PERSONAL WEALTH ADVISORY BY
Laird Norton Wetherby

Fixed Income Back in the Spotlight

For much of the past four decades, investors came to think of bonds as the quiet part of a portfolio. Interest rates generally trended down, inflation was relatively contained, and for the most part high-quality bonds provided both steady income and ballast when stock markets struggled.

The last several years have been different, however, with 2022 a dramatic illustration that stocks and bonds *can* struggle simultaneously. Most recently, renewed volatility in the Treasury market has pushed longer-term interest rates sharply higher, reminding investors that even high-quality bonds can experience meaningful price swings.

That can be uncomfortable. But it does not mean bonds are failing at their job, nor does it suggest that investors should abandon a carefully constructed fixed income strategy. In fact, some of the same forces creating short-term volatility are also making the long-term opportunity in bonds more attractive.

What is driving the volatility in the bond market?

Bond prices move inversely to interest rates, so when Treasury yields rise, existing bond prices generally fall. Recently, several forces have pushed yields higher at the same time.

Inflation remains stubborn. Inflation has declined substantially from its post-pandemic peak, but it has remained above the Federal Reserve's long-term objective. More recently, higher energy prices have renewed concerns that progress on inflation could stall. As a result, investors have reassessed how quickly monetary policy might become easier - and whether the Federal Reserve might need to keep rates elevated, or even tighten policy further.

The economy has remained resilient. Stronger economic growth is generally good news. For bond investors, however, an economy that can tolerate higher borrowing costs gives the Federal Reserve comfort that they can pursue inflation objectives, and, as a result, higher interest rates, without overly disrupting activity. Expectations for future short-term rates have consequently shifted higher.

Unorthodox Treasury buyback activity. The US Treasury managing market liquidity isn't unprecedented. However, Treasury Secretary Scott Bessent signaling that yields are "too high" to the market in the process is. Markets initially took accelerated Treasury buybacks as a reason to price in more uncertainty.

Government borrowing is substantial. With US politicians seemingly disinterested in reining in government spending, the US national debt notably hit the $40T milestone. The Treasury must continue to finance these large deficits which has renewed scrutiny from the bond market.

Corporate Issuance is elevated as well. Corporations are borrowing heavily to fund investments ranging from artificial intelligence infrastructure to traditional capital projects. Greater demand for capital can require higher yields to attract investors.

Investors are demanding more compensation to lend for long periods. The outlook for inflation, fiscal policy and interest rates is unusually uncertain. Investors therefore want to be paid more for committing money for 10, 20 or 30 years. This "term premium" is an important reason longer-term yields can rise even without a comparable change in Federal Reserve policy.

Together, these forces have created a difficult environment for some bond segments, particularly those with greater sensitivity to interest-rate movements. But it is important to distinguish volatility from a debt crisis or a deterioration in the fundamental role of fixed income.

Are we nearing a US debt crisis?

Even with consideration to recent market volatility, the bond market isn't pricing in an imminent crisis. That would assume by definition some kind of collapse in confidence and a lack of functioning in Treasury markets. Treasury markets continue to function normally and investors expect the US will pay its debts. However, that doesn't mean that the US is on a good trajectory with regard to its balance sheet and spending. The CBO projects the debt-to-GDP ratio to rise from a little over 100% in 2026 to over 120% by 2036. Unfortunately, neither major US political party seems to have the will to reduce public debt hoping/relying instead on growth, from Artificial Intelligence and otherwise to improve the GDP part of the equation.

But we've actually been here before historically with public debt spiking after World War II nor are we alone: Much of the developed world carries debt-to-GDP around 90% or above. And as long as investors of all kinds are willing to lend to the US government, a high debt load isn't necessarily problematic on its face.

Moreover, there has been no credible alternative store of value that has emerged to this point that could dethrone either the US dollar or the US Treasury as a safe haven, which has brought that steady investor patronage for decades. Would investors prefer China, the European Union or cryptocurrency? While some circumvention of the dollar in trade has occurred, a complete replacement of the dollar as the default currency for world trade doesn't seem probable (at least in the short-to-intermediate terms). To that point, the US dollar has appreciated year-to-date and the 30-year Treasury bond yield of 5.2%, admittedly at its highest level since 2007, only broke through its previous post-Covid, 2023 high of 5.1%, this summer.

Looking forward, a more realistic assessment is that the market is signaling the US government will face challenges of fiscal constraint versus a full-blown crisis in the years ahead. That would be an environment characterized by greater and greater costs to finance spending via higher interest rates. The consequences of that financing regime is more dollars that must be spent on servicing debt and less that is available for government initiatives to stoke growth or fail-safe programs should we encounter an economic crisis along the lines of the global financial crisis or Covid. Higher base interest rates also are a headwind to equity markets as every dollar of future earnings becomes less valuable in today's terms.

These are all real consequences but do not rise to the level of crisis.

What we are watching

None of this means the current environment should be ignored. There are genuine questions facing bond investors.

We are closely monitoring inflation and the Federal Reserve's reaction to it. We are watching the significant supply of government debt and whether investors continue to demand greater compensation for owning longer-maturity Treasuries. We are evaluating credit markets for signs that higher financing costs are beginning to pressure corporate balance sheets. And we continue to assess where yields adequately compensate investors for the risks they are assuming. On these latter two points we are watching for a sustained upward shift in credit spreads, the additional yield investors demand for investing in riskier debt, as a first signal of deterioration in the US markets and economy.

These developments may lead us to adjust exposures at the margin. That is different from rebuilding portfolios around each change in the market narrative.

Our investment process is designed around the recognition that forecasts are uncertain at best. Instead, we construct portfolios capable of navigating several plausible environments versus making them dependent upon accurately predicting one.

Staying focused on the job bonds were hired to do

To this point, core fixed income has held up well: Through 8/24/2026 the Bloomberg US Aggregate Bond Index has produced a -0.2% loss year-to-date but is up 0.6% month-to-date. We often say that, "we want our bonds to behave like bonds." That means we don't take outsized risks with our fixed income allocations with the reasoning that our bonds are supposed to diversify our portfolios first and foremost and those risks can be taken elsewhere in portfolios. As a result, our fixed income is built around a core allocation of high-quality bonds with a modest allocation to credit.

For most investors, bonds are not in a portfolio because we expect them to outperform stocks over long periods. They are there to serve several important purposes: generate income, preserve capital, diversify equity risk, provide liquidity and create a more stable source of funds for portfolio withdrawals.

Recent volatility, to the extent that it has materialized, has not changed those objectives.

Today's higher yields have improved the prospective economics of fixed income. The adjustment required to reach those yields may have been a bit painful (certainly 2022 was a challenge), but investors are now being compensated much more meaningfully for owning high-quality bonds than they were for much of the past decade.

There will inevitably be periods when bonds disappoint, just as there will be periods when stocks, real estate or other investments disappoint. Successful portfolio management does not require eliminating those periods. It requires understanding why each investment is owned, sizing the risks appropriately, diversifying among different return sources and resisting the temptation to abandon a sound strategy at precisely the wrong moment.

The levers we can pull

That all said, we *have* recognized that fixed income could potentially provide less ballast in market drawdowns than it had historically with a nod to the considerations above. It is one of several reasons why we have been advocates of improving diversification in portfolios with the incorporation of real assets, those that are inflation sensitive, and the aptly named diversifiers category, that include strategies like hedge funds that offer uncorrelated sources of return that can zig when the rest of the equity market zags.

Should gold or cryptocurrency be included as well? A case can be made that either might be an appropriate exposure for a specific client but dedicated allocations aren't for everyone. We believe investments in cryptocurrency in particular, should be considered as a high risk investment versus being a hedge to market risk. That perspective has been supported by both the outsized gains in some periods contrasted by the sizeable losses we've seen recently after shifting sentiment toward risk assets. We would first recommend clients include diversifiers and real assets before considering either gold or cryptocurrency for incorporation. Moreover, we would suggest reviewing the client's overall portfolio risk objective.

That is where we believe we can add particular value. We can't promise that markets will be calm but we can build portfolios with the expectation that they sometimes will not be - and to help our clients remain focused on their long-term objectives when volatility inevitably arrives.

The bond market may remain unsettled for some time. But volatility and opportunity often arrive together. With yields considerably more attractive than they were pre-Covid, diversified sources of fixed income exposure and a disciplined investment process, we continue to believe bonds can play an important and valuable role in client portfolios.

ABOUT THE AUTHOR

David Baker, CFA, works with LNW's Chief Investment Officer to design and implement LNW's investment strategy. Specifically, David leads the portfolio modeling process, both for strategic and tactical positioning, including the development of capital market assumptions, portfolio optimization and risk analysis.

ABOUT LNW

LNW Advisors provides services to support exceptional families and individuals seeking to activate the full potential of their wealth. To help turn lifetime ambitions and multigenerational aspirations into reality, Laird Norton Wetherby (LNW) brings to each client a high level of care combined with deep expertise in wealth and legacy planning, investments, and trust and estate services.

Offering both RIA (registered investment advisor) and trust services, LNW is committed to providing clients with unbiased, independent guidance and solutions. LNW has offices in Seattle, San Francisco, New York, Los Angeles and Philadelphia, as well as an affiliated trust company in South Dakota, empowering clients across the U.S. and around the world.

LNW is owned by employees and majority owned by Laird Norton Company, one of the longest-sustained family enterprises in the United States. To learn more, please visit LNWadvisors.com

LNW

PERSONAL WEALTH ADVISORY BY
Laird Norton Wetherby

DISCLOSURES

LNW or LNW Advisors refers to Laird Norton Wetherby Trust Company, LLC, a State of Washington chartered trust company; LNW Trust Company of South Dakota, LLC, a state of South Dakota charted trust company; and an investment adviser registered with the Securities and Exchange Commission, Laird Norton Wetherby Wealth Management, LLC.

This presentation includes candid statements and observations regarding investment strategies, individual investments, economic and market conditions; however, there is no guarantee that these statements or forecasts will prove to be correct. These comments may also include the expression of opinions that are speculative in nature and should not be relied on as statements of fact. LNW Advisors views and opinions regarding the investment prospects of our portfolio holdings include "forward looking statements" which may or may not be accurate over the long term. While LNW believes there is a reasonable basis for the appraisals and there is confidence in our opinions, actual results may differ materially from that was anticipated.

All investments involve a level of risk, and past performance is not a guarantee of future investment results. The value of investments and the income derived from them can go down as well as up. Future returns are not guaranteed, and a loss of principal may occur. All investment performance can be affected by general economic conditions and the extent and timing of investor participation in both the equity and fixed income markets. Asset allocation, due diligence, and diversification do not guarantee a profit or protect against a loss.

This presentation is not intended as investment advice; LNW offers investment advice only on a personalized basis after understanding the client's individual needs, objectives, and circumstances. The information presented herein does not constitute and should not be construed as legal advice or as an offer to buy or sell any investment product or service. Any accounting, business or tax advice contained in this presentation is not intended as a thorough, in-depth analysis of specific issues, nor a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties. Any opinions or investment planning solutions herein described may not be suitable for all investors nor apply to all situations. All opinions expressed are those of LNW and are current only as of the date appearing on this material.

Certain information herein has been obtained from public third-party data sources, outside funds, and investment managers. All data presented is current only as of the date shown. Although LNW believe this information to be reliable, no representation or warranty, expressed or implied, is made, and no liability is accepted by LNW or any of its officers, agents or affiliates as to the accuracy, completeness or correctness of the information herein contained.

Should a reader have questions regarding the applicability of information presented to her/his individual situation, she/he is encouraged to consult with the professional adviser of her/his choosing. A copy of LNW's current ADV Part 2 & 3 discussing our advisory services, fees, and other relevant information is available upon request. LNW recommends individuals visit Investor.gov/CRS for a free and simple search tool to research us and our financial professionals.

A benchmark is an unmanaged index, and its performance does not include any advisory fees, transaction costs or other charges that may be incurred in connection with your investments. Indices are statistical composites and are shown for informational purposes only. It is not possible to invest directly in an index. Indices are unmanaged and are not subject to management fees. Any benchmark whose return is shown for comparison purposes may include different holdings, a different number of holdings, and a different degree of investment in individual securities, industries, or economic sectors than the investments and/or investment accounts to which it is compared. Comparisons of individual account or portfolio performance to an index or benchmark composed of indices are unreliable as indicators of future performance of an actual account or portfolio. Actual performance presented represents past performance net of investment management fees unless otherwise noted. Other fees, such as custodial fees or transaction related fees may not be reflected in the actual performance results shown.

DEFINITION OF INDEXES

Global REITs = FTSE EPRA NAREIT Global Index

A global equity benchmark designed to track the performance of publicly traded real estate companies and REITs worldwide. It includes property owners and operators that meet strict criteria for real estate activities, liquidity, and transparency.

Intermediate Muni Bonds = Bloomberg Municipal 1-10 Year Index

A bond index measuring the performance of U.S. investment-grade municipal bonds with maturities between 1 and 10 years. It includes tax-exempt bonds issued by state and local governments and their agencies, focusing on the short-to-intermediate segment of the muni market.

US Core Taxable Bonds = Bloomberg U.S. Aggregate Bond Index

A broad, market-capitalization-weighted benchmark for the U.S. investment-grade fixed income market. It includes U.S. Treasuries, government-related bonds, corporate bonds, mortgage-backed securities (MBS), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS).

Hedge Funds = HFRX Global Hedge Fund Index

An investable index designed to represent the global hedge fund industry using a rules-based selection of hedge funds. It covers multiple strategies (e.g., equity hedge, event-driven, macro, relative value) and emphasizes transparency, liquidity, and lower survivorship bias.

US High Yield Bonds = Bloomberg U.S. High Yield Bond Index

A benchmark tracking the performance of U.S. dollar-denominated, below-investment-grade corporate bonds publicly issued in the U.S. domestic market. It reflects the high-yield (or "junk") segment of the corporate bond market.

US Large Cap Equities = S&P 500 Index

A widely followed equity index measuring the performance of approximately 500 large-capitalization U.S. companies. It is market-cap-weighted and designed to represent the core of the U.S. equity market across multiple sectors.

US Small-cap Equities = Russell 2000 Index

A U.S. equity index that measures the performance of approximately 2,000 small-cap companies drawn from the broader Russell 3000 Index. It represents the small-cap segment of the U.S. stock market and is widely used as a benchmark for U.S. small-cap equities, which typically exhibit higher growth potential and higher volatility than large-cap stocks.

Global Equities = MSCI ACWI (All Country World Index)

A global equity index capturing large- and mid-cap stocks across both developed and emerging markets. It represents the broadest commonly used benchmark for global equity performance, covering roughly 85% of global investable market capitalization.

Emerging Markets = MSCI Emerging Markets (MSCI EM)

An equity index representing large- and mid-cap companies across emerging market countries. It provides exposure to faster-growing economies with higher potential returns and higher volatility relative to developed markets.

Developed Int'l Equities = MSCI EAFE

An equity index covering large- and mid-cap stocks in developed markets outside the U.S. and Canada, specifically Europe, Australasia, and the Far East. It is a standard benchmark for international developed-market equities.

Commodities = Bloomberg Commodity Index

A broadly diversified benchmark tracking the performance of futures contracts on physical commodities. It provides exposure across major commodity sectors, including energy, metals, and agriculture, with weighting constraints to limit concentration in any single commodity or sector.

Global Infrastructure = S&P Global Infrastructure Index

A global equity index designed to measure the performance of publicly traded infrastructure companies around the world. It includes firms involved in infrastructure-related businesses such as transportation (airports, toll roads, railways), utilities (electricity, gas, water), and energy infrastructure (pipelines and storage). The index is structured to provide diversified exposure across regions and infrastructure subsectors and is commonly used as a benchmark for global listed infrastructure investments.