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As we look toward the final quarter of 2012 and onto the 2013 horizon, you may find yourself evaluating your investment goals or particular items within your wealth management

plan. Any new term or cycle provides us with an additional opportunity to review current strategies and confirm tactics or adjust accordingly. If proactive review has been top of mind for you, this newsletter will provide some additional food-for-thought.

In this edition, KC Mathews provides perspective on items affecting the “fiscal cliff” and what that means for investing, while UMB Chairman and CEO Mariner Kemper shares his thoughts on the need to emerge from the crippling financial crisis mentality in order to move America forward. Also, as gifting continues to be a topic of interest for many of you, we’ll address some key considerations for planned giving intentions.

When it comes to your personal wealth management needs, you can rest assured knowing that your UMB Investment & Wealth Management team will keep you up-to-date on the issues affecting you and your strategy. And to that point, our team has already begun planning our 2013 economic outlook events, so stay tuned for further information about where and when you can attend these in your city.

We hope you find the enclosed information helpful and informative, and we look forward to talking with you soon.

Sincerely,

The Policy Basin

KC MathewsExecutive Vice President &
Chief Investment Officer,
UMB

The looming tax cut expirations and budget cuts, often referred to as the fiscal cliff, are set to play out at the end of this year. My forecast suggests that we will not experience the full fiscal cliff in 2013, which would be a 4 percent to 5 percent hit to our economy, but rather we will be caught in a “policy basin” for an extended period of time. A basin can be defined as a low and sometimes sinking region. Over the next several years, we may be subject to an economic environment that will experience low growth or even sinking growth due to the following:

1. Ineffective monetary and fiscal policies
2. Growth challenges due to excessive debt levels
3. Demographics

If a policy basin comes to fruition, I believe it can still be an environment that is modestly supportive of the U.S. economy and equity markets. This forecast calls for Gross Domestic Product (GDP) growth to be less than 2.5 percent for a three- to five-year period. While the policy basin may ensure low growth, it avoids a recession. A contraction of GDP could be set into motion if politicians mishandle the delicate fiscal situation and lead the economy back into a contraction, much like the double-dip recessions of 1937 and 1982.

Policy

Despite unprecedented policies enacted to support the economy since the Great Recession, GDP is barely growing and our debt-to-GDP ratio is near 100 percent. Simply stated, accommodative fiscal and monetary policies have not yet worked to the extent desired. The Fed has aggressively pursued unconventional monetary policies as more traditional policy tools, but these have failed to move GDP back to normal levels. These unconventional measures included: purchasing equity in banks via the Troubled Asset Relief Program (TARP), three rounds of quantitative easing (QE), and a program designed to lower long-term interest rates known as Operation Twist. With all of these actions, the Fed’s balance sheet has expanded by nearly \$2 trillion since the recession began. Fiscal policy has also been accommodative. Congress passed an \$800 billion fiscal stimulus package in 2009 known as the American Recovery and Reinvestment Act, in an attempt to spur aggregate demand.

While the overall impact of monetary policy action on growth is debatable, it is clear that fiscal policy is now serving as a drag to growth. Excluding the Q3 2012 GDP reading, in which defense outlays increased significantly on a one-time basis, reduced government expenditures have detracted from economic growth for eight quarters in a row. Furthermore, while monetary policy may not be a drag on growth, it has proven largely ineffective in stimulating aggregate demand to any meaningful degree. Some suggest the ineffectiveness of monetary policy can be attributed to what is known as a liquidity trap. A liquidity trap essentially means that interest rates are close to zero, but the rapidly expanding monetary base (savings) does not get translated into a growing money supply. As such, the low rates fail to stimulate economic activity.

Lastly, as a result of expansionary fiscal policies, the budget deficit (relative to GDP) is at an unsustainable level. The total government debt-to-GDP ratio, which caused Standard & Poor's to downgrade our debt from AAA in the summer of 2011, will likely negatively impact growth in the years ahead. Lastly and unfortunately, the debt ceiling debate will once again come to the forefront in March 2013.

Growth/Debt Challenge

The U.S. is currently muddling through the weakest economic expansion since World War II. Normally following deep recessions, economies tend to grow at an above-trend growth rate for several quarters to make up for the lost economic output during the recession. For example, after the deep recession in the early 1980s, during which both unemployment and inflation were running in excess of 10 percent, economic growth eclipsed 3 percent for 13 consecutive quarters. By comparison, since the most recent recession ended in 2009, we have only grown in excess of 3 percent in two quarters, total. This forces the question as to why growth has been so anemic relative to past recoveries and what type of economic growth can be expected in the future. I would submit that the household and financial sector deleveraging process seen over the past couple years helps explain the slow rate of economic growth. Economies that enter recessions in conjunction with or due to a financial crisis typically exhibit slower recovery rates as the mechanism by which capital flows through an economy (banking/financial system) is impaired and households/corporations/governments tend to focus on the repair of their balance sheets. The latter typically involves an increased savings rate (deleveraging) that inhibits the normal quick rebound from the recession.

Research suggests that for both advanced and emerging economies, the relationship between growth and debt seems relatively weak at "normal" debt levels, median

growth rates for countries with public debt more than 90 percent of GDP are roughly 1 percent lower than normal and average (mean) growth rates are several percentage points lower.¹ This phenomenon can be explained by the necessity of either raising taxes, lowering spending, or both, to bring down the deficit and debt. The 90 percent of GDP threshold can be partially attributed to rising risk premiums in the bond markets that call for fiscal contraction to maintain credibility in terms of willingness and ability to pay creditors. To highlight the predicament of the U.S. with respect to public debt, Moody's recently stated the following: "Moody's views the maintenance of the Aaa [debt rating] with a negative outlook into 2014 as unlikely. The only scenario that would likely lead to its temporary maintenance would be if the method adopted to achieve debt stabilization involved a large, immediate fiscal shock—such as would occur if the so-called "fiscal cliff" actually materialized—which could lead to instability."

I analyzed 45 historical episodes of deleveraging since the Great Depression in both developed and developing economies. Having specifically focused on the 32 episodes that followed financial crises, I found that deleveraging has been painful and long lasting, generally lasting six to seven years, on average. As such, if history is a guide, I would expect several more years of debt reduction. This process will exert a significant drag on GDP growth.² However, some have suggested that a less painful pathway for reducing debt is to grow the economy at high enough rates to offset the negative impact of deleveraging as opposed to imposing fiscal austerity. This option seems unlikely in the current environment given the reduced tailwind from favorable demographics and accommodative fiscal policy going forward.

Demographics

Some experts have argued the U.S. will experience a lost decade consisting of low growth and deflation similar to Japan in the 1990s. From 1986 to 1991, Japan experienced rapidly increasing real estate and equity prices only to have the bubble burst in 1991. In contrast to normal recoveries, Japan's asset prices showed no propensity to recover and actually continued to decline for more than a decade. Some of Japan's lost decade story is starting to sound familiar, as the country implemented ineffective and/or inept economic policies that failed to revive the economy after a severe recession.

1 Reinhart, Carmen M., and Kenneth S. Rogoff. *Growth in a Time of Debt*. Rep. N.p.: American Economic Review Papers and Proceedings, 2010. Print.
2 Roxburgh, Charles, Susan Lund, Tony Wimmer, Eric Amar, Charles Atkins, Ju-Hon Kwek, Richard Dobbs, and James Manyika. *Debt and Deleveraging: The Global Credit Bubble and Its Economic Consequences*. Tech. N.p.: McKinsey Global Institute, 2010. Print.

However, there are several important distinctions between Japan and the U.S. I would argue the most significant contributor to Japan's lost decade was the dramatic deterioration in its demography in terms of the working age population. Japan's working age population peaked in the mid 1990s before falling sharply. This is in contrast to the U.S., where according to U.N. projections, the pace of growth of the U.S. working-age population is expected to slow over the coming decades, but still grow.

Another meaningful divergence was regulatory forbearance afforded to the banks in Japan with respect to the recognition of bad loans. Japan's banking system was festering with troubled loans for more than a decade, limiting the willingness of banks to make loans and thus clogging the monetary transmission mechanism. By comparison, the U.S. quickly purged the banking system of problem loans.

Lastly, Japan experienced deflationary conditions for nearly a decade whereas U.S. inflation has been running consistently in the 2 percent range. Therefore, in my view, the U.S. will not experience a lost decade similar to Japan in terms of asset prices. That being said, I would suggest that the potential economic output in the U.S. is lower than in the past due to fiscal and monetary policies, deleveraging, and changing demographics. Thus, I anticipate slower and slower economic growth going forward – a basin.

Demographics are a critical variable in terms of potential growth in an economy. Our demographic situation will be challenging, but is not nearly as dire as that of Japan or even that of Europe. Between 1950 and 2000, the U.S. civilian labor force grew at an average annual rate of 1.6 percent. The growth rate has slowed since then and is expected to continue to do so as a result of the aging baby-boomers. Between 2000 and 2010, the annual growth rate of the labor force fell to 0.8 percent. Our labor force growth forecast for the next 10 years is 0.7 percent.

Productivity growth has ebbed and flowed over time. Between 1947 and 1973, productivity grew at a pace of 2.8 percent. From 1973 to 1995, productivity slowed to an annual rate of 1.4 percent. It re-accelerated to 2.9 percent from 1995 to 2005. Finally, it slowed, again, to 1.6 percent between 2005 and 2011.

Forecast long-term trend growth can be distilled into a simple formula:

$$\begin{array}{r} \text{Labor Force Growth} \\ + \\ \text{Productivity} \\ \hline = \text{Real Economic Growth} \end{array}$$

Checking the efficacy of the formula, since World War II, U.S. GDP growth has been 3.3 percent. Labor force growth has been 1.3 percent and productivity growth has been 2.2 percent. My formula would have forecasted a fairly accurate 3.5 percent economic growth.

Based on my forecast of 0.7 percent labor force growth rate and 1.6 percent in productivity growth, my long-term trend growth rate forecast is 2.3 percent, consistent with expectations of the Congressional Budget Office (CBO), which publishes projections of potential economic growth. Its most recent forecast suggests real GDP will not reach its potential, meaning real GDP growth less than 2.3 percent for the next 10 years – creating what I term the policy basin.

Final Thoughts

I think politicians will not allow the economy to go over the fiscal cliff and create the next recession. Rather, I believe a hybrid solution will be reached, generating a policy basin for protracted U.S. economic growth of less than 2.5 percent. The fiscal cliff is certainly a concern; however, it took us 40 years to create the problem, and I'm not convinced it can be resolved in a year or two.

It is important to note that this news may not be negative for the equity markets. In fact, I think corporations may be able to grow earnings in the 4 percent to 6 percent area in this environment, which has historically produced attractive total returns.

While there is lingering uncertainty about how the fiscal cliff situation will play out, I think the U.S. will continue to persevere, even if we remain in a temporary period of slow or sinking growth. If a policy basin does in fact come to fruition, I believe we will still have an environment that is modestly supportive of the U.S. economy and its equity markets.



As executive vice president and chief investment officer, Mathews is responsible for the development, execution and oversight of UMB's investment strategy. KC Mathews has more than 20 years of diverse experience in the investment industry. Mathews earned a bachelor's degree from the University of Minnesota and a master's degree in business administration from the University of Notre Dame. He also attended the ABA National Trust School at Northwestern University and is a Chartered Financial Analyst (CFA) and member of the CFA Institute.

Planned Giving

Whether it's during their lifetime or as a part of their legacy, many individuals have a desire to provide support to nonprofit organizations or charitable causes through planned giving. Having an experienced financial partner help guide this process can help ensure a positive and meaningful experience.

Jan Leonard

Senior Vice President &
Managing Director, UMB

Susan Teson

Senior Vice President &
Senior Counsel, UMB

First, what constitutes a meaningful gift?

Any gift is a meaningful gift, but many are under the impression that only the wealthy can be philanthropic. Gifts of any size are greatly appreciated by nonprofits, especially as economic challenges have affected many individuals' ability to donate, in both frequency and amount.

Smaller gifts to church, a university or community organizations accumulate over time and truly make a difference. Gifts may be made during a person's lifetime, as part of the estate plan at death, or both.

Motivations for gifting

The reasons for gifting vary greatly. Compassion for those in need, an extension of a religious or spiritual commitment, desire to share good fortune, and memorializing the lives of others are some of the most prevalent reasons. Individuals should personally evaluate their motivations when determining how and when they want to support a cause.

Selecting the "right" organization

Determining the cause and choosing the nonprofit that best fits a person's giving intentions are extremely important. Once the motivation for giving has been identified, making a short-list of potential groups or causes is the next step. Organizations should be carefully researched to ensure personal comfort and that the individual's philanthropy is used in a meaningful way.

For larger gifts, a financial partner like UMB, together with the client's other trusted advisors, such as their lawyer or accountant, can help define the client's vision, determine how the gift will be made and then evaluate, when possible, its result afterwards.

Gift options

Another item to consider is the type of gift an individual may want to bequeath. Cash is the easiest gift to make, but sometimes there is a desire to donate other types of property. Many organizations have a gift acceptance policy, which may exclude certain types of donations. Items such as stocks, real estate and art are valuable, but individuals should have a conversation with the organization first to ensure they are able to accept these types of items.

For major gifts there are many tools available, including different types of trusts. Individuals can also create their own charity by setting up a private foundation or a donor-advised fund, which will have long-term impact and permits people to continue gifting beyond their lifetime.

Have a plan and a team

For the optimal result, consult with legal and tax advisors as well as financial partners, such as UMB, when devising a charitable gifting plan. These advisors can help execute personal goals both now and into the future.

Value-add factor

Finally, the “value-add” for many is the associated tax benefits that come with planned giving—whether the gift is made during life or when an individual passes away. While this is not the primary motivator for most, many people view the potential income, gift and estate tax savings as a nice bonus. A tax advisor can provide good insight on this subject.

If you have specific questions or would like to discuss a personal planned giving strategy, please contact Jan Leonard (jan.leonard@umb.com) or a member of your UMB account team.



As senior vice president and managing director for UMB Charitable Trusts and Foundations, Jan Leonard is responsible for the management of charitable trusts and foundations, as well as fine art asset services. She has developed a unique niche for UMB as the Midwest’s single source for comprehensive fine art advisory services. Leonard earned a bachelor’s degree from Arkansas Tech University and a master’s degree in business administration from Ottawa University in Ottawa, Kan. She is a graduate of the Cannon School of Foundation Management and is pursuing certification to appraise fine art.



As senior vice president and senior counsel, Susan Teson manages the Investment & Wealth Management legal team. Her team is responsible for reviewing trust and will documents and working with attorneys, clients, trust advisors and bank associates on estate planning and legal issues concerning the administration of trusts, investment management and custody accounts and estates. Teson earned a bachelor’s degree in English from the University of Missouri-Kansas City and a Juris Doctor from the University of Missouri-Kansas City School of Law. She is a Certified Financial Planner and a member of the Missouri Bar, the Kansas City Metropolitan Bar Association, including its Probate Committee, the Estate Planning Society of Kansas City and the Kansas City Estate Planning Symposium Committee.

Economic Indicators

2012 Outlook by the Numbers	2010	2011	Current	2012 (Estimated)	Year End Target
Real GDP Growth Rate	3.00%	1.80%	1.30%	1.90% - 2.25%	
Housing Starts	526K	681K	872K	700K	
Unemployment Rate	9.40%	8.50%	7.80%	7.90% - 8.20%	8.20%
Projected Fed Funds Rate	0.25%	0.25%	0.25%	0.25%	0.25%
Projected 10-Year Treasury Rate		2.00%	1.79%	1.25% - 2.50%	1.75%
S&P 500 Price	1257	1257	1433	1200 - 1450	1375
S&P 500 Operating EPS Growth	47.00%	15.10%	5.40%	5.00% - 8.00%	
Inflation - Core CPI (Year-over-Year)	0.80%	2.20%	2.10%	2.10%	
Core PCE Deflator (Year-over-Year)	0.90%	1.90%	1.80%	1.80%	

2012 Global Economic Growth Forecasts	Average 1990-2007	2011	2012 (Estimated)
U.S.	2.90%	1.80%	2.00%
Eurozone	1.90%	1.50%	-0.75%
Japan	1.60%	-0.50%	1.00%
Developed World	2.40%	1.10%	0.80%
China	10.20%	8.50%	7.00%
Emerging Economies	6.50%	6.80%	5.50%
Total World	3.60%	2.90%	2.40%

Moving America Forward

In the movie “Back to the Future,” the teenager played by Michael J. Fox accidentally propels himself back to 1955 – and gets stuck there for a time. He can’t return to *his* life because the fuel of the future, which powered his time machine backward, doesn’t exist yet.

Mariner Kemper
Chairman &
Chief Executive Officer,
UMB

In 2012, America seems stuck in a similar time warp. It’s as though we are lingering in late 2008—the darkest days of the financial crisis. Our society has a “retro” perspective, especially when it comes to banks and the financial system.

Critics are still scoring political points by blaming Wall Street, banks or “the 1%.” They react with glee whenever some financial giant stubs its toe. New layers of regulation are being positioned as the cure for the “crisis.” Even monetary policy seems stuck on near-zero interest rates, punishing savers and retirees to maintain an economic stimulus designed for 2008.

A pervasive attitude is that, whatever our problems are, Washington needs to bail us out. The core value of accountability, saying “I am responsible for my actions,” doesn’t get much press.

The risk is that lingering in the crisis mindset may *keep us from better times*. America needs to stop running scared and casting blame – and start seizing opportunities to prosper and grow.

Role of banking in recovery

Banks are at the heart of America’s economy, and to achieve a stronger recovery our financial system needs to be free to accomplish what banks do best: Help depositors safeguard and use their money, and invest the community pool of funds in loans for businesses and consumers.

This traditional banking model is, in fact, the core focus of most banks. U.S. commercial banks currently provide depositors with safekeeping and liquidity for about \$9 trillion, and fund about \$7 trillion in loans outstanding.

Loans dropped modestly in the economic pullback of 2009 and 2010, but U.S. banks resumed the growth in lending in 2011 and 2012.

Banks also keep money flowing in the economy. As bankers, we take our role as intermediaries seriously, processing more than 40 billion checks a year with an estimated value of \$40 trillion, plus about twice as many electronic payments (debit cards and the like).

The banking industry employs more than 2 million people. And if you think you don’t have a personal stake, check your 401(k) or pension fund: Common stocks of financial institutions are part of nearly everyone’s retirement, representing 17 percent of the total stock market.

I cite these statistics simply to make the point that tearing down “the banks” benefits no one. Finger-pointing solves no problems. We already have new layers of regulation, with vast scale and complexity. Consider that the Dodd-Frank Act occupies 2,319 pages, while landmark bank reforms of the past were simpler: the Federal Reserve Act at 31 pages and Glass-Steagall at 37. Since the mid-1800s the country has experienced more than 30 recessions – each one followed by cries for “never again” legislation. But each time, a crisis has recurred within a few years.

The cycle of crisis continues because what we really need is a change in thinking – the will to do business differently rather than another law to punish someone else’s misbehavior. Today, rather than endlessly replaying 2008 with its bailouts and blame casting, we will make more progress if we start trusting each other again and focus on doing business the right way.

The real change we need

In 2012, even as we still face economic challenges, opportunities abound. Emerging technologies are creating whole new businesses and transforming old ones. Some markets are growing, even rapidly. Savvy people are turning innovative ideas into businesses.

What will make the difference between remaining mired in the crisis mentality – and climbing to new heights? I believe the answer lies in three philosophies:

- Free markets and private enterprise will drive a return to growth, creation of jobs and expansion of opportunities.
- People and companies that seize opportunities will thrive. The core strength of America is still the entrepreneurial impulse to create and grow enterprises.
- Focusing on basics is the path to success. It's all about discipline in doing the right things, working hard, being financially prudent and taking calculated, measured (but not blind) risks.

Even in a slow-growth economy, it's possible to find and seize opportunities. We see them all around. Energetic people are doing great things *right now*. Steady efforts that focus on real needs in the marketplace will continue to be rewarded by success in business.

The accountability of the market is what motivates businesses (and individuals) – energizing creativity, balanced with discipline. If you know your actions have consequences in a free market, it's a powerful incentive to pursue great outcomes and to avoid foolish risks. And government can contribute best by stepping aside, except to ensure honest markets.

So, I say, let's escape this crisis mentality and get back to pursuing the American dream. When we embrace the entrepreneurial spirit that says success or failure is up to us, we tap into the energy source that can blast our nation "back to the future" – the prosperity we all seek.



Mariner Kemper is Chief Executive Officer and Chairman for UMB Financial Corporation. In 2012 Kemper was recognized by Forbes as America's 10th Most Powerful CEO 40 and Under. He also was honored by American Banker as its Community Banker of the Year in 2008. Under Kemper's leadership, UMB has been recognized as one of the best banks in the US for the past three years (based on eight financial measures of asset quality, capital adequacy and profitability, according to studies by Forbes and SNL Financial) and was also one of 45 banking institutions recently named to KBW's 2011 "Bank Honor Roll." UMB was also entered into the Congressional Record in 2010 for excellent performance during the financial crisis.

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