GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

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William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary

The Federal Reserve's announcement that they will reduce their asset purchasing from banks to $65 billion in February as well as continue that trend throughout 2014, fully exiting the program by December, gave financial markets pause in January, which trimmed the Dow and S&P 500 by about 5%. First let's examine what the Fed is seeing that tells them 2014 is the year to end purchasing assets from banks and, secondly, let's review the market and economic implications of doing so.

Evidence of continued economic improvement is growing, though it remains far from robust. Unemployment dipped to 6.7% and the underlying data reveals some sustainability. There are 1.3 million more people working than there were a year ago and on the non-farm payroll side, that number is over 2.2 million. U-6 unemployment is now down to 13% and current private job growth trends suggest this year's unemployment rate may finish at 6%. Full recovery from an employment standpoint? No, but better than the incremental progress of the last four years and setting the stage for the possibility of mid 5% by the end of 2015. Average duration of unemployment is now 37 weeks, down a full five weeks from its high in 2012. As we know, small business optimism is key because that is where most job growth is derived from. The help wanted index and online placement of job ads rose to 5.3 million for the month, which is an increase of over 400,000 year over year. What the Fed knows is that, especially in a recovery of incremental improvement, jobs matter a lot. The trend in place should put more consumer dollars in the economy simply as a function of employment and that drives economic growth.

In every indicator across both residential and commercial construction we see positive incremental growth. To be certain, this spending of growth is geographically uneven as is the entire economic recovery. It follows that where population, income and employment growth occur so does the spending rate associated with construction. Housing values retreated in the second half of 2013 but that retreat followed a significant increase in 2012 and the first half of 2013. November's Case - Schiller housing survey of ten key markets shows a return to growth over the previous survey.

Economic Commentary, continued

Consumer confidence for January came in at 80.7%, a full 38 points higher than January of 2012. We have offered before that consumers gain confidence not only when they are employed but when their neighbors, friends and relatives are employed as well. The growth in employment is largely responsible for this growth in confidence and when confident, consumers spend more. We don't expect to see great January economic numbers especially in auto and retail. The polar vortex winter weather hit high density population belts very hard and thus, consumers were not out in droves. As the winter weather normalizes we expect to see the return of stronger consumer purchasing results.

Production continued its incremental improvement with factory order backlog, durable as well as non-durable goods growth. The purchasing manager's index came in at 57.6% which is a significant year-over-year growth of 7.6 points. This is a leading indicator and while we would like to see this number above 60%, it is a decent distance above the near-recessionary level of 49.0%. The inventory-to-sales ratio remained constant which should mean that factory orders will be in lockstep with consumer demand. Any increase on the demand side should result in more production. Factory utilization was constant at 79.2%, revealing capacity to do more. Although we expect autos to retreat in January, industry surveys still remain confident that total production could reach 17 million units in 2014.

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Personal income grew while the personal savings rate declined in the last reporting period and consumer debt increased slightly. All totaled the latest data as well as trends in place of GDP growth give the Federal Reserve the chance to ratchet down and perhaps fully dismantle the asset purchase program that has cured the balance sheet of most of our large commercial banks and kept interest rates artificially low during the fifty seven months of our economic recovery.

IMPLICATIONS FOR THE ECONOMY AND FINANCIAL MARKETS

We think the Fed has it right on the economy. We are fifty seven months into a historic recovery and the evidence of sustainability seems clear. The transition between purchasing assets from banks thereby providing them liquidity to selling bank's assets and removing levels of liquidity is gradual as well as artful and requires really good data. We also expect some market nervousness. Short-term investors have very little patience and they often act with herd-like mentality, so we should not be surprised with equity market sell-offs of five to ten percent as this transition is executed by the Fed. The balance required is clear for all to see, tighten too much on the liquidity lever and the economic engine slows, tighten too little into economic growth expansion and inflation eats at asset values. The Fed has the targets in their sight and it is now up to the leadership of Chairperson Yellen to make certain those targets are hit. We like the trends in place and the Fed's announced strategy.

Long-term investors' willingness to take risk by purchasing stocks has always been about valuations. A central or key valuation dating back to "The Prudent Investor" thesis put forth by Graham and Dodd was the relationship between risk-less yield, i.e., treasury securities and the price of stocks as measured by their yield or dividend. This ratio or relationship is often referred to as the "yield gap." Theoretically, when this yield spread or gap is low or narrow, investors are being paid well for their investment risk in owning stocks and thus, their risk is lower. Conversely, if the gap or spread is wide, investors are accepting greater risk. There is a bit more to it and many other valuations enter into risk assessment but as the Fed exits its asset purchase program, you are likely to hear more or perhaps read more about the yield gap and enhanced risk to equities if dividend rates don't keep pace with increased interest rates on treasury securities.

One assumption that some investors make is that the transition the Fed is making will immediately increase fixed income yields and that bonds will be stiffer competition for stocks globally. This argument is one of extremes and falls short on the evidence. Bonds have at times been very stiff competition for equities but we are not currently in that scenario nor are we likely to be there for quite some time. Currently, the yield gap of stocks to treasuries is at 1% and even if treasury yields increased to 4% on the ten year maturity, which is currently yielding 2.84%, the yield gap would still be only 2.3%, which from a historical perspective is very low. To be certain the Fed has kept interest rates artificially low and over the next year we will be returning to market driven pricing of treasuries and those values will be driven by many factors that include domestic and global economic performance and geo-political happenings. Transparency and balance will go a long way in calming the jittery nerves of investors. Increased volatility in the transition of policy execution is possible, but in the longer term the 2014 equity market performance will have a lot more to do with the economy and the collective performance of companies increasing revenue and earnings than it does about increasing rates on the ten year Treasury bond.

As many of you know one of my favorite authors and global thinkers is Thomas Friedman, who has authored many books during the past fifteen years providing really good insight into the impact of

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Economic Commentary, continued

globalization. Last week Mr. Friedman was responding to questions on a blog called the "World Post" and he said that as he was revisiting his 2004 book *The World is Flat* and realized that in 2004, "Facebook didn't exist, Twitter was still a sound a bird made, a cloud was something in the sky and 4G was a parking spot." He was referencing the rapidity of change that continues to affect all of us globally. He went on to suggest that the forces of the 21st century made the world connected and flat but what has happened in the last seven years has been at warp speed and we have gone from connected to hyper-connected and from inter-connected to interdependent; in only one decade, we have seen this fundamental nonlinear explosion of the tools to create, connect, compete and collaborate globally. There are now three to four billion people globally wired to platforms that are racing towards universal connectivity. What are the implications of going through a global recession and recovery while simultaneously going through a technical revolution? What are the implications for governance, transparency, equality, power, employment, education, and access to technology as a global right? Knowledge is power, those with it have it. What happens to average, what happens to the global, not just the US, middle class? Mr. Friedman always provides insight that makes me squirm a little. In the next issue we will tackle some of these questions and see if we get more or less comfortable as a result of doing so.

"There are now three to four billion people globally wired to platforms that are racing towards universal connectivity."

Seven Truths Over 15 Years

Michael F. Odar, CFA
President

This month I am celebrating my 15th year with Greenleaf Trust. For me, it's both hard to believe and very gratifying. Where did the time go? Looking back, a lot has happened both personally and professionally for me over that time. I now have a teenager whose shoe size is bigger than mine and professionally have taken on a few more responsibilities since moving from a Junior Research Analyst when I started to the President of our unique organization.

As I take time to reflect, I can't help but think of all the lessons I have learned and how they get woven into the fabric of the organization. The lessons become beliefs, good things happen, and then they are simply how you do what you do. If my teenager ever wants my advice on how to run a business, here are a few of my nuggets.

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Relationships Matter

We are in the relationship business and deeply value our relationships with clients. If we don't take the time to really get to know our clients and have them really know us, we won't be able to do the impactful work for them that we aspire to. Relationships are also built with hard work and lots of communication.

People Matter

The people that make up our team (I like to call them Greenleafians) are our greatest asset. It's a primary responsibility of our leadership team to make sure our team is engaged and inspired. The result will be exceeding the wants, needs, and desires of our clients.

Culture Means Everything

You can hire all the talented people you want, however if you don't provide the right culture for them to thrive they won't stick around long. A vibrant culture multiplies the impact of those you bring into it.

Clients Should Always Come First

We are in business for our clients and because of our clients. Our hierarchy has always been clients first, employees second, and shareholders third. Our clients are not getting our best if they are not first.

Don't Ever Stop Learning

Institutional hubris has been the demise of many organizations. And if you stop looking for opportunities to learn because you think you know

Seven Truths, continued

it all, you will stagnate and the world will pass you by. Continuous improvement involves learning every day.

Trust is Something You Earn

We go to work every day on behalf of our clients, and take that responsibility very seriously. Trust starts with a relationship and is earned over time through experiences involving reliable, good, honest, and effective work.

Teamwork is Not Just a Word

It's a powerful multiplier. It's a relationship built on trust, commitment, candor, accountability, and attention to results. Our team started 15 years ago at 10 members and now stands 90 strong. Our growth is because of teamwork and we rely on each other because our clients rely on us.

Kathleen J. Waldron, QKA
Vice President
Assistant Director of
Retirement Plan Division

Projecting Retirement Income

At around age twelve, and at least every few months, each one of my siblings and I had "a meeting" at my dad's desk. This meeting consisted of reviewing our bank statement and discussing financial matters. We usually arrived with an eye roll and some whining but he ignored all that and the meeting went on as scheduled. It wasn't until I was well into high school that I realized that not everyone had these meetings to talk about money. It became apparent to me that not everyone was saving for a rainy day. My dad had a keen interest in investing, and taught us all the value of saving and sharing with those less fortunate. He would explain compounding and interest income, and how that appeared every month on our statement — just because we kept a balance in our account (albeit very small)! Money earned babysitting or by selling a calf was usually cheerfully deposited into our bank accounts by my dad because he would be "driving right by the bank anyway."

In matters of saving for retirement, the operative word is "saving." The best constructed financial plan or investment alternatives will not serve anyone well if one is not consistently putting money aside — saving. Our children, particularly those under 30, are aware that workers have to save for their own retirement; investment losses are real and can impact retirement accounts drastically; it is hard to get jobs and that social security retirement income will not be enough for a person to live in reasonable comfort. Our children will probably live to be 100 or, if they live to age 65, they likely will live another 35 to 40 years. That is a long time in retirement. Saving for retirement is critical and income replacement will be critical. Helping the next generation to understand the importance of saving and investing in a retirement plan should be at the forefront of good participant communication. There has been much information provided to this generation, and they know some of the obstacles they face, but we can do more to arm them with meaningful information regarding their retirement. The Department of Labor (DOL) is working on a proposed regulation that might mandate retirement income projections. Projections would be based on assumptions and, while not perfect, will be at least a guideline based on reasonable assumptions and, frankly, will be better than nothing. Income projections would be helpful estimates, but not a guarantee. Updated projections would be provided at least once a year and, as time goes by, the projections for a participant should grow increasingly more accurate because there are more years of actual experience and fewer years of projections. On the retirement journey, we all will need to ask ourselves basic questions about how we want to live in retirement. Do we want to travel or focus on hobbies? Where do you want to live in retirement? Do we want to help our grandchildren with college costs? The answers to these and other questions will lead us in the right direction and help us focus on the amount we need to save toward these goals. Retirement income projections can provide another tool in this process.

I realize how fortunate I was to have financial guidance as a youngster and, as a result, it has given me a passion to help others realize a secure future by providing sound information and to encourage them to save for a rainy day.

“It wasn’t until I was well into high school that I realized that not [all children] had these meetings to talk about money.”

Allison L. Birmingham
Wealth Management Advisor

Paying less to Uncle Sam? GRATifying.

"A Grantor Retained Annuity Trust (most commonly referred to as a GRAT) is one vehicle to help those with a desire to pass wealth down to heirs to save on taxes."

The more you earn, the more you pay… to the government. Nothing is sweet about this statement. Which begs the question, where can I save?

Saving on taxes has always remained top of mind for most, especially the wealthy, with increasing tax rates and growing earnings. A Grantor Retained Annuity Trust (most commonly referred to as a GRAT) is one vehicle to help those with a desire to pass wealth down to heirs to save on taxes. A GRAT is a trust funded with an initial donation, structured as an annuity, making annual payments to the donor for a fixed period of time. At the end of the term, the remaining value is passed on to the beneficiary (family member). To realize a tax benefit, the sum of the scheduled annuity payments of a GRAT is set to be about equal to the principal plus estimated interest (by the IRS). Thus, for tax purposes, the initially calculated gift value is zero, since what will be paid back to the grantor in annuity payments is anticipated to be about equal to what the grantor invested, plus interest. If a GRAT is funded with highly volatile assets, however, it is possible that the actual interest earned on the assets will be substantially higher than the estimated interest. At the end of the term the value remaining in the GRAT may still be large, even though the initial IRS interest calculation suggests that it should have been zero. This remaining value is then passed on to the beneficiary without incurring a gift tax. The GRAT technique is particularly effective where the income or earnings largely exceeds the estimated interest.

Some of the ultra-wealthy have used this technique to the extreme, such as Audrey Walton, former wife of the brother of Wal-Mart Stores Inc. founder Sam Walton, through establishing two $100 million "zeroed-out" trusts. Richard Covey, the lawyer who created GRATs, coined this term. Simply put: money is placed in a GRAT with instructions to return the entire amount to the grantor within a set time. Because the grantor does not have to pay tax on a gift to herself or himself, the trust incurs no gift tax. The IRS claimed GRATs of this nature were banned and took Audrey Walton to court. She was victorious.

Owning a large position in a single asset, with significant appreciation expected over the short term, is another cause to consider a GRAT. The technique would act as a shelter for significant appreciation, which would then be transferred tax free to heirs. The asset could be a business with plans to go public or a single stock position. It is important to note, that using a separate GRAT for each security or asset is wise, as to not dilute the earnings from one asset should the other not perform as well.

So what's the downside? An attorney bill for approximately $5,000 to $10,000… If investments earn large enough gains, the excess is passed to heirs tax-free; if not, the only costs are lawyers' fees.

Although attempted several times by the current administration, the GRAT loophole is unlikely to be closed any time soon.

If the GRAT is structured so that the remainder interest is relatively small, the downside of a GRAT is slight and the upside is large. Now that's GRATifying.

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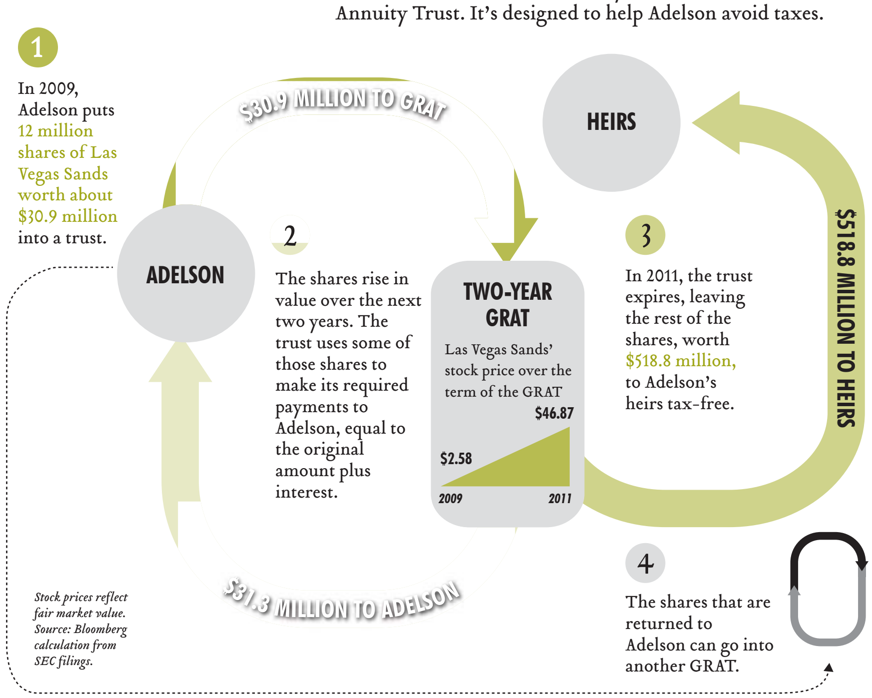
HOW THE WALTON GRAT TAX SHELTER WORKS

Sheldon Adelson and his wife, Miriam, have created at least 25 GRATs. Below is an illustration of one of them. called the Sheldon G. Adelson February 2009 Two-Year LVS Annuity Trust. It's designed to help Adelson avoid taxes.



Sharon A. Conran, JD
Trust Relationship Officer

It Isn't Always About the Money

Having an estate plan in place provides you with the reassurance that your directives regarding the distribution of your assets will be handled smoothly without the disruption of family harmony. Many times in the estate settlement process, it is not the stocks, bonds and monetary assets that create disputes among the beneficiaries, but the distribution of the tangible personal property.

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Tangible personal property consists of your personal belongings. Personal belongings can include, but is not limited to, household furnishings, jewelry, artwork, boats, and automobiles. When drafting a Will or a Trust, your attorney will most likely include language that provides for the distribution of your tangible personal property. Usually the provision states that the tangible personal property is to be distributed to your surviving spouse or, if there is no surviving spouse, to your children to be divided among them as they agree. The distribution of personal belongings is often the root of many family controversies, and can cause delays in the estate settlement process, as it tends to be the little things that create the biggest issues among family members.

In an attempt to alleviate disagreements among beneficiaries, some documents may go as far as to provide a procedure should there be no agreement among the beneficiaries. Although this can assist in the distribution of the tangible personal property, it does not necessarily relieve family tensions or hard feelings regarding the gift of a cherished family heirloom to one sibling over another based on an ordered rotation (each beneficiary picking one item at a time in rotation) or drawing for items (via the hat).

To truly guarantee that your personal effects will be distributed according to your wishes and reduce the discord among the beneficiaries, you should consider the following approach:

1) Talk to your beneficiaries about your personal effects. Find out what items are important to them. This dialogue may enlighten you as to what items are meaningful to your beneficiary. Many times it is not the item itself, but the memory the item evokes.
2) Create a list of gifts, or a memorandum, which designates what item goes to which beneficiary. You should keep this list or memorandum with your Will or Trust so it can be located when needed, or inform your family members where the list or memorandum is located.

You should also be very descriptive in the items you are gifting and information regarding the beneficiary who is to receive the item (e.g. contact information). Often times the list will say "my gold necklace to my cousin Suzy." This statement would not provide enough information about which one of your 5 gold necklaces is to be given to which one of your two cousins named Suzy. The intent being that you took the time to leave the item to a particular person and you should make sure that they receive the right item.

3) Take an inventory of your safe deposit box. Many times individuals will place family heirlooms in a safe deposit box for safekeeping (they know it is there but no one else does) and forget to include these items in their discussions with family members or list the items on their list of gifts or memorandum.
4) Review documents, such as birth certificates, marriage licenses, family trees, family Bibles and adoption papers. These documents might not seem important to you, but to members of your family, these documents are priceless! It can be very disconcerting to family members when these items are not located.
5) With today's technology it is easy to create duplicates of photos; however, many times a family member will take possession of the photos over the objection of other family members with the intention to sort through the photos and make copies. It would be wise to review photos with family members and create the duplicates while you are living. By doing so, you are sharing past memories and possible family history with your loved ones while you are living. This would also be an opportune time to create a memorial of your family's history when the questions can be asked and answered.
6) Give the gifts while you are living, but keep in mind the consequences of any gift tax liability.

In addition, you may want to consider obtaining an appraisal of any items you consider to be more valuable, including jewelry, artwork, china and collections (e.g., coins, stamps). Although an appraisal will establish an item's monetary value, it will not measure the item's emotional value. To ensure your item is being gifted to the appropriate beneficiary you may also wish to consider the following:

1) Does the item represent a special hobby, principle or belief? Perhaps you are an avid hunter and have a wide assortment of hunting treasures. These items may not be truly appreciated by a beneficiary who is an advocate of animal rights.
2) Is the item associated with family events? You may have a set of china that is always used at family gatherings that should be gifted to a family member who would utilize it rather than sell or store it because that person is most likely not going to be the family member who will continue the hosting of the family gatherings.
3) Is this an item the beneficiary wants and will cherish? Sometimes a beneficiary may not want a particular item as it is not something that fits in with their lifestyle. Because it is a gift, they may have a tendency to keep the item (stored) to avoid any guilty feelings if they sold/discarded the item.

The grief that comes with the death of a family member can be overwhelming. It is often the time spent going through personal effects that ease the grief of a family member, as the items often evoke good memories. By preparing in advance for the gifting of your personal property, you can provide guidance to your beneficiaries as to your specific wishes for your cherished belongings.

Stock Market Pulse

Index	1/31/14	Total Return Since 12/31/2013
S&P 1500	414.26	-3.36%
DJIA	15,698.85	-5.07%
NASDAQ	4,103.88	-1.70%
S&P 500	1,782.59	-3.46%
S&P 400	1,313.08	-2.12%
S&P 600	639.51	-3.86%
NYSE Composite	9,967.65	-4.16%
Dow Jones Utilities	506.26	3.28%
Barclays Aggregate Bond	108.07	1.54%

P/E Multiples	1/31/14
S&P 1500	16.5x
DJIA	14.5x
NASDAQ	19.8x
S&P 500	16.2x
S&P 400	20.1x
S&P 600	20.6x

Key Rates

Fed Funds Rate	0% to 0.25%
T Bill 90 Days	0.02%
T Bond 30 Yr	3.62%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	414.26	16.5x	1.99%
S&P 500	1,782.59	16.2x	2.08%
DJIA	15,698.85	14.5x	2.29%
Dow Jones Utilities	506.26	NA	3.88%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.63%

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

GREENLEAF® TRUST

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