Q2 2020 Economic Outlook

The Markets Confront a New Reality

Let me begin by expressing my sincere hope and concern for the health and well-being of all of our clients, their families and friends, and our team here at LNWM. As I write this note from home in collaboration with my team who is also working from home, I realize that we are only beginning to see the long lasting impacts of the devastation brought on by Covid-19. Our focus has been, and will continue to be, on being stewards of your capital; however, the trust our clients place in us reminds me daily that there is more to what we do than investing. We are all in this together and we will come out of this together.

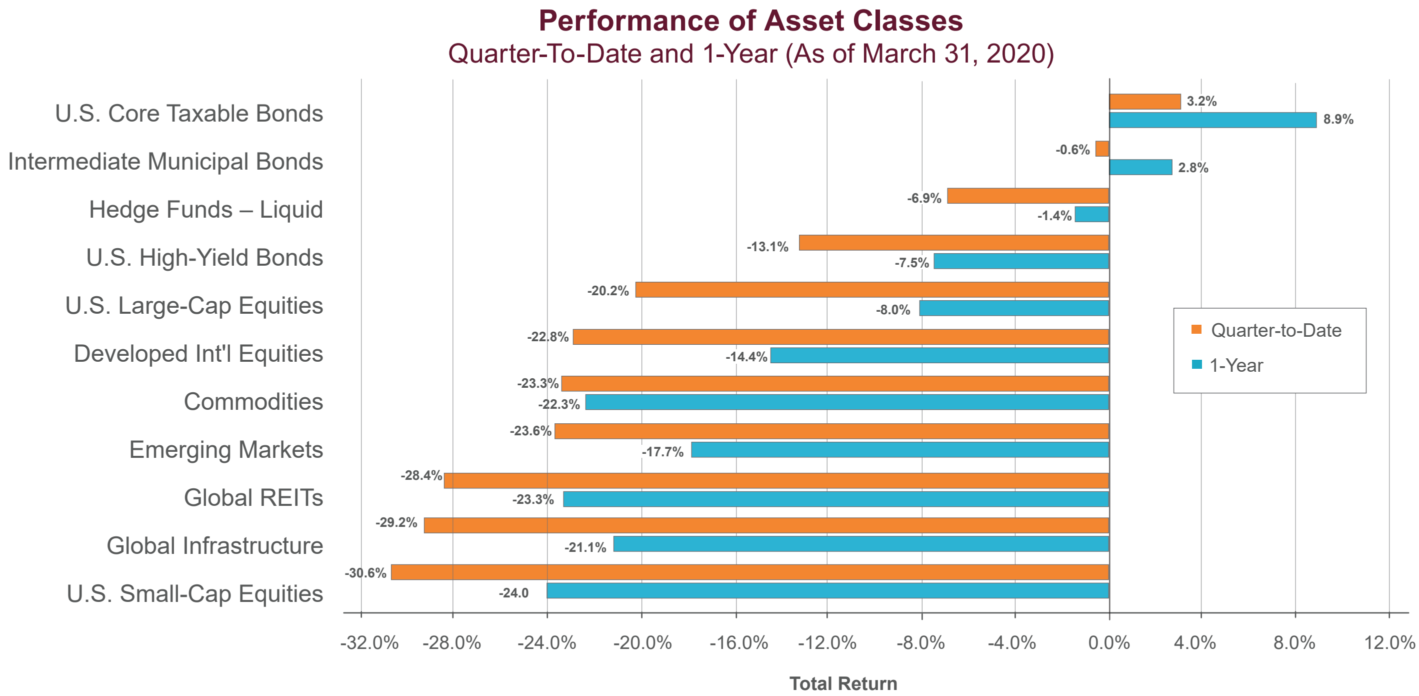
> "The future is never clear; you pay a very high price in the stock market for a cheery consensus. Uncertainty actually is the friend of the buyer of long-term values."
>
> – Warren Buffett

The economic realities of effectively "turning off" an economy are yet to be fully felt. We've only begun to see economic data that reflects the damage, beginning with US unemployment claims that have sky rocketed to record levels and capital markets attempting to price in those new realities. From February 19 to March 23, the US equity market saw the most rapid decline in history, as the S&P 500 fell by almost 34%, only to rally back 17.5% in the best three-day stretch since the 1930s. The absolute size of the daily moves are also remarkable, in that 2% daily swings have become commonplace. We think this reflects the incredibly wide range of possible outcomes and the lack of updated economic data.

In my career, I've never seen this much divergence between market optimists and the pessimists, although there are some points of common ground developing. As the pandemic has continued, fewer and fewer are foreseeing a V-shaped quick recovery, and it seems there is agreement that we are now in the midst of a recession. The two questions all are grappling with are: How deep will the recession be; and how soon will we begin to recover?

Here at LNWM, we are less focused on trying to call a market bottom; we are long term investors. Prior to the beginning of the pandemic, we were skeptical of the pricing in many sectors of the credit and equity markets. Since the crisis began, all assets have repriced in concert (the baby has been thrown out with the bath water), and we are working closely with the managers we use in client portfolios to determine which specific assets and even market segments may have been oversold.

Eventually, we think more opportunities will arise as the year unfolds, and we want to be poised to capitalize on those. I'm often asked if this is a "time to buy." As I noted earlier, we are not attempting to call a bottom. What I do know from my experience is that the "time to buy" is most often when it is least comfortable to do so. I don't think we've hit that point yet, especially in light of the market recovery we saw in early April.



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

What We Do Know

To date, we have very little fundamental economic data, which is driving the extreme market volatility in our view. This is about to change as corporations start to report 1st quarter 2020 earnings, with the major banks reporting first. We will be closely tracking the forward-looking guidance provided by companies, and how the market interprets that. We know that more that 16 million Americans have lost their jobs and millions more across the globe, with more to come. The dramatic impact of halting the US economy is indicated in the types of economic forecasts now being issued, with some forecasting a 20% annualized drop in US GDP in the second quarter of 2020 from the previous quarter and unemployment to hit 20%.

We've long emphasized the importance of the consumer to the US economy, which is also why we focus on employment. If unemployment does reach 20%, as forecasted, it is difficult to know how that will ultimately be interpreted by capital markets. On the bright side, if there is one, is that US consumers are generally much better-positioned, with less household debt than in 2008, which will be important in the recovery. Also, consumers who have lost their jobs to date are mostly in service industries that are relatively easy to reboot, such as retail, travel and entertainment.

However, it is nearly impossible to know how many of those businesses will survive the crisis. We think that is why the Federal Reserve and the US Treasury are right to be throwing the "kitchen sink" at the problem via trillions of dollars in monetary and fiscal support, with more to come.

On March 24, the Federal Reserve and US Treasury announced their coordinated response to the crisis. The market reacted as if this would guarantee success, posting the best three-day gains since the 1930s. Policy makers have made it clear that they will do whatever it takes to minimize the permanent impairment of the US economy, including a payroll protection program whereby the Small Business Administration provides forgivable loans through banks, if those loans are primarily used to pay employees. Clearly, the Federal Reserve sees the importance of the consumer to our economy.

The Fed has also launched several major programs to purchase a variety of fixed-income assets, aimed at maintaining market liquidity and corporate access to the debt markets. Consider that in the two weeks prior to the March 23 low in the stock market, there was almost no issuance of investment-grade corporate bonds; following the announcement of the Fed and US Treasury programs, there was record new issuance.

Looking Forward

As we begin to think about the factors that will allow the US economy to reopen, we are focused on these three things:

1) A vaccine for Covid-19
2) Effective treatment
3) Testing for the virus

Without an effective vaccine, one can never claim complete victory over a virus. Social distancing, stay-at-home orders, and other societal actions seem to be controlling the spread of Covid-19. Most forecasts predict that the virus will be brought under control within three months, which experts claim can be asserted when the curve showing new infections turns downward. However, until a vaccine is developed, it will be impossible to completely reopen the economy, unless we can effectively identify those who have the disease and treat them properly; otherwise we risk the reemergence of the virus. Hence, it's our view that testing and treatment are the near-term solutions, and there is progress being made on both these fronts in the US and elsewhere.

Market Crises: Duration and Recovery

Crisis	Stock Market Peak to Bottom	Duration	Recovery
2020 Covid-19 Pandemic (ongoing)	-34%	0.1 yrs so far	Unknown
2018 Global Stock Market Downturn	-20%	0.3 yrs	0.3 yrs
2008 Great Recession	-57%	1.4 yrs	4.1 yrs
2000 Dot-Com Bubble	-49%	2.5 yrs	4.6 yrs
Early 1990s Recession	-20%	0.2yrs	0.3 yrs
1987 Black Monday	-34%	0.3 yrs	1.6 yrs
1981 - 1982 Recession	-23%	1.0 yrs	0.2 yrs
1973 Oil Crisis	-48%	1.7 yrs	5.8 yrs
1962 Kennedy Slide	-28%	0.5 yrs	1.2 yrs
1929 Great Depression	-86%	2.7 yrs	22.3yrs

Source of Data: S&P, Dow Jones Indices, National Bureau of Economic Research.

It is important to highlight that, unlike 2008, banks are far less vulnerable primarily because they are less leveraged. We think this is extremely important for the effective implementation of fiscal and monetary policy but also for reduced recovery time. Nonetheless, the global economy will contract at a record rate in the 2nd quarter of 2020, as millions are no longer working and governments force the shut downs of business.

Government programs will help to substitute paychecks, but consumers will not have as many places to spend and less willingness to spend. We think the government support programs can never be a long-term solution, and any program will be fraught with issues such as timing and selection of recipients. In addition, it is unknown what percentage of businesses that were forced to shutter will survive. We think recovery is extended at an exponential rate with each passing day of the economic shutdown, and no government program will ever completely supplant a fully functioning economy. Further, it is difficult to conceive of a society that functions in the same manner as it did prior to the outbreak of Covid-19, the economic ramifications of which we are only beginning to understand.

What We Have Done and Are Doing

In our March 17 note to clients, we described the early decisions we took as a result of the virus, which included eliminating all direct commodity exposure. Since then, we have continued to reduce risk, including lowering exposure to non-US equity and debt in favor of the safest segments of the US equity and debt markets. These moves are predicated on our belief that the global economy is in a recession that has not been fully priced in by capital markets, and any subsequent recovery will be led by the US. Thus far, these risk-reductions have been additive to client portfolios.

In most (if not all) portfolios, we have raised a higher than normal level of cash to increase liquidity, which we think is necessary for our clients to weather higher market turbulence and not be forced to sell. Further, we continue to evaluate liquid and illiquid opportunities to exploit the eventual recovery, which we think will depend on effective testing and treatment of individuals infected with the disease. Opportunities will arise as high-quality assets, primarily within credit, recover from what we believe has been a disproportionate, and in some case unjustified, level of selling. On the private markets side, we are evaluating opportunities in distressed capital structures, which we think will provide superior risk-adjusted returns as the economy recovers.

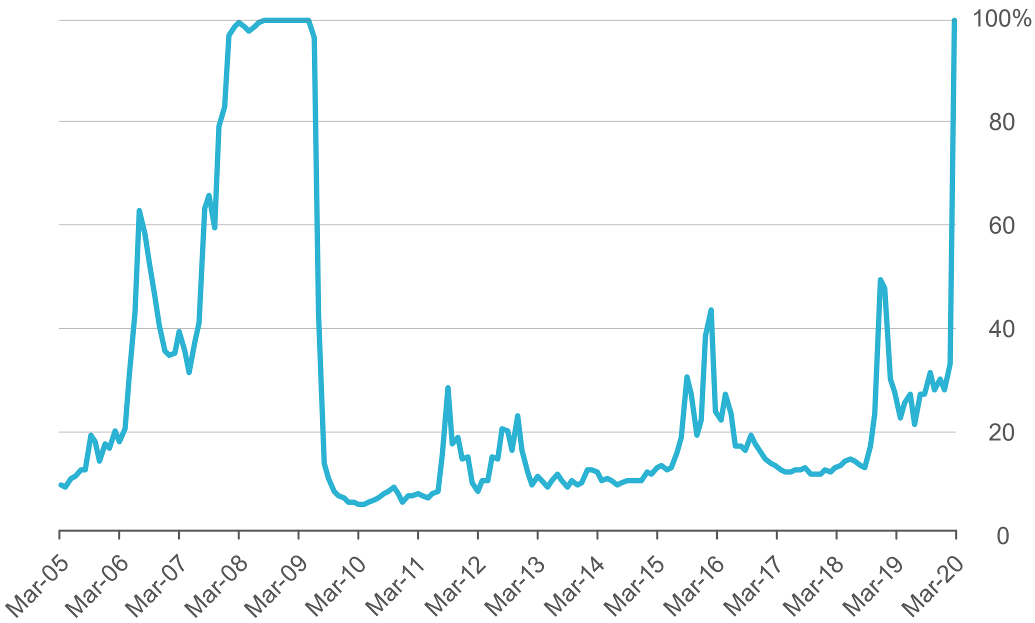
We realize market turbulence can be extremely trying, as Covid-19 has taken the economy into unchartered territory. To be prepared for what lies ahead, we have reduced risk in our portfolios while continuing to focus on high-quality assets, active management, and diversified holdings. And we remain ever viligent and ready to make changes as necessary.

Q2 2020 Key Economic Drivers

Normally, the economic drivers we see impacting the markets don't change much in the course of a year. However, we are in unprecedented times, resulting in new concerns and a different order.

- **Covid-19.** This new type of coronavirus has caused an abrupt halt of the global economy; hence, any forward looking discussion on the economy has to consider it. We believe there are three factors that will allow for the reopening of the global economy: testing, treatment, and ultimately a vaccine. By any expert measure, a vaccine is at least one year away and will be the only true solution. However, effective testing with results that are quickly turned around seems to be on the horizon. Testing combined with effective treatment will allow for a partial reopening of the economy and we think a subsequent improvement in capital markets.
- **Corporate Earnings.** In our view, earnings have never been more important to market pricing as during the current pandemic. We have already seen the record increase in unemployment and dramatic drop in consumer sentiment. However, we're yet to see the direct impact on corporate performance, making April and July 2020 earnings reports a key focus.
- **Fiscal/Monetary Policy.** The Federal Reserve and Treasury combined are committed to doing "whatever it takes" to provide aid to an ailing economy. What's more, they are implementing support in record time, having done nearly as much in one month as was done in one year during the financial crisis of 2008, with further action anticipated, as necessary. Time will tell if these measures are effective, but the playbook developed in 2008 combined with the healthy status of our banking system, for now, should allow these policies to have a positive impact.
- **The US Consumer.** Normally, we look at the state of consumer finances for clues as to consumer spending, which is close to 70% of US GDP. US government programs to support consumers are a band-aid in our view, not a long-term fix. As our economy begins to heal, will the US consumer return to buying habits of the past? The answer to this will greatly affect the type and strength of the economic recovery we have from Covid-19, which we believe will likely not happen fully until sometime in 2021 or even later.
- **US Presidential Election.** While the headlines have justifiably been focused on the impact of Covid-19, there will be a presidential election in 2020. Given all that has occurred, we think economic policies will likely be a focus of debate, as all will be focused on recovery. We now know who the Democratic nominee will be, although specifics on policies from both parties remain to be seen. We hope there will be some focus on reducing the higher levels of US government debt once the current crisis is under control.

Probability of US Recession: 100%

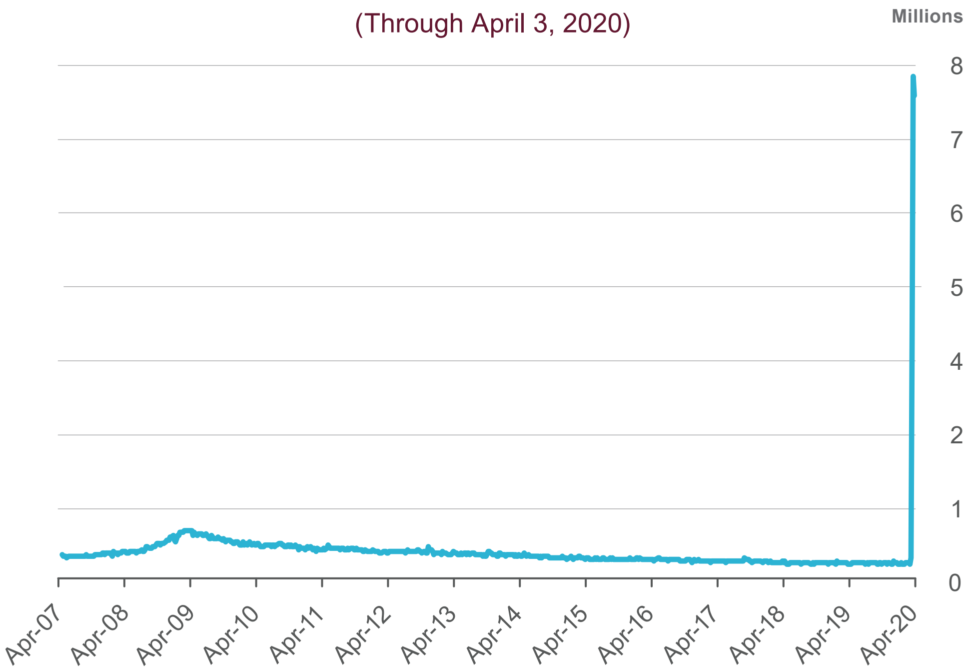


Source of Data: Bloomberg.

The consensus among economists is that we are currently in a global recession (negative GDP growth for at least two consecutive quarters), even if all the data hasn't come through yet. In the chart, Bloomberg's recession indicator, which considers equity market activity and interest rates, indicates that a US recession has almost certainly begun.

Weekly US New Unemployment Claims

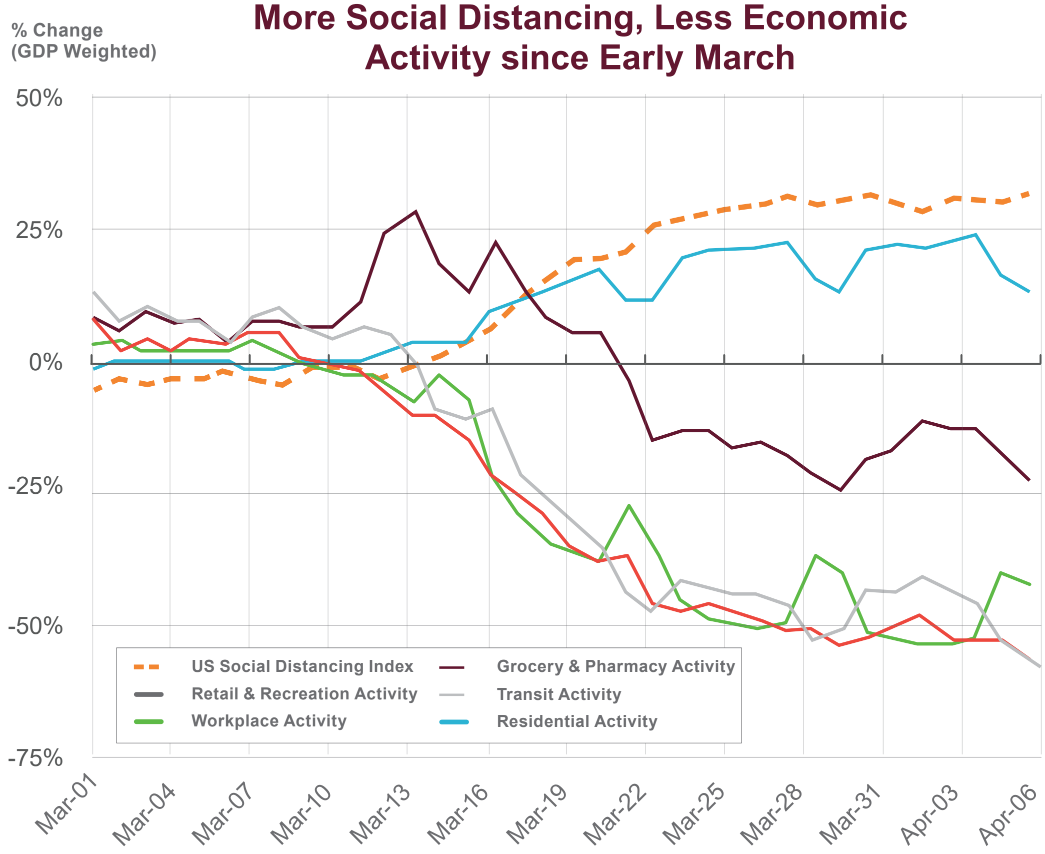
(Through April 3, 2020)



Source of Data: Bloomberg.

April 2020 is showing the highest initial jobless claims ever, given the sudden stop in broad economic activity. We expect continued high unemployment claims through April and May, as many more states have issued stay-at-home orders and secondary effects weigh on businesses that were not initially affected but depend on ongoing consumer spending and/or small business spending.

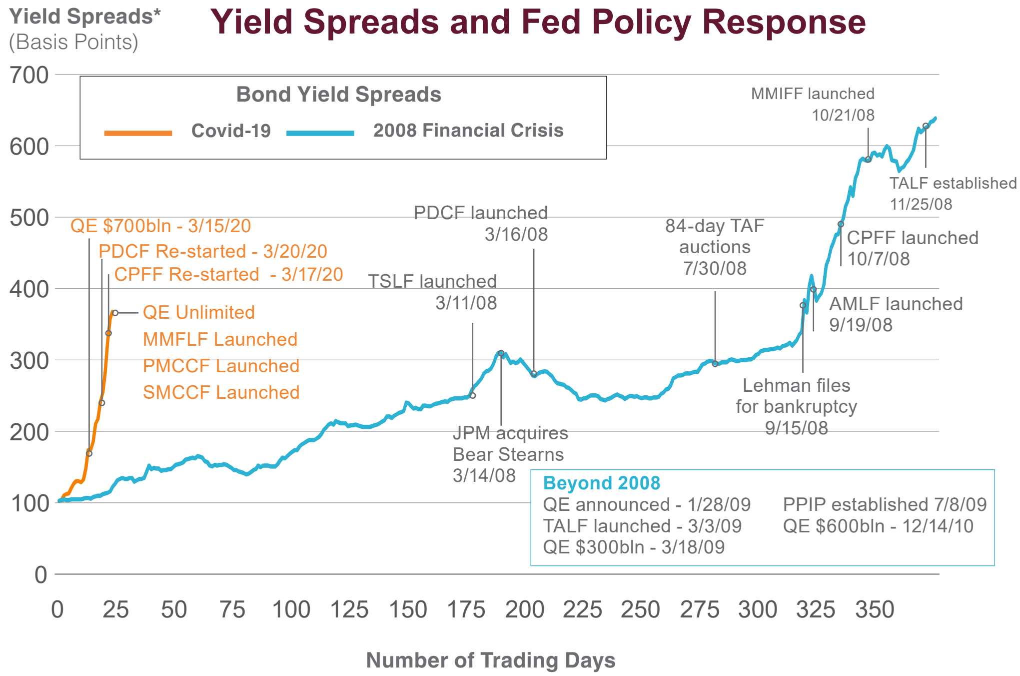
More Social Distancing, Less Economic Activity since Early March



Source of Data: Google, Goldman Sachs Global Investment Research.

As displayed in the chart at left, US economic activity fell significantly, due to more social distancing measures across the country. Even grocery and pharmacy activity started plummeting after an initial spike. It is likely that work activity will lag reductions in social distancing, as many vulnerable workers cut back on their hours voluntarily and other workers are not called back to work as businesses cut costs.

Yield Spreads and Fed Policy Response

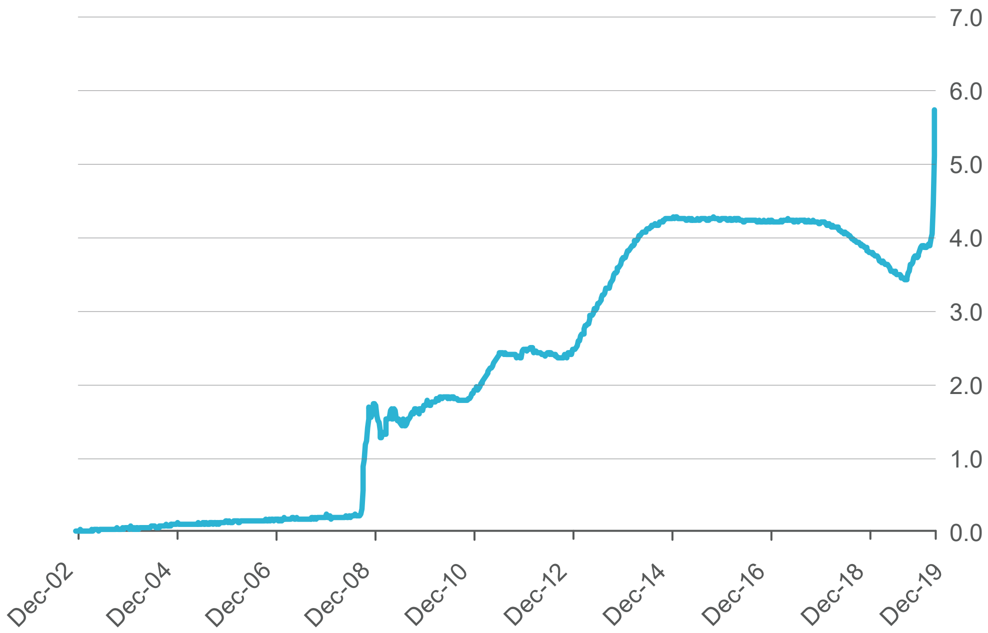


*On investment-grade corporate bonds.

Source of Data: Bloomberg, Voya Investment Management.

The Federal Reserve responded to the Covid-19 crisis swiftly and remarkably. As the orange line shows, the yield spread (or difference in yield) between investment-grade corporate bonds and US Treasuries shot up dramatically in March 2020. The Fed then reinstituted most of the financial tools used to counter the 2008 crisis, but in a much faster timeframe. A menu of initiatives that took over a year to implement during the 2008 crisis happened in less than 30 days.

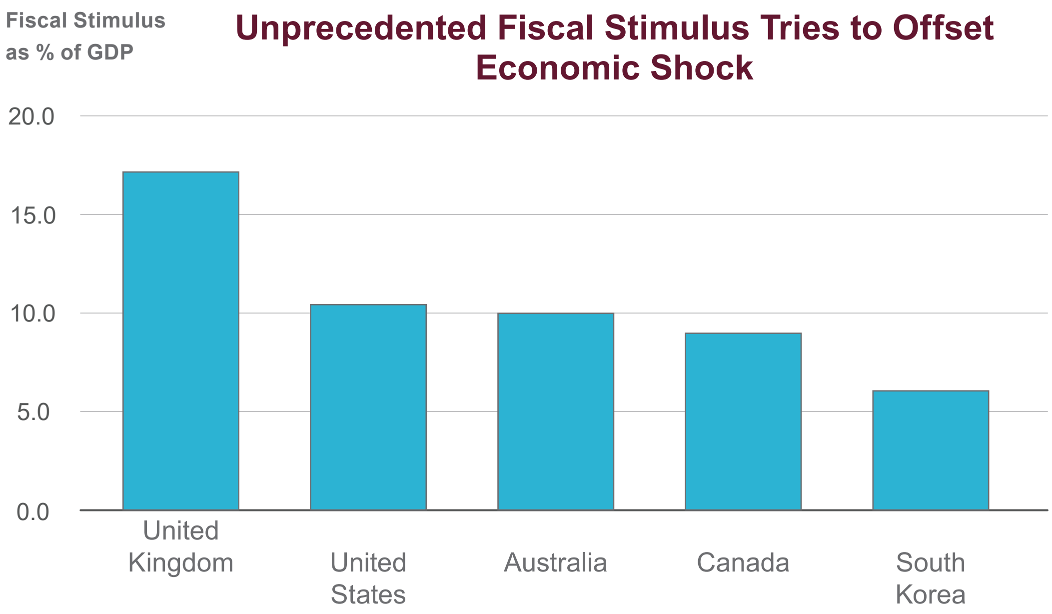
The Fed Ramps Up Asset Purchases



Source of Data: Federal Reserve.

Along with cutting interest rates to zero and increasing support to the repo market (overnight lending), the Fed revived policy tools used during the 2008 crisis, including different types of security purchase programs, including Quantitative Easing (buying fixed-income securities). All these efforts combined have resulted in a large and rapid increase in the level of fixed-income assets on the Fed's balance sheet.

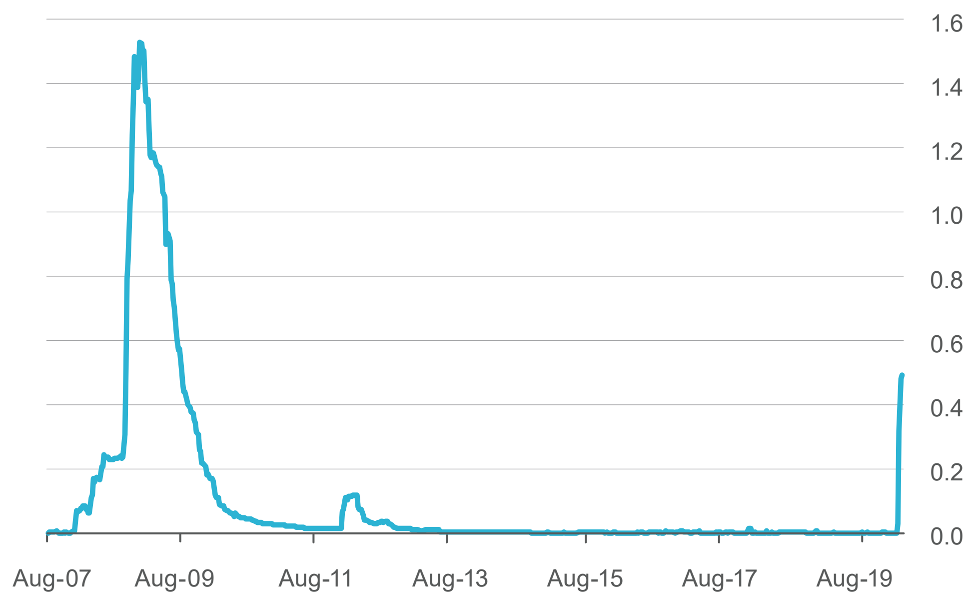
Unprecedented Fiscal Stimulus Tries to Offset Economic Shock



Source of Data: Putnam, Bloomberg, Strategas Research Partners.

Fiscal stimulus to counter the impact of Covid-19 is many orders of magnitude higher than spending during the financial crisis of 2008-2009. The amounts are staggering as a percentage of GDP, as shown in the chart at left, given the unprecedented threat to the economy in order to slow the spread of the virus. While we know that we will have a recession, the question is: will the stimulus be enough to keep us out of a severe recession or even a depression?

Usage of Fed Liquidity Programs

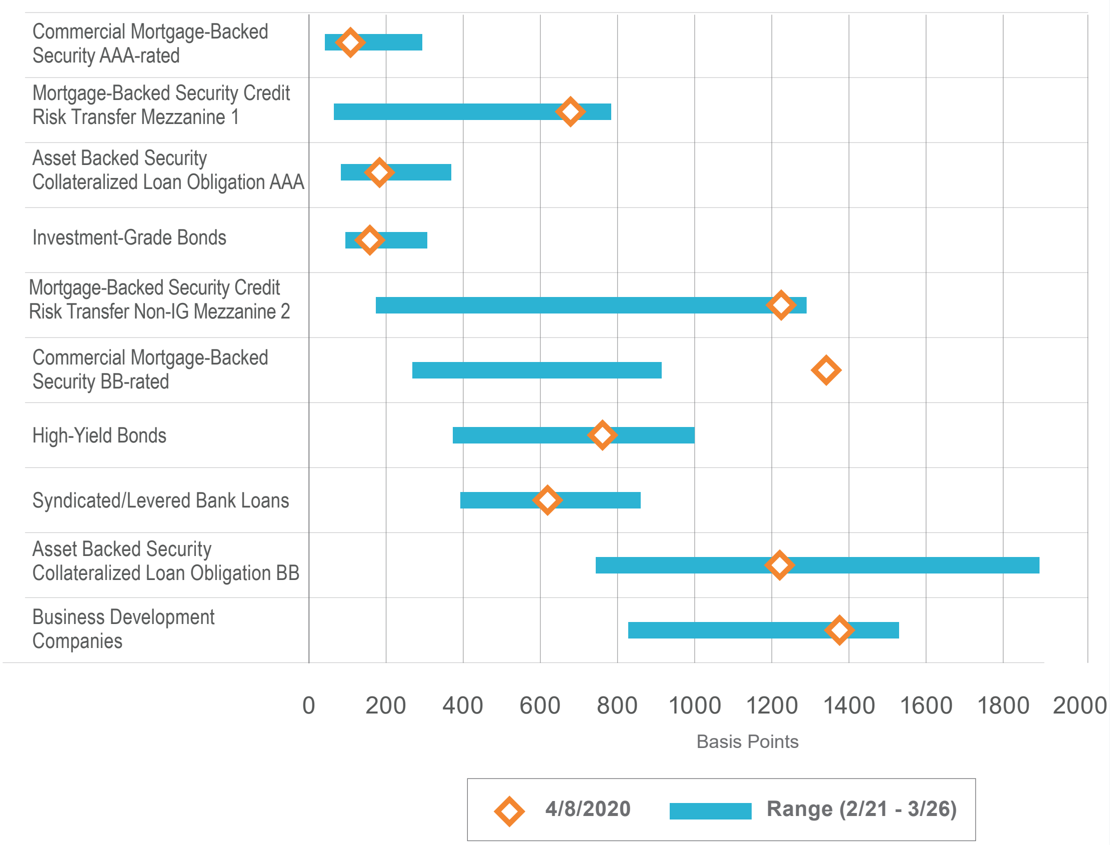


Source of Data: Federal Reserve.

While the Fed acted swiftly to put a floor under the capital markets, actual implementation of its efforts to suport market liquidity will take some time to fully execute. Of the $2.3 trillion available through a variety of Fed progams, less than 25% -- some $487 billion -- had been utilized as of April 8, 2020.

Pain and Opportunity in the Credit Markets

Credit Spreads on US Corporate and Securitized Debt Securities

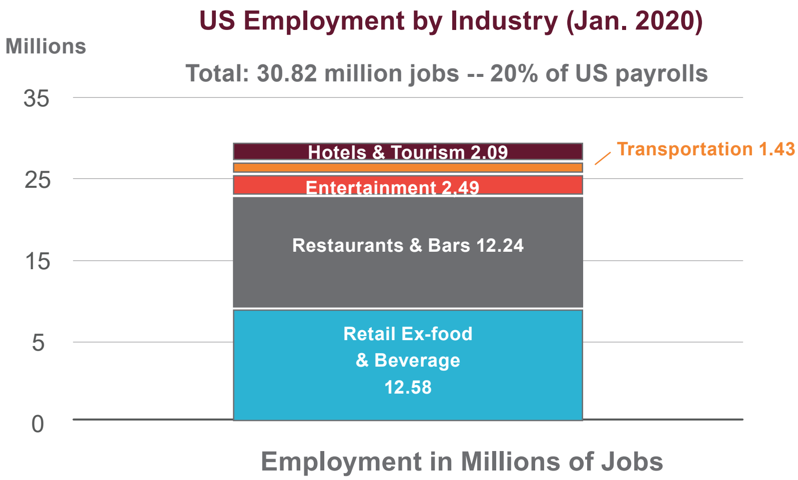


Spreads shown for BDCs and HY Bank Loans are calculated using yield less 3 Month LIBOR.
Source of Data: Bloomberg, BofA, Voya.

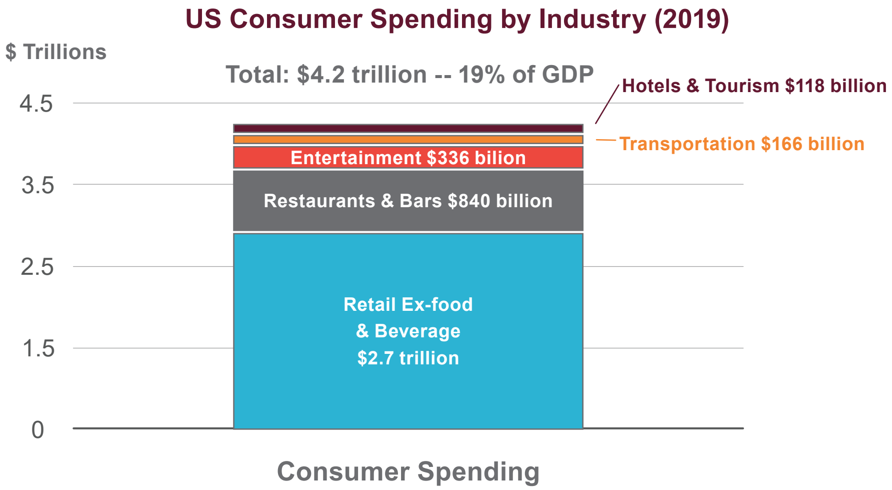
US corporate and securitized debt securities of all types saw rising yields and a massive increase in credit spreads. The credit spread is the difference between the yield and the "risk-free" rate, usually a government bond, and is the risk premium to compensate for a borrower's risk.

Credit spreads peaked around March 26, after hitting a low around Feb. 21 but remain close to their highest levels, providing attractive yield opportunities in the credit markets for the first time in many years.

Social Distancing Vulnerability



Source of Data: Bureau of Economic Analysis, Bureau of Labor Statistics, FactSet, S&P 500, JP Morgan.

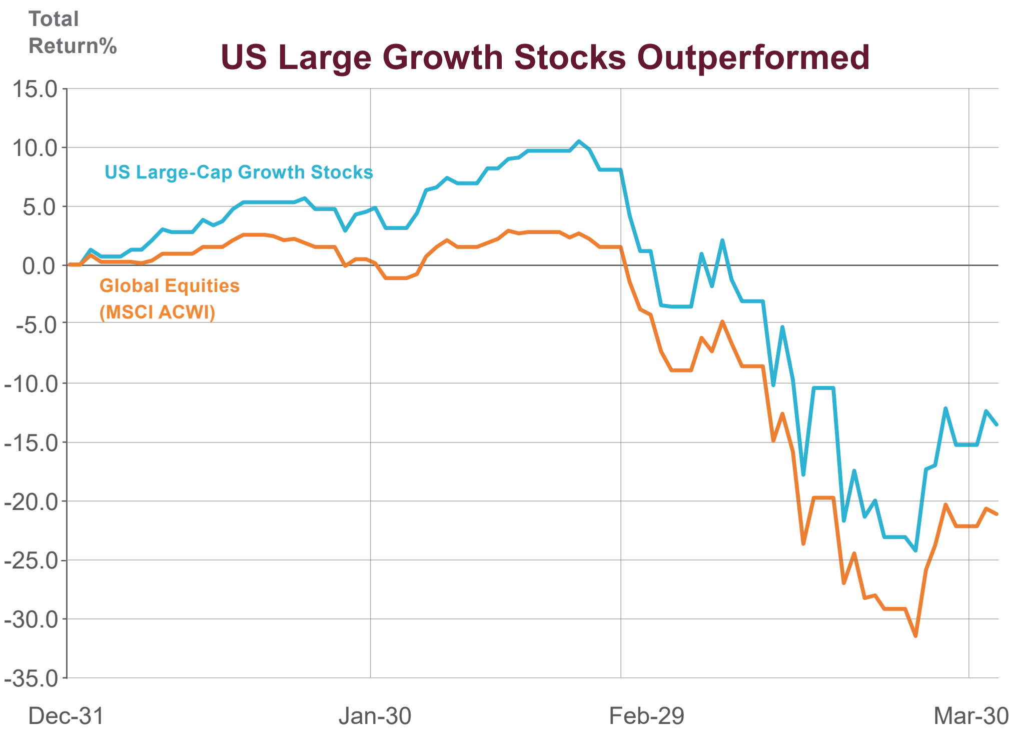


Source of Data: Bureau of Economic Analysis, Bureau of Labor Statistics, FactSet, S&P 500, JP Morgan.

Social distancing will have broad impact across many industries, especially in key consumer sectors (retail, restaurants, travel). As the chart at left shows, more than 30 million US jobs will be affected immediately, with a lot of these workers put on furlough, temporarily laid off, and/or permanently laid off.

The near-term outlook is less demand for goods and services due to consumers cutting back on spending, new government restrictions (such as caps on how many people will be allowed in restaurants), and company bankruptcies as a result of cash flow and debt servicing issues.

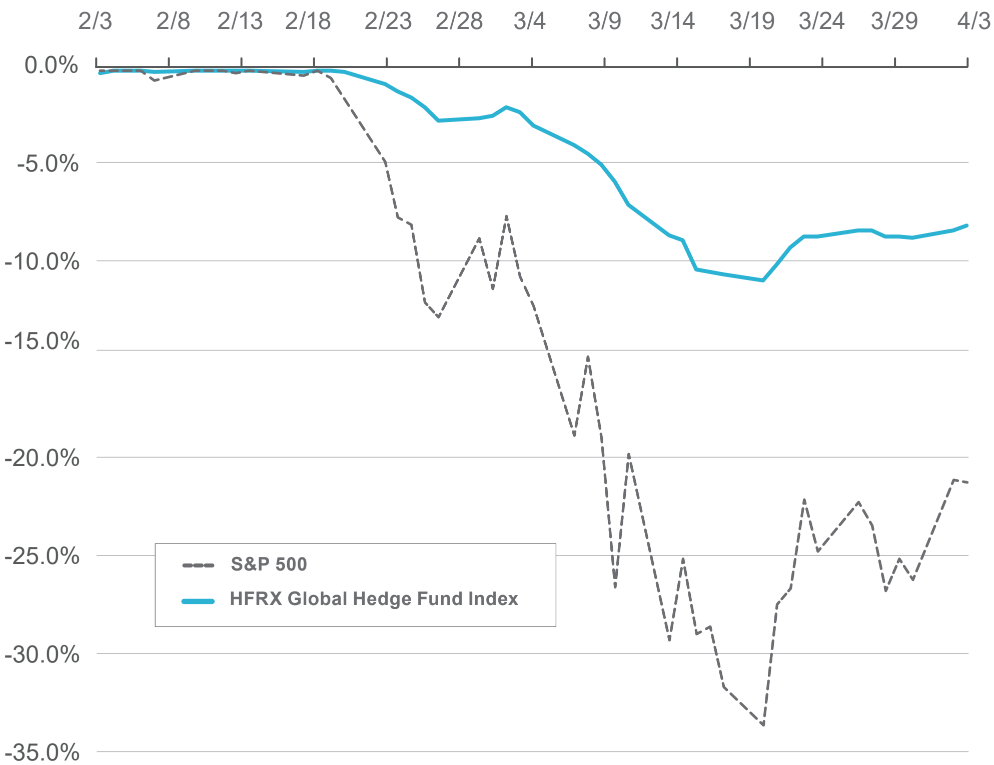
US Large Growth Stocks Outperformed



Source of Data: Morningstar

During the recent surge in market volatility, we increased our allocation to US large growth stocks, given their strong balance sheets, high liquidity and the defensive nature of their cash flows, which tend to be relatively stable. Additionally, many of these companies are likely to benefit during and after Covid-19, as adoption of technology accelerates. Two examples are Seattle-based Amazon (e-commerce, online entertainment, cloud computing) and Microsoft (work from home, cloud software and security, gaming).

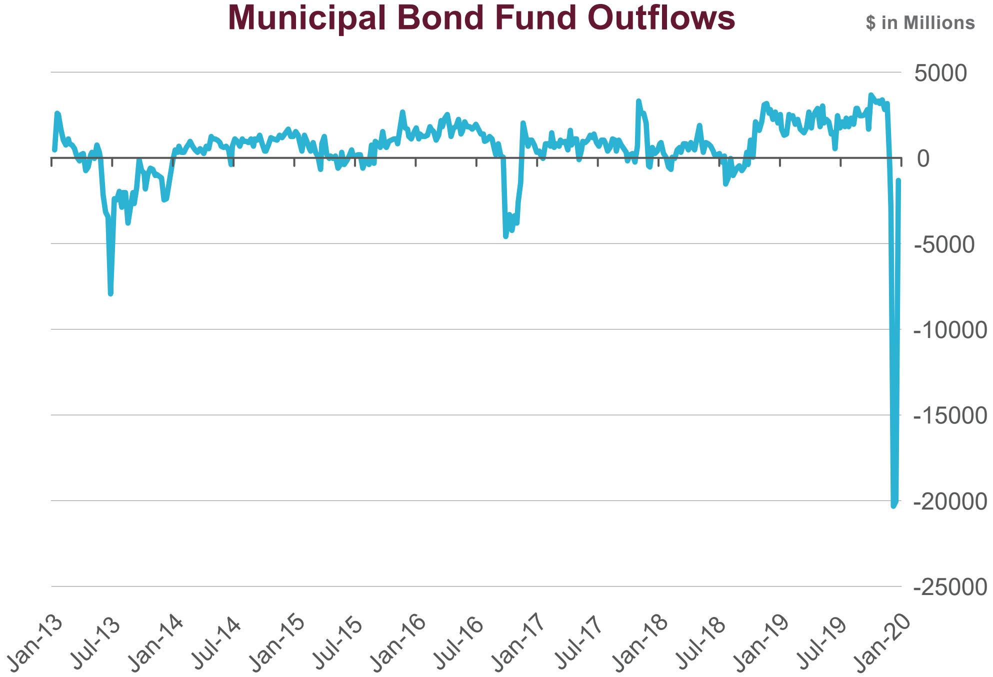
Hedge Funds Performed Relatively Well



Source of Data: Bloomberg.

Hedge fund results for the 1st quarter of 2020 demonstrated why we include them in portfolios: they provided much needed diversification. While hedge funds were down in the quarter, they performed in-line with expectations, given their low level of correlation with equities and overall lower volatility.

Municipal Bond Fund Outflows



Source of Data: Bloomberg.

Due to Covid-19, the creditworthiness of state and local governments is cause for concern as tax revenue falls and payouts for support programs rise. Investors in municipal bonds tend to be regular investors – not institutions – and they sold en masse. Without many buyers left to pick up the slack in what is not a very liquid market to begin with, muni prices fell relative to those of high-quality taxable bonds.

The Benefits of Diversification

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

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Q1 2020	15-Year Annualized Return	15-Year Annualized Volatility#
Best Performance	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 31.43%	10yr Treas 11.93%	US Large Cap 7.63%	MSCI EM 21.38%
	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 25.52%	US Bonds 3.15%	US Small Cap 5.71%	Global REITs 18.58%
	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 Treas -0.03%	Global REITs 23.06%	Muni Bonds -0.56%	MSCI EM 5.44%	US Small Cap 18.55%
	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 22.01%	Liquid HF -6.85%	Diversified 5.11%	MSCI EAFE 16.39%
	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 19.53%	Illiquid HF -8.31%	10yr Treas 5.06%	COMM. 16.19%
	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 18.42%	Diversified -16.51%	Global REITs 4.78%	US Large Cap 14.04%
	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 10.48%	US Large Cap -20.22%	US Bonds 4.40%	Diversified 10.81%
	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 Treas 8.91%	MSCI EAFE -22.83%	Illiquid HF 3.94%	10yr Treas 6.90%
	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 8.72%	COMM. -23.29%	Muni Bonds 3.55%	Illiquid HF 5.76%
	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%	Liquid HF 8.63%	MSCI EM -23.60%	MSCI EAFE 3.06%	Liquid HF 5.39%
	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%	COMM. 7.69%	Global REITs -28.34%	Liquid HF 0.45%	US Bonds 3.17%
Worst Performance	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 5.63%	US Small Cap -30.61%	COMM. -4.98%	Muni Bonds 2.70%

***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 3/31/2020. 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 2005 to 2020 (as of March 31, 2020). 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 2020, we've seen outperformance by high-qualiity bonds. Most asset classes have had negative returns during the quarter of 2020, amid a high level of market volatility.

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.

Disclosure