Q3 2017
ECONOMIC OUTLOOK

By the LNWM Investment Strategy & Research Group

SUMMARY

- **The rally in global stocks could continue, albeit abated,** based on optimism about global economic growth and corporate earnings. Factors that could impede this: continued uncertainty of US passing tax cuts and other pro-growth legislation, geopolitical events, and the prospect of rising interest rates.
- **We may be at the outset of a longer-term selloff in bonds,** as interest rates shift to an upward path (assuming economic data remains relatively strong). The Federal Reserve has raised the target rate twice so far this year, and it is expected to do so again later this year. The Fed has also agreed on a plan to slow the growth of their balance sheet, initially by letting a portion of their Treasury securities mature.
- **Market volatility could pick up in the second half of 2017.** We are currently at an inflection point, with US stock prices signaling growth and inflation, while the bond market points to possible deflation and recession. We think the most likely scenario is mildly rising interest rates and no recession but with uneven growth in corporate profits as some industries fare better than others.
- **LNWM Portfolio Positioning.** We are maintaining globally diversified equity portfolios, with the changes that went into effect earlier this year: lower allocations to fixed income and alternative assets (hedge funds) in favor of international equities, both in emerging and developed markets. Our fixed-income allocations have limited exposure to rising US interest rates and slightly higher exposure to credit.

UPDATE ON ECONOMIC DRIVERS

- GLOBAL MONETARY POLICY

  The Federal Reserve is on a path toward tighter monetary policy and along with the European Central Bank has revealed plans to reduce the size of its balance sheet by decreasing the amount of fixed-income securities they purchase. Both central banks will need to be cautious to avoid shocks to the system after many years of loose monetary policies.

- US FISCAL STIMULUS

  It seems unlikely that significant pro-growth federal legislation will be enacted by Congress by the end of 2017, as there seems to be no resolution to the political tensions. What's more, given Congress' current agenda, the size of a tax reform or infrastructure spending package will also remain in flux.

- US DOLLAR STRENGTH

  The direction of the US dollar relative to other currencies will depend on global monetary policy. Given the coordinated efforts among central banks, forecasting direction is very difficult at this point.

- CORPORATE PROFITS

  Profits have been strong as evidenced by double-digit earnings growth for the S&P 500 companies during first quarter 2017. Globally, the earnings story is also positive; however, this seems to be priced in at higher levels in the US.

- EMERGING MARKETS GROWTH

  Emerging markets have maintained their strong growth trajectory in spite of the selloff in commodities, particularly oil, demonstrating their decreased dependence on commodity exports. We believe many countries that were considered emerging are developing beyond the traditional definition leading to two tiers of emerging markets.

NO TIME FOR AUTOPILOT

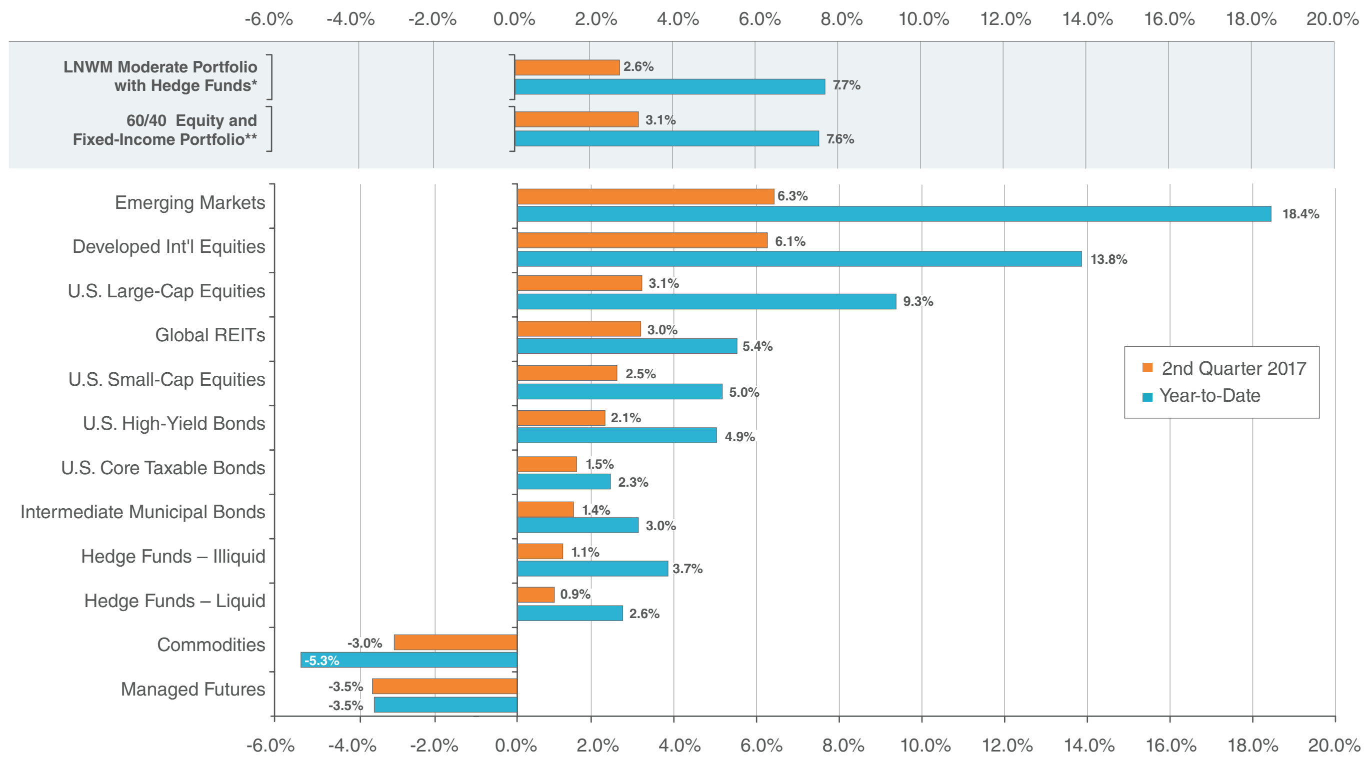
> "Success breeds complacency. Complacency breeds failure. Only the paranoid survive."
>
> - Andy Grove

In the quarter ended June 30, equity markets reached new highs while asset price volatility remained extremely low. The S&P 500 finished the quarter up over 3% and year-to-date is up over 9%. By almost any measure, equity returns are already at levels that have outpaced most investors' expectations for the year, including yours truly. Early in 2017, we chose to reduce our hedge fund and fixed-income exposures in favor of non-US developed and emerging market equities; these moves have paid off as developed market equities are up nearly 14% through June 30 and emerging markets over 18%. Globally, equities are pointing to further continued growth.

The bond market, on the other hand, was at odds with equities in Q2. The 10-year US Treasury yield, at quarter end, was about where it was when the Federal Reserve began tightening. This has led to a flatter yield curve (short-term rates rising more than longer-term rates), as the market continues to doubt the reality of increasing inflation. Furthermore, flatter yield curves have historically been leading indicators of recessions, although we don't think there's much risk of that now.

2017 Performance of Asset Classes

2nd Quarter and Year-to-Date (As of Jun. 30, 2017)



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

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

What we have been seeing are mixed signals: The equity market pricing in optimism and reflation, while the bond market prices in deflationary pressures or even the likelihood of recession. This dichotomy — higher equity prices and lower bond yields – does not follow traditional economic theory (the growth that is driving stock prices higher, should theoretically also be driving bond yields higher).

OIL GLUT CONTINUES

The price of oil, traditionally a gauge of inflation, has fallen below $50/barrel, given the surge in US production (shale-based) that is effectively neutralizing the impact of OPEC's production cuts. We expect the volatility of oil prices to remain high as the market continues to price in the relatively less-regulated US oil producers that are setting the marginal price. Furthermore, we don't anticipate the price of oil to exceed $50 in the foreseeable future.

Historically, economists have considered lower oil prices beneficial to the US economy, which is driven by consumer spending. If people spend less to fill up their cars, they could spend more on other things. We still believe this to be true; however, we've yet to see lower oil prices leading to higher consumer spending, which may partly be due to less demand given less driving and increased fuel efficiency. Thus far, lower oil prices have affected only the oil sector and its suppliers.

LOOKING AHEAD

Two areas we believe will have increasing influence on asset prices are Washington politics and geopolitical events. The current administration has communicated that two issues are top priorities: 1) healthcare; and 2) tax reform. They've promised to repeal and replace the Affordable Care Act (ACA) with a better plan, but as of now this seems unlikely. The ACA promised coverage for everyone and also promised lower costs and plenty of choice; this seems an unrealistic goal. However, the current alternative being discussed is equally unrealistic. Why is this important for your portfolio? Healthcare and the cost of healthcare greatly impacts national budgets as well as consumer spending. Furthermore, the slow crawl toward healthcare reform (if any) is making tax reform less likely.

Tax reform was a key tenant of the new administration's campaign. It seems unlikely that anything will be passed in the near term. While we believe tax reform is necessary and would likely provide a stock market boost, we don't think the recent market rally is a result of optimism regarding tax reform. Rather, we think the rally reflects positive market fundamentals, and any progress with legislation would only be additive. We will continue to monitor events in Washington and the potential impact on your portfolio.

In terms of geopolitical risk, what is happening in North Korea is particularly of concern. How the US and our allies respond to this threat could have significant impact on global trade and subsequently, capital markets.

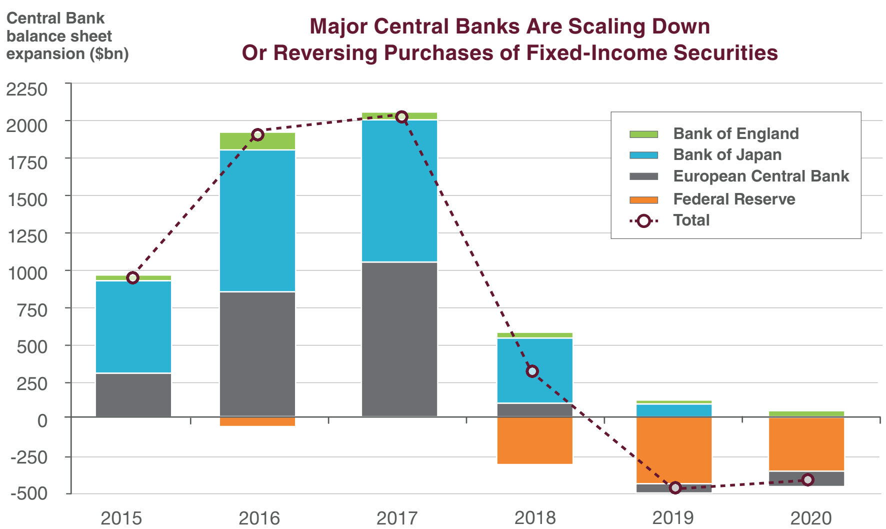
CENTRAL BANKS ARE SHIFTING GEARS

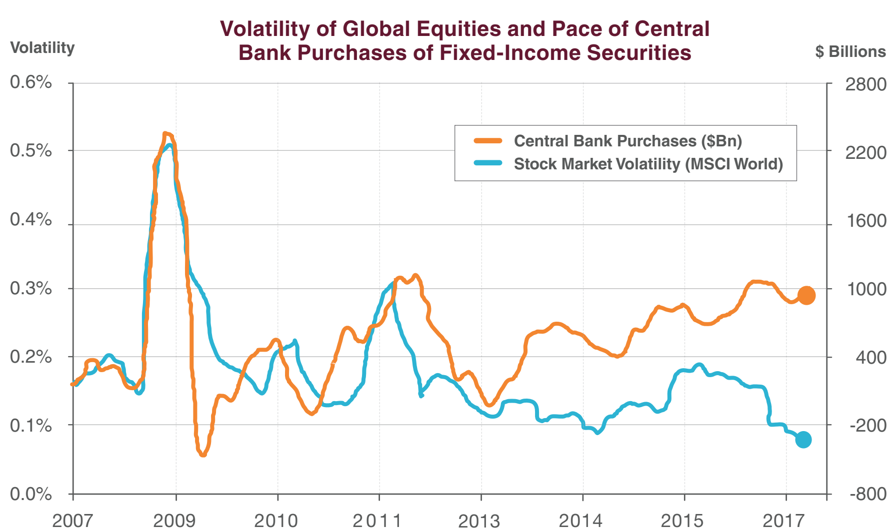
Returning to central bank policy and the accompanying market sentiment, the recent hawkish rhetoric has given a pause to the equity market rally and caused bonds to sell off. Minutes from the latest Federal Reserve Board meeting showed that members are concerned about asset price bubbles induced by low interest rates. Minutes from the European Central Bank's most recent meeting also indicate intent to scale back on its Quantitative Easing program.

Given the shift in central bank policy, we believe we may be at the outset of a longer-term selloff in bonds due to higher rates, assuming economic data remains relatively strong. We also think the change in stance could usher in higher market volatility. The charts below demonstrate that since 2013, central bank asset purchases (up) and market volatility (down) have moved in opposite directions. According to projections by JPMorgan, 2018 will see a significant drop in the amount of fixed-income assets held by central banks, as they step back from being a key participant in fixed-income markets. We think this could lead to higher market volatility and greater opportunity for active management in certain asset classes. We believe LNWM's portfolios are well-positioned for such an environment, given that we are maintaining limited interest rate risk in our fixed-income allocations.

THIS IS NOT 2008

Recently, I've been asked frequently about current asset price valuations and "tail risks," or unexpectedly large market losses. We would agree that asset prices in particular segments seem inflated based on traditional valuation metrics. We are constantly searching for the optimal asset allocation and will make portfolio changes that reflect our views on where value exists. That is what led us to our portfolio changes earlier this year, which we are maintaining, as well as our low interest rate risk positioning (admittedly, we were early with that). Regarding the risk of major unexpected losses (tail





SOURCE OF DATA: J.P. Morgan.

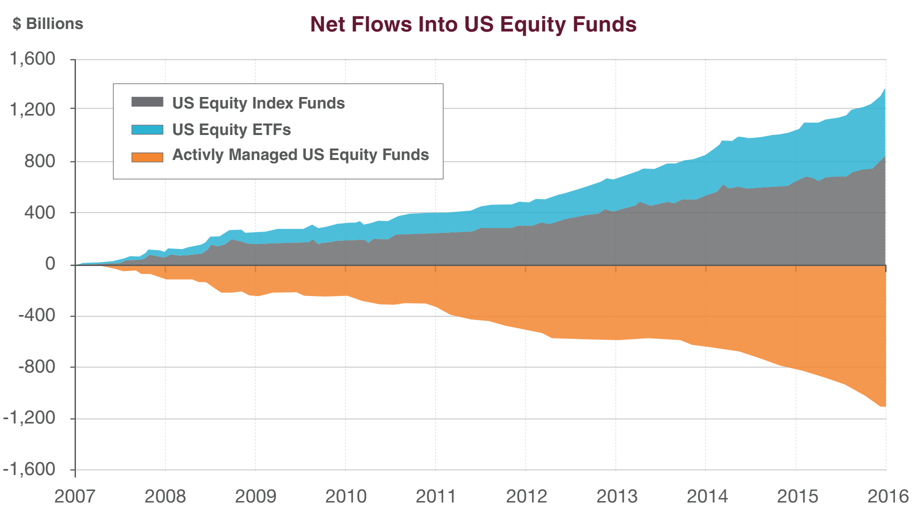
risk), many have expressed concern about the potential for a crisis like that of 2008. The financial crisis of 2008 was a multigenerational event, which we think is unlikely to repeat itself in our lifetime. Further, we don't think one can invest for such an event. This is not to say that we don't believe a market correction is possible; it is, and many market pundits have been calling for one for some time. But a crisis is different. Predicting the timing of such an event is extremely difficult and perhaps impossible. We continue to ask ourselves: Where will additional return come from? And as always: Are our current portfolio allocations optimal given current market conditions?

ACTIVE VS PASSIVE INVESTING

At LNWM, we believe the most important decision we make on behalf of our clients is asset allocation, and academic research backs this up. Part of that is allocating between active and passive asset managers. Active management gives managers greater freedom to deviate from a prespecified benchmark they are seeking to outperform and is typically accompanied by higher fees. Passive vehicles buy and hold a prespecified set of stocks, bonds or other securities and look to match performance of an index.

In recent years, there has been a deluge of money flowing into passive vehicles, especially US index funds — during a time when by many metrics, US equities have become overvalued. The flows out of active and into passive strategies have accelerated, as passive funds have outperformed active managers, leading investors to potentially become complacent. This is not the first time in history when passive funds have outperformed active and the trend can reverse very quickly.

We acknowledge that capital markets may have significantly changed (electronic trading, dark pools, quant funds), leading to more efficient markets and potentially reducing the opportunity set for active managers. However, we continue to believe in active management in asset classes where markets are least efficient, such as small-cap stocks or emerging markets, and we will continue focusing research efforts in these areas.



SOURCE OF DATA: Investment Company Institute.

PERFORMANCE NOTES

As the chart on page 2 shows, using our moderate portfolio as a reference, we've generally outperformed a passive 60/40 mix (60% stocks/40% bonds) year-to-date. We are generally pleased with our overall performance.

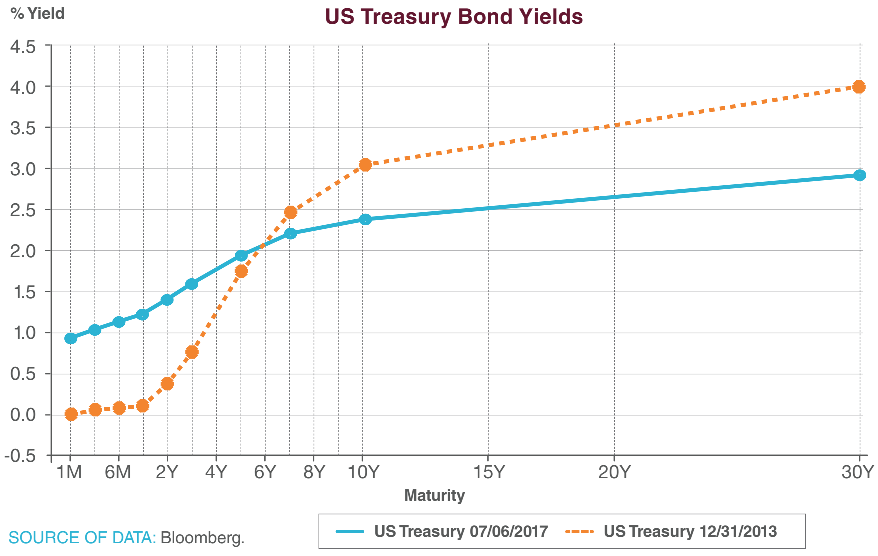
However, we recognize that while our asset allocation decisions have been favorable, some of our managers underperformed in the 2nd quarter, in particular, those invested in developed foreign markets (Europe, Japan, etc.) as well as our managed futures managers. Our managers in foreign developed markets have a long track record of outperformance, and we remain confident in their abilities. In one instance, the manager took an overweight position in energy, which was a headwind in Q2 as OPEC issues materialized. In the other instance, the manager maintained a larger than usual cash position, which was a drag as markets were rallying.

Regarding managed futures, we are reviewing not only the managers but also the role of this asset class in our portfolios. We're loath to sell at what could be a bottom, but we are equally unwilling to "call a bottom." Rather, we are reviewing if, given changes in capital markets, managed futures have a place in the portfolio. We expect to make some changes during the second half of the year.

IN SUM

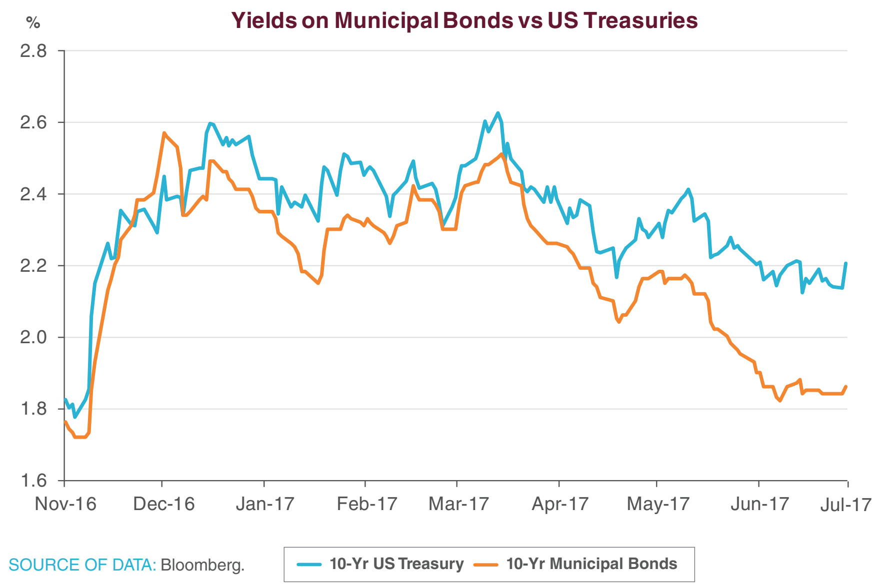
The first half of 2017 has been great by many measures, including rising stock prices and low volatility. However, we are not becoming complacent; despite recently low volatility, risk is still an inherent part of investing. Keeping our portfolios globally diversified (by both asset class and geographical region) should not be mistaken for inaction. We constantly seek new tactical allocations as opportunities present themselves and regularly review our existing allocations. Given the potential for higher volatility, we will continue to work with our underlying managers to uncover opportunities as they arise.

US ECONOMY & FIXED INCOME



SOURCE OF DATA: Bloomberg.

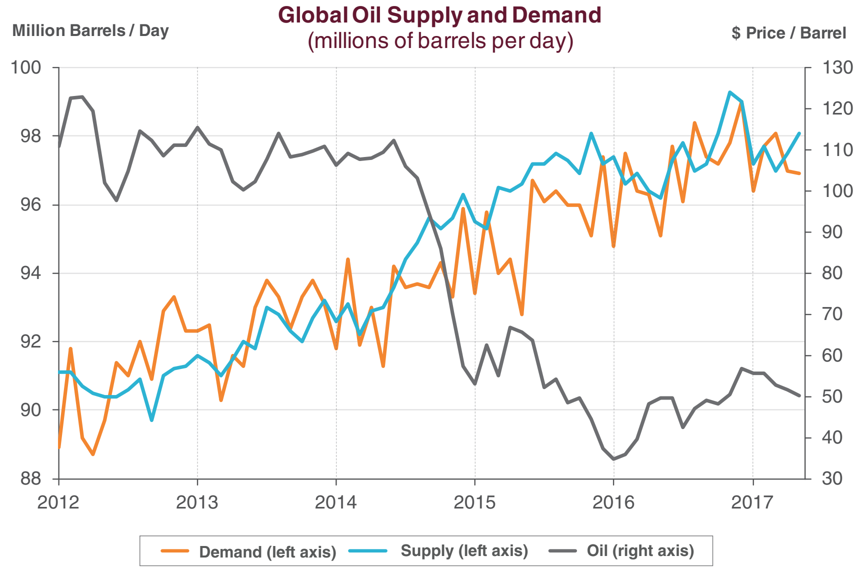
While the Fed has attempted to take its foot off the gas by tightening monetary policy, longer-term interest rates haven't responded. This has caused the yield curve to "flatten" — shorter rates have risen more than longer-term ones. Keeping a lid on longer rates: strong global demand. Looking forward, we think further rate increases by the Federal Reserve and the paring back on fixed-income securities on its balance sheet will lead to higher rates across the yield curve.



SOURCE OF DATA: Bloomberg.

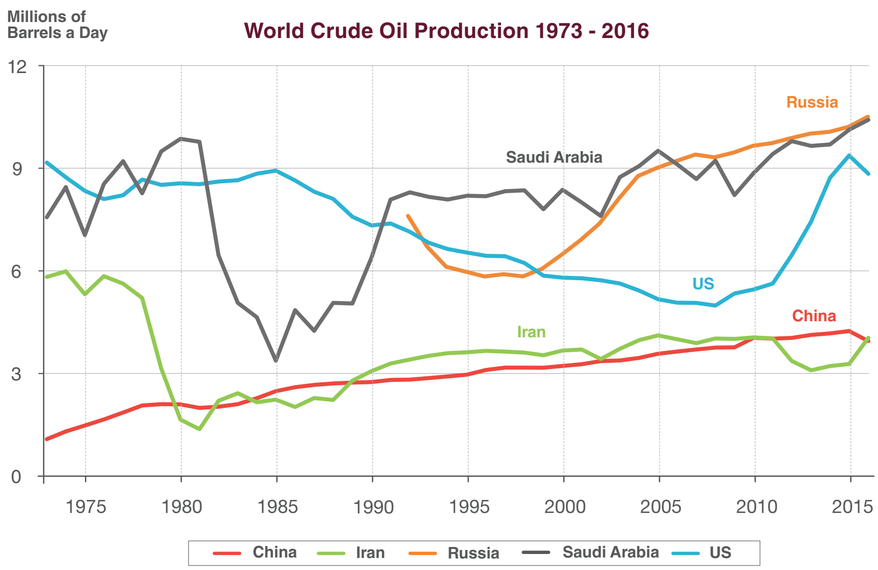
Not all government bonds are created equal. So far in 2017, muni bonds have distinctly outperformed Treasuries. Demand in the form of mutual fund and ETF flows had turned negative in 4Q 2016 driven by uncertainty about tax reform, infrastructure spending and fears of rising interest rates under a pro-growth presidential agenda. With all that now looking to be further on the horizon, demand for munis has resumed. Simultaneously, issuance is on pace for 15% less than in 2016, which has provided a nice technical backdrop we expect will continue given our outlook for rates and investor requirements for yield.

OIL SUPPLY, DEMAND AND PRICING



SOURCE OF DATA: Energy Intelligence Group.

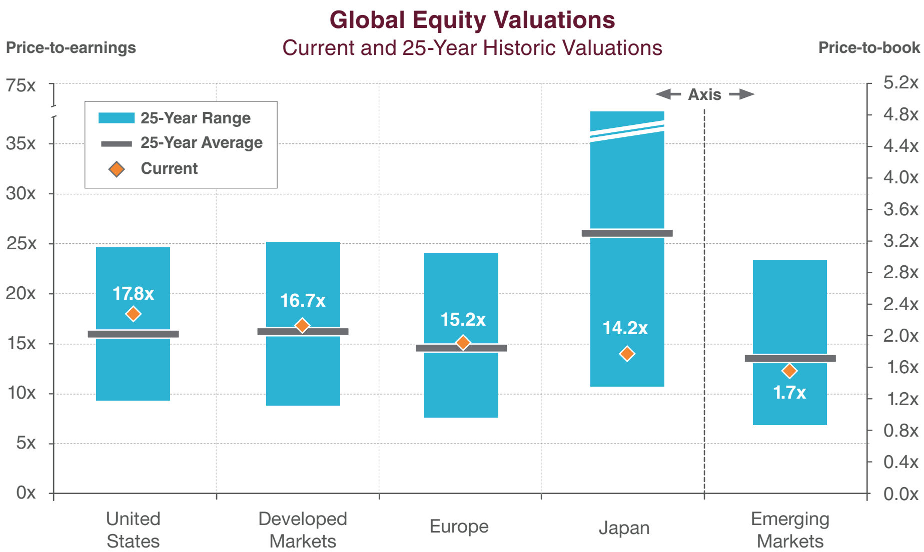
Global demand for oil has fallen slightly while supply has increased. Supply cuts by OPEC that were meant to drive up prices are being quickly met with supply from US producers, causing prices to fall below $50/barrel, down nearly 20% from a year ago.



SOURCE OF DATA: U.S. Energy Information Administration.

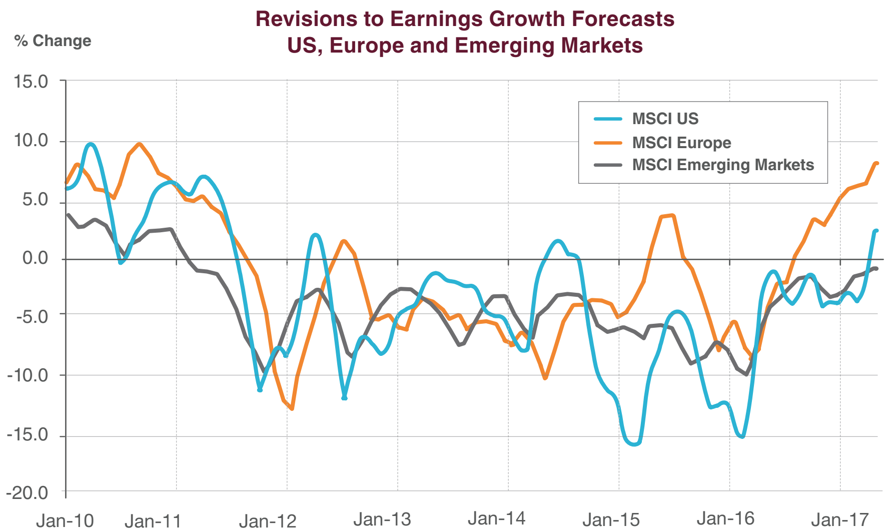
Saudi Arabia and Russia are still the world's largest producers of oil. However, the US has very quickly become a close #3, due to higher US output (from shale drilling), even as OPEC has cut back on production. While the rise in US oil production took a pause in 2016, in 2017 it has resumed its upward climb.

GLOBAL EQUITIES



SOURCE OF DATA: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.

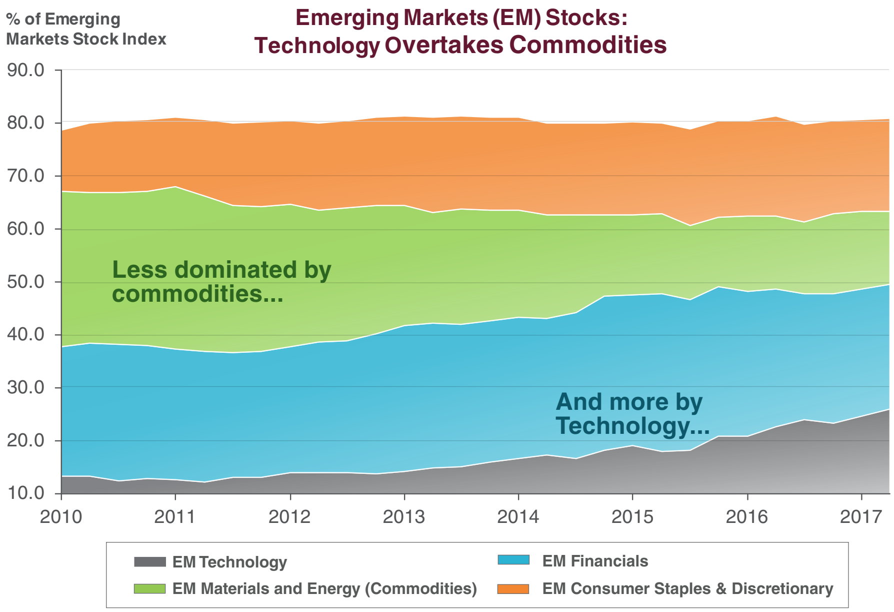
Relative to historical averages, valuations across the globe, not including Japan and emerging markets, are elevated. However, when considering regions relative to one another, we think Europe and emerging markets continue to offer the most attractive opportunity set.



SOURCE OF DATA: MSCI, IBES, Morgan Stanley Research.

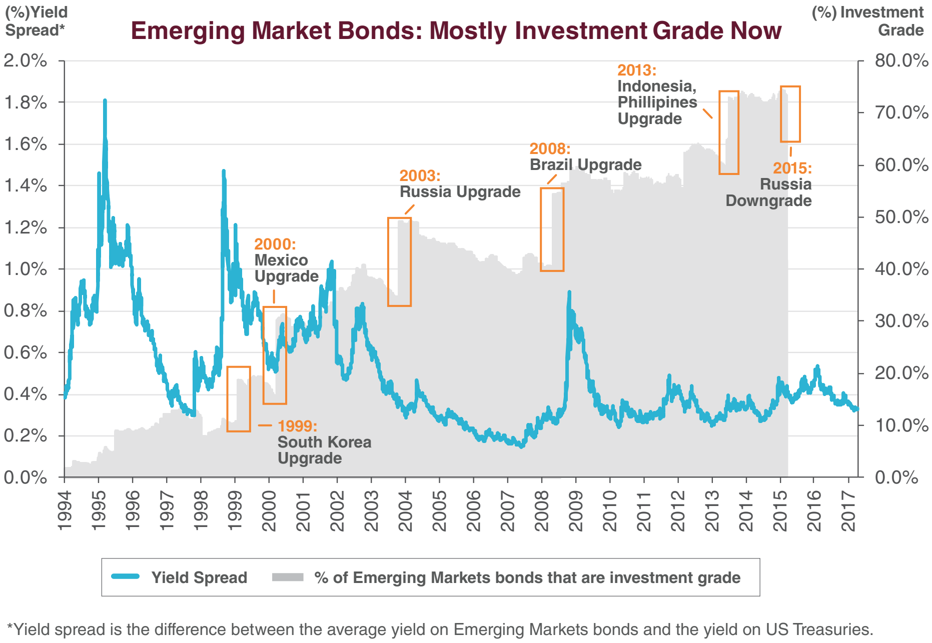
On average, earnings forecasts are being revised upwards for US and European companies, with emerging markets catching up quickly. We believe that at current valuation levels, Europe and emerging markets will be attractive areas of investment and we continue to overweight these regions in our portfolios.

EMERGING MARKETS



SOURCE OF DATA: MSCI, Bloomberg.

Since 2010, emerging market economies have transitioned further away from commodity exports and toward technology. As a result, equity markets in emerging economies are less affected by moves in commodity prices, which historically have been a big generator of export income.



*Yield spread is the difference between the average yield on Emerging Markets bonds and the yield on US Treasuries.
SOURCE OF DATA: Fidelity, JPMorgan, LNWM.

In the past 20 years, the creditworthiness of emerging market bonds has improved dramatically. Recently, roughly 55% of emerging market bonds were investment-grade quality. As a result, yields on emerging market bonds have fallen and prices risen. We believe current EM bond yields provide relative value and that they will drop further (prices will rise), coming closer to the yields of developed market bonds in the coming years.

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 Tyee 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 manager fees for comparison.