GREENLEAF TRUST

Perspectives

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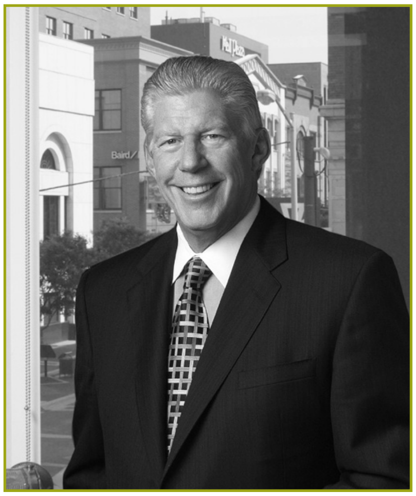


William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary

What is the largest economic issue that faces us today? This is a question that can and often does have a different answer from month to month. A recurring theme of significance and one that isn't going to go away quickly is Europe, specifically the European Union. A bit of history will be helpful.

Recessions are all different and some very unique. Typical business cycles; that is, the cycle from expansion to contraction, are generally characterized by low unemployment, rising prices, increasing inflation and tightening credit at the top of the cycle to be followed by rising unemployment, falling prices, lower inflation and easier credit supply at the bottom. The tools that monetary policy makers have is the supply of credit. Central banks throughout the world utilize essentially the same tools. They monitor employment and inflation and use their control of the money supply to moderate inflation and maintain employment at optimal levels. The United States Federal Reserve has, for the past four decades, been transparent in their goals oF targeting 3.5% unemployment as "full employment" while keeping an inflation target at no more than 2.5%.

The majority of recessions experienced in our country's history have been typical business cycle recessions that were addressed successfully with typical Federal Reserve monetary tools. The recession of 2008–2009 was unique in that it was not created by a traditional slowing of the business cycle, but rather by a huge housing bubble and credit market freeze. The normal recession model of moderately decreasing demand was instead replaced with extremely low levels of global demand for products and services. The recession was global in nature and impacted eighty percent of the world's economies. Banks were failing, and the general public was increasingly doubting the solvency of the world's banking system and its major institutions. We don't need to revisit the horror of that time period and suffice it to say it was apocalyptic and not something that any of us want to revisit.

Given the severity of the downdraft in demand and the global credit freeze, central banks were left with some common options. The first need was to address liquidity and to assure the general public of financial

Commentary, continued

institution solvency. In essence, they integrated banks, liquidated the weak, strengthened the balance sheets of the surviving institutions and provided liquidity for commerce to begin the economic healing process. We can recall the Congressional hearings, the testimony of the various parties involved and the political theatre that was constantly on stage at the height of the crisis.

On one side of the argument were those who focused on the Federal Reserve's balance sheet and increasing debt levels of the United States Treasury. Pure free market advocates lobbied vociferously for the Fed to let the free market take its course and urged Congress to allow financial institutions and automobile companies to fail and proceed through liquidation and bankruptcy processes and outcomes.

> "The recession of 2008–2009 was unique [and]... the difference in direction that the United States traveled... and the direction that the European Union took... have produced drastically different results."

This same camp was of the opinion that there was too much government debt and the Federal Reserve was simply adding to levels of debt that were already unsustainable, especially when added to the cost of the Affordable Health Care Act working its way through the chambers of Congress. The other side of the argument focused their attention on the immediate need to repair credit markets, get the economy moving and lower unemployment. Longer term structural changes that would cure the issues of sustainability would need to be addressed after the economy was cured. Mixed into the conversations were things like default, debt ceilings, federal budget votes and sequester. So at this point you might be wondering, why all the review of the past and what does this review have to do with Europe and specifically the continued recession and economic weakness in the European Union which is now being defined by some as the largest economic issue facing us today?

The answer to the above question is really the difference in direction that the United States traveled to cure our recession (financial institution capital investment, modest austerity, and credit liquidity stimulus), and the direction that the European Union took (structural austerity and much more limited central bank stimulus). The contrasts between the approaches have produced drastically different results. As we have travelled our journey of incremental improvement beginning in the spring of 2009, we have observed the slow but sustained improvement in our economic indicators yielding inconsistent yet improving GDP results as well as consistent reductions in unemployment over the last third of the recovery cycle. Europe, not including Great Britain and Ireland (non-euro currency members of the EU) continues to be mired in recession and is struggling with significant threats of deflation. Recent moves by the ECB (European Central Bank) over the protests and strong opposition of Germany, to begin asset repurchases from European banking institutions, (as our Federal Reserve announced the cessation of our asset repurchase program) is an attempt to begin a more aggressive approach to economic stimulation as well as asset stimulation.

Those responsible for public policy discussion, as well as those with authority to act upon and or effect public policy, have often confused the importance of getting the austerity argument right. The debt a government ultimately ends up with as long-term debt isn't always created by short-term stimulus generated debt. Did Europe need to restructure its entitlement programs to be in alignment with the other members of the EU? Yes, of course, at the appropriate time. The issue of sovereign debt and bank defaults was clouded and muddied due more to political power (sought by Germany and likewise feared by France, Italy, Greece and Spain) than by economic argument. Had the EU traveled the path of the US, Great Britain, China and Japan — while simultaneously gaining alignment with member countries on social contracts — the region which produces about one-fifth of the globe's output would be significantly better off, and so would US companies that export products and services into the EU.

Most of the arguments against stimulus of any kind center around near- and longer-term debt on government balance sheets, and the ability of governments to not only service but also to pay off their debt. When faced with making the correct decision, elected officials routinely defer or choOse the less courageous path. The result of weak leadership is almost always wrong-headed action. Continuing to print money devalues currency in the long run and inflates prices. Most governments fear inflation and therefore limit growth more than they otherwise should. Must there be a spread between inflation and GDP growth? Yes, absolutely, in a perfect world that is a goal that makes the most sense. Does our emphasis on inflation and the Fed's balance sheet help to deflate assets, restrict economic growth and reduce income growth? Some economists suggest that it does and, if three-fifths of the world's output producers are following that same path, does that mean that we are magnifying the slow growth syndrome to an even greater extent? There are currently forty-six banks that target inflation as a goal, including our own Federal Reserve. Of those forty-six, thirty have not come close to exceeding their targeted goal of balancing inflation with growth. Germany in particular has been overly keen to focus on austerity, limited stimulus, and structural reforms of EU member's social contracts with near-term austerity measures. Chancellor Merkel has repeatedly drawn lines in the sand on all of the above, and has now also raised common immigration reform among EU members as a response to the right wing side of the German body politic that is gaining more momentum in her country.

"When faced with making the correct decision, elected officials routinely defer or choOse the less courageous path. The result of weak leadership is almost always wrong-headed action."

The covenants for the ECB are somewhat limited and the best solutions

Commentary, continued

seem somewhat out of reach. Many have argued that government balance sheets should separate long term infrastructure investments such as airports, highways, ports and bridges from annual operating budgets. Doing so in the Eurozone as well as the United States would treat the investment more appropriately and recognize the debt and its resulting service more realistically. The ability to do so would also mean a significant increase in global projects such as those in China and India and gains in employment, household income and demand for consumer and corporate capital spending. Europe's interest rates are near zero; reduction in interest rates will not be the solution to the preservation of the single euro currency or growth out of their current recession. They will not be able to cut their way to GDP growth, solvency or sovereign debt stability. The best course of action will be to inject capital to their banking system, increase liquidity, invest in infrastructure and defer crisis-focused reforms that will be immaterial if their economies fail, assets deflate and massive numbers of their citizens are unemployed.

"A stalled or retreating Euro zone economy reduces customers as well as pricing opportunities."

As we know, a large portion of our manufacturers as well as financial and technology service sector companies export products and services globally. A stalled or retreating Euro zone economy reduces customers as well as pricing opportunities. While it is only one-fifth of the globe's market place, it is not insignificant and if left to muddle in mediocrity at best or prolonged recession at worst, the impact will be felt in our GDP as well as corporate earnings growth.

Harry S. Truman and Teamwork

Michael F. Odar, CFA
President

My interest in history has continually drawn me to famous quotations. I have always found that a quote's relevancy to you at the time of reading can make it more or less meaningful to you. If the quote is relevant at the time of my reading, it takes me a while to forget it. Recently, I was passed along a quote from Harry S. Truman that piqued my interest because it was very relevant to work that I was doing.

Most of us have heard "If you can't stand the heat, get out of the kitchen.", "The buck stops here.", and "It's a recession when your neighbor loses his job; it's a depression when you lose your own." All are attributed to our 33rd President of the United States, Harry S. Truman. But it was "It is amazing what you can accomplish if you do not care who gets the credit." that really struck a chord with me as I prepared for our 2015 Strategic Planning Meeting. Our Strategic Planning Meeting on November 10th is where I review with everyone in the organization our plan for 2015.

The quote resonated with me first because I felt it embodied the essence of "teamwork." And as you know, teamwork is one of our core values. We believe our clients benefit from the collective wisdom of our team. It's why we built an eight-person Research Team with the highest number of Chartered Financial Analyst (CFA) designations in west Michigan that provides unbiased thoughts on the tools we use to manage client portfolios. It's why we have three members of every Client-Centric Team with diverse backgrounds; a Wealth Management Advisor, Trust Relationship Officer, and Team Service Coordinator. And it's why our Retirement Plan Division clients are serviced by both a Participant Services Coordinator, who gets to know the participants' needs, and a Client Services Specialist, who gets to know the plan administrator's needs.

Secondly, the quote resonated with me as I reflected on all that we have accomplished so far in 2014 and how we talk about those accomplishments. In our strategic planning employee questionnaire, we ask everyone the question "What have we as a company been most impactful in accomplishing so far in 2014?" In the 65 responses to the question that cited more than 65 different accomplishments, there were only two names mentioned once in all of the responses. And, the two names that were mentioned were recognized from someone they lead for empowering them to improve. "We", "us", and "our" were however mentioned multiple times throughout the responses. It is amazing what you can accomplish if you do not care who gets the credit.

"It is amazing what you can accomplish if you do not care who gets the credit."
–Harry S. Truman

Karen A. Bouche, CTFA
Executive Vice President
Family Office Advisor

Engaging the Next Generation

Imagine... several generations ago, a family who started with modest means but had a vision and the drive to start and grow a business. They took risks, may have failed, but tried again...and again and again. They worked hard to build the family business and the family values. They made sacrifices so future generations would not have to and their hard work and dedication paid off; they were successful! Now, the family wealth has appreciated and so has the family's reputation. As the legacy of the family name and the family wealth is passed onto the next generation, the feeling of responsibility can be overwhelming.

Children who are born into significant wealth at some point begin to realize that they are different. Parents often spend many hours and dollars on planning for their financial assets to transfer to the next generation in the most tax-advantageous way. However, few focus enough time and resources on preparing the next generation for the responsibilities and burdens of wealth. Having open and honest dialogue about the family's wealth, values and desired legacy, as well as the related social pressures and perceptions, can pay dividends for years.

"Parents often spend many hours and dollars on planning for their financial assets to transfer to the next generation in the most tax-advantageous way. However, few focus enough time and resources on preparing the next generation for the responsibilities..."

It may be helpful to describe the long term vision of the family's legacy over several generations, specifically looking at the current generation's responsibilities. No one wants to be responsible for foolishly managing or losing what their ancestors worked so hard for. They want guidance and want to understand expectations. They often crave the knowledge necessary to do their part to continue to build upon the existing family legacy. To help future generations prepare for this tremendous responsibility, consider having standing, scheduled family meetings to provide an intentional forum for these discussions. Provide them with introductions to key team players and resources. The family meetings can also serve as time dedicated to family office updates regarding investments, taxes, charitable gifts or legal items.

The families that are most successful in this process work together to define and understand the following:

- Your family history – where did we come from and how was our wealth created?
- Shared values of the family – what do we stand for?
- Common goals of the family – what impact do we want to make?
- Agreed-upon practices of sharing information with each other and others – what is acceptable behavior?
- Clear expectations – what are roles and responsibilities with family owned entities and assets?
- How success is defined - how often do we want to measure our progress?

By asking and answering questions like these, as a family, the transition of wealth and legacy begins. If the desire of the wealth creators is to maintain the family wealth and values into perpetuity, the team of professionals within Greenleaf Trust's Family and Foundation Services Division can provide the comfort of continuity and regulation. We stand ready to serve you and your family in a uniquely personal way.

2015 COLA Adjustments

Kathleen J. Waldron, QKA
Vice President, Assistant Director of Retirement Plan Division

The Social Security Administration (SSA) recently announced that a 1.7% Cost-Of-Living Adjustment (COLA) will begin in January 2015. In addition, adjustments to the maximum amount of earnings that are subject to the Social Security tax will increase to $118,500, up from $117,000.

The Social Security tax functions very much like a flat tax. The taxable wage base caps the amount of employee compensation subject to the 6.20% Social Security tax rate imposed on both employers and employees. In 2015, employers must withhold Social Security tax on each employee's first $118,500 of compensation. This means that the employer and employee must each pay $7,347. Compensation above $118,500 is not subject to Social Security taxes, although Medicare taxes will apply.

The Internal Revenue Service (IRS) also recently announced various dollar limitations applicable to retirement plans for 2015. Some plan and IRA limits will remain unchanged because the Consumer Price Index did not meet the statutory thresholds for their adjustment. Highlights include the following:

RETIREMENT PLAN LIMITATIONS	2015	2014
Annual 401(k), 403(b) and 457 deferral limit	$18,000	$17,500
401(k), 403(b) and 457 contribution catch up limit	$6,000	$5,500
Annual compensation limit	$265,000	$260,000
Defined Contribution Plan "415 limit"	$53,000	$52,000
Defined Benefit Plan "415 limit"	$210,000	$210,000
Highly Compensated Employee definition	$120,000	$115,000
Social Security Taxable Wage Base	$118,500	$117,000
IRA contribution limit	$5,500	$5,500
IRA catch up contribution limit	$1,000	$1,000

The Saver's Tax Credit for low- and moderate-income workers will reflect modest adjustments as well. The credit is between 10-50% of the individual's eligible contribution up to $2,000 ($4,000 if married filing jointly). The limit for 2015 is $30,500 for singles; $46,750 for head of household; and $61,000 for married couples filing jointly.

Should you have any questions regarding the various limitations that apply to retirement plans, including some that are not included in the table at left, please contact our Retirement Plan Services Team.

Daniel C. Haines
Fixed Income Analyst

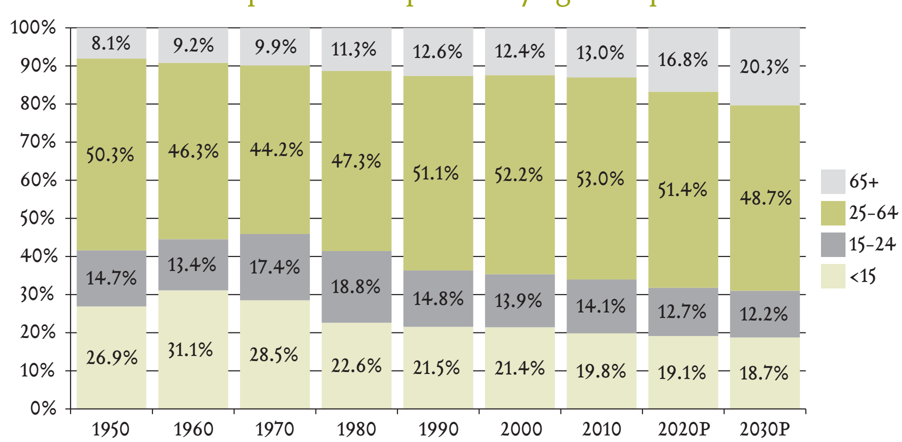
Changing Demographics and the Impact on Long-Term Economic Growth

For the second half of the 20th century there were numerous tailwinds that propelled the US to strong economic growth. One of these is the baby boom that occurred from the end of World War II through 1964. From 1950-2000, US real GDP growth (the change in gross domestic product adjusted for inflation) averaged 3.7%. Since the year 2000, the US economy has grown at an average of 1.8% per year.[1] However, this period included the tech bubble and the great recession of 2008 and many Americans view 3% GDP growth as the norm they expect going forward. For various reasons we will explore, slower growth is more likely as demographic tailwinds turn to headwinds over the coming decades.

"For various reasons we will explore, slower growth is more likely as demographic tailwinds turn to headwinds over the coming decades."

The baby boom period covers mid-1946 through mid-1964. During this period, the US averaged 4 million births per year, compared to 2.6 million births per year in the 20 years prior and 3.5 million births per year in the 20 years following (in 2012, there were 3.95 million births).[2] The sustained increase in the level of births during this period has had a long-term impact on the age structure of the US as is demonstrated by the aging of the US population. In 1980, only 11.3% of the population was above 65 whereas 20.3% of the population is expected to be in this age group by 2030.[3] The oldest baby boomers are now 68 while the youngest are turning 50 this year. This impacts the long-term economic outlook in several ways.

US Population Composition by Age Group

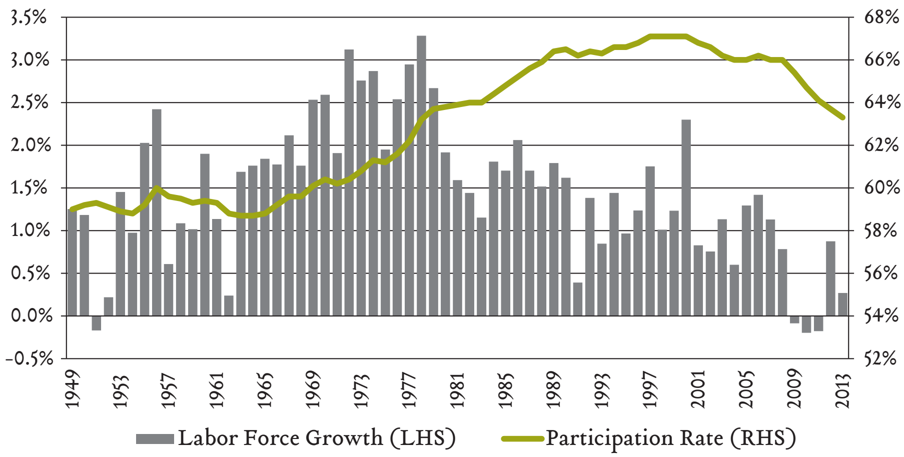


Source: U.S. Census Bureau

A high level way to think about real GDP is that it is the combination of the number of workers (the labor force) and the amount of output per worker (productivity). If either measure is growing, real economic output grows as well. The aging of the US population has the largest impact on the labor force.

To examine the impact of the aging population on the labor force, it is helpful to think about the components of the total labor force. The labor force is determined by two things: the size of the overall population and percentage of the population seeking employment (the labor force participation rate). The baby boomers helped to boost population growth and labor force participation from the 1950s through the 1990s as birth rates were high and the boomers entered the labor force. However, both components have slowed in recent decades with total population growth declining from 1.75% per year in the 1950s to 0.7% in 2013 and the labor force participation rate peaking in 1999 at 67% and falling to a recent reading below 63%.[4]

US Labor Force



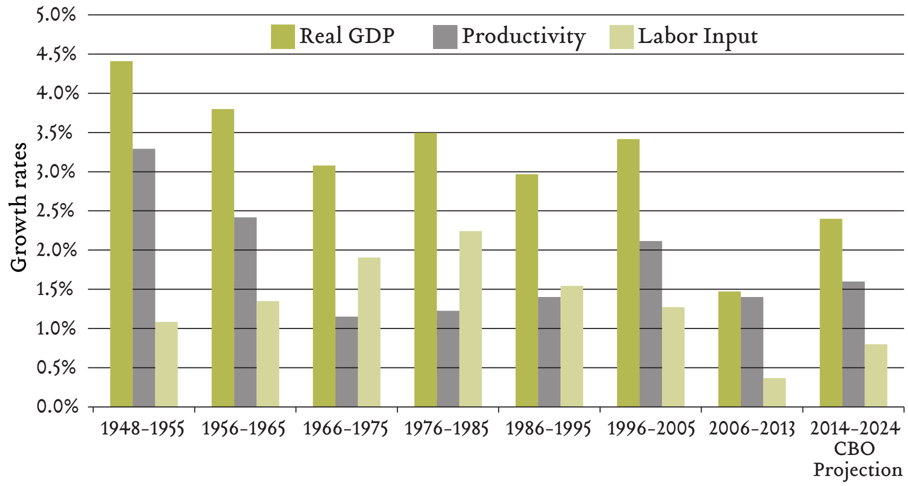
Source: U.S. Department of Labor: Bureau of Labor Statistics

"The baby boomers helped to boost population growth and labor force participation from the 1950s through the 1990s..."

Our view is that the aging population is the primary driver of these trends which we expect to continue. As the population ages, the average birth rates will continue to fall, slowing total population growth. In addition, as the portion of the population over age 65 grows, the labor force participation rate is under pressure since many civilians over 65 choose not to work.

While we believe the aging population will depress total labor force growth, real GDP could still exhibit strong growth due to the second factor mentioned earlier, productivity. Productivity is driven by increases in physical capital such as buildings and machines, human capital which is the education and knowledge of workers and technology which is improvement in the production of goods and services.[5] Advances in productivity were strong following World War II and then again from the mid-1990s through the mid-2000s due to advances in computing and internet usage. Without some type of substantial innovation or a rapid increase in capital investment, it is unlikely that productivity growth will be back around 2% and will more likely be in the 1%-1.5% range.

GDP Growth Contribution



Source: CBO, FRED, Greenleaf Trust; labor input includes impact of changes in the unemployment rate

With labor force growth of around 0.7% due to an aging population and productivity growth of 1%-1.5%, it is likely that longer term GDP growth will be closer to 2% than the 3% level that many expect. However, in the short term economic output can be cyclical and growth may be at or above the 3% level over the next year or two as the US continues to recover from the downturn of 2008-2009.

Lower long-term growth expectations have implications for asset prices. With lower growth expected, it is likely that real interest rates will be lower than their historical norms. The US Federal Reserve Board currently expects long-run inflation of 2%, below the 4.2% average of the last 50 years.[6,7] Since inflation is expected to be contained, nominal rates are expected to remain below historical levels also, although we believe they will rise from where they stand currently. Lower interest rates, in turn, have implications for equity pricing. When bond yields are low, stocks look relatively more attractive and are usually valued at higher multiples of earnings. However, if growth in cash-flows and earnings are expected to be lower, earnings multiples will be negatively impacted. While we have not radically altered our allocations in response to this outlook, we keep these long-term trends in mind as we manage portfolios.

"Lower long-term growth expectations have implications for asset prices. With lower growth expected, it is likely that real interest rates will be lower than their historical norms."

Impact of Aging Population on Financial Markets

Financial Market Indicator	Impact vs Long-Run Historical Average
Real GDP Growth	Lower
Interest Rates	Lower
Equity Valuation Multiples	Mixed to Higher

Sources

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"Lower interest rates, in turn, have implications for equity pricing."

Stock Market Pulse

Index	10/31/2014	Total Return Since 12/31/2013
S&P 1500	466.19	10.37%
DJIA	17,390.52	6.98%
NASDAQ	4,630.74	11.92%
S&P 500	2,018.05	10.99%
S&P 400	1,418.71	6.90%
S&P 600	679.50	3.10%
NYSE Composite	10,845.00	4.28%
Dow Jones Utilities	596.93	25.27%
Barclays Aggregate Bond	110.08	5.15%

P/E Multiples	10/31/2014
S&P 1500	17.3x
DJIA	15.0x
NASDAQ	21.8x
S&P 500	17.0x
S&P 400	19.7x
S&P 600	21.1x

Key Rates

Fed Funds Rate	0% to 0.25%
T Bill 90 Days	0.01%
T Bond 30 Yr	3.06%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	466.19	17.3x	1.93%
S&P 500	2,018.05	17.0x	1.99%
DJIA	17,390.52	15.0x	2.17%
Dow Jones Utilities	596.93	NA	3.33%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.13%

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