



# LNWM INVESTMENT PROCESS & PHILOSOPHY

## An Overview

### OUR GUIDING PRINCIPLES

We invest your money as part of an overall financial plan that reflects who you are and what you want to accomplish in life. We call this integrated wealth planning.

We invest objectively and independently on your behalf. We do not accept sales commissions or other incentives to recommend certain investments over others.

The basis of our success is the work we do for clients in these four areas:

1. Asset allocation optimized for risk and return.
2. Superior manager selection and monitoring.
3. Tax-aware investing.
4. Integrated wealth planning.

### 1. OPTIMIZED ASSET ALLOCATION.

Many studies have shown – and we agree – that long-term investment results are determined mostly by how much you allocate to stocks vs. bonds vs. other asset classes. That decision, known as asset allocation, greatly affects the level of risk and return in your portfolio.

Risk management plays a key role in our asset allocation decisions. By managing the level of risk, we can:

- Set boundaries for the overall price volatility of your portfolio, usually lower than the market averages. With lower volatility, the cash flow from your investments is more reliable. You're also less likely to sell during a market plunge – either out of fear or for cash flow reasons – undoing perhaps years of wealth buildup.
- Determine if the potential returns justify the level of risk in your portfolio. Typically, the higher the risk, the higher the return. But that is not always the case, especially since the markets have become more volatile in the past decade due to globalization, computerized trading and thousands of new financial products. While this has heightened price volatility, it also creates more opportunity for those who understand the level of risk they're taking on and what is driving returns.

We start by establishing a targeted level of risk for your portfolio. That is based on the level of price volatility you and your finances can tolerate AND which we think can allow your portfolio to grow at a rate that can fund your goals. We then attempt to maximize returns while staying within that targeted level of risk. This is known as maximizing your “risk-adjusted” return.

How do we this? Each asset category (various types of stocks, bonds, etc.) has unique risk/return characteristics that we use in combination to lower risk to the target level, while still allowing for targeted rates of return.

“We believe in fully informed, intelligent risk-taking.”



We systematically analyze global capital markets (valuations, money flows, growth projections) and key economic variables to develop risk and return forecasts for each major asset class. LNWM's Investment Strategy & Research (ISR) team then runs thousands of simulations to test whether the mix of investments we are recommending for your portfolio is likely to result in the targeted levels of risk and return.

**Global Investment Platform.** We invest globally, in terms of geography and asset class. We find that a global portfolio offers more opportunity for both risk management and superior returns. Our client portfolios are invested in the U.S. and foreign markets (both developed and emerging), mostly in equities and fixed-income securities, with smaller allocations to sectors such as real estate and alternative investments (see following section).

**Short- and Long-term Strategies.** LNWM has a long-term investment horizon (10 years is our usual forecast period), and we aim to keep your portfolio fully invested at all times. However, along with the asset managers we use in client portfolios, we regularly evaluate short-term market events in search of opportunities to enhance returns. On occasion, LNWM will make tactical, shorter-term allocation shifts to take advantage of what we think are significant market opportunities or to reduce heightened levels of risk.

Typically, all short-term changes to client portfolios are within the targeted allocation range we have established for each asset class in each portfolio.

## Alternative Investments

As we noted earlier, globalization, computerized trading and thousands of new financial products are creating new challenges that increase risk without necessarily enhancing returns. These new challenges include: (1) Markets moving in the same direction more of the time (higher correlation); (2) occasional bouts of heightened short-term volatility; and (3) higher "event risk," or the likelihood that one event will trigger a chain reaction of selling across markets.

To offset these relatively new risks, and when appropriate given a client's unique circumstances, we include some or all of these alternative investments: hedge funds (including managed futures), private equity, private real estate and natural resources. The benefits are twofold: (1) the returns on alternative assets are less correlated with traditional assets like stocks and bonds, providing the diversification required to lower risk; (2) alternative-asset managers can use a variety of strategies to limit losses during massive market disruptions and downturns.

**Our ultimate goal for including alternative investments is to improve "risk-adjusted" return.** This means that for the same investment return, the portfolio should have lower levels of price volatility, or risk. Generally speaking, we believe alternative asset managers should be able to add value to a portfolio by taking advantage of short-term discrepancies in pricing or through a "liquidity premium" if they participate in investments that require lock-up periods, during which investor money is "illiquid" or cannot be withdrawn.

**"Our focus is on your risk-adjusted return after taxes, fees and inflation."**



Given that the returns on alternative investments have been statistically independent from those of traditional investments, carefully selected alternatives should be able to dampen portfolio price volatility without sacrificing long-term return.

**However, alternative assets have extensive drawbacks.** These include: limited transparency, higher fees, illiquidity and potential tax inefficiency for individual investors. Therefore, we firmly believe that not every client is a good candidate for alternative asset classes.

Before recommending any alternative investments for client portfolios, we have a detailed conversation with each client about their overall finances and cash flow requirements. Other important considerations include a client's risk tolerance, expectations, and comfort level with new asset classes.

## 2. SUPERIOR MANAGER SELECTION AND MONITORING

Objective and independent, LNWM's manager selection process offers a distinct competitive advantage. We do not work on commission nor are we compensated in any way by the investments we recommend. This allows us to recommend only the asset managers we're convinced will work best for your portfolio.

**We think the markets are inefficient to varying degrees.** That is, the price levels do not at all times reflect all the existing and relevant information. We therefore seek to find asset managers who are well-positioned to take advantage of inefficiencies in their area of expertise. In the most efficient markets – such as that for large US stocks – we might opt to use low-cost, tax-efficient index funds, if we determine that it will be difficult for asset managers to “beat the market.”

In less-efficient markets, such as small U.S. equities and foreign equities, we typically use “active” management, or funds whose managers seek out the best investments they can find, regardless of how the indexes for their market are positioned.

### 5-STEP SCREENING

LNWM's asset manager searches vary in length and complexity based on the strategy or investment vehicle. However, all our searches consist of these five steps:

#### Universe creation

We develop a comprehensive list of all the managers in this particular asset category.

#### Operational cohesiveness

We determine which managers meet our requirements for size, accessibility, and trading efficiency.

#### Regulatory review

We screen for regulatory infractions, conflicts of interest, pending litigation, or other detractions from corporate governance or professional stewardship.

#### Quantitative analysis

We analyze historical performance against the benchmark and peer group.

#### Qualitative analysis

We develop an investment thesis (how this manager is likely to perform in the future) by thoroughly analyzing the firm, its investment experts, its philosophy, process and execution, and documentation related to the firm and this specific investment strategy.



**LNWM chooses managers in which we have a high degree of confidence, and we give them the freedom necessary to invest in line with their specific strategy and goals.** Too often, we see portfolios whose assets are spread across numerous competing managers, each with a small allocation. We feel this adds unnecessary complexity and cost to a portfolio while eliminating a manager's ability to meaningfully add to returns. Additionally, because of our size and relatively small number of managers, LNWM is able to negotiate more favorable terms (such as lower fees and minimum initial investments) for the benefit of our clients.

**LNWM has a proprietary, methodical process for evaluating managers and assessing which are best-suited for client portfolios.** Our overall goal is to keep you invested comfortably for the long term with asset managers that: (1) excel at maximizing opportunities in their area of expertise; (2) take on risk only if it is likely to be compensated by return; (3) use an investment process that we understand and can fully assess; and (4) have strong corporate governance and leadership. LNWM's Investment Strategy and Research (ISR) team uses a peer review system, so that each analyst's research recommendation is questioned and tested by all the other ISR team members. This allows for open debate, teamwork and accountability in the process of manager selection.

### Ongoing Tracking and Review

**Once a manager is approved for client portfolios, LNWM analysts continue to monitor the manager's performance and operations to assess if they're meeting expectations.** We require all members of our Investment Strategy and Research team to develop strong relationships with their assigned asset managers, and we believe these relationships increase the level of insight our firm has regarding not only the asset managers' performance but also the markets and individual investments.

At regular intervals, we analyze and rank the performance of each manager on our platform. While we take into account a manager's short-term results, we focus mostly on long-term performance metrics and our level of confidence in the investment strategies and capabilities.

Periodically, we assess each manager on the LNWM platform against their universe — all of the managers in the same asset class. How often we do this depends on the manager being reviewed, the relative risk of the asset class and capital flows into it. While we try to minimize turnover in our clients' accounts, we feel periodic re-examination is key to assessing whether we have at all times superior managers in our client portfolios.

### STAYING INFORMED

We think it's important for clients to know how we're investing and why. Our Investment Strategy & Research team keeps you informed through monthly and quarterly reports, client presentations, and occasional emails about unusual market activity.

Each member of LNWM's Investment Strategy and Research team is available to meet with clients and their LNWM advisor.



### 3. TAX-AWARE INVESTING

LNWM investment portfolios are designed to serve high-net-worth individuals and families, and they are scalable for our institutional clients (foundations and endowments). Many of our clients have a complex array of account types with varying degrees of taxability.

**We look at each client's wealth comprehensively and invest in a way that maximizes overall tax efficiency.** For asset allocations and/or managers that are likely to produce a larger tax burden, we might recommend placement in a client's tax-deferred accounts, such as IRAs. We would then place the more tax efficient strategies and managers in taxable accounts. We look at each client's investments in the context of their financial plan, and for each individual account make allocation decisions that are appropriately tax-efficient.

Just as important, we select asset managers with an eye on tax management. Many of our approved investment managers make it a point to limit tax burdens, either by not trading as often to avoid short-term gains and/or using tax-loss harvesting (timing the realization of losses so they can be used to offset gains). When we select a manager, tax management is not a requirement. However, LNWM will recommend a manager only if we have conviction that their potential to generate above-market return outweighs the likely tax burden.

**“We align your investments with your overall financial plan and life goals.”**

### 4. INTEGRATED WEALTH MANAGEMENT

**We are committed to helping our clients and their families achieve financial security, find happiness and thrive in every aspect of their lives.** This starts with each member of our Investment Strategy & Research team. Our core strength comes from having dedicated experts in allocation strategies and risk management, global equities, fixed-income and alternative assets all working together on your behalf to maximize risk-adjusted return over a full market cycle (both up and down periods).

But we don't stop there. We align your investments with your overall financial plan as well as your estate plan, which we begin to develop with you starting Day One of our relationship. How well we align all these moving parts is key to our success and our clients' success. We believe this level of integration provides our clients with a lifetime advantage, allowing them to make decisions that build one upon the other. The result is peace of mind and readiness for the future.

#### ABOUT LAIRD NORTON WEALTH MANAGEMENT

With nearly \$5 billion in assets under management, Laird Norton Wealth Management is the Northwest's premier wealth management company. Founded in 1967 to serve the financial management needs of the Laird and Norton families, the firm now provides integrated wealth management solutions to more than 600 individuals, families, business leaders, private foundations and nonprofit organizations.

#### DISCLOSURE

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