Quarterly Letter
4Q 2017

A Rising Tide Lifts All Boats. John F Kennedy's speechwriter, Ted Sorensen, borrowed this slogan from a Chamber of Commerce in New England for a speech the President gave in 1963. It certainly is a good way to describe what happened in 2017. Economists have noted that last year marked the first time in quite a while that we benefited from a 'synchronized global economic expansion', meaning that is was hard to find an economy anywhere on the globe that wasn't growing. And this large and rising economic tide was one of the main forces that helped propel stock markets to new heights.

For the full year 2017, risky assets did exceptionally well. Emerging markets stocks gained 37% and stocks from developed economies rose 22%. Moderate risk assets performed OK, with high yield bonds up 7.5% and investment-grade corporate bonds returning close to 3.5%. Less risky Treasuries did less well, and returned just over 1% for the year.

We Expect the Tide to Keep Rising in 2018. The forecast is bright for the equity markets in the new year. All major developed economies are expected to continue to expand in 2018. In the US, the labor market is buoyant, unemployment is low, wages are rising, and sentiment of business owners, consumers and investors is positive. Corporate earnings are expected to grow at a double-digit clip. And the new US tax law will add more to corporate coffers and consumer wallets, which may turn out to be an additional tailwind for stock prices over the near term.

Our 2018 Expected Returns (ER) for Asset Classes vs 2017 Actual & 10-Year Average Returns:

Benchmark	2018 ER	2017 Act	10Y Ave	Risks
Emerging Markets Stocks	12.0	37.3	1.7	1. US dollar strengthens; commodity rally stalls
Non-US Stocks	10.0	25.0	1.9	2. ECB & BoJ tighten policy sooner than expected
US Stocks	8.0	21.8	8.5	3. Inflation heats up
High Yield Bonds	1.5	7.5	7.9	4. Liquidity conditions tighten
US Treasuries	-2.0	1.1	2.8	5. Federal Reserve tightens policy faster than expected
Investment Grade Bonds	-3.0	3.5	4.0	6. Longer-dated Treasury interest rates move higher

Notes: Returns expressed in USD %. Morningstar is source for historical data. 2017 Act (Actual) and 10Y Ave (Average) are annualized returns as of 12/31/2017. See Disclosure section at end of this letter for reference to specific benchmarks used in this table. 2018 ER are Laurentide Advisory forecasts.

Because sound fundamentals and strong sentiment are set to coincide with positive market momentum from lower taxes and a possible infrastructure spending bill, we anticipate another solid year of returns for equities in 2018.

The Downside of Debt. The troubling part is that the federal government isn't taking in enough money to pay for the new tax cut or any large-scale infrastructure spending. And each year, the costs mount. In time, layering on more and more debt may become a drag on the US economy, an impediment to providing certain types of social services, and a headwind for expected stock market returns.

Our country's debt dynamics, in broad terms, are as follows: the US national debt is now approximately $20 trillion, or 110% of Gross Domestic Product (GDP). Government debt to GDP has averaged about 60% during the past 75 years. Over the next decade, if the annual deficit doesn't change, we will likely add another $10 trillion to our national debt. The new tax law is expected to cost an additional $1.5 trillion, and an infrastructure spending bill could be as large as $1 trillion.

One way that these very large sums could hurt individuals is through higher borrowing costs. As the government becomes a bigger debtor, the markets may begin to charge Uncle Sam a higher rate for the privilege of borrowing. Many other interest rates, such as mortgages, student loans and credit card rates are effectively set off US Treasury rates. So those of us with loans will likely have to allocate more of our budgets in the future to service our personal debt.

A Storm Is Brewing for Bonds. Bond buyers have benefited from decades of advantageous market trends, with the yield on the 10-year Treasury moving generally lower since 1981. This has provided a tailwind to the prices of most assets, from stocks, to high yield credit to real estate. The US debt dynamics mentioned above may in fact mean inclement weather for the markets in the medium to long term. But a real change in the weather pattern may be closer at hand. The US Federal Reserve has been slowly increasing short term rates, and is expected to do so three or four more times (at 0.25% per hike) in 2018.

The big question for investors is: will longer-dated interest rates move higher, too? We think there is a good chance that this will indeed happen this year. In addition to the Federal Reserve pushing up short-term rates, concerns about higher inflation may put pressure on longer-term interest rates. Wage and price pressures, mostly absent since the financial crisis, could accelerate in 2018. The last time rates rose substantially for an extended period of time, beginning in the spring of 2013, the broader bond market declined by 2%. Short-term Treasuries eked out a small gain, while longer-maturity bonds lost about 13%.

Outlook for 2018. We think the biggest downside risk for 2018 lies in the bond markets. Rising rates will be a headwind for bond returns. We expect that only higher-yielding bonds and loans will be able to fully offset the negative effect of higher rates. For fixed income exposure, we favor short-dated corporate bonds and loans over US Treasury bonds, and we reduced duration further in the 4th quarter of 2017 because of our interest rate concerns. Our expectations are for below-average performance for bond allocations this year.

Regarding upside risks, some prognosticators are pointing to the possibility of a market melt up, and another year or two of 20%+ returns. This strikes us as a lower-probability event. Our conviction toward stocks remains strong, but our expectations regarding returns are more tempered. As a base case scenario, we expect equity returns to range from 8-12% for 2018. The most attractive opportunities likely are in the foreign markets, because economic growth is now widespread, consumer confidence is on the rise abroad, and stock prices of non-US companies generally appear to have more room to run than US stocks.

In closing, we stress the benefits of professional active management of your accounts and your financial well-being. Our institutional quality approach seeks to add incremental returns in good times, and protect your capital in bad times. We stand ready to shift our constructive stance and move to a more conservative posture in order to preserve your wealth when we sense markets are ready to do a significant about-face and turn from sweet to sour.

Sincerely,

Rob Kania John Kirby

Global Stocks is the MSCI World Index, a market capitalization weighted index that is designed to measure the equity market performance of developed markets. US Stocks is the S&P 500 index, a market capitalization weighted index consisting of a basket of 500 stocks that are widely held. Non-US Stocks is the MSCI EAFE Index, which represents the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. Emerging Market Stocks is the MSCI Emerging Markets Index, which represents 23 countries and 10% of world market capitalization. Investment Grade Bonds is the Bloomberg Barclays US Aggregate Bond Index, which measures the total return of the investment grade, US dollar, fixed-rate taxable bond market. U.S. Treasuries is the Bloomberg Barclays US Treasury Intermediate Index, which measures the total return of USD denominated, fixed rate 1-10-year nominal debt. High Yield Bonds is the ICE BofA/ML US Master HY Index total return of high yield US corporate bonds. Please visit our website www.LaurentideAdvisory.com for important disclosures.