



Q1 2018 ECONOMIC OUTLOOK

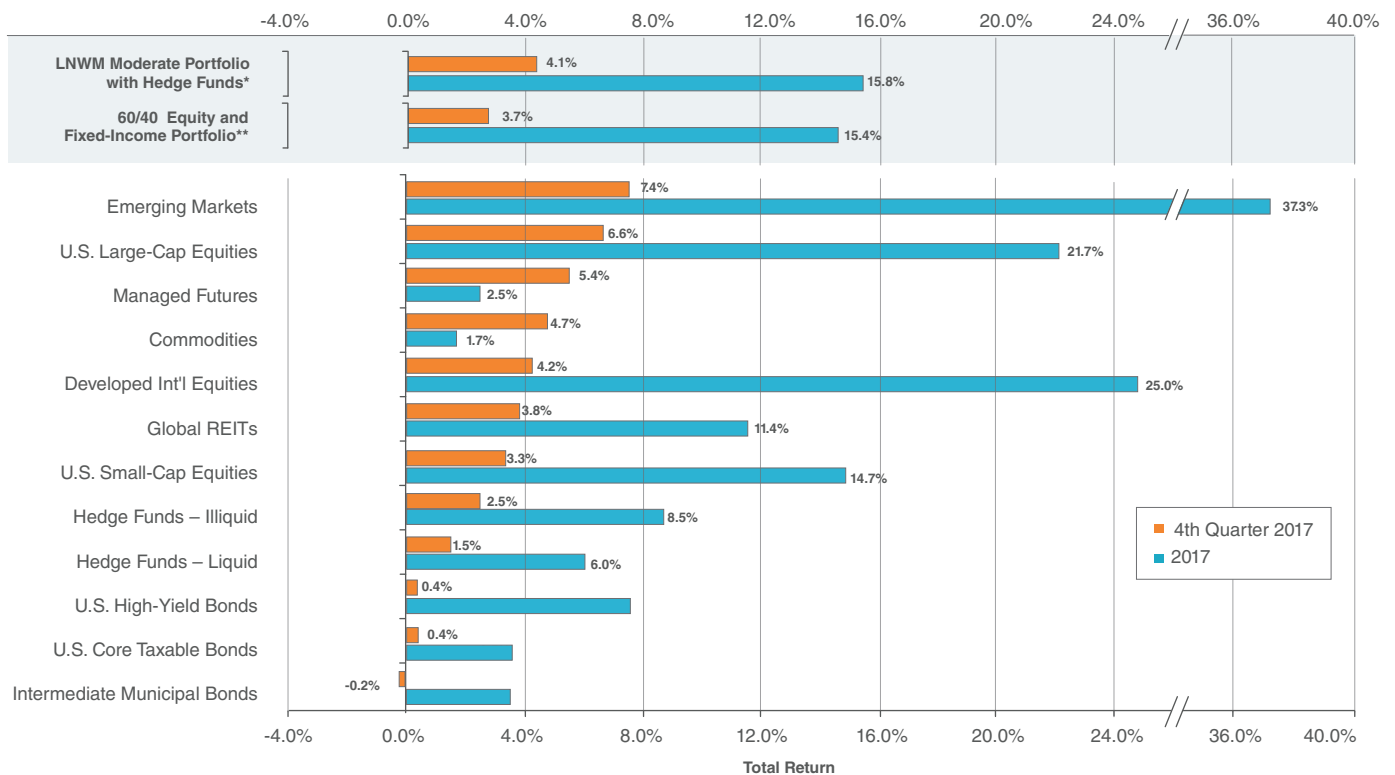
By the LNWM Investment Strategy & Research Group

SUMMARY

- Real GDP in the US (adjusted for inflation) is poised to grow at above-trend levels in 2018, at about 2.5%, which will likely give the Federal Reserve reason to move the Fed Funds target higher at least three times in 2018.
- At the 12th hour, Congress passed tax reform (the Tax Cuts and Jobs Act). While we think the US economy was on solid footing prior to this, we think tax cuts will generally be supportive of equity valuations. However, we are uncertain as to the long-term benefits and are concerned about the possible negative effects of an increase in the already high US deficit.
- Bond yields globally have started to rise due to expectations of higher inflation and central bank balance sheet reduction through asset sales and maturations. Globally, central banks have begun shifting toward a less dovish stance, which will ultimately mean they purchase fewer bonds. We think central banks will continue to be transparent regarding this, which should lead to minimal market surprises, although rates will continue to move higher.
- Many believe that equity prices are at, or near, peak levels. We find it hard to substantiate where we are in the cycle and when it will turn. However, we do think current US market valuations are pricing in a near-perfect or “Goldilocks” economy. We continue to think there is more value to be had in markets outside the US. Hence, we are maintaining globally diversified portfolios and reducing some risk in our 2018 allocations.

2017 Performance of Asset Classes

4th Quarter and 2017 (As of Dec. 31, 2017)



* Net of manager fees | ** Assumes no manager fees

SOURCE OF DATA: Morningstar, Bloomberg, Hedge Fund Research.

THE RISING COST OF GROWTH

“ We live in an age when unnecessary things are our only necessities. ”

- Oscar Wilde

At the end of 2017, US equity markets were hitting record highs, economic growth was moving toward above-trend, unemployment was hovering around levels one would consider full employment, and inflation was beginning to rise back to normal levels. Then, the Tax Cuts and Jobs Act (TCJA) was passed. In the short run, we think the TCJA will be supportive of asset valuations, particularly equities, as US corporate earnings benefit from significantly lower tax rates; however, we think this could come at the expense of higher US deficits. The architects of the new tax law will tell you that economic growth will pay for the tax cuts, making them revenue neutral, although this comes with many assumptions.

2018 KEY ECONOMIC DRIVERS

Inflation – Recent growth momentum across the globe has been better than most expected at a time when monetary policy has remained accommodative. Moreover, we now have additional fiscal stimulus in the US via tax reform. All of this has been reflected in buoyant markets for risky assets. An increasing rate of inflation is a concern because this could drive central banks to tighten monetary policy more aggressively than currently anticipated.

Geopolitical Disruption – We’ve had a decade of a relatively benign geopolitical environment. Driven by an electorate that seems to prefer an inward focus, leaders have done just that. Some say this is rightfully so, considering the historical role the US has played in maintaining world order. Regardless of one’s view on what the role of the US should be, one must acknowledge that the geopolitical environment feels less stable, increasing the probability of some disruption (including trade wars), which would be detrimental to the global economy and financial markets.

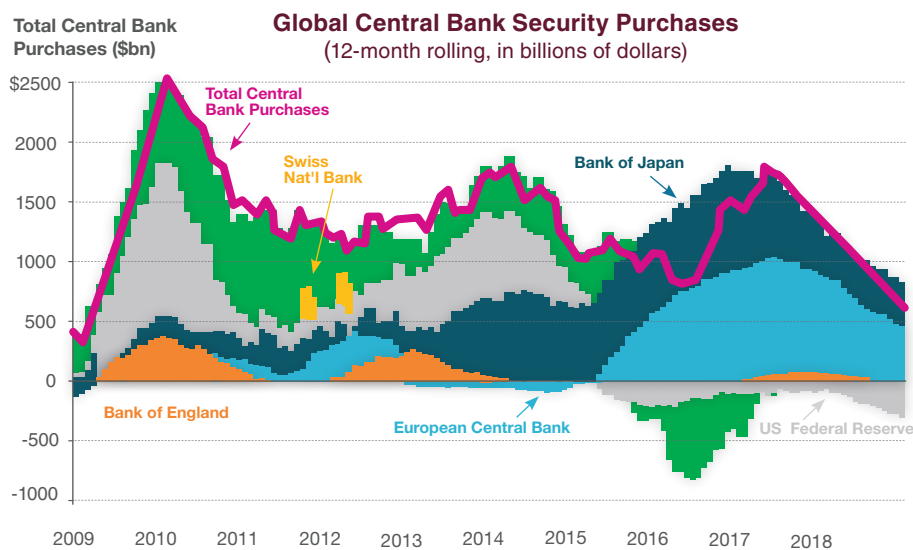
Corporate Earnings – Earnings are always a focus given the importance to valuations. We’ve already begun to see the benefits of the recent US tax overhaul, as companies are increasing their forward-looking earnings estimates. What remains a question: will this lead to valuations expanding and higher stock prices? Or will earnings catch up to stock prices that already fully reflect the higher estimates?

Shift in Monetary Policy – As economic data turns more positive, there is a risk that central banks will become too aggressive in their efforts to tighten monetary policy. We believe markets have become accustomed to easy money, thereby becoming more sensitive to any changes. With that said, we believe some pull back on monetary stimulus is necessary and expect three additional interest rate hikes in the US in 2018, along with Federal Reserve continuing to sell (or not replace) the fixed-income assets on its balance sheet.

Longer-term Benefits and Costs of Tax Policy Changes – One could argue that the US economy did not need an additional “shot in the arm” (lower taxes) as we are at, or close to, full employment and GDP growth has improved. We agree with tax policy that increases US competitiveness and productivity, although we are also hopeful that this will not be a lost opportunity to reduce the national debt.

We are supportive of productive changes in fiscal policy, such as less onerous regulation and tax reform that allows US companies to be more competitive. However, at a time when US economic growth is already moving toward above-trend, we think it would have been more prudent to have incorporated deficit-reducing policies (potentially decreasing spending, not necessarily higher taxes). The Trump administration is fulfilling a campaign promise by implementing tax reform, although we are left wondering if -- as Oscar Wilde put it -- something unnecessary has been deemed otherwise. It is possible that the growth unleashed by the tax cuts will result in higher government revenue, getting us to revenue neutral. But that is far from certain.

LNWM believes lower tax rates will drive equities higher in the short run on continued corporate earnings growth. However, given that the impact of tax reform will likely be front-loaded, we believe increased inflation will cause the Federal Reserve to move interest rates higher quicker than the market anticipates. These two items -- tax reform and higher expectations for inflation -- are likely to have counter effects on each other and could ultimately dampen market exuberance.



The Goldilocks Economy: Can It Continue?

The term “Goldilocks Economy” is credited to David Shulman of Salomon Brothers who first used it in 1992 to describe why he was remaining bullish. By “Goldilocks” Shulman meant the just right combination of falling inflation expectations and improving GDP growth. Generally speaking, this is what we’ve experienced since mid-2016. Globally, equity markets are now almost 30% higher and bond yields (until very recently) had remained relatively stable. Emerging market equities have been among the best-performing assets, at least in part because of low inflation both in the US and abroad.

So, where are we today? We are nine years into a bull market and current macroeconomic conditions remain very buoyant. In the last year, increases in economic growth seem to have been synchronized across global economies like never before, which we think will continue, limiting the probability of recession in the near term.

However, the very positive economic backdrop and sustained growth do not come without risks. Inflation, which is a natural derivative of growth, is the greatest risk in our view. In 2018, inflation is likely to come close to the Fed's stated target of 2%, although given current levels of employment and recent rises in commodity prices, we think inflation could ultimately be higher than that. Rising inflation expectations will drive interest rates higher and cause the Federal Reserve to further tighten monetary policy, which will quickly cool the recent equity market rally.

Of the possible exogenous events, one cannot ignore the continued banter between the US and North Korea, as well as the seemingly renewed volatility in the Middle East. We think the tensions around North Korea will likely increase in the coming year and could also lead to rising tensions with China. Recently, China threatened to slow its purchase of US Treasury securities, which led to a brief selloff in the US bond market. Bonds quickly recovered, but in some ways, this was an acknowledgement of the power of China as a purchaser of US debt (and further evidence as to why the US deficit needs to be a greater priority).

With regard to the Middle East, historically, oil prices have been a significant concern given any tensions there. The price of oil (WTI Crude) recently moved past \$60 a barrel, the highest level since the selloff of 2014, mainly due to increased demand. We think North American shale production is much more price-elastic, making tensions in the Middle East less impactful on oil prices.

2018 Allocations for LNWM Portfolios

We recently updated our asset allocation models. Given that US equity and bond markets are "priced for perfection," we've begun lowering exposures there. We are maintaining our positions in non-US equities, and even increasing some of those.

In alternative assets, we've begun lowering our exposure to managed futures as they've become increasingly correlated with global equity markets -- the precise exposure we look to those strategies to offset -- in favor of hedge fund strategies. In hedge funds, we continue to focus our research on strategies that are not correlated with equities yet have unique sources of return. Fees are often an area of concern for hedge funds; we always leverage our size to attain the most favorable fee structures.

Our Take on Bitcoin/Blockchain

Given the ongoing media buzz surrounding bitcoin and blockchain, coupled with the many questions clients have asked about cryptocurrency, we decided to provide some thoughts. While entire books have been written on this topic, our stance on cryptocurrency can be summarized in four points.

1. Bitcoin (or any cryptocurrency) is simply a new "fiat currency," or a currency that offers no physical store of value. Historically, a similar evolution occurred as people went from carrying leather pouches filled with gold to paper money and now to card-based transactions. Further, bitcoin is not the first attempt to bypass central banks in the production of currencies.

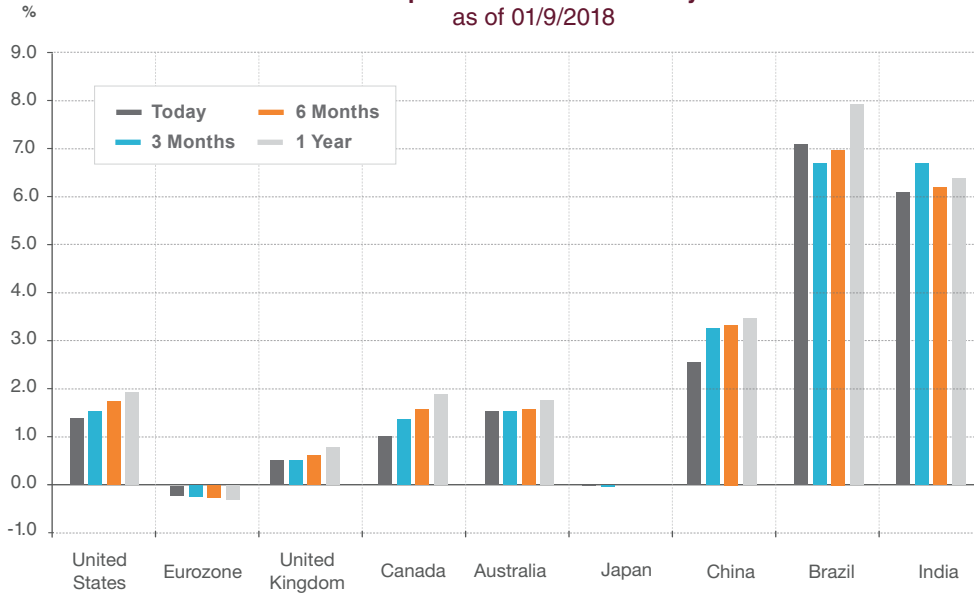
2. Value is dependent on participation for any fiat currency, including bitcoin. In other words, can I pay for goods and services using bitcoin? The more I can buy in exchange for bitcoin, the more relevant bitcoin will become. Until then, any value derived from bitcoin depends on how many dollars, yen, euros (or any other hard currency) you can get for it. Ultimately, all buyers and sellers have a base currency and need to translate back to that currency for consumption.
3. We don't view any currency as a long-term investable asset from which one can extract rent, economic or otherwise, although many continue to debate this. In our view, buying any one currency versus another is a speculative bet. When we begin writing this Outlook, for example, a single bitcoin was trading at \$16,000; very recently it dipped below \$10,000, demonstrating the extreme volatility.
4. Blockchain is here to stay. The second point above is the most important in our view. A simple google search turns up certain retailers that accept bitcoin such as Expedia, Overstock.com, Dish, and Microsoft. I've also heard of a pizza restaurant in Chicago that will accept bitcoin in exchange for slices. And several of these businesses accept ethereum, litecoin, or bitcoin cash as well. However, in all cases, the quantity of goods or services one purchases in exchange for bitcoin depends on the prevailing bitcoin rate (per dollar) and is at a discount to that because of the extreme volatility of the currency. For example, Expedia's policies state that when purchasing with bitcoin "to complete your booking...you will see the total cost of your booking in bitcoin, based on exchange rate set by Coinbase." That rate will only remain valid for 10 minutes.

In all these examples, the value of bitcoin is translated to dollars to establish value. This means bitcoin is a fiat currency like the dollar, yen, euro or any other. As participation in bitcoin increases and its price volatility decreases, it will be easier to make purchases using bitcoin. However, the common characteristics of a fiat currency will remain.

Key to bitcoin is blockchain technology, which effectively utilizes private computers globally to update a common ledger and verify transactions. Bitcoin transactions are "off the grid" (for now), which has attracted nefarious transactions, although this also provides a self-regulating mechanism making counterfeiting very difficult and transactions more efficient.

Regardless of what happens to the value of bitcoin, blockchain technology is here to stay, and we also believe digital currencies will continue to grow. For governments and central banks, the decentralization of bitcoin or any other digital currency is concerning, and we find it difficult to believe that governments will stand by idly as activity grows. Personally, I would not want to be in the cross-hairs of the US Treasury. Nevertheless, only time will tell which of the digital currencies succeeds. Like blockchain, digital currencies will continue to proliferate, and we will continue to monitor their progress.

Market Implied Central Bank Policy Rates
as of 01/9/2018

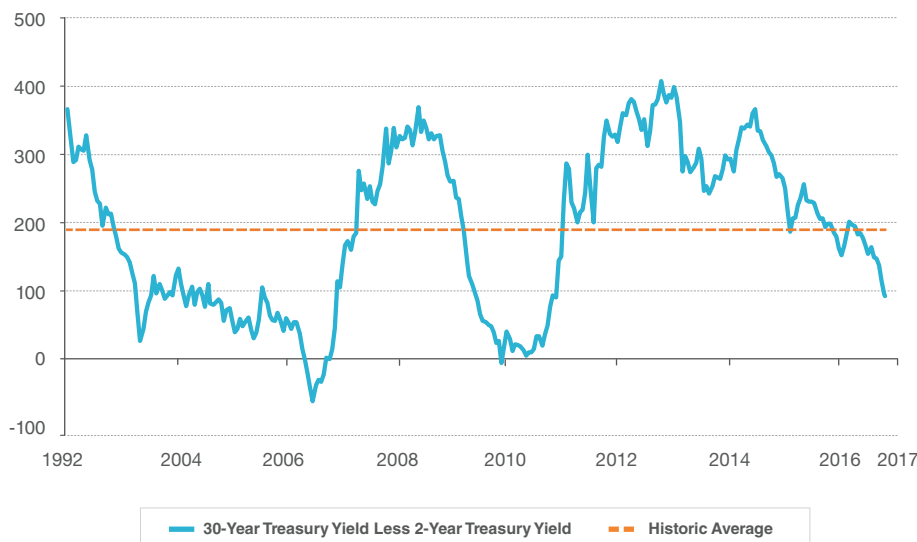


SOURCE OF DATA: BLOOMBERG.

The world's central banks are moving away from supporting low interest rates and easy credit. With the notable exception of Japan, markets are indicating higher interest rates globally over the next 12 months. Ultimately, we think inflation-fighting will become the new driver of central bank policy around the globe. Our concern is that central bank policy changes might become too onerous, negatively impacting growth.

US Dollars (\$) in Billions

Will the US Yield Curve Get Even Flatter?

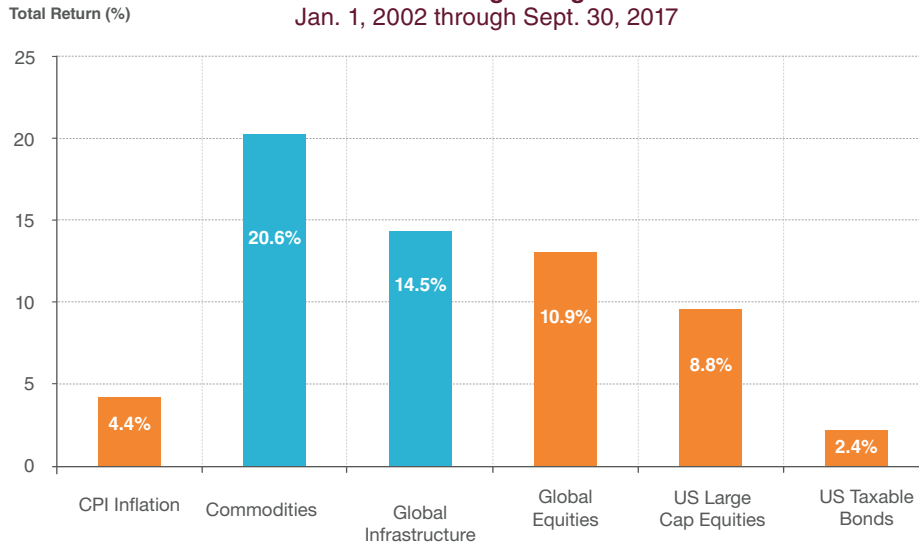


SOURCE OF DATA: Bloomberg.

The extra yield paid to US investors to hold long-term bonds relative to short-term bonds fell below the historical average in 2017. We expect this phenomenon to continue with a nod to history as shown in the chart. Additionally, as the Fed continues to increase the Fed Funds target rate, short-term yields will rise. A fixed income strategy that incorporates exposure to credit and is flexible with interest rate risk should outperform a short-duration portfolio in this environment.



Total Return During Rising Inflation* Jan. 1, 2002 through Sept. 30, 2017

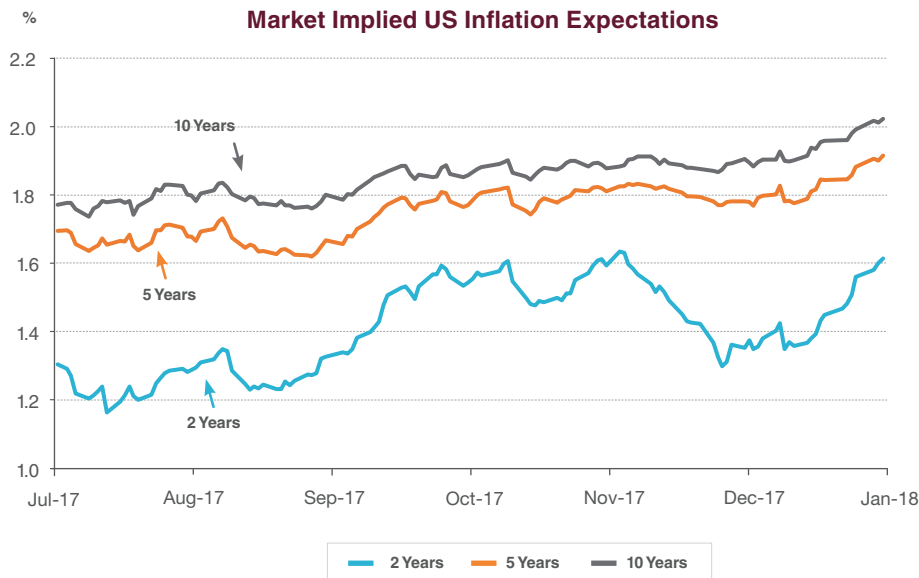


*Rising inflation in this analysis is considered to be when CPI is greater than 0.7% for a given quarter. The returns for the quarters which met this criteria for each of the asset classes from 2002-1Q through 2017-3Q are then annualized.

SOURCE OF DATA: Russell Investments, Bloomberg, Morningstar, LNW.

Due to our expectations for higher inflation, we are recommending increased allocations to real assets, which include commodities and global infrastructure equities. Normally, Real Estate Investment Trusts (REITs) would fit in this category. However, we think the limited ability of REITs to raise rents will not offset the impact of higher interest rates going forward. During periods of rising inflation and interest rates, global infrastructure and commodities have outperformed both the stock and bond markets.

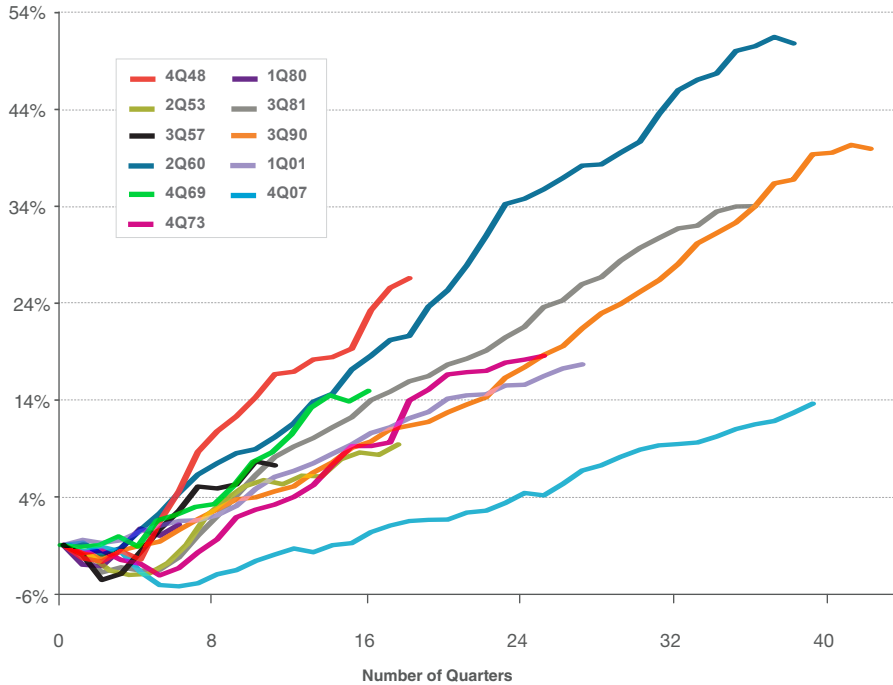
Market Implied US Inflation Expectations



SOURCE OF DATA: Bloomberg.

In the second half of 2017, market-based inflation expectations rose substantially, alongside expectations for passage of tax reform. Rising production costs, rising wage growth and full employment all indicate the US economy is operating at near full capacity. While technology continues to hold down prices in many sectors, our expectation is that an economy operating at near full steam will eventually experience a rise in inflation, and this is a risk for 2018 that is likely underappreciated by many investors.

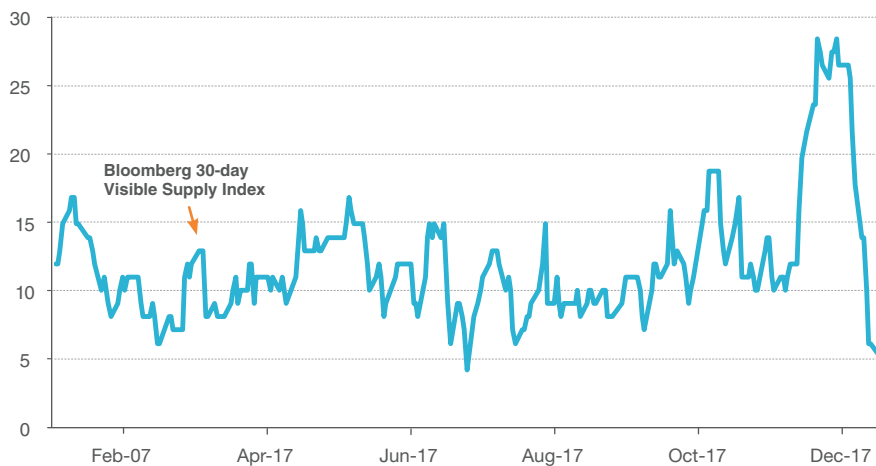
Strength of US Economic Expansions Cumulative Real GDP Growth Since Prior Peak (%)



SOURCE OF DATA: BEA, NBER, J.P. Morgan Asset Management.

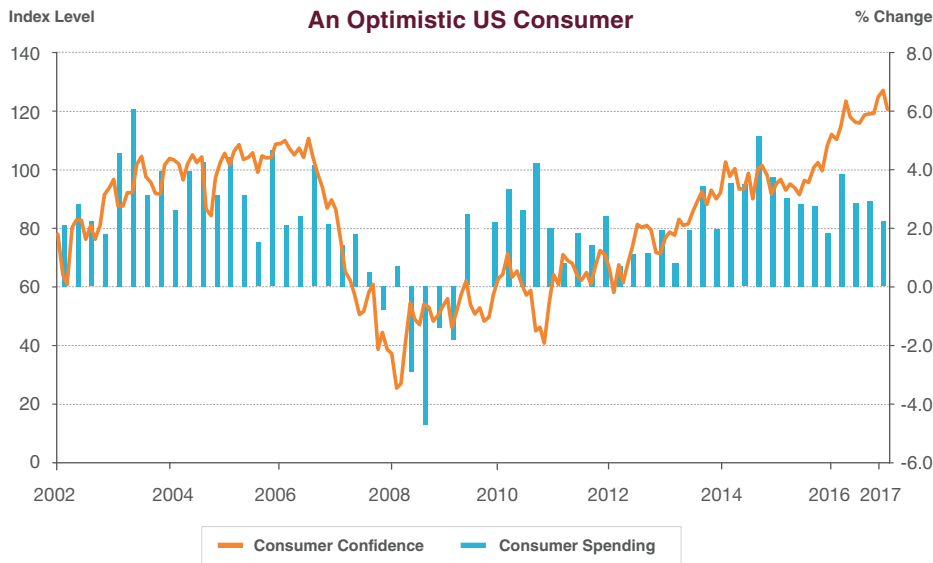
We are expecting three more quarters of US growth, which will make this expansionary period the longest in US history (see 4Q07 | Bright Blue line at left). However, cumulative growth has been less than in prior expansions. Given current robust conditions, we expect the US growth rate to get steeper during the first half of

US Municipal Bond Issuance Set to Slow



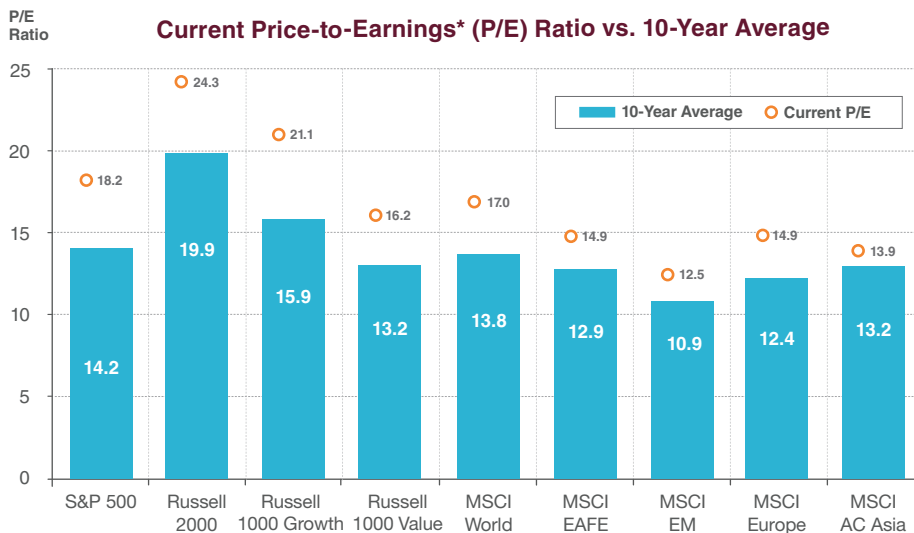
SOURCE OF DATA: Bloomberg.

Municipal bond issuance spiked in Dec. 2017, as state and local governments rushed to sell bonds ahead of tax reform, which many feared would do away with the tax-exempt status of certain muni bonds. That did not happen. The new tax law does limit issuers' ability to refinance but generally leaves the tax exemption alone. Our expectation is that municipal bond supply will be limited going forward, while demand will remain strong, particularly from investors in high-tax states. This provides a solid backdrop for municipal bond performance in 2018 relative to taxable bonds.



US consumer confidence has continued to rise, although actual consumer spending has tailed off since the end of 2014. Our expectation is for consumer spending to increase as wage growth continues, unemployment remains low and tax reform is implemented.

SOURCE OF DATA: Bloomberg.

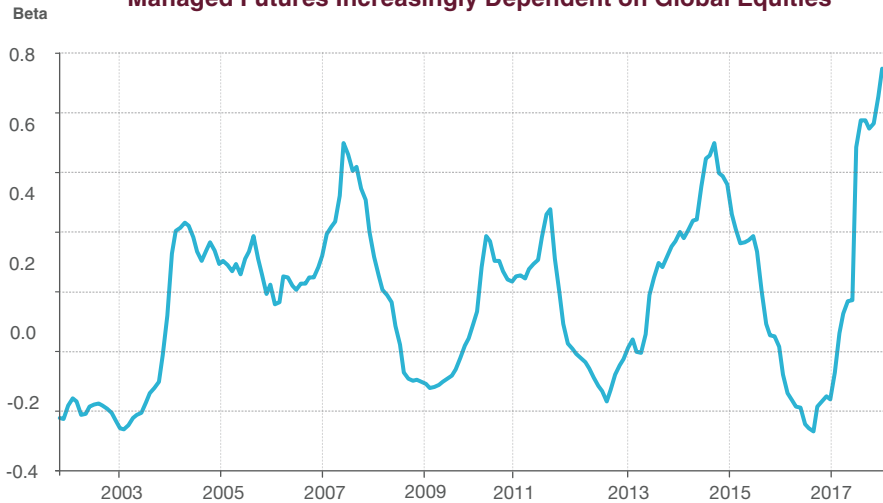


Globally, equity valuations are now well above historical norms, less so outside the US. We're maintaining our tilt toward non-US equities.

SOURCE OF DATA: FactSet, Eaton Vance. *Based on earnings estimates for next 12 months.



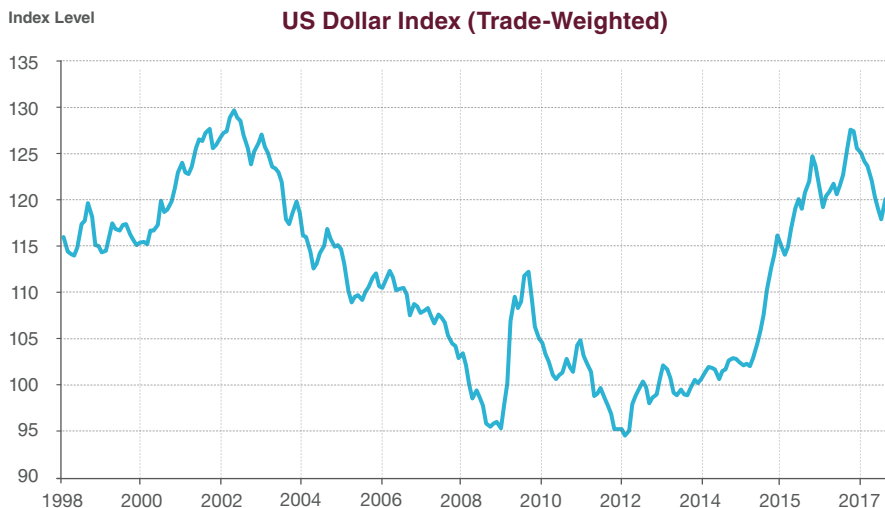
Managed Futures Increasingly Dependent on Global Equities*



*1-Year Trailing Beta of SG CTA Index to MSCI ACWI.
 SOURCE OF DATA: Morningstar.

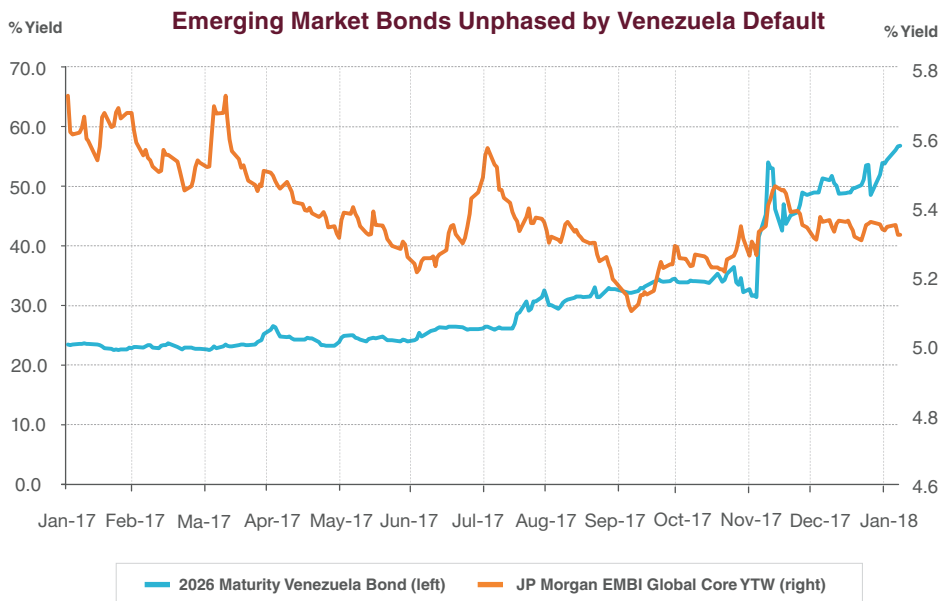
Historically, managed futures have demonstrated a low or even negative market risk relationship with the overall equity markets (as measured by beta in the adjacent chart). Over the course of the last year, however, managed futures have collectively positioned themselves with significant equity risk. Such positioning allows managed futures managers to benefit from further gains in stocks. But it also means that, should equities suffer a downturn, managed futures are not likely to provide the downside protection we expect from the asset class. Consequently, we are recommending further reductions in our managed futures positions.

US Dollar Index (Trade-Weighted)



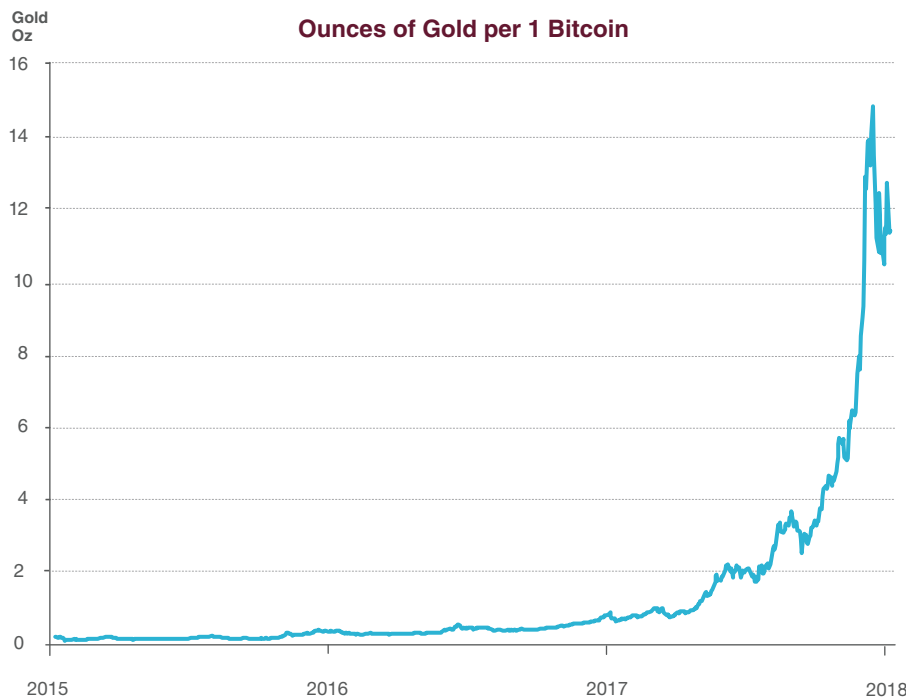
SOURCE OF DATA: Bloomberg.

Since the end of the financial crisis (around 2010), the US dollar has strengthened relative to the currencies of our major trading partners, and this has contributed to the outperformance of US versus foreign equities. The recent pullback in the dollar is a trend we think is likely to continue as rising inflation is offset by rising US interest rates, and investors find better relative value in foreign stocks.



SOURCE OF DATA: Bloomberg.

Venezuela defaulted on its debt in Nov. 2017, which led to a temporary spike in the yields of emerging markets (EM) bonds. However, investors quickly realized that most EM economies were in good shape and Venezuela's problems were unique to that country. Therefore, credit spreads tightened and yields stabilized for the overall market. We continue to recommend an allocation to emerging markets debt with the expectation that spreads will continue to fall on EM debt over time as creditworthiness improves to levels approximating that of developed countries.



SOURCE OF DATA: Bloomberg.

Extremely strong recent performance in bitcoin and other cryptocurrencies masks their underlying daily volatility. In less than a year, bitcoin has gone from being valued at less than the price of 1 ounce of gold to nearly 15 ounces at one point.



ABOUT THE AUTHOR

GINO PERRINA, Ph.D., CFA is the Chief Investment Officer at Laird Norton Wealth Management and has more than 15 years of experience in investment analysis, strategy and risk management. Prior to joining LNWM in November 2015, Gino was a Managing Director at BlackRock Inc. in New York City, responsible for managing risk in the firm's alternative asset portfolios (+\$100 billion in total investment). He was also Managing Director of Research and Risk Management at BlackRock Alternative Advisors (2006 to 2010), Head of Fixed Income Research at Russell Investments (2010 to 2012) and a fixed income analyst and portfolio manager at Microsoft and IAC/InterActive Corp.

ABOUT LAIRD NORTON WEALTH MANAGEMENT

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The LNWM Moderate Model Portfolio with Hedge Funds performance shown is comprised of a hypothetical combination of actual investment returns generated by investment managers and funds recommended by LNWM during the time period indicated. Past performance is no guarantee of future results. The model portfolio allocation ranged from 20%-33% fixed income, 36%-67% equity, 10%-33% hedge funds and 0-5% cash. The actual allocations at any given time are available upon request. Within equities there is a mix of active and passive strategies, value and growth, various capitalizations and international stocks. The Model reflects all changes in LNWM's recommended managers during the period. The investment results include the reinvestment of dividends and other earnings. The Model Portfolio is net of mutual fund fees and gross of LNWM management fees.

The Moderate Model Portfolio is not an actual portfolio and it is not possible to invest in the Model directly. Neither is it possible to invest directly in any index used in the comparative asset allocation blends shown. The Model investment performance does not represent the actual performance experienced by any client or group of client accounts. Actual performance results in client accounts will have varied substantially from the performance shown as a result of the inception of the investment, the timing and expenses of trades in the portfolio, the addition or withdrawal of cash, funds or securities, the imposition of taxes, expenses of custody and other variables not accounted for in the Model Portfolio.

Fees charged by Laird Norton Wealth Management will reduce the net performance of your investment portfolio. For example, a \$3,000,000 investment for the 10-year period ending December 31, 2016, allocated in line with a Moderate Portfolio Model, would have a value of approximately \$4,863,109 at the end of the period. A 1% annual fee, collected monthly in arrears, would reduce the ending balance to approximately \$4,403,809. The Laird Norton Tye Asset Strategies, LLC standard schedule of fees is set forth in our Form ADV Part 2A and is available upon request. Fees for accounts managed by Laird Norton Trust Company are based on the trust company's standard fee schedule and may include fiduciary fees and related expenses in addition to investment management fees.

The 60/40 Equity & Fixed-Income Blend Portfolio: Annually rebalanced blend of the Barclays Capital U.S. Aggregate Bond Index and the MSCI All-Country World Index (ACWI). The blend is intended to reflect a typical moderate asset allocation without active management or