GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

JULY 2022 VOLUME 31, ISSUE 6

William D. Johnston
Chairman, Greenleaf Trust

Happy Birthday 4

2022 Mid-Year Market Review 5

Choosing the Right Trustee 10

Retirement Security is Again on the Congressional Agenda 13

Annuities: The Good, the Bad, and the In-Between 14

Delaware Directed Trust OR Michigan Directed & Divided Trust 18

Economic Commentary

The malaise in current economic conditions seems somewhat omnipresent in most media so it seems the right time to look under the hood and see not only what the current common set of facts are, but also examine what the likely scenarios are for the forward economic cycle. The Weekly Economic Index produced by the New York Federal Reserve Bank currently stands at 2.62% and while that is a steep decline from the high of 14.2% in the spring of 2021, it is a far more normalized level of economic activity from a historical perspective and reinforces a positive GDP rate. Declines in the index are due to expected influences such as declines in retail sales, steel production, tax withholding revenues, consumer confidence, rail traffic volumes, electricity output and an increase in weekly unemployment gains. Current unemployment is 3.6% and expectations for job gains to be released on July 8 are 273,000. The Federal Reserve begins their July meeting on Wednesday, July 6.

Expectations of future economic strength or weakness are important because consumer and business activity is often influenced by those expectations. If consumers are more anxious about their jobs, income and savings, they tend to spend less and save more. Even minor changes to consumption and saving habits can influence GDP growth in meaningful ways. The Consumer Confidence Index, Composite Leading Indicator Index and Business Confidence Index all indicate increasing rates of concern about the forward economic cycle though none have deteriorated to levels experienced in 2009 or March of 2020. Each of the above surveys are structured so that a reading above 100 reflects positive thoughts about the future and results below 100 reflect pessimistic views of the forward cycle which, as stated previously, reduce activity and increase savings. We like to access these results in combination with the PMI (Purchasing Managers Index) to see what correlation might be happening between consumer expectations and actual production activity. The PMI includes data and survey questions around new orders, inventory levels, production hours, supplier deliveries and employment. The survey represents 400 large employers in 19 industry sectors and is weighted to sector contributions to GDP. It has long been thought that readings

Economic Commentary, continued

below 50 represented economic cycles of contraction while readings above 50 represented cycles of expansion. The June PMI was recorded at 53, a decline of 3.1 from the May reading at 56.1 suggesting a slowing of economic expansion that began in April of 2021 but yet still positive.

As you might expect, the anecdotal comments repeated often in the survey results are concerns with energy prices, labor scarcity and ongoing logistical supply issues. I had the opportunity to travel in Eastern Europe for three weeks in June visiting Southern Germany, Austria, Slovakia and western Hungary. Each of those countries were experiencing almost identical economic conditions to those present in the United States. Each were benefiting from low unemployment and wage rate growth. All faced issues of global supply chain interruption and gas prices were slightly in excess of 2.00 Euros per liter or equivalent to about $8.50 per gallon. Inflation is both real and global. The contributors to inflation in the U.S. are the very same contributors to inflation in other countries. Ranked in order of year-over-year inflation, the contributors to increased prices are:

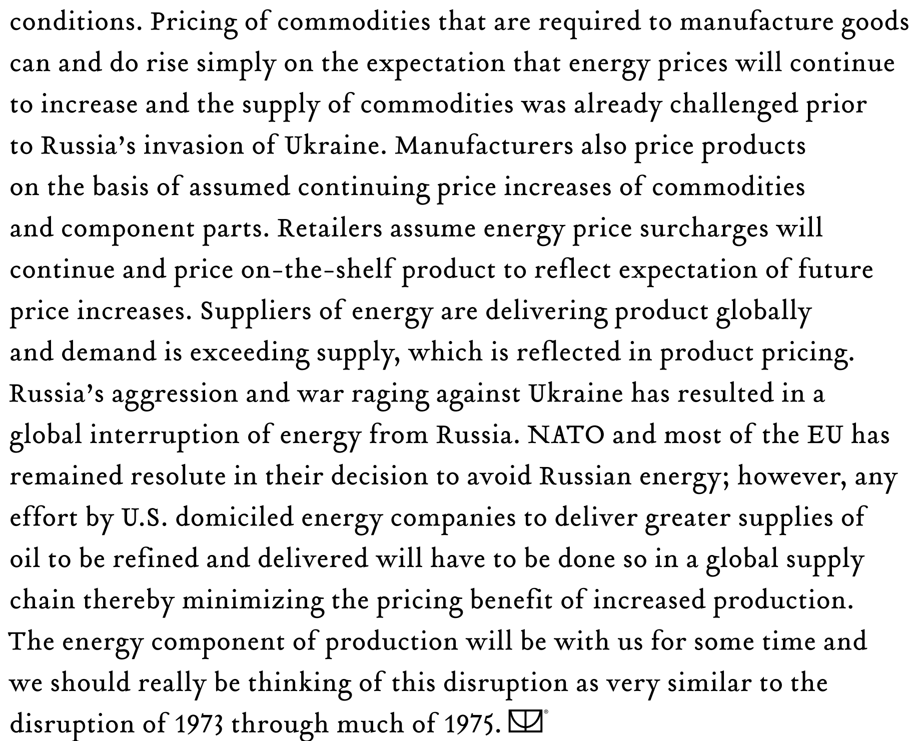
Energy	34.8%	Durable Goods	7.2%
Transportation	14.6%	Education	5.4%
Non-Durable Goods	13.8%	Services	5.2%
Food	8.8%	Clothing	2.2%
Shelter	7.5%		

“The largest component of price increases … was gasoline”

The largest component of price increases in the above categories was gasoline, resulting in shipping and delivery surcharges. The second largest component of price increases was energy prices that made the actual production of finished goods and raw commodity products more expensive and placed upward pressure on finished goods pricing. Also present in the component contributions to finished goods pricing was labor, reflecting the wage growth pressure due to wide spread labor shortages. The US current inflation rate is 8.3% year-over-year and when we exclude energy and food from the equation, inflation rests at 6.3% which remains 4% above the 2% target of the Federal Reserve.

The ten year treasury is currently yielding 2.80% which is a decline from the recent highs of 3.53%. Thirty year mortgage rates have declined for the past two weeks and some regions are experiencing stalled price growth in existing homes with days on market expanding. Are we seeing the beginning stages of a housing slow down? Perhaps, but yet too soon to confirm. Certainly the frantic activity level of the past near thirty months was unsustainable and eventually market forces will impact product availability to align with buyer demand. What can be said currently is that the advantage sellers experienced for the past pricing burst is eroding. How much is yet to be seen.

Significant inflationary pressure is simply the expectation of future


conditions. Pricing of commodities that are required to manufacture goods can and do rise simply on the expectation that energy prices will continue to increase and the supply of commodities was already challenged prior to Russia's invasion of Ukraine. Manufacturers also price products on the basis of assumed continuing price increases of commodities and component parts. Retailers assume energy price surcharges will continue and price on-the-shelf product to reflect expectation of future price increases. Suppliers of energy are delivering product globally and demand is exceeding supply, which is reflected in product pricing. Russia's aggression and war raging against Ukraine has resulted in a global interruption of energy from Russia. NATO and most of the EU has remained resolute in their decision to avoid Russian energy; however, any effort by U.S. domiciled energy companies to deliver greater supplies of oil to be refined and delivered will have to be done so in a global supply chain thereby minimizing the pricing benefit of increased production. The energy component of production will be with us for some time and we should really be thinking of this disruption as very similar to the disruption of 1973 through much of 1975.

"Significant inflationary pressure is simply the expectation of future conditions."

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

"Our growth over the last 24 years has been purposeful… We now have 167 teammates in those offices serving more than 1,200 Family Office, Institutional, Personal Trust, and Retirement Plan Services clients."

Happy Birthday

It's hard to believe but the little company we started in a historic home on the corner of South and Westnedge streets in Kalamazoo will be 24 years old this month. In May of 1998 we received our charter to become one of Michigan's first trust only banks open to the public and in July of that same year we opened our doors with six teammates. Amazing how time flies.

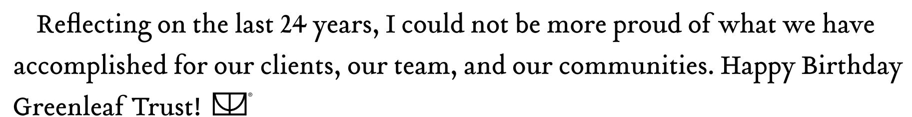
The founding vision for Greenleaf Trust was to create a fiduciary that put the client first and foremost with no conflicts of interest. We would align our company with our clients' wants, needs, and desires. We would find really talented people and create a workplace culture that would be engaging and inspiring to them. We would serve generation to generation because our ownership structure prohibited us from being bought or sold. Teamwork, honest and honorable, continuous improvement, and fiduciary excellence would also be foundational core values. The client would be first, the team second, and the shareholders last.

In our "Preliminary Budget Plan" for 1999 we hoped to have $1 billion in assets and just over $700,000 in revenue by the end of the year. The "lag effect" between winning new business and fee collection may have impacted our success though with those goals. At the time, from the date that new client transfer agreements were signed, to when fees were actually billed was six months. Today we have over $15 billion in assets under advisement and our asset transfer goal is under 30 days.

I joined Greenleaf Asset Management in February of 1999 as a Junior Research Analyst. I actually answered a blind ad in the classified section of the Kalamazoo Gazette Sunday edition to become teammate number seven. I still have the ad and its text still holds true – *"We are an equal opportunity employer that expects our team to volunteer in our community. This is a career path opportunity, not a job. If you know the difference, understand that this challenge is chess and not checkers and want a chance to work with a great team, please do the following."*

Greenleaf Asset Management was a registered investment advisor (RIA) firm that originated at Kalamazoo Investment Group in 1991. Our office that we shared with three other businesses was in Parkview Hills in Kalamazoo. As our market told us that they wanted and expected their trust bank to manage their wealth, we officially merged Greenleaf Asset Management and Greenleaf Trust in 2002 and became one company with 22 teammates.

Our growth over the last 24 years has been purposeful. In addition to our six Michigan offices in Kalamazoo, Birmingham, Grand Rapids, Traverse City, Petoskey, and Midland, we opened the doors to Greenleaf Trust Delaware in 2018. We now have 167 teammates in those offices serving more than 1,200 Family Office, Institutional, Personal Trust, and Retirement Plan Services clients.



Reflecting on the last 24 years, I could not be more proud of what we have accomplished for our clients, our team, and our communities. Happy Birthday Greenleaf Trust!

2022 Mid-Year Market Review

Nicholas A. Juhle, CFA®
Chief Investment Officer

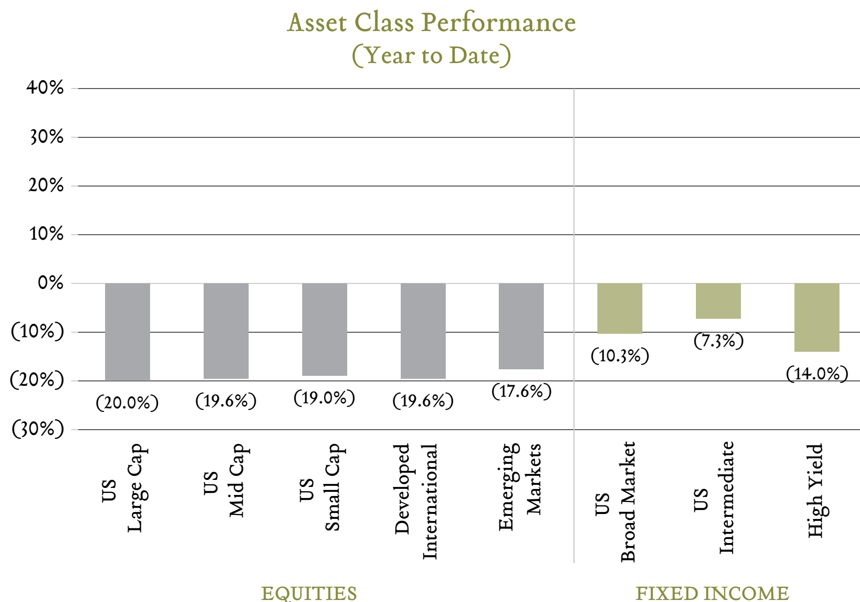
In January, we delivered our annual outlook seminar. As is our custom, we described the range of risks and uncertainties we faced entering the New Year. We highlighted supply chain issues, the potential for persistent inflation, and geopolitical concerns including escalating tensions between Russia and Ukraine. We acknowledged that there were plenty of circumstances that might test our discipline in the year ahead and unfortunately that has been the case in the first half of the year.

In this update, we offer historical perspective on the current market experience, highlight issues likely to shape the path forward (for better or worse), and evaluate the likelihood of a recession. Most importantly, we remind our clients that maintaining discipline during periods of uncertainty is the most reliable course for growing and preserving wealth.

"… we offer historical perspective on the current market experience, highlight issues likely to shape the path forward (for better or worse), and evaluate the likelihood of a recession."

Double Negative?

Thus far, 2022 has been difficult for investors, offering limited opportunities for positive returns. Year-to-date, global equities are down about 20%. Domestic large caps, as measured by the S&P 500, are down 20.0%, while developed international and emerging market stocks are down 19.6% and 17.6%, respectively. At the same time, fixed income categories are down 7% to 14% as key rates have climbed from 1.5% starting the year to 3.0% at the end of the first half.

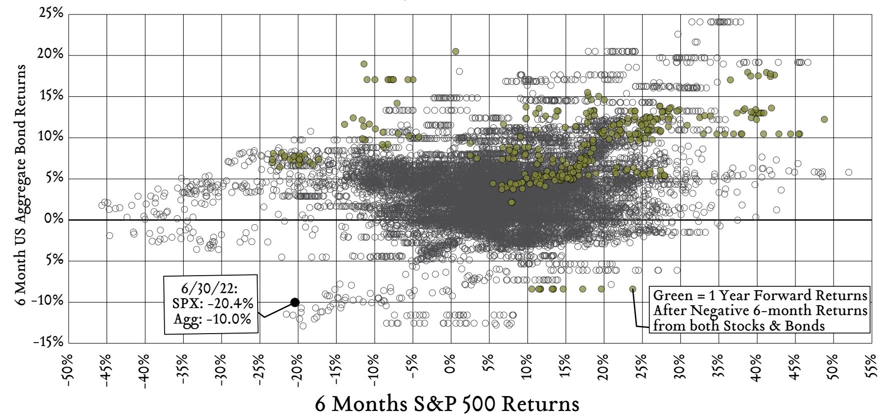


Historically speaking, it is rare for stocks and bonds to fall together. The table below illustrates returns for both asset classes over rolling six month periods. The upper right quadrant, which contains the vast majority of the

2022 Mid-Year Market Review, continued

plot, represents periods where both stocks and bonds moved higher. Most other points fall into the top left (bonds up, stocks down) or bottom right (bonds down, stocks up) quadrants highlighting the benefits of diversification. Very few points fall in the bottom left quadrant (bonds down and stocks down), although this has been the experience in the first half of 2022.

Poor Performance for Both Stocks & Bonds
1976-2022



We also plot one year forward returns following each six month period when both stocks and bonds moved lower. In most cases, both stocks and bonds post positive returns (and have never posted concurrent declines) in the twelve months following a bottom left quadrant experience.

Bear Markets: Not Fun, but Not Uncommon

In mid-June, the S&P 500 officially entered a bear market, closing down more than 20% from the January 3 high water mark. Large drawdowns can be unsettling, but are much more common than most might appreciate. Over roughly the last 100 years, we have experienced 33 drawdowns of 10% or more. Eleven of those drawdowns were 20% or more otherwise known as "bear" markets. This means investors should expect to experience a large drawdown about once every three years on average, including bear markets about once every ten years.

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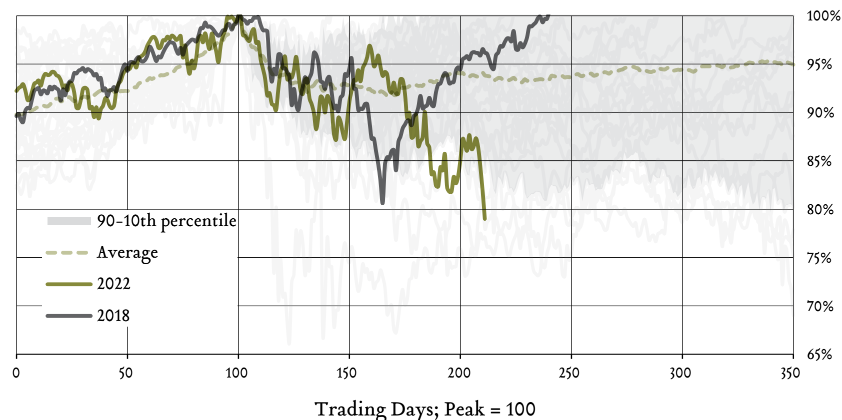
Historical S&P 500 Drawdowns & Recoveries



The good news is that equity markets have demonstrated a perfect record of recovering from drawdowns, eventually reaching new highs over time. The chart above plots each of the historical drawdowns, highlighting that on average, much of the recovery tends to occur in the first year after a market bottom. We can see that the pace and magnitude of the current drawdown (green line) has been more severe than most, and actually looks a lot like the drawdown we experienced in the fourth quarter of 2018 (gray line).

Uncertainties Abound, Markets Pricing in Bad News.

There are several key issues that may influence the path ahead. Uncertainty in these areas is high and the range of potential outcomes wide. Peace could break out in Eastern Europe, or the war could escalate rapidly. The pandemic could be over or a resurgence in cases could elicit a variety of government responses around the world. Inflationary pressures, exacerbated by the war in Ukraine and strict Covid policies in China, could moderate or persist. Accelerated tightening by the Fed, arguably playing catch up in the battle against inflation, could be effective or push the economy into a recession. It is impossible to know which way each of these issues, and others, will break, but it is safe to say that equity markets are pricing in quite a bit of bad news half way through the year. For investors, the antidote to this uncertainty is discipline and diversification and we continue to advocate both.

Sentiment, Historically a Contra Indicator, is Decidedly Negative.

Investor sentiment is extremely negative right now. The AAII Bearish sentiment index recently notched its fifth & sixth highest readings ever (dating back to 1988) with 59.3% of investors identifying as bears as of late June. Historically, this metric has been pretty good contra indication of what's to come. The highest readings on record were in October 1990 (oil price shock, Iraq invades Kuwait) and March 2009 (financial crisis). In both cases the most extreme levels of bearishness coincided with a market bottom. In 1990, stocks returned 33% in the twelve months that followed and in 2009, stocks returned 66% in the twelve months that followed. We also experienced elevated bearishness readings (very negative sentiment) in December 2018 (after a 20% market decline on recession fears) followed by a 28% return in 2019, and similar dynamics around March 2020.

Headed for Recession, or Not So Fast?

There are plenty of risks to the current expansion (there always are), but we also see some bright spots in the fundamentals. The labor market is strong. Unemployment is at 3.6%, one of the lowest levels observed in 50 years. There are almost two vacant jobs out there for every person counted as unemployed. Household spending remains robust, benefitting from savings built up during

"There are plenty of risks to the current expansion (there always are), but we also see some bright spots in the fundamentals."

the pandemic. Surveys of business people (purchasing managers index, PMI) are still in expansionary territory in the United States. The Fed is tightening policy in an effort to tamp down inflation and the market is expecting (and pricing) for additional hikes. The risk would be tightening too quickly and driving the economy into a recession, but there appears to be enough underlying strength to cushion the blunt tools of the Fed. While the onset of a recession in the next twelve months is not our base case, we acknowledge that the risk has increased significantly over the first half of the year.

We Will Enter a Recession at Some Point, and That's OK.

Dating back to World War II, we've experienced a recession about every 4-5 years. The question isn't whether we will have another recession, the question is when will the next recession occur? Investors fear recessions because they often coincide with the larger drawdowns we described above. That said, a disciplined and patient approach has historically paid off. Looking all the way back to the Great Depression, the median recessionary experience includes a double-digit return in the 12 months leading up to the recession, a low single digit decline in the year of the recession and a double digit return in the year following the recession – netting an annualized return of almost 9% over the three year period.

> "Dating back to World War II, we've experienced a recession about every 4-5 years. The question isn't whether we will have another recession, the question is when will the next recession occur?"

We Knew This Would Happen… Sort Of.

Our capital market assumptions rely heavily on the historical return experience. Historical returns were not achieved in the absence of geopolitical events, natural disasters, health crises, presidential elections, legislation, regulation, deregulation, recessions etc. The world is predictably unpredictable. If we look out over the next ten or twenty years, we can virtually guarantee we will encounter recessions, temporary market drawdowns, geopolitical issues and even the occasional pandemic. We won't always know what is coming, but if we know that certain types of events are pretty much guaranteed to happen, we can (and do) develop financial plans and construct client portfolios with that knowledge in mind.

Looking Forward - Capital Market Assumptions

As for the market experience going forward, we share our updated capital market assumptions below. These forecasts represent our expectations for average annualized returns for each asset class over the next ten years. Over the next decade, there will be years where returns exceed our expectations and years where returns trail our expectations. We believe short-term market-timing strategies are unlikely to improve long-term outcomes.

Asset Class	10 Year Expected Return (Jun 2022)	10 Year Expected Risk (Standard Deviation)
US Large Cap	6.8%	14.0%
US Mid Cap	9.0%	16.0%
US Small Cap	9.5%	19.0%
Developed International Equities	7.5%	17.0%
Emerging International Equities	10.0%	22.0%
Core Fixed Income	3.7%	4.5%
Non-Core Fixed Income	7.3%	10.0%
Diversified Alternatives	5.0%	7.5%
Cash	3.4%	0.5%

Source: Greenleaf Trust, as of 6/30/2022

We continue to recommend most of our clients hold a full weight to global equities in accordance with their individualized risk profile and we remain marginally more constructive on international equities. Concurrently, we are less constructive on the outlook in fixed income markets and believe a modest underweight in favor of an allocation to diversifying strategies (alternative assets) remains prudent.

Despite an ever-changing landscape, our disciplined approach and long-term orientation serve us well as we endeavor to create comprehensive investment solutions that help our clients reach their financial goals. Investment decisions are made in alignment with our documented investment philosophy and always with the intention of serving our clients' best interests. On behalf of the entire team, thank you for allowing us to serve on your behalf and well wishes for the second half of the year.

"We continue to recommend most of our clients hold a full weight to global equities in accordance with their individualized risk profile..."

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

Choosing the Right Trustee

"Many forms of conduct permissible in a workaday world for those acting at arm's-length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is the standard of behavior."
Meinhard v. Salmon, 249 NY 458 (1928) (Cardozo, J.)

The selection of a trustee is critical to the success of an individual's estate plan (as well as their disability plan when their trust holds assets.) Often individuals initially opt to name their spouse and/or their adult children to serve as trustee of their trust without giving much thought to the role and responsibilities that a trustee assumes. More often than not, that individual is either oblivious to family dynamics that could impact their trust and its efficient administration, or they do not fully understand the fiduciary duties faced by a trustee.

Under Michigan's Trust Code a trustee must administer a trust in good faith and in accordance with the trust's terms and purposes, and the interests of the trust beneficiaries. These duties are mandatory and cannot be eliminated by the terms of the trust instrument, nor can they be blissfully ignored by the named trustee. Good faith on the part of the trustee is not a defense against a claim of disloyalty. Moreover, it is not necessary that a trustee gain from a transaction with regard to the trust, or the trust's assets, or that the trust beneficiaries were financially damaged, in order to find that the trustee breached the fiduciary duty of loyalty to the trust beneficiaries.

"Under Michigan's Trust Code a trustee must administer a trust in good faith and in accordance with the trust's terms and purposes, and the interests of the trust beneficiaries."

Some (but not all) of the legal duties imposed on a trustee in Michigan include the following:

- To act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests;
- To invest, manage and diversify trust assets as a prudent investor would by considering the purposes, terms, distribution requirements, and other circumstances of the trust, satisfying this standard exercising reasonable care, skill and caution;
- To take reasonable steps to take control of and protect trust property;
- To keep the trust beneficiaries reasonably informed about the administration of the trust and the material facts necessary for the beneficiaries to protect their interests in the trust;
- To promptly furnish to the trust beneficiaries a copy of the trust instrument;
- To file annual tax returns; and
- To send to the beneficiaries of trust income or principal at least annually, and at the termination of the trust, a report of the trust property, liabilities, receipts, disbursements, including the sources and amount of

the trustee's compensation, a listing of the trust assets and, if feasible, their respective fair market values.

With these many responsibilities and the high standard of behavior expected of a trustee, an ideal trustee would be one that would be: willing, available, reliable, responsible, organized, responsive, financially stable, emotionally stable, able to ask questions if uncertain, able to follow directions, be honest, be trustworthy, and be detail oriented.

When individuals consider naming their adult children as the successor trustees of their trust, they should ask the following questions of themselves:

1) Do my children get along with one another?
2) Do my children get along with each other's spouses?
3) Do my children's spouses get along?
4) Are my children able to work together?
5) Do my children communicate regularly?
6) How would my child react to a sibling who manages and distributes assets?
7) Are my children financially stable?
8) Are my children in financially similar situations?
9) Can I foresee a child demanding his or her inheritance immediately?
10) How would a react to a sibling receiving compensation for managing and distributing trust assets?
11) How would my child react to a sibling having a position of power over them?
12) Does my child have time to fulfill their fiduciary responsibilities as trustee?
13) Does my child have the financial and personal skills needed to administer the trust?
14) Is there a family friend or business party that all of my children respect?
15) Does my child considered as the trustee possess a sense of my morals and values?

No general rule exists for when an individual is better suited than a corporate or professional trustee and vice-versa. However, a professional trustee may be more appropriate when: (i) there is a blended family of spouses, children and step-children, or mixed children from different parents; (ii) the trust estate is comprised of complex assets like a closely held business, real estate, mineral interests, collectibles, or intellectual property rights (like copyrights or royalties); (iii) the assets are to be held in trust and distributed over a long period of time, such as a dynasty trust that is intended to reduce future federal estate or generation skipping transfer taxes; (iv) trust assets are spread over many different jurisdictions and subject to different tax laws, e.g. inheritance tax exposure; (v) assets

"No general rule exists for when an individual is better suited than a corporate or professional trustee and vice-versa."

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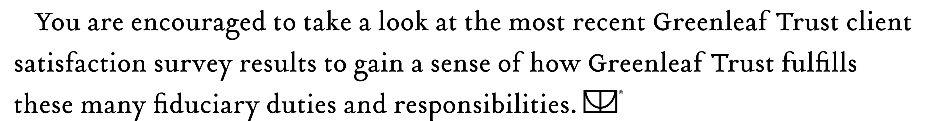
are to be held in a supplemental needs trust for a disabled beneficiary who receives governmental benefits; (vi) some level of dysfunction exists among trust beneficiaries, where a professional trustee will allow family members to continue to be family members, without placing one family member in a position of power over another; and (vi) significant tax considerations exist based upon the value of the gross estate and/or substantial lifetime gifts have been made that complicate the calculation of federal estate taxes.

An unambiguous estate plan that details an individual's wishes for the administration and distribution of his or her estate can go awry if the trustee does not abide by the terms of the trust instrument, does not pay attention to the detailed legal responsibilities imposed on all trustees, goes on a 'power trip' over the trust beneficiaries, or breaches his or her fiduciary duties, whether intentionally or through their misinterpretation of the trust. The selection of a professional trustee that possesses the experience and that possesses the time and talent the to carry out these duties can go a long way to ensure the success of an estate plan.

You are encouraged to take a look at the most recent Greenleaf Trust client satisfaction survey results to gain a sense of how Greenleaf Trust fulfills these many fiduciary duties and responsibilities.



"The selection of a professional trustee that possesses the experience and that possesses the time and talent the to carry out these duties can go a long way to ensure the success of an estate plan."

Retirement Security is Again on the Congressional Agenda

Lorey L. Matties
Participant Services Specialist

Retirement security has been a featured topic with legislation over the past several years and was recently on the agenda again. Back in December of 2019, Americans saw a number of changes to their retirement savings plans when the Setting Every Community Up for Retirement Enhancement Act, or the SECURE Act, became law.

One requirement that came from the SECURE Act was the addition of two lifetime income illustrations for participant statements. These two illustrations are intended to help the participant visualize how much lifetime monthly income their current account balance could provide for them and for their surviving spouse, starting at the normal retirement age of 67.

The illustrations are based upon assumptions specified by the US Department of Labor (DOL) using a specialized retirement vehicle, called an annuity, and are calculated as if the participant converted their current account balance from a lump sum amount to a fixed, lifetime monthly payment.

The sentiment of this requirement is to encourage more Americans to be engaged with their financial future and ultimately to save more. Greenleaf Trust is compliant with the required timeline and all participant statements beginning with the June 30, 2022 quarter-end will include these illustrations.

"The sentiment of this requirement is to encourage more Americans to be engaged with their financial future and ultimately to save more."

Next on the timeline, in 2021, the House Ways and Means Committee unanimously voted to advance a second bill, the Securing a Strong Retirement Act of 2021, or the SECURE Act 2.0 that would continue to enhance the rules for contributing to and withdrawing from retirement savings vehicles, while providing tax incentives for small business owners.

Further Increase of the Required Minimum Distribution Age

The original SECURE Act raised the age at which you must start taking required minimum distributions (RMDs) from traditional IRAs, 401(k)s and 403(b) plans from age 70½ to 72. The proposed legislation would further raise the age to begin taking RMDs, this time to age 75. That means you could have more time for your money to grow tax free, but if you delay taking the RMDs, your withdrawals may need to be larger.

If passed, the age for RMDs would initially increase to 73, then to age 74 in 2029 and age 75 in 2032.

Doug P. Bajor, CFA®, CPA, CFP®
Senior Wealth Management Advisor

Annuities: The Good, the Bad, and the In-Between

The word "annuities" can generate a range of reactions from clients, their family members, and their advisors. Some reactions are positive while others are not so much. Everyone, however, can agree that they can be very complex.

That said, sales of annuities were exceptionally strong during 2021 up 16% to $254.8 billion. Some of this growth can be attributed to the strong stock market results which encouraged purchasers to consider riskier but potentially more lucrative variable annuities. Also, the low yields on most fixed income investments made the income from fixed annuities seem relatively more attractive. Finally, the potential for tax deferral was attractive because of concerns about higher rates.

This article will examine these complex vehicles to help provide some solid background information as to why they have appeal for certain individuals but also what drawbacks exist.

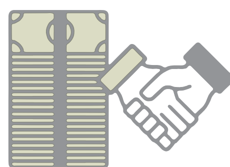
WHAT IS AN ANNUITY?

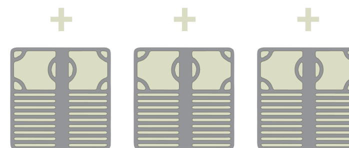
"An annuity is an insurance contract, not an investment."

An annuity is an insurance contract, not an investment. They can make regular payments to you immediately or at some point in the future. These payments can be for a fixed term or for the lifetime of the individual. Each payment will include both return of principal and some income/gains. Any income earned is deferred from taxation until paid as a distribution. An individual can purchase an annuity via a lump sum or through periodic payments.

HOW ANNUITIES WORK: THE BASICS

An annuity is a contract between you and an insurance company in which you purchase a regular stream of future payments.

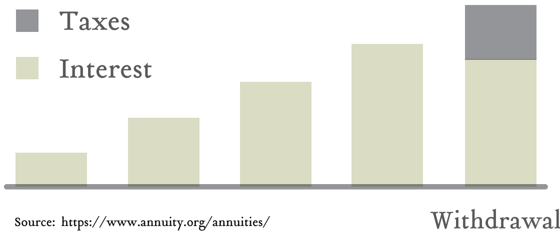




You pay a premium to the insurer, with a lump sum or periodic payments.

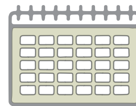
The insurer turns your premium into regular payouts.

Money in the Annuity Grows Tax-Deferred



When Am I Paid?

Immediate Annuity
Payouts start immediately.



Deferred Annuity
Payouts start at a later date.

WHAT ARE THE DIFFERENT TYPES OF ANNUITIES?

Insurance companies have been creative in expanding the types of annuities available to broaden their appeal. The four most common types are as follows:

> "Insurance companies have been creative in expanding the types of annuities available to broaden their appeal."

Fixed Annuities: These annuities are the most conservative variety as they offer a stated rate of interest and provide principal protection. The annuities can be for a specified number of years or for the life of the annuitant. The guaranteed income for life option is one of their biggest attractions for individuals fearful of outliving their retirement assets.

FIXED ANNUITIES

Fixed annuities have periodic payment amounts.

Payment amounts contractually pay at an agreed upon rate.

A 5% payout rate on a $100,000 annuity will be $5000 a year.

Source: https://www.annuity.org/annuities/

Fixed Index Annuities: These annuities have the potential to earn a higher rate of return than a traditional fixed annuity because a portion of the returns on an underlying index (such as the S&P 500) are credited to your account each year using a specified participation rate. If the participation rate is 60% and the return on the S&P 500 was 10%, 6% would be credited to your annuity account. Most annuities of this type will "cap" the amount of appreciation that they will credit in any one year. But gains are locked in so that you will not lose earnings if the index declines in a subsequent year.

Annuities, continued

Structured Annuities: These annuities are similar to fixed index annuities but allow for potentially higher upside participation with less downside protection. For example, the upside participation may be set at 100% up to a specified rate of return (such as +10%) but the downside may only partially protect you against any losses up to a specified limit (such as -10%). For example, if the index has a return of 13%, your account would be credited with a maximum of 10%. If the market declines by -13%, your account would decline -3% (-13% less the 10% downside buffer).

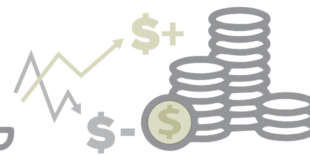
Variable Annuities: These annuities are the most investment – oriented but also entail the most risk and complexity. They are structured as deferred annuities with payments to begin at some point in the future. The value of the annuity is based in the performance of underlying mutual funds or exchange-traded funds with no guaranteed return or principal protection. Variable annuities, however, can have a rider or provision allowing for a return of principal (less any withdrawals) as a death benefit.

"A steady stream of payments can be attractive to help supplement pensions and Social Security. Also, many people are fearful about out-living their investment assets."

VARIABLE ANNUITIES

Fixed annuities have payout rates that vary.

The amount you receive depends on the portfolio's gain or loss.



This potentially leads to bigger gains or losses each payout.

Source: https://www.annuity.org/annuities/

THE POTENTIAL BENEFITS OF ANNUITIES

Four key attributes are often shared by financial advisors when they are encouraging clients to purchase an annuity to achieve "peace of mind" for at least a portion of their wealth.

- Cash Flow Stream: A steady stream of payments can be attractive to help supplement pensions and Social Security. Also, many people are fearful about outliving their investment assets.
- Tax Deferral: Any gains or income earned is not taxed to the purchaser of the annuity until the payments are received.
- Protection Against Downside Volatility of the Investment Markets: This attribute is true for fixed and fixed index annuities, but is less accurate for structured and variable annuities as they are designed to offer the potential for higher returns to the annuitant.
- Easy Solution: For people that are uncomfortable managing their retirement assets, annuities represent an easy approach to having someone else handle this responsibility while receiving distributions along the way.

THE POTENTIAL DRAWBACKS OF ANNUITIES

- Fees: Financial advisors can receive sales commissions of up to 10% of a contract's value. Also, to obtain some of the benefits provided by annuities, insurance companies need to charge additional fees for administration, mortality, investment, and distribution expenses. Additional charges can be incurred if a purchaser would like to have principal protection, inflation protection, a long-term care provision, and a lifetime income guarantee. These additional features are referred to as "riders" by the insurance companies. All in, annual fees can total 2% or more per year. Keep in mind that higher fees reduce investment returns.
- Liquidity/Surrender Charges: Should a purchaser's personal circumstances change, it can be difficult or expensive to withdraw assets from an annuity. Most annuities have a surrender charge for any amounts withdrawn in a given year. These surrender charges can be in place for six to eight years, but gradually decline over the life of the contract. Insurance companies employ such surrender charges to protect against excessive withdrawals in any one year. For example, the first year surrender charge may be 10% of the withdrawal amount. In the second year, this charge may be 8% and will decline further in subsequent years.
- Withdrawals Before Age 59½ Subject to IRA Penalty: If an individual withdraws funds from a deferred annuity before reaching age 59 ½, the IRS will assess a 10% penalty on any income realized from the withdrawal. This penalty can further complicate the annuitant's liquidity issues.
- Income from Distributions Taxed at Ordinary Rates: Distributions from an annuity are part income and part return of principal if the annuity was purchased with after-tax dollars (rather than in a qualified account like an IRA). The income portion is taxed at ordinary rates even if a portion of this income is from capital gains. Most investors are taxed at capital gains rates of 15% or 20%. Ordinary rates can quickly jump into the 22% bracket and can be as high as 37% at the federal level. This taxation of the income at ordinary rates mutes the tax deferral benefits of annuities.
- No Step-Up in Basis at the Date of Death: Unlike a traditional investment portfolio, annuities do not get a step-up in basis to the date of death value. This basis step-up can help to reduce future capital gains for the beneficiaries of the estate.
- Pre-Mature Death: If you purchased a fixed annuity with "life only" payments but did not also purchase a death benefit rider, your family may not receive any additional payments such as the balance in the annuity or a guaranteed minimum amount. In this scenario, your pre-mature death could negatively impact the value received from the annuity.

"For people that are uncomfortable managing their retirement assets, annuities represent an easy approach to having someone else handle this responsibility while receiving distributions along the way."

Annuities, continued

"A steady stream of payments can be attractive to help supplement pensions and Social Security. Also, many people are fearful about out-living their investment assets."

BEST APPROACH TO PURCHASE AN ANNUITY

The idea of an annuity simply intrigues some individuals and provides them with some peace of mind. For those individuals, the following guidelines may be appropriate.

- Candidly ask the financial advisor selling the annuity to explain the benefits and drawbacks to you in as simple of terms as possible.
- Utilize annuities for only a portion of your retirement or investment assets. This helps to avoid some of the liquidity issues that we described earlier and allows for greater diversification with lower fees.
- Invest growth assets such as stocks outside of the annuity and use fixed annuities for a portion of the fixed income asset allocation holdings.
- Use annuities to complement Social Security benefits in terms of providing a monthly stream of income. This approach may be particularly beneficial if you do not receive pension payments.
- Utilize traditional and Roth IRAs instead to generate strong tax deferral benefits without the need for a formal annuity.

CONCLUSION

Annuities are extremely complex and can be expensive in terms of underlying costs. For some individuals, however, they can play a role within a well-diversified portfolio. It is important to review them in conjunction with a comprehensive wealth management plan including a sustainability analysis of cash flow needs.

Dawn Moore
Senior Trust Officer
Delaware (Affiliate)

Delaware Directed Trust OR Michigan Directed & Divided Trust

A directed trust is a feature that can be included in various types of trusts, and provides the ability to bifurcate trustee duties between administration, investment, and distributions.

Grantor's commonly use directed trusts to give more control to current and future beneficiaries. Especially in cases where the trust holds family owned investments so the family retains control and can vote proxies. Additionally, by appointing a distribution advisor this allows individuals who are closer to the beneficiary to make distribution decisions.

For over 35 years, establishing or moving a trust to a situs friendly state has been top of mind for clients and wealth planners. Fast forward to current day, several states have enacted some form of directed trust language, leading you to ask – which state is best for me?

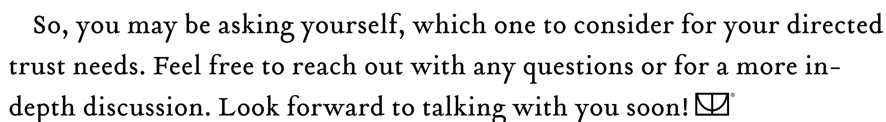
At Greenleaf Trust, we offer directed trust services in Delaware and Michigan. Choosing which situs is best depends upon the client's goals and circumstances. It is important to note that the client does not have to reside in the state to take advantage of this type of trust.

Delaware is considered by some to be a national leader with its history as a trust-friendly jurisdiction, chancery court, and well-established case law. In fact, Delaware adopted the first directed trust legislation which was enacted in 1986. Michigan added directed and divided trust language in 2019 and has no case law to date.

> "Grantor's commonly use directed trusts to give more control to current and future beneficiaries."

In both Delaware and Michigan, a directed trust can be set up by dividing traditional trustee responsibilities between a corporate trustee, commonly known as the administrative trustee; an investment advisor, who is solely responsible for investments of the trust and provides direction to the trustee; a distribution advisor, who directs the trustee to make distributions; and a trust protector, who is an independent third party who oversees the actions of the trustee and advisors. The trust protector can also have the power to modify the trust. Under Delaware law, the corporate trustee has no duty to monitor any of the advisors. Michigan law, the corporate trustee has a duty to monitor certain actions of the trust protector for purposes of amending the trust. The trustee will need to ensure the trust protector was not indirectly or unduly influenced by a trust beneficiary to amend the trust.

Another important item to note is the tax difference between Delaware and Michigan. A directed trust with Delaware situs will have no Delaware state income tax or state capital gains tax as long as neither the grantor nor beneficiaries reside in Delaware. With Michigan situs, Michigan state income tax applies regardless of whether the grantor or beneficiary reside in Michigan. This can result in a significant tax savings in certain circumstances.



So, you may be asking yourself, which one to consider for your directed trust needs. Feel free to reach out with any questions or for a more in-depth discussion. Look forward to talking with you soon!

Stock Market Pulse

Index	6/30/2022	Total Return Since 12/31/2021
S&P 1500	863.41	-19.92%
Dow Jones Industrials	30,775.43	-14.44%
NASDAQ	11,028.74	-29.22%
S&P 500	3,785.38	-19.97%
S&P 400	2,268.92	-19.57%
S&P 600	1,127.97	-18.97%
NYSE Composite	14,487.64	-14.52%
Dow Jones Utilities	969.30	0.37%
Barclays Aggregate Bond	2,111.40	-10.35%

P/E Multiples	6/30/2022
S&P 1500	18.4x
Dow Jones Industrials	16.7x
NASDAQ	37.0x
S&P 500	19.0x
S&P 400	14.2x
S&P 600	14.0x

Key Rates

Fed Funds Rate	1.50% to 1.75%
T Bill 90 Days	1.68%
T Bond 30 Yr	3.18%
Prime Rate	4.75%

Current Valuations

Index	Aggregate	P/E	Div. Yield
INDEX	AGGREGATE	P/E	Div Yield
S&P 1500	863.41	18.4x	1.71%
S&P 500	3,785.38	19.0x	1.70%
Dow Jones Industrials	30,775.43	16.7x	2.15%
Dow Jones Utilities	969.30	18.3x	3.34%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.47%

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