion amount, meant that an unused portion of the first-to-die's exclusion amount was sometimes wasted, even with such trusts. Moreover, not all married individuals die with a trust in place, or die with one that was not properly funded.

For a number of reasons, the bypass trust is still the preferred method for preserving the deceased spouse's exclusion amount. Assets in a bypass trust may be shielded from a beneficiary's creditors, they may be exempted from generation-skipping transfer tax, and they may be used to benefit the children of a previous marriage. However, the portability election enables widows and widowers to add any unused estate tax exclusion of their deceased spouse to their own, exclusions that might otherwise be wasted. The following simple example may help you understand how portability works.

Assume that Husband dies in 2013, with an estate of $3.25 million. An election is made on Husband's estate tax return to permit Wife to use Husband's unused exclusion amount. Wife's applicable exclusion amount is then $7.25 million (her $5.25 million exclusion amount, plus the $2 million unused exclusion amount from Husband), which she may use for lifetime gifts or for transfers at death.

To take advantage of the portability law, an executor is required to file a federal estate tax return (Form 706) for the first-to-die spouse's estate. This return is due nine months after death, with a six-month extension allowed. The return must be filed even if the executor is not otherwise obligated to file a Form 706, for example, because the decedent's estate is too small. If the executor doesn't file the return or misses the deadline, the surviving spouse loses the right to portability.

A thorough recitation of the

"For a number of reasons, the bypass trust is still the preferred method for preserving the deceased spouse's exclusion amount."

Marx. Marriage and Taxes, continued

detailed requirements and limitations of the portability law is beyond the scope of this article. For instance, the election is only available for deaths occurring after December 31, 2010, it is only available for surviving spouses that are US citizens, and it may be impacted by the remarriage of the surviving spouse. With the recent changes to federal estate tax law, you should discuss your estate plan with your estate planning attorney if you have not done so in the last few years. More importantly, you must consult with a knowledgeable estate planning attorney or tax advisor at the time of your spouse's death, to determine whether or not you should avail yourself of the portability law.

When asked for the secret of my long marriage to my wife Jenny, I reply that we take time to go to a restaurant two times a week where we enjoy a little candlelight, dinner, soft music and dancing. She goes Tuesdays, I go Fridays. (Thank you, Henny Youngman.)

Michael A. Storms, CFA
Research Analyst

Municipal Bond Market – "Risk vs. Reward"

The municipal bond market has been at the forefront of fixed income investors' minds for a while now. The strong returns during 2012 and so far into 2013 have been one of the primary reasons investors are taking a deeper dive into this asset class. The other primary contributor is the recent increase in tax rates on high income earners. Most municipal bond investors are individuals that are in the upper tax brackets.

Municipal bond yields are near historic lows and have remained at this level for a while despite heightened concern of credit quality. The supply of municipal bonds has declined and investors have continued to pour capital into mutual funds containing municipal bonds. The supply/demand dynamic has held the municipal bond yields at extremely low levels.

Despite the strong returns and increased tax equivalent yields resulting from the recent tax increases, credit quality remains our biggest concern. The following is a list of some of the specific topics we are focusing on when it comes to credit quality:

- Revenue Growth
- Unfunded Liabilities
- Reliance on Federal Funding

Revenue Growth

State government revenue is continuing to recover from 2012 levels. State tax revenues have increased eleven consecutive quarters. While the rate of growth has slowed somewhat in recent quarters, state tax revenues are now above pre-2012 levels, although they are still below the levels during the first quarter of 2008.

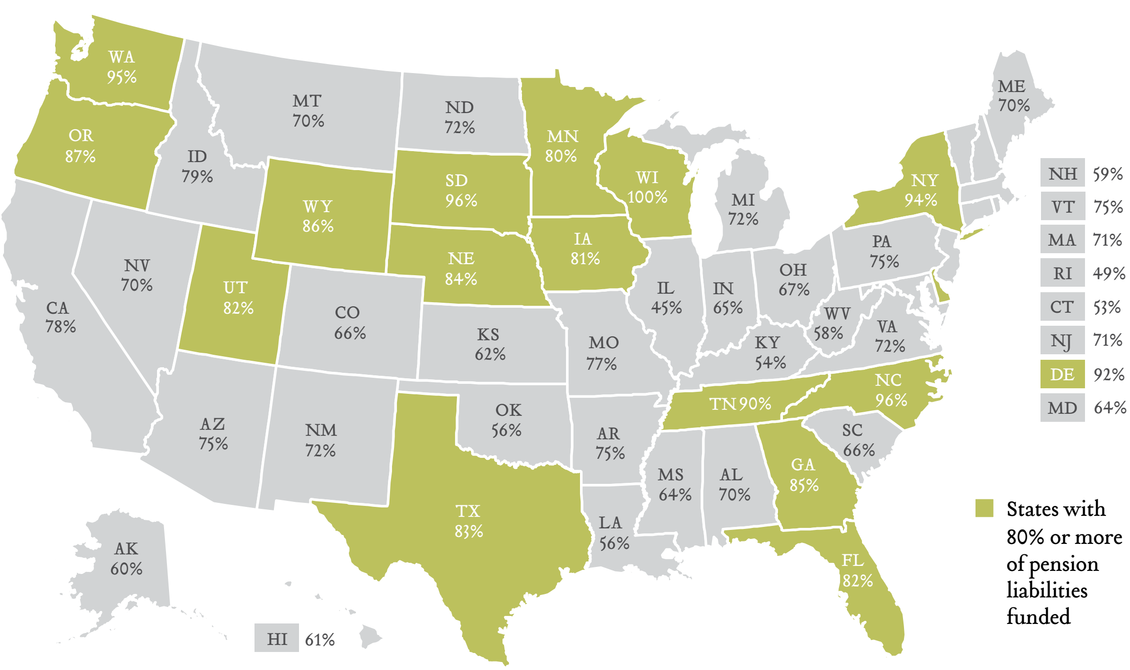
State revenue growth has outpaced local revenue growth. This is primarily due to the growth of property taxes, which typically lag state revenue growth. Local tax collections have been weak, largely due to the impact of falling house prices on property tax collections, which on average account for 30% of local government revenue. Beyond property taxes, the other main source of local revenue is state aid, which typically accounts for 35% of local budgets. States have increasingly cut aid to local governments to balance their own budgets.

"States have increasingly cut aid to local governments to balance their own budgets."

In summary, revenue growth has been recovering, but is still below levels prior to the 2008 market downturn. In addition, the pace at which revenue levels are recovering is starting to plateau.

Unfunded Liabilities

Pension funding remains an issue for many states. The Pew Center on the States published a study that showed states had an aggregate of $757 billion of unfunded pension liabilities. Annual required pension costs are increasingly becoming a larger percentage of state budgets. The map below presents each state's funding ratio.



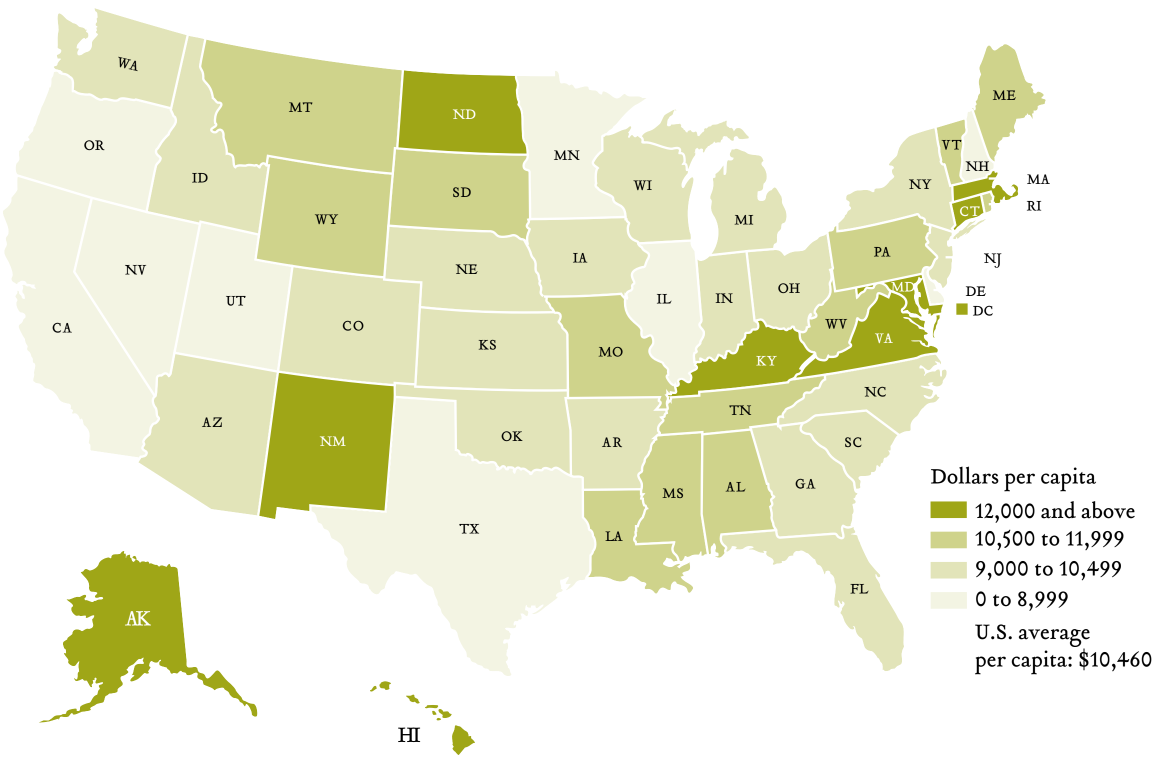
Municipal Bond Market, continued

"Sequestration will also have an impact, but even without sequestration, federal spending is expected to be cut to state governments."

Many state and local governments have begun implementing structural reforms, recognizing that current funding levels are insufficient to cover future pension liabilities. This growing liability is concerning and must be considered when purchasing municipal bonds within the high risk states.

Reliance on Federal Funding

Changes in federal spending can have a material impact on state and local government budgets. Sequestration will also have an impact, but even without sequestration, federal spending is expected to be cut to state governments. The impact on individual states will vary depending on the federal support they receive. The map below from the Federal Funds Report indicates the degree to which state governments rely on federal spending.



States such as Virginia, Kentucky, New Mexico, North Dakota, Connecticut, Massachusetts, and Maryland, receive more than 30% of their income from federal expenditures, while states like Delaware and New Jersey are less reliant on federal expenditures.

Careful consideration needs to be taken when purchasing municipal bonds within states that heavily rely on federal spending. Further analysis into what type of federal spending being issued may be necessary in order to assess the risk of this spending being cut (e.g. defense spending).

Risk vs. Reward

When focusing on all of the credit risks previously mentioned, one would infer that municipal bond yields would have risen (prices declined) given the worsening of credit quality and the expectations that there will be continued strain on the financial health of the state and local governments. The exact opposite has occurred. Municipal bond yields have continued to decline (prices increased) providing municipal bond investors with strong returns.

In general, we continue to view municipal bonds as an overvalued asset class, with some exceptions. Realizing that tax rates have recently increased and the potential for future increases still remains (in most cases), the taxable bond market is providing tax equivalent yields that are superior to that of comparable quality tax-exempt bonds. Consequently, we are being extremely selective when including municipal bonds in fixed income portfolios.

"In general, we continue to view municipal bonds as an overvalued asset class, with some exceptions."

Stock Market Pulse

Index	3/31/13	% Change Since 12/31/2012
S&P 1500	363.84	10.88%
DJIA	14,578.54	12.02%
NASDAQ	3,267.52	8.52%
S&P 500	1,569.19	10.61%
S&P 400	1,153.68	13.45%
S&P 600	531.38	11.81%
NYSE Composite	9,107.05	7.86%
Dow Jones Utilities	508.40	13.39%
Barclays Aggregate Bond	110.73	0.07%

P/E Multiples	3/31/13
S&P 1500	15.4
DJIA	14.1
NASDAQ	16.6
S&P 500	15.0
S&P 400	18.8
S&P 600	19.4

Key Rates

FFed Funds Rate	0% to 0.25%
T Bill 90 Days	0.11%
T Bond 30 Yr	3.12%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	363.84	15.4x	2.04%
S&P 500	1,569.19	15.0x	2.14%
DJIA	14,578.54	14.1x	2.40%
Dow Jones Utilities	508.40	NA	3.77%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.07%

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