GREENLEAF® TRUST

Perspectives

A Greenleaf Trust Newsletter

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William D. Johnston
Chairman, Greenleaf Trust

The Law of Unintended Consequences

Greed is a terrible emotion. It is almost never, in the longer term, rewarded. Nearly two decades ago each major political party launched a strategy of redistricting congressional districts to accommodate for movements of our population. On the surface, changing the size of congressional districts as population sizes and shifts occur allows for better representation. This was a concept our founding fathers held dear. Control of legislative bodies based upon geographical size created the dilution of representation for individuals in some districts and over-representation in more rural districts. Until the Republican and Democratic political parties hijacked the redistricting process, it was largely a census-driven consistent process of making certain that all of the population was represented with equality.

An examination of today's congressional districts provides substantial evidence that the process is far more political than egalitarian, and the objective of party representation has now taken center stage. Both parties have been equally disingenuous in their attempt to craft "safe" districts for their individual parties. Their success in accomplishing their goal can be seen in the relative stability of party representation in the House of Representatives. There are fewer and fewer districts that include comparable representations of both parties, making it less and less likely that control of the house by one party will change dramatically over any one election cycle. This process is commonly referred to as gerrymandering.

While the process of gerrymandering may have created "safe" congressional seats as defined by party, what the leaders of this strategy didn't anticipate is that it would make their party vulnerable to extreme elements within their own party and that the primary election process would now become infinitely more important than the general congressional election. The last two congressional election cycles have resulted in well-funded "Tea Party" supported candidates winning primary elections and then benefiting from the gerrymandered boundaries of the congressional district to be elected in the general election. These newly elected members of Congress have resisted the traditional customs of the "House" leadership of their party and know that their continued presence in Congress is hugely dependent on voting not on party lines but rather according

Unintended Consequences, continued

to the expectations of those who elected them in the primary rather than general election process. Each party has a range of political philosophy across the bandwidth of their elected representatives in each house. The role of leadership in both the House and Senate has always been to accommodate and blend this bandwidth to deliver legislation that most felt represented enough elements of their party's legislative agenda but also enough of the opposition's agenda to gain a bipartisan agreement. Our current government shutdown is reflective to a large degree of the gerrymandered "safe" congressional districts where the primary election process took the general party leadership by surprise. Is it a failure of leadership? Sure, but there has to be an audience inclined to be led by, rather than be in opposition to, its own party.

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While it is my sincere hope that the budget and debt ceiling is resolved by the time you are reading this, the resolution, if it occurs, is more likely to be another kick of the can down the proverbial road than a sensible solution that has at its core our collective long term best interests. While previous newsletter articles have framed the issues, it makes some sense to define them in the context of the respective branches of government.

The President and his party have known, from the moment that he was successful in having the Affordable Health Care Act legislation passed, that the opposition intended to continue the fight to mute it if not outright repeal it through the funding mechanism of the legislative process. Given the current state of chaos, let's review the respective authority of each branch. Approximately 85% of our government expenditures are not discretionary but rather already codified in legislation with respect to amount. The balance of expenditures are discretionary. The current battle is not a fight over discretionary spending. The President is traditionally responsible for framing the budget with respect to program and priorities that are then legislated. There is no more obvious budget program than the Affordable Health Care Act, now described by most as Obamacare. The President proposed the concept, the legislature codified it and the Supreme Court even weighed in. End of argument? Not quite. The Senate's responsibility is to propose and pass a budget which then goes to the House for its input and approval. If the two bodies differ with respect to their budgets, each party appoints conferees and the two budgets are reported to a conference committee for hashing out the outcome. This process has traditionally worked, but for at least the last five years the leadership of both parties have been unable to engage in it.

The President's perspective is simple. He campaigned on the concept of universal health care and was elected twice as a result. The legislation was passed and the Supreme Court affirmed that the universal requirements of the act were constitutional. As you can imagine, the President's political party agrees with him and the Democratically controlled Senate does as well. The House, controlled by the Republicans, feel that they had no input in the legislation and are using their budget funding responsibility to try to defund and delay the implementation of the legislation. Approval ratings of Congress are now below 10% and many citizens, regardless of affiliation, are frustrated with the impasse and, thus, the strategy is risky. From the perspective of conservatives their strategy is based upon the very strong belief that the health care act is harmful to the economy, the current budget, as well as current and future deficits and they feel obligated to take extreme measures to gain some control over the future condition of our fiscal house.

Sequester, you will recall, was the result of both party's unwillingness to compromise on a budget or debt ceiling four years ago during the depths of the recession and initial recovery stage. The appointed super committee was unable to reach a compromise and thus sequester, which directed cuts to the discretionary portion of our budget, took effect in early 2013. There are many that confuse the issues of budget deficits, debt and debt limit. The deficit is the amount by which spending in any budget year exceeds revenues in that year. The total of these annual deficits over the course of our history is our debt. The debt limit is the legal ceiling on how much total debt the government can issue. This setting of our legal debt limit was enacted after World War One and since that time we have raised the limit forty two times. Most don't realize that the debt limit includes amounts one part of the government lends from another like treasury securities issued to federal trust funds like Social Security. In essence, our debt is simply what we borrow to pay for legislation that we have already passed. Most industrialized nations do not have a debt limit; rather, they let the financial markets price their debt securities on the basis of the country's ability to pay future maturities. The use of a debt limit is far less effective than accepting fundamental responsibility for the financial impact of the legislation that is passed. Everyone knows that we have made too many promises for the future and that longer term we cannot sustain the gap between the social contracts we have made and the tax revenue we take in. The largest portion of that gap is in Medicare and Social Security. Fundamental reform in those areas is required; however, arbitrary use of debt ceiling and current budget year deficit is disingenuous and, from a default basis, very dangerous. Spending time talking about the impact of default should in a rational sense not be necessary, because one would assume that neither party wants to grab that third rail and, thus, we will hope that the political brinksmanship currently being played out will give way to a sense of urgency to negotiate the debt ceiling increase necessary to meet our obligations.

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As many have argued, a sound goal for long term fiscal responsibility would be to stabilize our debt, particularly the debt held by the public as a 3% share of GDP, and eliminate the artificial dollar amount currently used. To do the above both parties will need to create legislation that most will find objectionable. As I have offered previously, the more that the objection is widespread across both extremes of the political spectrum the closer we will be to a solution set that matters.

Michael F. Odar, CFA
President

The Question Why

The Greenleaf Trust Executive Leadership Team (ELT) recently spent two days off site together at our 2013 ELT Advance. During that dedicated time together, we worked on strategic initiatives, addressed corporate opportunities, discussed our Key Performance Indicators (KPI's) with members from our Board of Directors, and reviewed the "Why" of Greenleaf Trust. Our work with Why has its roots in a concept called The Golden Circle developed by Simon Sinek in his 2009 book *Start With Why*.

In the book and through the concept of The Golden Circle, Mr. Sinek, an advertising executive by training, reasons too many businesses focus on what they do rather than why they do what they do. What they do is the result of actions taken and is essentially everything tangible an organization says or does. Why they do what they do is the single purpose, cause or belief that serves as the unifying, driving and inspiring force for any organization. For an organization, the Why inspires the products, services, marketing, culture, hiring profile and partnerships the organization makes or performs. Therefore, the Why should be the starting point.

From an advertising perspective, Mr. Sinek reasons that people don't buy what you do; they buy why you do it. And, that people do business with people who believe what they believe. What you do is proof of what you believe.

"… people do business with people who believe what they believe. What you do is proof of what you believe."

We spend purposeful time talking about our Why not as a strategic way to advertise, but instead because it is the guiding force of our organization. It is the reason behind our Client Centric Team service model that includes a Wealth Management Advisor, Trust Relationship Officer, and a Team Service Coordinator for every personal trust client. It is the reason we don't have proprietary products to sell or accept any soft dollar remuneration offers. It is the reason we do all of our research in-house with a team of research analysts, all of whom have their Chartered Financial Analyst (CFA) designation. It is the reason behind providing clients with one simple up-front fee for service without a bunch of hidden or a la carte fees. It is the reason behind having accountants and attorneys on staff, but not completing client tax returns or writing their estate plans. It is the reason behind our comprehensive hiring process that includes multiple interviews and behavioral profiling tools. It is the reason behind not offering a Greenleaf Trust mutual fund to corporate retirement plan clients. It is the reason behind a philosophy driven budget that puts the clients first, employees second, and shareholders last. It is the reason behind our unwavering commitment to fiduciary excellence – the highest standards of integrity and trust. It is the reason behind being honest and honorable in everything we do.

You can watch the video on our website or ask our Chairman. The reason Why William Johnston started Greenleaf Trust was simply as a better way to serve clients. And, that is the guiding force that drives all of the above and helps our clients concentrate on life.

Definition of "Spouse" and "Marriage" in Employee Benefit Plans

Kathleen J. Waldron, QKA
Vice President
Senior Plan Manager

The US Department of Labor (DOL) recently announced new guidance that same-sex couples legally married in a jurisdiction that recognized their marriage will be treated as married for purposes of the Employee Retirement Income Security Act of 1974 (ERISA). The move comes after the Supreme Court of the United States ruling, in United States v. Windsor, that section 3 of the Defense of Marriage Act (DOMA) is unconstitutional. Section 3 provides that, in any Federal statute, the term "marriage" means a legal union between one man and one woman as husband and wife, and that "spouse" refers only to a person of the opposite sex who is a husband or a wife. The terms "spouse" and "marriage" appear in numerous provisions of title I of ERISA and the Department's regulations.

Same gender marriage is a component of federal law and ERISA plans are governed by federal law. The DOL's announcement in Technical Release 2013-04 coincides with the Internal Revenue Service (IRS) ruling from August, 2013, which states that any same-sex marriage legally entered into in one of the 50 states, the District of Columbia, a US territory, or a foreign country will be recognized. Like the IRS ruling, the release does not extend recognition to registered domestic partnerships, civil unions or similar formal relationships recognized under state law. The release appears to be effective immediately although future guidance may offer some transitional relief to employers. In fact, Secretary of Labor Thomas E. Perez said "The department plans to issue additional guidance in the coming months as we continue to consult with the Department of Justice and other federal agencies to implement the decision." In addition, the Department's Employee Benefits Security Administration (EBSA) intends to issue future guidance addressing specific provisions of ERISA and its regulations.

Some of the areas affected for qualified retirement plans include the following:

- Automatic spousal survivor benefits
- Qualified joint and survivor annuity and pre-retirement annuity rules
- Spouse's right to roll death benefits over to an IRA
- Qualified domestic relations orders
- Delay in commencement of required minimum distributions (RMD's)and extended period for RMD's

Employers should consider this guidance and any changes to systems or processes and other matters to reflect the new rule. Greenleaf Trust remains committed to stay abreast of current and future guidance and will communicate such information to our clients.

Dave P. Mange, CFA
Vice President
Senior Research Analyst

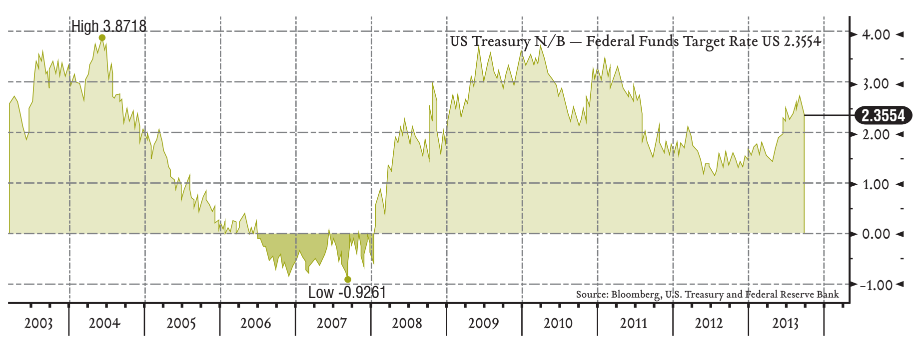
Does the History of Fed Funds Rate Increases Foreshadow the Treasury Yield Curve?

"… I recently wondered if there was a useful trend in looking at how the US Treasury yield curve interacts with the Fed Funds rate."

There are two human endeavors that lend themselves to voluminous statistical analysis. One is the bond market. Yet the bond market almost pales in comparison to the most statistically analyzed aspect of human behavior, Major League baseball. The human mind has a lot of information to process in the course of a day, let alone a lifetime, so it is typically looking for shortcuts and rules of thumb. Some useful examples might include the calculation that snarling aggressive dogs are not happy with your proximity and that ripe bananas are more often yellow than green. The list of useless and inaccurate maxims is much longer but that does not stop data miners from drawing conclusions.

Never one to pass up a good predictive rule, I recently wondered if there was a useful trend in looking at how the US Treasury yield curve interacts with the Fed Funds rate. Since the conventional wisdom holds that the Federal Reserve Bank will gradually raise the Fed Funds rate beginning in 2015, it would be helpful to know if investors should expect some correlation in how the Treasury bond yield curve will behave in reaction.

Searching for this data literally and graphically demonstrates why the bond market is so uncertain of how to price fixed income assets while large scale changes in Federal Reserve policy are expected. The graph below shows the yield spread between the benchmark ten year Treasury bond yield and the Fed Funds rate. It does NOT show the actual Fed Funds rate. The caption below the graph summarizes this data. It would seem logical that Treasury bond yields would be priced at



SPREAD SUMMARY
Last: 2.3554 • Mean: 1.7765 • Off Avg: 0.5789
Median: 1.916 • StDev: 1.2859 • StDev from Mean: 0.4502 • Percentile: 61.7054 • High 06/14/04: 3.8718 • Low 09/10/07: -0.9261

some reasonably consistent rate higher than the Fed Funds rate, but as we can see, this has not been the case during the beginning of the twenty-first century.

The Federal Reserve cut the Fed Funds rate to 1% in the aftermath of the September 2001 terrorist attacks to provide liquidity to the economy. The stock market closed for several days and the economy was already in a recession. That 1% rate stayed in effect until mid-2004, when the Fed quickly began stepping the rate up to 5.25% by July 2006. While the Fed was furiously raising rates (perhaps realizing that it had left them too low too long) the benchmark Treasury yield barely moved.

One inference that might be drawn is that the Fed is usually playing catch up and over correcting while the bond market is a better indicator of long term trends in both inflation and economic growth.

I would hesitate to offer any opinion of the proper level of the benchmark ten year maturity Treasury bond based on the information presented in this chart. There is probably a simpler metric that makes intuitive sense as well, but I will conclude this piece by suggesting that it too could be quite misleading.

In both educational seminar presentations and in private client discussions we have pointed out that the long term level of the ten year maturity Treasury bond is from 2% to 2.5% over the rate of consumer price inflation. Of course, as we show this chart going back more than 60 years, the variance can be high at any given point, but interest rates tend to revert to that mean. This makes intuitive sense, since investors would typically demand a "real" inflation adjusted return on investment. This rule of thumb might suggest that the benchmark Treasury yield should be in the neighborhood of 4% rather than the 2.65% yield currently in place. Of course, as yields rise, bond prices fall and the converse, so moving yields up would be bad for the bond market.

Such yields may well occur by 2016 if the Fed stops buying bonds and the economy recovers to the Fed's employment and inflation targets. Yet, intermediate term bond yields do not reflexively have to rise. We have seen that the last decade of history suggests that the yield curve is not tied to the Fed Funds rate. It may be the changing demographics and slower economic growth in the developed world has led to a global surplus of debt capital that could keep interest rates lower than we expect for decades. That would be good news for bond holders and bad news for those looking to put fresh cash to work to generate investment income.

"I would hesitate to offer any opinion of the proper level of the benchmark ten year maturity Treasury bond based on the information presented in this chart. There is probably a simpler metric..."

James R. Curry, CFP®
Senior Wealth Management Advisor

“You have probably heard of Alpha and Beta as measures of effective portfolio management; however, you may not have heard of… Gamma.”

A Focus on Your Goals

Gamma — The Newest Addition to the Greek Alphabet of Financial Planning

You have probably heard of Alpha and Beta as measures of effective portfolio management; however, you may not have heard of or focused any attention on Gamma. Gamma is a measure recently developed by Morningstar® researchers in an attempt to quantify the additional expected retirement income achieved by an individual investor from making more intelligent financial planning decisions. They specifically focus on investors making intelligent financial decisions during retirement. There are specific risks that are unique to retirement planning that are not of concern to investors in the accumulation phase of their financial QWXCI0 planning strategy. The researchers' study indicates that more intelligent planning can increase an investor's annual, long-term return by nearly 2%.

Defining the Components of Gamma

The five components of Gamma as identified by the Morningstar® researchers are:

- Total Wealth Asset Allocation – Using human capital in conjunction with the market portfolio to determine the optimal equity allocation. The asset allocation should be based on a combination of risk preference and risk capacity with more weight given to risk capacity. Risk capacity is determined by an investor's total wealth, human capital and financial capital.
- Annuity Allocation – Outliving one's savings is perhaps the greatest risk for retirees. The contribution of an annuity or annuity like arrangement within a total portfolio framework should be considered.
- Dynamic Withdrawal Strategy – Determining the annual withdrawal amount annually based on the ongoing likelihood of portfolio survivability and mortality experience.
- Liability Relative Optimization – Incorporating the liability into the portfolio optimization process in order to build portfolios that can better hedge the risk faced by a retiree.
- Asset Location and Withdrawal Sourcing – Tax efficient investing for a retiree including asset location strategies and withdrawal sequencing from accounts that differ in tax status.

Why is Gamma Important to Investors

It is a measure of the value of financial planning and not solely portfolio management. For each investor the components of Gamma may be more or less important depending on their ultimate goals. Developing a consistent thought process for financial planning and portfolio management is vitally important to our clients' ability to achieve their goals. We are not implying that the prudent management of your portfolio is not important; we are suggesting that structuring the portfolio to meet your goals and achieving your goals in an intelligent manner is the most important element of our financial planning process. The researchers state this theory as, "While a financial advisor may have failed from a pure alpha perspective, the underlying goal was accomplished. This is akin to losing a battle but winning a war."

We have always focused on providing our clients with customized solutions in order to assist them in achieving their goals. In order to accomplish the goal(s), the Gamma components that Greenleaf Trust provides may extend beyond those listed to also include risk management, estate planning, tax planning, and specific goals based advice for unique circumstances. Many of the components will also require the expertise of trained professionals who are on your advisory team, your attorney, CPA, etc.

We agree with the Morningstar® researchers that intelligent financial planning decisions are extremely important factors in meeting our clients' goals and objectives. Gamma is a tool to assist in viewing the value of the management of your entire financial picture and not solely the value of the asset management. The value of service and goals-based wealth management in conjunction with intelligent portfolio design is nearly impossible to quantify, however, is important to employ in order to assist clients in meeting their goals. We continue to look forward to adding positive Gamma-equivalent alpha to your financial lives and thank you for the opportunity.

"Developing a consistent thought process for financial planning and portfolio management is vitally important to our clients' ability to achieve their goals."

Mary C. Gergely, JD
Trust Relationship Officer

Should the Pease Limitation Affect Your Planning?

We all remember the fiscal cliff of 2012 and the American Taxpayer Relief Act that was passed earlier this year. This legislation returned what has been dubbed the "Pease Limitation" on itemized deductions. This is also referred to as a "phase-out" of itemized deductions. Named after the provision's author, former Rep. Donald Pease (D-Ohio), the Pease Limitation was originally enacted in 1991. The reintroduction of the Limitation raised the threshold amount of adjusted gross income earners that would be affected. For the year 2013, taxpayers with adjusted gross income above the following thresholds are subject to the Limitation: $250,000 for individual filers, $275,000 for heads of households, $300,000 for married couples filing jointly, and $150,000 for married filing separate. In essence, the Limitation reduces the amount of itemized deductions by the lesser of either 80% of the total value of the taxpayer's itemized deductions or 3% of the amount by which the taxpayer's income exceeds the threshold amount.

"... the American Taxpayer Relief Act that was passed earlier this year... returned what has been dubbed the "Pease Limitation" on itemized deductions."

All itemized deductions are affected by the Pease Limitation except for medical expense deductions, the investment interest deduction, casualty theft, or gambling loss deductions. These deductions, however, tend to be less common or difficult to obtain. For example, deductions for medical expenses only apply to qualified medical expenses over 10% of an individual's adjusted gross income in 2013.

Some common deductions that are included under the Pease Limitation are:

- Charitable Contributions
- Mortgage Interest
- State, Local, and Property Taxes

To see how the Limitation actually works, consider the following example:

In 2013, a married couple has an AGI of $500,000. The applicable amount for a married couple filing jointly is $300,000. The couple's itemized deductions equal $45,000 as follows:

- Mortgage Interest Deduction-$5,000
- Property Tax Deduction-$5,000
- State Income Tax Deduction-$20,000
- Charitable Deduction-$15,000

To determine the actual amount of the Limitation in this example, we would first need to calculate 3% of the amount above the adjusted gross income threshold

($500,000 - $300,000 = $200,000 x 3% = $6,000). Secondly, we would then compare this amount with 80% of the entire amount of the couple's deductions (80% x $45,000 = $36,000). The couple's itemized deductions for 2013 would be reduced by the lesser of the two results. As such, the couple's itemized deductions would be reduced by $6,000 using the first calculation since this is the lesser of the results. It should be noted that the second calculation is a rare occurrence.

An optimistic view for those impacted by Pease and who wish to increase their charitable contributions in 2013, is that while the marginal tax rate has increased on ordinary income from 35% in 2012 to 39.6% in 2013 for high income earners ($400,000 for single taxpayers and $450,000 for married couples), the Pease Limitation is not increased by the amount of deductions. In other words, while each dollar of income would be taxed at a higher marginal rate with a reduction of itemized deductions, the value of the "deductible amount" of each dollar would not be reduced by more itemized deductions but rather remain the same.

For those affected by the Pease Limitation, the following planning suggestions may be helpful:

- Lower "above the line income" through contributions to retirement plans or health savings accounts in order to reduce your adjusted gross income.
- You can also reduce adjusted gross income with "above the line deductions" which include: losses on the sale of property, alimony payments and educational expenses.

Your Client Centric Team is available to review the Pease Limitation with you and to coordinate a conference with your trusted legal and tax advisors to discuss these and other planning suggestions.

"The reintroduction of the Limitation raised the threshold amount of adjusted gross income earners that would be affected."

If you'd like to join us in our efforts to conserve natural resources and create a greener environment, you may choose to save paper by receiving email notifications to view your statement online.
Simply give us a call at 269.388.9800 and ask to speak with a member of your client centric team.

Stock Market Pulse

Index	9/30/13	Total Return Since 12/31/2012
S&P 1500	391.02	20.39%
DJIA	15,129.67	17.67%
NASDAQ	3,771.48	26.12%
S&P 500	1,681.55	19.79%
S&P 400	1,243.85	23.23%
S&P 600	607.76	28.66%
NYSE Composite	9,621.25	13.95%
Dow Jones Utilities	482.29	9.69%
Barclays Aggregate Bond	107.20	-2.00%

P/E Multiples	9/30/13
S&P 1500	15.6x
DJIA	13.9x
NASDAQ	18.4x
S&P 500	15.2x
S&P 400	19.4x
S&P 600	20.7x

Key Rates

Fed Funds Rate	0% to 0.25%
Tbill 90 Days	0.02%
T Bond 30 Yr	3.69%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	391.02	15.6x	2.04%
S&P 500	1,681.55	15.2x	2.13%
DJIA	15,129.67	13.9x	2.39%
Dow Jones Utilities	482.29	NA	4.06%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.65%

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