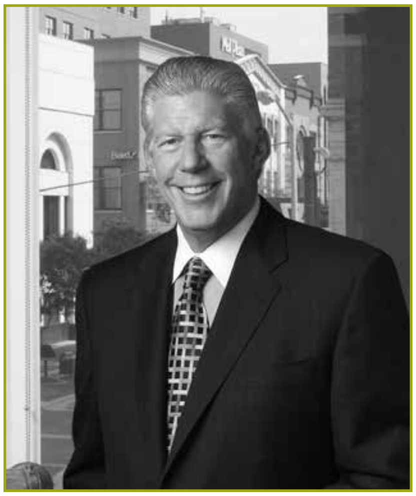
GREENLEAF® TRUST

Perspectives

A Greenleaf Trust Newsletter

DECEMBER 2013 VOLUME 22, ISSUE 11



William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary & 2014 Forecast

A rearview mirror look at the economy for 2013 reveals results as expected. Slow incremental improvement but not yet strong enough to yet be termed sustainable and robust enough to do without Federal Reserve assistance. We will review the major components of our GDP with expected 2013 results, as well as offer some commentary as to where we expect performance to be in 2014.

EMPLOYMENT: Stubbornly high unemployment would be an apt description of our current circumstances. An economy that grows at a rate under three percent simply will not create a new job rate of 250,000, which is necessary to begin to reduce the reported level of unemployment. I intentionally used the term "reported" unemployment because U6 unemployment—which includes the underemployed, temporary workers seeking full time work, and those who have simply stopped looking for employment— is not counted in the household surveys that make up the "reported" unemployment figures. When we add those categories, our unemployed are really around 13% of our labor force which now totals about 155 million. Our current average new job creation total of about 175,000 has impacted those entering the workforce for the first time, and specifically the age group of 21 to 26 year olds. For the first time since 2009, new college grads experienced increased job opportunities. For those out of work, particularly those 45 years of age or older, the average duration of unemployment grew and now on average stands at 36.1 weeks.

2014 EMPLOYMENT FORECAST: The moons are not aligning well for a significant improvement in unemployment. We must have sustained job creation on a monthly basis of 250,000 to move the needle in the right direction. Currently we do not see a ramp up of demand that will increase employment. Simultaneously we see a continued reduction in state, municipal, education and local employment which is forecasted to continue through 2016. Sequester rules have impacted federal, as well as federal contractor, employees and it is presently unclear whether sequester rules will continue through the balance of 2014. The largest portion of employment gains in 2013 were in the private sector, a trend that must continue in 2014 if unemployment rates are to stabilize at current levels.

CONSUMER CONFIDENCE: Demand for goods and services drives our GDP. Together, goods and services account for $11.5 trillion of Gross Domestic Product, *Commentary and Forecast, continued*

or 68.6% of the $16.7 trillion projected for 2013. As we know, confidence in the future is highly dependent upon employment. Confidence surveys not only ask about your family's employment but also your neighbors' and community's status as well. If our friends and neighbors are being laid off, we are less likely to have confidence about the future and that lack of confidence will be reflected in our consumer shopping practices. Noteworthy in 2013 were the reductions in large layoff notification or Warren Act notices. While not singularly impactful on current employment statistics, the reduction in rate of layoffs does help with absorption on the newly employed. Consumer confidence spiked to the 80% level in Q3 of this year but fell back to 71.2% when we experienced the government shutdown and default brinksmanship. As with every year, geopolitical strife, natural disasters, energy crisis and domestic political disruption can and does impact how secure and confident we feel about the future. 2013 has experience almost all of the above and thus the range of confidence from 61% to 82% is not surprising.

"Consumer confidence spiked to the 80% level in Q3 of this year but fell back to 71.2% when we experienced the government shutdown and default brinksmanship."

2014 CONSUMER CONFIDENCE FORECAST: The range for 2013 consumer confidence surveys was between 61% and 82% with the most recent survey almost exactly at the average of 71%. What is likely to move the confidence needle north? Stable employment, few major layoff announcements, limited geopolitical strife, hints of a more bipartisan approach to tough political decisions, continued low interest rates, continued housing value stabilization and growth in wealth factor (i.e., 401k balance growth). This scenario would most likely drive the surveys to a consistent 80% level and be recognizable in the quarterly GDP growth rate data. Unfortunately some if not all of what I described to improve consumer confidence could also turn in the opposite direction, causing a contrary result. Geopolitical and natural disasters are impossible to predict and we have no current evidence that the bipartisan conference committee appointed by both political parties will be successful in their assigned duty to have a compromise plan for debt and deficit reduction. Absent of our ability to predict what we cannot predict and absent of evidence of domestic resolution of really tough issues, we see consumer confidence continuing to struggle in the 70% range, which will continue to limit the growth of demand beyond the current 2.5% range.

PRODUCTION: As you can surmise, production data for 2013 reflects a very modest growth in GDP. The PMI, or purchasing managers index, is a forward looking survey that reveals the activity in a confidence survey of purchasing managers. These are typically the roles within larger companies that order the raw material product that is essential for manufacturing of durable goods. Economists over the years have said that PMI data below 50% is highly correlated with a recessionary economy, while results above 50% reflect growth. Our most recent 65 year history of GDP growth has averaged 3.25%. PMI data reveals that when our economy is in fact producing GDP growth of that level PMI data is at 65%. Currently, the PMI is at 56.4% and for the year has drifted in a range of 51% to its present high of 56.4%

Durable goods orders are reported at $234.3 billion for the quarter. This number has been relatively flat for the year but substantially above the levels experienced during the recession of 2008/2009. Durable goods often include goods produced for business investment which accounts for $2.1 trillion of our annual GDP or 12.7% of the total. Improvement of this portion of production is really important to recovering the $685 billion in lost output experienced during the recession. Recent data suggests that we have now fully recovered that lost output, however durable goods orders stuck in the $240 billion dollar range will not expand business investment as a percentage of GDP in any meaningful way. Domestic autos sold inclusive of light trucks and foreign cars produced in the United States for domestic sale are having another very solid year. Current estimates have total units projected for the year at slightly in excess of 16 million. The age of the current fleet of domestic cars is 11.2 years, signaling a solid market for continued sales and production. Non-durable goods have been consistently in the $260 billion range and are not likely to increase beyond that level as consumer spending continues to be flat.

2014 PRODUCTION FORECAST: Reductions in defense spending continue to put the pressure on the private sector for non-government related business investment. Demand really must be the catalyst for new investment and capital expenditures. Much has been written and spoken of the lack of business investment spending due to uncertainty about taxes, health care changes, etc. Most of that verbiage is political in nature. The real retardant to business capital expenditure is lack of demand for inventories already produced. The silver linings that current inventories are low by historical standards and capacity is moderate, meaning that any uptick in inventory depletion will positively impact both production and hours worked. We are a slow growth mature economy with very limited growth in population. Organic demand will be hard to develop with an economy of those characteristics. Incremental improvement based upon increasing demand will be our watchword for production in 2014.

HOUSING: A long road to recovery but solid evidence that with the exception of some distinct and severely overbuilt geographic areas, housing in general experienced another full year of growth in value. During the depths of our financial crisis housing values retreated to 1998 levels. Current national average data suggests that those levels have now grown back to 2001 prices. Some markets have fully recovered but they are distinct and driven by population and income growth. In general those will be the continued accelerants of value for single family homes. New housing permits as well as starts along with residential investment all improved for 2013.

2014 HOUSING FORECAST: Our economy is adjusting to the return to traditional financing mechanisms for single family home purchases. The demand for new product and sale of existing homes will be tied at the hip with growth of income and population both in geographical locations and in national averages. Hot spots of growth will grow at levels consistent with their growth in each category and similar fates though with less positive results will be experienced by communities with little to no growth. The housing affordability index is at historical lows and mortgage rates will remain in the 4% range through 2014. We anticipate that housing, which represents 3.1% of our GDP or approximately $0.5 trillion, will improve slightly but in doing so produce about the same percentage of GDP as it did in 2013.

GDP GROWTH: Full year adjusted data will reveal an economy that grew at 2.5% for fiscal year 2013, and our forecast for 2014 is a range between 2.4% and 2.9%. Some of that result could improve if Congress finds a way to restructure what we commonly refer to as sequester so that it doesn't penalize both employment and private investment. Many models suggest sequester reductions took approximately 0.3% of growth from the current fiscal year GDP growth rate. Combined with the Government shutdown, our 2013 GDP results could have been much closer to 3%. Here is hoping that the dialogue becomes reasonable and that current fiscal year decisions are reflective of the knowledge that economic sustainability is not currently here. Any thoughts of shooting ourselves in the foot should be reevaluated before the trigger is pulled.

Michael F. Odar, CFA
President

Building on TEAM IMPROVE PROCESSES for CLIENTS

In the September issue of *Perspectives*, I explained our strategic plan construction process and how it involves both a bottom-up and top-down approach with input from everyone in our company. We engage in this process annually to stay on track with what we want to accomplish. Our view is that successful strategic plans don't attempt to address everything at once and are not wrapped-up neatly over the course of a calendar year. They involve tactical moves over the course of a longer measurable time frame that help achieve the ultimate goal. At the beginning of 2013, we set out to create more focused time for our talented team to spend 'with' and 'for' our clients. It was an acknowledgement that we wanted and could be doing more for them by improving many of our processes and work flows to make us more efficient.

“Our view is that successful strategic plans don't attempt to address everything at once and are not wrapped-up neatly over the course of a calendar year.”

I believe we accomplished a lot in 2013 and our agreed upon plan for 2014 is to keep on going. We will do this by focusing on five key initiatives: Innovation, Communication, Benchmarking, Talent Development, and Business Development.

TEAM IMPROVE PROCESSES for CLIENTS created a movement for us to work more efficiently this year and challenge why we have always done something a certain way. Innovation is more than just process improvement. Innovation is transformation of workflow, more sophistication, more automation, and more operational excellence. We believe innovation is the critical next step to creating more value added time 'with' and 'for' clients.

World class service requires teamwork and the effective exchange of ideas. Communication is a critical component of each and a building block for trust. We recognize there are many forms of communication in society today and each has its situational appropriateness. Choosing a communication method based solely on efficiency rather than appropriateness could actually do more to hinder teamwork and the construction of trust rather than build them. Can teamwork and trust be built through emails? We believe communication involving personal contact is important, appropriate, and meaningful. At its core, communication is a pre-requisite to serving more collaboratively.

Being the best at what you do starts with understanding yourself and then benchmarking yourself against the best. Internal and external benchmarking help guard against institutional hubris. At its core, benchmarking means self-reflection and accountability through measuring key performance indicators (KPI's) and then benchmarking ourselves against the best to serve more, more often, and more effectively.

In order to be the best for our clients we need to constantly create more opportunities to 'engage' and 'inspire' our team. It's not enough just to find talented people to join our team. We need to develop and grow that talent. Talent development involves creating opportunities for teammates that align with their strengths and challenge them to do more.

Finally, our end goal is not growth for the sake of growth. Our goal is to provide world class service for our clients. We know from experience that remarkable service is worthy of remark. More remarkable service means our clients will talk and our footprint will grow. By striving to be top of mind with our clients, we create more business development opportunities thereby enhancing both the breadth and depth of our services for clients.

Successful Giving

Carlene R. Korchak, CTFA
Vice President
Trust Relationship Officer

As I write this, it is the week of our national holiday to give thanks for our many blessings, to be followed shortly thereafter by the busiest season of the year for giving. I thought this would be a good time to discuss some techniques that we at Greenleaf Trust discuss with our clients who have expressed gifting (whether to individuals or charities) as one of their goals. Gifting is a very personal decision, usually motivated by an important belief, passion or desire, such as providing for the education of grandchildren or giving to charitable causes near and dear to one's heart. Each client's situation is different—some techniques are simple and others are more complex. As always, we are happy to develop a customized plan to help our clients meet their specific goals.

Some Tax Basics

The United States Tax Code provides various important parameters for gifting, including, thankfully, some impactful incentives. Just as we tell clients that investment decisions should not be driven mainly by tax consequences, the same is true with gifting. While tax implications may help determine the best method to use, the core of the gifting process is always the clients' goals and desires.

Under current tax law, in 2013 there is a combined lifetime gift and estate tax exemption of $5.25 million for each individual, with special provisions for married couples where the surviving spouse may have access to the deceased spouse's unused exemption under specific guidelines. While this exemption amount is substantial

Successful Giving, continued

compared to many prior years, a fairly onerous tax rate of 40% applies to amounts in excess of this exemption.

A concept with which most people are familiar is the charitable income tax deduction for donations to qualified charities. The amount that can be deducted depends on the type of charity, the type of donation (e.g. cash versus other property), and the value of the gift versus the amount of the donor's Adjusted Gross Income. The charitable deduction can also apply to estate tax for gifts made at the donor's passing.

"A concept with which most people are familiar is the charitable income tax deduction for donations to qualified charities."

Annual Exclusion Gifts

In 2013, all individuals may gift up to $14,000 to another individual exempt from any calculation of gift tax, including calculation against the lifetime exemption amount. This is called an "annual exclusion gift," with the annual limit indexed for inflation. The annual exclusion limit will remain at $14,000 in 2014.

Direct Payment of Medical and Tuition Expenses

Similar to annual exclusion gifts, direct payment of medical and tuition expenses are exempt from calculation of gift tax. This is one of the simplest and most common methods to make gifts to individuals. Critical to qualified gifting under this technique is that the donor must make the payment directly to the medical provider or school, and only tuition payments qualify (no books, transportation costs, room and board, etc.).

Gifting Exception for 529 (College Savings) Plans

529 Plans are excellent vehicles for tax-free savings for qualified college education expenses. When used according to plan guidelines, the tax-free nature of this account allows for assets to grow over time substantially more than taxable savings accounts.

While many people use annual exclusion gifts to make 529 Plan contributions, there is also a gifting exception for these specific types of plans. Any individual may gift up to five years of annual exclusion gifts in a single year to each beneficiary with a 529 Plan. For example, in 2013 an individual could contribute as much as $70,000 to a 529 Plan for a grandchild without incurring any gift tax consequences; a married couple could contribute up to $140,000 this year. Such gifts are ratable over five years. For example, if the annual exclusion amount does not increase over the next five years and the full $70,000 is contributed by an individual this year, no additional gifts could be made for the next five years.

In addition to this exception, Michigan taxpayers who contribute to Michigan's MESP 529 Plan may be eligible for a state income tax deduction on contributions up to $5,000 for individual filers, and up to $10,000 for married couples filing jointly.

This technique is very useful for couples who become grandparents late in life and want to assure substantial funding of their grandchild's college education as quickly and simply as possible. This technique is also useful for those who have obtained substantial wealth later in life and can afford to make a sizable contribution toward a young person's college education, while allowing for the benefit of tax-free growth over time.

IRA Techniques

A reminder: Distributions from Traditional IRAs, whether to the account owner or to individual beneficiaries following the account owner's death, are taxable as ordinary income.

For those who are charitably inclined, naming charities as beneficiaries of a Traditional IRA may be appropriate, especially in situations where there are substantial other assets to pass to individual heirs. Qualified charities do not pay income tax on IRA distributions, and the charitable deduction can be applied to the donor's final income tax return (or estate tax return if applicable). Using this technique, there is the potential to pass more assets to charity and heirs and less to Uncle Sam. In certain situations, it can also make sense to do additional planning with an Irrevocable Life Insurance Trust to pass to individual heirs lower-taxed assets (proceeds from a life insurance policy) in an amount similar to the value of the IRA.

Until December 31, 2013, the IRS continues to allow direct charitable contributions up to a total of $100,000 to certain qualified charities from Traditional IRAs for account owners over age 70½. Such payments must be made directly to the charity and a receipt from the charity must be filed with the account owner's income tax return. Such distributions may be deducted from the account owner's required minimum distribution and are not included as "ordinary income" on the tax return; however, there is no charitable deduction for such distributions. At this writing, it is unclear if the ability to make direct charitable distributions will be continued in 2014.

When leaving IRA assets to individuals, converting from a Traditional to a Roth IRA during the account owner's lifetime may be advisable. This technique should be used only after considerable analysis and consultation with a CPA, but often makes sense when the account owner does not anticipate needing the funds during his or her lifetime, can afford to pay the income tax due for the year of conversion from assets "outside" the IRA, and when the individual beneficiaries will not need the funds for a period of time (e.g. self-sufficient children or young grandchildren). The concept is that when the account owner pays the tax due now, this allows for tax free growth and tax free distributions in the future (e.g. over the long term, more to heirs and less to Uncle Sam).

"For those who are charitably inclined, naming charities as beneficiaries of a Traditional IRA may be appropriate..."

Successful Giving, continued

"…the simplest, most important and most affordable technique is the concept of giving our time and talent."

Family Foundations

In addition to involving younger family members in philanthropy, establishing a foundation can transfer considerable sums of money over a long period of time (potentially many generations) to charitable causes important to the family. Tax benefits include charitable deductions and avoidance of some capital gains tax. Establishing and maintaining a family foundation involves set up and on-going operational costs, as well as annual meetings and distributions, but this is a wonderful technique for "leaving a legacy."

Split-Interest Trusts

Charitable lead and charitable remainder trusts work well for those who are charitably inclined, who own low cost basis assets for funding the trusts, who have sufficient assets to justify the costs of establishing the trust and filing annual trust tax returns, and who want to reduce the size of their estate below the estate tax exemption amount.

These "split interest" trusts name one or more individual beneficiaries and one or more charities as beneficiaries. In the case of a remainder trust, the donor receives a charitable deduction for a portion of the contribution to the trust, and the low basis assets can be sold within the trust with lower capital gains tax consequences. Once the individual beneficiaries die, the remaining assets in the trust pass to the charitable beneficiaries. For a charitable lead trust, the charitable beneficiaries receive an income stream for a period of time; low basis assets are sold each year as distributions are required, with no capital gains tax consequences. At the end of the period, any remaining balance in the lead trust passes to the individual beneficiaries with no tax consequences.

Time and Talent

Not to be forgotten in all of this, the simplest, most important and most affordable technique is the concept of giving our time and talent. This can range from volunteering our services to a charity, to spending time with young people and others, teaching them the value of giving by "paying it forward" or "giving back" for all we have been blessed to receive. Over the years I have learned that I often receive much more than I give in such circumstances.

I'll end this with some excerpts from "What is Success?" by Ralph Waldo Emerson that I think apply to giving, whether financial or otherwise: "To find the best in others without the slightest thought of return; to have accomplished a task whether by a healthy child, a rescued soul, a garden patch or a redeemed social condition;… to know that even one life has breathed easier because you have lived, that is to have succeeded." Best wishes for much "success" to you and your family for the remainder of this year, and into the next.

2014 Cost-of-Living Adjustments for Retirement Plans

Lorey L. Matties
Participant Services Coordinator

The Social Security Administration (SSA) recently announced that a 1.5% cost-of-living adjustment (COLA) will begin in January 2014. In addition, adjustments to the maximum amount of earnings that are subject to the Social Security tax will increase to $117,000, up from $113,700.

The Social Security tax functions very much like a flat tax. The taxable wage base caps the amount of employee compensation subject to the 6.20% Social Security tax rate imposed on both employers and employees. In 2014, employers must withhold Social Security tax on each employee's first $117,000 of compensation. This means that the employer and employee must each pay $7,254. Compensation above the $117,000 is not subject to Social Security taxes, although Medicare taxes will apply.

The Internal Revenue Service (IRS) also recently announced various dollar limitations applicable to retirement plans for 2014. Some 401(k)/403(b) and IRA plan limits will remain unchanged because the Consumer Price Index did not meet the statutory thresholds for their adjustment. Highlights include the following:

Retirement Plan Limitations	2014	2013
Annual 401(k), 403(b) and 457 deferral limit	$17,500	$17,500
401(k), 403(b) and 457 contribution catch up limit	$5,500	$5,500
Annual compensation limit	$260,000	$255,000
Defined Contribution Plan "415 limit"	$52,000	$51,000
Defined Benefit Plan "415 limit"	$210,000	$205,000
Highly Compensated Employee definition	$115,000	$115,000
Social Security Taxable Wage Base	$117,000	$113,700
IRA contribution limit	$5,500	$5,500
IRA catch up contribution limit	$1,000	$1,000

"The Social Security Administration (SSA) recently announced that a 1.5% cost-of-living adjustment (COLA) will begin in January 2014."

The Saver's Tax Credit for low- and moderate-income workers will reflect modest adjustments as well. The credit is between 10-50% of the individual's eligible contribution up to $2,000. The limit for 2014 is $29,500 for singles; $44,250 for head of household; and $59,000 for married couples filing jointly.

Should you have any questions regarding the various limitations that apply to retirement plans, including some that are not included in the above table, please contact our Retirement Plan Services Team.

Nicholas A. Juhle, CFA
Mutual Fund Analyst

Bull Markets Can Be Taxing

"Nothing is certain in this world, except death and taxes." Benjamin Franklin penned this adage in a letter to Jean-Baptiste Leroy not long after ratifying the constitution, and more than 200 years later it (unfortunately) endures. It's hard to say which of the two certainties (death or taxes) makes more depressing fodder for a newsletter article, but with year end rapidly approaching, I'll leave estate planning for another day and focus instead on taxes as they relate to the living. Specifically, I'll focus on mutual funds, which are unique in that investors can realize gains (and resulting tax implications) even without selling shares.

"I'll leave estate planning for another day and focus instead on taxes as they relate to the living. Specifically... mutual funds..."

Most investors are familiar with basic tax principles as they relate to individual shares of stock. Mr. Smith buys shares of ABC Company for $100 and sells them for $110 realizing a $10 profit, or gain, on which he is expected to pay taxes. If Mr. Smith holds the shares for more than one year, the gains are considered long-term and subject to a federal tax rate of up to 23.8% (in 2013). If Mr. Smith holds the shares less than a year, the gains are short-term and taxed as ordinary income. The key here though, is that Mr. Smith has to sell the shares to realize the gains. He controls the timing, and has the ability to delay realization of gains and the resulting tax liability for as long as he holds the shares. The same concept is only partially true when it comes to mutual funds.

A share in a mutual fund represents a share in a portfolio of stocks (or other investments), and the price of that share (the net asset value, or NAV) fluctuates with the prices of the underlying securities. The mechanics here are really no different than in the individual stock example above. Mr. Smith buys shares of the ABC Fund for $100, the underlying securities in that fund collectively appreciate by 10%, and Mr. Smith sells them for $110, realizing a $10 gain and the associated tax liability. Pretty straightforward right? Here's where it gets a little more complicated.

If a mutual fund sells a holding in which it has a gain, it has to distribute that gain to the fund's shareholders in the year it was realized. Remember, the fund company is managing an underlying portfolio of individual stocks on behalf of investors who own shares in the fund. If the mutual fund buys shares of ABC Company for $100 and sells them for $110, it has to distribute the $10 gain (short or long-term) to shareholders who are responsible for the tax liability. Instead of distributing gains after every transaction, funds typically make a single distribution at year-end which incorporates all gains netted against any offsetting losses or applicable loss carry forwards.

So there are two ways a fund investor can realize gains: 1) by receiving a capital gain distribution from the fund; and 2) by selling a fund share for more than the purchase price. Mechanically, capital gains distributions are processed similarly to dividends. There is a record date (holders of record on this date will receive the distribution), an ex-date (the first day you can buy the fund without receiving the distribution) and the pay date (the date the gain is actually distributed). This means that a fund could set a record date of December 15 and if our friend Mr. Smith bought shares on December 14, he would receive the distribution and a tax bill. Likewise Mr. Smith could have bought shares earlier in the year and sold them on December 14th and he would avoid the distribution altogether.

Perhaps this seems unfair. The fund accumulates gains all year and then distributes them to whoever happens to be holding the shares on the record date. Fortunately, there is a mechanism in place that prevents fund investors from being taxed twice – specifically, the distribution results in a corresponding reduction to the NAV or price of the fund share, which effectively reduces any gain in the shares themselves.

To illustrate, let's say Mr. Smith buys one share of ABC fund for $100 on December 14 and the fund distributes $10 in capital gains on December 15. Mr. Smith receives the $10 and will pay taxes on that amount (clearly unpleasant), and his share immediately re-prices to $90. Sounds like a lose-lose, but it means Mr. Smith's share could appreciate as much as $10 (from $90 back to $100) before he would realize gains on a sale. On a side note, capital gains distributions are often reinvested automatically so following the distribution and reinvestment, Mr. Smith would hold 1.1 shares at $90 instead of 1.0 share at $100. Either way he still has $100 invested in the fund.

This discussion is particularly timely for two reasons: first, most mutual funds make capital gains distributions around the end of the year, and second, given market strength, distributions will likely be more meaningful this year than they were in the last several. In 2012, the average expected distribution across our fund focus list was about 2% of NAV with a maximum single fund distribution of 8%. In 2013, the average is about 4% with a maximum of about 16%. Why the big increase? Over the last few years, funds had tax losses on their books carried over from the bear market which they could use to offset incremental portfolio gains, but five years into the post-2008 recovery, much of these tax-losses have been exhausted

"… [capital gains] distributions will likely be more meaningful this year than they were in the last several."

Bull Markets, continued

"Nobody looks forward to paying taxes and rational investors will make every effort to avoid, minimize, or delay them."

as the market has continued to move higher.

Fortunately, our hands are not completely tied. In fact, several steps in our process are inherently geared toward managing tax liabilities generally and specifically as they apply to mutual funds. First of all, this discussion does not apply to 401(k)s, IRAs, or other qualified accounts and we ensure clients are maximizing these vehicles in the context of a broader wealth management plan. For non-qualified accounts, our fund selection process carefully considers turnover rates - typically, higher turnover (more trading) means more realized gains while lower turnover means the opposite. We also monitor funds closely for manager or prospectus changes which may drive higher turnover if the portfolio is repositioned. Additionally, we analyze capital gains estimates to inform decision-making around year end - under unique circumstances, there may be benefits to strategic repositioning during the distribution season based on a host of account-specific factors. You can rest assured that we are thoroughly examining every account for opportunities.

Lastly, perhaps a little perspective is in order. Nobody looks forward to paying taxes and rational investors will make every effort to avoid, minimize, or delay them. Greenleaf Trust is in your corner working diligently to ensure that we're avoiding, minimizing, and delaying every chance we get. But at the end of the day, taxable gains are, well... gains. So don't lose sight of the fact that while taxes are a certainty,they're also a certain indicator of a growing portfolio.

If you'd like to join us in our efforts to conserve natural resources and create a greener environment, you may choose to save paper by receiving email notifications to view your statement online. Simply give us a call at 269.388.9800 and ask to speak with a member of your client centric team.

All I Want for Christmas is Next Year's Best Performing Asset Class

Steven J. Christensen, CTFA
Wealth Management Advisor

Tis the season for many great things: giving thanks, religious celebrations, special time with friends and family, parties, tacky sweaters and of course year-in-review investment data results. Each of these things holds a special place in my heart, after all who doesn't love a tacky holiday sweater, but for purposes of this article I will be focusing on the investment data piece.

Whether you are reviewing your portfolio with a trusted Greenleaf Trust Advisor, reading about personal finance on the internet or watching one of the several "market watch" television shows, year-end performance results seem to be published everywhere. What was this year's best performing asset class, what was this year's worst performing asset class and how did what I own compare? Knowing the year's results one cannot help but facetiously question in retrospect "on January 1st why didn't I load up exclusively on what I know now was the year's best performing asset class and divest completely of all others?" Setting aside the obvious crystal ball issue let's examine the results of the year's best portfolio, analyze a few more realistically implemented strategies and draw some comparisons between them. If we are willing to accept the constraints of reality when developing a goals based investment strategy the absence of a crystal ball may not be as big an issue as you may think.

The chart on page 14 details the last ten full years of performance returns for ten commonly used asset classes often found within a diversified portfolio. In addition to providing a great visual supporting the benefits of diversification, the chart provides us with data points to consider as we analyze some of the "what if's" of portfolio construction.

What if starting in 2003 we were able foresee each year's leading asset class and allocated our entire portfolio accordingly on January 1st? Further, what if we were able to do this for each of the ten years shown in the chart? Our average return of this clairvoyant portfolio strategy would have an average annual return of 34.34% with a standard deviation, a measure of volatility, of 19.56%. $10,000 invested into this strategy would have grown astronomically to $191,478. These results seem both amazing and too good to be true. Volatility for this portfolio is high but not off the charts. Let's consider this strategy our base case, and the $191,478 result as our must accomplish goal, a loved one's future college tuition perhaps.

"Discipline is the bridge between goals and accomplishment"
– Jim Rohn

Best Performing Asset Class, continued

"Let's look at some other strategies, strategies that do not require clairvoyant abilities."

The crystal ball strategy sets the bar high. Let's look at some other strategies, strategies that do not require clairvoyant abilities.

What if for the same time period, 2003 through 2012, we allocated all of our portfolio to the previous year's worst performing asset class, a buying low hoping to sell high strategy. The information needed to construct this portfolio is readily available and using it to develop a strategy is realistically possible. The result is an average return of 12.89% with a comparatively high standard deviation of 27.37%. Our $10,000 is now worth $33,620. This return seems more believable but we rode the roller coaster of volatility to get there.

What if we decided to chase last year's top performers by investing into last year's best performing assets class with the expectation that what was great last year is likely be great again next year. This popular strategy is also easy to construct because the year-in-review data is available. The average return for the return chasing strategy for the same time period would have been 5.18%, an inferior result with a standard deviation of 23.80%. The $10,000 we started with is now worth $16,566.

We have yet to find a strategy

Benefits of Diversification through Q3 2013

PERFORMANCE	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	YTD	10 Yr Average
HIGHEST	Emerging Int'l 55.82%	Real Estate 31.58%	Emerging Int'l 34.00%	Real Estate 35.06%	Emerging Int'l 39.39%	Government 12.39%	Emerging Int'l 78.51%	Real Estate 27.95%	Government 9.02%	Real Estate 19.70%	Small Cap 28.66%	Emerging Int'l 23.08%
	Developed Int'l 39.17%	Emerging Int'l 25.55%	Commodities 21.36%	Emerging Int'l 32.17%	Commodities 16.23%	Corporate 5.24%	High Yield 58.21%	Mid Cap 26.64%	Real Estate 8.28%	Emerging Int'l 18.22%	Mid Cap 23.23%	Real Estate 14.64%
	Small Cap 38.79%	Small Cap 22.65%	Developed Int'l 14.02%	Developed Int'l 26.86%	Developed Int'l 11.63%	High Yield -26.16%	Mid Cap 37.38%	Small Cap 26.31%	Corporate 7.84%	Developed Int'l 17.90%	Large Cap 19.79%	Mid Cap 12.69%
	Real Estate 37.13%	Developed Int'l 20.70%	Mid Cap 12.55%	Large Cap 15.79%	Government 8.66%	Small Cap -31.07%	Developed Int'l 32.46%	Emerging Int'l 18.88%	High Yield 4.98%	Mid Cap 17.88%	Developed Int'l 16.59%	High Yield 12.45%
	Mid Cap 35.62%	Mid Cap 16.48%	Real Estate 12.16%	Small Cap 15.12%	Mid Cap 7.98%	Commodities -35.65%	Real Estate 27.99%	Commodities 16.83%	Large Cap 2.11%	Small Cap 16.33%	Real Estate 3.03%	Small Cap 12.21%
	High Yield 28.97%	High Yield 11.13%	Small Cap 7.68%	High Yield 11.85%	Corporate 6.97%	Mid Cap -36.23%	Large Cap 26.46%	High Yield 15.12%	Small Cap 1.02%	Large Cap 16.00%	High Yield 2.28%	Developed Int'l 11.62%
	Large Cap 28.68%	Large Cap 10.88%	Large Cap 4.91%	Mid Cap 10.32%	Large Cap 5.49%	Large Cap -37.00%	Small Cap 25.57%	Large Cap 15.06%	Mid Cap -1.73%	High Yield 15.81%	Corporate -1.89%	Large Cap 8.84%
	Commodities 23.93%	Commodities 9.15%	High Yield 2.74%	Corporate 4.33%	High Yield 1.87%	Real Estate -37.73%	Commodities 18.91%	Developed Int'l 8.21%	Developed Int'l -11.73%	Corporate 4.22%	Government -1.92%	Commodities 5.85%
	Corporate 4.10%	Corporate 4.34%	Government 2.65%	Government 3.48%	Small Cap -0.30%	Developed Int'l -43.06%	Corporate 5.93%	Corporate 6.54%	Commodities -13.32%	Government 2.02%	Emerging Int'l -4.35%	Corporate 5.19%
LOWEST	Government 2.36%	Government 3.48%	Corporate 2.43%	Commodities 2.07%	Real Estate -15.69%	Emerging Int'l -53.33%	Government -2.20%	Government 5.52%	Emerging Int'l -18.42%	Commodities -1.06%	Commodities -8.56%	Government 4.74%

- Large Cap ➢ S&P 500 Index
- Mid Cap ➢ S&P 400 Index
- Small Cap ➢ S&P 600 Index
- Developed Int'l ➢ MSCI EAFE
- Emerging Int'l ➢ MSCI EEM
- Real Estate ➢ FTSE NAREIT Equity Total Return
- Commodities ➢ iPath Dow Jones UBS Commodity Index Total Return ETN
- Government ➢ Barclays Capital Markets U.S. Government
- Corporate ➢ Barclays Capital U.S. Aggregate Credit
- High Yield ➢ Barclays Capital U.S. Corporate High Yield

Asset classes shown may or may not be used by Greenleaf Trust. Greenleaf Trust portfolios may have exposure to these or other asset classes or investment vehicles. Performance information represents past performance and does not guarantee future results.

that compares to our crystal ball portfolio. Perhaps we should explore a more simplified portfolio comprised of stocks we know well. Our go with what you know strategy will invest exclusively into large cap domestic stocks, the same stocks found in the S&P 500. For the same time period the domestic large cap portfolio would have produced an average annual return of 8.84% with a standard deviation of 17.38% and our $10,000 would be worth $23,324. The standard deviation for this strategy is fine. Compared to some of the other strategies the return is not as high and I still do not have a balance that compares to the tuition bill I am anticipating.

Perhaps a strategy that incorporates the most basic fundamentals of investing should be considered. Diversification, think diversification. What if we held equal weights in each asset class for each of the years we are examining? Implementing this strategy is realistically possible because I know the value of the portfolio and I know the asset classes available for investment. To implement this strategy all I need to do is rebalance the portfolio every year. The average rate of return for this diversified strategy would have been 11.13%, a close third in ranking to the volatile buy low hope to sell high strategy and the unrealistic crystal ball strategy. This diversified portfolio has a standard deviation of 15.86% which is the lowest of all the portfolios measured. However, our original $10,000 is now only worth $28,730, well below the $191,478 tuition bogie. From a planning perspective I like this diversified strategy because it's based in reality, has the lowest volatility of all of the portfolios examined and possesses a healthy return that I can build a plan around.

Realistic return assumptions are a critical component to most financial plans. Those of us who have looked at normal market returns understand that an annual return of 34.34% over a ten year period is not something that can be expected. So how do we get the realistic diversified portfolio that I like so much to produce a return that will result in a balance equal to or greater than the $191,478 tuition target? The answer is simple, a disciplined savings plan. If I start with $10,000 utilize a diversified portfolio that returns on average 11.13% and add $8,703 at the beginning of each year, at the end of 10 years the portfolio should be mathematically worth $191,478.

Understanding and stating your goals is the first step, crafting a realistic plan to get there is the next, but it is discipline that will provide the bridge to their successful completion.

"Realistic return assumptions are a critical component to most financial plans."

Stock Market Pulse

Index	11/30/13	Total Return Since 12/31/2012
S&P 1500	419.19	29.51%
DJIA	16,086.41	25.51%
NASDAQ	4,059.89	36.11%
S&P 500	1,805.81	29.12%
S&P 400	1,304.18	29.50%
S&P 600	656.85	39.30%
NYSE Composite	10,183.23	20.60%
Dow Jones Utilities	487.13	11.53%
Barclays Aggregate Bond	107.44	-1.43%

P/E Multiples	11/30/13
S&P 1500	16.5x
DJIA	14.6x
NASDAQ	19.9x
S&P 500	16.1x
S&P 400	19.9x
S&P 600	21.5x

Key Rates

Fed Funds Rate	0% to 0.25%
T Bill 90 Days	0.18%
T Bond 30 Yr	3.81%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	419.19	16.5x	1.92%
S&P 500	1,805.81	16.1x	2.00%
DJIA	16,086.41	14.6x	2.24%
Dow Jones Utilities	487.13	NA	4.03%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.89%

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

TRAVERSE CITY OFFICE:
130 South Union Street
Traverse City, MI 49684
office: 231.922.1428

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

PETOSKEY OFFICE:
406 Bay Street
Petoskey, MI 49770
office: 231.439.5016

HOLLAND OFFICE:
150 Central Avenue
Holland, MI 49423
office: 616.494.9020

GRAND RAPIDS OFFICE:
51 Ionia Avenue SW
Grand Rapids, MI 49503
office: 616.454.0311

GREENLEAF® TRUST

e-mail: trust@greenleaftrust.com
www.greenleaftrust.com