GREENLEAF TRUST

Perspectives

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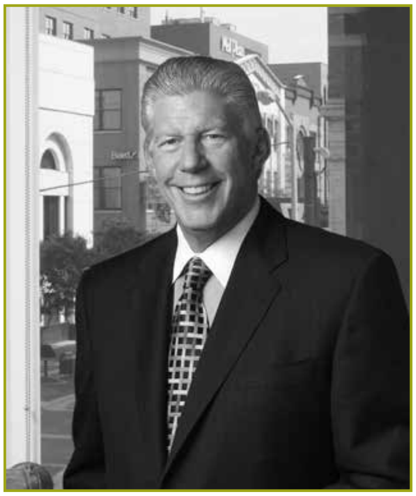

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Economic Commentary

As I write, the election is but one day away. When you receive this, the election will have taken place and perhaps a decision rendered. I purposely say 'perhaps' as the polls reveal a race that could not be tighter. Voter turnout will of course, and as usual, determine the outcome for both the popular and electoral college vote. It is impossible to predict yet many want to know the impact of either candidate being victorious. Much not only depends upon the winner of the Presidential race but also changes in the House and Senate balance of power. With a slight edge in the Senate and a larger edge in the House, the Democratic party can't afford to lose seats in either chamber. Conversely, the Republicans know that without the gap narrowing with respect to Congressional balance of power, even if their candidate wins the White House it will be difficult to frame public policy by one party rule. Four years ago the President had very long coat tails and many Democratic Party Congressional candidates were swept into office as a result. The victory was short lived as two years later in the 2010 elections Republicans gained significant seats. As we have discussed previously, most districts are either Democratic or Republican majority in make up, with few "in- play" districts. How those results play out, however, will be essential to future policy agendas.

There are several scenarios that could play out and I have identified what the implications could be of those scenarios.

The President wins popular plus electoral college vote and "in play" Senate and Congressional districts go to the Democrats.

A lot of political capital will be won under this scenario and would be received as a mandate for the President's party platform and campaign promises. Republicans would be hard pressed to continue a defensive and obstructionist strategy and work across the aisle for what compromises they could win. The probability of this scenario is low, yet possible. How would this look 24 months out? Higher tax rates on the top 5% of income earners as well as higher estate tax liabilities and higher tax and premium costs for those above 4.5 times the poverty rate. These are party platform as well as campaign promises, and if your party wins all battles the party will expect the President

Commentary, continued

to deliver. The deficit will be marginally lower, as any health care, specifically medicare, savings will not materialize until 2016. Global bond markets will require structural deficit progress, at least with respect to legislation, and no President of either party will want a fragile economy impeded by global capital interruptions and, thus, legislation to reduce long term deficits will have a greater chance of surfacing than before the election. The economy will continue to get incrementally better.

"... no President of either party will want a fragile economy impeded by global capital interruptions and, thus, legislation to reduce long term deficits will have a greater chance of surfacing than before the election."

The President wins the popular and electoral college vote but the "in play" seats go to the Republicans.

Can you spell gridlock on steroids? Both parties will be hard pressed to have the political capital in sufficient form to win the day, and some form of accommodation will have to occur as neither will want to be behind the wheel when the proverbial bus approaches the cliff. This scenario could manifest itself into compromise. The President and Republican leadership could out wait the other by refusing to blink, knowing that the election forthcoming could be used to structure a mandate for their respective ideology. Once the election occurs and they have neither the mandate nor time to wait out another election cycle they both may be forced by global bond markets to reach a compromise on tax, revenue, spending and deficits that will be acceptable to the rest of the globe.

Mitt Romney wins the popular and electoral college vote yet "in play" seats are won by Democrats.

No clear mandate will be won yet the new President will be obligated to press party platform and campaign promises. The first attention will be on fiscal cliff issues of expiring tax cuts, federal budget and structural deficits. The victor in this scenario, Mitt Romney, will have to walk the line of satisfying the staunch conservatives in his party while getting enough votes on the Democratic side of the aisle to avoid those automatic reductions that will prove threatening to our fragile low growth economy. Unless compromise is found and a budget is implemented, the prospects for continued economic progress will be muted and financial markets will suffer.

Mitt Romney wins the popular and electoral college vote and the Republican party wins the "in play" seats.

Once again a great deal of political capital will be won on the Republican side of the aisle and we can expect an aggressive attempt to execute the party's platform and fulfill campaign promises. Tax rates will be both extended and reduced for many, deductions for the wealthiest will be eliminated or drastically cut, health care reform as it pertains to the Affordable Health Care Act will be restructured substantially and entitlement reforms will be in play.

The fiscal cliff could be avoided but will take solidarity amongst Republicans and the acquiescence of some conservative Democrats who are more senior in the party and not threatened by party leadership. If successful, the economy will continue it's incremental journey forward and global bond markets as well as equity markets should remain stable.

There are other scenarios that could happen, like either candidate winning the popular and not the electoral or the reverse. It has happened before. This result mutes all mandates and renders the winner weaker and only emphasizes the importance of the Congressional balance of power, focussing attention on the "in play" districts. The worst scenario, of course, is a tie in the electoral college. The chances of this happening are remote and, although the procedure is well defined in our constitution and would be a remarkable civics lesson for the entire globe, it would cause chaos in the near term and definitely render the next President weak.

The highest probability is that within 60 hours of this writing, and prior to you receiving this, the results will be known and we can concentrate on the future. Each candidate has, I think, accurately stated that this election is about a very clear and distinct choice regarding key economic and social public policy choices. They represent very different views on both. They are more similar than not on foreign policy. Different as they are, and as obvious as those differences are, at this writing those differences split the polls 47% to 47%, suggesting that our country is equally split on those issues as well. It is this divide that makes legislating and governing so difficult. As citizens we want issues resolved, but apparently only framed in the image of our personal beliefs. Landslides are easy to interpret, 47/47 isn't so easy.

"Different as they are… at this writing those differences split the polls 47% to 47%, suggesting that our country is equally split on those issues as well."

So headed into the election, what is the state of the economy? The first six months of 2012 saw a significant decline in job growth and a stalling of momentum on incremental economic growth. Conversely the last three months have demonstrated a return to 120,000 plus job growth and an uptick in consumer sentiment. Many have asked what the devastation of Hurricane Sandy will be. Beyond the human tragedies of death, injury, loss of self identity and displacement from life long homes, the economic impacts are really segregated into near and long term results.

Disruption of normal economic activity for densely populated areas of our economy will have a near term impact on overall GDP growth. Economic models can quickly forecast the next two to three quarters and calculate interruptions in consumer spending and employment income resulting from the hurricane. Most models are suggesting a negative near term strain on our overall GDP of about 25 bsp. Longer term, the rebuilding will have a stimulative effect and be of greater magnitude than the near-term head wind. A simple way to look at the longer term is to look at the aggregate through the lens of one home destroyed by any event, fire, flood, etc. As the home is replaced, every piece of material used for the reconstruction as well as the labor used to rebuild it and the tools necessary to do so has a multiplying effect on the economy. The devastation path of Hurricane Sandy was large and involved one of the most densely populated areas of the country. There is a high probability that over the next 48 months most of the devastation will be rebuilt—as horrific as the result was, it did not interrupt the national and international distribution of oil, gas and goods as it well could have had it hit a major port and shipping center. In either case the short term negatives are not enough to drastically damage the economy, and the longer term positives are not sufficient to dramatically improve the economy going forward. Our hearts go out to all who have been impacted by the hurricane and we wish them a speedy recovery and as much peace as they can find in the duration of time it takes to heal.

Financial markets have been muted of late, as one would expect on the eve of an election too close to call. The results will provide plenty of fodder for the prognosticators and analysts. Next month we will begin our analysis of the results as well as exploring why, as a nation, we are becoming older, fatter, slower and dumber, when we really must become younger, healthier, faster and smarter.

Christopher T. Haenicke, JD, CTFA
Vice President
Trust Relationship Officer

Inherited IRAs

At the end of 2011, Americans held $4.9 trillion in Individual Retirement Accounts (IRAs). Another $4.5 trillion was held in employer sponsored defined-contribution plans such as 401(k)s and 403(b)s. All told, 69% of all US households had retirement plans through work or IRAs. As the baby boomers retire at a rate of 10,000 per day over the next 18 or so years, much of the assets in those employer sponsored plans will be rolled over into IRAs. Thus, trillions of dollars of IRA assets will pass to beneficiaries as IRA account owners die over the next few decades. In many cases, the bulk of a decedent's assets will be held in his or her IRA. Unlike an inherited share of the family homestead or grandmother's silver, however, inherited IRAs are subject to complex income tax rules and regulations. The beneficiaries of today and tomorrow who inherit these assets will need to familiarize themselves with the tax consequences of their inheritance, or be prepared to suffer the consequences of their ignorance.

First, it should be noted that in almost all cases, an IRA passes to the beneficiary named on the most recent beneficiary designation form on file with the IRA custodian. Such beneficiary designation forms take precedence over contrary dispositions made in a decedent's will or trust. Thus, it is vitally important that every IRA owner have a valid and up-to-date beneficiary designation form on file with their IRA custodian, preferably one that names both a primary beneficiary, and also a contingent beneficiary.

When an IRA account owner dies, there are a host of decisions to be made and actions to be taken by various parties, including the executor of the deceased owner's estate and the beneficiary (or beneficiaries) of the IRA. The options available to a beneficiary are numerous, and vary depending upon the beneficiary's status as a spousal or non-spousal heir. Every beneficiary has the option of disclaiming their interest in an IRA, i.e., refusing to accept the interest, though few do.

Most beneficiaries of a traditional IRA will desire to preserve their ability to defer the withdrawal of the inherited assets for as long as possible, thus deferring the taxation of the assets held in the IRA. In the case of a spousal beneficiary, this usually, but not always, entails either rolling the assets over into an IRA in her own name, or electing to treat the deceased spouse's IRA as her own. Either way, the surviving spouse will then be able to keep contributing to the account and put off required minimum distributions until she turns 70½.

A non-spousal beneficiary does not have the same ability to roll the asset into an IRA in her own name. Instead, most non-spousal beneficiaries will opt to establish an inherited IRA. Care must be taken when the non-spouse beneficiary contacts the custodian of the IRA. She must make certain that the result is not a distribution of the account balance, as such a distribution from a traditional IRA directly to a beneficiary will cause the immediate taxation of the entire amount! Moreover, a distribution to a non-spouse beneficiary cannot be reversed, even if done in error or by accident. Nor should the non-spouse beneficiary attempt to roll over the assets into his or her existing IRA. This too will result in the immediate taxation of the entire amount.

The IRA custodian will typically have the non-spouse beneficiary sign an agreement for a new account that will bear a title such as "John Doe, deceased, f/b/o Daughter Doe." Once the inherited account is established, the beneficiary is able to transfer the assets to an account of the same name payable to the same beneficiary at her preferred financial institution by way of a "trustee to trustee transfer." The non-spouse beneficiary of the inherited IRA cannot make contributions to the IRA, nor can she put off required minimum distributions from the IRA. However, the beneficiary can take distributions according to her life expectancy which will defer the taxation of the assets held in the IRA. These withdrawals must start by the end of the year following the year in which the deceased IRA owner passed away. If the beneficiary does not start taking these required withdrawals by December 31 of the following year, she will pay a penalty.

Note: this article is simply an overview of otherwise complex and consequential tax matters, and is intended to heighten the awareness of the reader as to the issues raised. The reader should consult with a financial services professional well-versed in IRA rules and regulations when faced with a potential inherited IRA.

Bethany L. Cwalina
Participant Services Coordinator

IRS Announces Benefit Plan Cost-of-Living Adjustments and Tax Adjustments for 2013

American savers will be glad to see that the Internal Revenue Service has announced 2013 Cost of Living Adjustments (COLA) affecting dollar limitations for retirement plans and other retirement-related items. For the second year in a row, participants in a qualified retirement plan will be able to increase the amount deferred into their 401(k).

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Cost-of-Living Adjustments (COLA) are triggered by the Consumer Price Index (CPI), which measures the average change over time in the prices paid by consumers for a market basket of goods and services. The COLA is reported monthly by the Bureau of Labor Statistics and usually hovers at or near the average inflation rate.

In 2013 employees will be able to contribute up to $17,500 per year to their defined contribution plan. The 2012 limit was $17,000. The increased contribution limit provides a great opportunity for retirement plan participants to save more for retirement. Although $500 may not seem like a large adjustment, over time, it could add up to tens of thousands of dollars with some help from sound investments. It is recommended that participants who want to contribute the maximum salary-deferral amount start early in the year. Deferring income throughout the year allows the participant to lessen the impact of reduced take-home pay.

Maximizing the deferral limits each year is an excellent strategy for many reasons. First, contributions made to a traditional 401(k) allow a participant to lower their taxable income thereby reducing the amount paid when filing their income taxes. The other reason to max out a 401(k) contribution is, of course, that it will help to get a participant closer to a financially secure retirement. Especially during peak earning years when one can afford to do so, a participant should set aside larger and larger portions of their income to build up a healthier nest egg.

The catch-up provision, aimed at older workers that may have under-saved, remains intact. The 2013 catch-up contribution limit is $5,500 per year and is available for those workers age 50 or older. Again, the earlier a participant can take advantage of these contributions, the greater the impact they will have on their saving's balance.

Following is a comparative table listing some of the most common retirement plan limitations:

Retirement Plan Limitations	2013	2012
Annual 401(k), 403(b) and 457 deferral limit	$17,500	$17,000
401(k), 403(b), 457 catch-up contribution limit	$5,500	$5,500
Annual compensation limit	$255,000	$250,000
Defined Contribution Plan "415 limit"	$51,000	$50,000
Defined Benefit Plan "415 limit"	$205,000	$200,000
Highly Compensated Employee definition	$115,000	$115,000
Social Security Taxable Wage Base	$113,700	$110,100
IRA contribution limit	$5,500	$5,000
IRA catch-up contribution limit	$1,000	$1,000

The Social Security Administration also announced cost-of-living adjustments to the maximum amount of earnings that are subject to the Social Security Tax, as well as increases to monthly Social Security and Supplemental Security Income benefits. Based on the increase in the Consumer Price Index, Social Security and Supplemental Security Income (SSI) beneficiaries will receive a 1.7% increase for 2013. The Social Security Wage Base will increase in 2013 from $110,100 to $113,700. The tax rate on the Social Security portion of earnings (up to the applicable taxable maximum) is 6.20%. The Medicare tax remains at 1.45% on all earnings.

Another incentive to help participants save for retirement in 2013 is the Saver's Tax Credit. The credit is between 10-50% of the individual's eligible contribution of up to $2,000. The earnings criteria for the credit will increase in 2013 and allow for more participants to benefit. They are now $59,000 for married couples filing jointly, up from $57,500 in 2012; $44,250 for heads of household, up from $43,125; and $29,500 for married individuals filing separately and for singles, up from $28,750.

Lastly, a notable tax item that remains unknown for the 2013 tax year is the Temporary Payroll Tax Cut Continuation Act of 2011. This reduced the Social Security payroll tax rate by 2% on the portion of the tax paid by the worker through the end of February 2012. This law benefited nearly 160 million workers in 2011. The Middle Class Tax Relief and Job Creation Act of 2012 extended the Temporary Payroll Tax Cut reduction through the end of 2012, but under current law this temporary reduction expires at the end of December 2012.

Should you have questions regarding contribution limits, please contact the Greenleaf Trust Retirement Plan Division at (866) 553-8400 or by email at participant@greenleaftrust.com.

"Another incentive to help participants save for retirement in 2013 is the Saver's Tax Credit."

Josh D. Wheeler, CFA
Research Analyst

"… we have revised our equity selection framework, which drives our stock-picking process for client portfolios."

Introducing the Four-Pillar Test

In the spirit of continuous improvement, we have revised our equity selection framework, which drives our stock-picking process for client portfolios. Many clients are familiar with our previous framework—the Twelve-Point Test. Our new policy is the Four-Pillar Test, and it retains many of the concepts of the Twelve-Point Test, but distills it down to the four most important attributes we look for in a stock.

These attributes are:

1. an Attractive Business,
2. with Consistent Free Cash Flow Generation,
3. run by Good Capital Stewards,
4. a price which indicates the stock is Undervalued.

First, we look for an Attractive Business, of which the most important determinant is a sustainable competitive advantage, or a "moat." This is something that allows the company to outperform or ward off competition for the foreseeable future. Examples are high switching costs, such as Apple's software ecosystem, which gives the customer incentive to keep using Apple products once all her music, photos and apps communicate seamlessly across different Apple hardware devices, or a recognizable brand name in industries where that is important, such as Pepsi in soft drinks. These advantages allow the incumbents to earn excess returns—returns on capital above their cost of capital, or the rate of return investors require on their equity investment. Companies with excess returns drive higher valuations over time.

In addition to a moat, attractive businesses have revenue that is recurring in nature, not dependent on constant large-scale innovation and a continuous flow of entirely new products or services, as this is more speculative and makes cash flow less predictable. Similarly, although it may sound simple, we look for businesses that we can readily understand, which keeps us in our circles of competence and makes us more likely to pick outperformers. Also, given we are long-term investors, we want to align with broad macro trends, and therefore will look for companies that are positioned to benefit from a product-, industry- or demographic-related tailwind for the foreseeable future. In the least, we want the absence of a macro headwind.

Second, we focus on Consistent Free Cash Flow Generation. Free cash flow is what a company has left over from the cash it takes in after it pays out expenses, interest on debt, cash taxes, and makes necessary investments in working capital and property and equipment. We think free cash

GREENLEAF TRUST 4-PILLAR EQUITY TEST

When selecting equities for clients' investment portfolios, we look at four key criteria. Of the thousands of publicly traded companies, a small percentage make it through this 4-Pillar Test. Of those, even fewer earn a place in our clients' portfolios. Adhering to this methodology positions our clients for superior returns with less volatility as per our investment objectives.

THE FOUR PILLARS ARE AS FOLLOWS:

I ATTRACTIVE BUSINESS

- Understandable business model
- Sustainable competitive advantage
- Demonstrated consistent excess returns – ROIC/ROE above required rate of return
- Revenue is recurring in nature
- Long-term macro tailwind

II CONSISTENT FREE CASH FLOW GENERATION

- Free cash flow is consistent and growing
- Driven by steady organic revenue growth
- Margins are stable, leading to predictable cash flow

III GOOD CAPITAL STEWARDS

- Management has track record of following through with stated goals
- Use of cash flow aligned with shareholders
- Acquisitions are done only when they generate excess returns
- Prudent debt levels

IV UNDERVALUED

- Priced to offer material upside to our estimate of fundamental value
- Above-average free cash flow yield
- Normalized multiple and expected earnings growth imply attractive returns

Assuming the aforementioned four pillars are met, Greenleaf Trust may choose to add the company to our clients' portfolios. At which time any of the four pillars are not being met, the equity position in the company will be reassessed.

Four-Pillar Test, continued

flow is a truer representation of a company's earnings, as opposed to accounting net income or earnings per share, which are more easily manipulated. A high-quality company's free cash flow is consistently growing due to revenue growth, not simply from cost-cutting, which is not sustainable long term. And we prefer that revenue growth be mostly organic, not solely driven by acquisitions, which often leads to lower returns. Finally, we look for consistent margins because this makes future cash flow easier to estimate, which leads to a more accurate valuation. This doesn't mean we won't consider cyclical companies, but we'll be more conservative on their valuation, given the higher level of cash flow volatility.

Third, we seek managers that have been Good Capital Stewards. One of a management team's most important tasks is allocating capital, and we look for a good track record here—investing more in the business when it generates attractive returns and returning capital to shareholders through buybacks and dividends when better investment opportunities aren't available. Stewarding capital well also means maintaining prudent debt levels. We like management to take a conservative approach, using debt minimally so as not to jeopardize future growth or put the company at risk for financial distress when earnings are under pressure.

Lastly, we invest only in stocks we believe are Undervalued. Numerous studies have shown that the key driver of future returns is the price paid—the lower price, the higher the return. A great company is a bad investment if the price paid does not leave room for appreciation. Getting the price right is just as important as getting the company right. Therefore, we conduct rigorous research to estimate the fundamental value of a company, and look for stocks where the market price is well below our estimate of its true value. We think this gap between price and fundamental value, or the "margin of safety," is critical in driving superior returns. If our investment thesis is right and the mispricing exists, the price of the stock will eventually move higher to converge with fundamental value. If we are wrong, the margin of safety should limit the downside. We use various methods in the valuation process including discounted cash flows (DCF), relative free cash flow yield and trading multiples.

"...we invest only in stocks we believe are Undervalued. ... A great company is a bad investment if the price paid does not leave room for appreciation."

One might ask, "Why would a high-quality company trade for much less than it is worth?" Mispricings aren't commonplace, but they do occur. The market can misprice a stock by mistakenly extrapolating short-term trends into the future (perhaps due to a bad quarterly earnings report), or by overreacting to macro news that won't matter long term, or by irrationally piling into certain sectors in the market, thereby leaving others too cheap. We are long-term investors, not traders, and we can look past short-term hiccups. Our time horizon may be our biggest advantage relative to the market.

Finally, a word on style labels. The investment community often speaks in terms of "growth" and "value," as if the two are mutually exclusive. We disagree, and look for both in our investments. Growth is one characteristic we seek in a high-quality company, and we will always look to buy stocks at a price that offers compelling value. Instead of using these labels, we would summarize the Four-Pillar Test this way: we look to invest in high-quality companies at discounted prices—you might say "quality at a discount." Most of the companies we invest in will not pass the entire test, but the framework helps us identify shortcomings and the mitigating positives.

The process of revamping the 12-Point Test and developing the Four-Pillar test was rigorous, research based, and collaborate across the research team, Investment Policy Committee and senior management. It is an example of the continuous improvement discipline at Greenleaf Trust—a value we feel is core to who we are and our ongoing success. We believe the Four-Pillar Test is the best approach for building long-term wealth for clients through equities, and if you have any questions, please call a member of your Client Centric team or any of us in research. We would be happy to hear from you.

"The investment community often speaks in terms of "growth" and "value," as if the two are mutually exclusive. We disagree, and look for both in our investments."

Stock Market Pulse

Index	10/31/12	% Change Since 12/31/2011
S&P 1500	325.40	14.08%
DJIA	13,096.46	9.62%
NASDAQ	2,977.23	15.75%
S&P 500	1,412.16	14.29%
S&P 400	980.45	12.87%
S&P 600	458.15	11.50%
NYSE Composite	8,221.40	9.96%
Dow Jones Utilities	475.49	6.44%
Barclays Aggregate Bond	112.19	3.73%

P/E Multiples	10/31/12
S&P 1500	13.8
DJIA	12.8
NASDAQ	16.1
S&P 500	13.5
S&P 400	16.3
S&P 600	17.5

Key Rates

Fed Funds Rate	0% to 0.25%
T Bill 90 Days	0.12%
T Bond 30 Yr	2.85%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	325.40	13.8x	2.18%
S&P 500	1,412.16	13.5x	2.28%
DJIA	13,096.46	12.8x	2.61%
Dow Jones Utilities	475.49	NA	3.97%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.67%

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