Annual Investment Update

ECONOMIC REVIEW AND OUTLOOK

DECEMBER 31, 2018

The start of 2019 is a stark contrast to the beginning of 2018. Optimism ruled the day last year, as the S&P 500 closed with a 6.6% return in the fourth quarter and the bond market behaved in orderly fashion. Global economic growth was synchronized and set to accelerate its pace. The tax reform bill passed by the U.S. Congress was going to increase corporate capital expenditures and the individual tax cuts would trickle down, acting as a multiplier to growth.

2019 begins with concerns seemingly mounting—weaker-than-expected global economic data; uncertainty regarding the outcome of trade talks between the United States and China; the impact higher interest rates will have on corporate earnings, consumer spending and housing; how fast the European and Japanese economies are slowing; and whether the dollar will keep rising or reverse course and weaken like last year, among others. Although there are plenty of headlines to grab our attention, we are focusing our efforts on deciphering the noise from the signals. There seems to be more uncertainty in the capital markets than in recent years, and as a result we forecast outcomes to be prepared, which allows us to adjust better to unforeseen events.

Global economic growth continued in 2018, but the rate of expansion is slowing, and global market sentiment is following the same path. In 12 months, the positive feelings heading into 2018 based on the global economy experiencing its best growth since 2010 have all but dissipated, and concerns about the future are building. Whereas conversations to start 2018 focused on synchronized global growth, the year ended with discussion about a potential synchronized global slowdown.

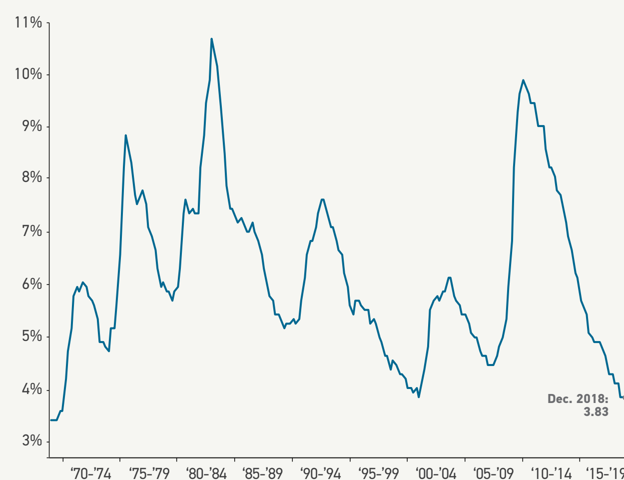
German manufacturing is sputtering, retail sales in China are growing at the slowest pace in 15 years and the increasing rhetoric of nationalism across the globe is reducing business confidence on several continents. The latest economic data released from Eurozone countries and Japan have failed to meet expectations. Notably, China's overall economic results may be signaling a sharper economic slowdown than anticipated by policymakers.

KEY ECONOMIC RELEASES

EMPLOYMENT	As of	Expected	Actual	Prior Period	12 Months Ago
Unit Labor Costs (3rd Quarter)	DEC	1.0%	0.9%	-1.0%	-0.2%
Unemployment Rate	NOV	3.7%	3.7%	3.7%	4.1%
Change in Nonfarm Payrolls	NOV	198K	155K	237K	148K
INFLATION (Year Over Year)	**As of**	**Expected**	**Actual**	**Prior Period**	**12 Months Ago**
Consumer Price Index	NOV	2.2%	2.2%	2.5%	2.2%
CPI Ex Food & Energy	NOV	2.2%	2.2%	2.1%	1.7%
Producer Price Index	NOV	1.3%	1.3%	0.8%	3.1%
HOME PRICES (Year Over Year)	**As of**	**Expected**	**Actual**	**Prior Period**	**12 Months Ago**
S&P/Case Shiller Top 20 Mkts.	OCT	4.9%	5.0%	5.2%	6.4%
MANUFACTURING ACTIVITY	**As of**	**Expected**	**Actual**	**Prior Period**	**12 Months Ago**
Capacity Utilization	NOV	78.6%	78.5%	78.1%	77.1%
Leading Indicators	NOV	0.0%	0.2%	-0.3%	0.4%
GDP Annualized (3rd Quarter)	DEC	3.5%	3.4%	4.2%	3.2%

Source: Bloomberg

UNEMPLOYMENT



Source: Bloomberg

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ECONOMIC REVIEW AND OUTLOOK (CONTINUED)

Overall, signs of caution should not be ignored, and it is highly likely that growth around the globe in 2019 will continue to moderate. We don't see a "hard landing" in China or recession in the United States causing the globe to sink into recession this year, however. China does have the financial wherewithal to support their economy to moderate the deceleration. Our cautious tone stems from the potential of a government policy misstep arising from escalating global nationalism resulting from anemic or slowing economic data.

U.S. economic growth, in contrast to the globe, expanded at a faster clip than in recent years. For the 12 months ending on September 30, 2018, the U.S. economy grew at an average of 3.02%, compared to 2.65% for the previous 12 months. Figures for 4Q 2018 growth have yet to be released, but the annualized GDP growth estimate for the quarter is 2.7% and 3.1% for the full year of 2018, which is much better than in recent years.

Unemployment, currently 3.83%, remains at historically low levels not attained in nearly 50 years, yet wages are not increasing at the pace expected for such low unemployment. The result of this slow growth in wages has been lower-than-anticipated inflation. Historically, the U.S. Federal Reserve (the Fed) has started increasing interest rates when wages were growing at 3.5% per year, compared to the current reading of 3.1%, and the Fed has already increased interest rates five times. The Fed normally raises interest rates to ward off inflation due to an overheating economy, and it would be a big stretch to characterize the U.S. economy as "overheating."

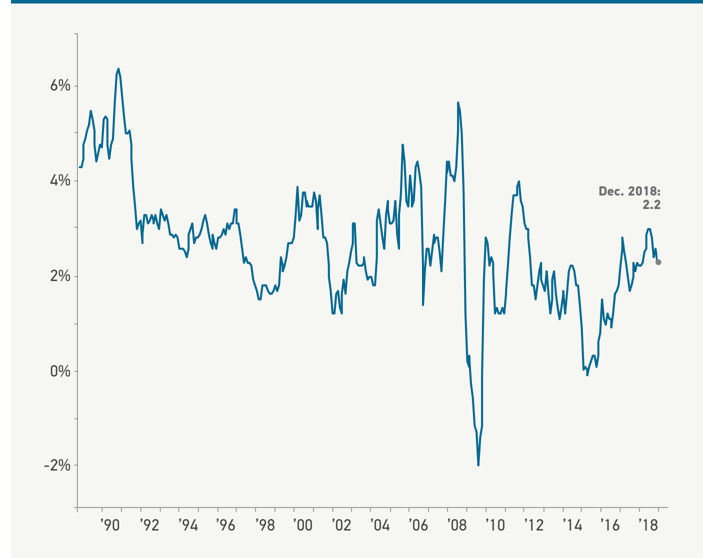
The Fed has two mandates: (1) achieve full employment and (2) contain inflation. The Fed is meeting both mandates yet appears intent on finding pockets of economic and market strength to hike short-term interest rates. Skepticism is rising regarding the Fed's intent to move interest rates to a "normal range" because there is no economic reason to keep pushing interest rates higher. This activity is also raising the level of concern about the impact the rising cost of capital will have on corporate earnings.

The housing market is already showing signs of slowing due to higher interest rates, as builders are constructing fewer single-family homes. Interest rates, especially their rise from historically low levels, have a much greater impact on home affordability than varying home prices. Housing has been additive to growth, especially in recent years, so we are monitoring the situation closely for potentially greater-than-anticipated impacts.

Trade talks, notably between the United States and China, are a wildcard with uncertain outcomes that could have far-reaching influence on global business sentiment. If the United States and China cannot reach an accord, we could face the specter of a 10-15% increase in the prices of everyday items—which would have the greatest effect on the poorest in society, who already exhaust all disposable income. The bad news raising interest rates may prove ineffective to stave off inflation, because price gains would no longer be driven by demand, but an inorganic influence instead. We do expect an agreement to be reached, though, given the current White House administration's propensity for aggressive blustering, only to strike a deal and claim victory.

The U.S. economy should perform much like the global economy, with the pace of growth moderating but not contracting us into recession. It's important to remember that moderating economic activity is common during periods of recovery and expansion.

U.S. DOLLAR INDEX



Source: Bloomberg

BOND MARKET REVIEW AND OUTLOOK

DECEMBER 31, 2018

2018 wasn't supposed to unfold like it did. A year ago, bond market predictions for 2018 centered around higher interest rates across the board due to runaway inflation. Inflation was going to be a problem caused by the individual tax cuts creating greater demand. Interest rates did rise, but not precipitously. A modest rise is a better description, and, as discussed, rapidly rising inflation has not been an issue.

The flattening of the U.S. Treasury yield curve may be providing a signal. The U.S. Treasury yield curve chart included shows how much flatter the curve is at the end of 2018 compared to the end of 2017. The dramatic flattening that occurred during the year is striking, and the cause was the Fed hiking interest rates. The greatest difference between the two curves shown is the interest rate spread between the 2-year maturity issues (2018 = 2.53% vs. 2017 = 1.89%), which shows the Fed's influence on interest rates is primarily limited to the short end of the curve. The more important aspect to recognize about a flat yield curve is the suggestion that future economic growth and inflation will not reach levels warranting further interest rate increases. Consequently, the Fed might be raising rates too quickly and/or too much—this is the reason an inverted yield curve is a reliable indicator of an economic slowdown potentially leading to recession.

Inversion is on the mind of investors. There is also a heightened awareness for any hints regarding the mindset of the Fed and the future direction of interest rates. Part of the 2018 curve is already slightly inverted, but it is a minor inversion in a narrow segment of the curve. Minor inversions like this are frequently false signals regarding economic health. A major yield curve inversion is characterized by short-term interest rates exceeding long-term ones (10+ years) and should set off alarms that get louder as the inversion worsens. We are close to this occurrence, but not there yet.

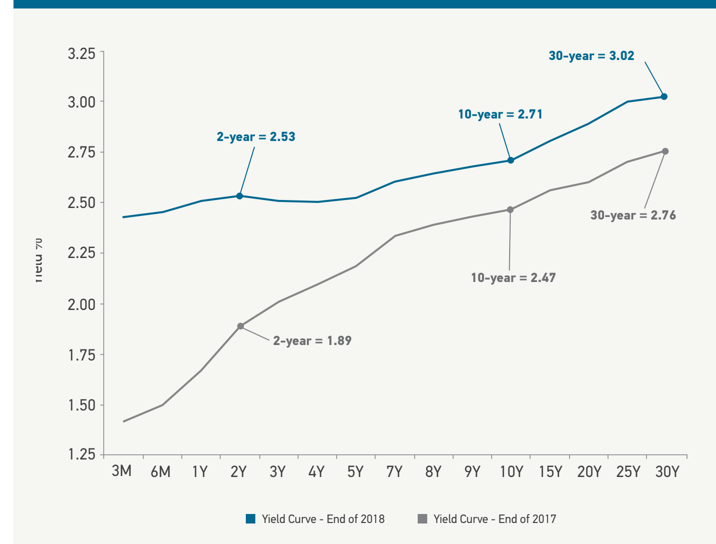
Despite the doom and gloom foreseen, there is reason for optimism. The falling 10-year yield influenced mortgage rates lower, which should help boost home sales. The strength the U.S. dollar exhibited during 2018 is not expected to persist, and if interest rates remain within the current range, the greenback is likely to weaken. A weaker dollar makes domestically produced goods more competitive in foreign markets, potentially increasing sales and earnings.

Corporate America looks healthy because, overall, companies are not overleveraged and have significant amounts of cash on their balance sheets. Obviously, good financial footing increases

BOND MARKET RETURNS	Latest Quarter	12 Months	Last 3 Years
Bloomberg-Barclays Intermed. Gov/Credit	1.65%	0.88%	1.70%
Bloomberg-Barclays 10-Year Municipal	2.16%	1.32%	2.19%
Bloomberg-Barclays High Yield	-4.53%	-2.08%	7.22%
Merrill Lynch 90-Day T-Bill	0.56%	1.83%	0.96%
Treasury Infl. Protected Securities	-0.42%	1.26%	2.11%

Source: Bloomberg

U.S. TREASURY YIELD CURVE



Source: Bloomberg

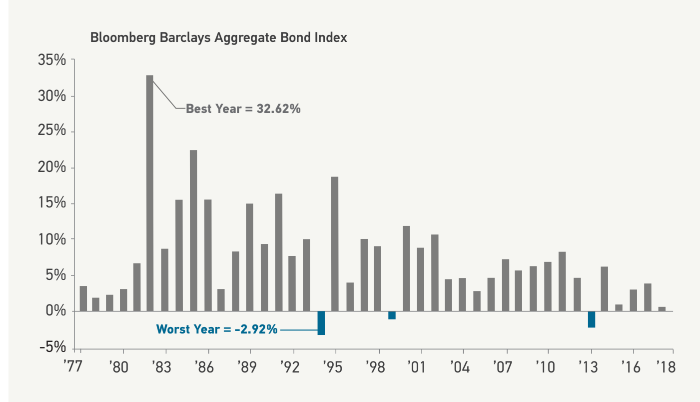
BOND MARKET REVIEW AND OUTLOOK (CONTINUED)

the ability of corporations to withstand an economic slowdown/recession. Additionally, U.S. consumers are resilient and financially healthier than at the onset of the last recession, and because interest rates remain near historically low levels, debt is not overly burdensome.

We don't anticipate bonds to suffer greatly in 2019, although yields may experience volatility at times during the year. A critical benchmark for interest rates is the 10-year U.S. Treasury note, and its upper boundary for rates appears to be roughly 3.5%, whereas the lower boundary seems to be around 2.5%. Because we are closer to that lower boundary, we think yields will rise slightly from the current level. However, within the range we defined for the 10-year yield during 2019, stocks remain competitive and should benefit from persistently low interest rates. The ever-increasing number of retirees seeking reliable sources of income in the global centers of wealth is a contributing factor adding to the voracious demand for reliable income worldwide, which only helps to suppress bond yields and results in lower-than-anticipated volatility, a view contrary to popular opinion.

The Bond Market Calendar Year Returns chart shows 42 calendar years of returns for the bellwether bond index, the Bloomberg Barclays U.S. Aggregate Bond Index, and provides perspective on bond market performance. The worst year of performance during the period observed was -2.92% in 1994 and, out of those 42 years, the index posted a negative return in only three, with an average loss of -1.92%—this means that the index posted positive returns 92.86% of the time and negative returns only 7.14% of the time. Comparatively, the worst year of performance for the bellwether stock index, the S&P 500, during the same 42 years was -37% in 2008, and it experienced 8 years of decline, carrying an average loss in those years of -13.24%—this equates to positive returns 80.95% of the time and negative returns 19.05% of the time. We hope that this information provides some context to allay any anxieties about bonds. Moreover, we see no cause for panic, as much of the recent bond volatility is caused by "noise" based on speculation regarding yet-to-be determined outcomes for numerous headline-making issues.

BOND MARKET CALENDAR YEAR RETURNS 1977–2018



Source: Bloomberg

STOCK MARKET REVIEW AND OUTLOOK

DECEMBER 31, 2018

Fear infiltrated global markets in the final quarter of 2018. The S&P 500 fell 13.5% in the fourth quarter and finished the year with a drop of 4.4%, its first negative total return in a decade. After hitting multiple new market highs through August and September, gains were stripped away as investors suddenly grappled with the uncertainty surrounding the Fed's interest rate hike policy and the impact of tariffs on profit growth, a weakening global economy and rising political dissension in Washington. Smaller company stocks, which had been outperforming large caps during the first half of the year, fell 20% in the fourth quarter and ended the year with a loss of 11%, as measured by the Russell 2000 Index. As the bull market charged higher through September, growth stocks outpaced value stocks again this year. This trend began to reverse course in the fourth quarter, however, as value stocks became relatively more appealing amidst the volatility and prospects for slowing profit growth.

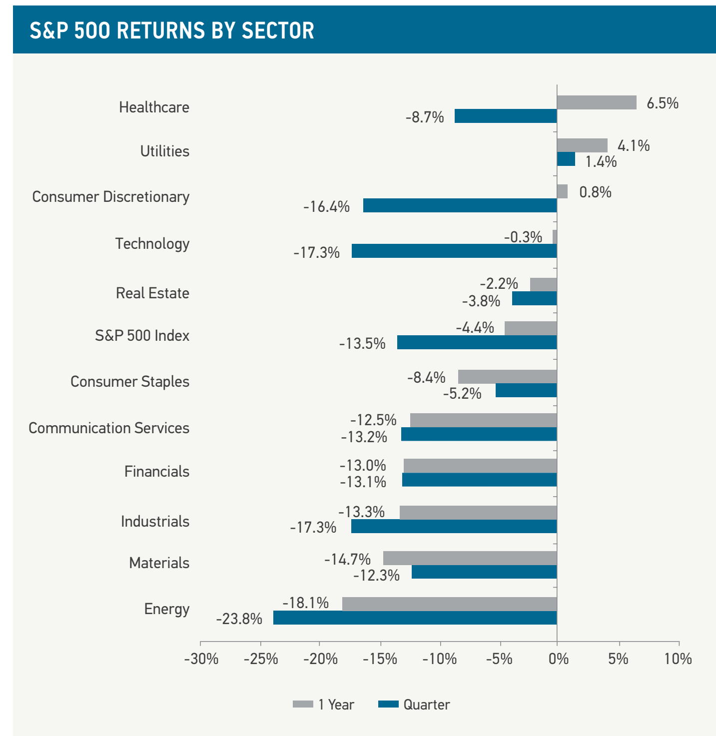
Healthcare, Utilities and Consumer Discretionary posted positive returns for the year. In the final quarter of 2018, defensive sectors gained some ground as cyclicals gave way. The sectors that posted the strongest returns for the year were Healthcare, Utilities and Consumer Discretionary, gaining 6.5%, 4.1% and 0.8%, respectively. The Technology sector, despite being down over 17% in the fourth quarter, ended nearly flat for the year. The market sector that suffered the worst return was Energy, plunging over 24% during the quarter and 18% for the year as oil prices sank. Trade war fears impacted other cyclical sectors—the Materials sector lost 14.7% and Industrials fell 13.3% for the year.

In stark contrast to last year, international markets fell sharply in 2018. A number of challenges on the international front eroded investor confidence this year. The MSCI EAFE Index slid 13.3% and the MSCI Emerging Markets Index dropped 14.6%. Although global earnings growth continued to rise, expectations were high and economic data disappointed in Europe as well as Japan. Numerous trade-related conflicts arose during the year and U.S. dollar strength also negatively impacted returns.

Market activity in the final quarter did not fairly reflect fundamentals. Corporate earnings growth surprised to the upside in 2018, domestically. The first two quarters of 2018 produced earnings growth of approximately 27%, which topped estimates. Third-quarter earnings growth reached 32%, the highest level of annual growth since 2010. It is expected that fourth-quarter earnings growth will

STOCK MARKET RETURNS	Latest Quarter	12 Months	Last 3 Years
S&P 500	-13.5%	-4.4%	9.2%
Russell 1000 Growth	-15.9%	-1.5%	11.1%
Russell 1000 Value	-11.7%	-8.3%	6.9%
S&P 400 MidCap	-17.3%	-11.1%	7.6%
Russell 2000	-20.2%	-11.0%	7.3%
MSCI Developed (EAFE)	-12.5%	-13.3%	3.4%
MSCI Emerging Markets	-7.5%	-14.6%	9.2%
Alternative Asset Returns			
Bloomberg Commodity	-10.0%	-13.0%	-0.8%
MSCI World Real Estate	-4.5%	-5.6%	4.2%

Source: Bloomberg



Source: Strategas

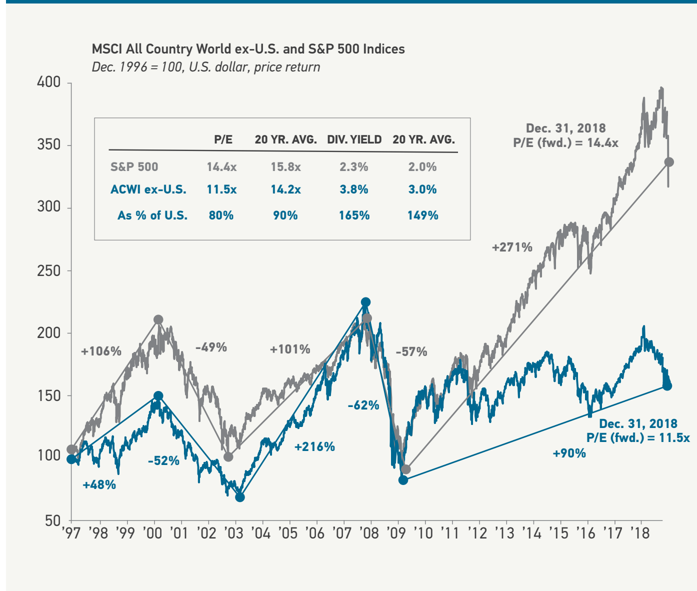
STOCK MARKET REVIEW AND OUTLOOK (CONTINUED)

taper off as companies are up against tougher comparisons versus last year with the tax cut benefit behind us and continued strength of the U.S. dollar. Earnings growth will moderate in 2019, yet low double-digit growth is expected, driven by consumer spending and historically low unemployment. A rise in capital spending as productivity picks up will also be additive to earnings.

Market valuations should support higher returns in 2019. At the start of the year, the forward price-to-earnings (P/E) ratio for the S&P 500 stood at 18.2x earnings, exceeding the long-term average of 16x. At year-end, following the market correction, the forward P/E ratio stands at 14.4x earnings—a more attractive level at 9% below the average. While investors have grown wary of the risks of investing internationally, valuations have become increasingly attractive on a relative basis, at just 11.5x earnings at year-end. With greater long-term growth prospects for many regions outside the United States, maintaining appropriate exposure to international stocks remains an important component of one's portfolio.

The bull market may not have reached its end, but the extended period of low market volatility likely has. Market volatility, as measured by the VIX Index, has risen as a mood of caution has overtaken complacency. We expect volatility to remain elevated in 2019. A measure of volatility known as the "intra-year decline" is defined as the largest loss measured from the highest point to the lowest point over the course of a year for an index, fund or portfolio. Since 1980, the S&P 500 has had an average intra-year decline of 13.9%; the largest drawdown during that period was -49%, occurring during the financial crisis of 2008. The intra-year decline of 2018 reached -20% on December 24. Although unsettling, market corrections are normal and keep a check on valuation levels. Identifying ways to take advantage of market corrections can provide benefits including the following: (1) allowing one to put idle cash to work at attractive levels; (2) offering the opportunity to reposition or rebalance a portfolio for improved return potential; (3) enabling losses to be actively harvested in a taxable portfolio to lower one's tax bill; and (4) providing a better understanding of one's tolerance for risk, which may require a change in asset allocation. World events, changes in monetary and fiscal policy, and unexpected economic and earnings news will continue to shake up markets. Maintaining focus on one's objectives and having the discipline to weather the market's ups and downs will ultimately reward investors in the long run.

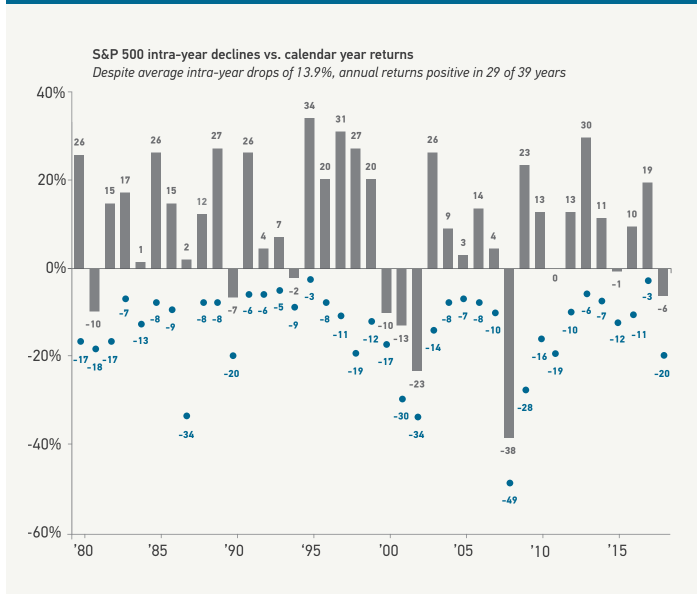
U.S. AND INTERNATIONAL EQUITIES AT INFLECTION POINTS



	P/E	20 YR. AVG.	DIV. YIELD	20 YR. AVG.
S&P 500	14.4x	15.8x	2.3%	2.0%
ACWI ex-U.S.	11.5x	14.2x	3.8%	3.0%
As % of U.S.	80%	90%	165%	149%

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management

ANNUAL RETURNS AND INTRA-YEAR DECLINES



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

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PATRICK A. CASEY is President and Chief Executive Officer of Perkins Coie Trust Company. He has over 30 years of experience in the financial services industry advising private clients in the areas of banking, trust and investment management, and wealth planning. He graduated from St. John's University with a Bachelor of Science in finance and received his MBA in management from Fairleigh Dickinson University. Patrick is a Certified Trust and Financial Advisor. He is involved with the Fred Hutch Planned Giving Advisory Committee and is a member of the Seattle Estate Planning Council.

JOHN DE CARVALHO, CFA®, is Chief Investment Officer of Perkins Coie Trust Company, and is responsible for all investment-related activities at the company, including the creation and management of investment portfolios; research and due diligence of portfolio securities; managing a team of investment professionals; and providing the economic and market outlook for the company. He has over 20 years of financial services industry experience, during which time he performed a wide-range of roles. John is a graduate of the University of Washington, a Chartered Financial Analyst® charterholder and a member of the CFA Institute and the CFA Society of Seattle.

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INVESTMENT PROCESS

1. **LEARN** CLIENT GOALS & NEEDS
2. **ESTABLISH** CLIENT INVESTMENT OBJECTIVE & STRATEGY
3. **DETERMINE** ASSET ALLOCATION STRATEGY
4. **CONSTRUCT & MONITOR** INVESTMENT PORTFOLIO
5. **REVIEW & REASSESS** CLIENT NEEDS

TRUST COMPANY SERVICE

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We meet routinely with clients to ensure that we incorporate changing life-cycle needs into our investment strategies.

Annual Investment Update

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