GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

APRIL 2022

VOLUME 31, ISSUE 4

William D. Johnston
Chairman, Greenleaf Trust

Our Brand Awareness 5

Diversification and Discipline 7

Watch Your Step! 12

Have You Noticed a Change to Your Retirement Plan Statement? 16

Establishing Cash Reserve Targets 18

Economic Commentary

It is always helpful to me to scan popular culture media sources to understand what most consumers are reading, watching and listening to. Of course, the source of what people select to read, watch and listen to shapes much of what they end up believing as fact. Early in my education in economics, I was cautioned to be careful of where I got my information. It has been a valuable lesson in my lifetime, and helped to shape my perspective on economics, investments and politics. In the 1980s, as I was making my usual early morning stop at the venerable "Michigan News Agency" on West Michigan Avenue to pick up the six newspapers that I read each day, the young person behind the counter inquired if all of the papers were for me. I assured him that they were and he immediately with raised voice said "Do you have to read all of those papers every day?" I smiled and said, "I not only have to read them, I want to read them." Online sources of information were not yet available, and news and data aggregators were in their infancy. The value of reading the Financial Times, Wall Street Journal, The New York Times, Investor's Business Daily, Detroit News, and Detroit Free Press each day was not because they had the same viewpoint, but rather because they had differing perspectives with different analysis of the same events that were of interest to me and critical for me to understand to better serve my clients' interests. The process caused me to be less, not more, certain of my intuitive assumptions and more aware that differing perspectives were of value even when I didn't agree with them.

Over time, the tactile feel of newsprint in my hands — that required a good post-read handwashing session — was replaced by electronic sources from Bunker Ramo terminals and Bloomberg machines that aggregated economic data and offered access to real time data and, if you searched hard enough, access to divergent perspectives. As we all have witnessed, the digital world has achieved the success of instantaneous distribution of information while also simultaneously achieving the failure of massive distribution of misinformation. Our current geopolitical, domestic political, global and domestic economic environment has never been more complex and perhaps more dependent on cogent and thoughtful

Economic Commentary, continued

discernment than it is today. Certainly from an investor standpoint there are a good number of concerns and issues before us that require a solid and fundamental understanding that will better allow us to weave our way to success. It is hard to read current headlines without Ukraine, de-globalization, inflation, recession and stagflation being in the conversation, each of which seem to have pushed COVID-19 to the sideline. Most of the above are related so let's explore them in order.

UKRAINE

It is becoming clear after forty days of Russia's invasion of Ukraine that this "Military Exercise," as Putin has defined it, is about the Europeanization of Ukraine. For all of the years Putin has been in power, he has been frustrated that he could not stop Ukraine's move towards democracy and a market-based economy. For almost all of the Ukrainian region's history, they have been controlled by either Prussia (when it existed), Poland or Russia. When the Soviet Union collapsed and Ukraine became an independent country, they began their march toward a new identity that was more European than Russian. As we discussed last month, Eastern European history is complicated and the political and cultural scar tissue between Russia and Western Europe is centuries long and runs very deep. The previous political leadership of Ukraine prior to Zelenskyy were not early adopters of the EU, nor were they thrilled with a populist democracy. Populist demonstrations in 2014, primarily in the western regions of Ukraine, led to the EU's overt support of pro-democracy Ukrainian candidates and, ultimately, Zelenskyy's victory. Russians have always felt some disdain from the European Union countries who were quite willing to buy energy from Russia but always kept Russia at arm's length from stronger ties that would bind. This tension helps to inflame the we vs. they, or more practically speaking, east vs. west political power structure. There are many nuances to the centuries old conflict of boundaries and culture in Europe, but there is no denying that the Ukrainian attraction to the European Union, and the mutual admiration of Europeans and Ukrainians of one another, is what threatened Putin the most. If he could not force the Ukrainian people to love and be loyal to Russia, he would punish them for jilting him, and in the process amplify the distance between the east and west. Few know what Putin's end goal is now that he has achieved some results that he didn't expect. The European Union is not the United States of Europe that many had envisioned it would become forty years ago. Britain's exit demonstrated that very well. At best, the EU is an amalgamation of trading and commerce partners that have significantly different histories, cultures and social compacts. For the first time, however, Russia's invasion of Ukraine has united the

"If [Putin] could not force the Ukrainian people to love and be loyal to Russia, he would punish them for jilting him, and in the process amplify the distance between the east and west."

EU and solidified NATO in a way that few had imagined. Putin has few allies in this struggle. China's interest is simply to protect the east, and specifically China, from western interference in China's internal politics and, more specifically, Taiwan. Putin knows well that China's interests are just that, and not Putin's success in Russia's invasion of Ukraine. More will be learned in the weeks ahead, but the global instability of Putin's actions cannot be understated, which leads us to the next issue of concern.

DE-GLOBALIZATION

The late 1970s began the race to globalization. The rapidity of change in digitization of data and the ability of transfer data rapidly advanced numerically controlled processes. This breakthrough in technology broke down borders and allowed manufacturing to reduce labor and scale automation. Companies now could expand their manufacturing processes globally and chase the lowest cost of labor, benefiting manufacturing, distribution and cost. The benefits to emerging economies were huge. It resulted in the expansion of economic and political stability, and built middle class opportunities in developing countries. For developed economies, the benefits were more constrained and fell to fewer people but in greater amounts. Globally, GDP surged and poverty declined; however, the benefits were uneven and serious middle class erosion occurred in the United States and Western Europe. Supply chain management followed suit, and just-in-time inventory of product and processes exploded, resulting in concentration of producers who could deliver components for the cheapest price to producers. Suppliers of commodity-based component parts like computer chips were extreme outliers in this evolution. As the demand and capacity of chips to deliver manufacturing outcome benefits grew, supply became more concentrated. As the demand for electronic goods dependent upon commodity ingredients grew, the suppliers of those commodities became more concentrated. As Europe's demand for energy grew, they became more dependent upon the east (Russia) and Middle East for supply of product. The pandemic that began in 2020 accelerated the implosion of this globalized concentration of commodities and processes, forcing many to re-think and re-order entire manufacturing processes and supply chains. De-globalization is the rationalizing of processes that create centralized dependency. Globalization — as it pertains to innovation, creation of product, manufacturing and distribution — is fifty years in the making and will not be significantly changed in the short term. In physics we learned that any action has a reaction associated with it. The problems amplified by the pandemic are not the fault of globalization in general, but rather by logistical and manufacturing processes that became too concentrated and less diversified, which accelerated risk. Creating

"The late 1970s began the race to globalization [which] resulted in the expansion of economic and political stability, and built middle class opportunities in developing countries."

Economic Commentary, continued

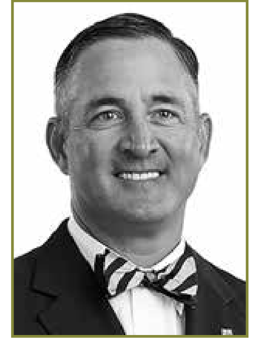
more domestic suppliers of component parts within the United States, or any country for that matter, is not inherently difficult to do; it simply is a cost allocation calculation to mitigate or reduce supply chain risk. Commodity supply chain solutions are significantly more difficult to achieve as mining capacity is more geographically and even continent driven. The pandemic interrupted the supply of necessary product, which increased costs of product globally and domestically, which is accelerating inflation and causing central banks to increase interest rates, theoretically to slow the pace of the economy and bring prices under control. Central banks globally have used interest rates either to stimulate growth or control rising prices and, in normal economic cycles, those tools seem effective. The ideal objective in normal economic cycles is to achieve a "soft landing," or a slowing of the growth rate — moderation of demand followed by a resumption of a moderated growth cycle. Recent events with COVID-19 in China, and the interruption of oil and gas in Europe caused by Russia's invasion of Ukraine, have some fearing stagflation.

"The landscape before us economically, while inclusive of some geopolitical turbulence, will be a tough economy for stagflation to attack."

STAGFLATION

The term generally means that inflation continues to be persistent but growth of GDP turns negative and unemployment increases. Some commentators refer to the 1973 and 1974 energy crisis as a stagflationary period, when we had both high interest rates (10% municipal bond rates and 14% mortgages) with high unemployment. The energy crisis in 1973 and 1974 was created by an oil embargo, which is a lack of supply. Today's global energy deficit is not due to a lack of supply or sellers, but rather to a coordinated effort not to buy oil from Russia; therefore, it is a lack of buyers causing the commodity price increase. In 1973 and 1974 we did not have the reserves or capacity to change the condition we were in. Today, we find ourselves with reserves as well as the production capacity to sustain a period of global interruption. Interest rates in 1973 and 1974 were at historical highs, and though yields have increased by about 100 basis points recently, on a real or actual level interest rates remain at historical lows. Stagflation is not an economic condition that happens with instant velocity. We have weakened consumer confidence which has resulted from the Ukraine invasion. We have an employed consumer (unemployment at 3.6%, which is at pre-pandemic levels) with increased wages (+5.6% year-over-year) and pandemic restrictions on the economy that have been all but eliminated. The Weekly Economic Index indicates current GDP growth at an annual basis of 5.53%. The landscape before us economically, while inclusive of some geopolitical turbulence, will be a tough economy for stagflation to attack.

Our Brand Awareness



Michael F. Odar, CFA®
President and
Chief Executive Officer

In 2015, we implemented our 10-year strategic plan to be Top of Mind Market Brand Dominant in the state of Michigan. Each year we assess our progress and initiate tactics to take one step closer to our goal in 2025. This year, as part of our marketing plan, we partnered with public relations firm Lambert to see just how far we have come. Their first job was to conduct a survey of Michigan residents to better understand what they look for in a wealth management firm. We also wanted to know if they have ever heard of Greenleaf Trust.

First, what does it mean to be Top of Mind Market Brand Dominant? To us it means when families, foundations, endowments, and companies have comprehensive wealth management, fiduciary, retirement plan, or family office needs they think of Greenleaf Trust.

What were a few of our learning outcomes from the survey? In general, our survey confirmed to us that people like to work with people they know and trust. As a result, they like to work with advisors who already work for and are recommended by their friends, family members, or peers. They also like to work with advisors who already have relationships with their other advisors such as their tax planner or attorney. This makes sense. When you need work done to your home, how do you usually start looking for the "best" contractor?

That said, they tend to feel their specific situations are unique. They want to work with an advisor who can understand their specific needs and create customized solutions for them. Experience here is also important, because although they feel their specific situations are unique they are also comforted to know that an advisor has successfully found solutions for other clients with similar needs. There is a difference between unique and unusual. We believe that each client is unique, not unusual. The solutions to their unique needs should not feel unusual to their advisor. One of Farmers Insurance's television advertising slogans is "We know a thing or two, because we've seen a thing or two." I like this, because it lets potential customers know they have helped solve many unique client needs with solutions that are not unusual to Farmers.

"We believe that each client is unique, not unusual. The solutions to their unique needs should not feel unusual to their advisor."

There were also more than a few in the survey who feel that wealth management firms are all the same, perhaps because their primary focus was portfolio management. Portfolio management is only a small component of true comprehensive wealth management. We believe wealth management plans are important. Would you build a house before approving the blueprint? Before clients hire us or pay us any fees, we construct customized wealth management plans for them

Our Brand Awareness, continued

> "Our marketing plan... will be purposeful and respectful of the brand we have built..."

with solutions to their unique needs. Those solutions go well beyond portfolio management to include planning in other areas such as cash flow needs, insurance, education, estate, income tax, philanthropy, family dynamics, etc.

So, how many in the survey have heard of Greenleaf Trust? Opportunistically, not enough. And that is OK. We have more work to do on our brand awareness. The results of the survey confirmed many of our thoughts and opened our eyes to new ones. Our marketing plan moving forward with this information will be purposeful and respectful of the brand we have built with our reputation. For those families, foundations, endowments, and companies with comprehensive wealth management, fiduciary, retirement plan, or family office needs we believe we have solutions specifically for them. We just need to meet them.

Diversification and Discipline

MANAGING GEOPOLITICAL EVENT RISK

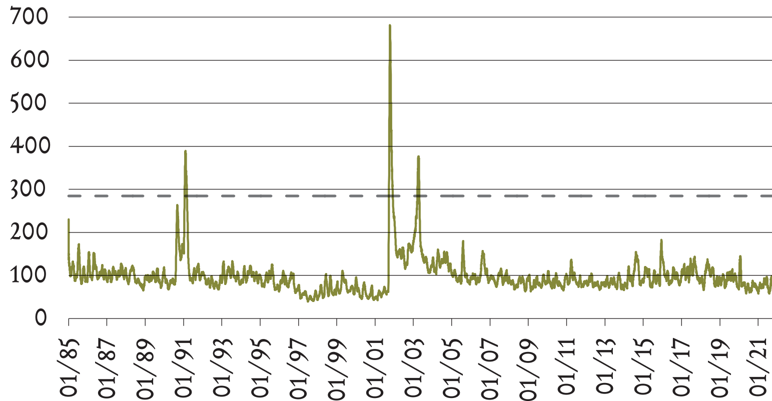
Nicholas A. Juhle, CFA®
Chief Investment Officer

Geopolitical uncertainty is an ever-present source of risk for the economy and financial markets. International tensions ebb and flow – sometimes simmering down to base levels and sometimes boiling over as is currently the case in Ukraine. In this article, we will take a closer look at how financial markets have responded to the events in Eastern Europe and illustrate how basic principles like diversification and discipline have helped protect our clients' wealth in the face of uncertainty.

How does today's uncertain geopolitical environment compare to other tumultuous periods? The Caldara and Lacoviello Geopolitical Risk (GPR) index quantifies risk based on the percentage of published articles related to adverse geopolitical events. A measure of 100 represents a normal or baseline reading. Readings above 100 indicate higher risk levels and readings below 100 indicate relatively lower risk. The index spiked higher in conjunction with the Gulf War, after 9/11, and most recently with Russia's invasion of Ukraine.

"How does today's uncertain geopolitical environment compare to other tumultuous periods?"

Geopolitical Risk Index

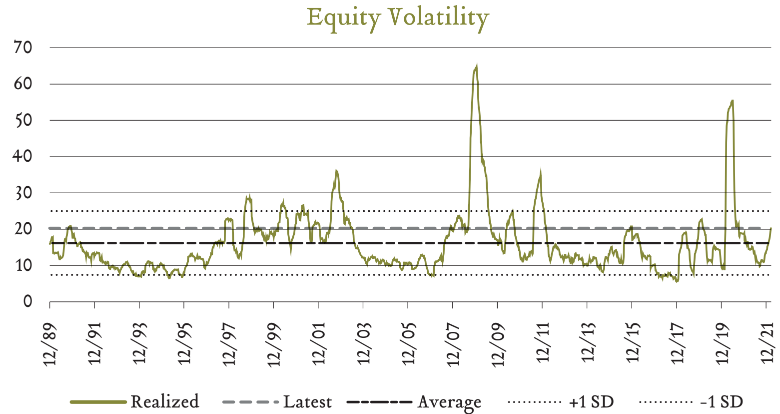


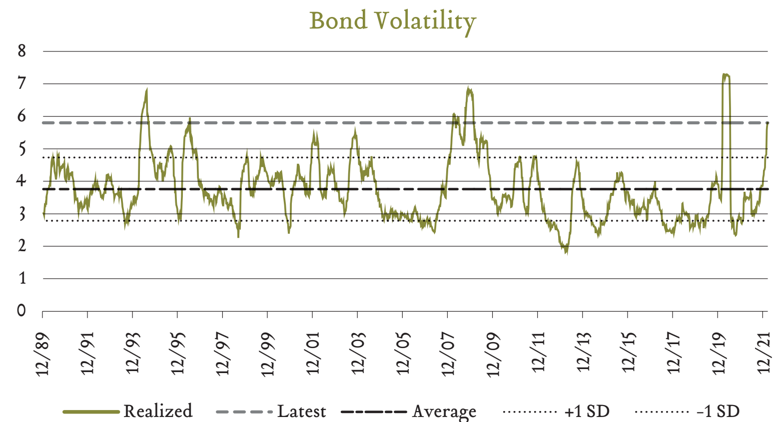
Source: www.matteoiacoviello.com/gpr.htm

IMPACT ON MARKETS

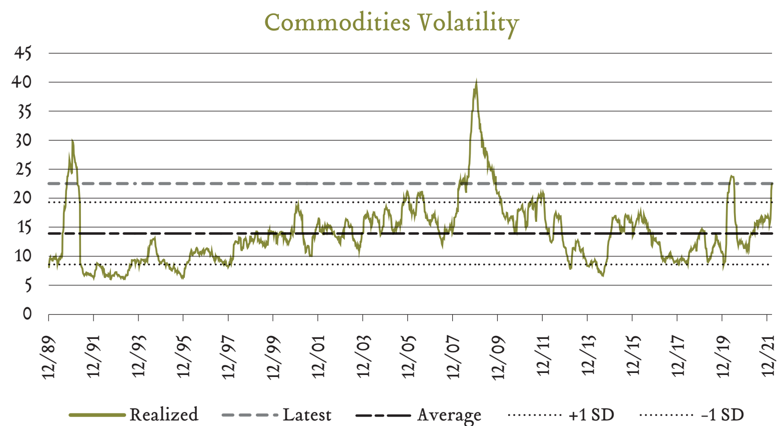
Investors price assets based on their expectations for future cash flows, growth, inflation and discount rates. The onset of significant geopolitical risk widens out the potential future outcomes. It becomes more difficult to value assets based on a short-term outlook when possible future states range all the way from WWIII to peace. As a result, asset prices become more volatile. We have seen evidence of this across a wide variety of asset classes, but particularly in bonds & commodities.

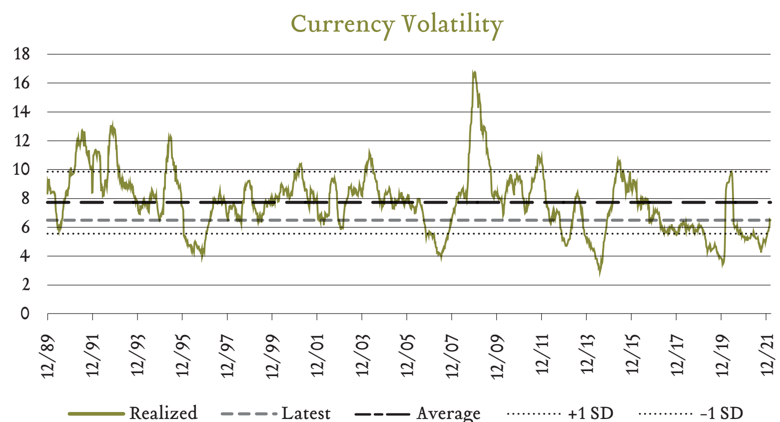
Diversification and Discipline, continued





"... when possible future states range all the way from WWIII to peace... asset prices become more volatile."





Source: Bloomberg, LP, realized 90d volatility.
Stocks = S&P 500,
Bonds = Bloomberg, Barclays US Aggregate Bond Index,
Commodities = Bloomberg Commodity Index
Currency = DXY Index, dated 3/22/22.

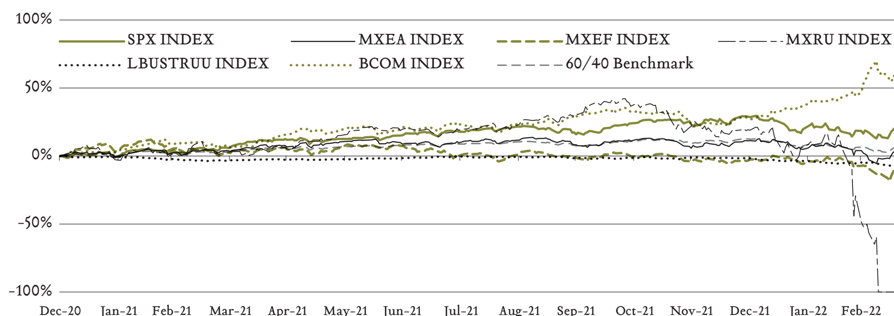
After the initial shockwaves associated with the pandemic, we enjoyed a period of below average volatility until late 2021. Entering 2022, there were plenty of unanswered questions with regard to new COVID variants, supply chain constraints, inflation levels, and monetary and fiscal policy expectations. In addition, tensions were escalating in Eastern Europe as Russia began posturing for an invasion of Ukraine which occurred in late February and continues today. Below, we highlight asset class returns for calendar year 2021, pre-invasion 2022 (12/31/2021–02/23/2022), and post invasion 2022 (02/24/2022–03/22/2022).

	2021	Pre-Invasion 2022	Post-Invasion 2022
US Equities	28.68%	-11.17%	5.32%
Developed Int'l Equities	11.26%	-5.71%	3.22%
Emerging Market Equities	-2.54%	-1.94%	-1.84%
Core Bonds	-1.54%	-4.18%	-2.33%
Balanced Portfolio	12.41%	-6.74%	1.75%
Russian Equities	19.01%	-24.23%	-100.00%
Commodities	27.05%	15.30%	8.92%

Source: Bloomberg, LP, Total Returns. US Equities = S&P 500 Index, Developed International Equities = MSCI EAFE Index, Emerging Market Equities = MSCI EM Index, Core Bonds = Bloomberg Barclays US Aggregate Bond Index, Balanced Portfolio = 60% Global Equities 40% Core Bonds, Russian Equities = MSCI Russia Index, Commodities = Bloomberg Commodity Index

“Entering 2022, there were plenty of unanswered questions...[and] tensions were escalating in Eastern Europe as Russia began posturing for an invasion of Ukraine...”

Price Returns: 12/31/20 -03/22/22



Source: Bloomberg, LP, Price Change. US Equities = S&P 500 Index, Developed International Equities = MSCI EAFE Index, Emerging Market Equities = MSCI EM Index, Core Bonds = Bloomberg Barclays US Aggregate Bond Index, Balanced Portfolio = 60% Global Equities 40% Core Bonds, Russian Equities = MSCI Russia Index, Commodities = Bloomberg Commodity Index

MANAGING WEALTH IN VOLATILE MARKETS

During periods of increased volatility, there are basically two approaches an investor can take to manage assets. One approach, the one that often looks the most attractive in hindsight, is to anticipate events and resulting short term asset class movements in advance. The investor would take concentrated positions in assets that are primed to appreciate and exit (or even short) positions that are primed to decline in value.

211 SOUTH ROSE STREET, KALAMAZOO, MI 49007 269.388.9800

Diversification and Discipline, continued

While it sounds simple enough, this approach is actually fraught with challenges that make it exceedingly difficult to implement effectively.

For starters, effective implementation of this strategy assumes the investor 1) can accurately predict specific future events as well as their timing and 2) knows how the markets will respond to those events. As an example, this would mean knowing (in advance) that following a period of failed diplomatic reconciliation, Russia would invade Ukraine on February 24, arguably increasing the odds of a broader global conflict, AND foresee that domestic stocks would appreciate by more than 5% in the month that followed. Consider:

- What if Russia didn't invade?
- What if they didn't invade on February 24?
- What if peace broke out on February 25?
- What if some unrelated event completely usurped the market impact of a Russian invasion?
- What if stocks declined following the event instead of the opposite?

With the benefit of hindsight, it's easy to convince ourselves that all of these questions had obvious and predictable answers. This simply isn't the case if we're being honest, and the downside risk of being wrong under this approach is significant.

What if we could predict anomalistic events like the onset of war in Ukraine? In a way, we can. The world is predictably unpredictable. If we look out over the next ten or twenty years, we can virtually guarantee a few things. We can't guarantee an invasion on February 24, but we can pretty much guarantee we will encounter recessions, temporary market drawdowns, geopolitical issues and even the occasional pandemic. We won't always know what is coming, but if we know that certain types of events are pretty much guaranteed to happen, we can construct client portfolios with that knowledge in mind.

"... if we know that certain types of events are pretty much guaranteed to happen, we can construct client portfolios with that knowledge in mind."

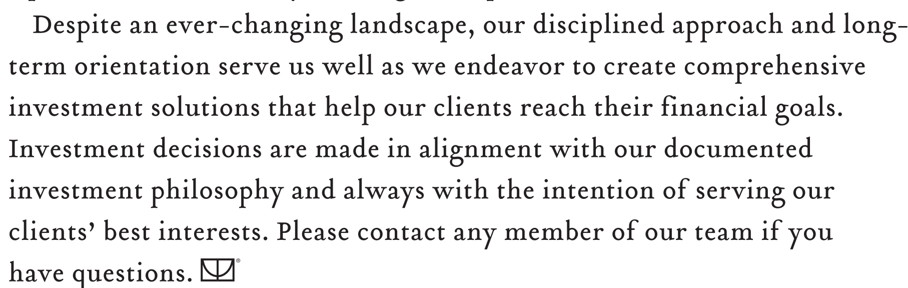
This approach, which aligns with our investment philosophy, calls for constructing a properly diversified portfolio, developing a long-term investment plan in advance, and sticking to it when one of these predictably unpredictable events occurs. Diversification across and within asset classes reduces unsystematic risk. It eliminates the possibility of owning an entire portfolio of Russian stocks before their values plummet. In fairness, it also eliminates the possibility of owning an entire portfolio of commodities which have spiked higher for the same reasons. Given the challenges with predicting specific events and the market's short-term response, it's a trade-off we believe will pay off for our clients.

While we may not know how a specific asset class will perform in a given month or even a year, we have a better sense for longer-term risk and return characteristics. We use this knowledge to construct the

diversified portfolios that underpin clients' financial plans, balancing return requirements with their ability and willingness to take risk.

An allocation to equities will support long-term growth if we maintain discipline in uncertain times. We believe short-term market-timing strategies are unlikely to improve long-term outcomes. Stocks have outperformed cash in 60% of one month periods and 72% of 12 month periods dating back to 1933. Attempting to avoid a down month or a down year risks missing out on periods of growth and potentially impairing long-term portfolio returns. The better approach, we believe, is to own diversifying assets like bonds and alternatives so that a down market in equities will not derail your long-term plans.

Despite an ever-changing landscape, our disciplined approach and long-term orientation serve us well as we endeavor to create comprehensive investment solutions that help our clients reach their financial goals. Investment decisions are made in alignment with our documented investment philosophy and always with the intention of serving our clients' best interests. Please contact any member of our team if you have questions.



"An allocation to equities will support long-term growth if we maintain discipline in uncertain times."

Kristen M. Tidd, CTFA
Assistant Vice President
Senior Trust Relationship Officer

Watch Your Step!

COST BASIS STEP-UP, A QUICK HISTORY AND WHY IT IS STILL IN THE NEWS

You may recall there was a lot of discussion around tax reform in 2021, with quite a bit of attention given to the threat to repeal the step-up in cost basis upon the death of the asset's owner. While that change in the tax law did not come to fruition in 2021, the deliberation on the merits of a basis step-up is not going to go away anytime soon.

The step-up in basis rule came into effect in 1921, a mere five years after the federal estate tax became law in 1916. The step-up in basis rule states that when an heir inherits an asset, of any sort, the cost basis for taxation purposes will be the asset's fair market value on the date of the owner's death.

"In 1921 Congress was apparently concerned about imposing an income tax on an inherited asset's unrealized appreciation after the same asset was just subjected to the federal estate tax at its fair market value… or essentially double taxation…"

ALTERNATE VALUATION DATE: One exception to this rule is that the personal representative or executor of a decedent's estate can opt to apply an alternate valuation for inherited assets based upon the asset's fair market value six months after the decedent's death. However, all assets owned by the decedent will be subject to the alternate valuation date, meaning that the executor cannot 'cherry pick' which assets receive the alternate date fair market value. It should be noted there is a condition to using the alternate valuation date; the use of a 'snapshot' valuation date six months after death must reduce the estate's tax liability.

ONE-YEAR TRANSFER RULE: A second exception to this step-up rule is that no step-up in basis will be allowed if the asset in question was acquired by the decedent (i) from the designated heir (ii) during the year prior to the decedent's death. This prohibition of the step-up rule is intended to deter tax-motivated death bed transfers simply to gain a basis step-up on the recipient's death.

The federal Joint Committee on Taxation projects that because of the application of the step-up in basis rule almost $42 billion was lost in federal revenue in 2021. The original reasons for the step-up in basis rule are not exactly clear. The main rationale seems to lie with the federal estate tax. The federal estate tax is levied on the transfer of the fair market value of all assets owned by the decedent at the date of his or her death. Therefore, the taxable base of the assets involved with the federal estate tax is their entire worth, not just the amount of appreciation that has accrued since the asset was acquired by the decedent.

In 1921, Congress was apparently concerned about imposing an income tax on an inherited asset's unrealized appreciation after the same asset was just subjected to the federal estate tax at its fair market value. Thus, to avoid excessive taxation of the same asset, or essentially double taxation,

Congress provided that such an asset would have a basis for income taxation purposes in the hands of the heir equal to the asset's value that was used to determine the estate's federal estate tax liability, i.e., the asset's fair market value.

1976: In the Tax Reform Act of 1976, Congress repealed the step-up in basis rule, imposing in its place a carryover basis rule like that used for lifetime gifts. This legislative change was immediately challenged primarily due to the record-keeping problems associated with reconstructing what a long-deceased relative might have paid for assets that had been held for generations. As a result of this opposition, Congress initially delayed the effective date of the carryover basis rule. Ultimately Congress repealed the carryover basis rule in 1980.

2010: Carryover basis was in effect for only 2010, when the federal estate tax was also repealed for that year. IThis law dates back to 2001 in George W. Bush's first term. The change in law indirectly acknowledged that without the federal estate tax, the purported rationale of the step-up in basis rule was effectively nullified and, therefore, the step-up rule had to be repealed. In its place, still another variation of the carryover basis was enacted for inherited assets, but a significant remnant of the step-up in basis rule was retained: $1.3 million of appreciation was allowed to be stepped-up on a decedent's death, plus an additional $3.0 million for assets transferred by a decedent to his or her surviving spouse. These allowances recognized that while repealing the federal estate tax in exchange for no step-up in basis rule appealed to taxpayers with considerable wealth that exposed them to federal estate taxes, the vast majority of beneficiaries that inherit property would receive a step-up in basis without having any exposure to federal estate tax.

CLINTON PROPOSAL: President Clinton proposed during his presidential campaign an alteration of the step-up in basis rule, but the proposal never made it out of the House Committee.

OBAMA PROPOSAL: President Obama also proposed a repeal of the step-up in basis rule, but since it was made prior to an election year, nothing happened to that proposal.

BIDEN PROPOSAL: President Biden's revenue proposals for fiscal 2022 sought to repeal most of the basis step-up rule without a quid pro quo to eliminate the federal estate tax. This proposal was part of 'package' of several revenue proposals in an attempt to equalize the taxation of what the President called 'work' and 'wealth.' Hence, Biden proposed to tax long-term capital gains as ordinary income for those individuals with an income of $1.0 million or more. However, in order to prevent wealthy taxpayers from easily avoiding this new income tax rule on their long-term capital gains by simply holding onto their appreciated assets until death and gain the benefit of a basis

"No matter how any of these prior proposals are viewed, the rationale for the step-up in income tax basis rule has always been to avoid double taxation."

Watch Your Step!, continued

step-up, President Biden's proposal removed this disincentive to realize capital gains during the owners' lifetime with a repeal of the basis step-up rule. This proposal did provide a $1.0 million basis step-up per individual like the current law (adjusted for inflation after 2022, and portable between spouses) recognizing that an income tax due on the death of the asset owner would cause a hardship on non-wealthy Americans. As we now know, this proposal did not go anywhere during last year.

Some observations on the possible future repeal or modification of the basis step-up rule follow:

DOUBLE TAXATION RATIONALE DISAPPEARS: No matter how any of these prior proposals are viewed, the rationale for the step-up in income tax basis rule has always been to avoid double taxation. The rationale of this line of thought is questionable if no federal estate tax is actually paid by the originating decedent's estate. With a federal estate tax exemption per person now exceeding $12 million in 2022, there is no duplicate second layer of taxation on a decedent's assets for 99% of Americans, so there is no reason for the inherited property's basis to be stepped-up to its fair market value when the decedent passes away. According to the Tax Policy Center, with the currently high federal estate tax exemption, less than one out of a thousand decedents will likely owe any federal estate tax. Another way to look at it, a step-up in basis in an inherited asset is not contingent on that asset actually being subject to the federal estate tax due to the likelihood that no federal estate tax will ever be paid. As a result, the appreciation in value of inherited assets, for most heirs, will escape both income and estate taxation. Therefore, the double taxation reason for the step-up in basis rule applies only to a very small minority of situations when appreciated property is transferred at a wealthy owner's death.

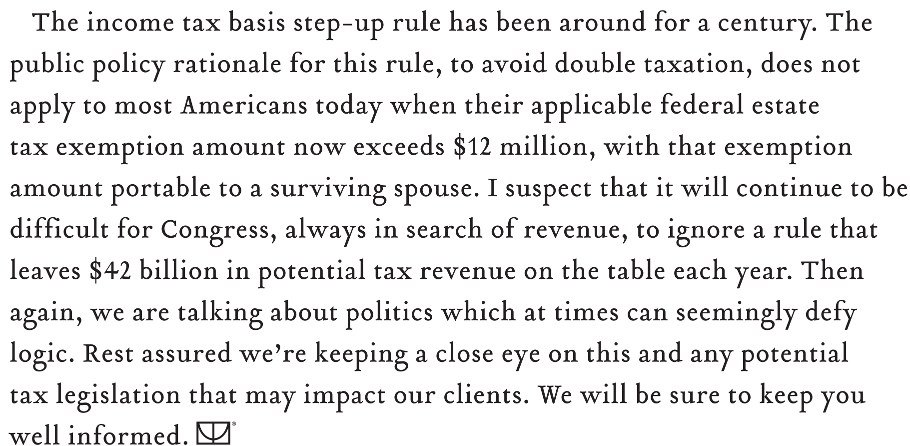
> "It is important to also acknowledge that an increasing number of individuals in this country have the bulk of their financial assets held in retirement accounts, for which there is no income tax basis."

INCREASE IN RETIREMENT ACCOUNT SAVING: It is important to also acknowledge that an increasing number of individuals in this country have the bulk of their financial assets held in retirement accounts, for which there is no income tax basis. With a change in the step-up in basis rule, these retirement account assets might be placed on a more equal footing with a taxable investment portfolio, which has its entire appreciation exempted from income taxation due to the current step-up in basis rule. With a change in the basis step-up rule there might be more incentive to invest in retirement accounts than in after-tax investments when any gain would be recognized on the owner's death. Whether that is a good thing or a bad outcome is debatable.

LIFETIME GIFTS INCREASED: Rather than sitting on appreciated assets until death to gain the basis step-up, asset owners might be inclined to make lifetime gifts of those appreciated assets to their heirs if there is no

benefit to be gained for holding the appreciated assets until their death.

AN ADMINISTRATIVE NIGHTMARE FOR FIDUCIARIES: Assuming some proposal close to what President Biden submitted with regard to a limited repeal of the step-up rule comes to pass, e.g. $1.0 million of tax-free appreciation is available on the owner's death, that new rule would require fiduciaries of estates with appreciated assets that exceed the threshold dollar amount to determine which appreciated assets would go to which beneficiary and whether to consider the individual beneficiary's individual tax circumstances. While some fiduciaries might simply ignore the limited step-up basis opportunity, other fiduciaries might try to minimize the tax liability of the recipient beneficiaries as a whole. Some estates may consist of highly illiquid assets, yet a constructive disposition of assets at-death could create a 'fire-sale' situation where estate assets have to be immediately liquidated simply to pay the resulting capital gain tax. An alternative concern for the estate fiduciary is that there are few records available to the fiduciary to calculate the amount of the unrealized gain, or loss, the decedent's estate may have to declare.



The income tax basis step-up rule has been around for a century. The public policy rationale for this rule, to avoid double taxation, does not apply to most Americans today when their applicable federal estate tax exemption amount now exceeds $12 million, with that exemption amount portable to a surviving spouse. I suspect that it will continue to be difficult for Congress, always in search of revenue, to ignore a rule that leaves $42 billion in potential tax revenue on the table each year. Then again, we are talking about politics which at times can seemingly defy logic. Rest assured we're keeping a close eye on this and any potential tax legislation that may impact our clients. We will be sure to keep you well informed.

"The… rationale for this rule, to avoid double taxation, does not apply to most Americans today when their applicable federal estate tax exemption amount now exceeds $12 million…"

Lisa A. Hojnacki
Participant Services Coordinator
Team Lead

Have You Noticed a Change to Your Retirement Plan Statement?

As a result of a provision of the SECURE (Setting Every Community Up for Retirement Enhancement) Act, passed in 2019, retirement plan providers are required to begin providing lifetime income illustrations on retirement plan statements by September 18, 2022. Many plan providers send quarterly statements; therefore, if you have not yet noticed a change to your retirement plan statement, it is soon to come.

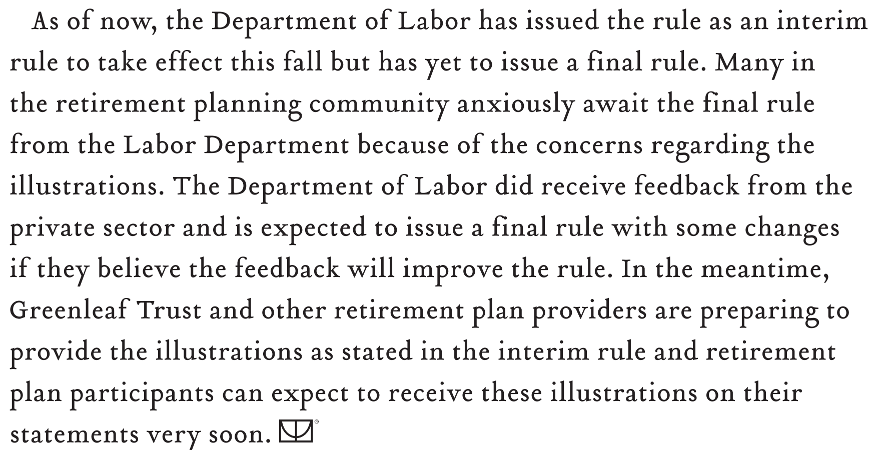
WILL THIS BE USEFUL?

The provision is intended to give investors a realistic illustration of how much monthly retirement income they could expect to purchase with their account balance. The provision requires that sponsors of retirement benefit plans must disclose the estimate of the monthly amount the participant's account balance will pay them in the form of a life annuity or a qualified joint and 100 percent survivor annuity. The estimates are calculated as if the lifetime income payments were to have begun on the last day of the statement period, and as if the participant is 67 years old at that date, unless the participant is older, in which case the actual age should be used.

"… retirement plan providers are required to begin providing lifetime income illustrations on retirement plan statements by September 18, 2022."

While the intent of the provision is to help retirement plan participants identify if they are on track to retire, many experts question if the provision will be useful. This is in large part because of the methodology of the illustrations. For instance, if a 35-year-old has $50,000 in their account, the illustration will tell them what $50,000 would buy them at age 67. This does not consider any future earnings or growth of the account balance for 32 years in this example. Not only is there question about the usefulness of the methodology but the confusion it may cause for participants who are not aware of the methodology.

Additionally, experts argue whether or not pointing to annuities as a distribution method is the right way to go. Annuities, which are insurance products with a guaranteed stream of income, aren't necessarily right for everyone. Some of the drawbacks to annuities are their complexity, costly fees, often weaker returns than possible through traditional investing and their lack of liquidity. Many plan sponsors don't offer annuities as a distribution method from their retirement plans for this reason.



WHAT TO EXPECT

As of now, the Department of Labor has issued the rule as an interim rule to take effect this fall but has yet to issue a final rule. Many in the retirement planning community anxiously await the final rule from the Labor Department because of the concerns regarding the illustrations. The Department of Labor did receive feedback from the private sector and is expected to issue a final rule with some changes if they believe the feedback will improve the rule. In the meantime, Greenleaf Trust and other retirement plan providers are preparing to provide the illustrations as stated in the interim rule and retirement plan participants can expect to receive these illustrations on their statements very soon.

> "While the intent of the provision is to help retirement plan participants identify if they are on track to retire, many experts question if the provision will be useful."

Mark A. Jackson, CFA®
Vice President
Senior Wealth Management Advisor

Establishing Cash Reserve Targets

We are frequently asked how to set an appropriate level of cash reserves in a client's financial holdings and the answer is, it depends. It varies by individual and entity, the level of predictable expenses or distributions and whether there are other sources of funds besides the investment portfolio. But there are steps to follow to help with the decision.

The first step is estimating your cash outflows. Expenses include monthly living expenses, quarterly and annual tax payments, trips, annual house repairs and desired or required distributions for a non-profit. Establishing an estimate of expenses or outflows requires working on a budget or cash flow forecast, with an understanding of what normally occurs in your living or non-profit operating circumstances, as well as identifying less frequent expenses, such as replacing a vehicle. There are tools to help individuals and families with the budgeting process and your client centric team at Greenleaf Trust can assist as well.

"Establishing an estimate of expenses or outflows requires working on a budget or cash flow forecast..."

A typical on-line search using the question, "What is the correct amount of cash reserves?" might provide the answer of three to six months of expenses. But for an individual or family, the correct answer may be more or less than this formula. For example, if a family has two incomes with cash inflows that exceed their monthly cash outflows, including amounts being set aside for savings, they may be comfortable with less than six months. For a couple in retirement, that has worked hard to build an investment portfolio to fund their retirement, a comfortable level of reserves may be 12 months to several years. The objective is to minimize unexpected sales from your equity, alternatives and fixed income allocations to pay expenses, particularly if one or more of these asset classes is experiencing volatility. This is different than the rebalancing among these asset classes that Greenleaf Trust performs in a client's portfolio in response to market outcomes and circumstances and to manage to changes in a client's risk tolerance.

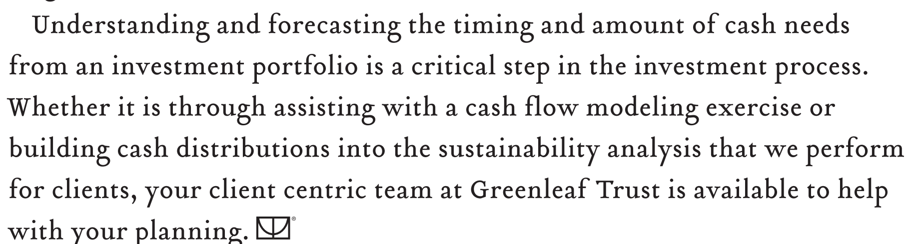
Non-profits may have known outflows in terms of the amount and timing of those distributions. Depending on the entity, the cash management strategies may vary from keeping the known distributions in a money market fund to buying fixed income securities with maturities to match the distribution amounts and dates. Some entities have contributions to their portfolios, which also offset the outflows. While the categories of the budgeting process are different than for a family, the objective is still to understand and plan for cash flows so that an appropriate level of reserves may be established.

Once an individual or entity has determined through a budgeting process a level of appropriate reserves, the next step is deciding how to invest these funds. Money market funds have not provided a return since

the Federal Reserve and the fixed income markets moved the returns on short maturity bonds to essentially zero as the pandemic unfolded. But that should change. Investors have already driven interest rates higher and the Federal Reserve will increase the interest rates that the Fed controls. This will eventually improve the return on money market funds and reduce the cost of holding funds in cash equivalents versus bonds, for example. In the capital markets assumptions that our research team prepares, our expectation is that pre-tax returns on cash investments will rise to 1.6% while our expectation for the pre-tax return on fixed income securities over the same time period is 2.2%. In addition, the price risk on cash investments is minimal, while there is price risk with fixed income securities which is driven by the maturity date of the bonds or the average maturity of the entire bond portfolio. As the financial markets have demonstrated thus far in 2022, there is the potential for considerable price volatility within the markets, including on fixed income securities.

If a potential need for funds is several years in the future, we may be asked if those funds should be invested in the equity market, rather than in a money market fund or short maturity bonds. While Greenleaf has a favorable outlook for equities over the long-term, we respect the potential for volatility in stocks over a shorter time period of three to five years. Our response to clients is what would be the impact on a major remodeling or building project, for example, if the equity market was experiencing a cyclical decline in prices and the available funds were less than the original investment?

Understanding and forecasting the timing and amount of cash needs from an investment portfolio is a critical step in the investment process. Whether it is through assisting with a cash flow modeling exercise or building cash distributions into the sustainability analysis that we perform for clients, your client centric team at Greenleaf Trust is available to help with your planning.



"Once an individual or entity has determined through a budgeting process a level of appropriate reserves, the next step is deciding how to invest these funds."

Stock Market Pulse

Index	3/31/22	Total Return Since 12/31/2021
S&P 1500	1,032.29	-4.64%
Dow Jones Industrials	34,678.35	-4.10%
NASDAQ	14,220.52	-8.94%
S&P 500	4,530.41	-4.60%
S&P 400	2,693.66	-4.89%
S&P 600	1,318.54	-5.64%
NYSE Composite	16,670.91	-2.31%
Dow Jones Utilities	1,041.96	7.16%
Barclays Aggregate Bond	2,215.38	-5.93%

P/E Multiples	3/31/22
S&P 1500	22.7x
Dow Jones Industrials	18.3x
NASDAQ	58.5x
S&P 500	23.3x
S&P 400	17.9x
S&P 600	17.4x

Key Rates

Rate	
Fed Funds Rate	0.00% to 0.25%
T Bill 90 Days	0.52%
T Bond 30 Yr	2.45%
Prime Rate	3.50%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	1,032.29	22.7x	1.38%
S&P 500	4,530.41	23.3x	1.37%
Dow Jones Industrials	34,678.35	18.3x	1.86%
Dow Jones Utilities	1,041.96	20.0x	3.09%

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

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

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

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

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

GREENLEAF TRUST DELAWARE:
4001 Kennett Pike, Ste 226
Greenville, DE 19807
office: 302.317.2163

TRAVERSE CITY OFFICE:
160 E State St., Suite 200
Traverse City, MI 49684
office: 231.922.1428

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

MIDLAND OFFICE
117 East Main Street
Midland, Michigan 48640
office: 989.495.2033

This newsletter is prepared by Greenleaf Trust and is intended as general information. The contents of this newsletter should not be acted upon without seeking professional advice. Before applying information in this newsletter to your own personal or business situation, please contact Greenleaf Trust. We will be happy to assist you.

Greenleaf Trust Delaware, a Delaware limited purpose trust company, is regulated by the Office of the Delaware State Bank Commissioner. Greenleaf Trust Delaware is wholly owned by Greenleaf Financial Holding Company, a Delaware corporation. Greenleaf Financial Holding Company is also the sole owner of Greenleaf Trust, a Michigan non-depository trust bank regulated by the Michigan Department of Insurance and Financial Services. Both Greenleaf Trust and Greenleaf Trust Delaware provide various fiduciary and non-fiduciary services, including trustee, custodial, agency, investment management and other non-depository services. Greenleaf Trust and Greenleaf Trust Delaware offer personal trust, retirement plan and family office services to families and entities.

Greenleaf Financial Holding Company and its subsidiaries do not provide legal, tax or accounting advice. Please consult your legal, tax or accounting advisors to determine how this information may apply to your own situation.