GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

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Chairman, Greenleaf Trust

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Economic Commentary

President Trump delivered his first address to the joint session of Congress last night and we saw what the priorities of his administration would be in the near term. They were not different from the promises he made to the electorate during his campaign, yet seemed somewhat softer around the details. Generally speaking, the first address a president delivers to a joint session of Congress provides a direction to the leaders of the House and Senate what the legislative agenda in the forward period will be like. The President and his key staff members will begin to try to put legislative detail onto the multiplicity of executive orders already publicized.

Several of the priorities have budget as well as economic implications. The rough cut budget was laid out in the week before the address and had two clear implications. The first was that the defense budget was going to grow by about $54 billion to $604 billion, and the second was that non-entitlement discretionary spending was going to be reduced by about the same amount. Nobody in the defense department is going to turn down a healthy increase in their allocation. Non-entitlement discretionary spending is the smallest portion of the federal budget and many agencies have been put on notice that their budgets can be expected to be cut by about 10%. Government programs have a heavy human capital expense, with much smaller allocations to goods and services, and so it will be understandable that doing more with less, as the President has termed it, will be doing more with fewer people. The hiring freeze for all government agencies, except for the Department of Defense, that was announced on the day after the Presidential inauguration was at least in part to allow attrition within various departments to, in some measure, adjust for the budget reductions.

The budget director and former Republican Congressman, Mick Mulvaney, described himself as likely to be the most hated man in Washington DC, and he is probably going to feel some sense of the reality of that prediction soon, as on the day after the President's address to Congress the proposed allocations were delivered to agency heads. A mentor of mine once said to me "You can tell a lot about a company by examining their P&L statement and how they allocate their resources." That statement

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Commentary, continued

has proven to be true many times over for me. While various agencies are mulling over their future priorities within this administration, others outside of our country are watching closely as well.

The first significant increase—nearly 10%—in defense department spending in a decade, and a significant—$38 billion—reduction in discretionary State Department spending, sends a simple and clearly defined message to the rest of the world. Comments and statements made by senior advisors like Steve Bannon that the President's focus would have a national theme to it were quickly reinforced in the budget priorities outlined by Budget Director Mulvaney. It takes years for funding to make its way into both the human capital, research, technology, capital investment and service delivery that the Department of Defense will apply if Congress passes the budget proposal. Other governments will be looking at the philosophical message of the budget priorities, and wondering what the future relationship with the Unites States will be as the administration looks more inward with resource allocation.

"GDP growth projections and current tax rates are the two largest categories that make up the revenue projection. Changing either of the components… has huge implications for revenue totals."

A major part of a budget is the revenue side of the equation. GDP growth projections and current tax rates are the two largest categories that make up the revenue projection. Changing either of the components, given the total size of our economy, has huge implications for revenue totals. From the post World War II period to the present our GDP growth has averaged 3.1%, and for the period of 2000 through 2016 our GDP growth rate has averaged 2.5%, which is inclusive of the 2007/2008 recession. For the last eight years our economy's growth has been stuck at 2.0%. The aforementioned growth rates are an important backdrop because the administration's budget is proposed with a significant tax reduction as well as a projection of a 3.1% GDP growth rate in 2017 and a longer term (ten years) growth of 3.5% annually, an average growth rate that has not been achieved in any rolling ten year average since World War II. Mark Twain once said "Facts are stubborn but statistics are pliable." Many of us remember the joke about the candidates applying for a position as an accountant. They were given a test to determine their competence. The test was one of profitability of a company applying for a loan. Two of the candidates dutifully completed the calculations and stated their results to the president and owner of the company that would potentially hire them. The third candidate wasted very little time and asked the president, "What do you need the number to be, sir?"

The Office of Management and Budget, as well as the Director of the Budget, present many facts to the President, and those facts include what are commonly referred to as sensitivity tests given various economic growth and tax rates. The President and his senior advisors, ultimately, are going to pick a number—and that set of numbers will be the marching orders of the budget director who will be tasked to sell the budget to Congress.

A fairly major selling point that spokespeople associated with the current administration are making, not only on the "hill" when lobbying Congress but also on every media outlet that will have them, is one of "dynamic scoring" of the budget. Traditionally, "static scoring" has been the method of budget projections. Simply put, the static method assumes that the economy is not impacted by either taxes or government spending. Dynamic scoring assumes the opposite and at its extreme pushes forward the notion that the reduction in tax receipts as a result of tax cuts will be offset by the increased tax receipts that result from higher growth. The dynamic scoring argument will not be received well by those who do not buy the correlation that cuts in taxes yield higher economic growth and will in fact ask for the evidence that such a correlation exists.

Most economists will argue that labor force productivity and participation rate determine the majority of economic growth. There are many factors that drive productivity as well as labor force participation rates, but tax rates are not one of them. When we focus on labor force participation rates, the evidence is obvious. Prior to the 2007/2008 recession, our labor force participation rate was 63% which had declined from the post-World War II average of 66%. January's Bureau of Labor Statistics data revealed a labor force participation rate of 59.8%. Increasing the participation rate back to the 66% level would have a huge impact on growth but ignores the reasons our participation rate has been declining for decades. The graying of the baby boomer generation is real and tangible. Ten thousand people turn 65 every day in our country and our birth rate has now declined to 10,800 births per day. We do not have a second "Baby Boomer" generation waiting in the wings and our growth rate as a population is currently 1.12%. Tax rates will not spur birth rate and population growth and our available for work population will continue to be under pressure.

Much has been written and said about immigration within the last few years. Most of the rhetoric has been divisive and fueled by fear and national security issues. Very little of the dialogue has been factual and focused on the long-term economic success of our country. Here are facts that can be gathered from the Bureau of Labor Statistics. In January of this year, foreign-born individuals accounted for 17% of our workforce. If growth of population in our country is going to occur it will require a thoughtful immigration policy to generate that growth. Absent of that growth in population our longer term labor participation rate will continue to decline, and with that so will our GDP rate.

"Much has been written and said about immigration within the last few years… Very little of the dialogue has been factual and focused on the long-term economic success of our country."

Michael F. Odar, CFA
President

Investing in Our Communities

Investing can come in many different forms. Of course, as part of our work on behalf of clients we know about the long-term benefits of investing in capital markets. As a team and corporate citizen, we also recognize the far-reaching benefits of investing in our communities; so much so that we made it an initiative in our strategic plan.

This past President's Day marked our second annual Day of Caring at Greenleaf Trust. With banks and capital markets closed on this holiday, we provide everyone in the organization with a choice of either coming into work that day or going out into the community and volunteering. Teammates are empowered to take the day and choose an organization in their community that they want to support. More than 80% of our team participated in one (or more) of fourteen volunteer opportunities.

We had teammates volunteering in each of our four markets: Kalamazoo, Grand Rapids, Birmingham, and Northern Michigan. In many cases, they formed teams to cover different shifts or areas of need at a particular charity. Teammates made blankets and pillow cases, served hot meals, helped in fundraising, painted, and spent focused time helping at risk or sick children remember what it's like to be a kid. In general, there seemed to be a strong emphasis on serving the homeless, those needing food support, and children in our communities.

"As a team and corporate citizen, we also recognize the far-reaching benefits of investing in our communities..."

As we all know, it's better to give than receive. I think the following quote from one of our teammates involved in the Day of Caring sums it up nicely.

"Being able serve those less fortunate in my community is such a gift. I loved that I was able to choose an organization that is important to me and spend my work day giving back with my team. I'm so thankful that I work for a company that values corporate citizenship and the people in our community."

Who Cares About Fees?

Rosalice C. Hall
Relationship Service Coordinator

Based on recent legislation and litigation, everybody cares about retirement plan fees these days. In conjunction with the implications of the Department of Labor (DOL) Fiduciary Rule becoming a hot button in the political landscape, retirement plan participant-based litigation has also increased over the past several years and looks poised to continue. From industry giants like Boeing, Anthem, and Fidelity, to small companies with fewer than 100 employees, plan sponsors are being dragged into court to defend their retirement plan actions. Participants are voicing strong opposition to excessive fees and lack of fiduciary oversight by plan sponsors and plan administrators. Most cases allege a breach of fiduciary duty highlighted by excessive fees and revenue sharing arrangements, essentially acting as "kickback payments" that are part of a "pay-to-play" scheme. Allegations also include offering investments laden with proprietary funds, when allegedly cheaper and better-performing options were available.

Plan investment menus should provide the right balance of breadth, depth and simplicity: enough breadth for a participant to easily put together a diversified portfolio, enough depth to meet the needs of different types of investors, and an overall focus on making the participant's experience (and plan sponsor's experience) a smooth and simple one.

Despite increased litigation, several retirement plan based lawsuits have been dismissed if the fiduciary followed a prudent process for the evaluation of their investment lineup. The legal standard is not based on being a perfect predictor of future performance but, rather, to demonstrate that reasonable measures are in place to ensure the participants' best interests are continuously considered.

To assist in this prudent process, the Greenleaf Trust (Greenleaf) Research Team performs regular fund reviews to ensure our clients have best in class investment options at the lowest possible cost. Many criteria are used to determine the strength of each mutual fund. For instance, in recent years Greenleaf has transitioned several funds into lower expense options, triggering expected annualized savings of over $548,000 for our participants! These are obvious improvement opportunities as the participants experience the same underlying investments and simply pay a lower cost. And this real dollar savings will increase as participants' account balances grow and as investment managers continue to offer additional lower cost options.

As an open architecture investment platform provider, we seek to minimize the expenses embedded in each respective mutual fund (i.e. share classes that have low or no "soft dollar" remuneration baked into the expense ratio), instead of holding higher cost investments that provide a rebate on the excess fees. According to a recent Cerulli Associates - Economics of Product Development and Pricing Service Survey, "retirement plan asset managers

"…with the implications of the Department of Labor (DOL) Fiduciary Rule becoming a hot button in the political landscape, retirement plan participant-based litigation has also increased over the past several years and looks poised to continue."

Fees, continued

"As a stated fiduciary… we have always operated within the confines of the proposed rule."

report that institutional and retirement share classes (the R6 shares, which typically have no revenue sharing) have witnessed significant asset growth." The report notes that "the lower cost share classes brought in positive net flows for 2015 and 2016, while A-shares had outflows for the same timeframes." The verdict is clear: lower share classes are the way of the future.

Regardless of whether or not the 2016 Fiduciary Rule is implemented in the coming months, increased investment-focused litigation has led plan sponsors to monitor and evaluate fees. As a stated fiduciary, Greenleaf will not need to change anything to be in compliance, as we have always operated within the confines of the proposed rule. We are fundamentally aligned and positioned to serve in our clients' best interests. Rest assured, our overall philosophy on the design of plans and recommended investment options is to attempt to give participants the best chance of retirement success. The Retirement Plan Team at Greenleaf welcomes the opportunity to assist you in achieving financial success with your company's retirement plan.

Are you a Quinquagenarian?

Nicole E. Asher, CFP®, CPWA®, ChFC®
Vice President
Senior Wealth Management Advisor

Fifty years ago the headlines spoke of many milestones, some serious and some frivolous. The heart transplant, the ATM, the handheld calculator, and the Super Bowl were all introduced. We saw the debut of the Big Mac and the 7-11 Slurpee. LBJ was president, and the Vietnam War seemed unending. Those that were lucky were watching Gunsmoke, M*A*S*H, or Bewitched on their new color TVs. And popular music at the time produced bands that sounded like things you would see at the zoo—The Monkees, Beatles, Animals, and even The Turtles.

In 1967, the Dow Jones was at 905, gas cost 33 cents per gallon, the average income was $7,300, and the average cost of a new home was $14,250. A lot has changed in the last fifty years. Closer to home, Kalamazoo dug out from the Blizzard of 1967. Typical of Michigan winters, the weather went from 60 degrees to 30 inches of snow in two days! And on Good Friday of that year, right here in Kalamazoo, I was born. I was the youngest of seven children, and my oldest brother was a freshman at Notre Dame. He still blames me for ruining his spring break! I am part of Generation X, probably one of the most overlooked age groups. We were latchkey kids who came home from school and watched The Brady Bunch, Gilligan's Island and The Partridge Family. There were no energy drinks; we drank Tang and Kool-Aid. We were entertained by a cool guy named Fonzie, an alien named Mork, a wild and crazy Steve Martin, a zany Lucille Ball and we had a love hate relationship with Archie Bunker. We rode in the backs of station wagons and pick-up trucks and never wore seatbelts. We didn't have helmets when we rode our bikes. We had forts and tree houses where we would disappear for hours and no one cared or came looking for us…and no one worried. A bologna sandwich on wonder bread and a Ding Dong was considered a healthy lunch. How on earth did we survive?

While my upcoming birthday is a bit daunting for me, I'm doing my best to embrace this new milestone in my life and am spending some time reflecting on where I have been, where I need to be, and where I want to go with my life. It's no secret that by the time you are fifty, there are a few things that you should have figured out. The first is your career. I consider myself extremely lucky to have found my "calling" right out of college. Hopefully, if you are in your fifties, you are in a career or job that you love, enjoy, and are passionate about. While it's not impossible, it would be challenging to start over in a new field.

The second is you should have little debt. Most fifty year olds still have a mortgage, and that's fine. But we need to be working on being otherwise debt free and putting our disposable income aside for the third thing we should have figured out by the time we reach 50, and that is our retirement savings. This is the time to "max out" your retirement savings into your 401(k) or IRA. It is also the time to increase and "catch up" your contributions. We lucky 50 year olds now get to put an extra $6,000 per year into our 401(k) plan.

If you haven't already done the math, try and figure out how much you will need in retirement. While retirement may still be 15–20 years away, this is a good opportunity to figure out what changes you might need to make in your savings or spending. It's time to set new goals.

The fourth is checking to see if you still need the same amount of life insurance. The policies that we put in place when our children were young to pay off the mortgage, pay for their education, replace the lost income of ourselves or our spouse, may no longer be necessary. You may want to consider replacing your life insurance with a Long Term Care policy.

Finally, we should also review our estate plans, including beneficiary designations, and update them to be sure that they fit this new chapter in our lives.

If you are reading this and you are a Millennial, slow down and take a look at where you are at in your life. If you have a job and a 401k, you should be contributing! The earlier you look at your future milestones, the easier it will be for you in the future. Do not wait to do this. Even if it's a small amount, do it. I must admit that I thoroughly enjoyed my trip down memory lane as I wrote this. If you enjoyed these memories, you are likely a quinquagenarian or have moved on and are now a sexagenarian, a septuagenarian, an octogenarian, or like my father, you are now a nonagenarian. I would be lying if I said that I am excited to turn 50, but it is what it is. I will soon be a quinquagenarian and I plan to use this milestone to reevaluate my goals and plan for the next semi-centennial.

"In 1967, the Dow Jones was at 905, gas cost 33 cents per gallon, the average income was $7,300, and the average cost of a new home was $14,250. A lot has changed…"

Daniel C. Haines, CFA
Investment Strategist
Senior Fixed Income Analyst

Stubborn on Vision, Flexible on Details

Jeff Bezos is the founder of Amazon.com, a company that has become one of the largest retailers in the world and has changed the way consumers shop. I recently read a quote by Jeff Bezos where he said, "We are stubborn on vision. We are flexible on details." The way I interpreted the quote is that there are two parts to success. First, you need a vision of what you want to accomplish along with a set of core beliefs to guide you. Second, you need to be willing to make changes in the details of your approach to better accomplish your vision.

As part of the Investment Research team, I see our vision as creating comprehensive investment solutions that help our clients reach their goals. To achieve our vision, we have a set of core beliefs – our investment philosophy - that guides us. Below is our investment philosophy and some of the thoughts behind it.

"First, you need a vision of what you want to accomplish... Second, you need to be willing to make changes in the details of your approach..."

Greenleaf Trust Investment Philosophy

1) Portfolios should maximize after-tax, after-fee returns for a given level of risk.
   - ◊ As we build portfolios, we focus on the returns clients actually experience. That means considering fees and taxes. Some portfolios are taxed at high rates while others face no tax burden. The best strategy for each account may differ. Fees are a reality and it is important to be conscious of them when we look at different investment options.
2) Independence and an open architecture approach allow for unbiased investment decision-making.
   - ◊ Greenleaf Trust is an independent company. We do not receive commissions for selling products and our only compensation is the fees paid by our clients. This allows us to be unbiased and free to choose whatever investments we feel are best for our clients.
3) Investment decisions should be based on accepted principles and empirical data.
   - ◊ Our decisions need to have a rationale backed by evidence. We believe this leads to better decision-making. This also helps investors stick with investments that aren't working over the short-term.
4) Asset allocation is the primary driver of long-term investment performance.
   - ◊ Having the right mix of stocks, bonds and cash is the biggest factor in what long-term returns our clients will experience. Getting this

decision right is more important than what specific bond, stock or fund a client has in their portfolio. This is why our advisors take the time to get to know our clients and their financial situation, allowing them to construct a portfolio that is tailored to meet the client's goals.

5) A long-term perspective and disciplined approach lead to improved investment outcomes over time.
   - ◊ From experience, we know that while stocks may be up 10% one year, they can also be down 10% the next year. To achieve financial goals, it is important to focus on the long-term by remaining committed to an asset allocation and being disciplined about rebalancing. Likewise, even successful investment strategies will face times when they are out of favor and underperforming. To realize the benefits of these strategies, investors must take a long-term view and stay committed.

With this philosophy in place, we are confident in our ability to fulfill our vision. We feel fortunate to work for an independent company that allows us to make decisions with our clients' best interests in mind.

Now I'll get back to the second part of the quote where Bezos talks about being "flexible on details." As market conditions change or we find more effective ways to invest, we will make changes in portfolios. These can include switching a fund or changing the way we approach investing in a particular asset class. These changes are not made lightly. They are the outcome of significant research and a group decision-making process.

Over the last few years, I can think of several changes we have made in the details of our approach. These include:

- The increased use of fixed income mutual funds instead of individual bonds in certain accounts.
- A higher long-term allocation to international stocks.
- The use of index-based strategies in some asset classes.
- An increased allocation to alternative strategies.

All these changes were made in an effort to better achieve our vision – creating comprehensive investment solutions that help our clients reach their goals. The ability to make changes over time is crucial and I'm sure there will be additional changes in the years to come. I'm also sure that they will be guided by our philosophy and will always be made in the best interests of our clients.

"As market conditions change or we find more effective ways to invest, we will make changes in portfolios."

Charles P. Knoll
Manager Selection Analyst

Selecting Managers is Only Half the Battle

At Greenleaf Trust, we employ a robust three-part process for the selection of externally managed investment strategies that we include in client portfolios. The process depends on structural, quantitative, and qualitative evaluation to inform discussion that ultimately results in a decision whether or not to allocate our client's capital to a specific manager. As the title suggests, initial selection is really just the front end of a much more involved process of evaluating and re-evaluating our conviction in a given manager once they are funded. How do we evaluate whether a period of outperformance is the result of luck or skill? On the contrary, how do we know if a period of underperformance is a temporary setback or a long-term impairment? Similarly, how do we determine if a process or team change will compromise outcomes? The answers lie in our approach to ongoing monitoring and evaluation, which I will describe in further detail below.

> "How do we evaluate whether [success] is the result of luck or skill?… how do we know if a period of underperformance is a temporary setback or a long-term impairment?"

Phase 1: Monitor

The monitoring process requires a consistent and meaningful dialogue with the investment manager including frequent portfolio updates and in-depth discussions on the team, firm and investment process. By maintaining frequent contact with the investment team we are able to foster a deeper relationship with the team and a deeper understanding of the portfolio. We believe this combination is crucial to developing the conviction to stay the course with a given manager.

Our team believes that a targeted frequency of one portfolio update each quarter allows us to remain familiar with the portfolio on a key holdings basis as well as to observe trends within the strategy over time. The primary goal of these updates is to obtain the manager's commentary. This commentary explains the investment team's rationale behind their decisions. We then pair this commentary with a quantitative analysis of a given strategy's monthly investment performance.

In addition to regular calls to discuss performance, our manager selection group seeks dedicated meetings with principal members of the funds' investment teams. These more intimate meetings promote a mutually beneficial connection with each manager that strengthens our overall partnership. Developing true partnerships and relationships with our investment managers provides a more intimate and complete understanding of a team's inner workings as well as who the key contributors are within the team. It can also provide us with a more granular level of knowledge about the fund and its positions compared to the standardized distribution materials.

Phase 2: Review

The second phase of our process requires a systematic quarterly review of the dataset that has been gathered during the monitoring phase and prior. First, we break down portfolio performance quantitatively on a holdings basis to analyze what's actually driving a given fund's returns. Then our team compares the results with the commentary and explanation that was provided by each of the management teams. Typically, the comments provide a reasonable rationale for performance and managers clearly justify detracting allocations with logical explanations. The in-depth review of these past data points permits us to emphasize more substantive or difficult issues in our subsequent discussions. Further, leveraging the relationship that is built with a manager during the monitoring phase gives us an opportunity to challenge the manager's decisions without harming the long-term partnership.

Phase 3: Assess

The final phase of this process is the assessment of all of the information collected in the monitoring and review phases. We only have a few hard and fast rules that mandate removal or replacement of a manager from our recommended list of approved options. This is because it's difficult for simple rules to capture the complex mix of considerations that govern our decision to remain invested with a given manager. The assessment phase combines data points gathered through update calls with our more in-depth quarterly reviews to ensure that the process we originally bought into continues to be evident in the manager's decision-making. We look for any signs of deviations from our understanding of the process such as style drift or potential return-chasing behavior. Finally, after extensive discussion amongst our research team, the variety of quantitative and qualitative factors we evaluate are synthesized into a singular decision to maintain or eliminate exposure to a given manager.

Greenleaf Trust's manager selection and monitoring process is most visible when strategies are added or removed from a client's portfolio. However, the process is truly ongoing, whether or not it results in frequent changes to the investment lineup. We hope that our approach to investment manager monitoring and evaluation helps you to trust the process and focus, as we do, on the long term. Please contact any member of your client centric team if you have questions and, as always, it is an honor to serve on your behalf.

Stock Market Pulse

Index	2/28/17	Total Return Since 12/31/2016
S&P 1500	548.73	5.66%
DJIA	20,812.24	5.82%
NASDAQ	5,825.44	8.43%
S&P 500	2,363.64	5.94%
S&P 400	1,729.34	4.34%
S&P 600	846.49	1.19%
NYSE Composite	11,512.39	4.12%
Dow Jones Utilities	703.16	7.27%
Barclays Aggregate Bond	108.77	0.86%

P/E Multiples	2/28/17
S&P 1500	19.8x
DJIA	19.0x
NASDAQ	23.3x
S&P 500	19.6x
S&P 400	21.4x
S&P 600	22.4x

Key Rates

Fed Funds Rate	0.50% to 0.75%
T Bill 90 Days	0.51%
T Bond 30 Yr	2.97%
Prime Rate	3.75%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	548.73	19.8x	1.96%
S&P 500	2,363.64	19.6x	2.02%
DJIA	20,812.24	19.0x	2.30%
Dow Jones Utilities	703.16	NA	3.22%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.01%

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