GREENLEAF® TRUST

# Perspectives

A Greenleaf Trust Newsletter

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*William D. Johnston*
*Chairman, Greenleaf Trust*



## Economic Commentary

Economic trends often don't reveal themselves from month to month, but rather take a longer passage of time for directional change to be revealed. Nonetheless, it is our task to keep our fingers on the pulse of the economy and report what we know. In essence, the change month over month is a bit more negative than last month's data. More will be revealed the first full week of May with respect to jobs and, thus, we will gain a fuller understanding than we have currently.

Financial markets hate ambiguity, and when faced with conflicting data they elect the sell rather than buy side of options available. The May 2nd ISM/PMI index reported that manufacturing activity in the US fell to 50.8% from last month's reading of 51.8%. For the second straight month the index remained above 50%, which is the level by which most economists gauge expansion or recession. For the eight months prior to the March report the PMI took a significant beating from all energy and energy related sectors. Recent stabilization in oil prices and a weakening dollar have lifted some of the clouds hanging over economic forecasts. As we know, the future is not simply about the US PMI survey or relative strength of our currency. The Chinese PMI was reported on Tuesday, May 3rd, at a reading of 49.4%, a reduction of 0.3% from the March report of 49.7%. China's Caixin Manufacturing PMI is not composed exactly as ours, and so we shouldn't interpret it as we would ours. To put it in perspective, the all-time high of the Caixin PMI was recorded in January 2013 at a level of 52.3%. Conversely, the all-time low was revealed in September of 2015 at 47.2%. To be certain, there is a very watchful eye on the direction of China's economy and any indication that their economy is slowing beyond expectations will roil financial markets. What the markets are currently missing is that the index has rebounded from its low last September and has had consecutive months of growth before a slight pull back in April's results.

Whether it is the US, China, Europe or those countries that compose the largest GDP economies, the preferred direction is expansion and the fragile nature of all expansions currently focuses unusually intense scrutiny on single monthly data releases. Europe rose slightly in April, *Commentary, continued*

while Mexico, Japan, India, Brazil and Russia continued to contract modestly. Globally, the message is mixed and certainly absent of robust growth. What we know about all economic recoveries is that retraction must slow before stabilization allows expansion to begin. What could be said of the global picture is that retraction has slowed and that there is some evidence of stability with even less evidence of expansion.

Months ago we offered that the migrant crisis in eastern Europe would place severe near-term economic pressures on countries whose economies had yet to recover. Governments that were attempting to solve the humanitarian needs of millions of Syrian refugees would come under significant political pressure to take a harder line on immigrating more refugees. It is difficult to find any European country currently holding elections that does not reflect the pressures and choices of trying to deliver humanitarian aid while simultaneously addressing their country's economic struggles.

"Months ago we offered that the migrant crisis in eastern Europe would place severe near-term economic pressures on countries whose economies had yet to recover."

Consumer confidence, as well as the index of small business confidence, is under a bit of pressure the past two months and reflects the current condition of an economy that is growing marginally in a global environment that is struggling for stabilization. Employment is strong, wage growth is very low, and we are in the throes of a primary election cycle that is fractious and intense. If you have reached your tolerance levels and think, as many do, that the current primary contests are the worst in history you may want to get a copy of *Anything for a Vote* by Joseph Cummins. As a country our memories tend to be the memories possible due to an electronic record of sorts. In essence, if we can't see it on a video, DVD, CD or the Internet, it didn't happen. Cummins takes us back through our country's history of Presidential elections and the trickery, fraud, manipulation and malfeasance used to get elected. It is not stuff you will remember from your US History classes, but it is well documented and, unfortunately, true.

The methods and strategies used by campaigns where social media was not instantaneous nor delivered electronically were as, if not more, dreadful than what we see on a nightly basis from our current state of political affairs. While our current primary political theatre seems off-putting and crude beyond what we have previously known, it is child's play compared with early presidential elections.

We are, however, close to unfamiliar waters with respect to the Democratic and Republican nominations. I purposely used the term of unfamiliar rather than uncharted waters. Most of the current voting population has never witnessed a brokered party convention, where multiple candidates were in play for the party's nomination as well as the formulation of the party ticket and platform. It is likely that the conventions of 2016 will win more, not fewer, media viewers as the stakes of post-convention party loyalty have never been greater.

In their current condition, both political parties find themselves with likely candidates that they will have difficulty in building coalitions of significant support for. Will the argument that each party puts forth to their base be that if we don't unite around this candidate that you don't value or trust, the other party will win the White House!? The argument seems unlikely to energize a base and create great voter turnout.

What seems to be prevalent in polls taken by both political parties as well as news services is that the electorate is angry and disappointed. A recent survey of 18-29 year olds by both Harvard and the Pew Center for Research revealed a growing negative view of capitalism with the Pew study showing that 46% of those surveyed viewed capitalism positively while 47% viewed capitalism negatively. The poll wasn't helpful in getting at the why of the results, and many have offered their own theories, but it is clear on many levels voters are feeling an angst at levels not seen since the late 1960s.

When the candidates are finally chosen we will be in a better position to know their respective platforms with respect to global and domestic economic policy, at which time we will be able to contrast each. Until that time, the political theatre continues and the angst grows.

"In their current condition, both political parties find themselves with likely candidates that they will have difficulty in building coalitions of significant support for."

*Michael F. Odar, CFA*
*President*

# Greenleaf Trust in Grand Rapids: Service is Back in Town

We will be opening our new office at 25 Ottawa Avenue SW in downtown Grand Rapids this fall. Leading our efforts from the new office will be two longtime Grand Rapids community members. Please join me in welcoming Thomas A. DeMeester as our new Managing Director for Grand Rapids and John G. Grzybek as our new Director of Family and Foundation Services!

Tom joins us from Northern Trust Company where he was a Senior Wealth Strategist. He was responsible for originating and developing qualified business, coordinating marketing activities and team member sales development across several regions to ensure brand awareness and strategic growth. Prior to Northern Trust Company, Tom worked for Fifth Third Bank as Sales Director in the Private Bank, Senior Manager in Wealth Management Consulting and as a Group Manager within the Wealth Management Group. In his final role as Sales Director he was responsible for directing the private bank sales process over seven regions across Western Michigan. His team was responsible for coordinating delivery of investment management, private banking, fiduciary services, wealth planning, brokerage and insurance solutions. Before Tom's success in banking he practiced law for 14 years in Grand Rapids. Tom has his Bachelor of Business Administration from Cedarville College and his Juris Doctor (Cum Laude) from Thomas M. Cooley Law School.

"We will be opening our new office… in downtown Grand Rapids this fall."

John joins us from Fifth Third Bank where he was a founding member of Mirador Family Wealth Advisors. There he was responsible for successfully attaining, adding and retaining ultra-high net worth family relationships in the capacity as new business officer and Sr. Relationship Manager. John worked directly with clients to develop, implement, and administer highly complex and customized comprehensive, multi-generational wealth plans. He also worked directly with clients and their outside lead tax advisors in goals based meetings, analysis and assessments, and initiated the development of highly sophisticated wealth planning strategies. Prior to Fifth Third Bank, John worked for Innovative Wealth Solutions as the founding member, Director of Wealth Strategy & Sr. Relationship Manager; Old Kent Bank in their Special Client Group and prior to that practiced law for six years. John has his Bachelor of Science in Political Science from the University of Michigan at Dearborn, his Juris Doctor from the University of Detroit Mercy School of Law and participated in the Masters in Taxation Program at Grand Valley State University.

Tom and John go back over 30 years and have spent several of those years working side by side. We're excited and thrilled to have the two of them together again and representing Greenleaf Trust in Grand Rapids alongside several existing members of our team already living in Grand Rapids.

# The Letter of Intent: A Critical Piece of Your Estate Plan

*Ean P. Hamilton, Esq.*
*Trust Relationship Officer*

Even the most clearly drafted estate planning documents are full of legalese, often making it difficult to truly express to your loved ones the intent behind the words. Including a Letter of Intent with your estate planning documents may be the best way to clearly express the meaning and thought process that is reflected in your will or trust. Further, being able to express your thoughts in your own words in a Letter of Intent can be a more personal way to connect with your loved ones.

Disparities in gifts among beneficiaries can often cause resentment due to confusion as to why, for example, a parent chose to leave a larger gift to a sibling. While there is likely a calculated reason for a disparity in gifts, this reasoning is often absent in the will or trust. If the reasoning behind certain distributions is not shared with your beneficiaries while you are living, beneficiaries may be left questioning your decisions for many years. A Letter of Intent can be used to clear up any uncertainty as to why disparities in gifts were made or why restrictions were placed on an inheritance.

"If the reasoning behind certain distributions is not shared with your beneficiaries while you are living, beneficiaries may be left questioning your decisions for many years."

Not only can a Letter of Intent be used to express why assets were distributed in a particular way, it can also be used to communicate your hopes and desires for the futures of your children and/or grandchildren. Are there strong moral or ethical values that you have lived by that you hope your children or grandchildren will follow? These values can be expressed in your Letter of Intent for your children to read many years after your death. For parents with young children, a Letter of Intent may be the perfect way to speak directly to your named guardian regarding your preferences of how to raise your children or to share information that you believe will help the guardian to provide the best care for your children.

### Writing the Letter

A Letter of Intent does not have to be written in a correct form or with the perfect language, as the purpose of the letter is solely for you to express your sentiments outside of your will or trust. A handwritten Letter of Intent often adds an empathetic and personal touch to an estate plan that was written primarily by an attorney or other estate planning professional. Your letter can be addressed to whomever you trust will share your reflections with your family members. Typically your trustee or executor will be the person reading through your documents, so writing the letter to that person may make the most sense. After you've written your Letter of Intent, be sure to sign and date it and then place it with

*Letter of Intent , continued*

your estate planning documents. Finally, remember that updating your Letter of Intent during your life is just as important as updating your estate planning documents.

### Involve Your Loved Ones

As you write your Letter of Intent, consider getting the input of your family and loved ones. By involving them in this process you will have an opportunity to learn their thoughts and feelings. They will certainly appreciate that you chose to involve them in the decision making process and how your Letter of Intent is a reflection of your relationship together.

### Charitable Giving

If your estate plan includes charitable contributions, you may also want to identify these charities specifically in your Letter of Intent and explain why these charities and causes are close to your heart. This can help your executor, trustee or family members understand what your intentions were as an overall picture of your estate plan. A particular program or project of a charity might have inspired you to make a gift and those around you should know that. While this might not be appropriate to state in your will or trust, your Letter of Intent is a great tool to provide context to better understand your wishes when you are gone.

"As an important element of your estate plan, your Letter of Intent should be revised and reviewed by a licensed estate planning attorney…"

### Not Legally Binding

A word of caution: Letters of Intent are not legally binding. What does this mean? It means that while your executor, trustee or family members may refer to the Letter of Intent to gain a better understanding of your desires and wishes, it does not have the same effect as a validly executed will or trust. If your Letter of Intent contradicts your will or trust, the language of the will or trust will likely govern. As an important element of your estate plan, your Letter of Intent should be revised and reviewed by a licensed estate planning attorney to ensure that it is in line with your other estate planning documents.

# Suitability Is No Longer Suitable

*Nicholas A. Juhle, CFA*
*Vice President*
*Asst. Director of Wealth Management*

Greenleaf Trust was founded on a set of core values that guide the way we work and do business, and how we conduct ourselves in the service of our clients. These principles ensure that we are fundamentally aligned and positioned to serve in our clients' best interests, which is, of course, the goal and the standard we have held ourselves to from the start. While serving in clients' best interests seems like it would be an obvious or otherwise basic expectation in our industry, it isn't, or at least it wasn't until the Department of Labor (DOL) recently updated its definition of the term "fiduciary" such that the definition Greenleaf Trust has been using all along is now the law.

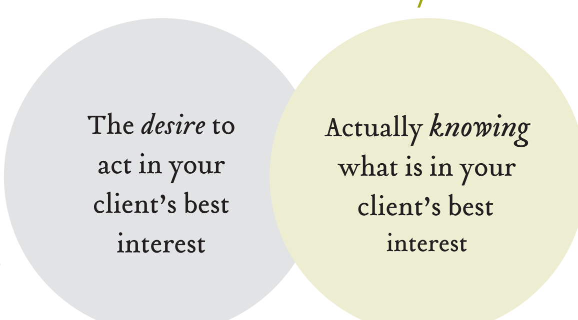
On April 4, the DOL published an updated fiduciary rule, officially called "Definition of the Term 'Fiduciary'; Conflict of Interest Rule—Retirement Investment Advice." The rule itself is as verbose as the official title and wrought with complexity, but in plain English, the new fiduciary rule imposes a best-interest test on investment advisors acting in a fiduciary capacity. Surveys illustrate that most people have been operating under the belief that their investment advisor was already required to work in their best interests. Sadly, the existing definition of "fiduciary" held these professionals to the much lower bar of suitability. In a nutshell, "suitability" requires that investment recommendations be reasonable or appropriate based on a client's objectives and financial means.

"… in plain English, the new fiduciary rule imposes a best-interest test on investment advisors acting in a fiduciary capacity."

Suitability isn't a bad thing. Investment recommendations should indeed be reasonably appropriate based on a client's unique circumstances. The problem is that there can be an expansive gap between what is suitable and what is best for the client. Consider a scenario where a fiduciary could recommend either of two similarly suitable funds, but selects one with a higher fee in order to collect an incentive payment from the fund company. Is the selection suitable? Sure. Is it in the client's best interest? Not even close.

Another good example highlighting the difference between suitability and best interest is in the area of IRA rollovers. Many advisors have historically made a blanket recommendation for clients or prospects to roll 401(k) assets over to an IRA at retirement. On the surface, the recommendation is benign enough – moving assets from one suitable arrangement to another – but is the rollover in the clients' best interest? Maybe and maybe not… the answer requires thoughtful analysis of the 401(k) plan, the IRA, and the cost of the transition all in

What makes a Fiduciary?



*Suitability, continued*

"[The best interest requirement] is not a search for subjective good faith — a pure heart and an empty head are not enough."

the context of the client's unique circumstances. Fees, investment options, additional services, withdrawal penalties, creditor protection, estate planning needs, and convenience should all be taken into account to ensure that the client's best interests, as opposed to the advisor's bottom line, are driving the decision. Clearly, the advisor or fiduciary must be capable of performing the type of analysis described above if they are to be capable of acting in the best interest of their client. As noted by the DOL: "[The best interest requirement] is not a search for subjective good faith — a pure heart and an empty head are not enough."

To be clear, an advisor may still recommend that an investor roll over money from a 401(k) into an IRA, may still collect a commission on an IRA, and may even sell an investment product with high fees. But the advisor will need to establish documentation showing that a particular investment decision was in the best interest of the client. If they can't document that the decision or recommendation serves the clients' interests, the advisor could face regulatory or legal action.

In the days and weeks since the updated rule was published, there has been a proliferation of articles published around what advisors need to know, and how the new rule will change the way they conduct business. We don't foresee any need to change our approach at Greenleaf Trust because we've known what we needed to know for over 18 years now. We applaud the DOL for applying the highest standard in the updated fiduciary rule and we look forward to continuing to live by our founding principle to serve in our clients' best interest.

# 401(k) Automatic Enrollment

*Lorey L. Matties*
*Participant Services Specialist*

Corporate retirement plans seem to be in a constant state of change. Retirement plans were simple once. You got hired, worked hard, retired, and then sat back and collected a monthly benefit check for the rest of your life.

Pension plans are now a thing of the past. Today, few in the private sector work force are covered by such a plan. The reason: most companies cannot afford to offer one.

Partly because of the runaway pension costs, the 401(k) plan was created in the early 1980s and radically changed retirement benefits in corporate America. 401(k) plans reduced company costs and gave employees much more control in determining their retirement income. They also gave employees more freedom to switch jobs and take their retirement assets with them.

Over the past 36 years, the 401(k) plan has continued to progress. Recent employer concerns about the underuse of 401(k) plans, the instability of Social Security and growing life expectancies have created momentum for the addition of automatic enrollment as a key plan design feature.

Automatic enrollment is a plan provision in which the employer "automatically" enrolls the eligible employee in the retirement plan. The company designates a default contribution rate and default investment option. Employees have the ability to opt out of the automatic enrollment process and make their own contribution and investment decisions at any time.

Automatic enrollment has grown in popularity over the past few years as there is compelling evidence that this feature improves participation, increases deferral percentages, accelerates investment results and helps with discrimination testing.

Companies can no longer afford to contribute as much as they once did to corporate retirement plans and still compete in a global marketplace. They must work hard to find creative ways to help employees maximize their retirement benefits. Making 401(k) plans more automatic is the perfect step.

In the end, we will have come full circle – a retirement plan that is simple and maximizes the chances that employees will be able to sit back, collect a monthly benefit check and enjoy a comfortable retirement.

Our Retirement Plan Division welcomes your inquiries regarding this or any other plan design feature.

"…there is compelling evidence that [automatic enrollment] improves participation, increases deferral percentages, accelerates investment results and helps with discrimination testing."

*Dave P. Mange, CFA*
*Vice President*
*Senior Research Analyst*

# Trading Frequency in Equity Portfolios

In September 2015 we initiated a plan to realign domestic equity portfolios with our best thinking as supported by enhanced quantitative screening tools and our independent research partner. Using more methodical identification of factors that compose quality companies and an increase in the number of companies held in the portfolio should help our term more effectively manage risk and improve risk adjusted returns.

Execution of this plan has required more trading activity in client accounts than historically experienced and more trading than we would normally anticipate. This increase in portfolio turnover is likely to persist through May and June as we complete the portfolio transition. We are actively managing the tax implications in all taxable accounts. Greenleaf Trust always acts on behalf of our clients with no conflict of interests. It is important to note that Greenleaf does not benefit in any way from trading volumes.

## What Is Portfolio Turnover?

Portfolio turnover is a statistic most often used to describe the trading activity in mutual funds, although it can be applied to any portfolio. Many clients may have considered the turnover ratio of a particular mutual fund since this is a frequently discussed topic. Published turnover ratios usually exaggerate the true nature of the amount of trading that a manager does because they do not differentiate between completely selling a stock and adjusting the position size. The customary calculation of portfolio turnover as reported by Morningstar and many brokerage services is the dollar amount of the lesser of securities bought or sold dividend by the net asset value of the fund. The turnover ratio is usually reported for a twelve month period.

> "Portfolio turnover is a statistic most often used to describe the trading activity in mutual funds, although it can be applied to any portfolio."

The eVestment Alliance large cap equity universe of US mutual funds shows a turnover ratio of approximately 56% over the trailing three years. Turnover ranges are from 5% annually on the low end for index funds (rebalancing once a year) to over 900% for "rotation" funds.

The turnover ratio by itself does not tell us how likely it is that the manager or fund has sold any given company in the portfolio. For the purpose of this article, I am going to simplify the definition of portfolio turnover to mean the number of companies that were sold in one year divided by the number of companies in the portfolio.

## "Normal" or Expected Portfolio Turnover at Greenleaf Trust

Defined as the number of companies in the portfolio that change over a one year period, our portfolio turnover ratio is normally close to 30%. We analyze all of the stocks in the portfolio with a targeted holding period of three to five years. Because we frequently update our valuation models and fundamental analysis of each company, we can allow our winners to run for several years without the need to sell.

There are essentially two reasons to sell a stock. On the positive side, a stock price may exceed our full valuation target or be acquired by another company, causing us to sell and move to a holding that we believe has greater potential. Since we realigned our equity strategy in September 2015, this happened rather quickly to one of the names we added, ITC holdings. The negative reason to sell is that our investment thesis will not be realized or the stock significantly underperforms its sector or industry and we do not foresee rebound potential. It is important to note that we do not use a turnover ratio target as we manage our Focus List portfolios, but we are always sensitive to tax impacts in non-qualified accounts.

Over the past six months, our trading activity has increased as we have enhanced our Focus List process. We have increased the target number of positions in the core Focus List portfolio. This is the principal factor driving our increased turnover (more accurately, increased trading) since September 2015. By increasing the targeted number of holdings from prior approximately 35 holdings range to the current 50 name target, we have been purchasing additional names, which has increased the volume of trades. This is clearly seen by those who read our monthly trading synopsis letters. Finally, putting tighter limits on sector over and under weights in comparison to the benchmark has caused us to add positions in some sectors.

> "Over the past six months, our trading activity has increased as we have enhanced our Focus List process."

### When Does Portfolio Turnover Return to the Expected Normal Range?

We expect that our core Focus List portfolio will be fully positioned as to both the number of holdings and their target weightings by end of June. We are nearing our goal of reducing potential tracking error in the Focus List equity strategy. As we embarked on that task in September 2015 we knew that this would increase portfolio turnover. We believe that the goal of focusing on performance versus the benchmark and driving lower volatility was worth a temporary increase in trading activity. As always, we welcome your comments and questions on this or other equity strategy topics.

## Stock Market Pulse

| Index | 4/30/16 | Total Return Since 12/31/2015 |
|---|---|---|
| S&P 1500 | 477.35 | 2.05% |
| DJIA | 17,773.64 | 2.83% |
| NASDAQ | 4,775.36 | -4.27% |
| S&P 500 | 2,065.30 | 1.74% |
| S&P 400 | 1,461.65 | 5.06% |
| S&P 600 | 694.56 | 3.86% |
| NYSE Composite | 10,436.92 | 2.89% |
| Dow Jones Utilities | 654.44 | 14.31% |
| Barclays Aggregate Bond | 110.89 | 3.29% |

| P/E Multiples | 4/30/16 |
|---|---|
| S&P 1500 | 17.8x |
| DJIA | 16.7x |
| NASDAQ | 20.7x |
| S&P 500 | 17.7x |
| S&P 400 | 18.9x |
| S&P 600 | 19.0x |

## Key Rates

| | |
|---|---|
| Fed Funds Rate | 0% to 0.25% |
| T Bill 90 Days | 0.20% |
| T Bond 30 Yr | 2.66% |
| Prime Rate | 3.50% |

## Current Valuations

| Index | Aggregate | P/E | Div. Yield |
|---|---|---|---|
| S&P 1500 | 477.35 | 17.8x | 2.13% |
| S&P 500 | 2,065.30 | 17.7x | 2.18% |
| DJIA | 17,773.64 | 16.7x | 2.56% |
| Dow Jones Utilities | 654.44 | NA | 3.25% |

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.54%

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