Q3 2019 Economic Outlook

By the LNWM Investment Strategy & Research Group

SUMMARY

The incredible market rally so far in 2019 has been unusual in at least one way: investors have flocked to blue chip equities in developed markets and not so much to higher-risk investments (small stocks, emerging markets, high-yield debt). Normally during powerful rallies, riskier investments tend to outperform. Simultaneously, global bond yields have fallen, as defensive sectors such as utilities and infrastructure have surprised to the upside. Despite the conservative stance that we took in late-2018 and into 2019, LNWM portfolios have performed well. We benefited from our allocation to real assets and infrastructure, while our addition of short-term fixed income detracted.

It seems that markets are interpreting bad news as good news, as a slowing economy increases the likelihood that the Federal Reserve will lower rates significantly. Much like the proverbial pistol on the wall, the Fed may not have a choice at this point but to lower rates. Most economists are calling this an "insurance policy," given that the US economy remains generally stable and the Fed has expressed willingness to do what it takes to keep the expansion going. Of concern is the Fed bashing emanating from the White House, which stirs up fears of political pressure being put on the Federal Reserve. We believe Fed Chairman Powell will remain neutral and act accordingly given the relevant economic data.

> "If in the first act you have hung a pistol on the wall, then in the following one it should be fired. Otherwise don't put it there."
>
> **– Anton Chekhov**

Trade and geopolitics, while having moved off the front page, remain key risks to the US economy. The Trump administration backed down from imposing new tariffs on Mexican imports, which seemed to quell markets. Trump and China's President Xi met at the recent G-20 meetings, and while nothing official was released, markets interpreted that as progress. Nevertheless, trade frictions are taking a toll on US business as capital spending and manufacturing data are turning negative.

Asset allocation in this environment is as challenging as ever. Given that the downgrade in global growth will likely continue in the second half of 2019, we continue to favor maintaining a lower risk profile. Central banks globally have turned accommodative, which will likely help extend the already record-long US expansion but we think riskier assets have already priced in the lower yields. Hence, we are maintaining our current allocations although some manager changes are likely within certain asset classes.

Central Banks Take Center Stage — Again

As we enter the second half of 2019, US stock and bond markets are at record highs after the Federal Reserve indicated it would be lowering interest rates, as soon as this month. The oft-repeated reason for the Fed's about-face? Potential economic weakness in what has been the longest economic expansion in US history. While the markets cheer the return of an "accommodative" Fed, and our portfolios continue to benefit, we have some concern about what this shift in Fed policy is likely to mean for the markets and our portfolios going forward.

As we said last quarter, US economic fundamentals remain sound, and the Fed is meeting its twin mandates: full employment (latest official unemployment was under 4%) and price stability (consumer price inflation is around 2%). US GDP is 70% driven by the American consumer, not so much by the economies of our trading partners. And the American consumer is going strong, with consumer spending up a healthy 0.4% in June, boosted by wage increases (3.2% annual rate), more workers feeling confident enough to quit jobs, and relatively low consumer debt relative to net assets.

We are not saying that the US economy has nothing to worry about. Trade tensions, which have caused uncertainty among corporate decision makers, have manifested in lower capital spending as it seems companies are unwilling to make significant new investments given the current environment. Outside the US, growth has been anemic with some European economies facing the prospect of recession, which could begin to have spillover effects on the US.

Generally speaking, however, one would not normally expect an interest rate cut given the balance of recent economic data, including a stock market at record highs. And yet, after a recent Fed Committee meeting and subsequent release of the meeting minutes, it became abundantly clear that the Fed is no longer seeking to move interest rates higher. In fact, they left open the possibility that they would lower the target Federal funds rate at the next meeting, which will take place in about two weeks. Currently, the markets are pricing in 100% chance of a Fed rate cut; anything short of that would be disappointing. So the question is not whether but by how much. Given a Fed

Is the Fed Being Politicized?

In an unprecedented series of comments via Twitter, President Trump has chastised Federal Reserve Chairman Jerome Powell for not lowering interest rates, despite the fact that Trump was the one who appointed Powell. Some examples:

Dec. 24, 2018 — "The only problem our economy has is the Fed. They don't have a feel for the Market, they don't understand necessary Trade Wars or Strong Dollars or even Democrat Shutdowns over Borders. The Fed is like a powerful golfer who can't score because he has no touch - he can't putt!"

March 29 — The U.S. economy "would be in a better place" if the central bank had "not mistakenly raised interest rates, especially since there is very little inflation."

April 4 — "Despite the unnecessary and destructive actions taken by the Fed, the economy is looking very strong."

April 14 — "If the Fed had done its job properly, which it has not, the Stock Market would have been up 5,000 to 10,000 additional points, and GDP would have been well over 4% instead of 3%."

July 5 — "…that our Federal Reserve doesn't have a clue! They raised rates too soon, too often, and tightened, while others did just the opposite."

We have no evidence that the Fed is responding to political pressure to cut interest rates. However, that this is even a concern is worrisome. Interest rate policy has huge implications for investors in all asset classes and must be perceived as impartial in order for market pricing to accurately reflect risk and return. We therefore continue to think the Federal Reserve Committee will be able to brush off political pressures, as they did in December 2018, when they raised interest rates despite Trump's tweets.

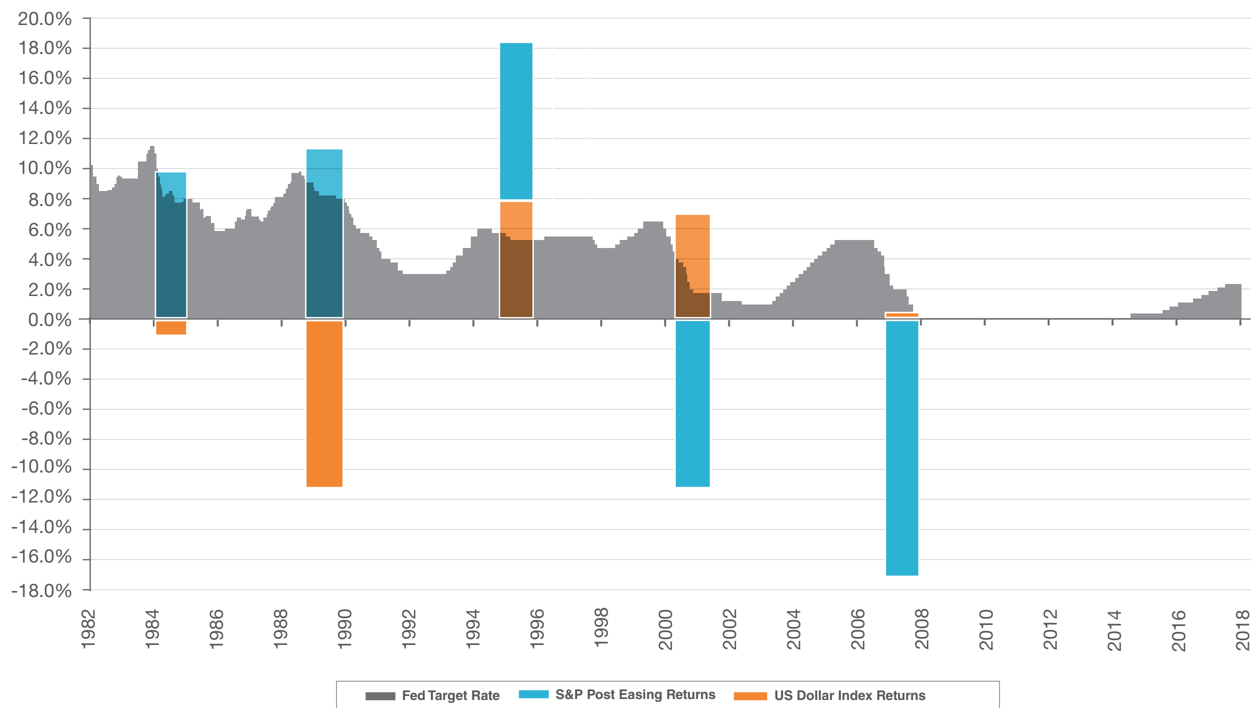
funds rate of 2.25% to 2.5% now, we expect a cut of 25 basis points in July, while the markets are pricing in a possible 50 point drop.

Why Now

We ask ourselves: Why is the Fed about to lower rates? In our view, the Fed is lowering rates because the benefits of an economy running "hot" during a period of tame inflation outweigh the risks of recession. This calculation, however, veers from the twin mandates of full employment and price stability, which are being met. There is no mandate for the Fed to protect asset values. In fact, by lowering interest rates at a time of full employment and record high asset prices, the Fed could end up creating distortions in valuation.

In the near term, a drop in interest rates can extend what is now the longest economic expansion in US history and perhaps give another boost to real estate prices, which are not rising as much. The long-term risk is that a market bubble is more likely to develop, and interest rates, already being low, cannot be lowered enough to stimulate the economy when the bubble finally bursts. This would be a novel situation for the US, although Japan and parts of Europe have been in this situation for years.

As we embark on what appears to be another Fed easing cycle, what can investors expect in terms of financial market returns? Historically, the results have been mixed (see chart). After interest rate cuts by the Fed, returns on the S&P 500 and the value of the US dollar have varied 12 months later, including about just as many negative as positive results.



SOURCE OF DATA: Bloomberg, FRED.

Looking Ahead: Slowdown or Ramp-Up?

In the *Q2 2019 Economic Outlook* (April 2019), we warned of FOMO (Fear of Missing Out) as markets continued to drift higher, enticing investors to increase allocations to riskier assets in an attempt to generate returns. We also highlighted the increasing tensions between President Trump and China's President Xi as they negotiated a trade agreement. Regarding monetary policy, we took the stance that the Federal Reserve would keep interest rates steady for the remainder of 2019, although we are now seeing a rate cut as very likely.

Of special interest to us is the behavior of longer-term interest rates, which are set by the markets and not so much by Fed policy. As equity markets continued marching higher, longer-term interest rates had for the most part been falling, although that started to reverse recently. Consider that toward the end of June, the yield on 10-Year Treasuries fell briefly below 2% and was actually lower than the yield on 2-Year Treasury notes.

Longer-term yields typically fall in anticipation of slowing economic growth. In fact, growth globally has slowed, and several members of the Federal Reserve's Open Market Committee expect two rate cuts this year in response to "risks to the US economy." Meanwhile, the futures markets are even more sanguine, pricing in three Fed interest rate cuts in 2019.

Hence, as mentioned earlier, we are at a perplexing juncture. Is the US economy fundamentally slowing, or is it about to get an unnecessary boost from lower interest rates? In the near term, we think the latter is more likely, especially if there is some good news on trade negotiations. Also, the incredibly strong June and 2nd quarter for US equities suggest that a US recession is not imminent, as equities tend to begin drifting lower about three months ahead of an economic downturn. Still, we are remaining cautious and fully diversified given the higher level of economic uncertainty.

How We Did/What We Are Doing

At the end of March, we reduced risk generally, but in spite of our conservative stance, the second quarter was very strong for us. Our allocation late last year to real assets and infrastructure has outperformed both its respective benchmark and equities generally. Most surprising for us was the decrease in interest rates (about 50 basis points in the 10-year US Treasury), which accompanied the strong US equity performance. Overall, we are pleased with the positive performance of the asset allocation changes we have recommended for our clients' portfolios, but we are far from complacent.

Our decision to reduce risk in favor of short-term fixed income has been mixed. With the dramatic sell-off in the equity market in May, that allocation was favorable. However, as the Fed continued pivoting toward lowering interest rates, equities rebounded strongly in June. While our short-term fixed income investments have performed as expected, they have lagged returns on most other major asset classes.

In the first half of the year, we redeemed our allocation to hedge fund limited partnerships due to underperformance and excessive fees. Those proceeds were invested in a balanced portfolio (60% US equities/40% US bonds), which has performed very well. However, we do intend to maintain our overall allocation to hedge funds and are working on an internally managed fund that will provide access to top-tier alternative asset managers for qualified investors.

Q3 2019 Key Economic Drivers

Central Bank Policy – Central banks are back in the spotlight. The US futures market is pricing in a 100% probability that the Federal Reserve will cut interest rates in late July, while the European Central Bank (ECB) has re-introduced the possibility of additional stimulus as global growth has slowed. While the ECB will soon be headed by Christine Lagarde (former head of the IMF), we expect little change in its stance. Looking out, we don't think the Fed will cut rates as much as markets are expecting, but the Fed is turning accommodative nonetheless.

Corporate Earnings – After a big jump last year due to the 2017 tax cuts, corporate profit growth is flattening, and the impact of tariffs on earnings will begin to be acutely felt in the year ahead, in our view. To put this in perspective, the US import tariffs imposed so far are equal to 10.5% of pre-tax US corporate profits, and the value of threatened tariffs totals almost 50% of pre-tax profit. Hence, we think tariffs pose a direct threat to corporate earnings going forward. Currently, the S&P 500 is priced at roughly 17 times estimated earnings for the next 12 months. While this is slightly above-average, it is below the peak levels in late-2017.

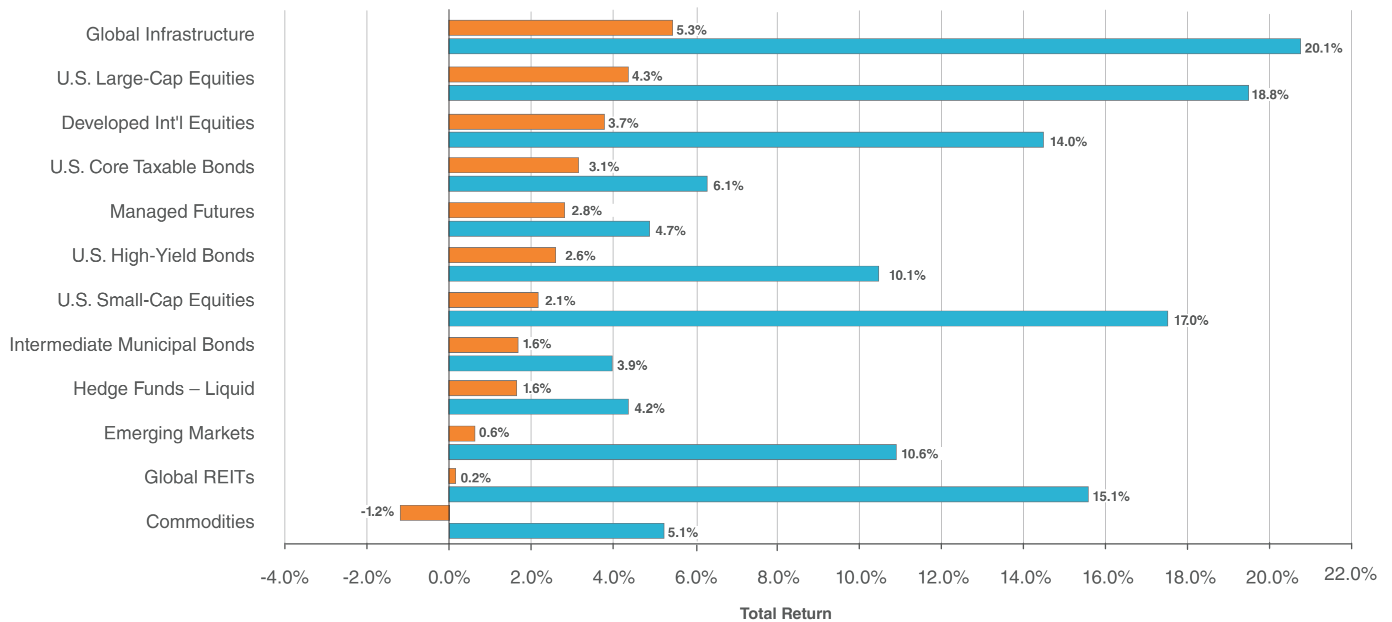
Global Trade – We've focused on trade since president Trump began threatening tariffs on China and Mexico. Most recently, he is considering tariffs on European goods as well. While a deal has been reached with Mexico, much still needs to be done with China and now, Europe. This is beginning to weigh on growth and certain sectors are feeling the pain more acutely. The Trump Administration has already announced aid for US farmers and many firms are shifting manufacturing away from China. However, there is little sign that this "competition" between the US and China will subside anytime soon, and we think it could lead to a currency war.

Currency War – President Trump has accused several foreign nations of manipulating their currencies (China and Europe most recently). He has also tried to exert pressure on the Federal Reserve to ease monetary policy in an effort to stem the rise of the dollar. Inflation remains elusive, globally. The lack of inflation combined with the increased risk of recession could lead countries down a path of currency devaluation in an effort to fight deflation.

Geopolitics – Recent actions by Iran in the strait of Hormuz as well as the continued enrichment of uranium could become an increasing risk to global markets. The US has intensified pressure on Iran, which is having crippling effects on their economy and currency and is backing a hostile regime into a corner. The "go it alone" stance the US is currently taking will increase the likelihood of further incidents, in our view. The Persian Gulf is not the only area of geopolitical risks, as Brexit remains unsettled pointing to further uncertainty within the Eurozone.

Performance of Asset Classes

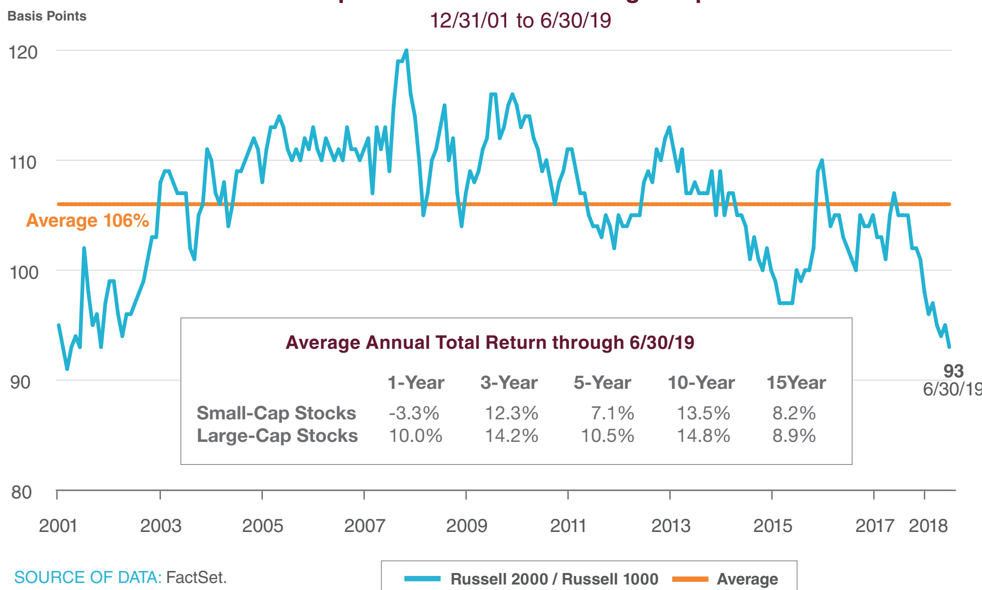
Quarter-To-Date and Year-To-Date (As of June 30, 2019)



Source of Data: Morningstar, Bloomberg, Hedge Fund Research. Please see the disclosure and definitions.

US Small-Cap Stocks are Lagging:
Small-Cap Returns Relative to Large-Cap Returns

12/31/01 to 6/30/19

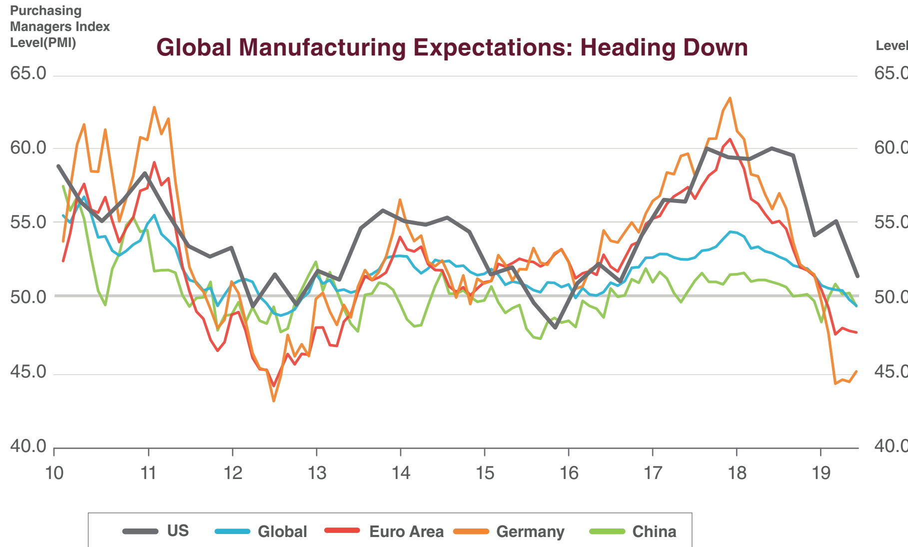


Average Annual Total Return through 6/30/19

	1-Year	3-Year	5-Year	10-Year	15Year
Small-Cap Stocks	-3.3%	12.3%	7.1%	13.5%	8.2%
Large-Cap Stocks	10.0%	14.2%	10.5%	14.8%	8.9%

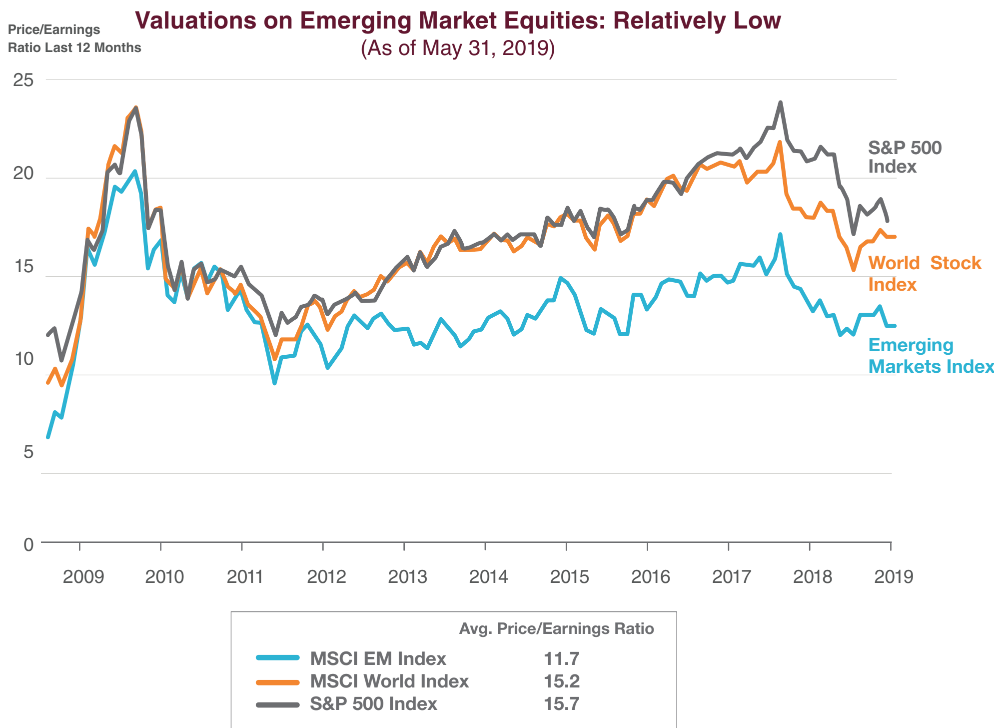
SOURCE OF DATA: FactSet.

Over the past year, returns on US small-capitalization stocks have significantly lagged those on US large-cap stocks, as represented by a comparison between the Russell 2000 Index (small stocks) vs. Russell 1000 Index (large stocks). As a result, US small-cap stocks are now trading below their 10-year average on many valuation measures and are at their cheapest level relative to large-cap stocks since 2001.



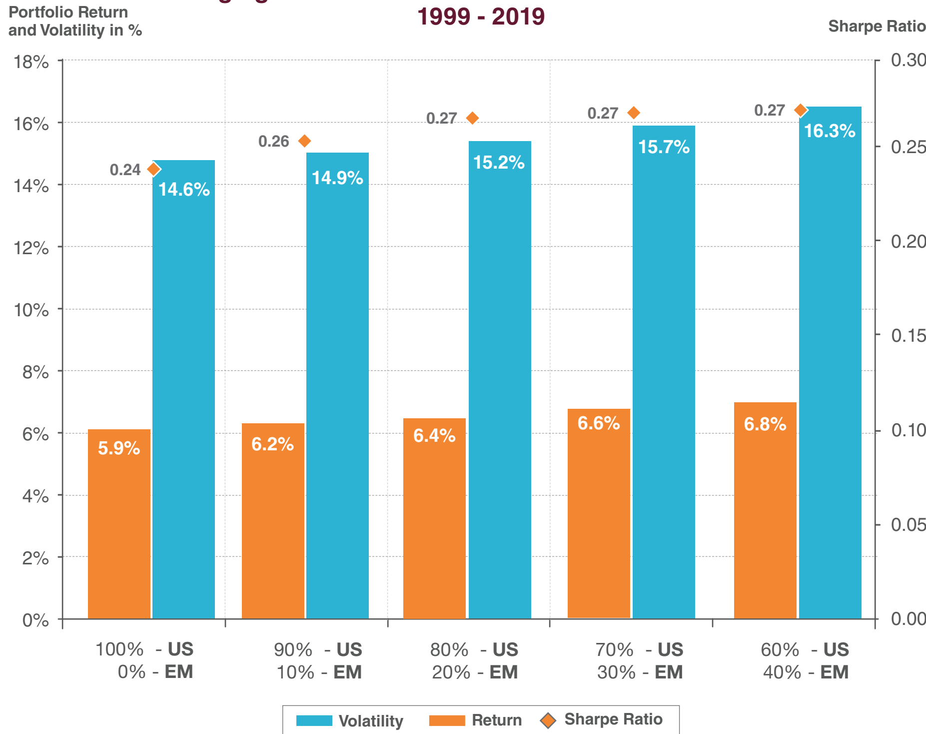
SOURCE OF DATA: IHS Markit, CXN, JPM, BME, Haver Analytics, Deutsche Bank.

We believe the Federal Reserve has seen enough deterioration in US economic data to allow it to proceed with lowering interest rates (accommodative policy). Case in point, the Fed must consider manufacturing expectations, which have fallen globally and point to weaker growth in the US and abroad.



SOURCE OF DATA: FactSet.

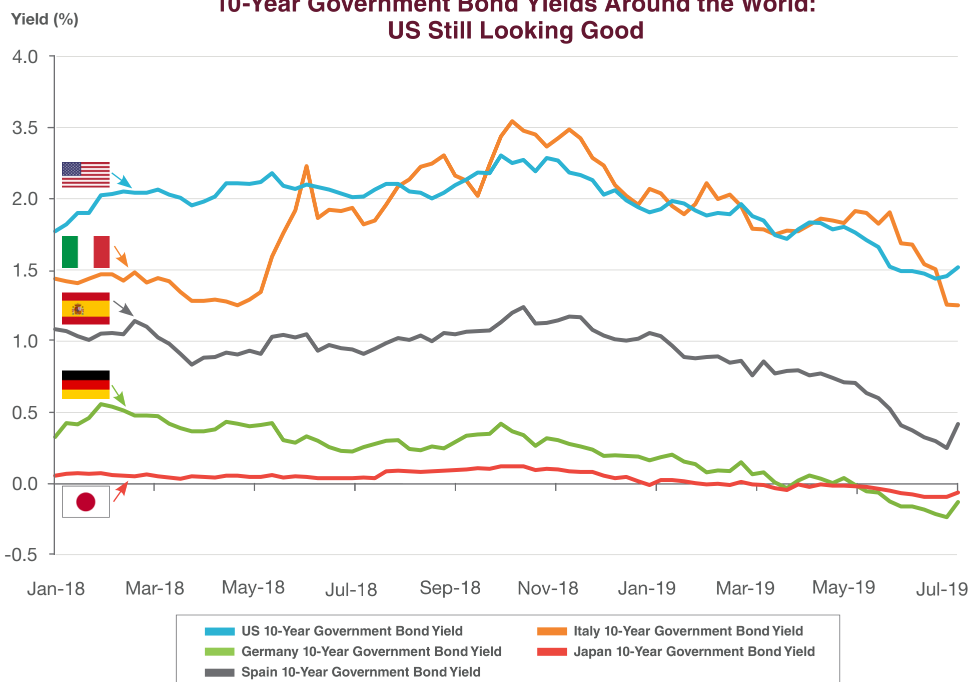
Emerging Market (EM) equity valuations remain near lows by historical standards and also compared to US stocks (the S&P 500 Index) and global equities (MSCI World Index). The chart shows a comparison of average Price/Earnings (P/E) ratios, but other valuation measures show similar results. We believe that over time, valuations will revert back to longer-term norms and that the discount given to emerging market equities compared to equities in other markets will close.



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

Historically (over the past 20 years), increasing a portfolio's allocation to emerging markets minimally increased the volatility of that portfolio while improving both the nominal return and the risk-adjusted return as measured by the Sharpe Ratio. Ultimately, our goal as asset allocators is to produce the highest risk-adjusted returns for our clients over a full market cycle.

In the chart, US equity performance is measured by the S&P 500 Stock Index and EM performance by the MSCI EM Index.

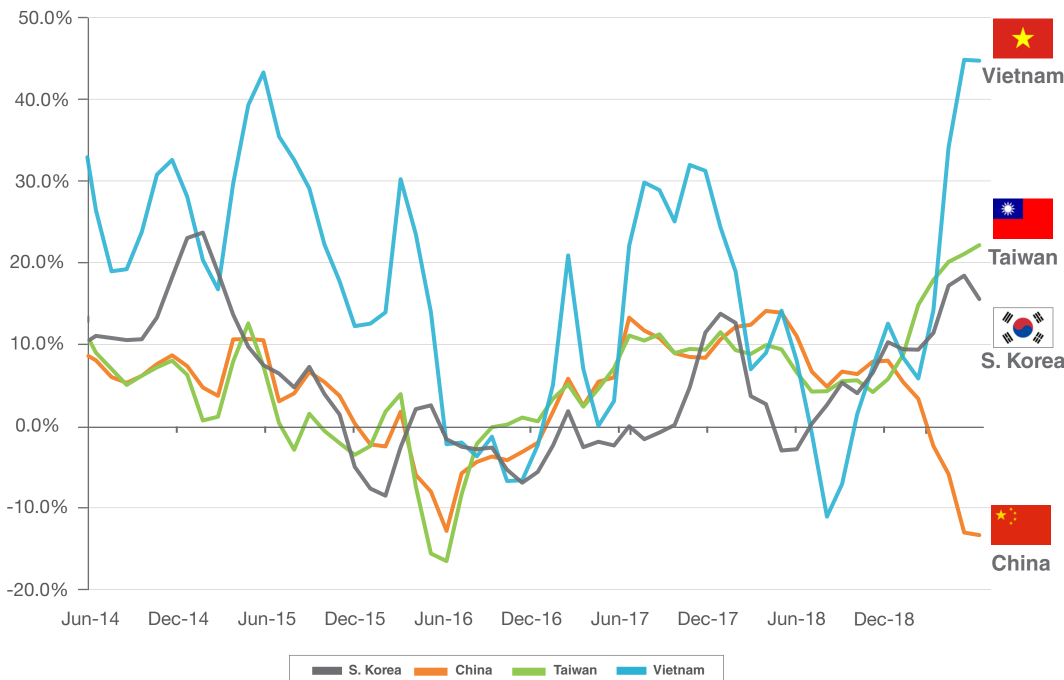


SOURCE OF DATA: Bloomberg.

After a slow but steady rise in 2018, US interest rates have begun falling, particulary on longer maturities. Yet, as the chart shows, an investor receives more income when buying US Treasuries compared to the bonds of other governments, some of whom are now offering negative yields, including Japan and Germany. Underpinning the attractiveness of US Treasuries is our relatively stable economy offering higher creditworthiness and the US dollar as the world's reserve currency.

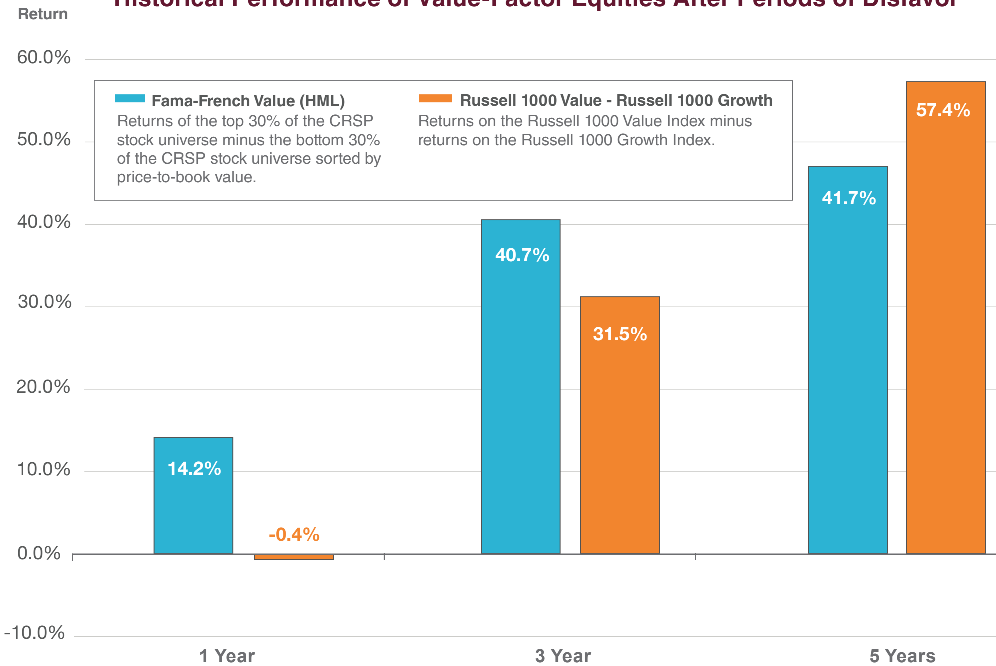
SOURCE OF DATA: Bloomberg.

The US-China trade war is certainly having a negative impact on trade. China imports of US goods have seen a precipitous decline since the highs hit in 2017 and are contracting at the fastest rate in recent history. US exporters are scrambling to accelerate deliveries to China ahead of further tariffs and to find new markets outside of China for their goods.



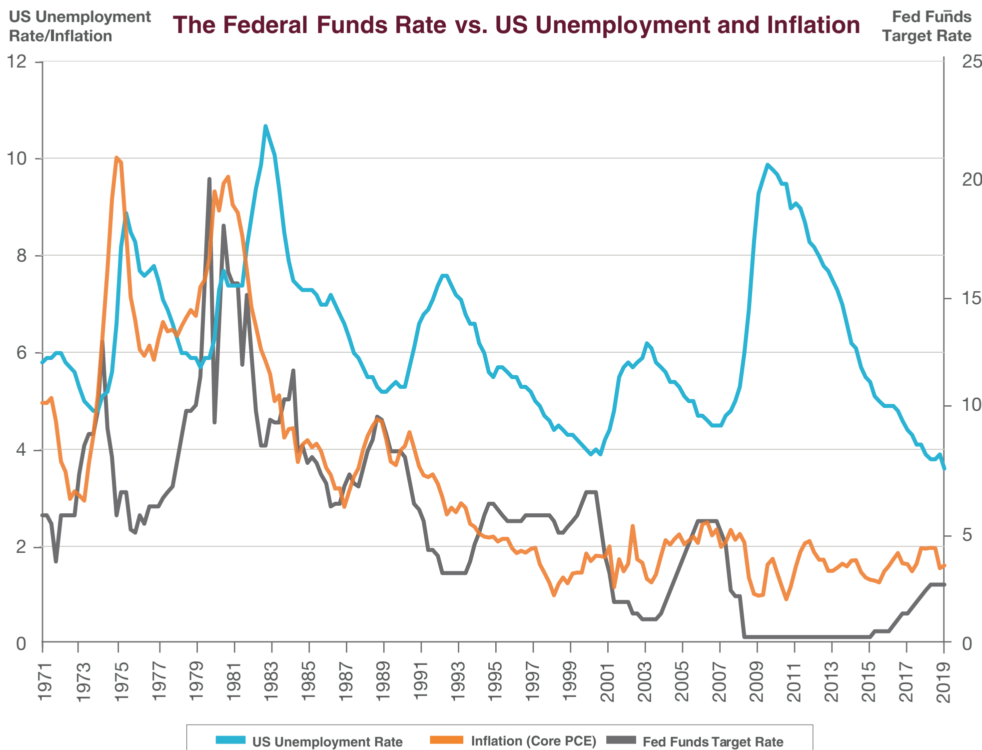
SOURCE OF DATA: Bloomberg.

To get around US tariffs, Chinese companies have been actively shifting their logistics supply chains from China to Vietnam. The switch is highlighted in the surge in US imports from Vietnam and drop in imports from China (see chart).



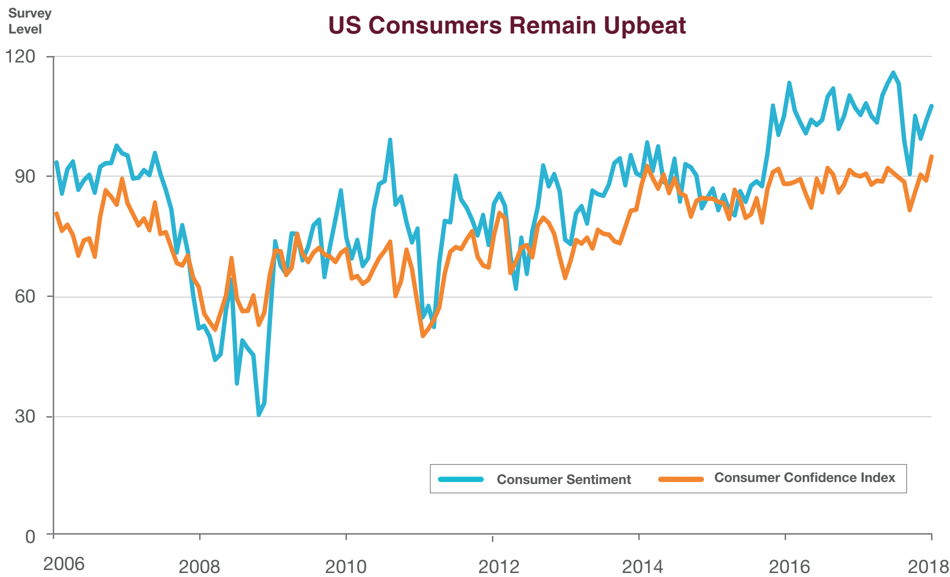
SOURCE OF DATA: Data for Russell 1000 Value – Russell 1000 Growth is from 12/31/1978 and Fama-French since 7/31/1926. Data is from Morningstar and Ken French's website: https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html

US value stocks have been underperforming growth stocks since 2010. The good news is that when value stocks are as out-of-favor as they have been recently, historically they have rebounded dramatically over the following three- and five-year periods. The chart shows average cumulative returns on value-factor equities (defined in two different ways) after periods of disfavor as bad or worse than the current one.



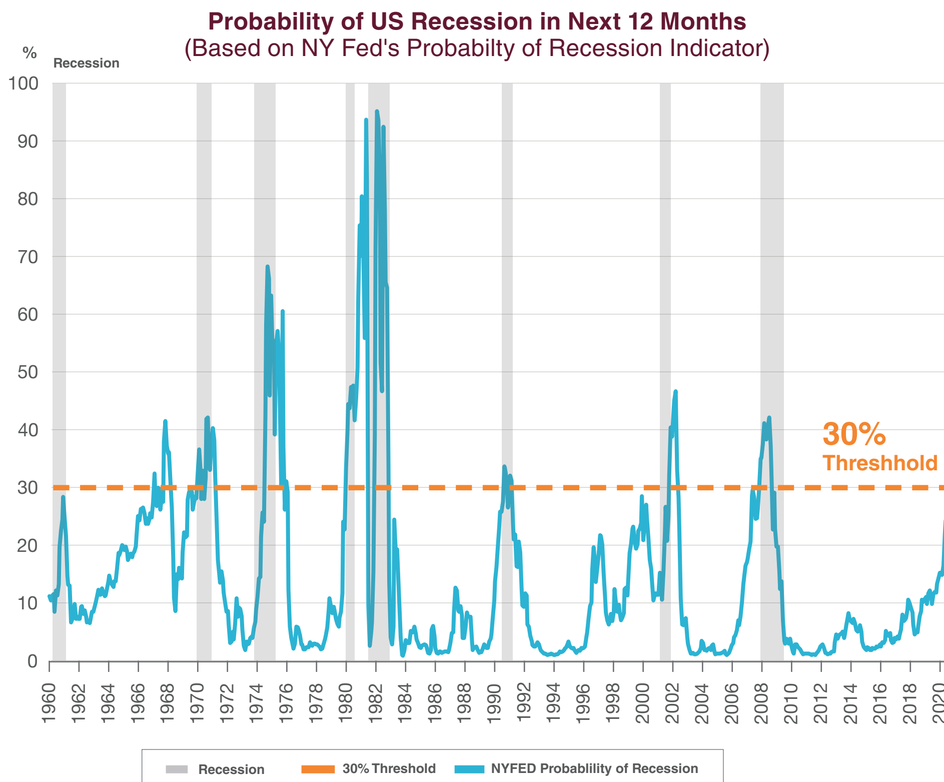
SOURCE OF DATA: Bloomberg.

It is debatable whether or not the Federal Reserve should be lowering its target rate this July (the Federal funds rate), given that the US economy is meeting the Fed's two mandates: full employment and price stability. However, what we do know is that the Fed has chosen to cut interest rates under similar economic conditions in the past. For example, US inflation and unemployment were at similar levels in 2000 and 2008 as they are today, times when the Fed launched interest rate cuts.



SOURCE OF DATA: Bloomberg, University of Michigan, Conference Board, 01 Jan 2006 to 31 May 2019.

While many headlines have suggested a US recession is likely, we do not see major signs of an imminent downturn. A major positive is that US consumer sentiment remains upbeat (see chart). This is important because sentiment tends to influence consumer spending, which makes up roughly 70% of US GDP.



SOURCE OF DATA: Bloomberg.

One indicator of interest is the New York Fed's Probability of Recession, which includes the shape of the yield curve (yield on 10-Year Treasury notes minus the yield on 3-month Treasury bills).

Currently, this indicator is pointing to a 30% probability of recession by June 2020 — up significantly since 2018. Given that we are now well into the longest US economic expansion in history, the possibilty of recession seems higher based on historical norms, especially given recent commentary by the Fed.

THE BENEFITS OF DIVERSIFICATION

Total return by asset category relative to a diversified* allocation.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 YTD	15-Year Annualized Return	15-Year Annualized Volatility#
Best Performance	Global REITs 37.96%	MSCI EM 34.00%	Global REITs 42.35%	MSCI EM 39.42%	10yr Treas 20.06%	MSCI EM 78.51%	US Small Cap 26.85%	10yr Treas 17.15%	Global REITs 28.65%	US Small Cap 38.82%	Global REITs 15.89%	Muni Bonds 2.45%	US Small Cap 21.31%	MSCI EM 37.28%	Muni Bonds 1.64%	US Large Cap 18.84%	US Large Cap 8.94%	MSCI EM 21.35%
	MSCI EM 25.55%	COMM. 21.36%	MSCI EM 32.14%	COMM. 16.23%	US Bonds 5.24%	Global REITs 38.26%	Global REITs 20.40%	US Bonds 7.84%	MSCI EM 18.22%	US Large Cap 33.11%	US Large Cap 13.24%	US Large Cap 0.92%	US Large Cap 12.05%	MSCI EAFE 25.03%	US Bonds 0.01%	US Small Cap 16.98%	MSCI EM 8.70%	Global REITs 18.72%
	MSCI EAFE 20.25%	Global REITs 15.35%	MSCI EAFE 26.34%	MSCI EAFE 11.17%	Muni Bonds 4.23%	MSCI EAFE 31.78%	MSCI EM 18.88%	Muni Bonds 7.62%	MSCI EAFE 17.32%	MSCI EAFE 22.78%	10yr Treas 10.72%	10yr Treas 0.91%	COMM. 11.77%	US Large Cap 21.69%	10yr T -0.03%	Global REITs 15.09%	US Small Cap 8.15%	US Small Cap 18.61%
	US Small Cap 18.33%	MSCI EAFE 13.54%	US Small Cap 18.37%	Diversified 10.91%	Illiquid HF -19.03%	US Large Cap 28.43%	COMM. 16.83%	US Large Cap 1.50%	US Large Cap 16.42%	Diversified 15.60%	US Bonds 5.97%	US Bonds 0.55%	MSCI EM 11.19%	Diversified 17.29%	Global REITs -4.74%	MSCI EAFE 14.03%	Global REITs 8.00%	MSCI EAFE 16.38%
	Diversified 13.73	Diversified 10.39%	Diversified 17.36%	Illiquid HF 9.95%	Liquid HF -23.25%	Diversified 27.48%	US Large Cap 16.10%	Diversified -3.56%	US Small Cap 16.35%	Illiquid HF 9.14%	US Small Cap 4.89%	Global REITs 0.05%	Diversified 7.11%	US Small Cap 14.65%	Illiquid HF -4.75%	Diversified 12.48%	Diversified 6.65%	COMM. 16.25%
	US Large Cap 11.40%	Illiquid HF 9.27%	US Large Cap 15.46%	10yr Treas 9.76%	Diversified -30.77%	US Small Cap 27.17%	Diversified 12.00%	US Small Cap -4.18%	Diversified 12.54%	Liquid HF 6.73%	Muni Bonds 4.66%	MSCI EAFE -0.81%	Illiquid HF 5.46%	Global REITs 11.42%	US Large Cap -4.78%	MSCI EM 10.58%	MSCI EAFE 5.35%	US Large Cap 13.95%
	COMM. 9.15%	US Large Cap 6.27%	Illiquid HF 12.89%	US Bonds 6.97%	US Small Cap -33.79%	Illiquid HF 20.01%	Illiquid HF 10.24%	Illiquid HF -5.25%	Illiquid HF 6.37%	Global REITs 4.39%	Diversified 3.79%	Illiquid HF -1.11%	Global REITs 4.99%	Illiquid HF 8.58%	Liquid HF -6.74%	Illiquid HF 7.45%	Illiquid HF 4.82%	Diversified 10.78%
	Illiquid HF 9.05%	US Small Cap 4.55%	Liquid HF 9.25%	US Large Cap 5.77%	COMM. -35.65%	COMM. 18.91%	10yr Treas 7.90%	Global REITs -5.82%	US Bonds 4.21%	Muni Bonds -0.32%	Illiquid HF 2.98%	Diversified -2.23%	US Bonds 2.65%	Liquid HF 5.98%	Diversified -7.07%	10yr T 7.45%	10yr Treas 4.45%	10yr Treas 6.85%
	10yr Treas 4.83%	Liquid HF 2.72%	US Bonds 4.33%	Muni Bonds 4.79%	US Large Cap -37.60%	Liquid HF 13.40%	MSCI EAFE 7.75%	Liquid HF -8.88%	10yr Treas 4.18%	US Bonds -2.02%	Liquid HF -0.57%	Liquid HF -3.64%	Liquid HF 2.51%	US Bonds 3.54%	US Small Cap -11.01%	US Bonds 6.11%	US Bonds 4.27%	Illiquid HF 5.76%
	US Bonds 4.34%	US Bonds 2.43%	Muni Bonds 3.74%	Liquid HF 4.24%	MSCI EAFE -43.38%	Muni Bonds 7.18%	US Bonds 6.54%	MSCI EAFE -12.14%	Muni Bonds 3.56%	MSCI EM -2.60%	MSCI EM -2.19%	US Small Cap -4.41%	MSCI EAFE 1.00%	Muni Bonds 3.49%	COMM. -11.25%	COMM. 5.06%	Muni Bonds 3.66%	Liquid HF 5.38%
	Muni Bonds 2.92%	10yr Treas 1.99%	COMM. 2.07%	US Small Cap -1.57%	Global REITs -47.72%	US Bonds 5.93%	Liquid HF 5.19%	COMM. -13.32%	Liquid HF 3.51%	10yr Treas -7.83%	MSCI EAFE -4.90%	MSCI EM -14.92%	Muni Bonds -0.10%	10yr Treas 2.07%	MSCI EAFE -13.79%	Liquid HF 4.23%	Liquid HF 0.77%	US Bonds 3.14%
Worst Performance	Liquid HF 2.68%	Muni Bonds 1.67%	10yr Treas 1.36%	Global REITs -6.96%	MSCI EM -53.33%	10yr Treas -9.71%	Muni Bonds 3.13%	MSCI EM -18.42%	COMM. -1.06%	COMM. -9.52%	COMM. -17.01%	COMM. -24.66%	10yr Treas -0.16%	COMM. 1.70%	MSCI EM -14.57%	Muni Bonds 3.88%	COMM. -2.58%	Muni Bonds 2.73%

2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 YTD 15-Year Annualized Return 15-Year Annualized Volatility#

***Diversified asset allocation:** 20% U.S. Large Cap Equities; 20% U.S. Municipal Bonds; 20% Hedge Funds (10% Absolute Return, 10% Market Directional); 15% Int'l Developed Equities; 5% U.S. Small Cap Equities; 5% Emerging Markets Equities; 5% Global REITs; 5%, Commodities; 5% Managed Futures.

#Annualized Volatility as measured by standard deviation (the dispersion of outcomes around "the mean," or average result). When the standard deviation is lower, realized results tend to be closer to expected results (and vice versa). Standard deviation is not intended to reflect the entire range of gains or losses possible from an investment.

Past performance is no guarantee of future results. Data as of 6/30/2019. Returns are for period and index indicated (see Disclosures page for index definitions). "Diversified Allocation" returns assume quarterly rebalancing.

Source of Data: Morningstar.

The chart above highlights annual returns on a diversified portfolio consisting of the asset classes noted in the footnote, for each year from 2004 to 2019 (as of June 30, 2019). The last two columns show 15-year annualized returns and price volatility for the diversified portfolio as well as for the asset classes. Thus far in 2019, we've seen the resurgence of large-cap and small-cap US equities. No asset class has been a detractor during the first half of 2019, and we remain most surprised by the magnitude of the returns.

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

With nearly $5 billion in assets under advisement, 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.

LNWM ASSET CLASS RETURNS CHART INDEX DEFINITIONS

Intermediate Municipal Bonds: Barclays Municipal Bond 1-10 Year Blend Index that measures the performance of municipal bonds with maturities between one and 10 years.

U.S. High-Yield Bonds: ICE BofAML US High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market.

U.S. Core Taxable Bonds: The Barclays Capital U.S. Aggregate Bond Index covers the USD denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

U.S. Large-Cap Equities: The Russell 1000 Index is an index of approximately 1,000 of the largest companies in the U.S. equity market.

U.S. Small-Cap Equities: Russell 2000 Index, a measure of the performance of the 2,000 smallest companies in the Russell 3000 Index, representative of the U.S. small capitalization securities market.

Developed International Equities: MSCI EAFE Index, a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada. As of June 2014, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

Emerging Markets: MSCI Emerging Markets Index, a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of June 2014, MSCI Emerging Markets Index consisted of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

Commodities: The Bloomberg Commodity Index is made up of 22 exchange-traded futures on physical commodities. The commodities are weighted to account for economic significance and market liquidity and weighting restrictions on individual commodities and commodity groups promote diversification.

Global REITs: FTSE EPRA/NAREIT Global Equity REIT Index, a measure that tracks the performance of listed real estate companies and REITs worldwide.

Managed Futures: The SG CTA Index provides the market with a reliable daily performance benchmark of major commodity trading advisors (CTAs). The SG CTA Index calculates the daily rate of return for a pool of CTAs selected from the larger managers that are open to new investment.

Hedge Funds – Liquid: HFRX Global Hedge Fund Index – A daily-valued index designed to be representative of the overall liquid hedge fund universe. It is comprised of all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset weighted based on the distribution of assets in the hedge fund industry.

Hedge Funds – Illiquid: HFRI Fund Weighted Composite Index – A global, monthly-valued, equal-weighted index of over 2,000 single-manager funds that is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies. Constituent funds report monthly net of all fees performance in U.S. dollar and have a minimum of $50 Million under management or a twelve (12) month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

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