GREENLEAF TRUST

Perspectives

A Greenleaf Trust Newsletter

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William D. Johnston
Chairman, Greenleaf Trust

Economic Commentary

We attempted to defer our publishing deadline until the outcome of the 2020 presidential election was determined, but, as you can surmise, as of November 6th the outcome was not known. At this writing, President Trump has won 214 electoral college votes and must be declared the winner in Arizona, Georgia, Nevada, North Carolina and Pennsylvania to secure the necessary 270 electoral college votes required to win the presidency for his second term. Former Vice President Biden has won 253 electoral college votes, is leading in Arizona, Nevada, Georgia and Pennsylvania and must be declared the winner in only two of the states identified to reach the required electoral college requirement. On the surface it seems President Trump has a tougher, if not impossible, pathway to victory. Amplifying that challenge is the fact that all of the states identified are now counting the category of absentee and/or mail-in votes cast. In the 2020 election, voters who either identified as Democrats or leaning Democrat were far more likely to vote absentee or mail-in ballot, mostly out of fear of COVID-19 and long lines. The Democratic Party made their ground game pitch to match their electorate, and encouraged absentee/mail-in voting. The Republican ground game was to turn out their voters on Election Day. Both parties were hugely successful in their ground game strategies. By all analyses and assessments, voter participation in 2020 has been at historically high levels in all categories, including early in-person voting, absentee/mail-in ballot voting and actual in-person Election Day voting.

Reporting of voting results almost always begins with those ballots cast in person, either early or on Election Day. Ohio is the exception, which begins with absentee/mail-in ballots and then reports Election Day or in-person votes. Most states begin processing and scanning absentee and mail-in ballots once they are received at the respective county clerk's office. It is important to know that in none of those states are results either known or released as the tabulation of the scanned votes does not occur until the polls close in the respective states. Battleground and swing states were well known by both parties and each applied different strategies to earn success. Democrats concentrated on registration,

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Commentary, continued

absentee applications and appeals to either mail or deliver the ballots early. Republicans concentrated on rallies and Election Day turnout. Republicans also spent time in states where they also controlled the legislature to prohibit early scanning of ballots. The result has been that in the five battleground states that we are now waiting on, early results only reflected Election Day and early in-person voting and didn't include the massive amount of absentee and mail-in ballots cast in this election.

As Republicans went to bed Tuesday night, they were probably assured that they would wake up with the news that President Trump had been elected to his second term. He was leading in Arizona, Nevada, Michigan, Wisconsin, Pennsylvania, North Carolina and Georgia — all had been identified as necessary states to win on the pathway to 270 electoral college votes and victory. The President declared victory at 2:30 A.M. on November 4. As the sun rose on the fourth, and results of absentee/mail-in ballots began to be released, the landscape began to shift. The clear Democrat preference for absentee/mail-in ballots began to erode Republican vote leads in those key states. By Thursday morning Michigan and Wisconsin were called for Biden and the likelihood of Arizona and Nevada moving to the former Vice President's column was becoming clear. Simultaneously, President Trump's rather robust leads in Georgia, North Carolina and Pennsylvania began to wither as well.

> "The President declared victory at 2:30 A.M. on November 4. As the sun rose on the fourth… the landscape began to shift."

We will not know the outcome of the race until two things happen. First, all ballots must be counted and reported. There is a great probability that this will happen by Friday evening, November 6. With the trends currently in place for absentee/mail-in votes being counted, the higher probability is that former Vice President Biden will earn 270 Electoral College votes and therefore be the next President of the United States. Secondly, there will be legal challenges put forth contesting many separate and distinct portions of votes cast, particularly in these identified battleground states. It is not unusual for these types of legal actions or suits to take place and they almost never result in election results being reversed. Most of these types of challenges have been at the state level and few have made it to state appellate, federal or Supreme Court hearings. The well-known exception, of course, was in 2000 when Florida's 25 electoral college votes hung in the balance. The winner of Florida, either Bush or Gore, would become President depending on the contested vote results. The Supreme Court of Florida heard arguments from both sides and the arguments were broadcast on live television. The court's decision was to require a manual recount of the entire state of Florida's ballots. The process of delivering the ballots to Tallahassee had actually been initiated when the Federal

Supreme Court intervened. This was highly unusual because no one had actually petitioned the Federal Supreme Court. Nonetheless, the arguments before the court proceeded and in a 7 – 2 vote the court decided that the recount ordered by the Florida Supreme Court violated the 14th amendment of the Constitution and that the recount could not proceed. Vice President Gore and the Democratic Party were now out of options and Gore conceded, allowing President Bush to become the 43rd President of our country. This history lesson is simply to remind us that courts can get complicated in election results, though the precedent of this Supreme Court decision would not serve anyone requesting a statewide recount well. The other lesson is that, within our history, just two decades ago we had a contested election that was not officially decided until December 12 of 2000.

Given the acrimony and heated levels of challenge in the election of 2000, including through the Supreme Court of the United States, we still were able to achieve a peaceful transfer of power. President Bush served his first term in office challenged almost daily by those who perceived him as an illegitimate President who "stole" the election, yet he later won a second term by a significant electoral college victory, earning substantial political capital in the process.

> "… [despite] the acrimony and heated levels of challenge in the election of 2000… we still were able to achieve a peaceful transfer of power."

There is ample opportunity for us to learn many things about the 2020 presidential election if we allow ourselves to learn it. If you love democracy, you have to love and respect the large turnout of citizens expressing their constitutionally guaranteed right to free and fair elections. If you observe the nearly equal numbers who voted for each candidate you must acknowledge the nearly equal divide in the electorate. It is palpable that there is great intensity of passion on both sides of the ballot. If we acknowledge the intensity of the divide, then we must also acknowledge that unification and commonality will be hard to achieve in the near term. The citizens of our country did not get to this place of intense discord by ourselves. Our two political parties and the collective leadership of those parties share much of the responsibility for where we are.

Those that were expecting massive change in political control did not get their expectations met. Control of the Senate remains, at this writing, in the hands of Republicans though with a slimmer margin — and Democrats saw their control of the house be reduced though still retained. If Democrats gain the White House, they will govern with some known realities. The collective house of our country is divided. Citizens in large numbers in both parties feel left out. The pandemic was on the ballot, but has not been defeated by the election. Quick and decisive actions leading to defeating COVID-19, while simultaneously

Commentary, continued

"The message and implication — that some want to make America great while others don't — cannot win the day."

focusing on the quick restoration of our economy, will go some distance towards reducing anxiety and the sting of political wounds that will be raw for some time. Political rhetoric and actions that are ideological in nature, and focused on blaming or demeaning the opposition as enemies, will be self-fulfilling in the reinforcement of the divide that exists.

The message and implication — that some want to make America great while others don't — cannot win the day. We have the opportunity to make America great for all and, in doing so, search for the value of what each in that great divide want and find a pathway to forming a more perfect union in the process. This will be an especially difficult challenge if each party sees the other as an enemy rather than simply rivals that have mostly moderately different views and sometimes really big ones. Elections usually result in politicians feeling that they have won political capital that they must spend quickly — because they also know political capital erodes in a hurry. Often, we see a President elected who starts with their 100-day agenda. It would be a welcome change to see that 100-day agenda in 2021 be about reconciliation and inclusion, and a philosophy of governing that acknowledges the divide within us and leads toward unity where possible.

Greenleaf Cares

Michael F. Odar, CFA®
President

Consider these statistics from the recently released U.S. Census Bureau Household Pulse survey conducted in collaboration with multiple federal agencies. Data was collected between mid-August and mid-October:

Nearly 37% of households have at least one adult that has substituted some or all of their typical in-person work for telework because of the coronavirus pandemic.

Working mothers in states with early stay-at-home orders and school closures were 68.8% more likely to take leave from their jobs than working mothers in states where closures happened later, according to the U.S. Census Bureau and Federal Reserve.

Of those not working, women ages 25–44 are almost three times as likely as men to not be working due to childcare demands. About one in three (32.1%) of these women are not working because of childcare, compared to 12.1% of men in the same age group.

In the United States, around one in five working-age adults said the reason they were not working was because COVID-19 disrupted their childcare arrangements.

The responsibilities of working from home, caring for family members and now (for many) virtual learning are overwhelming, and a lot of our teammates were feeling the burden. In response to this, Greenleaf Trust created a small group that researched ideas, conducted team member surveys and partnered with moms and dads to develop our Greenleaf Cares Program, which includes our COVID-19 Relief Fund. This initiative allows all employees to participate in financial support or seek reimbursement for the things that are important and necessary for them during these difficult times. Funds can be used for increased expenses for childcare, education and for technology needs due to work-from-home arrangements caused by the coronavirus pandemic.

We also heard from our teammates that "time" was creating a lot of angst. With childcare, virtual learning, and work all going on at the same time in the same household, teammates with children were feeling the stress of getting things done during "normal" working hours. No one on our team wants to disappoint each other or our clients. Our Business as Unusual philosophy during these times guided us to do such things as allowing more flexibility in schedules, starting internal meetings after the virtual learning day had already begun, and shortening internal meetings to be more efficient.

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Our desire with these efforts was to alleviate stress in areas that are beneficial to everyone, meet teammates where they are and support teammates to the best of our ability. You often hear people say, we are in this together, and we most certainly are. The needs of our teammates to be both loving and nurturing parents as well as productive team members must be made possible in order for us to be successful in serving our clients.

Christopher D. Burns, CFA®, CPA®
Investment Strategist
Senior Fixed Income Analyst

Pondering the Post-Election Debt Markets

Greenleaf Trust has written and spoken a fair amount about the 2020 U.S. election. If you pay attention, you know that we do not advise speculating with your portfolio on the outcome. In his last article, our Director of Investment Research, Nick Juhle wrote:

> "Your investment objectives have a longer life than politicians and election cycles... the short-term market experience is always unpredictable, but we build portfolios for the long-term."

He is absolutely right.

Nevertheless, in this article we will side step this sage wisdom and ponder what might be in store for debt markets after the election. Federal policy, especially tax and spending policy, can impact the economy. We will consider the candidates' proposals and provide our outlook on the potential consequences of certain proposals, if enacted.

"We will... provide our outlook on the potential consequences of certain proposals, if enacted."

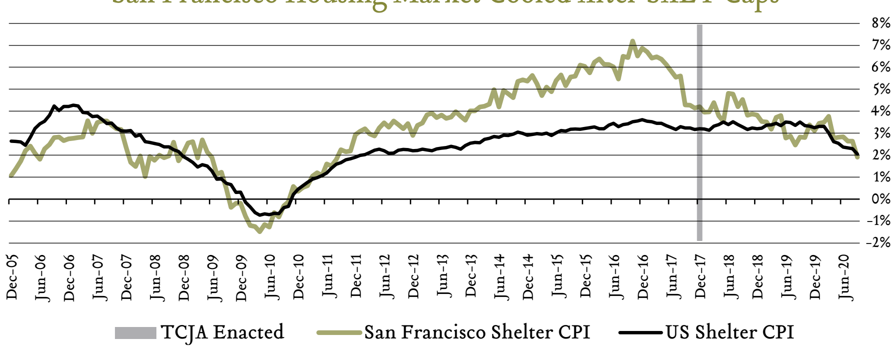
A Quick Example

Back on the campaign trail in 2016, then-candidate Trump's tax proposals included limiting itemized deductions, but did not specifically mention the State and Local Tax Deduction (SALT). This deduction allows taxpayers to write off the property tax and either the income or sales tax paid to their state and local governments when filing their federal tax returns. For high-income taxpayers in high-tax states, that deduction could be quite valuable.

Fast forward and, at the end of 2017, President Trump shepherded the Tax Cut and Jobs Act (TCJA) into law. The new tax plan placed a limit on SALT deductions at $10,000 beginning with the 2018 tax year.

Back in 2016, real estate values on the coasts were booming. High tax states like California and New York had some of the hottest property markets in the country. Shelter prices in San Francisco were increasing 6-7% per year.

San Francisco Housing Market Cooled After SALT Caps



Well, after the SALT caps, San Francisco property owners and residents could no longer deduct their relatively high state and local taxes. By our estimate, the SALT cap increased the median San Francisco household's federal tax bill by about $2,300.

Median San Francisco Household estimate:

City Income Tax	$1,400
State Income Tax	$3,600
Property Tax	$15,500
SALT Taxes	$20,500
Old Federal Tax Reduction	$4,510
TCJA SALT Cap Reduction	$2,200
Difference	($2,310)

Shortly after the TCJA implementation, the San Francisco property market cooled and reverted to the national averages for price appreciation. We believe the new tax policy was a contributor to this dynamic.

If you were an investor depending on real estate appreciation on the coasts, or on inflation-linked bonds tied to further appreciation in shelter costs, you would have been wise to ponder the post-election impacts back in 2016 and 2017.

"If you were an investor… you would have been wise to ponder the post-election impacts back in 2016 & 2017."

The 2020 Candidates' Tax and Spending Proposals

Now let's consider some of the primary differences in policy proposals among the candidates in 2020. We will focus on the main points of differentiation and some of the potential implications for debt markets.

Policy Differences:

1. Personal and Corporate Income Tax Rates:
   - Biden favors a slight increase of income tax rates on individuals making more than $400,000 per year (from 37% to 39.6%).
   - Biden favors increasing the corporate tax rate from 21% to 28%.

   Potential Investment Implications:
   - Higher income tax rates increase the value of tax-exempt investments, like municipal bonds.
     - ◊ The corporate tax rate is important here. Since 2017, banks and insurance companies (taxed at the corporate rate) have reduced their holdings of municipal bonds by about 10.5%. A higher corporate rate could incentivize them to consider adding municipal bonds.
2. SALT Deduction Limitation:
   - Biden favors removing the $10,000 SALT deduction limitation.

   Potential Investment Implications:
   - A lower tax rate (by allowing property and income taxes to be

Post-Election Debt Markets, continued

deducted) should benefit property values in high-tax jurisdictions. (Effectively reversing the dynamic we noted in our 'quick example' earlier in the article.)

3. Infrastructure and Federal Spending Plans:
   - Both candidates' spending plans include large deficit spending.
     - ◊ Under a baseline scenario, CBO projects cumulative deficits of roughly $5.35 trillion for 2021-2025.
     - ◊ Moody's projects deficits under Trump's plans to add roughly $250 billion to this figure.
       - Trump has called for a $1 trillion infrastructure plan, which would be offset by other spending cuts.
     - ◊ Moody's projects deficits under Biden's plans to add roughly $2.5 trillion to this figure.
       - Biden has called for a $2 trillion infrastructure plan.
   - The ability to implement spending plans will depend heavily on whether we have unified federal government or divided government.

   Potential Investment Implications:
   - Large federal deficits are considered inflationary, which generally influences interest rates upward.
   - However, the impact on interest rates may depend on the Federal Reserve's action.
     - ◊ So far, the Fed has responded to the COVID recession with very accommodative policy, including setting the Fed Funds rate at 0%-0.25% and using unlimited quantitative easing.
     - ◊ If the Fed changes course, and is no longer the primary purchaser of new Treasury issuance, then the private market will need to absorb the supply and interest rates may drift higher.
     - ◊ Fed Chairman Jerome Powell's term does not end until January 31, 2028, so a dramatic change in the Fed's orientation will likely depend more on the economy than on the results of the election.

"Both candidates' spending plans include large deficit spending."

4. Additional COVID Stimulus:
   - There are two main points of differentiation in the latest negotiations:
     - ◊ Democrats favor $600/wk. in supplement unemployment benefits, Republicans have offered $400/wk.
     - ◊ Democrats favor $436 billion in aid for state and local governments, Republicans have countered with $300 billion.

   Potential Investment Implications:
   - The main question is whether we will see another aid package passed at all. After some hope in early October, odds have shifted out until 2021 before we see another round of stimulus.
   - If a more generous aid package is passed, it could be positive for

creditworthiness in both municipal and corporate bonds.
- If no package is passed, it would be negative for credit and for struggling sectors like transportation, real estate and leisure and hospitality.

Conclusion

Regardless of the outcome of this election, our advice is always to vote with your ballot and not with your portfolio. We will have time to digest federal policies over the next presidential term and will take advantage of any planning or investment opportunities that arise. This article mentioned several potentialities, but we will remain vigilant to the dynamics on the ground and will act in a prudent manner to help you preserve and grow your wealth in these next four years and beyond. Thank you for the opportunity to serve on your behalf. Please contact a member of your client centric team if you would like to discuss any of these ideas further.

Sources:
Bureau of Economic Analysis, SIFMA, the Tax Foundation, Moody's, Congressional Budget Office, St. Louis Federal Reserve

"… we will remain vigilant to the dynamics on the ground and will act in a prudent manner to help you preserve and grow your wealth in these next four years and beyond."

John Graham
Guest Contributor

As a long-time friend of Greenleaf Trust specializing in foreign economic and financial markets, John Graham shares his global investment perspective as a guest contributor in this month's Perspectives. John is a founding member of Rogge Global Partners headquartered in Great Britain and former head of JP Morgan's Multicurrency Asset Management Practice in London.

> "It is worth remembering that Brexit is not finished. Just now, the European Union and Britain are trying to hammer out a final divorce settlement."

Fork(s) in the Road for Europe

Historians, at least in the near term, will struggle to pin a handle on 2020. It has been one of the most difficult and decisive years for decades. Its only potential rival might be 2008 with that year's economic crash, though on reflection, 2008 lacked this year's fractures in the social contract which have been so revealing and disturbing not just in the liberal democracies of the West, but in most nations with just a few, fascinating exceptions. For Europe in particular, the social contract and the European experiment have been tested like never before.

It is worth remembering that Brexit is not finished. Just now, the European Union and Britain are trying to hammer out a final divorce settlement. If no settlement is reached, then while the UK leaves the European Union without a trade agreement, Britain may be tempted to renegotiate or renege on its £37 billion separation payment. Oddly enough, though many of the trade issues between the two parties have been settled, fishing remains the big and hottest area of contention. The French are particularly keen for their fishermen not to lose access to Britain's waters, a possibility in the case of a no deal departure.

Also, in the background of the current COVID crisis, is the ongoing push by countries in the East of the EU bloc toward less democratic governance. In Hungary, in particular, the creeping authoritarianism of the Viktor Orbán government finally came to full bloom at the end of March when he was handed full authority to rule with unlimited authority for an indefinite period of time. After years of muzzling the press, curbing judicial independence and restricting civil society activities, the Hungarian Parliament set in law what was already happening in real life. In response to Orbán's behaviour, the EU has triggered Article 7, the constitutional mechanism which the EU can use to deal with EU governments which put the EU's values at risk. However, due to internal EU politics, little has actually been done to roll out sanctions against Hungary.

Hungary's neighbour Poland has also moved against the "rule of law." Its Law and Justice Party has been steadily destroying the independent judiciary by placing the judiciary under party control and undermining an independent media. The Poles have consistently refused to accept the supremacy of European law over domestic law and have challenged the legitimacy of the European Court of Justice.

This drift towards authoritarianism has presented the EU with a big problem. The EU Charter of Fundamental Rights requires its members to maintain values which include democracy, human rights and freedoms, an independent media and rule of law No one, for various reasons, initially seemed willing to take on Orbán in Hungary and Andrzej Duda in Poland.

(Orbán's Fidesz party is part of the European People's Party, the largest bloc in the European Parliament. Angela Merkel's CDU is also a member). Article 7, mentioned above, removed some EU voting rights from the two countries but really provided for no significant sanctions. So here is one fork in the road for Europe. Does it, in spite of the Union's stated aims and objectives, allow the rising tide of authoritarianism in the East to continue, or does it take a sharp stand in an attempt to bring Poland and Hungary (and those who might look to them as examples) back into line?

Enter COVID and the European Rescue Package. We don't need to rehearse the dramatic impact COVID has had in Europe. While it, so far, hasn't been as politically divisive as in the United States (though political divisions over the economics around COVID are rising sharply in the UK just now) the economic impact has been dramatic. The charts below show the projected sharp declines in GDP which are arising from the economic slowdown through a double whammy of reduced government income and fiscal stimulus designed to prevent mass unemployment. Readers of *Perspectives* will remember the threat of the Doom Loop in Italy, but the threat of cascading credit failure exists in other European countries as well.

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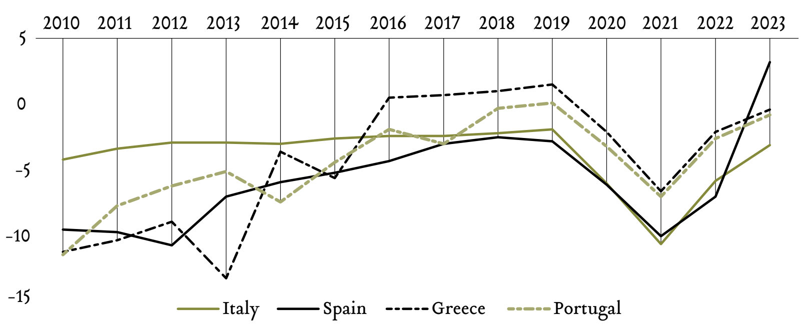
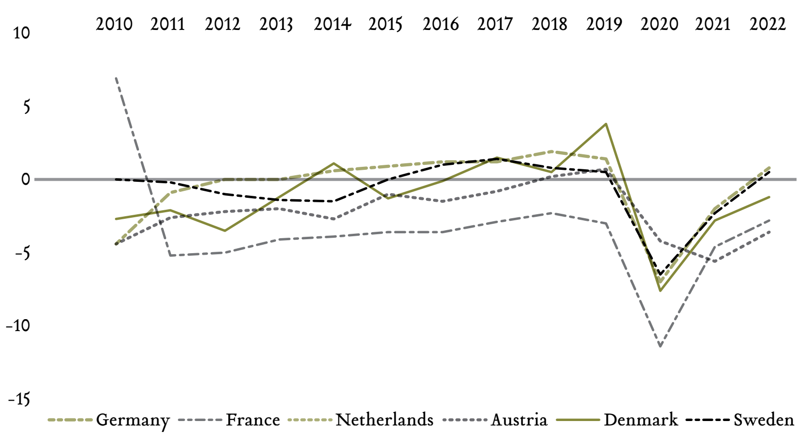
Southern European Budget Deficits



Source: National Statistics offices and Trading Economics

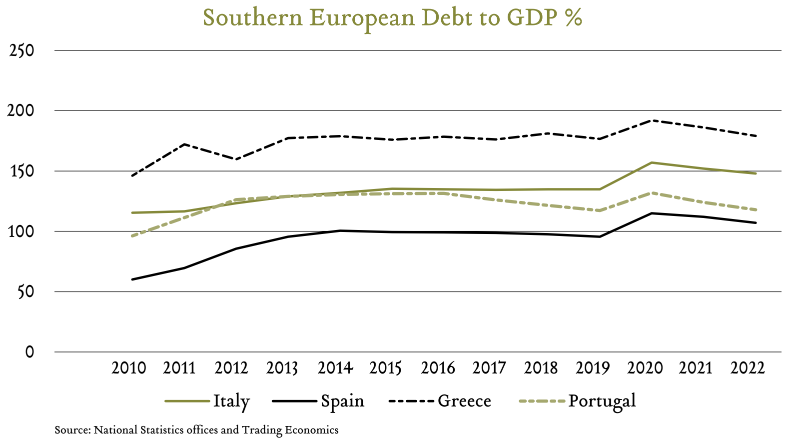
Northern European Budget Deficits %



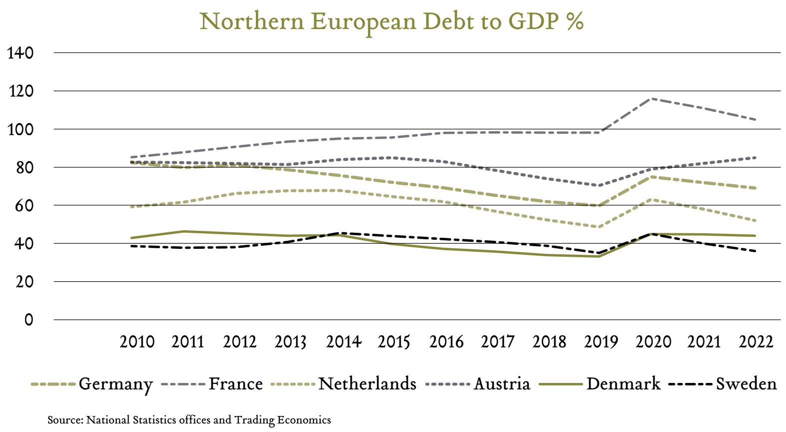
Source: National Statistics offices and Trading Economics

Fork(s) in the Road for Europe, continued

The two charts below show the burden of debt that this shock to the economies of Europe will produce. Already high levels of debt will get much higher. All the countries of Southern Europe already have a debt to GDP ratio of over 100%. Given the uncertainties around COVID, it is reasonable also to assume that these debt ratios will be revised up.



> "Given the size of this economic shock, the EU moved this spring to develop a rescue package."



Given the size of this economic shock, the EU moved this spring to develop a rescue package. The eventual proposal provided for the EU's budget to increase from €1.1 trillion to €1.85 trillion over the next seven years. The extra €750 billion would be funded by borrowing through various entities including directly by the European Commission. This would be the first time that Europe, as an entity, would borrow funds directly in the market on this kind of scale. This gave rise to two questions:

1. How would the funds be dispersed?
2. Who would repay the borrowing?

The first question illuminates a second fork in the road for Europe. Heretofore, any funds normally dispersed by the EU have been paid back via the agreed formula for community-wide funding, largely GDP based.

Rescue operations, such as that undertaken for Greece during the 2008 crisis, have been dispersed as loans to be repaid by the countries receiving the funds with dispersion supervised by the funding organizations (in the case of Greece, by the EU, the ECB and the IMF – The Troika). However, intense financial scrutiny of Greece and its reform program by the Troika produced a considerable backlash among the voting public, not just in Greece, but also in the rest of Southern Europe. The perceived "colonial" attitude of the Troika resonated with every anti-European and left-wing group in Europe. If another package were to be put together, the two leading countries in Europe, Germany and France, felt that the new facilities would have to work differently. Some of the funds would need to be grants meaning that the amounts repaid by any country would only be in proportion to their normal contribution to the EU budget i.e. the wealthier North would bail out the poorer South.

From the time the Euro was first suggested, through its launch and subsequent operation, many observers felt that the lack of a fiscal transfer mechanism could be its undoing. The lack of a mechanism for the EU bloc to transfer funds to parts of the system in need meant that poorer countries, deprived of currency devaluation as a way to address economic difficulties, had only fiscal spending and internal devaluation as a way of addressing economic problems. Over the years, this has proved very difficult to implement in liberal democracies. Many observers have concluded that it would be better for a central financing authority to provide funds to meet contingencies, as would happen in a single country or under a federal system as exists in the US. However, fiscal transfers in a single state mean that relatively wealthier areas of a nation provide subsidies for less well-off areas. These fiscal transfers do not happen as loans which need to be repaid. They are outright grants or targeted fiscal expenditures — roads, buildings, programs, et alia.

"In Europe, the wealthier countries of the EU have been reluctant to "subsidise" the poorer areas."

In Europe, the wealthier countries of the EU have been reluctant to "subsidise" the poorer areas. Where transfers occur, as in the case of the Greek bailout, they happen as loans which need to be repaid. Critics of this system argue that the need to repay large loans during a time of financial reform put a huge burden on countries which are already struggling economically. Moreover, the administration of these loans, sets up an "us vs. them" dynamic as is the case with the Troika. In Italy in particular, right-wing and populist movements have gained power by promising to fight against this dynamic. All across Southern Europe this spring, requests for a rescue package emerged as the impact of COVID became worse and worse. But the same governments who were requesting aid, were adamant that the aid should come in the form of grants, not loans.

Fork(s) in the Road for Europe, continued

As the negotiations over the question began in April and May, the second fork in the road for Europe became immediately clear. Nations lined up strongly either in favour of taking the more federalist approach or maintaining lending as the status quo. In particular, the so called Frugal Four, The Netherlands, Austria, Sweden and Denmark, came out strongly against extending grants to countries targeted to receive rescue funds. They clearly saw the precedent such a move would set and were opposed in principle to using their taxpayer Euros to bail out "less prudent" nations. On the other side, Italy and Spain argued vociferously that they would not take loans and be subject to Troika-like supervision going forward. They too understood that taking the grant giving road could lead Europe to a different dynamic, one that they favoured. In the middle of this sat France, who needed funds herself and Germany who was keen to avoid, at all costs, a North-South split in the Union. And, from the side lines, Poland and Hungary were busy trying to avoid having any provision in the package that would prohibit countries deemed in violation of the "Rule of Law" provisions of the EU Charter from receiving rescue funds.

"... Europe has taken a step down the road to a more centralized financial system."

So, Europe arrived at two forks in the road when all 27 countries gathered in Brussels in July to thrash out a deal. With Germany and France driving all parties to stay at the table, a deal was announced on July 24, with much relief and some triumphalism. Indeed, Europe has taken a step down the road to a more centralized financial system. The Frugal Four acquiesced when the amount of grant money in the deal in the €750 billion deal was cut from €500 billion to €390 billion and they were assured that this mechanism was being used on a one-off basis. The South was ecstatic that grant money would be forthcoming and a Troika-like system of supervision would be avoided (Italy will receive €65.5 billion and Spain will receive €59 billion of the Recovery and Resilience Facility). In the East, Poland and Hungary claimed victory as no specific provision for withholding funds for Charter violations was included. Nonetheless, Germany et alia are aware that something must be done to halt the spread of authoritarianism in the East. So, instead of spelling out clear rules, the rescue agreement allows the European Commission to propose methods to the Community for ensuring that the rescue funds don't go to countries breaking those rules.

To observers from cultures where things happen more swiftly, the moves described above may not seem particularly revolutionary, however, given the glacial pace of change in the EU and its historical modus operandum this change in financing is significant. This type of facility will be called on again, one can be sure, and in a decade may be the standard operating procedure for the Community. One only has to think back to recent ECB innovations like negative interest rates and common funding for ESM bonds which were once "one offs", but are now standard parts of the financial picture in Europe to see that borrowing by the European Commission on behalf of the Community as a whole will become common place. Which road the EU takes in regards to its members in the East is less obvious. Poland and Hungary have been playing a winning game against the centre for some time banking on a lack of will to do as they please. However, the centre, particularly the Commission and Germany are now determined halt the erosion of the rule of law in Poland and Hungary and, within the constraints of the Pandemic, are mobilizing their fellow nations do what needs to be done behalf of the liberal democratic ideals of the EU.

Investment Thoughts

It seems sensible to assume that, though the EU faces severe economic challenges, the step taken towards providing funds on a grant basis to nations in economic difficulty will make the EU stronger. There will still be arguments about this kind of operation in the future, but given the way the EU has operated since the beginning, this type of centralization will continue and is necessary to make the Euro a stronger currency. Moreover, the ability to make fiscal transfers to areas in need in the Community will strengthen the economy of Europe as a whole. European investments on the whole should look better after this year.

The coming confrontation with Hungary and Poland will be disruptive for those countries and will take a long time to resolve. Investment in those areas should be considered carefully.

"It seems sensible to assume that, though the EU faces severe economic challenges, the step taken towards providing funds on a grant basis to nations in economic difficulty will make the EU stronger."

Eliminating Tax Incentives for Retirement Plans

Chris A. Middleton, CTFA
Executive Vice President
Director of Retirement Plan Division

Late last year, the Setting Every Community Up for Retirement Enhancement (SECURE) Act made significant improvements in the U.S. retirement system. Along with certain provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act in early 2020, we have welcomed many retirement plan legislative changes over the last 12 months. But it's election time, so a lot more ideas are being thrown around. Retirement policy might not seem like the most gripping topic of the moment, but there is one proposal out there that deserves comment.

This lousy idea is the reduction or elimination of tax incentives for retirement saving. Reducing the deductibility of 401(k) and similar plans has been floated for years through various proposals, but has thankfully never developed legs for legislative adoption or approval. The reasoning behind this proposed policy change appears to be twofold.

The first is related to how our federal government approaches budgeting. Since deferred savings into retirement accounts is not subjected to income tax by the federal government, it is viewed as lost "revenue" for the year. It's as though the money belonged to the government in the first place, and the deductibility was the equivalent of the government "spending" money. Thus, if you want to raise funds in Washington to pay for other programs, this "tax expenditure" can be targeted for reduction or elimination.

"... why in the world would we want to decrease the incentive for higher or middle class wage earners?"

The second argument is that the deductibility is unequal amongst varying demographics. A person in the 12% tax bracket who puts $1,000 into a 401(k) avoids $120 in taxes, while a person in the 24% tax bracket defers $240 from taxes. Although this disparity is true, it doesn't seem to be a concern for policy makers when collecting the funds on the flip side under the same tax schedule. That said, a smart case could be made to look for additional ways to increase the incentive for a lower wage earner to save for retirement. Programs like the current savers credit for lower income earners make a lot of sense. But why in the world would we want to decrease the incentive for higher or middle class wage earners? Are they saving too much and abusing the current retirement plan system?

It is informative to look at how well middle class earners are doing in their savings for retirement. Baby Boomers have an average of $152,000 saved for retirement, according to an Annual Retirement Survey of Workers conducted by the TransAmerica Center for Retirement Studies. That sounds like a decent amount of money until one realizes that the average adult between ages 65 and 74 spends $48,885. Based on these numbers, it could be difficult to make $152,000 work for 30 years or longer in retirement, even when augmenting retirement spending with Social Security. In fact, restricting retirement savings through punitive retirement policy will actually trigger the need for more government and social welfare spending to care for people who had the ability to prepare for retirement but were not incentivized to do so. In addition, undersaving leads to less spending, which is key driver of the country's economic engine.

The ultimate problem with this proposed retirement policy change is that it appears to have little to do with retirement policy and a lot to do with politics, especially in this election year. Washington is often dysfunctional, so most proposed ideas do not get the traction needed for legislative adoption. Hopefully this concept is yet another idea that gets put out to pasture.

We should be encouraging both low-income earners as well as the higher and middle class earners to save for retirement. Increasing savings incentives for lower wage earners is sound retirement policy. Decreasing saving incentives for higher or middle class wage earners is not. Even during a contentious election year, hopefully everybody can agree that we should not allow politics to get in the way of sound retirement policy for all citizens.

"Increasing savings incentives for lower wage earners is sound retirement policy. Decreasing saving incentives for higher or middle class wage earners is not."

George F. Bearup, J.D.
Senior Trust Advisor

Remainder Interests: Charitable Giving Made Easy

The gift of a remainder interest in a personal residence or a farm to a charity entitles the donor to an immediate charitable income tax deduction which can be used of off-set taxable income, or keep the donor in a marginally lower income tax bracket. The Tax Code regulates the form and type of charitable gifts that are tax deductible. One such rule is the recognized gift of the remainder interest in a home or farm to a charity.

A gift of a remainder interest in a personal residence or farm produces favorable income tax results due to the current low interest rate environment. The low interest rate is used to value the life estate retained by the donor. The retained use of the real estate is the equivalent to the donor's retained income stream; the lower the interest rate, the less the retained life estate is deemed to be worth. As a result, the more the gift of the charitable remainder is worth, the larger the current income tax charitable deduction.

For purposes of this tax rule, any personal residence, like a cottage, will suffice. A farm is broadly defined to include any land that is used by the taxpayer, or his or her tenant, for the production of crops or livestock.

> "A gift of a remainder interest in a personal residence or farm produces favorable income tax results due to the current low interest rate environment."

The size of the donor's charitable income tax deduction will depend upon several variables, including: (i) the fair market value of the residence or farm; (ii) the value of the land on which the residence sits; (iii) the useful life of the residence; (iv) the salvage value of the residence at the end of its useful life; (v) the donor's age at the time of the gift; and (vi) the required federal applicable interest rate that is used when the gift is made to value the donor's retained life estate.

The charitable gift is made in the form of a simple deed. The donor gives to the charity a deed to the residence or farm, reserving in the body of the deed a life estate. The deed is then recorded. As the life estate holder, the donor is responsible to pay the real property taxes, keep the residence insured, pay the utilities and generally pay for property maintenance expenses. On the donor's death, his or her life estate ends. The charity simply files with the Register of Deeds a copy of the donor's Death Certificate. The residence or farm is not part of the donor's estate, nor will it be subject to probate.

Assume that a donor, age 70, in July 2020 contributed a remainder interest in his $1.0 million waterfront cottage to the local hospital, which previously had been named as a charitable beneficiary of the donor's estate.

- Due to the size of the donor's available federal estate tax exemption, the donor's estate would no longer benefit from any federal estate tax charitable deduction. Accordingly, the donor decided to accelerate that charitable bequest to a lifetime charitable gift to take advantage of the federal income tax charitable deduction.

- The gift to the local hospital is in the form of a recordable warranty deed in which the donor retained a life estate. There is no mortgage on the cottage.
- The donor will continue to use and occupy the cottage for the rest of his life. He will also be responsible for the payment of real property taxes, home owner's insurance premiums, and general maintenance and repair expenses as the life estate holder.
- In July, the applicable federal rate of interest used to value the donor's life estate was 0.6%. The donor will be entitled to a federal income tax charitable deduction in 2020 of $919,000. For comparison purposes, had the federal interest rate been 6.0%, the donor's charitable income tax deduction would only have been $480,000.

As noted in the example, one of the reasons for the gift of the remainder interest was because the donor's estate would no longer benefit from a federal estate tax charitable deduction due to the dramatic increase in the federal estate tax applicable exemption amount. Any existing estate plans that feature a charitable bequest should be revisited, since it is likely that there will be no use for the charitable estate tax deduction, as there will be no taxable estate after the decedent's available estate tax exemption is used.

There could be yet another reason to accelerate the charitable bequest to a lifetime charitable gift, and that is to create a large federal income tax charitable deduction. At age 70, the donor will be looking at a time in the near future (at age 72) when he will have to start to take required minimum distributions from his IRA. The donor may want to convert his traditional IRA to a Roth IRA, but that conversion accelerates the traditional IRA into the donor's current income, thus increasing his income tax burden. The gift of the remainder interest in the cottage and the large charitable income tax deduction that it generates can offset, to a large extent, the additional income tax liability that the donor will face with his Roth IRA conversion. One way of looking at this is that the non-income producing equity in the donor's cottage is used to facilitate the conversion of his traditional IRA to an income tax-free Roth IRA which is not subject to required minimum distributions, at a time when everyone suspects we will be facing higher income tax rates and narrower income tax brackets to help pay for the pandemic relief expenditures.

Accelerating a charitable bequest to a lifetime charitable gift makes a lot of sense. Making an income tax deductible charitable gift with non-income producing assets also makes a lot of sense. Using the large income tax charitable deduction that arises from the gift of a remainder interest in a residence or farm to facilitate the conversion of the donor's traditional IRA to a Roth IRA to minimize future income tax liabilities perhaps makes the most sense.

"Accelerating a charitable bequest to a lifetime charitable gift makes a lot of sense."

Corbin M. Donaldson, CFP®
Wealth Management Advisor

’Tis the Season…

We are quickly approaching the end of 2020, and like most, frantically preparing for a season filled with friends, family, and festivities. This year might have a different twist, but the preparation likely remains the same. Like most Michiganders, it’s that time of year where we confirm our Amazon accounts are set-up for two-day shipping and our snow blowers are in optimal working condition for that first winter storm. Winter is coming, and just as we prepare for the ensuing next several months of winter, we must also fine-tune our year-end tax planning strategies before we close the books on 2020. Here at Greenleaf Trust, we recommend, depending on your unique circumstance, considering several different year-end strategies, including consideration to Roth IRA conversions, tax-loss harvesting techniques and estate planning strategies.

“… we recommend, depending on your unique circumstance, considering several different year-end strategies…”

Roth IRA Conversion

Benjamin Franklin stated that “two things in life are certain – death and taxes.” While a Roth IRA conversion does not escape the first certainty, it does provide you the opportunity to take advantage of historically favorable income tax rates. A Roth conversion strategy is a particularly powerful tool because of its ability to reduce your annual required minimum distribution (RMD) and allows for your assets to grow tax free. You are required to pay ordinary income tax on the conversion amount in the year of conversion; however, lower tax rates now translate into lower conversion costs from traditional IRA assets to a Roth IRA. The CARES Act passed in 2020 also waived RMDs for the year. With the ability to forgo taking an RMD from your traditional IRA in 2020, thereby reducing your taxable income, it may provide additional capacity to cost-effectively convert to a Roth. Additionally, Roth IRAs are not subject to RMDs during your lifetime and provide greater flexibility on how the assets are inherited, given no taxable implications are incurred by heirs since the tax was paid at conversion.

Tax-Loss Harvesting

In addition to the Roth Conversion strategy, Greenleaf Trust pays special attention to capital gains and the ensuing impact on the portfolios of our clients. We are intentionally focused on optimizing after-tax, after-fee returns through the utilization of tax-loss harvesting not only at year-end, but throughout the entire year. This strategy starts from the ground up with the construction of the portfolio, uniquely designed and tailored to match the goals and objectives of our clients. With intentionality, we allocate tax-efficient assets, such as exchange-traded funds (ETFs), within taxable accounts, while designing qualified accounts with tax-inefficient assets, such as fixed income investments yielding ordinary income. Qualified accounts shelter the impact of tax-inefficient assets as they are not subject to capital gains and accumulate on a tax-deferred basis. This strategy is commonly referred to as asset location. This strategy is regularly recommended to our clients due the after-tax impact on the return without comprising the desired level of risk in the portfolio.

Charitable Giving with Cash From Your Tax-Deferred IRA

The introduction of the CARES Act gave taxpayers new opportunities for charitable giving in 2020. One of those advantages was the increase to contribution limits for cash gifts made directly to almost all public charities. In previous years, gifts of cash by an individual to charities were limited to 60% of the donor's adjusted gross income (AGI) for the year. Exclusively for 2020, the CARES Act eliminated the 60% limitation for cash gifts to charities, allowing for deductible cash gifts up to 100% of an individual's AGI. Those who are between ages of 59½ and 70½ years old and have an IRA that they intend to bequest to a charitable beneficiary can generate valuable tax and charitable benefits. Somewhat of a younger-person's Qualified Charitable Distribution (QCD) for this year only, individuals who intend on fulfilling a bequest for a charitable beneficiary should utilize a cash donation indirectly from their IRA.

For example, John, who is 65 years old, distributes $100,000 from his IRA on November 4, 2020, and writes a check to a public charity on December 15, 2020. John's AGI is $300,000 and because the limit for charitable gifts of cash is 100% for 2020, John deducts the $100,000 from his $300,000 AGI at tax time. Not only does the indirect cash gift from John's IRA provide a benefit to him in 2020, but also provides a future benefit in the form of reduced required minimum distributions, and therefore, tax liability.

Qualified charitable distributions continue to remain an effective and powerful tool, allowing individuals age 70½ and above to continue to charitability distribute up to $100,000 directly from their IRA. However, for those between the age 59½ and 70½ who are charitably inclined, a cash gifting strategy proves to be the most effective route for 2020.

… for those between the age 59½ and 70½ who are charitably inclined, a cash gifting strategy proves to be the most effective route for 2020."

Education Savings through 529 Plan accounts

For those of you with children or grandchildren, 529 savings plan provide several competitive advantages for funding future educational expenses. Funding a 529 plan provides the ability to remove assets from your estate for future estate tax calculations, while potentially receiving a state income tax deduction (depending on your state of residence). You have the ability to gift up to five years of your annual exclusion amount of $15,000 per beneficiary, for a total of $75,000 as an individual or $150,000

Tis the season..., continued

if you are married. Earnings in the account grow free of federal income tax and distribute tax free when used for qualified education expenses. The definition of "qualified education expenses" were expanded to not only include your standard tuition, and room and board, but now can be utilized for laptops, computers, and related equipment. The ability to take a state income tax deduction, coupled by the ability to reduce potential estate tax are important considerations. Most important is the ability to fund the future education expenses of your children and grandchildren.

"Funding a 529 plan provides the ability to remove assets from your estate for future estate tax calculations..."

Election Driven Solutions:

With the 2020 election coming to a close, and still being in the thick of a global pandemic, we find ourselves in a unique position of traversing unchartered waters. Former Vice President Joe Biden is proposing six potential tax increases and changes that primarily impact those individuals and families whose income exceeds $400,000.

1. Restoration of the pre-Tax and Jobs Act rate of 39.6% for those in the highest marginal tax bracket (currently 37%).
2. Individuals with income over $400,000 will be subject to social security tax of 12.4%. Currently, there is a wage cap of $137,700 on the 12.4% social security tax split evenly between employers and employees.
3. Pease limitations, which reduce the value of itemized deductions for high earning taxpayers, will cap itemized deductions to 28% for individuals earning $400,000 or more annually. Pease limitations cap the value of itemized deductions for taxpayers based upon their AGI and are proposed to reduce the deduction by three percent of every dollar exceed $400,000. Pease limitations were suspended until 2026 under the Tax Cuts and Jobs Act (TCJA) reform in 2017.
4. For individuals and families with income that exceeds $1,000,000, long-term capital gains above that threshold will be taxed at ordinary income tax rate of 39.6%.
5. Proposed elimination of the commonly referred to step-in basis law. Inherited assets currently receive an income tax basis adjustment to the fair market value of inherited assets as of the date of death.
6. Proposed reduction of the federal estate and gift tax exemption to $3,500,000 from its current level of $11,580,000 and increased top rate for estate tax to 45%.

The proposed Biden tax changes provide a few big-picture take-ways that are important to highlight. First, for high income earners, gain harvesting in 2020 may become more important to complete prior to year-end, assuming tax rates will increase effectively in 2021. Second, loss recognition could become more valuable in 2021, as higher tax rates on capital gains, and a lowered threshold for the highest marginal tax bracket will impact tax planning strategies. The bunching of charitable gifts, and the use of QCDs, and charitable remainder trusts may make sense to complete in a single year to reduce taxable income.

President Trump's blueprint for a second term is speculated to remain consistent with current tax law, as the visibility of any proposed changes is somewhat limited. A few of the key items President Trump has proposed focuses on reducing taxes for the middle class, reduction in long-term capital gain rates, and a potential tax credit for domestic travel expenses. At this point, we don't have a clear definition of what changes or updates will be made for President Trump's second term in office.

Implementing tax-efficient planning strategies provide a competitive advantage when evaluating the after-tax, after-fee returns of a portfolio, and equally important, the reduction of potential tax liability of your estate. We're committed to providing uniquely designed approaches specific to the goals of our clients and proactively examining the impact of the changing economy, market and political arena. While several of the strategies introduced in this article are impactful, we understand the planning for year-end 2020 could change depending on the introduction of new policies. However, just as we've adjusted our snowblower settings to combat that first Michigan snow storm year after year, rest assured that Greenleaf Trust will be adjusting our year-end planning strategies to fit the uniqueness of each and every client.

"While several of the strategies introduced in this article are impactful… planning for year-end 2020 could change depending on the introduction of new policies."

Stock Market Pulse

Index	10/31/2020	Total Return Since 12/31/2019
S&P 1500	742.45	1.75%
Dow Jones Industrials	26,501.60	-5.38%
NASDAQ	10,911.59	22.57%
S&P 500	3,269.96	2.76%
S&P 400	1,900.18	-6.63%
S&P 600	876.59	-13.08%
NYSE Composite	12,429.28	-8.76%
Dow Jones Utilities	857.77	0.02%
Barclays Aggregate Bond	2,365.52	6.32%

P/E Multiples	10/31/2020
S&P 1500	25.6x
Dow Jones Industrials	21.7x
NASDAQ	68.2x
S&P 500	25.3x
S&P 400	25.2x
S&P 600	52.3x

Key Rates

Fed Funds Rate	0.00% to 0.25%
Tbill 90 Days	0.09%
T Bond 30 Yr	1.66%
Prime Rate	3.25%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	742.45	25.6x	1.84%
S&P 500	3,269.96	25.3x	1.84%
Dow Jones Industrials	26,501.60	21.7x	2.33%
Dow Jones Utilities	857.77	18.9x	3.59%

Spread Between 30 Year Government Yields and Market Dividend Yields: -0.18%

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