GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

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William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary

The latest news from Fed Chairman Powell is that the Fed is keeping a watchful eye on the negative impact of trade wars on the relevant current economic data as it is revealed. Specifically he offered, "We do not know how or when these issues will be resolved. We are closely monitoring the implications of these developments for the US economic outlook and, as always, will act as appropriate to sustain expansion with a strong labor market and inflation near our two percent target."

Fed Chair Powell did not say specifically that the Fed would lower interest rates, but the financial press and media in general ran with that assumption, which caused equity and bond markets to rally significantly. Many read into his comments the implications that the Fed could act if the impact of tariffs, which we will discuss later, have a diminishing effect on the current economy.

Recent economic data releases suggest that the condition previously described continues. The consumer is employed, job growth has exceeded forecasts, unemployment continues to be at historical lows, wage growth while not robust continues, personal savings is constant, consumer confidence strong and the PMI Index well above recessionary levels. To help the consumer, energy prices (other than holiday driving periods) remain low and inflation is benign (unless an individual is forced into being a consumer of health care and college tuition).

The environment that I described above, which I believe accurately describes the data released, would normally send any Federal Reserve Chairman and collective body of Fed Governors into a fairly defensive position and produce cautionary comments with respect to risks of "overheating" and therefore inferences of imminent tightening. While that was the case through February of this year, it is clearly not the case now. It is normal to assume that a very mature expansion with consistent growth and very tight labor market has implied recession risk in the near term. The data simply does not confirm any downward trend in employment, retail spending, consumer activity or yield curve inversion. Absent of those signals, what had tipped the Fed in the direction of signaling an appetite for easing rather than tightening with respect to the Fed Funds rate?

The answer I think is in the comments offered by Fed Chairman Powell

Commentary, continued

when he stated, "We do not know how or when these issues will be resolved." He is of course referring to the trade war with China and the newly announced tariffs to be imposed upon Mexico beginning June 15th (5%) and escalating by 5% per month to a maximum of 25% should Mexico not meet an as of yet unspecified benchmark of immigration and asylum seeker traffic decline across Mexico.

While I do not think for a moment that the Fed Governors believe that a potential tariff of 25% would be imposed upon all goods crossing the Mexico border it is still clearly on their mind. It is also on the mind of the Senate, whose Republican caucus had a tough meeting with Mick Mulvaney, current White House Chief of Staff, where they delivered the message through majority leader Senator Mitch McConnell that they had no appetite for the tariffs as described and could not guarantee the President that they had enough votes to deter the rescinding of or termination of the tariffs.

Through his comments, the Fed Chairman has now inserted the Fed in the tariff dialogue, a move that has some Fed observers and analysts a bit perplexed. The Fed is an independent body and theoretically unaligned with administrative economic and public policy decisions. It is well known that this President has attacked the Federal Reserve and its current Chair through his now ever-present "tweet barrage." Through their insertion into specific language about tariffs, the Fed may have moved a step closer to the political than it may be comfortable with in the future.

> "If the proposed Chinese tariffs… are allowed to stand the Fed estimates that, the bill to consumers will rise to $831 per household…"

The Fed does collect and analyze data and publishes many reports on the economy, almost all of which are available to the public on their website. According to a report released by the Fed in early 2019, tariffs imposed in 2018 cost the average household $419. If the proposed Chinese tariffs imposed by the President on May 10, 2019 are allowed to stand, the Fed estimates that the bill to consumers will rise to $831 per household or about 1.3% of the median household income per year.

Foreign goods do not simply arrive in the US. There is always an importer of those goods. While many are consumer discretionary items, many are also parts, vegetables, processed and unprocessed food products, automobiles, as well as pharmaceutical and medical device products. The exporting government does not pay the import duty created by the tariff and neither does the exporting company that produced the product. The importer of the goods pays for the duty. The importer of the goods passes on the cost of the tariff to distributors and end users of the final finished goods who then pass on the cost of the tariff to the end buyer, who in this case is the US consumer. For the president to suggest that China or Mexico will pay for the tariffs is disingenuous and certainly intellectually bankrupt.

Consumers avoid the "tax" implications of tariffs only when there is competition of goods in the marketplace that allows producers and suppliers of goods other than in this case China and Mexico to meet the demand of the consumers. One need only examine the price increase in tariff-related products to realize that this competition does not exist. I have long argued that trade policy must be fair to all and, in the main, designed to protect and promote our country's intellectual property and product advantages as experienced by global consumer demand. Tariffs are not best utilized to solve other geopolitical issues, but can be the leveraged opportunity to translate to constructing detente relationship building. As currently utilized, they raise consumer costs, disrupt supply chains, place mid-size country-specific exporters in excessive risk scenarios, dampen business investment, prolong business capital decisions and invite retaliation. My role places me in constant contact with manufacturers and business owners who must utilize commodities and component parts to develop, create, manufacture, market and distribute their final finished goods. These manufacturers are currently in a very difficult position and that may well be reason that the Federal Reserve Chairman has taken the political risk to enter the discussion on tariffs.

"For the President to suggest that China or Mexico will pay for the tariffs is disingenuous and certainly intellectually bankrupt."

Traverse City Growth

Michael F. Odar, CFA
President

As I wrote last month, our belief in and commitment to the communities in which we live and work is part of what makes our culture and firm uniquely different. So naturally we are extremely excited about our new future home in Traverse City at the corner of Cass and State streets that is necessary to accommodate our growth in the area.

Beginning the summer of 2020, our new home in Traverse City will be on the second floor of the Old City Hall, which is currently undergoing a complete historic renovation. The building originally built in 1904 served as Traverse City's post office for many years before it was sold to the city in 1939, at which point a second story was added and it became City Hall. We are honored to be a part of restoring a piece of the community's history through the renovation of the building alongside expert partners Catalyst Development, TowerPinkster, and the CSM Group. We were able to share that feeling and the support from the community with local friends and clients at a special Hard Hat Tour party on May 9.

Our commitment to the Traverse City community began over 10 years ago when John Welch joined our company as a Business Development Officer. A long-time resident of northern Michigan and a leader in the trust and financial services industry, John had a clear vision of the alignment between

Traverse City Growth, continued

"Our commitment to the Traverse City community began over 10 years ago…"

his community and the unique culture and service model of Greenleaf Trust. And, he was right. Today, John serves as Greenleaf Trust's Northern Michigan Managing Director and oversees a growing market that now includes 145 client relationships and more than $570 million in assets under advisement. In order to serve this growing market our team in northern Michigan has needed to expand as well. The team's expansion has not just been in number but also in diversity of experiences, talents, and knowledge. Today's Northern Michigan team includes:

- George Bearup, J.D. – Senior Trust Advisor
- Regina Jaeger, CTFA – Vice President, Senior Trust Relationship Officer
- Lauree VanderVeen, CTFA – Vice President, Senior Trust Relationship Officer
- Brad LaTour – Senior Trust Relationship Officer
- Jennifer Dohm – Team Service Coordinator II
- Sharon Sleeper – Team Service Coordinator II
- Corbin Donaldson – Wealth Management Advisor

And, together with John the team has more than 200 years of experience in comprehensive wealth planning, trust administration, estate settlement, and fiduciary oversight. We are excited about the future of Greenleaf Trust in northern Michigan and look forward to seeing everyone at our new home in summer 2020.

Opportunity Zones

Lucas W. Mansberger, CFA®, CAIA®
Investment Strategist
Senior Manager Selection Analyst

What is the Opportunity in Opportunity Zones?

Back in early 2018, few people outside of specialty economic development and real estate finance circles had heard of Opportunity Zones. Today, there is a national rush to raise money to invest in Opportunity Zones amongst high net worth individuals, economic developers and real estate investors. The Opportunity Zone incentives are being cited as potentially the largest economic development initiative in our country's history. What are Opportunity Zones, and how did they come to be the most talked-about topic in real estate in 2019?

Opportunity Zones History

Slipped inside the 2017 Tax Cuts and Jobs Act, the Opportunity Zones incentives were the brainchild of the Economic Innovation Group, a public policy-focused nonprofit. The intents of the incentives are to "free up" the estimated $2.3 trillion in capital that is currently subject to capital gains taxes and to nudge investors to invest that capital on a long-term basis in low-income communities.

The areas now designated as "Opportunity Zones" were nominated by individual state governors and designated by the Treasury in the first half of 2018. Each state could nominate up to 25% of its eligible low-income census tracts as Opportunity Zones. While each state could follow its own process in selecting the particular tracts to nominate, each tract had to be a low-income community as defined by the federal New Markets Tax Credit Program, which is a community with a poverty rate of at least 20 percent or that has a median family income that does not exceed 80 percent of the area median income.

Opportunity Zone Benefits

The law offers three distinct benefits related to federal taxes. If an investor realizes a capital gain, they have 180 days from the date of the realization to invest the realized gains in a Qualified Opportunity Fund (QOF) and earn the following benefits:

- Temporary deferral of tax on previously earned capital gains. Deferral of capital gains until the earlier of December 31, 2026 or the sale of the investment.
- Step-up in basis of previously earned capital gains invested. A portion of the deferred gain may be subject to permanent nonrecognition:
    - ◊ 10% reduction in the gain if the investment held for 5 years if investment is made by 12/31/2021.
    - ◊ 15% reduction in the gain if the investment held for 7 years if investment is made by 12/31/2019.
- Permanent exclusion of taxable income on new gains. The subsequent gain from increases in the value of a qualified opportunity fund interest will be completely exempt from federal capital gains tax if the investor holds their interest for at least 10 years.

Opportunity Zones, continued

Independent assessments of the impact of Opportunity Zone incentives show the potential for it to improve the after-tax internal rate of return on a given investment by as much as 30 to 40%.

How Does Investing in an Opportunity Zone Work?

How does an investor actually create a Qualified Opportunity Fund (QOF) or invest in one? On its face, it's very simple to do and presents far fewer administrative or bureaucratic difficulties than other federal economic development incentive programs. A creator of a QOF simply needs to create a corporation or partnership, then self-certify as a QOF by filing Form 8996 with its federal income tax return. Similarly, the IRS has indicated that investors in a QOF will need to complete and attach Form 8949 to their tax return to obtain the benefits.

A QOF must invest 90% of its assets in Qualified Opportunity Zone Property, which includes stock, partnership interests, or business property in a Qualified Opportunity Zone business. Investments are limited to equity investments in businesses, real estate, and other business assets located in a Qualified Opportunity Zone.

"The law offers three distinct benefits related to federal taxes."

QOFs can be a single asset fund, like an investment in a single piece of land, a building, or a business, or they can be a multi-asset fund, such as a real estate partnership with several holdings diversified by geography and property type.

The permissible businesses are nearly all-encompassing, and only exclude investment in a so-called "sin businesses", which are defined in the legislation as a "private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises."

However, while the top-level guidelines for QOFs are broad and straightforward, the requirements for the investment of QOF assets have become significantly more complex as the Treasury has clarified the rules. For example, some of rules include detailed requirements for "substantial improvement" of real estate property and for the amount of business activity conducted in an Opportunity Zone by a Qualified Opportunity Zone Business. As a result, those creating or investing in an Opportunity Zone fund need to retain expert assistance to navigate the requirements safely.

Investor Considerations

Opportunity Zone Funds are considered private alternative investments and share many risks with other private alternative strategies. For example, most Opportunity Zone investments will likely be in private real estate in non-core markets or in early-stage private companies, which are inherently speculative and illiquid. The requirement to remain invested for at least ten years to achieve the maximum tax benefits means that investors are expected to have a very long time horizon when investing in QOFs. Additionally, there are meaningful operational and execution risks associated with the investment activities of QOFs, and the underlying investments in a QOF are likely more concentrated exposures than an investor would have within traditional publicly-traded equity or fixed income strategies.

There also are a number of investment considerations that are unique to Opportunity Zones. By definition, Opportunity Zones are low-income areas, which means areas of high poverty that are often located outside of major hubs of economic activity. Not only do these characteristics add to the speculative nature of the investments, these investments may also be subject to highly localized and idiosyncratic risks. Opportunity Zone fund investments also have a higher regulatory or compliance risk. They are subject to a new and unique set of regulations that may be difficult for a developer or entrepreneur to meet, especially if they are somewhat inexperienced. What's more, some of the regulations are not yet promulgated, which requires something of a leap of faith on the part of the investor and confidence that your partners and the fund structure will be able to handle any changes in the regulatory environment that may occur.

Importantly, Opportunity Zone investments are subject to a number of requirements that lead to unique timing considerations. These requirements range from the 180-day window the investor has from the realization of gains to placing the money in a QOF, to QOF operator-specific rules regarding the timing of investments in underlying property, to the investor having to be prepared to pay their original (potentially reduced) Federal tax bill in year seven of the investment, to the potential for there being a QOF-driven glut of similar real estate being sold just after the ten year investment holding requirement is met.

"… the Opportunity Zone incentive can make a good deal better, but it does not turn a bad deal into a good deal."

Advice for Investors: Know Thyself!

Before investing, make sure you thoroughly understand your risk tolerance and tolerance for liquidity. Make sure you are comfortable with the particulars of the law and their ramifications for your tax and overall liquidity position.

Seeking Deal Flow? Make Some Calls.

Many investors have an interest in investing in Opportunity Zones, but aren't quite sure how to get connected with opportunities. Law firms and accounting firms are a great source of information, as they are often working directly with developers and entrepreneurs and can put you in touch with them. Additionally, it is helpful to reach out to local economic development agencies, as they have been attempting to coordinate Opportunity Zone investing activities and are aware of development plans in their respective regions.

Get some Guidance!

Finally, as several industry practitioners have observed, the Opportunity Zone incentive can make a good deal better, but it does not turn a bad deal into

Opportunity Zones, continued

a good deal. In many cases, the expected financial benefit of the incentive may not outweigh the incremental risks of a given deal or the difficulty of investing in it. The quality of the deal, its benefits and its risks are likely difficult for a nonprofessional to discern, and guidance from advisors such as attorneys and accountants is a must. It also helps to have an independent wealth manager, such as Greenleaf Trust, who can help you understand how your proposed investment fits into your overall wealth picture.

Brian C. Farrell
Wealth Management Associate

mywealth

'mywealth by Greenleaf Trust allows our clients to view their holistic financial picture… on an ongoing basis."

Benefits of Data Aggregators

As the financial services industry continues to add new technology, data is easier to access now than it has ever been; investors have more information readily available than they know what to do with. If investors have accounts with multiple advisors or at many institutions, it can be difficult to understand where they are investing their money.

Often, understanding the overall financial picture can be cumbersome, which can lead to neglect of important details: understanding asset allocation, staying on top of daily spending and creating dynamic financial plans with accurate data. Thanks to data aggregation technologies, these details are accessible through an online portal. While many tools allow investors to access this data, few tools are available that allow them to see what happens if changes are made to their asset allocation or spending preferences. However, our recently launched data aggregator and planning tool called mywealth by Greenleaf Trust is used to help clients achieve their goals by conducting the aforementioned "what-if" scenarios.

mywealth by Greenleaf Trust allows our clients to view their holistic financial picture — including their spending, assets, and liabilities — on an ongoing basis. Not only is this great for clients, but it is immensely helpful for advisors as it ensures that assets are properly allocated to meet clients' goals based on their tolerance for risk in a holistic way and on a consolidated basis.

Asset Allocation

Asset allocation is one of the top determinants of investment returns. When creating an asset allocation, advisors need to view it on a consolidated basis, and consider all investments (including real estate, closely held stock, and business interests). Viewing all of this information in one place allows a financial advisor to make an appropriate recommendation for the portfolio.

Budget

Often, people utilize multiple banks for their day-to-day spending, but logging into all of the accounts to review transactions can be time-consuming. Another benefit of using a data aggregator like mywealth by Greenleaf Trust, is that it allows the user to stay on top of their budget and daily spending so each client can understand where their money is going.

Dynamic and Accurate Planning

Because all account balances, transactions and holdings are updated on a daily basis, dynamic and accurate plans can be changed and generated with a few simple clicks. Clients are able to see assumptions in real time, allowing them to make their plans more accurate, impactful and actionable.

Data aggregation has changed the financial services industry by providing an investor a holistic overview of how their assets are allocated. The ultimate goal of mywealth by Greenleaf Trust is to help clients track and achieve their financial goals. If you are interested in seeing how mywealth by Greenleaf Trust can help you achieve your financial goals and stay on top of your budget, contact any member of your client centric team to get started.

Pending Legislation: Tenants-By-The-Entireties

Regina Jaeger, CTFA
Vice President
Senior Trust Relationship Officer

As a Trust Relationship Officer, I spend a fair amount of time with clients to make sure the titling of their assets and their beneficiary designations are consistent with their estate planning goals. In addition, many times clients have concerns about creditor claims. There are many different ways to hold the ownership (title) of real property. An important element of an individual's overall estate plan is to understand how ownership will affect the distribution of assets upon their death and the exposure of their assets to creditor claims.

In Michigan, forms of ownership include individual tenants-in-common, joint tenants, joint-tenants-with-rights of survivorship, and tenants-by-the-entireties. Each form has different exposure to creditor claims. Moreover, two bills have been introduced in the Michigan legislature that would enhance the current laws that surround tenants-by-the-entireties ownership. Before we explore the impact of the proposed changes, let us review some of the rules that pertain to joint ownership.

When more than one person owns an asset, the asset is generally not included in the estate of the decedent (the individual that has passed) for distribution purposes if there exists a right of survivorship. This means that the asset will generally pass directly to the surviving owner, or owners, without necessitating probate and bypassing distribution through a will or a trust, if a trust exists. The value of the interest could, however, cause an estate tax to be paid. This is an important element in understanding how an individual's assets will be distributed to their beneficiaries on their death.

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Tenants-By-The-Entireties, continued

Another important aspect to know about co-ownership is that it provides the surviving owner(s) with different rights to the property. For example, real property that is titled in the name of more than one individual as tenants-in-common means that when one owner dies or sells their share, the remaining tenant(s) are entitled to only their fractional share. Each tenant's share passes to his or her estate at death when there is no automatic survivorship right. This is in contrast to co-ownership as joint-tenants-with-rights of survivorship, in which the interest of the deceased automatically passes to the surviving owner by operation of law, thereby avoiding probate. It is important to note that a tenant-in-common interest can also be forcibly sold by a judgment creditor.

Tenants-by-the-entirety ownership is reserved for spousal joint ownership of real property. It provides the unique benefit of creditor protection to spouses. Both spouses mutually own the property as a unity of one rather than a type of fraction where each would have their own individual ownership rights. The entireties ownership cannot be claimed by a creditor of an individual spouse. Only creditors of the couple may make claims against the entireties property.

"Tenants-by-the-entirety ownership is reserved for spousal joint ownership of real property. It provides the unique benefit of creditor protection to spouses."

There are currently two bills well on their way through Michigan's state legislature and, barring any unforeseen challenges, they are expected to pass relatively soon. One bill would permit a married couple to classify all of the assets titled in their joint trust's name as being held as tenants-by-the-entireties. As discussed above, the unique benefit of entireties ownership is creditor protection. If the bill passes as expected, assets held in the name of an "entireties trust" would be protected from the creditor claims of one spouse. This is a significant benefit, especially for individuals where one spouse has an occupation or profession that exposes their assets to a high degree of liability. Further, on the death of one spouse, the creditor protection might continue with regard to the entireties trust assets for the surviving spouse's benefit. Consequently, entireties trust assets would be protected from creditors for the lifetime of both spouses (as the bill is currently interpreted). One drawback to entireties ownership is that on the death of one spouse, there is only a 50% increase in the income tax basis of the entireties asset. Accordingly, if the surviving spouse sells the asset, the survivor could incur capital gains.

The second bill would amend a long-standing Michigan statute that defines the assets that can be held by spouses as tenants-by-the-entireties. This bill would expand the type of assets that can be owned by the entireties, thus enabling virtually all assets held to enjoy the creditor protection afforded to all entireties assets.

These bills will greatly benefit spouses who want to own their assets jointly and to avoid the delays, expense, and publicity associated with probate by adopting a trust, but who also worry about creditor claims against one spouse if title to an asset is not in their joint names but is held in the name of a trust. We will keep you informed if these bills are passed.

Warning: 401(k) Loans Can Be Hazardous to Your Wealth

Lorey L. Matties
Participant Services Specialist

It sounds so simple. You need some quick cash because of a financial emergency and you decide to borrow from your 401(k) plan, provided your plan offers a loan feature. After all, it's your money and the principal and interest you pay goes back into your account. But as with most financial issues, it's not as easy as it sounds. In fact, for most people, borrowing from a 401(k) is not the best solution.

The Rules

Rules can vary by employer, but typically, the minimum amount you can borrow is $1,000 and the maximum is up to 50% of your vested account balance up to $50,000, whichever is less. Repayment periods are set at a maximum of five years, unless you are borrowing for the purchase of a principal residence, which may allow a longer payback. Repayments are made by way of payroll deduction.

Like any loan, there are definite pros and cons:

The Pros

1) Obtaining a loan is usually a very simple process. Most times you can arrange for a loan over the internet or telephone. 2) Any interest you pay on the loan goes back in to your 401(k) account. Typical interest rates for 401(k) loans are set at current prime rate plus 1%. Today, that rate is 6.5%.

"… for most people, borrowing from a 401(k) is not the best solution."

The Cons

1) You are borrowing against your financially-secure retirement. The money you borrow — or take — out of your 401(k) account is not available to take advantage of any investment gains, so you are potentially sacrificing significant investment returns. 2) Loan repayments are not tax-sheltered dollars anymore since all repayments are made with after-tax payments. Once you retire and begin taking withdrawals, you will pay taxes yet again. 3) The loan is not tax deductible. It's considered a consumer loan, therefore no tax advantage. 4) Unless you completely repay the loan, it is considered a premature distribution from the plan. You would owe federal and state income taxes as well as a 10% early withdrawal penalty if you are under age 59½.

The Bottom Line

It's better for most people to take out a home-equity loan or other line of credit, as you may be able to deduct the interest on your taxes. Accessing your 401(k) account prior to retirement affects your psychology of saving. If possible, your retirement money should sit untouched until you retire. It's too easy to get in the habit of dipping into your 401(k) account instead of saving for things you need along the way. To keep it in perspective, there are no lending institutions out there that will loan you money to retire.

Stock Market Pulse

Index	5/31/19	Total Return Since 12/31/2018
S&P 1500	632.49	10.52%
Dow Jones Industrials	24,815.04	7.54%
NASDAQ	7,453.15	12.86%
S&P 500	2,752.06	10.73%
S&P 400	1,810.50	9.59%
S&P 600	888.72	5.79%
NYSE Composite	12,264.49	9.12%
Dow Jones Utilities	784.43	11.58%
Barclays Aggregate Bond	110.40	4.69%

P/E Multiples	5/31/19
S&P 1500	18.1x
Dow Jones Industrials	15.8x
NASDAQ	22.1x
S&P 500	18.0x
S&P 400	18.0x
S&P 600	20.9x

Key Rates

Fed Funds Rate	2.25% to 2.50%
Tbill 90 Days	2.30%
T Bond 30 Yr	2.57%
Prime Rate	5.50%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	632.49	18.1x	2.01%
S&P 500	2,752.06	18.0x	2.03%
Dow Jones Industrials	24,815.04	15.8x	2.36%
Dow Jones Utilities	784.43	20.8x	3.15%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.56%

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