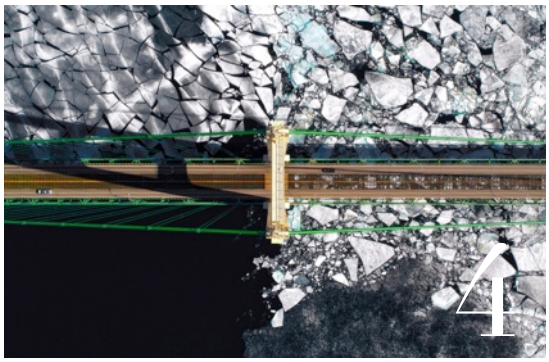
Old missioN

publication of the old mission investment & trust companies
spring & summer, 2018

trust administration
wealth management
investment services
retirement plan advisory

Old Mission

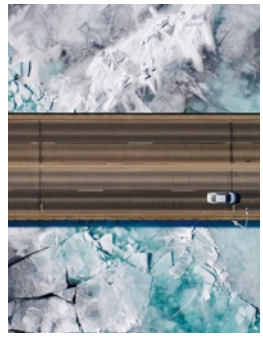
Spring and Summer, 2018



Contents

Privately owned and independent, Old Mission Investment and Trust serves families and investors through investment management and comprehensive wealth planning services to achieve peace of mind for all clients.

The Cover.



Cover Image: A different perspective using drone photography. Lakes Huron and Michigan meet under the Mackinac Bridge. Blue ice congregates under the bridge, giving local spectators and photographers a special show in the spring season once every 4 or 5 years. The water absorbs blue wavelengths, and the density and lack of bubbles in the ice allows the wavelength to penetrate further. Light reflected from the ice then appears blue.

Firm Summary

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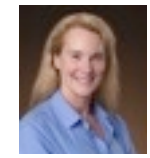

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The Theory of Repetition.

It's been said that 'doing the same thing over and over again, but expecting a different result' is the primary definition of insanity. In the financial advisory world, however, doing things over and over again *can* yield a different, yet better, result.

Ten thousand hours of practice, study, and hard work in your profession will position you as an 'expert' in your field. In our business, this is very true. Anyone can *give advice,* but is it *the right* advice? The complex nature of tax, trust, legal and investment management is an ever-moving target and with the recent tax legislation that was finally passed comes a new set of rules and tax laws that need to be navigated. Staying on top of those items is an essential part of maximizing after-tax returns and keeping your situation as 'financially fit' as possible.

Repetition is not boring. I have learned to love the repetitive nature of our business in many ways. While no client is identical, there are variations that are similar from one relationship to another. Having a review process allows us to continually refine the way we too, do business.

I was fortunate enough to go to Interlochen to study piano at a young age. Prior to that, my piano instruction and practice led me to spend countless hours on the piano bench learning my 'fingering' the proper way, and taking each piece of music - whether Beethoven, Bach, or Schubert - one page at a time. The timer was set on the kitchen stove for 45 minutes, and prior to dinner being served, it was my time to practice.

Measure by measure, page by page, I learned each piano piece well enough to a point where it could be memorized. It took time, and a little passion to keep me going. I attacked each piece in the same manner no matter how many sharps and flats it had. Back in the 1980's I was solidly intending on becoming a musician when I was a young adult, ultimately moving from classical piano study to the world of jazz piano, electronic music, keyboards, composition and rock stardom. It took practice, lots of practice. I can only think that my parents, hearing the same piece of music over and over again, plainly wanted to yell, 'Can you play something different?' more than once. I wanted to get better, and in order for that to happen it took mistakes, and lots of *repetition*.

In our business, repetitive behavior is a good thing. We use systems to analyze client portfolios, have regular investment and trust committee meetings, and try to maintain a review schedule that is, yes, repetitive.

When I was 17, I changed the direction of my life. My parents bought me a book called '*Understanding Wall Street*' after I had countless discussions with my uncle on the stock market during various family holiday gatherings that year. He had commented that 'owning IBM stock made [him] more money than being an attorney.' At that point, the stock market seemed a bit more interesting and the 'fall back plan' that my father had routinely suggested I have actually came into being. It's not that I couldn't make a *potential* living as a musician - actually, in hindsight I was seriously ahead of the curve for electronic music at the time, but there was a significant emphasis on *performing* arts and not the background performers that wrote for screen and television. My mom saw that Interlochen would either 'make me, or break me' and she was right. My father's suggestion that I have a 'fall back plan' was the next nail in my my music career's coffin. It was a masterful plan indeed, and it worked very well. Good cop, bad cop, I suppose.

'Practice makes perfect' is a good motto, and something to strive for. But at what point does an advisor quit *practicing?* The answer is 'never.' There is comfort in repetition.

We constantly strive to be better, learn from our mistakes, improve our systems, review methods, and policies to be more aligned with the needs of our clients. The repetitive nature of our business means that we get a chance to re-evaluate each client learning from the last relationship that was similar. As individuals we are a culmination of our learned behavior that brought us to where we are today. Sometimes, as evidenced by my own situation, parents, just like 'advisors,' are responsible for helping their children make important decisions at critical junctures in their lives so that life's trajectory is still kept on an appropriate glide path toward success.

As for me, I still play the piano on occasion. Certainly during the holidays the sheet music magically appears on the piano, and the piano bench that was my nemesis for so many years is now my comfortable friend. I make more mistakes now than ever, but practice has provided for a perfect level of enjoyment for me and my family. Practicing was well worth it.

Advisors have 'been there and done that.' We are there to provide the best guidance in light of our training, experience, knowledge, and professionalism. We help you and your family navigate through those elements of the financial landscape that are incredibly familiar to us and it's been our pleasure along the way.

Above all, we look forward to working with you and doing more of the... *same*.

Christopher M. Lamb, CIMA, CTFA
Managing Partner and Principal

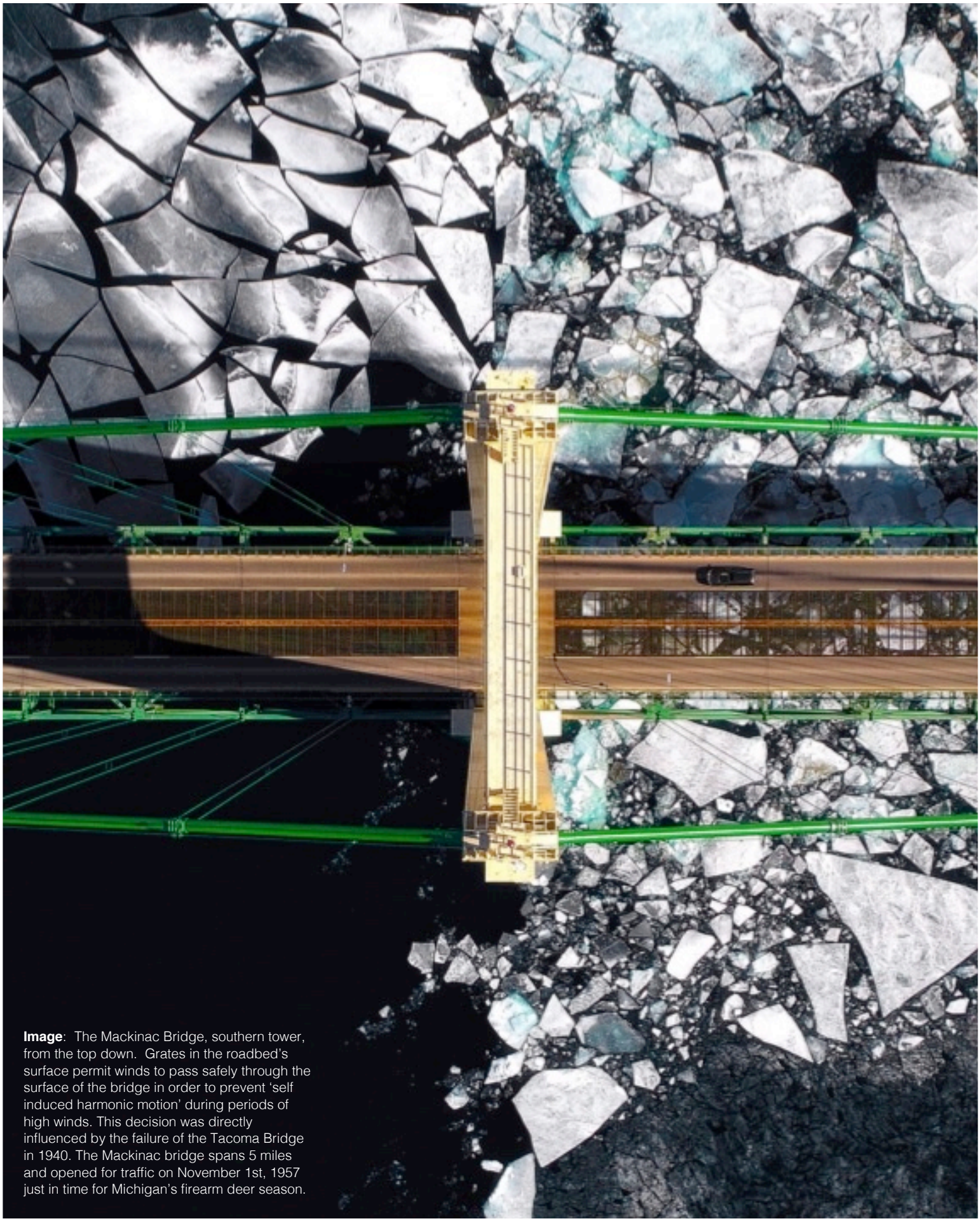


Image: The Mackinac Bridge, southern tower, from the top down. Grates in the roadbed's surface permit winds to pass safely through the surface of the bridge in order to prevent 'self induced harmonic motion' during periods of high winds. This decision was directly influenced by the failure of the Tacoma Bridge in 1940. The Mackinac bridge spans 5 miles and opened for traffic on November 1st, 1957 just in time for Michigan's firearm deer season.

THE *TAX*ING *PLAN*

The 2018 tax package is done and in the books. Love it or hate it, it's not exactly easy to understand.

The tax package was finally passed after much ado and fanfare. Was it the massive simplification of the tax code that we were hoping for? No. Did it complicate matters? Yes. Did the markets like it? *Absolutely.* Tax reform had a little for everyone. Some liked it, others hated it, and there are people in the middle that really don't know how it will impact them until 2019 when their 2018 tax returns are finally done.

Here are a few things that we felt were important enough to share:

Capital Gains Taxes. Capital gains taxes still retained their preferential 'tone' compared to ordinary income items. Capital gain tax rates will range from 20%, for joint filers with more than $479,000 in income, to 0% for joint filers with incomes below $77,000. For those in the middle, the capital gain tax rates are still incredibly favorable, with rates ranging from 5% to 15% depending on your income. For the most part, the benefits of capital gain income have remained 'untouched' apart from a few nuances that had very little impact.

The Standard Deduction. The largest departure from the 2017 tax code had to do with the standard deduction. The base standard deduction went from $6,000 to $12,000 per person, or $24,000 for joint filers.

For seniors that were largely itemizing, the good news *may* be that itemization is no longer necessary and a larger tax benefit may exist. The downside to itemization is that you had to account to the IRS concerning amounts and categories of certain deductible expenses. Now, to the extent that your itemized expenses and deductions are *lower* than the standard deduction, your tax preparation just got a lot simpler. A larger standard deduction now makes it more difficult for those who itemize to get the appropriate deductions. Property taxes and mortgage interest are harder to deduct since there are now limits in place concerning the amounts within those categories that can be deducted when taxpayers itemize. Under the new law, only property taxes under $10,000 can be deducted. Additionally, only mortgage interest on qualifying mortgages with principal loan amounts less than $750,000 will be entitled to a deduction.

Charitable Contributions. Charitable contributions are common for many retirees. Contributions to charitable organizations have been always regarded as 'deductible' by those making the contributions without giving it a second thought. *Think twice!* The passing of the 2018 tax package may have changed that, and for the worse.

Now, with the larger standard deduction, charitable contributions are going to be more difficult, or even impossible, to deduct for most people. The most likely outcome will be that donors won't recognize this new reality until 2019 after the contributions have been made *and without* the tax deduction.

Charitable Contributions, Part 2. There is a little good news for those that would still prefer to give charitably. For those that are over the age of 70 1/2 and taking required distributions, they can still direct a portion of their required minimum distribution from their IRA distribution to a charity of choice. Entities such as your churches, synagogues, food pantries, and other organizations can still receive your IRA charitable funds and you will still get a tax deduction for those contributions.

The deduction comes through a reduction in the *taxable* amount of your distribution that is transferred to your personal tax return. As an example, if you are required to

Image: Brooklyn Bridge. Started in 1869, finished 14 years later.

"WE MIGHT SUGGEST THAT 2018 WILL BE A *TRANSITION* YEAR FOR CHARITABLE CONTRIBUTORS. MOST PEOPLE MAY NOT REALIZE THAT THEY'VE BEEN FORGOING A TAX DEDUCTION UNTIL IT'S TOO LATE..."

take a $25,000 distribution from your IRA, and you request that $10,000 of that distribution goes directly to the American Red Cross, you will only be responsible for paying taxes on the remainder, or $15,000. The requirement is, however, that the check must go directly from your IRA account to the charitable organization in order to qualify for favorable tax treatment. You can distribute amounts up to $100,000 in this manner, and it's one of the best ways to ensure that your charitable deduction is received.

We might suggest that 2018 will be a transition year for charitable contributors. Most people may not realize that they've been forgoing a tax deduction until it's too late and their 2018 tax returns are already complete. If you have questions on your charitable giving - any question - we would strongly suggest that it's time to have a conversation just to ensure that you are doing things correctly.

Income Tax Brackets. Income tax brackets have also changed for the better. However, in looking at the big picture, it's also worth noting that the exemptions that were previously a part of our tax returns, are no longer around. This means that families with a larger number of children are losing a tax deduction for each child.

There are still seven tax brackets - 10%, 12%, 22%, 24%, 32%, 35% and 37%. Each tax bracket was modified, essentially reducing each former 2017 bracket by roughly 2% for 2018.

What's our take on the personal tax brackets and their impact on clients? Generally, it should produce a lower tax bill, on average, for *most* people. There are certain deductions that are no longer feasible to take in light of the fact that itemized deductions are harder to accumulate in excess of the standard deduction. Those taxpayers that are losing deductions in favor of the standard deduction may find that their tax bills actually increased under this plan.

Other Deductions. Previously mortgage interest was deductible up to the interest paid on mortgages that had balances of up to $1 million. In 2018, this number has been reduced to $750,000. This means that mortgage-related interest can only be deducted on the first $750,000 of mortgage-related debt. This continues to be an 'itemized' deduction and subject to whether or not this expense item exceeds the standard deduction.

State and local taxes are still deductible items on a taxpayer's Schedule 'A' on form 1040, but they are now limited. They are limited to no more than $10,000 in property taxes, sales taxes, and state-related income taxes for joint filers, with a 50% reduction for single taxpayers or married individuals filing separately.

Medical and dental deductions, for those able to itemize, are slightly more favorable. In past tax years, there was a 10% 'floor' for these expenses before a taxpayer was able to deduct these expenses. In the 2018 tax package, this number has been reduced to 7.5%, which in effect has lowered the hurdle for a person to deduct these expenses on their tax return.

Estate Taxes. For larger estates that are now under $22 million, you have nothing to fear. The estate tax exemption equivalent has been doubled from $5.5 million per person, to $11 million. For married couples, this now means that a couple can leave up to $22 million to anyone of their choice free from estate taxes. Estates in excess of the applicable exemption would face a 40% tax rate, which is not insignificant. Estates are valued as a sum total of all assets such as retirement accounts, life insurance, real estate, and personal property for purposes of calculating this tax. This tax, however, is separate from the *income taxes* that may be owed on inherited retirement plan accounts or annuities. While estate taxes may not necessarily apply, income tax ramifications may apply to estates and trusts no matter their size.

Corporate Tax Reform. The largest benefit may have gone to corporations under this tax bill. However, being an investor within the equity markets has recently proven to be a nice benefit, across the board, largely due to this tax bill.

Corporations were largely subject to a 39.6% tax rate on profits. As shareholders you were then subject to an additional tax when dividends were paid to you as an owner. This system was known as 'double taxation' and was largely an inefficient way to pass profits through to shareholders. The recent tax reform dramatically reduced the amount of tax that a corporation paid to no more than 21%. This is almost a 50% reduction to the corporate tax rate, and the markets took notice through increased stock prices, special dividend distributions, and employee rewards. When evaluating this benefit on its surface, it does stand to place domestic US-based corporations on a more level playing field when compared to the corporate tax structure of other countries across the globe.

Corporate Tax Reform Part 2. Corporations were also known to 'stash cash' in other countries. They would generate sales abroad, and maintain cash from those sales tucked into corporate subsidiaries that were domiciled in foreign countries with lower tax rates. The new tax reform provided for a 'repatriation tax' that permitted those cash balances when brought back to the United States to be taxed at a very generous rate. This incentivized companies to bring investment capital back to the US with the goal of deploying it in a more efficient manner. Apple alone incurred an additional tax of $30 billion during 2018 for this privilege with other companies following suit. This should permit companies to continue to add infrastructure, invest in their businesses, and spur growth in their hiring and bottom lines.

The recent tax package can go either way depending on your specific situation. Individuals with larger itemized deductions will not find this plan beneficial. Larger families will find that their tax burdens have increased, and married couples with equity-heavy investment portfolios and light debt loads will be happy. Corporations and their investors (which represents a large number of people) should be pleased. **OM**

Image: Sailing close-hauled, perfect breeze and gentle sea state. Telltales on the sails are demonstrating proper sail trim. Upper Lake Huron, south of DeTour Passage.

PROTECTING AN INHERITANCE

"No gift should ever be given unwrapped."

Written by: Susan Staffan Wipperman, JD, Trust Officer

You have worked hard for your money and invested wisely so why not take the steps necessary to ensure it stays in the family?

There are many foreseeable and unforeseeable situations; a spendthrift heir, a child's divorce, bankruptcy, or a disability that could result in the inheritance you left going to someone other than those you intended. Fortunately, there are solutions available that can protect your heirs' inheritance. Trusts offer protection beyond what traditional planning can offer that protect. A *discretionary lifetime trust*, if drafted properly, creates a legal barrier which protects the trust assets from your beneficiary's creditors, certain judgements and ex-spouses all while providing future estate tax benefits.

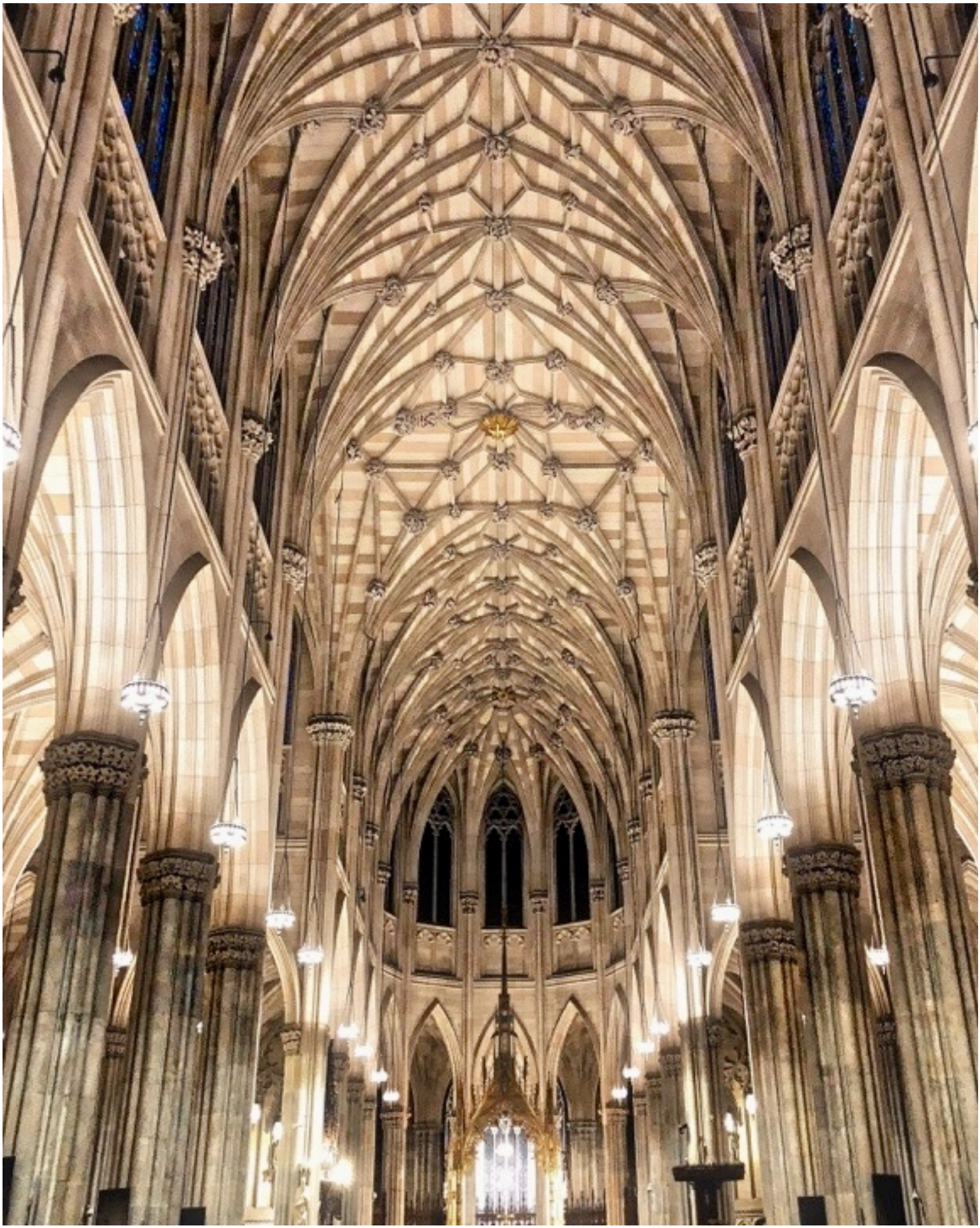
What is a Lifetime Discretionary Trust and How Does it Work? A lifetime discretionary trust provides for discretionary distributions for your beneficiary during his lifetime. Distributions are made pursuant to the standards you define in your trust. Instead of an outright distribution or staggered distributions (one third at 25, one third at 30, and the remainder at 35), the trust continues until your beneficiary passes. At your death, the lifetime discretionary trust is funded and holds assets for the next generation, while providing direction and control during the entire lifetime of at least one successor generation.

The trust names a trustee, usually a professional fiduciary like a trust company, who administers the trust after your death in accordance with its terms. The trusts are discretionary which means that the trustee is not required to distribute income or assets in a fixed manner. Instead, the trust grants the trustee the authority, within limits, to determine when, where, and how much should be distributed given the situation at that time. This flexibility allows the trustee to respond appropriately to a situation that could not have been known at the time the trust was initially funded. Perhaps one of the children is a spendthrift, has special needs, is bankrupt, or is experiencing a substance abuse issue. The discretion granted to the trustee allows for flexibility toward that heir and protects the inheritance you left from just about everything that can go wrong.

What Advantages Does A Lifetime Discretionary Trust Offer? *Protection in Divorce.* In most states an inheritance is not subject to division as marital property in divorce. However, with an outright distribution, it is easy for inherited assets to find their way into joint accounts or to become combined with other joint assets to become *commingled*. Once an asset is deemed commingled it is subject to division as marital property. However, with a lifetime trust, it is much easier to keep the inherited assets separate from marital property, as the assets that remain in trust must remain in separate accounts that are titled in the name of the trust.

Protection from Creditors. A discretionary lifetime trust that contains a spendthrift provision, a clause prohibiting the assignment of the interest to creditors, will generally protect the trust assets from attachment by the beneficiary's creditors. Assets held outright are not protected from the owner's creditors.

Image: St. Patrick's Cathedral, New York, NY. Accepting prayers on behalf of trustees, beneficiaries, and grantors since 1879.



Special Needs Beneficiary. For beneficiary's receiving or applying for needs-based benefits, lifetime trusts can be structured so it does not affect their ability to qualify or maintain their benefit.

Incapacity of the Beneficiary. In the event of a beneficiary's incapacity, assets held by a beneficiary outright may be subject to a court-ordered conservatorship. However, with a lifetime trust, the trustee will continue to be able to administer the assets for the beneficiary without court involvement.

Continued Control. You can continue to have some say in where the assets go upon the death of the beneficiary of a lifetime trust. That is, you can continue to protect your legacy by directing that any remaining assets go only to your descendants or to charities. To provide some flexibility, you can give your beneficiary the ability to alter how those assets are divided and distributed upon their death by giving the beneficiary the power to appoint, or direct the assets as they wish among your other descendants. Aside from these considerations, these trusts just make sense for certain beneficiaries. If you already know that an adult beneficiary is not good with managing his own money and you worry that he'll deplete his inheritance on vacations, cars, and luxury items in record time, a discretionary lifetime trust can be drafted to not only protect him from outside influences but also from himself. It can safeguard his inheritance against his own bad decisions or excessive spending habits.

Planning with Retirement Benefits. In 2014 the Supreme Court decided that assets held in an inherited IRA with a non-spouse beneficiary no longer constitutes retirement benefits for bankruptcy purposes and therefore are subject to creditor claims when the non-spouse beneficiary files for bankruptcy. States have the authority to enact their own law bankruptcy rules which would reverse this decision, but to date Michigan has not passed any such legislation. Therefore, IRA owners must look for other ways to protect their asset from their beneficiary's creditors. One way to accomplish this is to name a lifetime discretionary trust as the beneficiary of the IRA. Thoughtful consideration should be given to the tax consequences before changing the beneficiary designation on your IRA.

Tax Advantages. If there is a risk that the beneficiary's estate may be subject to estate taxes, a properly structured lifetime trust will allow the assets to pass to the beneficiary's descendants without the beneficiary paying estate tax. Assets held outright are always subject to estate tax.

Protection of illiquid Assets. An inheritance may contain valuable illiquid assets such as investment real estate, closely held stock from a family business, alternative investments, artwork, or collectables. Because of a lack of marketability, a forced sale to satisfy and fixed distribution may result in a deeply discounted selling price. A lifetime discretionary trust can provide that the assets to be sold in a manner to achieve the best price or alternatively to hold the assets for many decades. A properly structured and managed lifetime discretionary trust can provide better management of these assets.

Can You Super-Size a Lifetime Discretionary Trust? If a lifetime discretionary trust is good for one generation can it be expanded to cover several generations? Yes! Discretionary trusts designed to operate over several generations are referred to as Dynasty Trusts and can potentially last for multiple generations. In addition to the protections and benefits listed above, a Dynasty Trust will not cause any gift or estate tax for subsequent generations. The settlor will have to pay gift, estate and generation skipping tax if the amount used to fund the trust exceeds the current lifetime gift, estate, or generations skipping exemption amount. This can result in substantial estate tax savings—not in the estate of the settlor, but in the estates of the settlor's descendants. These estate tax savings are realized only if your family has enough wealth that future generations are anticipated to have taxable estates.

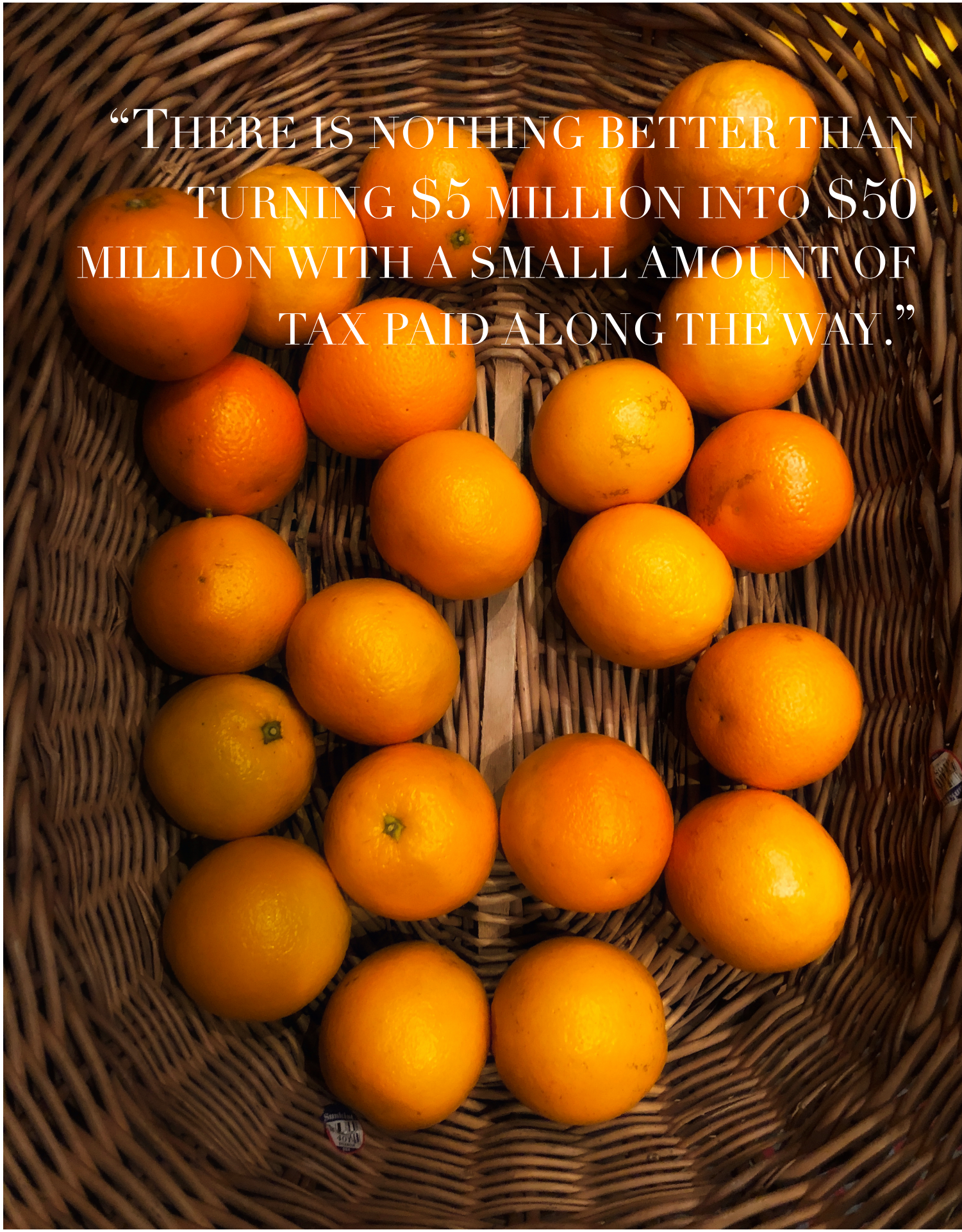
The biggest kicker or bang for the buck? Keeping assets in trust that generate income for your kids, your grandkids, and your great grandkids as needed, without a dime of inheritance taxes paid over the next 100 years. The government fumes at such vehicles, and has failed repeatedly at dismantling the rules permitting their existence. There is nothing better than turning $5 million into $50 million with a small amount of tax paid along the way.

Even with all the advantages offered by a lifetime discretionary trust, they are not for everyone. For a smaller trust, the costs of administering an ongoing trust could become prohibitive. In addition to the size of the trust other factors to consider are the beneficiary's age, the type of assets that will fund the trust, and the expense to manage the trust.

Use us! As a professional trustee, we serve for a number of families that need these types of services, not to mention a number of clients that have appointed our firm already within their trust documents. By serving as your advisor now, we offer a substantial amount of consistency once we step into the role as your trustee. If a long-term trust makes sense, or you feel it would be a good fit, let us know. We can give you our thoughts on your situation and begin the process.

Protecting assets against unintended beneficiaries, let alone the beneficiaries themselves, can be as much art as it is science with some significant benefits. Sometimes 'no' can be a term of affection, and when you weigh the costs *and* the benefits, long-term trust planning can make loads of sense in this interesting and unpredictable world. **OM**

Image: Inheritances, just like the oranges in this basket, should be protected against unwanted attempts by unintended 'takers.'



"There is nothing better than turning $5 million into $50 million with a small amount of tax paid along the way."

A TRUSTED *CONTACT?*

What is a 'trusted contact' and why should you add one to your account with our firm? A trusted contact is someone that WE have authority to speak with concerning your health, well-being, or welfare at times when we or your contact feels that you are at risk?

The planning process is about mitigating risks, and providing for those elements of life that may be uncertain. Insurance coverage goes unused for many people, but yet we still feel compelled to maintain insurance as a back up, '*just in case*,' we tell ourselves. We insure our cars, our houses, and in some situations, our lives.

Having a 'trusted contact' on record with our firm is no different. We maintain personal relationships with each and every client, and when things don't seem right who can we talk to? Is it a son or a daughter, or perhaps a neighbor that routinely checks on you?

The trusted contact doesn't have any authority on your account. They cannot remove money from your account, don't have the ability to sign on your behalf, make any trades within your account, nor do they have the right to obtain any financial information about you or your account. This plainly gives our firm the ability to reach out to your contact in situations where we suspect that you've been subject to fraud due to a mental or physical impairment, or it would permit our firm to obtain information about any behavioral changes linked to possible exploitation.

"...IF YOU CALL OUR FIRM AND BEGIN TALKING IN CIRCLES ABOUT JOINING THE CIRCUS WITH YOUR DECEASED SPOUSE, WHO SHOULD WE BE CONTACTING?"

Why should you appoint a trusted contact? With any luck, we all get older and hopefully *wiser*. Our money doesn't know that we've gotten sick, and our money can't tell when our decisions have been impacted by alzheimer's disease or dementia. However, who should we talk to when we may notice that your actions are inconsistent with your past? Not all of our clients have spouses that are alive. Clients without children require an additional level of planning - generally through additional trust planning - in order to assure that their assets are protected and safeguarded for their care when they don't have the ability to care for themselves. For single clients that don't have a support structure in place, having a 'trusted contact' can be a great idea. We just want to make sure that our ability to 'check in' with someone to assure your safety is a permitted action. One important note, however. Please don't think that we are trying to infringe on your privacy. It's not our intention to gather a trust contact's information in efforts to discuss or disclose personal financial information with this person. However, if you call our firm and begin talking in circles about joining the circus with your deceased spouse, who should we be contacting just to make sure that you aren't making terrible, life-altering decisions that would put you in harm's way, financially?

Our clients are important to us. We talk to you in person, on the phone, and with regularity. We've seen the checks that you've written, the charges on your account, and the actions you take on a daily basis. We know our clients personal lives, too, and that's where having a *relationship* with our firm is incredibly important for many reasons. Our goal, no matter who we may be working with, is to safeguard assets against fraud, or the intentional influence of others. Having a trusted contact is just one more safeguard we can have in place to insure that steps are taken if we feel your financial security is at risk. It's that simple.

How can you place a trusted contact on your account with our firm? It's really quite easy. Just give us a call, and we can initiate the paperwork in order to include this information on your account. Again, it's not permitting this individual access to your account information, or any other records. But, it does give us the ability to reach out to another party on your behalf just to make sure you are protected in the event we suspect that there is a problem.

Believe it or not, this is a real risk. Even to a point where regulators now have specific regulations referred to as the 'Financial Exploitation of Specified Adults' rule in order to address this significant concern. **OM**

Image: Iceboating on the ice of Lake Michigan.
Suttons Bay, Michigan.

CONSISTENCY COUNTS

When thinking in terms of estate administration, what are some of the decisions that you can make that could make the process of administering your estate more efficient and hassle free? ALL of your estate and trust documents should effectively play well together - from your trust, to your power of attorney, to your will.

Your estate and trust documents should be tightly wrapped up in a neatly constructed plan of action. These documents provide your loved ones, your power of attorney, your trustee, and your family's executor with a nicely-worded group of instructions concerning your care during your lifetime, and the care of your assets when you are gone. They possess the necessary 'road map' that is required outlining all the people that should be involved in this process. Having money can be fun, but taking care of it responsibly, both now and in the afterlife, is an important task at hand.

Same Team. Just like any professional team it's good to have everyone on the same page. There are goals and objectives to the estate settlement and administrative process, and apart from those items that pop-up now and again, there is little reason why administration, in general, can't go smoothly.

Different Assets, Different Documents. Contrary to popular belief, trust documents and wills do not control every facet of your financial situation. The type of account dictates the documents that provide control and even then it's also dependent upon whether or not you are alive at the time actions are required.

During your lifetime your durable power of attorney plays an important role in governing and managing non-trust assets such as individual and joint bank accounts, IRA accounts, 401K accounts, and annuity contracts. Powers of attorney do not govern trust accounts unless they are specifically designed to do so. In cases where we have seen any reference within a power of attorney used concerning trust-based assets, the responsibility is incredibly limited, and in most situations powers of attorney don't even mention governance of trust-based assets. That said, powers of attorney are specifically designed to exercise elements of control over your assets *during your lifetime*. Those actions that are required - such as required minimum distributions, tax payments, and tax filings - can be governed by your power of attorney.

Trust assets can exist as pieces of real property, stocks, bonds, checking accounts, savings accounts, and certificates of deposit. To the extent that the ownership of the various assets are titled in the name of your trust, they would be considered 'trust assets.'

While you are serving as your *own* trustee, you can manage trust property as you see fit. Upon your passing, your successor trustee will assume your role, and manage trust property in accordance with the instructions you provided within your trust document. A personal representative, also known as an 'executor,' has no rights or responsibilities to manage your 'trust estate' and only carries authority over your 'probate estate' to the extent that your estate is involved in some degree of probate involvement. As you can tell by the differing roles of trustees, agents under your power of attorney, and your executor, there are a number of different people that can be involved in this process. And above all, each individual may have a different

Image: The Vasa Festival of Races, fat-tire bike race. Fat-tire bikes have gained in popularity based on their ability to be ridden during the entire year. Racer Bonny Hall, 'head down, power up.'


BIKES
North American VASA
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"**IT** IS *SURPRISING* TO MANY THAT A DURABLE POWER OF ATTORNEY DOES **NOT** EXTEND TO YOUR TRUST, *AND* THAT YOUR TRUSTEE HAS **NO** AUTHORITY TO MANAGE NON-TRUST ASSETS, SUCH AS YOUR **IRA**."

responsibility depending on the type of accounts you hold within your overall estate. It can be confusing, no doubt.

Who to Appoint? The rules governing financial assets have gotten incredibly complex. Adding additional direction from your trust documents concerning split beneficiary interests, and complex ownership structures can make the process of estate settlement and administration difficult to understand.

Do yourself and your family a favor by naming the same people as your power of attorney, executor, and trustee under your estate planning documents. Your family will appreciate it, and those tapped for these positions will shoulder the responsibility with far greater efficiency. Above all, don't consider *different* people for the same 'large scale' responsibility. In thinking about a jetliner, a boat, or a ship, how many captains should there be? Quick hint, the answer isn't more than one and in a similar vein, tribes don't need more chiefs, they need more Indians.

How to Achieve Consistency. The most efficient, informed, and streamlined process will most likely produce the best outcome. There is a reason why teams work well together. They've been trained, understand the task at hand, and have been in settlement and administrative situations before.

To the extent that you are still alive, but incapacitated, your durable power of attorney will govern and manage your retirement and annuity assets. Also, if you are incapacitated, your successor trustee will step into your shoes, and begin managing trust assets as well. It is surprising to many, however, that a durable power of attorney does not extend to your trust, and that your trustee has no authority to manage non-trust assets, such as your IRA. To any professional advisor, it makes sense to have one individual or firm serving in a similar capacity - as both your power of attorney, and your trustee - so that the administration of those assets is handled in conjunction with the overall management plan.

Upon death your power of attorney is no longer valid, and any retirement account payable to your trust would be governed by your trustee. Also, should there be a probate estate through which assets must pass, it would also be advisable to appoint the same individual to handle the probate matters as your executor. Generally speaking, probate estates will eventually be payable to your trust, but first and foremost, the will must be probated in order to be validated, and then begin the process. In the end, the trustee will be the recipient of the probate estate, and it only makes sense to have the same person or company represent the estate-related matters across the board.

What is the policy of our firm, Old Mission Trust Company? We prefer to be named in all capacities - trustee, power of attorney, and executor. Plainly, in order to do the entire job effectively, we feel strongly that this should be considered as an overall plan for administrative harmony within any estate.

'Put Us In, Coach!' As a private trust company, we prefer to be named in your documents. Many of the new laws in place today permit adult children to serve in a non-administrative position within your trust documents, known as a 'trust protector.' This provides the family involvement necessary to keep families happy without individuals having to do the 'heavy lifting' of trust and estate administration. Additionally, we are confident in our ability to administratively serve, consistently, across all your asset types such as IRA's, 401K accounts, trust accounts, and annuities, since our knowledge base is extensive concerning the governance of those specific assets. During your lifetime the rules are written one way. After you pass away the rules change in favor of a convoluted set of rules, regulations, and requirements that very few people truly understand.

We aren't born as trustees or estate settlement professionals. It takes time to learn this as a skill and consistency does matter. In dealing with families having a central authority that can make decisions, sign documentation, and initiate actions swiftly and decisively can make a significant difference in the amount of time it takes to manage affairs and settle estates.

If you have any questions concerning how our firm can help manage your affairs during a period of incapacity, or following your passing, please let us know. We'd be open to having this discussion, and if any modifications are necessary to your existing documents we can guide you in that process.

We like consistency and families appreciate it too. In short, the right hand should really know what the left hand is doing, and by appointing the same people in a similar capacity, across the board, consistency of administration will be the result. **OM**

Image: Abandoned tennis court from above. Sugarloaf Resort, Leelanau County, Michigan, shuttered in March of 2000.

HOW CORPORATIONS WORK

What is a typical corporate structure? What's the difference between a President, Chief Executive Officer and the Chairman of the board? How does it all work, who is really accountable and to whom?

Corporations are comprised of *people*. People that are made up of shareholders, officers, and employees of the the company.

Shareholders. These are the owners of the company. They own shares of stock, and are the ultimate recipients of the profits of the company. They vote their shares in accordance with their intentions as owners of the company. Shareholders authorize things like issuing additional stock, voting on matters involving mergers and acquisitions, and are generally entitled to certain reports detailing the financial activities within the company.

Board of Directors. The Board of Directors of any company is elected by the shareholders. The Board serves as the representative governing body on behalf of the owners or shareholders of the company. The board *appoints* members to the executive team such as the Chief Executive Officer, President, and various other roles in order to specifically have those individuals carry out the goals and objectives of the company.

Chair of the Board. The Chair of the board of directors is responsible for guiding the board through meetings, setting the tone of matters involving policies and may initiate certain strategic recommendations and guidance over board activities. This is the most senior level of the company, and is an elected position among the members of the board of directors.

Chief Executive Officer. The 'CEO' is the person who is chosen by the board to oversee and direct large-scale operations of the company, in addition to carrying out the strategic vision of the company as provided by the board. They are tasked with managing the people and assets of the company in a manner consistent with the direction from the board of directors.

President. This position is also a board-appointed position. The president of a company handles the management of the various department heads and executive managers to run the company. In some circumstances, the president and CEO positions are one in the same. In other situations, the president is the second highest ranking individual at the company. A president is charged with leading the day-to-day operations of the company, dealing with matters involving excellence in execution by managers, and can be summarized as the individual having the most responsibility concerning the daily operations of the company.

Managers and Employees. These are people who are responsible with dealing with customers, clients, and work in the area where the 'rubber meets the road' for purposes of sales, distribution and manufacturing. Without them, nothing would happen.

Just remember, the wheels in the factory don't turn unless something is sold. **OM**

Image: Industry9 hub samples, Einstein Cycles, Traverse City, Michigan.


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BENEFICIARY DESIGNATIONS

Primary and secondary beneficiary designations provide our firm with direction concerning the disposition of your accounts after your death. What are the other variations that you might consider, as well as the implications of failing to appoint a beneficiary?

Beneficiary designations come in all types and forms. For many accounts you must appoint a beneficiary who would inherit your account upon your passing. It's an easy way to assure yourself that assets will go to your intended beneficiary free of any hassles or significant issues. Generally speaking, when a qualified beneficiary is appointed there is no probate involvement that is required in order to usher assets from your account to the new beneficiary. It's simple and easy.

Primary Beneficiary. This is the 'first line' of beneficiaries that will ultimately receive your assets when you pass away. Depending on the type of asset received, there are actions that are required in order to move the assets out of your account and into the name of the beneficiary. Surviving spouses have far more options than non-spouse beneficiaries concerning retirement accounts with some actions required prior to transfer in order to satisfy certain IRS rules. Non-retirement accounts that have appointed a beneficiary - such as 'transfer on death' designations - have no IRS rules to consider.

Contingent Beneficiary. A contingent beneficiary is a beneficiary structure that is in place in the event that your *primary* beneficiary is no longer alive. A contingent beneficiary will receive property in the same manner a primary beneficiary would, with the same rights, benefits, and responsibilities held by any primary inheritor.

Death of a Beneficiary. If a beneficiary has passed away, an original account owner can make other arrangements to have assets divided in a few different ways.

First, you can make an election known as 'per stirpes' (pronounced '*pur-sturps*') that provides that a beneficiary's share of your account will then pass to their *own* heirs. If your son was a 50% beneficiary of your IRA account with the remaining 50% left to your daughter, and your son were to pass away leaving children of his own, the per stirpes election would ensure that *his* portion of the IRA account would be transferred to his children and the remaining portion would transfer to your surviving daughter. If you named two beneficiaries on your IRA account, your deceased child's portion, under a per stirpes election, would not transfer to your surviving child. How do you make a per stirpes election? It's simple, really. There is a checkbox next to each named beneficiary on your IRA forms. If it's checked, then the election has been made.

Another option to consider is known as a 'per capita' election. Under a per capita election, compared to per stirpes, it provides a slightly different variation when there is a deceased beneficiary. Assuming a son and daughter are appointed as equal beneficiaries and the son were to pass away prior to distribution, the surviving beneficiary would receive the *entire* account balance upon the passing of the account owner. Generally speaking, per capita elections are the default account election when a per stirpes election is not made.

IF YOUR *TRUST DOCUMENTS* REFER TO A SPECIFIC BENEFICIARY SUCH AS A CHARITY OR A SPECIFICALLY NAMED INDIVIDUAL TO INHERIT YOUR ESTATE, AND YOUR *RETIREMENT DOCUMENTS* APPOINT SOMEONE OR SOMETHING COMPLETELY DIFFERENT, THE RETIREMENT ACCOUNT BENEFICIARY DESIGNATION FORM WILL **COUNT.**

Trust as a beneficiary. For those who have gone one step further, and created a trust for themselves and their family, appointing the trust as a beneficiary of a retirement account is another option to consider. Special language should be present within the trust document that specifically deals with retirement benefits left to a trust. We have also written about the benefits and protections of IRA assets left to a trust in another article in this publication, and quite frankly the benefits can be significant. In short, appointing a beneficiary outright gives them free access to the capital. Appointing the trust as a 'middleman' can provide structure to the distributions based on what's appropriate in light of the risks and circumstances.

There are a few more hoops that a trustee must consider when administering retirement assets left to a trust, and while it's not daunting by any stretch, the laws do make it more complex to handle in terms of how beneficiary distributions are calculated and ultimately handled in light of the trust as a beneficiary.

Failure to appoint. Failing to appoint a beneficiary isn't the end of the world, but it will cause a little bit of a problem. Organizations such as Fidelity, as well as banks and other institutions, have a set of rules that you agreed to when creating your account. One of those rules had to do with the various state laws that govern retirement account administration. Fidelity, for example, defaults to Massachusetts law that deems that any retirement account absent a proper beneficiary designation would first go to a surviving spouse with the appropriate proof of marriage. Absent a surviving spouse, the assets are then required to go through probate court and ultimately will be controlled by the property distribution provisions within the decedent's will. Needless to say, appointing a beneficiary on your account documentation is the best option, and contrary to popular belief, the government does not get your money absent a beneficiary designation. The government does, by state law, essentially 'draft' a will for you, indicating where your assets ultimately go.

The differences between a beneficiary and an heir. A beneficiary is an individual that you have specifically appointed within your documents. When you name a spouse, a son, or a daughter in your documents specifically, they are regarded as a beneficiary. An heir is a blood relation that, through most state's inheritance laws, would inherit property absent a specific direction from the decedent. Money is a 'heat-seeking missile,' and it will eventually find the appropriate person in your family lineage. People routinely believe that because an individual had no children that they've left no heirs. This is totally false. We all have relatives, and believe it or not absent children of our own, we all have legal heirs. Heirs, however, are not determined until our death, since many times legal heirs may have died leaving 'heirs of heirs.'

Worst Option of All. The worst outcome is failing to change a beneficiary appointment. Think of the ex-spouse that was still listed on an IRA account, life insurance, or an annuity contract as a beneficiary even after the divorce was final. Since many organizations will have a standard protocol concerning the failure to appoint a beneficiary, institutions can't really interpret your intentions and force a change posthumously. In many cases, what you've listed is permanent after your death.

401(k) plan accounts are different. Federal laws require that 401(k) plan accounts *must* list a spouse as a primary beneficiary and to the extent that a non-spousal beneficiary is appointed, the current spouse must sign a notarized affidavit attesting and consenting to this action. Laws do not permit an employee to disinherit their spouse concerning 401(k) plan accounts, where IRA accounts, by contrast, do not have such a requirement. An ex-spouse that asserts a claim on a deceased ex-spouse's 401(k) account will not prevail as a beneficiary since the *current* spouse is the bonafide beneficiary under law even if the documents on file with the 401(k) provider indicate something different.

It's the beneficiary form that matters! People should understand that beneficiary forms that are maintained for their IRA accounts, annuity contracts, and transfer on death designations are practically written in stone once they've passed away. The forms on file with your organization matter, and they carry substantial weight even to the point of trumping your own estate planning documents.

If your trust documents refer to a specific beneficiary such as a charity or a specifically named individual to inherit your estate, and your retirement documents appoint someone or something completely different, the retirement account beneficiary designation form will count, and your estate documents will remain lifeless and without distributive power concerning that *specific* asset. In the tug of war over your assets, the beneficiary designation forms held by your IRA will almost *always* win when compared to your trust and estate-related documents. If you want your trust to control the ultimate outcome of where and who inherits your property, your trust absolutely must be the entity that receives those benefits after you have passed away. To be clear, if you want your estate plan to have harmony with your intentions, please make sure that your documents are consistent in terms of their appointment of beneficiaries across the board.

Beneficiary designations, heirs at law, and charitable bequests are all complex decisions. While they may feel like easy things to do, the implication of taking those matters lightly can lead to issues, hard feelings, and outcomes that were not intended. As always, if you have any concerns regarding your beneficiary appointments or want to review your specific options don't hesitate to ask for a private meeting. **OM**

Image: Defunct chairlift from above, Sugarloaf Mountain Resort, Leelanau County, Michigan.

CRYPTO CURRENCIES

They are a digital wallet filled with a series of zeros and ones held on a computer in a land, far, far away. They trade like wildfire, and are as volatile as anything we've ever seen. They bewilder and confuse people since their value is a true enigma.

People have *heard* of Bitcoin. But what is it, how does it derive value, and how are they traded? Is there any value in owning such an 'investment?'

A 'crypto' currency is essentially a system that was created to facilitate payments between parties without having to use any sort of central authority, such as the Federal Reserve or the banking system. Cryptocurrencies aren't denominated in traditional currencies - such as yen, dollars, or euros - but rather they are held in electronic databanks that are verifiable based on *cryp*tography. Much like the serial numbers on each piece of currency in your wallet or purse, crypto currencies share a similar identifying trait. While a single bitcoin ranges in price from $4,000 to $15,000 over the past few years, they are divisible into as small as one hundred millionths of a bitcoin making them easy to transact no matter the size of the transaction.

Bitcoins are further broken down into two components: a 'bitcoin' - which is a token - and another *version* of bitcoin, that exists in cyberspace as a 'ledger balance' (like a bank balance) of the number of bitcoins a person may have on deposit. Both can be used for purchases and sales provided each party is a willing participant in the transaction. In a way it's no different than the beads that were used for purposes of bartering before our nation was born.

What makes such a currency attractive? Many believe that we are moving to a system that involves a single global currency. Whether or not this holds true will take a substantial amount time to figure out. Given the fact that cryptocurrencies such as bitcoin have successfully navigated this system for a number of years and quite successfully, it's no surprise that there has been a rush to purchase such a currency in the hopes that, once adopted and more accepted globally, prices will continue to move higher.

Bitcoins are also limited to a certain number, unlike traditional currencies. In the United States, the Federal Reserve system can continue to create and inject additional currency into the system for purposes of influencing economic growth. Bitcoins do not have this ability and have a maximum number of 21 million bitcoins that can exist in the market at any given time. Their value isn't based on anything 'intrinsic' such as gold, silver, or diamonds, but rather value derived from the simple fact that there are only so many to be 'mined,' as they say, as well as the other fact that people *believe* that they have value and use them interchangeably for purposes of paying for goods and services. Believe it or not, the same holds true for the US Dollar. There is nothing other than our own belief that the Dollar *has value* that actually *gives it value,* unlike times in the past when our own currency was backstopped by gold under the gold standard. In that light, are cryptocurrencies substantially different?

Cryptocurrencies are also protected by 'semi-anonymity,' meaning, the ability to specifically track their ownership and flows among those trading the currency is substantially impaired since there is no central system through which identification is made. From a money laundering standpoint, this is a significant concern held by governments across the globe. Most cryptocurrency exchanges are now required by law to identify their customers before customers are able to either purchase or sell cryptocurrencies, and since this network is largely transparent the trading done is visible to everyone.

Our guess is that bitcoin and other digital currencies are here to stay. While establishing the intrinsic value of such a currency is incredibly difficult, their value is completely determined by what one person is willing to pay. Again, if people *believe* that bitcoin has value, then it *has value* between the two parties in the transaction.

From our standpoint the digital currency market has a lot of room to grow. We don't regard digital currencies as anything other than speculative at this point, and have little knowledge of the long-term value of such an investment. They are interesting to watch, and perhaps may evolve beyond a financial experiment at some point. We are paying attention. **OM**

ECONO-SPEAK

'The economy, stupid' was the familiar phrase coined by James Carville, the campaign strategist for Bill Clinton in referring to what was important in terms of political victory. Economically, how are we doing?

GDP. The growth of our nation's Gross Domestic Product (GDP) has been steady and stable during the past year. With international economies beginning to improve, relatively speaking, it's no doubt that our international export business has been a significant contributor to our own GDP. GDP is a measure of all the output of the United States, including exports to other nations. Our year-over-year change has been positive by 2.6%, with the most recent quarterly change, compared to last quarter, positive by 2.9%. This compares to a long-term average growth rate of 2.9%.

Currency - USD. The dollar and it's relative value can control many things. An injection of currency within our own system can give corporations access to additional capital when needed. Additional capital within the system can also cause the prices of our goods and services sold internationally to be more attractive to international buyers. The past 24 months have seen a significant swing in the value of the Dollar, with 2017 ending negatively. The Trump administration has committed to a 'soft' Dollar policy encouraging a lower value of the US Dollar. Why? A lower value in the US Dollar will cause our exports to be less expensive compared with other countries' products, having a positive impact on *our* exports to international purchasers.

Inflation. Inflationary pressures have been significantly absent. We have benefitted from good economic growth without the negative effects of climbing prices. So far, having economic growth *without* substantial amounts of inflation is a 'have your cake and eat it too' scenario. There is an expectation that prices will begin to climb, slightly, as wages and demand for the materials necessary for product production begin to rise. Until now, however, we've been able to ride a 'fine line' between growth and controlled inflation.

Commodities Prices. Inflation and commodity prices generally go hand-in-hand. As demand for raw materials begins to increase so does the price of the products themselves. Commodity prices have been stable and relatively tame. Oil is one of the most significant commodities used in economic production, and to-date it's maintained a fairly stable posture. Since it's used in the manufacturing process in things like plastic, and it's certainly involved in the transportation of goods across our nation, as well as globally, it's no wonder that manufacturing keeps a keen eye on this precious resource. Oil prices, while volatile, are at the same levels as they were in 2014.

Markets. The stock market is a 'leading indicator' of things to come. On the heels of the 2017 markets the forecast is for economic growth to continue. Markets tend to provide investors with an opinion of the future, and with the passage of the tax package along with better international economic growth providing a positive stimulus to the economy, the markets have been pleased. Valuations, in light of the recent pull-back during February and March, are trading at 16.4 times next year's earnings, which is slightly higher than the 25-year average of 16.1. This means that equity prices, as demonstrated by their earnings and profits, aren't trading at extremely high levels relative to past and historical values.

Savings Rates. People are saving money, and being more prudent concerning debt management. If the housing crisis taught the United States 'saver' anything, it taught them to borrow less and save more. At present, 10.3% of household disposable net income is devoted to debt payment. This compares with 13.2% during 2007, the beginning of the debt crisis. This represents a 22% decline in debt payments, on average, for the American citizen. In 1980 Americans were spending 10.6% of their disposable incomes on debt payments. In short, we seem to have regressed back to a 'normal' pattern of debt management. Household 'net worth,' measured by the traditional formula of 'assets minus liabilities,' is now showing that the average American household now has 47% more in household assets than measured at the end of 2007.

Interest Rates. Interest rates have a tremendous amount of influence on the progress of our nation's economy. Specifically, as interest rates rise the cost of

Image: Tandem Ciders, Leelanau County. Taste testing is always fun.

"*Fun fact*, as of June 2017 China only held 5.8% of the debt of the United States. In our opinion, China needs us more than we need them."

carrying debt will also rise as will the potential attractiveness of using debt. Higher rates will negatively impact economic growth. Where are we today? Without a doubt we are seeing higher interest rates. The Federal Reserve has taken a more 'dovish,' or a more measured approach to higher rates. The past few months have certainly seen a higher rate environment become a reality with the 10-year Treasury bond now yielding 3%. Comparatively speaking, this is exactly where rates were in December of 2013. Market-watchers are expecting rates to continue to rise for the next few years, but not at a feverish pace.

The Debt. First, we are not bankrupt. Everyone focuses on the debt, and fails to consider the other side of the balance sheet - the assets. We are a nation in debt, with total debts of $146 trillion. Our assets totaled $270 trillion by the same measure. As a function of GDP, our assets and liabilities are 1,576% of our total output, and 852% respectively. Simply put, we have a positive net worth.

Speaking specifically of government debt, our total national indebtedness presently stands at $20.2 trillion. Much of this is financed at significantly lower rates than the past, and with longer-term bonds coming due and ultimately being reissued at lower rates of interest it should be no surprise that the national debt and its related costs, such as interest, now costs us slightly less than it did in 1950. Debt costs peaked in 1990 with the high interest rates of the early 1980's, and with lower rates today, the cost of carrying the national debt, as a function of total Federal outlays, is approximately 6.8% as provided by the Office of Management and Budget (OMB). How much interest does the government pay on the national debt, yearly? The OMB estimate in July of 2017 was that this number was $271 billion, with an average interest rate of 2.3%. How much of the interest was paid *back* to the United States taxpayer through ownership structures such as pensions, mutual funds, banks, insurance companies, and other private domestic entities? 71.4%.

Fun fact, as of June 2017 China only held 5.8% of the debt of the United States. In our opinion, China needs us more than we need them.

Global Growth. The world is a big place, no doubt. But global trade, no matter where you live or produce your product, is getting easier. Global growth is gaining momentum since 2016, and the pace of growth is substantial. International economies had a difficult time recovering from the global crisis in 2008, but things have changed. Their banks too, have undergone a rigorous stress-test and recapitalization causing a lag in their participation in the reflation of global economic growth. They've been late to the party, but since 2016 this seems to have reversed course. While the United States has enjoyed a booming economy, other international economies have struggled. Emerging markets have had the best growth with other regions such as Europe and Japan also benefitting.

Valuations of international equities have also become more attractive. As international companies have continued to improve their own fundamentals over the past decade, their stocks have not fully participated as much as United States companies have. Since the lows of 2009, international stocks have only rallied 123% while United States stocks have increased substantially by almost 290% during the same period. Valuations for international equities represent almost an 18.9% discount to domestic equity prices. If you assume that global growth rates were equal, international investments might be worth considering even further.

HOW much of the interest [from the national debt] was paid *back* to the United States taxpayer through ownership structures such as pensions, mutual funds, banks, insurance companies, and other private domestic entities? **71.4%.**

Housing. As interest rates have fallen, the attractiveness of buying a home has once again increased. As noted above, however, the type of buyer has also improved in light of better and improving credit scores. Lending standards have tightened to a point where the average borrower's credit score is now holding steady at 751, compared to 700 in the mid 1990's. Housing affordability has also increased, with 13.4% of household incomes devoted to mortgage payments in households that hold mortgages. This compares to a long-term average of 19.3%, with an average interest rate of 4.45% at the end of the first quarter of 2018.

Unemployment and Wages. Unemployment rates have continued to drop. As noted earlier, the ability to carry low unemployment with low amounts of inflation is a version of 'economic nirvana' in a way. Unemployment reached 10% in October of 2009, only to recently bottom at 4.1% in February of 2018. It's worth noting that as economic growth improves employers will have a more difficult time finding skilled labor to fill necessary positions. What's the best way to attract labor to your company? Offer higher wages. Higher wages will eventually translate into higher prices paid for the products that are produced. At this point a tight employment market has yet to translate into higher prices, but time will tell.

All in all, we get a B+. **OM**

Data and information for this article from Morningstar Advanced Analytics, JP Morgan Asset Management, Federal Office of Management and Budget (OMB).

Image: Topaz Lake, Upper Lake Huron, North Channel.

Re THE BALANCE

Stocks, bonds, and cash assets should be allocated in conjunction with not only your targeted rate of return, but your appetite and willingness to accept a certain level of risk. How do you adjust a portfolio in light of the moving parts, and how can 'rebalancing' be a beneficial exercise?

What's the best way to keep a portfolio on track and within its allocation and risk profile? Rebalance. The concept of rebalancing is not new. We've talked about it before, but wanted to once again bring it to the forefront in terms of why it's done and the benefits involved.

Why do it? The initial allocation decision among stocks and bonds is just that - an 'initial' allocation. It does not mean that your allocation is permanent and never changing. As actions are taken within your portfolio, such as distributions or contributions, we allocate funds based on your allocation target. Over time, however, the returns of different investments within your account will change and the values of your investments will eventually 'stray' from their intended target.

For the past several years, stocks have had great relative returns when compared to bonds. By comparison, when bonds have averaged a 4% return, and stocks have provided your portfolio with a 10% return, there will now be a larger exposure to stocks compared to your original targeted allocation. Simply put, one asset class now has more money than originally intended and the process of rebalancing will bring your allocation back to your intended target and back on track concerning an acceptable level of risk within your account.

When. It's not that rebalancing should be done every day, month or year. But a good rule of thumb that should be followed is that rebalancing should be done when an allocation strays 10% from an initial *relative* allocation. Another option to consider, is to rebalance after at least a 1-year period has passed. By waiting for at least 12 months and a day, investors will avail themselves of the favorable long-term capital gain tax treatment for taxable accounts. We'll discuss taxes in another section of this article.

Let's make the assumption that a portfolio was originally allocated with a 60% allocation to a standard stock portfolio of diversified funds, with the remaining 40% allocated to a bond portfolio. Over time let's also assume that stocks have outpaced your bond portfolio to a point where your stock allocation is now 70% of the total, which is 10% more than the original allocation. Relative to the original allocation this represents a 16% *excess* allocation to the stock portfolio which is greater than 66.6% that would have been normally permitted.

A rebalance will have the impact of removing 10% of the stock allocation. However, the money must go somewhere. As with a teeter-totter, when one asset class performs well, there is another that, relatively speaking, doesn't do *as well*. This doesn't mean that taking two investments together produces a sum of 'zero,' but rather it is possible to have to asset classes produce positive returns, with one returning less than the other. In the example provided above the 10% excess allocation in stocks would be removed, and the 10% would be redeployed into the bond portfolio.

Image: Birthday parties are always a good time. While many people may see balloons, portfolio managers may see overlapping allocations of investment styles, known as 'holdings-based style mapping' for purposes of portfolio analysis.

This action has the impact of 'selling high, and buying low.' Rebalancing actions sell the asset class that has done well, and adds to the asset class that may have been lagging. While conventional investment management wisdom has also provided that 'you should let your winners run, and cut your losers,' maintaining this posture can be problematic in light of risk considerations. Since stocks will most likely produce higher returns over the long-term when compared to bonds, a retired individual could eventually find that the vast majority of their portfolio is equity-based, ultimately assuming more risk than originally budgeted. Rebalancing actions have the impact of keeping risk in check while also 'pruning the trees' of the portfolio periodically.

Emotion control. Investing can be a psychologically-driven event. During any given day the markets are a sum total of the emotions, opinions, and 'bets' that are being placed either against or in favor of many of the companies within the market. Daily market actions are generally more 'reactive' to daily news items when longer-term market movements are more tied to the true economic picture.

Investor decisions can be made in reaction to panic, greed, missed opportunities, or loss aversion. The rebalancing done within a portfolio apply a more mathematical approach to investment management and risk control without the expense of having an emotional tie to the decision-making process. As portfolios stray from their intended targets a rebalance trigger might be a good rule to maintain thereby taking the emotional question of 'do I sell stocks today,' out of the equation.

Risk control. As a general market observation, risk and return go hand-in-hand. Generally speaking, the more risk an investor assumes, more return they can expect. While this doesn't always happen, risk control is important in the portfolio management process.

The ability to systematically trim positions when they are doing well while also adding to other positions that aren't can mitigate the inherent risk of the portfolio getting out of control. There was a point in the late 1990's when a substantial portion of the Standard and Poor's 500 index was represented by technology-driven companies. This existed within the index due to the simple fact that 'big companies kept getting bigger' and they continued to gather the lion's share of investments. Over time this was proven to be disastrous from a return standpoint when maintaining a more diverse approach of owning a variety of different asset classes, evenly - both value *and* growth - would have provided a far-less bumpy ride during the 2000, 2001 and 2002 markets.

The ability to systematically trim positions when they are doing well while also adding to other positions that *aren't* can mitigate the inherent risk of the portfolio getting out of control.

Tax considerations. Tax implications are always a concern when a substantial number of changes are made within a *taxable account* such as a trust account, single account, or a joint account. Rebalancing, when done, should take into consideration any sort of tax issues, while also being mindful of the tax 'cost' of such actions. As noted earlier, a one-year holding period for investments should be honored in order to avail investors of the beneficial long-term capital gain tax rate, when available.

Retirement accounts, however, can be rebalanced as frequently as needed without regard to tax implications. Since the gains on trades within retirement accounts are not subject to the prying eyes of the government, rebalancing trades produce no taxable events, and as such can be a tool for tax deferred accounts such as IRA's, 401(k) accounts, or Roth IRA's.

Rebalancing is a simple process, and if you know anything about 'simple' processes, understand that if is not done correctly, they are prone to failure. Letting emotion dictate when to rebalance can be a problem, and above all picking and choosing the assets to rebalance while ignoring others can be problematic. Stick to a plan, and execute that plan in order to keep the allocation moving along as expected and within an acceptable level of risk. It can work just fine, if you let it. **OM**

Image: Watertower, Building 50 complex, Traverse City, Michigan.

ETFs

Exchange Traded Funds represent a significant 'tweak' to the mutual fund concept and allowed for the use of a new(er) investment product for purposes of transparency, cost savings, and tax efficiency.

Exchange Traded Funds, commonly known as 'ETFs' have gained in popularity over the past 20 years. ETFs were originally developed as a way to deploy investments within a small group of international investments for large pension funds. They rapidly gained popularity in their pace of development and uses, ultimately becoming more mainstream in their application.

ETFs are investments that represent a diversified investment vehicle much like a mutual fund providing instant diversification among a broad number of asset classes. Within a traditional ETF investors are exposed to hundreds, if not thousands, of individual investments. ETFs can be managed in either an active fashion - where there are investments selected based on a certain level of criteria by a management team - or, they can be more quantitative or passive based on criteria alone.

Comparison to mutual funds. The mutual fund industry started in 1924 with the first mutual fund ever created - the Massachusetts Investment Trust - a fund that still exists today. Mutual funds were created to provide smaller investors the ability to 'pool' their resources with other investors in efforts to diversify over a large number of securities through a single investment. Individual securities, then as they are now, are comparatively riskier due to their concentrated nature with mutual funds addressing this issue quite nicely.

ETFs and mutual funds are cut largely from the same cloth. They both provide diversification, the ability to deploy assets quickly into a variety of different asset classes, they permit relatively small investments, and they are liquid.

Liquidity is defined by a variety of different factors, not the least of which is *time*. Mutual funds are bought and sold at one time during the day, usually at 4:00 in the afternoon. Orders are aggregated through various platforms, custodians and other programs and sent to the mutual fund company at the end of the day. At that time the value of the fund is calculated and the various purchases and sales are handled all at once. It's at that time the portfolio manager of the mutual fund raises cash for redemptions, or invests the cash received from purchases. These actions - buying or selling - impact the general portfolio managed by the mutual fund company with managers left to the task of determining what to buy, and what to sell in order to accommodate the various cash needs of the fund.

ETFs, however, are slightly different in this regard. ETFs are traded *during the entire day* with their market values published every 15 seconds through the various exchanges. ETFs are bought and sold like individual stocks, but again, they are far more diverse than individual securities. Since they are generally driven by mathematical formulas concerning their composition there are no requirements of a manager to 'tend the flock' when flows of cash are credited or sales need to be made. Shares are either purchased from other sellers within the secondary market, or are handled through primary market actions that involve the funds themselves. Either way, they are liquid and have enhanced trading options that traditional mutual funds do not have.

Tax efficiencies. ETF investments are incredibly tax efficient as a byproduct of their management. They rarely distribute capital gain distributions at the end of each year, and permit the investor or advisor with the ability to control when gains are harvested. Investors that have a substantial amount of money in retirement accounts don't have to worry about tax efficiency. However, investors that hold assets outside of deferred accounts - such as trusts, individual, and joint accounts - do have to consider taxes as a part of their overall cost and strategy.

Mutual funds have been known to provide investors with a 'wild tax ride' without regularity from one year to the next. Astute investors and advisors are aware of impending tax consequences concerning funds and may find ways to mitigate this issue. For many investors this can be a 'tax gotcha' at the end of each year depending on the actions taken within the individual fund.

Image: Sampling of metal cars, Darling Botanical Company, Traverse City, Michigan.


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"[ETFs] MAY ALSO USE ELEMENTS SUCH AS DIVIDEND YIELD, SALES, EARNINGS GROWTH, PRICE TO BOOK VALUE, OR A VARIETY OF DIFFERENT METRICS IN ORDER TO EFFECTIVELY 'PACKAGE' THEIR FUND BASED ON A SPECIFIC NICHE OR A MORE BROAD MARKET APPEAL. IT'S NO LONGER ONLY AN INDEX INVESTMENT PROXY.

Speaking broadly of taxable accounts, ETFs shine in this space. More specifically, for purposes of use within irrevocable trusts, they truly offer a level of tax efficiency that is unparalleled. The amount of tax control afforded the trustee in the case of an ETF portfolio can be very beneficial for long-term wealth creation and efficiency.

Cost structure. Since exchange traded funds do not require management on a day-to-day basis, their expense structure is significantly less than traditional mutual funds. As advisors, we are charged with researching, selecting, and managing assets on behalf of our client, and with lower internal operating expenses for client accounts this can be a great benefit. It's worth noting that low cost and high returns don't always go hand-in-hand, but in many instances they certainly can.

Performance. The performance of an ETF can be similar to a normal mutual fund. A large company value ETF can be compared to a large company value *mutual fund* just as easily as mutual funds are compared to one other. Since the 1990's the universe of ETFs has grown from a select few to 2,175 as tracked by our database. Mutual funds, by comparison, have ballooned to a little more than 27,000 including all the variations and share classes that are now offered. We believe that the absolute size of the combined ETF and mutual fund market make selection and analysis even more important.

ETFs are largely based within 'passive' investment strategies. As we had mentioned earlier, ETFs tend to lack a substantial manager presence within their structure, and as a result tend to be more quantitative or mathematically based investments. They will gravitate toward selecting investments based on a criteria rather than a manager's opinion. What are those criteria? An ETF might use 1,000 of the largest capitalized companies as measured by market size. They may also use elements such as dividend yield, sales, earnings growth, price to book value, or a variety of different metrics in order to effectively 'package' their fund based on a specific niche or a more broad market appeal. It's no longer only an index investment proxy.

One of the largest debates in our industry and within the investing public is the concept of 'passive versus active' which pits individual managers against an ETF or index-based strategy. Is there a clear winner? In the short run, ETFs have done a great job of providing good returns at a low cost. Active managers have had their backs against the wall but have demonstrated long-term value with some clearly better than others.

Our thoughts? There may not be a need to pick one over the other, since investment strategies - active or passive - can be like having two children, with both exceptional in their own right. ETFs make a compelling argument as a 'base investment' over some asset classes compared to others. As an example, the large company equity space has catered well to the ETF market, where other asset classes - such as small company equity, and international equity - have not been as beneficial. Why is this? In some asset classes, index-based or ETF investments may not truly be the best option in situations where a manager is required to properly vet investments. Additionally, there are other considerations that may require a more judicious approach to money management, such as currency hedging, the management of duration and maturity risk, and other items which would be regarded as moving targets that might be too specific for broad-based investment allocations through ETFs. In essence, those items which might be more nuanced might be best suited for active management compared to a single ETF allocation.

We feel strongly that if ETFs are to be used within a portfolio, that a 'core and explore' method should be used through which a small number of passive ETFs are used to build a base (referred to as a 'core'), while being 'flanked' by active strategies. Active managers are then paired with the passive ETF in efforts to provide a 'cover all bases' approach no matter which strategy is in favor. ETFs and funds can exist on the same playing field if managed appropriately.

The business of investment management is evolving with different strategies, varying investment products, and ways to use them interchangeably. When blended with a traditional portfolio for purposes of asset allocation, it can be a 'win-win' relationship across the board when both active and passive

Image: The American White Pelican, as spotted on northern Lake Michigan, Big Bay de Noc. American White Pelicans migrate from the Gulf of Mexico to their nesting grounds in Canada.

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