GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

DECEMBER 2019 VOLUME 28, ISSUE 12

William D. Johnston
Chairman, Greenleaf Trust

2019 Greenleaf Notables 4

Vote With Your Ballot, Not Your Portfolio 5

What It Means To Be a Fiduciary 8

Estate Planning in Low and High Interest Rate Environments 11

'Tis the Season to Be Bunchy? 14

Black Zero 16

Economic Commentary

Federal Reserve Chairman Powell gave a recent speech titled "Building on the gains from the long expansion." Within the speech, Powell focused on two important themes: maintaining a stable and reliable pace of two percent inflation and, somewhat surprisingly, spreading the benefits of employment more widely. Part of the Fed's stated mandate has always been to balance full employment and inflation; however, Powell's specific mention of spreading the benefits of employment more widely was somewhat unprecedented for a sitting Federal Reserve Chair. His messaging seemed clear. The Fed was not planning to do anything to cool the economy and was temporarily done with rate modifications. He amplified the benefits of a tight labor market coupled with low inflation even in the absence of productivity growth, a necessary driver of GDP growth. Powell spent considerable time clarifying that it was exactly these moments in economic cycles that most benefited the U-6 employment category typically referred to as last hired and first fired. The nuance was well heard and suggested that the risks of inflation were low enough that the Fed felt a moral imperative to maintain if not increase the rate of growth, thereby maximizing employment and wage growth opportunities.

Some analysts wondered aloud if the Fed's messaging through Chairman Powell's comments was to address the current polling on wealth tax proposals by Senators Warren and Sanders, which demonstrated broader support on both sides of the aisle than most expected. It's not hard to get a resounding "yes" response in a poll when you ask respondents if taxes on other people should be raised, yet it is interesting that the Fed chairman chose to differentiate the conversation from the balance between inflation and employment to the balance between economic growth and workforce expansion opportunities for those most often left behind.

Real GDP

The second estimate revision for Q3 GDP was revised upward to 2.1% from the initial or advance estimate and was well within the range of expectations. The revisions for each of the major components such as consumer spending and business fixed investment were as you can expect small. Still troubling is the lag in business investing -2.7%, once again confirming that the consumer is in

Commentary, continued

control of our GDP destiny. The holiday season is off to a stellar start as Black Friday, Cyber Monday and Giving Tuesday all surpassed an admittedly weak 2018 by 9%. Consumer surveys had anticipated the result as those surveyed expected to spend more this holiday season than last confirming the fact that aggregate wages are up 4.4% year over year, personal spending has increased 3.7% during the same time period, and the consumer price index advanced only 1.3% allowing for growth in real (adjusted for inflation) discretionary income.

“Absent of change to the primary driver of economic expansion, which is the consumer, it is hard to forecast anything except more of the same.”

ISM Survey

The Institute for Supply Chain Management released its November report and reported for the fourth month in a row that the index had declined, registering 48.1% from the October reading 48.3%. Any reading below 50% is considered a contraction in manufacturing activity. Most analysts expected automotive activity to pick up in November, due to the return of GM workers to the plants, but that evidence did not surface in the current data. The non-manufacturing ISM survey (service industries) remained stable at 54.4% while durable goods orders actually rose 0.6%.

Employment

At the current unemployment rate and labor participation rate, we need to produce about 100,000 new jobs per month to maintain unemployment. Our twelve-month moving average is currently 167,000 job gains per month, which is almost exactly what occurred last month. Some might wonder how the employment rate can remain the same when we create more jobs than necessary to maintain the current unemployment rate. Labor statistics are both amazing and really quite fluid. In essence, you might say there are a lot of moving parts to 152 million workers on a monthly basis. The number of people moving to, within, and out of the workforce in any particular month is amazing, as is the number of people moving from part time to full time status. In large part, the participation rate of the labor force (employed relative to total population) determines the directional change in the unemployment rate. If demand for labor remains constant and participation falls, the unemployment rate could actually fall and, clearly, the opposite is true. Jobs gained in excess of jobs growth required also demonstrates greater demand for labor, which in a tight labor market fuels job advancement, employment status such as part time to full time and wage growth, all of which Fed Chairman Powell was referring to in his most recent speech.

Q4 Projections

Absent of change to the primary driver of economic expansion, which is the consumer, it is hard to forecast anything except more of the same. We have no current evidence to see growth in business investment (-2.7%) nor residential

fixed real estate investment (+ 3.7%). The net impact on import/export trade is likely to be a negative to GDP growth, though the gap did narrow slightly in October. Government consumption and spending — Federal, state and municipal — is budgetary controlled and therefore a constant in Q4 and will not affect growth in either direction for the remainder of 2019. Even the threat of new tariffs or the announcement that a China trade deal will wait until after the 2020 elections will not alter the next three weeks of the year. With all of the above taken into context we expect Q4 results to mirror the average of this year's GDP growth and finish in the 1.8% – 2.2% range.

Economics Lessons

We always like to take advantage of the political landscape to advance economic education, especially during the political silly season. Recently the administration announced proposed new tariffs on aluminum from Brazil and Argentina as a punishment for devaluation of their currencies which made their export products cheaper (mostly agricultural) and therefore hurt US farmers in the world marketplace. Let us begin with currency valuation. There are direct relationships with economic health and currency valuation. Unless a country has a large economy with substantial foreign trade and a liquid currency, manipulation of currency value would be almost impossible. All currencies float in value based upon the economic strength of the country of domicile. Currency traders know the economic condition of the countries they buy currencies in as they know the back of their own hand. If a country is in weak relative economic health to the rest of the global economy, there will be less demand for other countries or traders to own their currencies and, consequently, the valuation of their currency will decline. Brazil's economy is ranked tenth in the world while Argentina's is ranked 28th. Neither is of the size that would allow for the necessary attraction of currency traders important to manipulation activity. Secondly, Brazil's economy is 8.5% of the size of the US economy while Argentina's economy is 1.2% in relationship to our total economy. The real gripe of the current administration is that China is buying more beef and chicken from both Brazil and Argentina due to the trade war and tariffs imposed on Chinese goods by the US. Tariffs have hurt our farmers as well as aggregate and ferrous metal producers, and the current proposal to add tariffs to Brazil and Argentina is about trying to gain political capital with constituencies, and not about a false narrative of currency manipulation. If we really wanted the economies of Brazil and Argentina to become strong and therefore increase the value of their currency, we would not take actions to impair their economies.

"... the current proposal to add tariffs to Brazil and Argentina is about trying to gain political capital with constituencies, and not about a false narrative of currency manipulation."

211 SOUTH ROSE STREET, KALAMAZOO, MI 49007 269.388.9800

Michael F. Odar, CFA®
President

2019 Greenleaf Notables

It's hard to believe that 2019 is almost over. Time sure does fly, and it seems even more so for me considering the late submission of this article. I ask forgiveness from our newsletter editor as it has been a busy year for Greenleaf Trust. By many measures, this has been a successful year for us as well. So as we approach the end of the year, I think it's important to take a step back, breathe, and be mindful of what we have accomplished in 2019.

Our team of "Greenleafians" continues to grow. In 2019, we hired 15 new teammates. We now have 136 teammates in our five Michigan offices and Delaware bank. Our hiring goal from the beginning in 1998 has been to build a diverse and talented team with an unwavering commitment to hire each one better than our best. We also are passionately focused on providing our teammates with a workplace culture that engages and inspires them. If we are successful, those talented teammates do great things for our clients during a very long career. Our measurements in 2019 were 99% client retention and 97% teammate retention.

"Our team… continues to grow… We now have 136 teammates in our five Michigan offices and Delaware bank."

Our unique workplace culture was also validated in 2019 with 10 new awards recognizing our human capital practices and ranking us relative to best practices and best companies. All of the awards were based on survey input from teammates.

As our team grows, so does our need for space. Construction, or more aptly reconstruction, has started on our new home in Traverse City (second floor of the Old City Hall) and expansion efforts have begun in our Birmingham office as well. We are also excited to announce that our offices in Kalamazoo will be expanding into more of the building immediately to the south of our main office where our Retirement Plan Division resides (277 Rose St.).

Greenleaf Trust of Delaware continues its growth, too, as we now have approximately $2.2 billion under administration at that bank. The attractiveness of the trust and tax law advantages create what we refer to as the Delaware Advantage for our clients.

Finally, our Retirement Plan Division that provides retirement plan services to corporate clients has exceeded $1.2 billion in plan assets under advisement in 2019. We now administer retirement plans for over 150 clients and are helping more than 22,000 plan participants save for their retirement effectively.

I'm excited to tell you about these accomplishments in 2019 because they are tangible and all aligned with our desire to purposely grow and continuously improve the service we provide to our clients. Our success in 2019 is meaningful and a direct result of exceeding our clients' wants, needs, and desires. We hope your holidays are filled with joy and we look forward to a successful 2020.

Vote With Your Ballot, Not Your Portfolio

Nicholas A. Juhle, CFA®
Vice President
Director of Research

With the 2020 Presidential election less than 12 months away, many of our clients have been asking how we think about investments during an election year. As human beings, each person on our team has their own set of political preferences, but as research analysts, we try to approach polarizing topics (like politics) in the most objective way possible. This article will lean heavily on data to examine the historical experience of investing in election years, the concept of the election cycle, and the upcoming presidential election in particular. Our discussion is predicated on data that dates back 84 years and covers the 21 presidential elections following the great depression.

Stock Market Performance in Presidential Election Years

Do presidential elections influence the stock market? Perhaps the proximity of an election affects market fundamentals or investor sentiment every four years in a predictable way. The table below highlights what we have observed over the last 84 years. To set the baseline, if we look at all years from 1936 through 2019, calendar year price returns for the S&P 500 averaged 8.2% and returns were positive 70% of the time. If instead, we isolate the 21 election years over the same period, we find that returns averaged 6.7% with positive returns 76% of the time. Given the limited sample size and normal variation, it appears that stock markets behave quite normally during election years.

"Do presidential elections influence the stock market?"

S&P 500 Price Change (1936-2019)				
	Sample Size	Average Return	Frequency of Gain	Frequency of Loss
Calendar Year Returns	n=84	8.2%	70%	30%
Election Year Returns	n=21	6.7%	76%	24%

Source: Bloomberg & Author's Calculations

Stock Market Performance Based on Party in Power

It would appear that an election year itself does not carry heavy influence over market outcomes, but it must make a difference which party wins the election, right? Conventional wisdom might suggest that a Republican administration (generally assumed to be more business friendly), would be better for stocks, but the data simply doesn't bear it out. As highlighted in the next table, there has been virtually no discernable difference in stock market price returns based on which party was in the White House in a given year. Over the last 84 years, across 11 Democratic administrations and 10 Republican administrations, stock prices have risen a little better than 8% with similar success rates (frequency of gains) regardless of who was in power.

Vote With Your Ballot, Not Your Portfolio, continued

S&P 500 Price Change (1936-2019)				
	Sample Size	Average Return	Frequency of Gain	Frequency of Loss
All Years	n=84	8.2%	70%	30%
Democrat Years	n=44	8.1%	68%	32%
Republican Years	n=40	8.2%	73%	28%

Source: Bloomberg & Author's Calculations

Playing Off of the Election Cycle

Historical data suggests that on average, market returns in election years are average. History also suggests that on average, the political affiliation of the person occupying the White House does not matter. Is there anything to glean from the broader election cycle? Below, we dissect the four-year presidential term by year and by political affiliation. Term year three of four (the year prior to an election year) stands out with average returns of 14.9%, or nearly double the baseline average of 8.2% across all years. Thus far, 2019 is on track to keep the "year three" trend alive under a Republican administration. If the pattern holds, we would expect moderating returns in the 2020 election year based on the data.

"Historical data suggests that ... market returns in election years are average."

S&P 500 Price Change (1936-2019)				
	Sample Size	Average Return	Frequency of Gain	Frequency of Loss
All Years	n=84	8.2%	70%	30%
Term Year 1 of 4 ALL	n=21	4.8%	57%	43%
Term Year 1 of 4 DEM	n=11	8.8%	73%	27%
Term Year 1 of 4 REP	n=10	0.4%	40%	60%
Term Year 2 of 4 ALL	n=21	6.3%	62%	38%
Term Year 2 of 4 DEM	n=11	6.6%	64%	36%
Term Year 2 of 4 REP	n=10	6.0%	60%	40%
Term Year 3 of 4 ALL	n=21	14.9%	86%	14%
Term Year 3 of 4 DEM	n=11	12.3%	73%	27%
Term Year 3 of 4 REP	n=10	17.8%	100%	0%
Term Year 4* of 4 ALL	n=21	6.7%	76%	24%
Term Year 4* of 4 DEM	n=11	5.0%	64%	36%
Term Year 4* of 4 REP	n=10	8.6%	90%	10%

*Denotes Election Year Source: Bloomberg & Author's Calculations

Are We Just Data Mining?

In fairness, moderating returns in 2020 would be a reasonable expectation following a year like 2019 even in the absence of an upcoming election. In fact, it appears that election years specifically, and the election cycle broadly, carry little influence over market outcomes. That said, the data is far from useless. At the most basic level, the 84-year history tells us that the US stock market prices appreciate roughly 8% per year over the long term. It also tells us that

in most years, the market is up and mathematically, the up years outweigh the down years.

Our takeaway is reinforcement of one of the key tenets of our investment philosophy, which states: "A long-term perspective and disciplined approach lead to improved outcomes over time." Engaging with your advisor to develop a deep understanding of your risk tolerance, to create a plan, and to keep fees and taxes low are ways you can win as an investor, regardless of who wins the election.

But What if Warren, or Sanders, or Trump, or [insert name here] Wins?

Despite the data, there is no shortage of bold market predictions based on potential election outcomes – and this is nothing new. Several well-known hedge fund managers have recently described the market Armageddon that would occur if Trump were defeated in 2020. Interestingly, in 2016, many experts were predicting that a Trump presidency would completely derail markets, and as recently as last month, analysts from Raymond James predicted that the market could rally on a Trump resignation. We view all such predictions with a great deal of skepticism as there is very limited data to suggest that one individual (even the president of the United States) will single-handedly move the markets dramatically higher or lower.

> "... there is very limited data to suggest that one individual (even the president of the United States) will single-handedly move the markets dramatically higher or lower."

Vote With Your Ballot, Not Your Portfolio

Just to reiterate, this article is not intended to express a political view or to suggest that one candidate or another will be better for the stock market in 2020. On the contrary, we believe history suggests that the 2020 outcome will carry very little influence amid a wide range of exogenous factors at play. We recommend investors consider their portfolios in time horizons that extend well beyond the next presidential term and re-evaluate your risk profile if a shorter-term dislocation in the market will derail pursuit of your financial goals. Otherwise, stay disciplined and let your ballot do the talking in November. Please contact any member of the Greenleaf Trust team with questions.

SOURCES:
www.thebalance.com/presidential-elections-and-stock-market-returns-2388526
www.marketwatch.com/story/another-stock-market-worry-the-year-leading-up-to-a-presidential-election-tends-to-be-below-average-2019-09-10
www.kiplinger.com/article/investing/T043-C008-S003-how-presidential-elections-affect-the-stock-market.html

George F. Bearup, J.D.
Senior Trust Advisor

What It Means To Be a Fiduciary

The term *fiduciary* is used regularly in communications, but seldom do individuals actually know what it means to be a fiduciary. Often fiduciary refers to the role in which one serves another, such as the personal representative of an estate, a funeral representative, a conservator, a guardian, or the trustee of a trust. A deeper look into the concept of acting as a fiduciary is to focus on the duties of that particular role, and the standards by which that role-player is held accountable in the exercise of their delegated authority.

With regard to a trustee, there are four primary duties that influence a trustee's exercise of authority and discretion under a trust: the duty of loyalty, the duty of care, the duty to act impartially, and one administrative duty, which is to keep trust beneficiaries reasonably informed. Some of these duties are obvious, but their scope may not be fully appreciated.

DUTY OF LOYALTY: A trustee is under a duty to the beneficiaries of the trust to administer the trust solely in the interest of the trust beneficiaries. This duty of loyalty transcends any concerns that the trustee may have with regard to its possible removal by the trust beneficiaries. The Michigan Trust Code contemplates that in limited instances a trustee may enter into transactions for the trustee's own personal account or interest notwithstanding this duty of loyalty. However, those transactions that constitute a conflict of interest are otherwise voidable by the trust beneficiaries unless certain conditions are satisfied, such as the self-dealing is expressly authorized by the terms of the trust, a court order approves of the self-dealing, or the trust beneficiaries' consent to the trustee's self-dealing. An example where a trust instrument authorizes a modification of a trustee's general duty of loyalty would be if the company controller or a board of director's member is named as co-trustee of the trust that holds title to the business that they serve. Such an appointment would present a conflict of interest that the trust's creator could anticipate and modify in the trust instrument.

"The duty of care, also referred to as the duty to act, generally requires that the trustee must administer the trust in good faith... and in the interests of the trust beneficiaries"

DUTY OF CARE: The duty of care, also referred to as the duty to act, generally requires that the trustee must administer the trust in good faith, according to its terms and purposes, and in the interests of the trust beneficiaries. The Michigan Trust Code defines this duty as follows: Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, expeditiously, in accordance with its terms and purposes, for the benefit of the trust beneficiaries. This fiduciary duty results in multiple factors that the trustee must take into consideration to manage the trust's assets and make distributions from the trust. Those relevant factors relevant to this fiduciary duty include:

- Exercise reasonable care, skill and caution;
- Take reasonable steps to take control of and protect trust property;
- Act in a prudent manner;
- Take into account the particular facts and circumstances, i.e. become fully informed; and
- Act in accordance with the provisions of the trust instrument, the material purposes of the trust, the interests of the trust beneficiaries, and follow the law that governs the interpretation and administration of the trust.

This fiduciary duty is often reduced to act in good faith. However, because of the difficulty in how to define what constitutes good faith (or bad faith for that matter), and the implication that such vague terms require some assessment of motives, state-of-mind, or purpose, Michigan's Trust Code declined to use good faith as a standard to evaluate a trustee's performance of its duty of care. Unlike the duty of loyalty, as described earlier, which can be modified to an extent in the trust instrument, a trustee's duty of care in Michigan cannot be modified, or eliminated, in a trust. There is one Michigan court decision where the court noted that even though the administration of a trust involved a 'family situation,' that fact did not exempt the trust from judicial oversight nor did it excuse the family-member trustee from 'playing fast and loose' with the trust's administration.

DUTY OF IMPARTIALITY: The Michigan Trust Code requires that a trustee must act as would a prudent person in dealing with the property of another person. This duty also requires the trustee to manage and invest the trust's assets consistent with what is often called the prudent investor rule. This fiduciary duty of impartiality is particularly central to the trustee's discretion to make distributions from the trust. It requires the trustee to balance the interests of all trust beneficiaries, not just take into consideration the needs (or requests) of the beneficiary who may be entitled to currently receive a distribution from the trust. Restated, this duty of impartiality requires the trustee to administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust — current and future — balancing their respective interests in the same trust. The trustee must act impartially and with due regard for these diverse beneficial interests created by the trust's terms. This duty also entails the obligation to consult and otherwise communicate with all trust beneficiaries. In sum, the trustee must proceed in a manner that fairly reflects the diversity of all trust beneficiaries, including their concerns and their beneficial interests in the same trust, which often are not even remotely the same. Consequently, as a surprise to some, in order to fulfill its duty of impartiality, the trustee must take into consideration and accommodate both current and future beneficiaries' interests in the same trust, unless the trust instrument expressly provides otherwise.

"… a trustee must act as would a prudent person in dealing with the property of another person."

What it Means to be a Fiduciary, continued

"The trustee is obligated to keep all of the trust beneficiaries reasonably informed… to enable each trust beneficiary to protect their respective interests in the trust."

A trust instrument might modify the trustee's duty of impartiality to include a priority of a beneficiary's interests that must first be considered. An example would be a trust that authorizes a distribution of trust income or principal to the trust creator's surviving spouse in a second marriage, and upon his or her death, the trust assets are only then to be distributed to the creator's children from a first marriage. That trust instrument could direct that *In the trustee's exercise of discretion to make principal distributions to, or on behalf of, my surviving spouse for his/her health or support, the trustee need not consider the interests of any other beneficiary of this trust.* Otherwise, the trustee must balance the surviving spouse and children's respective interests in the same trust.

DUTY TO INFORM: Yet another fiduciary duty, that is the corollary to the duty of care, is the trustee's duty to inform and report to all trust beneficiaries. The trustee is obligated to keep all of the trust beneficiaries reasonably informed about the administration of the trust of the material facts that are necessary to enable each trust beneficiary to protect their respective interests in the trust. Accordingly, upon a reasonable request, the trustee must promptly furnish to a trust beneficiary a copy of the terms of the trust that describe or affect the trust beneficiary's interest and relevant information about the trust property. What is both reasonable and relevant is often open to debate. This duty to inform also entitles trust beneficiaries to the disclosure of the reasons and bases upon which the trustee makes discretionary distribution decision with regard to all trust beneficiaries. Thus, the expectation of confidentiality of a beneficiary's request for a distribution from the trust can be frustrated.

Trustees do not take their fiduciary duties lightly. When the discussion centers on who should act as the trustee of a trust, it is important to keep in mind these various fiduciary duties that both guide and constrain the trustee in the administration of a trust, as well as the probability that the trustee candidate is both capable and willing to adhere to these important fiduciary duties.

Estate Planning in Low and High Interest Rate Environments

Daniel L. Baker, J.D., CTFA
Vice President,
Director of Business Development
and Trust Relationship Officer

Some estate planning or wealth transfer strategies work well in a low interest rate environment, like the one we are in now, while others are more effective when rates are higher. It may be advantageous to implement those strategies that are most effective in a low interest rate environment now while preparing to implement other strategies when rates rise.

Each month, the Internal Revenue Service publishes short-, mid- and long-term rates (Applicable Federal Rates (AFRs)) and the §7520 rate. The AFRs reflect the minimum interest rate that must be charged for loans between related parties to avoid triggering imputed income or gift taxes. The §7520 rate, named after a section of the tax code, is 120% of the mid-term AFR, and is used to calculate annual payments for certain estate planning techniques. It is often referred to as the "hurdle rate" because certain strategies depend on investments returning more than the current §7520 rate to be successful.

This fall, the IRS lowered the mid-term (3 to 9 years), long-term (over 9 years) and §7520 rates to their lowest levels in three years. Loans originated within a particular month, with very few exceptions, keep the same rate throughout the lifetime of the loan. While not at the levels of the historically low 2012-2013 rates, the current low rates present timely opportunities for those looking to transfer assets to their heirs tax-free. The §7520 rate, for example, in November 2019 was 2.0%, roughly one-third of its average rate over the last 30 years.

Estate planning strategies which work well while interest rates are low include, intra-family loans, grantor retained annuity trusts (GRATs), sales to intentionally defective grantor trusts (IDGTs) and charitable lead annuity trusts (CLATs). When rates are higher, more efficient and commonly deployed strategies include charitable remainder annuity trusts (CRATs) and qualified personal residence trusts (QPRTs). If you are thinking about estate planning, in the midst of such planning, or even if your wealth transfers are complete, prevailing interest rates can have a significant impact on the effectiveness of your planning. Below, we will discuss some common estate planning strategies and how they are favored when interest rates are either low or high.

"If you are thinking about estate planning... prevailing interest rates can have a significant impact on the effectiveness of your planning."

Effective Strategies in a Low Interest Rate Environment

Planning when interest rates are low often involves one or more lending strategies that leverage low interest rates to transfer wealth with little or no gift tax. Typically, parents and grandparents make such loans to children and grandchildren at the appropriate AFR for the desired loan term with the loan proceeds invested by the younger generation. If the investment gains exceed the interest (hurdle) rate, the excess value is transferred to the borrower.

INTRA-FAMILY LOANS: Intra-family lending can be a good way to assist family members without incurring gift tax or using up any estate and gift tax exclusion. In addition to the benefits of a low interest rate (currently around 1.6% for a three-to-nine-year loan term), the interest is paid to a family member instead of a bank and, if used for the purchase of a home, may allow the borrower to avoid administrative loan costs and allow a child with poor or no credit history to buy a home. The lender can also forgive all or part of the loan each year up to the annual gift tax exclusion amount (currently $15,000 to any individual), without a gift tax consequence.

While intra-family loans are most often used in connection with a home purchase, in a low interest rate environment such loans can be a useful strategy in other contexts. If the borrower is able to earn a rate of return on the borrowed funds in excess of the loan interest rate, the borrower keeps the excess without any transfer tax cost.

“While intra-family loans are most often used in connection with a home purchase, in a low interest rate environment such loans can be a useful strategy in other contexts.”

INSTALLMENT SALE TO AN INTENTIONALLY DEFECTIVE GRANTOR TRUST (IDGT): This strategy is similar to an intra-family loan, the principal features of which are that the borrower is a trust created by the lender and the borrower trust is a “grantor trust,” which means the lender/grantor is responsible for the payment of any income and capital gains taxes incurred by the trust. This allows the assets to grow inside the trust on a tax-free basis. Another feature is that the assets sold to the trust or into which the loan proceeds are invested are often non-cash assets. The interest rate is the relevant AFR, so any appreciation of the assets, over and above the currently low interest rate, accrues to the beneficiaries free of gift tax.

GRANTOR RETAINED ANNUITY TRUST (GRAT): A grantor retained annuity trust, known in estate planning circles as a GRAT, is another wealth transfer technique that allows for the transfer of significant assets to the next generation with little or no gift or estate tax consequences. The grantor first establishes the trust and funds it with assets with appreciation potential that the grantor wants to pass on to the beneficiaries. The grantor receives annuity payments for period of years, usually two to five years (the GRAT term). The total value of all annuity payments is more than or equal to the initial value plus interest based on the §7520 rate. So, as you can see, the lower the “hurdle rate,” the more likely the assets are to appreciate above their value at the funding of the trust plus the interest payments. The assets remaining in the trust at the end of the term are passed on to the beneficiaries gift tax-free.

If the assets in the GRAT fail to outperform the §7520 rate, the assets are returned to the grantor. The grantor would have paid little to no gift tax and only incurred the legal and administrative costs to establish and maintain the GRAT. There are no other adverse tax consequences of a “failed” GRAT.

CHARITABLE LEAD ANNUITY TRUST (CLAT): A charitable lead annuity trust (CLAT) is similar to a GRAT, except the annuity payments for a term of years

are made to a charity and the grantor is entitled to a charitable deduction for the amounts passing to charity. Only the assets calculated to remain at the end of the term are subject to gift tax. If the trust is structured to "zero out" at the end of the term, there will be little or no gift tax. The trust is said to zero out when the annuity payments are at least as high as the AFR over a sufficient number of years leading to the actuarial value of the remainder interest to be zero at the end of the term.

Like a GRAT, a CLAT works best in a low interest rate environment because any investment performance in excess of the hurdle rate passes tax free to the beneficiary or beneficiaries at the end of the trust's term. The lower the rate, the larger the potential tax free transfer.

Effective Strategies in a High Interest Rate Environment

Estate planning strategies that work well in higher interest rate environments are those where the benefits hinge on using higher rates to reduce the actuarial value of a taxable gift or to increase the value of a charitable remainder interest.

CHARITABLE REMAINDER ANNUITY TRUST (CRAT): With a charitable remainder annuity trust (CRAT), the donor places an asset in a charitable trust with the annuity payments made to one or more persons (which may include the donor) for a term of years or a lifetime. The value of the annuity is calculated as a fixed percentage of the initial value of the trust's assets, but the amount must be no less than 5%. The charity receives whatever remains at the end of the term. The value of the remainder interest is calculated at the time of the trust's creation and the donor receives an income tax charitable deduction. The value of the remainder (the amount going to the charity) must meet a minimum threshold to pass IRS muster. When the §7520 rate is higher, the value of the charitable interest is higher and the more likely the trust will pass IRS review.

QUALIFIED PERSONAL RESIDENCE TRUST (QPRT): A qualified personal residence trust (QPRT) is a trust used to transfer a personal residence to trust beneficiaries. The homeowner places the residence in trust but retains the right to use it rent free for a number of years. At the end of the term, the residence passes to the beneficiaries. If the grantor wishes to continue to live in the home at the end of the term, the beneficiaries can rent it to the grantor. The initial transfer to the QPRT is a taxable gift of the remainder interest, calculated using the §7520 rate. The higher the rate, the higher the value of the grantor's right to use the residence during the term and the lower the future remainder interest. So as the §7520 rate increases, the taxable gift decreases. This makes the QPRT a more appropriate strategy at higher interest rates.

If you are considering one or more wealth transfer strategies, we encourage you to visit with your Greenleaf Trust client centric team or other financial and legal advisors to assist you in implementing strategies consistent with your overall goals and objectives.

> "Estate planning strategies that work well in higher interest rate environments are those where the benefits hinge on using higher rates to reduce the actuarial value of a taxable gift..."

Andrew L. Riker, CFP®, CTFA
Vice President
Senior Wealth Management Advisor

'Tis the Season to Be Bunchy

December is a busy time of year… holiday parties, shopping for gifts, and family gatherings. It is also a busy time of year for charitable giving. In fact, approximately one-third of charitable gifts occur in the month of December. As an advisor, it is very enjoyable to see the generosity of clients in support of charitable causes for which they are passionate. It is also rewarding to be in a position to help clients make their charitable gifts in the most tax efficient way possible. Typical strategies that we help clients execute on the charitable front include advising clients to use appreciated assets or making qualified charitable distributions from IRAs. However, one charitable giving strategy that continues to be somewhat overlooked is "bunching" of charitable gifts.

As we have written about extensively in the past, many important changes went into effect with the 2017 Tax Act. Perhaps most notable was the substantial increase in the standard deduction. The standard deduction was effectively doubled, which has resulted in fewer individuals itemizing on their income tax returns and thus not gaining an advantage from claiming the charitable income tax deduction. In 2019, the standard deduction for single filers is $12,200 and $24,400 for married couples who file jointly. The standard deduction can be thought of as a "hurdle rate." If available deductions exceed $24,400 for a married couple in 2019, they would itemize. If not, they would take the standard deduction of $24,400 and the tax benefit of charitable gifting would no longer apply.

"It is… rewarding to be in a position to help clients make their charitable gifts in the most tax efficient way possible."

A strategy called bunching could help tax filers itemize deductions in a year when they otherwise wouldn't be able to do so. Bunching, which is sometimes called pull-forward charitable planning, is a strategy where charitably inclined individuals may consolidate future years' charitable gifts into the current tax year, thereby creating a larger current year amount. This will enable them to bunch their deductible charitable gifts into one calendar year in order to be able to itemize their tax deductions for that single calendar year. A related strategy is to boost gifts by completing larger gift commitments in a single year rather than over an extended pledge-payment period. Both strategies suggest giving the same amount to charity that would normally be completed, but to be mindful of the tax year in which charitable gifts are made.

The illustration below considers a married couple that would normally make charitable gifts of $25,000 over two-years (i.e. $12,500 each year). It further assumes the couple has $10,000 or more in state and local income, sales, and personal property taxes (the ability to itemize these taxes is capped at $10,000), and has no other deductions to itemize. Scenario 1 assumes that the couple bunches or boosts the $25,000 of charitable gifts that would normally take place over two years into 2019. Scenario 2 assumes that the couple spreads out the gifts evenly by making charitable gifts of $12,500 in 2019 and $12,500

in 2020. In both scenarios, the couple makes total charitable gifts of $25,000 over the two-year time-frame. Scenario 1, where bunching or boosting takes place, results in the tax filer being able to itemize in one tax year because (they would have $35,000 of deductions available in 2019; greater than the standard deduction amount of $24,400). Scenario 2, where the gifts are evenly split, results in the couple taking the standard deduction in 2019 and 2020. If the couple's household income was $250,000, the total federal income tax savings from this strategy would approximate $5,000.

Scenario 1

2019		2020	
Property and State Income Tax	$10,000	Property and State Income Tax	$10,000
Charitable Gifts	$25,000	Charitable Gifts	$0
Total	$35,000	Total	$10,000

Scenario 2

2019		2020	
Property and State Income Tax	$10,000	Property and State Income Tax	$10,000
Charitable Gifts	$12,500	Charitable Gifts	$12,500
Total	$22,500	Total	$22,500

There is much reward in being able to support charitable causes that align with our philanthropic passions. Once charitably inclined individuals decide which charities and the level of desired support, proper planning can help boost tax savings. The team at Greenleaf Trust is well versed in philanthropic planning and we enjoy the process of helping clients support their chosen causes in the most efficient and effective way possible.

"Bunching… is a strategy where charitably inclined individuals may consolidate future year's charitable gifts into the current tax year…"

John Graham
Guest Contributor

Black Zero

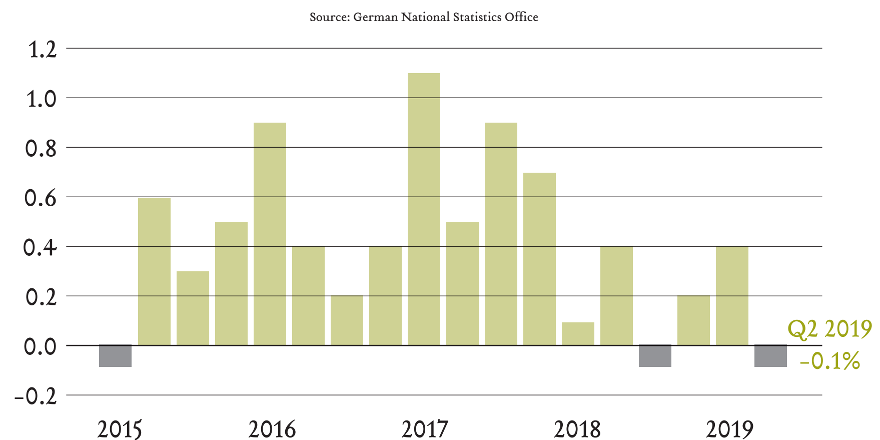
As a long-time friend of Greenleaf Trust specializing in foreign economic and financial markets, John Graham shares his global investment perspective as a guest contributor in this month's *Perspectives*. John is a founding member of Rogge Global Partners headquartered in Great Britain and former head of JP Morgan's Multicurrency Asset Management Practice in London.

George Santayana said, "Those who cannot remember the past are condemned to repeat it." For Germany, currently, a better thought might be "Generals always fight the last war."

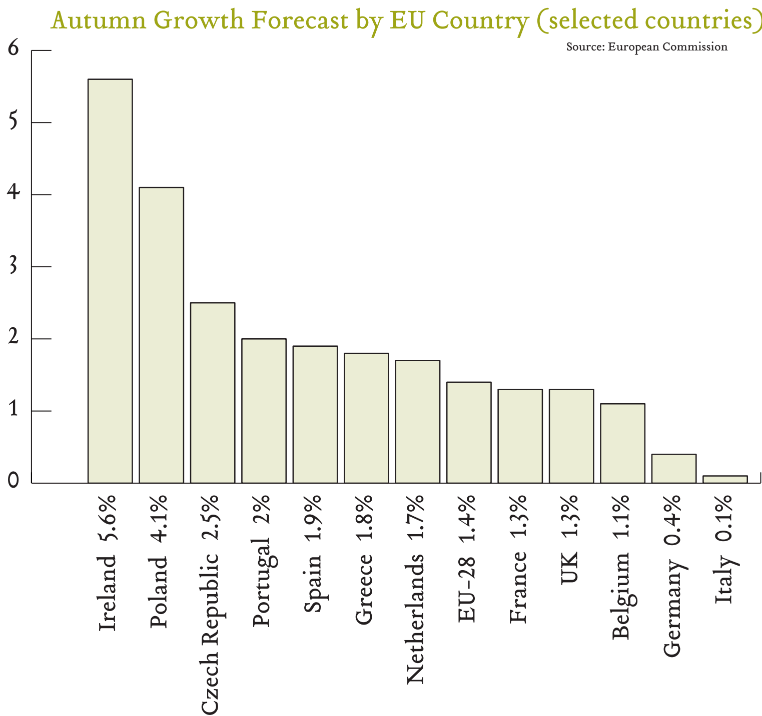
Germany and its other European partners have successfully avoided the next war for 62 years, but in binding itself to the rest of Europe through the European Union (EU) and the Euro, Germany has created a dilemma for itself in the current economic climate. Until recently, the EU worked well for Germany. The Deutsche Mark (DM) was undervalued due to the negative effects of German reunification hitting the German economy just as she went into the Euro giving her an intra-European advantage. Germany's trade machine was good at countering a rising DM and, later, Euro with higher productivity through investment. More recently, the ECB's negative rates and quantitative easing have kept the Euro undervalued versus the US dollar and other trading partners (though one could argue that America's massive debt pile, which has required US rates to remain high, has also strengthened the US dollar by attracting investors into the US markets). However, the economic crisis across southern Europe while keeping rates low for German companies, has put a massive strain on the Euro, a currency which does not have the backing of a single federal system that can effectuate transfers among member states to even out growth. The biggest single driver of the Euro has heretofore been the German economy which is now beginning to sputter.

"... in binding itself to the rest of Europe through the European Union (EU) and the Euro, Germany has created a dilemma for itself in the current economic climate."

German Annual GDP Growth % by Quarter Since 2015

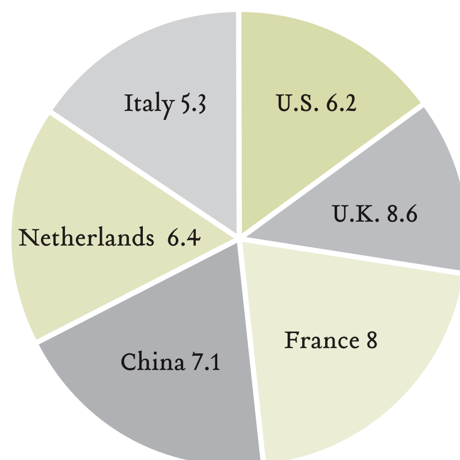


Germany is now near recession (recession was narrowly avoided when Q3 GDP came in at 0.1% after a fall of 0.1% in Q2 2019) and the bulk of Europe is facing extremely slow growth.



The single biggest reason for the slowdown is the turbulence in global trade on which Germany's manufacturing machine depends. With its main export markets slowing, Germany needs to do something to boost its economy. In an era of negative government yields, one immediate answer is expansionary fiscal policy. A fiscal expansion in Germany would not only help its domestic economy, but the rest of Europe as well. However, here is where Germany's leaders are fighting the last war.

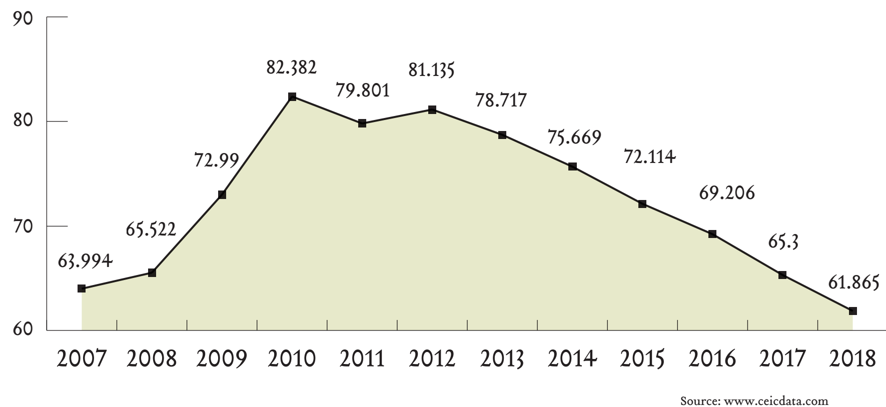
"The single biggest reason for the slowdown is the turbulence in global trade on which Germany's manufacturing machine depends."



After the recent sovereign crises in Southern Europe, £2 trillion spent on reunification and harkening back to the problems of debt-created inflation in the 1920's, Germany passed a constitutionally binding fiscal rule called the schwarze Null, the black zero. It was fathered by Wolfgang Schaeuble, the Finance Minister from 2009 to 2017. Under the "Debt Brake", the Federal government cannot run a deficit of more than 0.35% of GDP except in case of natural disaster or deep recession. The Lander (States) cannot run structural deficits at all from 2020 on. The policy of gradually reducing government debt by reigning in spending is supported by both the Christian Democratic Union and the Social Democratic Party (the junior coalition partner in Mrs. Merkel's government) as well as other pro-business and right-wing parties and has been successful in that aim. In 2018, the government ran a surplus of 1.9%, up from 1.2% the year before and 0.6% in 2014.

"... Germany passed a constitutionally binding fiscal rule called the schwarze Null, the black zero... the Federal government cannot run a deficit of more than 0.35% of GDP ... The Lander (States) cannot run structural deficits at all from 2020 on."

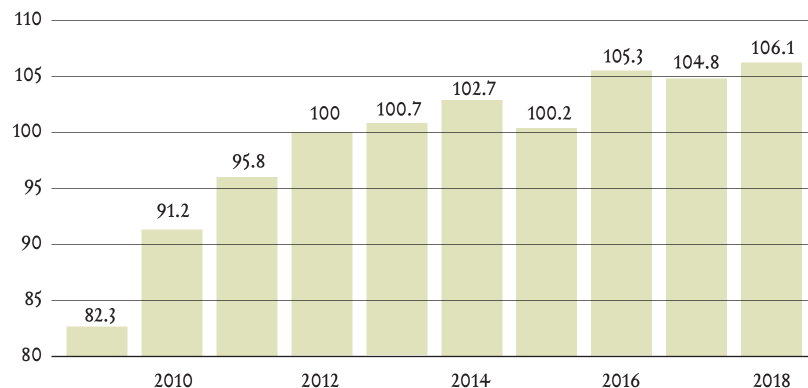
German Government Debt as % of GDP



Source: www.ceicdata.com

And, by comparison:

US Government Debt as % of GDP



Now with European interest rates in negative territory, however, a weak domestic and European economy, trade challenges in Asia and across the Atlantic, the left leaning Greens as well as the left of the Social Democratic Party in Germany are challenging this restrictive rule. In addition, a

new threat has emerged which the creators of the black zero could not have envisioned.

Under the new Brexit Withdrawal Agreement negotiated by Boris Johnson, Northern Ireland has gained a unique advantage in European trade. At least until a final agreement is reached during the post-Brexit transition period (until 2022), and thereafter if no agreement is reached, Northern Ireland will leave the EU customs union but retain frictionless access to EU bloc markets. Hence, there will be no customs border between the Irish Republic and Northern Ireland, and Boris Johnson has promised that there will be no customs checks over the Irish Sea. So, Northern Ireland will have the best of both worlds and, as they say, there's more. Should President Trump impose large tariffs on EU exporters of aluminium and steel (as threatened), Northern Ireland would not be subject to those tariffs. Any German or other EU exporter would then be mad not to consider moving a portion of their operations to Northern Ireland. Mrs. Merkel is, rightly, not very happy about this provision!

Coming back to the black zero, in order to loosen fiscal policy significantly, the German government would have to find a two-thirds majority in both houses of the Bundestag. As this is a nearly impossible task, any expansion of fiscal policy will have to happen at the margin in special programs. With Germany near full employment, only if a real global economic sell off were to hit the German workforce would the votes be found to overturn black zero. Nonetheless, pressure will continue to mount on the German government from inside and outside the country to find ways to expand fiscal policy and to halt the fiscal tightening, if not reverse course entirely. It is hard to imagine the Euro continuing ad infinitem without a tighter Federal approach where funds can easily be transferred from one region to the other. Getting there may prove difficult, but the alternatives are fairly stark, including:

- Another Brexit
- Further emergency funding in financial crises a la Greece
- A further polarization between the left and right parties within the EU

As an investor, this German fiscal rigidity is worth bearing in mind as it gives the EU a structural preference for low interest rates and a weak Euro. With growth dependent on external rather than internal forces, investors may well be advised to proceed cautiously until such time as global growth picks up and helps float the German economy. That being said, as intimated above, the German Government does have massive fiscal weapons at its disposal, so a crisis in the labour market there could give rise to investment opportunities predicated upon emergency German fiscal expansion. In these times of uncertainty, we will all be well advised to keep a watchful eye on the data coming out of Berlin.

"…in order to loosen fiscal policy significantly, the German government, would have to find a two thirds majority in both houses of the Bundestag. As this is a nearly impossible task, any expansion of fiscal policy will have to happen at the margin…"

Stock Market Pulse

Index	11/30/19	Total Return Since 12/31/2018
S&P 1500	720.21	27.08%
Dow Jones Industrials	28,051.41	23.05%
NASDAQ	8,665.47	31.93%
S&P 500	3,140.98	27.63%
S&P 400	2,010.15	22.72%
S&P 600	993.51	19.18%
NYSE Composite	13,545.21	22.17%
Dow Jones Utilities	851.72	23.02%
Barclays Aggregate Bond	2,226.55	8.79%

P/E Multiples	11/30/19
S&P 1500	21.0x
Dow Jones Industrials	19.3x
NASDAQ	32.0x
S&P 500	20.9x
S&P 400	21.7x
S&P 600	25.1x

Key Rates

Rate	Value
Fed Funds Rate	1.50% to 1.75%
Tbill 90 Days	1.54%
T Bond 30 Yr	2.21%
Prime Rate	4.75%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	720.21	21.0x	1.84%
S&P 500	3,140.98	20.9x	1.85%
Dow Jones Industrials	28,051.41	19.3x	2.25%
Dow Jones Utilities	851.72	22.0x	2.99%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.37%

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

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

TRAVERSE CITY OFFICE:
125 Park Street, Suite 495
Traverse City, MI 49684
office: 231.922.1428

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

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

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

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

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.