GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

SEPTEMBER 2014 VOLUME 23, ISSUE 9

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Chairman, Greenleaf Trust

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Economic and Market Commentary

Revision estimates for 2nd quarter GDP growth released last week were higher than expected. Real gross domestic product increased 4.0% at an annual rate in Q2 after posting a revised negative 2.1% result in Q1 of 2014. The positive increase in the second quarter was due to inventory investment, growth in exports, improved consumer spending, acceleration of non-residential fixed investment and flat state and local government spending. Remember that for several quarters the reduction in state and local government spending had been a negative for GDP results; so, while not contributing as a positive indicator the category was not a drag in Q2. Durable as well as non-durable goods increased, as did factory orders and automobile output. Energy usage declined and, therefore, was a detractor from GDP growth during the period. Is the growth rate estimate for Q2 sustainable for the remainder of 2014, and will we see a growth rate higher than 3% for the full year? The negative 2.1% result for Q1 makes that scenario unlikely, yet the consensus is certainly north of 2.5% for the full year and brightening up a bit above 3.0% for 2015. In essence, the economy is likely to act and feel more like a 3% growth rate as we move towards year end. If this is the case, are the deficit hawks correct that the Fed must become more aggressive on interest rates? Again, we think not, and the following data points are why we come to that conclusion.

Prices of goods and services purchased by US consumers increased at 1.9% on an annualized basis in the second quarter, following a 1.4% annualized growth rate in Q1. When we exclude food and energy from the calculation, prices rose at a rate of 1.7% which is well below the Fed target of 2.5%. Consumers also benefited by an improvement in real disposable income DPI (adjusted for inflation) which grew 3.8% during Q2, following a 3.1% growth rate in Q1. This growth contributed to the personal savings rate, which advanced to 5.3% from an annualized rate of 4.9% in the first quarter. Clearly, the Fed remains on the side of fighting deflation and not inflation. While the economic data is improving, we remain in the 3% growth arena with slightly improving employment and wage data and consistently low inflation. It is good to have a mix of deficit hawks as well as growth enablers on the open markets committee of the Fed. On balance, their strategy to first slow quantitative easing and then to sequentially reduce and ultimately stop the

Commentary, continued

flow of liquidity to banks seems to be working very well.

We will have an employment rate report released this Friday, and if the preliminary payroll service data is spot on we should see another 200,000 plus jobs created for the period, and the rate of unemployment should settle in at 6.1% to 6.2% This reporting period is always a bit more volatile, as many employed college students leave the workforce as they return to school. Hours worked for those employed increased by 0.1, as did average hourly wages earned and, as expected, the cost of employment rose modestly while productivity and capacity utilization both earned slight gains in the month. The revisions to the estimates were positive and reflected more incremental progress. U-6 unemployment data echoed the incremental improvement in the overall economy but remains stuck at the 12.1% level, which adds to the angst felt in this recovery by those at the lowest levels of employment. For this group of the unemployed the recovery is not robust enough and the pace of improvement far too weak.

"There was some intriguing data released from the Congressional Budget Office last week that revealed a substantial revision to estimates on longer term Medicare budget projections."

There was some intriguing data released from the Congressional Budget Office last week that revealed a substantial revision to estimates on longer term Medicare budget projections. Recall that entitlement programs, as currently structured, are unsustainable and that many projections had the total federal budget consumed by basic entitlements by the year 2045. It appears the metrics are changing and by a sizable amount. Is it sustainable and are we certain why the numbers are revealing such a positive trend? No, we presently don't have the answers to either question, but the current data is worth examining. In 2010, the year that the Affordable Health Care Act was put into law, the CBO forecasted that by 2019 we would spend $12,700 annually to care for each person in Medicare. They have now revised that to $11,300 in 2014 dollars. On the surface alone that 11% reduction is significant, but when you multiply it by the estimated sixty two million people who will be in the system the number is an astounding ninety five billion dollars. Does this mean that our future federal budget deficit is less than we were led to believe? Perhaps, but much more needs to be learned before we reach that conclusion. What we do know is that we have the lowest healthcare inflation data in over two decades. The sequester act that slashed Medicare payments to healthcare providers is real, and causing much pain in those institutions as they drive costs out of their systems while simultaneously improving quality outcomes. We know that individuals, through employer plans as well as individual plans, are being forced to be better consumers about what they buy with respect to health services, products and pharmaceuticals. We may be witnessing the beginnings of a stabilization of national spending on healthcare. To be certain many will have differing interpretation of the data and it is early in the process to draw meaningful conclusions and, thus, we will frame it as noteworthy and well worth additional examination.

It is our experience that when market statistics are reported in aggregate rather than relative numbers, misunderstanding results, fear is escalated and knowledge is impaired. If we read that the Dow Jones Industrial Average is in excess of 17,000 and or the S&P 500 stands in advance of 2000, what useful information do we have? Absent of any other data we have no ability to form any conclusion about those numbers, yet almost on a daily basis you will read or hear about those aggregate numbers in isolation, with the clear implication that a bubble is about to burst and investors should run for the hills. For all of the years that we have been advising clients, we have repeatedly stated that valuations matter and multiple valuations matter even more. In 1987, the most significant crash after the Great Depression and prior to the Great Recession of 2008 occurred, when the Dow, which stood at 2246, plunged 26% in one day to close at 1738. It took two years for the Dow Jones Average to recover to its opening level on that day.

There were several reasons for the crash, among those was legislation making its way through Congress eliminating tax deduction of interest for firms that borrowed money to take over other companies. Valuations of emerging technology companies were high, and computer trading programs triggered massive sell and buy programs. In the end, many reasons were given for the sell-off, but in the main it was about the valuation of stocks as risk assets vs. the yield on risk-less assets such as treasuries. Some reports in the media concentrate on the aggregate number of the Dow Industrial Average and the S&P 500 Index without any relative data on the size of the economy, sales, earnings, book value of assets and shares outstanding of the companies within the index. In 1987, the size of the US economy was $4.8 Trillion which was about 40% of a global economy of nearly $12.0 Trillion. Today our US economy is measured at nearly $17.0 Trillion and the global economy is calculated at around $37.0 Trillion. We know that the average export rate of US companies is approximately 46% of their gross revenues, and that most of the corporations in the major indexes are now participating in a global economy that is three times as large as the global economy of 1987.

> "It is our experience that when market statistics are reported in aggregate rather than relative numbers, misunderstanding results..."

During this same historical time frame we have seen consistent buy backs of shares of large companies, as well as the consolidation of many industries. The book value of the assets of the companies within the indexes has grown more than tenfold as a result of this consolidation. When we look at the markets we ask ourselves a fairly consistent set of questions that all center on valuations. What are the aggregate sales, gross margins, earnings and book values of the companies within the major indexes? With that knowledge, we can match our economic forecasts to the future landscape of economic activity and come to some conclusion about the ability of those companies to sustain or improve on their performance. With that awareness we can clearly see what investors are paying currently to own those baskets of assets

Commentary, continued

and evaluate that price level versus historical data. Is the current price being paid to own stocks high relative to historical norms, or is it justified based upon present valuation metrics? Lastly, we examine those risks to earnings assumptions such as interest rates, probabilities of global recessions, and geopolitical destabilization. Currently investors are paying about 15.3 times the next twelve months earnings per share forecast for the S&P 500 basket of stocks. This is 4% below the last 15 year average of 16.1 and well below the 26.7 peaks of 1987, 2000 and 2007. As you can see, the aggregate number on the Dow at 18,000, or the 2000 level of the S&P 500, tells us nothing about the future of the market direction. For that assessment we need to examine the underlying valuations of the assets being bought or sold. Currently, those assets are neither cheaply or richly valued and the risks to their future value are consistent with the risks of the last six years — which are trading partner recessions, drastic interest rate movements and domestic or geopolitical catastrophic events.

“The geopolitical situation is messy right now, and some would argue more destabilized than ever.”

The geopolitical situation is messy right now, and some would argue more destabilized than ever. The two central targets that are being focused on by the media are ISIS and the Ukraine. One is easier than the other, and is likely to be resolved sooner, so let’s stick with the Ukraine. Does anyone remember the Cuban Missile Crisis? I was in 10th grade and had a really good history teacher who explained the US sphere of influence and our right to it memorialized in the Monroe Doctrine. This argument was the basis for our blockade of Cuba and our insistence that Russia pull back from our hemisphere, which after much tension they did. Western Ukraine is more Russian than not. They speak Russian, and for the most part feel Russian. The rebels have been pressing the issue of separatism from Ukraine and insisting on a referendum vote to become a part of Russia. The issue is further inflamed by the Ukraine government’s desire to become a part of NATO and the European Union. Neither is likely to occur but both are a huge slap in the face to Putin and Russia in general. In essence this is Russia’s Monroe Doctrine. Putin is saying to the US and the West in general, “This is our sphere of influence and you are not welcome or needed, nor do you have any legitimacy of authority. This is for the people of Ukraine to figure out, even if they do so under the heavy hand of Russia.” The Ukraine government is not strong enough to win this fight, and a political solution will be the answer in the end. To be certain this struggle has a great deal to do with sovereignty, spheres of influence, language, culture and historical perspectives. This is not an issue that will be won by hanging on to previously described but historically fluent borders, and there is a great deal about our own history of claiming the right of sphere of hemispherical influence that suggests we should not escalate our involvement. Even when what we see on the news or read in the papers is uncomfortable.

How Was Your Summer?

Michael F. Odar, CFA
President

I hope everyone had an enjoyable summer and that you were fortunate enough to spend time in the great state of Michigan over the last three months. Summer is remarkable in Michigan — so much so that I know many of us try not to leave the state and actually play host to many visitors during that time. And at those gatherings during this time of year, it often seems a common opening conversation question is "How was your summer?" That one always catches me off guard. It's a struggle because I know the intent is to really find out what you did during the summer. I want to share as much as possible, however I often fall victim to what I call "The Recency Effect" — I'm able to quickly and accurately recount what happened over the last month of summer but that's about it on short notice.

So, do you want to know how summer went at Greenleaf Trust? Here's a little of what happened — or at least what happened over the last month.

We continue to expand our team and grow our presence in northern Michigan. Lauree VanderVeen has been a Trust Officer with Greenleaf Trust in our Kalamazoo office since 2008. At the beginning of 2009, John Welch joined our team as a Senior Vice President and Business Development Officer located in Traverse City. The two have worked closely together ever since. With the help of our strategic partner The Bank of Northern Michigan, John has been building our brand and introducing new clients to Greenleaf Trust in northern Michigan with great success. Lauree is the Trust Relationship Officer for many of those clients and has built deep relationships with them. In August, Lauree decided to move to Traverse City to be closer to the majority of her clients and help John continue to grow our presence in northern Michigan.

We continue to grow our presence in southeast Michigan. This August, we held our first annual Clambake in southeast Michigan at the Orchard Lake Country Club. The weather, venue, food, and company combined for a memorable event. Similar to events held in northern Michigan and the one earlier in the month in Kalamazoo, the clambake provided a fun and relaxed environment for Greenleaf Trust teammates, board members, clients, prospective clients, and friends to spend time together. We also had our Board of Directors meeting for the first time in our Birmingham office earlier that day.

We continue to be recognized for our unique culture. We received the news in August that we had been recognized as one of Metropolitan Detroit's 101 Best and Brightest Companies to Work For in 2014. This is the second year in a row Greenleaf Trust has won this award and we are extremely proud because it represents our commitment to a highly engaged workforce for our clients.

"We received the news in August that we had been recognized as one of Metropolitan Detroit's 101 Best and Brightest Companies to Work For in 2014."

Summer went by fast, but I am looking forward to this fall and all that we have going on.

Daniel C. Haines
Fixed Income Analyst

Fixed Income Four Point Test

As part of our focus on continuous improvement, we have amended our Four Point Test, used to analyze individual fixed income securities. These refinements align our processes to match our views of the salient risks in fixed income markets. These criteria are applied both in pre-purchase analysis and in ongoing monitoring of client portfolios. Overall risk tolerance is managed through the construction of the portfolio. These criteria ensure that the specific securities held are appropriate for each portfolio. The Four Points of the test are as follows: Credit Risk, Security Features, Liquidity and Valuation.

Expanding on the first point of the test, let's explore Credit Risk. Credit Risk is the risk that the debt issuer will be unable or unwilling to pay the interest or principal payments due. When we are examining credit risk, we consider both quantitative and qualitative factors. The analysis of credit quality differs depending on the type of issuer.

For corporate bonds, assessing Credit Risk is based on evaluating business factors and financial factors. In examining business quality of a company, we review the state of the industry, the company's competitive position, the operating history and the management team and its strategy. We prefer companies with a sustainable competitive advantage and a history of strong execution. In analyzing financial quality we look at a company's cash flow generation, capital structure, ability to cover payments, liquidity and financial policy. We prefer companies that generate stable cash flow, have a reasonable amount of leverage and have a history of treating bondholders well.

For municipal bonds, we assess Credit Risk by focusing on financial factors, economic demographic factors and the obligor structure. When analyzing an issuer's finances, we consider available reserves, historical budgetary performance, the sustainability and flexibility of revenue generation, current and historical leverage including retirement obligations, and collateral or escrowed assets. Economic demographic factors we examine include current and historical wealth demographics, revenue and expense dynamics, and the potential volatility of demographics. We also examine obligor structure factors such as an issuer's political risks, the predictability of their budgetary process and the propensity of the obligor to default.

Once we are satisfied with an issuer's Credit Risk, we move on to analyzing specific Security Features. Unlike common stock, where there is often only one type

The Four Points:

1. Credit Risk –
   The risk that the debt issuer will not pay the interest or principal payments when due.
2. Security Features –
   Bonds from the same issuer can vary widely. Understanding these differences helps understand how the bond may perform in different market environments.
3. Liquidity –
   The ease with which an asset can be bought or sold without affecting its price.
4. Valuation –
   Yields compared to bonds in the same industry and bonds with similar risks.

of stock issued by each company, bonds from the same issuer can vary widely. These features include its position in the issuer's capital structure (secured vs. unsecured), any specific revenues or assets backing the security (collateral), the use of proceeds from the debt, covenants, embedded options such as puts or calls, and the coupon structure (e.g., floating or step-up). Obtaining a deep understanding of these Security Features enables us to understand how the investment may perform in different market environments.

The third point we consider is the Liquidity of the asset. Liquidity is the ease with which an asset can be bought or sold without affecting its price. In analyzing liquidity, the factors we consider include credit quality, issue size, the issuer's debt outstanding, trading volume, the asset class and the minimum tradable piece size. An example of an asset with strong liquidity is a US Treasury Note. These securities are backed by the US Government and are heavily traded. The appropriate price for various US Treasuries Notes is widely known to participants as this pricing information is readily available. Corporate and municipal bonds are less liquid than US Treasuries. They have wider bid-ask spreads (the price the market is willing to buy from and sell to you at) because, in general, they have more credit risk, trade less frequently and because pricing information is not as transparent. Within the corporate and municipal markets there is a range of liquidity levels for different assets.

Last, but not least, in our Four Point Test is an assessment of the valuation of the asset. We analyze valuation using both relative and absolute valuation metrics. In analyzing relative value, we compare bond yields and spreads (incremental yield over a benchmark such as Treasury bonds) to comparable bonds in the same industry and bonds with similar risks. We also focus on whether we are receiving adequate incremental yield over Treasury bonds for the additional risk we are taking, including default risk, spread risk, downgrade risk, liquidity risk, and tax risk. Other data points we consider are CDS (credit default swap) levels and implied default probabilities.

When buying individual bonds, the best outcome as an investor is to receive interest and principal payments as-scheduled. It is important that we are investing in high quality securities and are compensated for any risk we are taking. By using the Four Point Test, we ensure that we have assessed the salient risks and are holding the right securities for each account.

"By using the Four Point Test, we ensure that we have assessed the salient risks and are holding the right securities for each account."

Thomas I. Meyers, Esq., CTFA
Trust Relationship Officer

Grantor Trusts — Part 2

In the June 2014 newsletter we wrote about the characteristics and ramifications of a trust being classified as a "grantor trust."

To recap, generally a trust is treated as a separate entity for federal income tax purposes. However, when certain criteria specified in the Internal Revenue Code are met, the trust is disregarded as a separate taxable entity and is classified as a grantor trust.

The primary consequence of grantor trust treatment is that in computing the grantor's taxable income for the year, the income, deductions and tax credits of the trust that is treated as a grantor trust must be accounted for on the grantor's personal tax return. In other words, the grantor trust is not treated as a separate tax entity apart from the grantor. The grantor is treated as the owner for income tax purposes of the trust's assets and the trust's income.

It is important to note that grantor trust treatment is not elective. Once one of the following powers that cause grantor trust status has been triggered, the grantor trust rules apply. While not elective, it is possible to structure the terms of the trust in order to allow the grantor trust rules to be voluntarily triggered.

"… generally a trust is treated as a separate entity for federal income tax purposes. However, when certain criteria specified in the Internal Revenue Code are met, the trust is disregarded as a separate taxable entity and is classified as a grantor trust."

Powers or interests that cause a trust to be treated as a grantor trust:

1. *Trust income can be used to pay premiums on an insurance policy on the life of the grantor or of the grantor's spouse. IRC § 677(a)(3).*

   While this seems straightforward enough, as do a number of the other powers (and most of the Internal Revenue Code), the technical provision is a bit more complex. The grantor shall be treated as the owner of any portion of a trust whose income, (i) without the approval or consent of any adverse party is, or (ii) at the discretion of the grantor or a non-adverse party, or both, may be applied to the payment of premiums on policies of life insurance on the life of the grantor or the grantor's spouse. There is an exception where the policy is irrevocably pledged for a charitable purpose in accordance with IRC § 170(c). What does this mean? If the decision of whether or not to pay premiums with the trust income will be made solely by an adverse party, such a decision will not trigger the grantor trust rules.

   What does "adverse" and "non-adverse" mean? An adverse party is anyone who has an interest in the trust who would be disadvantaged or adversely affected by a decision to exercise or not exercise the relevant power (in this case, the power to use trust income to pay premiums). For example, a decision to pay premiums on a life

insurance policy would adversely affect a named income beneficiary who would have otherwise received a cash distribution. Likewise, the interest of a remainder beneficiary is adverse with regard to a power over trust corpus. However, the remainder beneficiary would not be adverse with regard to the use of trust income to pay life insurance premiums.

2. *The power to "spray" income among the trust beneficiaries is held by the grantor, the grantor's spouse, or by a majority of trustees who are related, or subordinate parties who are subservient to the wishes of the grantor. IRC § 674.*

   The power to spray income is the power to distribute such income unevenly among a group of eligible beneficiaries. Such power held by an independent trustee would not trigger grantor trust status per IRC § 674(c). Individuals considered to be related or subordinate to the grantor include the grantor's spouse if living with the grantor, the grantor's parents, siblings, descendants, employees of a corporation that the grantor holds voting control over, or a subordinate employee in a corporation in which the grantor is an executive.

3. *The power to add beneficiaries (except after-born or adopted children) unless held by an adverse party. IRC § 674.*

   As an example, this type of power could enable the holder to add the spouses of the grantor's descendants as additional beneficiaries, or to add a charitable organization as a beneficiary.

4. *The grantor retains the power to remove and replace the trustees, unless the grantor is restricted to appointing an "independent" successor trustee that is not related or subordinate to the grantor. IRC § 674.*

   This power will not cause adverse estate tax inclusion as long as the successor trustee cannot be the grantor, or a related or subordinate party who is subservient to the wishes of the grantor. Regs. § 1.674(d)-2(a).

5. *A power exercisable by the grantor or a non-adverse party enabling the grantor to borrow from the trust without adequate interest or security. There is an exception if the trust provides a general lending power to make loans to any person without adequate interest or security. IRC § 675(2).*

   In order to prevent estate tax inclusion, the trust should require adequate interest, but allow inadequate security. Caution: not

"It is important to note that grantor trust treatment is not elective. Once one of the... powers that cause grantor trust status has been triggered, the grantor trust rules apply."

Grantor Trusts, continued

requiring adequate interest could cause the value of the entire trust to be includable in the grantor's taxable estate.

6. *Actual borrowing by the grantor. IRC § 675(3).*
   The trust will be classified as a grantor trust for any tax year during which any portion of the trust has been loaned either directly or indirectly to the grantor, and any portion of the loan principal or interest remains unpaid for even one day. Grantor trust status will not be triggered, however, if the loan provides for adequate interest and adequate security, and is made by a trustee other than the grantor, the grantor's spouse, or a related or subordinated party who is subservient to the wishes of the grantor. Note that a loan to the grantor that requires neither adequate interest nor adequate security will cause the value of the trust to be includable in the grantor's taxable estate.

7. *A power exercisable by the grantor or a non-adverse party (and without the consent of an adverse party) enabling the grantor to reacquire trust assets by substituting assets of equivalent value. IRC § 675(4)(c).*
   If someone holds such power other than the grantor, grantor trust treatment is not triggered if such power is held in a fiduciary capacity. Therefore, the power should be given to someone other than the trustee. The IRS has ruled that this power does not cause estate tax inclusion.

8. *A power to pay trust income to the grantor's spouse exercised at the direction of a non-adverse party or without the consent of an adverse party. IRC § 677.*
   The trust may cease to be classified as a grantor trust upon divorce or the death of the grantor's spouse. In order to avoid potential estate tax inclusion, the trust should prohibit the trustee from making distributions that discharge the grantor's legal support obligations.

"These are technical, complicated and often confusing provisions, and we invite you to speak with your Trust Relationship Officer, attorney and tax advisor if you have any questions."

These are technical, complicated and often confusing provisions, and we invite you to speak with your Trust Relationship Officer, attorney and tax advisor if you have any questions. We are passionate about trust administration and always welcome the opportunity to speak with you!

What If 2008 Happens Again?

Josh D. Wheeler, CFA
Research Analyst

In 2008, the S&P 500 declined 38% over the year, excluding dividends. From its October 2007 high to its March 2009 low, it declined 58%. We all remember how it felt to live through that time. The environment was rife with uncertainty, and watching such a rapid decline in our wealth was gut wrenching. Many investors also experienced a decline of similar magnitude when the tech bubble burst in the early 2000s. Having lived through two of these massive downturns in the span of a decade, nobody wants to experience another one.

It's normal for the stock market to go through cycles and experience corrections periodically, and we certainly expect that to continue, but it's important to remember that stocks are just one tool within a broader portfolio. At Greenleaf, we set each client's equity allocation based on their need for capital growth, as determined by their long-term goals, balanced with their tolerance for volatility. We allocate to equities knowing there will be ups and downs along the way, but structure the portfolio such that it can withstand the volatility over the long term. Each portfolio is tailored to meet the client's unique circumstances and goals, and there are some situations where equities are not appropriate, such as when there are short-term cash needs.

As to when the next 2008 happens, if it ever happens again, we don't know. But with the market up almost 200% since its March 2009 low, it's fair to ask, are there other measures we can take, outside of standard asset allocation, to prepare for the next stock market crash? Below, I'll discuss the approaches available and how we feel about each.

Temporarily reduce equities materially, increasing cash or other non-equity assets.

One approach taken by some investors is to respond to sustained rallies in equities by "going to cash," or materially reducing their equity position and increasing bonds and/or cash. It's a tempting strategy, and may even seem conservative and prudent, akin to not getting greedy and knowing when to walk away. However, it is essentially market timing, and it is nearly impossible to execute effectively. As my colleague Nick Juhle wrote in his July 2013 Perspectives article "Winning the Race," market timing doesn't work because it requires the investor to get the timing right twice — getting out and going back in. Even if one is able to exit stocks right before the crash, will the investor have the foresight, and, more importantly, the confidence, to re-enter the stock market at the bottom, when uncertainty is highest?

> "It's normal for the stock market to go through cycles and experience corrections periodically, and we certainly expect that to continue…"

2008 again?, continued

"... with the market up almost 200% since its March 2009 low, it's fair to ask, are there other measures we can take, outside of standard asset allocation, to prepare for the next stock market crash?"

This doesn't mean we won't look to make adjustments to clients' asset allocation based on valuation metrics. Our periodic process of rebalancing naturally reduces assets that have become more expensive while increasing those that are cheaper. Beyond this, we can modestly reduce a client's equity exposure up to 5% relative to the target delineated in the client's Investment Policy Statement. This range allows freedom to respond to valuation changes in the market while still adhering to a plan that positions the client to reach his/her long-term goals. The difference, relative to going to cash, is that the focus is on valuation, not timing. Again, each client's unique plan outlines the equities allocation appropriate to reach that client's objective, taking into account that there will be periods of volatility. We stay disciplined in not deviating from a client's plan, which has allowed us to be consistently successful in helping clients achieve their goals.

Using options to hedge.

Another method is to use options to hedge against stock market declines. The problem with this approach is that, unless one is able to time it perfectly, it becomes prohibitively expensive. For example, a put option on the S&P 500 that would protect an investor from a decline greater than 10%, expiring June 30, 2015, currently carries an expense of 2.8%. Let's say an investor purchases that now, but the stock market continues to rise, or even stay flat, for the next year. The investor continues to roll the option over given continued fear of a sharp correction. The cost of the option would have a significantly negative impact on the portfolio over the long term. One could argue that the option would just be used at times of the most uncertainty or when a correction looks most likely, but then we come back to the timing point — it's nearly impossible to do. There are ways of structuring more complex put/call collars to be cost-free to the investor, but the amount of upside capped is typically unattractive relative to the downside protection.

Shift risky asset exposure to alternatives.

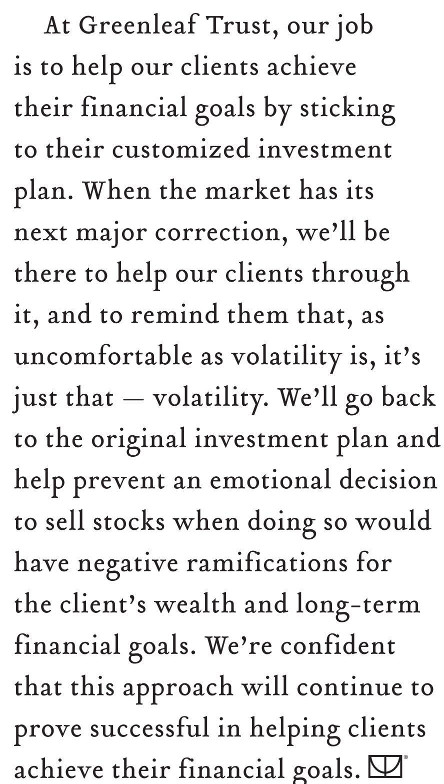
Another potential approach is to shift dollars out of stocks and into alternative assets, such as gold, commodities or hedge funds. At Greenleaf Trust, we do recommend the use of a select few alternative assets for a minority allocation in client portfolios — generally up to about 9% of total equities and alternatives. While this should modestly improve the volatility-adjusted returns of a portfolio, it won't make a meaningful difference to the overall portfolio in the event of a 30%+ decline in equities like we saw in 2008. Why don't we recommend a larger allocation?

Most alternatives will likely not deliver equity-like returns over the long run, so they don't make a good substitute for a larger portion of a client's equity exposure. In addition, our research shows that the popular alternatives that investors tend to gravitate towards when they are worried about a stock market crash, such as gold and commodities, have historically delivered poor returns, especially for their level of volatility.

What about hedge funds? Our research shows that certain hedge fund vehicles may make sense for some clients, although the same principle applies. They will generally offer returns below unhedged equities (but above fixed income), and therefore should not be viewed as a substitute for pure equity exposure.

What we recommend.

The best protection against the next downturn is the right frame of mind. While this might seem Pollyannaish, we think it's anything but. The great investors have always viewed risk not as volatility, but as permanent loss of capital. As volatile and as scary as the two downturns in 2002 and 2008 were, they only caused permanent loss of capital if one sold at the bottom. In fact, for investors that took the long view and held on through those downturns, returns on equities have ranged from decent to outstanding. The market has now returned an annualized 8.3%, including dividends, over a 10-year cycle ending August 26, 2014, which includes the massive 2008 downturn. This is only slightly below the long-term average that we use in our Monte Carlo modeling to determine equities allocation for client portfolios — not bad considering it encompasses the financial crisis and ensuing Great Recession.



At Greenleaf Trust, our job is to help our clients achieve their financial goals by sticking to their customized investment plan. When the market has its next major correction, we'll be there to help our clients through it, and to remind them that, as uncomfortable as volatility is, it's just that — volatility. We'll go back to the original investment plan and help prevent an emotional decision to sell stocks when doing so would have negative ramifications for the client's wealth and long-term financial goals. We're confident that this approach will continue to prove successful in helping clients achieve their financial goals.

"As volatile and as scary as the two downturns in 2002 and 2008 were, they only caused permanent loss of capital if one sold at the bottom."

Lorey L. Matties
Participant Services Coordinator

What Every Employee Should Ask About Their Retirement Plan

When it comes to knowing about and understanding their company's retirement plan, many employees are in the dark. They have little knowledge of the plan which often impacts their perception of this important benefit. Having a basic working knowledge of a retirement plan provides for better awareness, appreciation and participation with this significant benefit.

"Having a basic working knowledge of a retirement plan provides for better awareness, appreciation and participation with this significant benefit."

Following are 15 key questions that every employee should ask:

1. When can I join the plan?
2. Is there a maximum amount that I can personally save in the plan annually?
3. Does the plan allow me to make additional contributions when I'm age 50 or older?
4. Does the company "match" my contributions and if so, what is the match amount and when will it be deposited to my account?
5. Does the company make a "profit sharing" contribution and if so, what is the amount and when will it be deposited to my account?
6. Are employer contributions subject to a vesting schedule?
7. What are the investment options available to me?
8. What educational tools are available to help me with my investment strategy?
9. How often can changes be made to my contribution amount or to my investment options?
10. What kind of access do I have to my account?
11. How often will I get a statement of my account?
12. Can I transfer money from a previous employer's retirement plan or individual retirement account (IRA)?

13. How do I designate my beneficiary(ies)?
14. What happens to my money if I stop working for this company?
15. Who do I contact if I have questions about the plan?

According to the 2014 Retirement Confidence Survey (RCS), employees' confidence in having a financially comfortable retirement is strongly related to how informed they are about their company's retirement plan.

Encouraging the financial well-being of employees can also have positive results for the employer. Benefits education can demonstrate the company's concern for the security of its employees. This in turn can foster deeper employee engagement. It's found that companies with highly engaged employees experience 26% higher employee productivity, lower turnover risk and a boosted operating income of up to 19%.

At Greenleaf Trust, we believe that retirement education is a crucial employee benefit. Our Participant Services Coordinators are committed to providing your plan participants with the basic knowledge and understanding that is needed to help assure a financially secure retirement.

"... employees' confidence in having a financially comfortable retirement is strongly related to how informed they are about their company's retirement plan."

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	8/31/2014	Total Return Since 12/31/2013
S&P 1500	463.50	9.45%
DJIA	17,098.45	4.76%
NASDAQ	4,580.27	10.57%
S&P 500	2,003.37	9.89%
S&P 400	1,438.18	8.14%
S&P 600	671.88	1.74%
NYSE Composite	11,046.33	6.21%
Dow Jones Utilities	564.37	18.03%
Barclays Aggregate Bond	109.98	4.69%

P/E Multiples	8/31/2014
S&P 1500	17.1x
DJIA	14.9x
NASDAQ	21.5x
S&P 500	16.8x
S&P 400	19.9x
S&P 600	20.8x

Key Rates

Fed Funds Rate	0% to 0.25%
T Bill 90 Days	0.02%
T Bond 30 Yr	3.08%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	463.50	17.1x	1.92%
S&P 500	2,003.37	16.8x	1.99%
DJIA	17,098.45	14.9x	2.14%
Dow Jones Utilities	564.37	NA	3.49%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.17%

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