THIRD QUARTER 2018

Wetherby INSIGHT

Newsletter Highlights

Investment Overview

- Global opportunities and risks are increasingly divergent and we remain wary of increasing vulnerabilities that potential trade wars and tightening monetary policy present. Pro-growth tax reform has supported strong gross domestic product (GDP) and earnings growth, and attractive fundamentals reflect strong confidence in the economy. However, we expect increasing challenges to such economic strength because of investors' concerns of potentially aggressive monetary policy and the ultimate impact of any trade war on the U.S. economy.
- We continue to pursue broad diversification to help navigate through the transition we are experiencing late in the economic cycle. In addition, we seek to take advantage of significant valuation dislocations caused by concerns of potential trade wars, as we believe such an approach will enable investors with a long-term horizon to achieve their goals and help reduce the risk of overreacting in the near-term when markets test investors' mettle.
- We maintain moderate levels of risk in client portfolios, but with a heightened sensitivity to the increasing vulnerabilities associated with a shifting economic environment. We remain underweight in fixed income with lower overall duration compared to core bond benchmarks and a focus on higher credit quality. Conservative growth strategies will play an increasingly important portfolio role to help mitigate downside risk and potentially profit from volatility or market dislocations.
- Equities remain the primary source of risk and expected returns in portfolios, and we continue holding a neutral allocation to the asset class compared to our long-term strategic targets given the solidity of the U.S. economy balanced by increasingly attractive valuations abroad. Finally, we remain focused on allocating to real assets strategies that can serve as effective hedges against inflation as well as provide additional diversification from traditional bond and equity market risks.

WETHERBY NEWS

During the third quarter we hired Amin Baradaran, Investment Associate; Scott Dresser, Financial Operations Associate; Lyssa Grimaldo, Wealth Manager; Ijeh Ogbechie, Investment Associate; Jackson Reeder, Investment Associate; Brandon Smith, Director of Estate Planning; and Lisa Spaulding, Program/Project Manager. Welcome Amin, Scott, Lyssa, Ijeh, Jackson, Brandon and Lisa!

Bong Choi, Director of Research; Nick Ongaro, Research Analyst; and Maria Pyatigorsky, Investment Advisor, became CFA Charterholders. Nick Ongaro also had his five-year anniversary with Wetherby. Cameron Ribler, Investment Associate, became a CERTIFIED FINANCIAL PLANNER™ certificant, CFP®. Congratulations Nick, Bong, Maria and Cameron!

Curtis Kayser, Client Service Operations Team Lead, and his wife Anna welcomed their new daughter Katelyn Amelia Kayser. Congratulations Curtis and Anna!

Impact Update

- We are proud to announce that Wetherby Asset Management became a Certified San Francisco Green Business in August.
- We are pleased to highlight an additional recognition as a 2018 Best For The World: Changemaker that we received from the non-profit B Lab in September.
- Members of the Wetherby team participated in a service event with Project Open Hand, a local non-profit organization whose mission is to provide 2,500 meals with love to critically ill neighbors and seniors every day.

Financial Planning

- The financial planning section includes two articles. The first is about important tax considerations resulting from recent tax reform. Topics include standard deduction versus itemizing for 2018 and the future, changes to itemized deductions under the tax reform, aggregating deductions, and Qualified Charitable Distributions (QCDs) from IRA accounts. The second article is about why you may want to freeze your credit, especially now that credit freezes are available at no charge.

Investment Overview

By Bong Choi, CFA, CAIA, Director of Research; and Nick Ongaro, CFA, Research Analyst

Third Quarter Market Recap

Domestic Equities: Despite the numerous potential headwinds to markets, U.S. stocks as measured by the S&P 500 Index finished the quarter up 7.7%. Strong economic data in the form of solid year-over-year gross domestic product (GDP) growth, positive job creation and, more recently, improving wage growth kept positive market momentum intact. The technology and healthcare sectors were standouts in terms of positive performance backed by strong earnings results. The energy and materials sectors showed muted performance over the quarter driven by concerns over the continued trade skirmish with China.

International Equities: Developed international equities as measured by the MSCI EAFE Index returned 1.4% in the third quarter and emerging market equities as measured by the MSCI Emerging Markets Index finished down 1.0%. U.S. trade war concerns generally weighed on equites abroad. Emerging markets exhibited a volatile quarter as select countries like Turkey and Argentina suffered from structural economic issues. However, these countries represent a very small portion of the international and emerging markets overall.

Commodities: Commodities as measured by the Bloomberg Commodity Index were down slightly over the quarter. The metals complex was weaker on the back of trade uncertainties. However, oil and gas both moved higher over the quarter mainly due to supply concerns in the Middle East.

Fixed Income: Interest rates across the yield curve continued to trend higher over the third quarter of 2018 pressuring bond returns. U.S. fixed income as measured by the Bloomberg Barclays US Aggregate Index finished flat for the quarter and down 1.2% year to date. The Federal Reserve (Fed) hiked short-term interest rates for the third time this year in September bringing the federal funds rate range to 2.00% to 2.25%. The market is currently pricing in another rate hike in December and several more as we move into 2019.

Table 1. *Market performance as of September 30, 2018*

	3Q2018	1-Year	3-Year Annualized
S&P 500	7.7%	17.9%	17.3%
MSCI ACWI ex-US	0.8%	2.3%	10.5%
MSCI EAFE	1.4%	3.3%	9.8%
MSCI EM	-1.0%	-0.4%	12.8%
Bloomberg Commodity	-2.0%	2.6%	-0.1%
Bloomberg Barclays US Aggregate Bond	0.0%	-1.2%	1.3%

Source: Morningstar Direct

Outlook and Opportunities

Global market performance continued to diverge during the third quarter due to increasing concerns of potential trade wars, causing international markets to continue underperforming the U.S. All things considered, the U.S. market has remained relatively resilient to tariff threats given the strong fundamentals of the U.S. economy. Pro-growth tax reform has supported strong GDP and earnings growth. Attractive fundamentals such as historically tight labor markets have helped consumer and manufacturing survey data reflect strong confidence in the economy. However, we expect challenges to such economic strength to increase because of investors' concerns of potentially aggressive monetary policy and the ultimate impact of any trade war on the U.S. economy that is already being priced in throughout international markets.

We believe the global economy and financial markets are in the midst of a regime shift driven by rising interest rates in the U.S., transition into late stages of the economic cycle, and the increasing divergence between global economic conditions and performance of international markets. Factors driving these changes include tariff concerns, regional specific risks such as uncertainty in the Eurozone, Brexit concerns, and fears of contagion risk from small emerging economies such as Turkey and Argentina. We believe the increased volatility in financial markets reflects a regime transition as investors re-price assets and adjust expectations, and we expect the road ahead to remain bumpy.

Our main investing goals for client portfolios are 1) to methodically take advantage of attractive buying opportunities that present themselves during periods of market stress, 2) protect portfolios from the risks of significant drawdowns through broad diversification across strategies, and 3) rebalance portfolios in a disciplined and intentional manner. Volatile market conditions often test the strength of investors' convictions, and we believe maintaining a long-term perspective with clear portfolio objectives helps mitigate the risk of capitulating during the worst times.

As we have highlighted in previous newsletters, we maintain relatively moderate levels of risks in client portfolios, but with a heightened sensitivity to the increasing vulnerabilities associated with a shifting economic environment. We remain underweight in fixed income with lower overall duration compared to core bond benchmarks and a focus on higher credit quality. Despite the headwinds facing bond markets, such as rising interest rates and tight credit spreads, fixed income remains an important asset class due to the flight to safety aspect of bonds, particularly U.S. Treasuries, during periods of market stress when equities experience significant corrections. Similarly, we believe conservative growth strategies will play an increasingly important role in portfolios as they can help mitigate downside risk and potentially profit from volatility or market dislocations, particularly in the event of a dual fixed income and equity market sell-off.

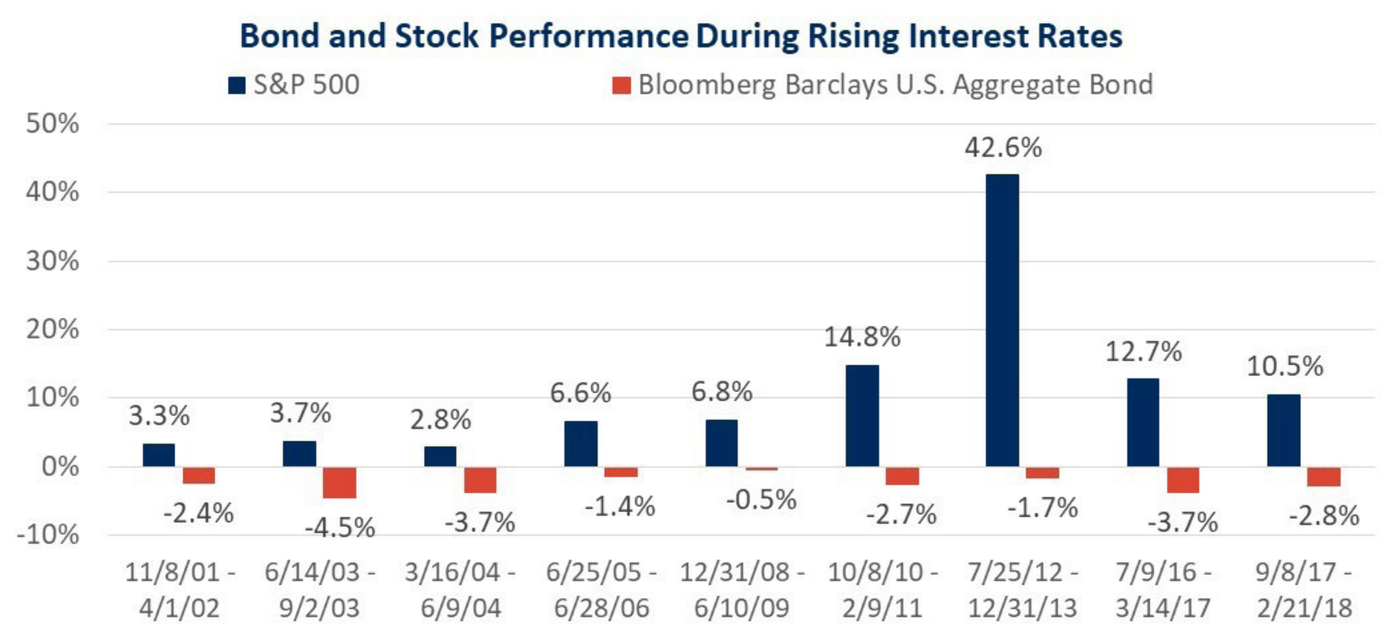
Equities remain the primary source of risk and expected returns in portfolios, and we continue holding a neutral allocation to the asset class compared to our long-term strategic targets given the solidity of the U.S. economy balanced by increasingly attractive valuations abroad. This year, as the U.S. markets have continued to climb, certain international markets have simultaneously experienced corrections of over 20% (often described as "bear" markets), and we seek to take advantage of rebalancing opportunities given the historically high differences in valuations between U.S. and international markets.

Finally, although the risk of unexpected surges in inflation remains under control, we recognize that rising inflation can erode clients' long-term purchasing power, so we remain focused on allocating to real assets strategies that can serve as effective hedges against inflation as well as provide additional diversification from traditional bond and equity market risks.

Are Rising Interest Rates a Risk for Investors?

The Fed has maintained its intention to gradually raise interest rates, as it has done since December 2015 when short-term interest rates were nearly zero. During their September meeting, Fed officials unanimously agreed to raise their benchmark rate to between 2.00% and 2.25%, with expectations that the Fed will raise rates one more time

Figure 1: ***Bond and stock performance during periods of rising interest rates 11/8/01 through 2/21/18***



Source: Wells Fargo; Morningstar

in 2018 and potentially three times during 2019. Despite the Fed stating that the U.S. economy's strength justified a continuing increase in interest rates to prevent the risk of the economy overheating, recent market volatility suggests that investors are concerned that the Fed may become too restrictive in its plan to raise interest rates, increasing the risks of a "Fed mistake." Based on history, rising interest rates are not in themselves necessarily a cause for concerns about the equity markets. Equity market returns have generally been positive when the yield of 10-year Treasuries has remained below 5% (it is currently at approximately 3.2%). Similarly, Figure 1 shows that equity markets have historically generated positive returns during periods of rising interest rates. As expected, bonds have generated negative returns during the same periods, highlighting the traditional negative relationship between stock and bond performance as well as the fact that rising rates tend to be a headwind for fixed income. Barring any unforeseen changes to the path the Fed has communicated regarding monetary policy, investors should not yet turn bearish on equities simply because the Fed is executing on its rate normalization plan.

There's No Place Like Home

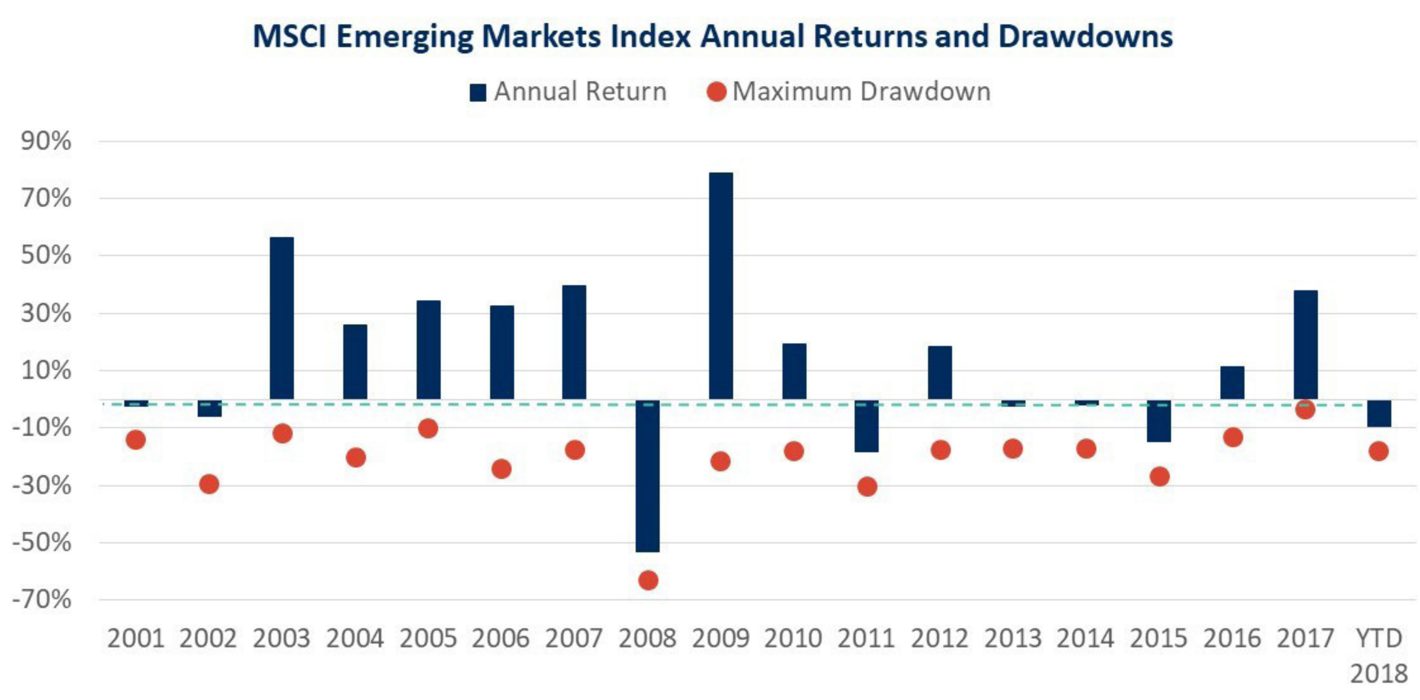
The U.S. has continued to reward investors, with the outperformance of U.S. equity markets relative to international markets continuing to increase throughout the year. Weakness in international markets has been largely attributed to emerging markets such as China, which accounts for 31% of the MSCI Emerging Markets Index. In addition, markets abroad have reacted negatively to tariff news, rising U.S. rates, the strong dollar, and idiosyncratic issues in countries such as Turkey and Argentina. Also, U.S. corporate earnings growth has been stronger than that of international markets. Looking forward however, earnings growth abroad is expected to be in line with U.S. corporate earnings growth at approximately 10%, and earnings growth in emerging markets is expected to outpace the U.S. at over 11%.

Investors who are skeptical of the opportunities in emerging markets point to the fact that many countries in the emerging markets have entered bear market territory. Figure 2 shows historical yearly performance of MSCI Emerging Markets Index and the most severe drawdowns experienced during those time periods. Relative to history, this year's emerging markets correction is within the average range of corrections investors tend to experience in emerging markets in both positive and negative return environments.

Why Bother Investing Outside the U.S.?

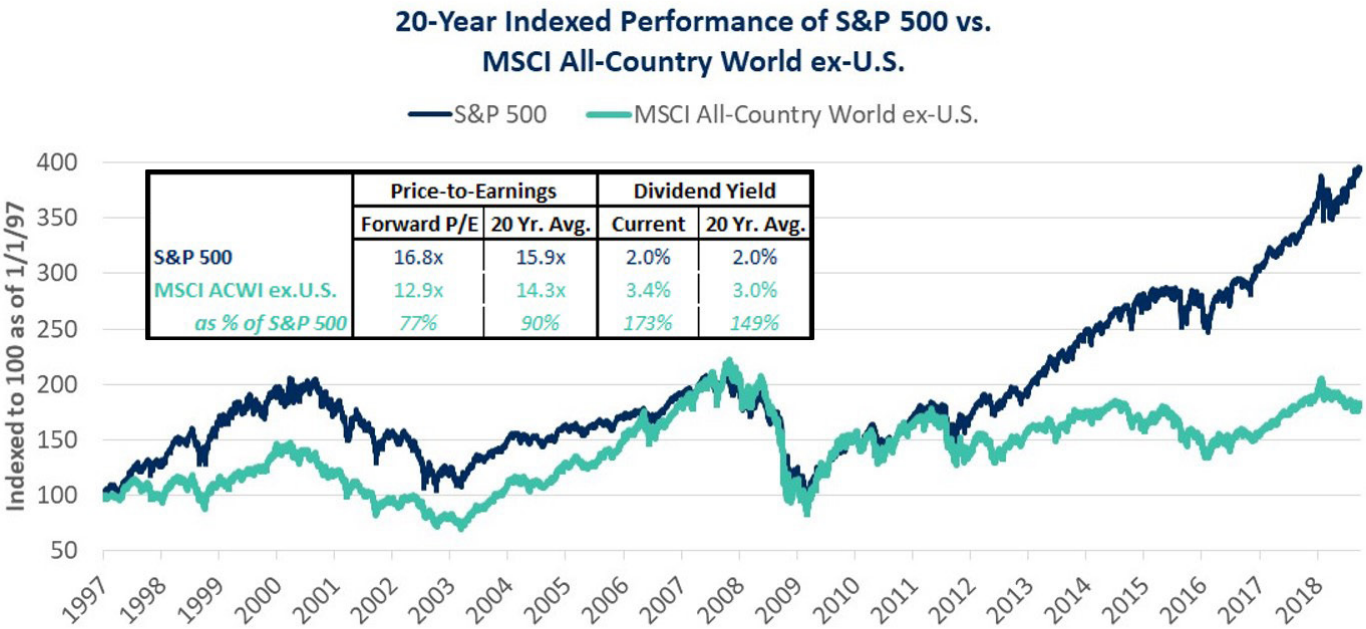
Investors' preference for domestic markets is understandable given the performance of the U.S. relative to international markets over the last several years, and this year is no exception. However, we question the sustainability of such significant divergence between the U.S. and abroad. Figure 3 shows the relative performance of the S&P 500 compared to the MSCI All-Country World Index, excluding

Figure 2: ***MSCI Emerging Markets Index annual returns and drawdowns 2001 through 9/30/2018***



Source: Bloomberg as of Q3 2018

Figure 3: ***Performance of the S&P 500 compared to the MSCI All-Country World Index, excluding the U.S., since 1997***



Source: J.P. Morgan; Bloomberg

the U.S., since 1997. The outperformance of the U.S. relative to the rest of the world has only widened over the last seven years. However, we challenge the view that this relative outperformance will continue, particularly when one accounts for the fact that we are in the later stages of the economic cycle, and the unprecedented quantitative easing program that helped fuel equity markets over the last decade has ended in the U.S. Moreover, the difference in valuations between the U.S. and the rest of the world now stands at historically wide gaps, where forward price-earnings (P/E) multiples outside the U.S. are trading at a 23% discount to those of the U.S, particularly given the fact that earnings growth is expected to be similar in the U.S. as abroad. Similarly, from the perspective of price-to-book value ratios, U.S. markets are now twice as expensive as their international counterparts, the highest valuation difference over the last two decades.

Tariff Risks No Longer Just a Bad Dream

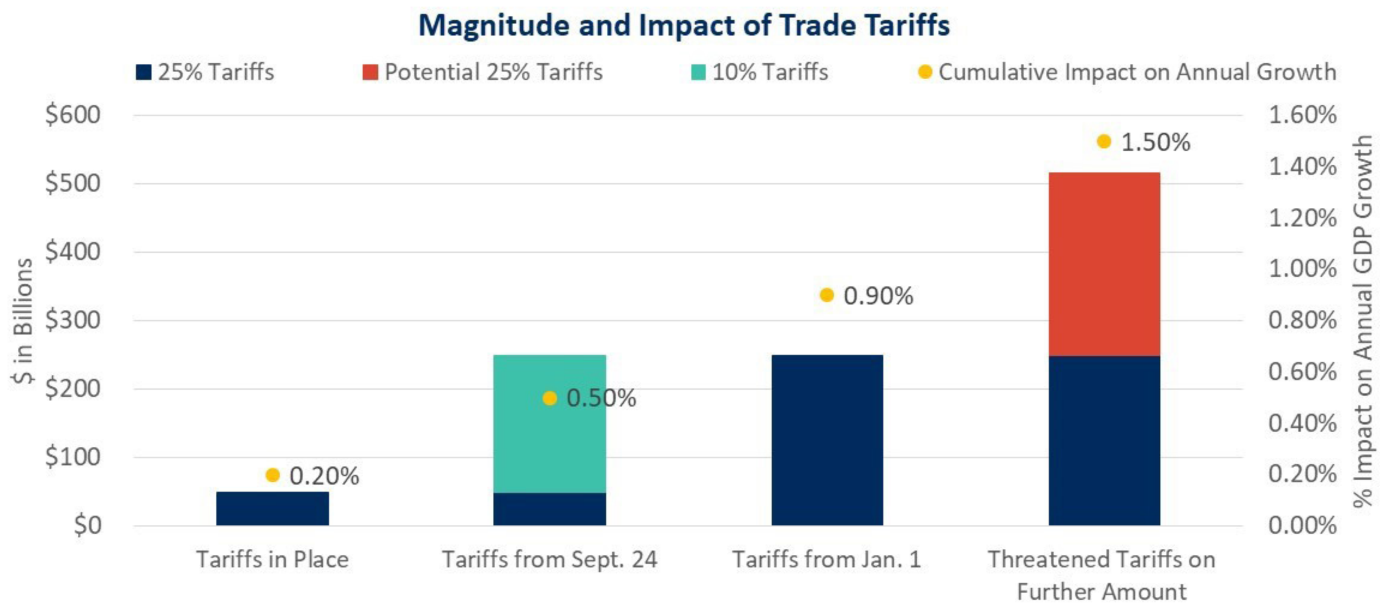
One of the largest risks for investors both in the U.S. and abroad remains potential trade wars. Although much of the risk regarding tariffs has already impacted international markets, the U.S. has remained relatively resilient given the strength of the economy. However, if tariff issues escalate to full-blown trade wars, the strong GDP and corporate earnings growth investors have enjoyed may begin to decelerate. Figure 4 shows the various tariffs that have been put in place as well as those proposed since January, when tariffs for solar panels and washing machines were first announced, with the expected cumulative impact on annual GDP growth. The confirmed tariffs, totaling over $200 billion in goods, are expected to reduce annual GDP growth by 0.9% fueling arguments that we are currently near or at peak GDP growth. If tariffs on the additional $267 billion of goods that have also been threatened are put in place, the expected impact on GDP growth rises to 1.5%. We are already witnessing a slowdown of global trade because of the tariffs that have been announced and/or implemented. Trade shipments, as measured by air and container shipments, have slowed down in the last several months. According to the Commerce Department, the merchandise trade deficit reached $76 billion in August, which is the largest in six months and close to a record.

Despite the rising risks of a trade war, many investors remain hopeful, albeit with diminishing confidence, that we will avert a full-blown trade war, citing the fact that the U.S. finally reached an agreement to replace the 24-year old North American Free Trade Agreement (NAFTA) with the U.S. Mexico Canada Agreement (USMCA) after having rejected NAFTA. Although we do believe that ultimately a compromise may be reached between the U.S. and China, we have been preparing portfolios for a deceleration of growth that could result from continued escalation of the U.S. and Chinese trade tensions.

Conclusion

We see more evidence that global opportunities and risks are increasingly divergent and remain wary of increasing vulnerabilities that potential trade wars and tightening monetary policy present. We continue to pursue broad diversification to help navigate through the transition we

Figure 4: ***Magnitude of tariffs and their impact on annual GDP growth***



Source: Bloomberg

are experiencing late in the economic cycle. In addition, we seek to take advantage of significant valuation dislocations caused by concerns of potential trade wars by exercising methodical rebalancing of portfolios, as we believe such an approach will enable investors with a long-term horizon to achieve their goals and help reduce the risk of overreacting in the near-term when markets test investors' mettle.

Impact Update

By Justina Lai, Director of Impact Investing

Certified San Francisco Green Business

We are proud to announce that Wetherby Asset Management became a Certified San Francisco Green Business in August. San Francisco Green Businesses are audited and recognized by the City and County of San Francisco for meeting rigorous environmental standards in reducing waste, preventing pollution and conserving resources. There are fewer than 300 businesses in San Francisco that have earned this recognition so we are honored to be amongst such an exclusive group of environmental leaders in our community.

We decided to pursue this certification to support our ongoing commitment to being responsible stewards of the environment, and to enable our clients, our team and our community to do the same. We are grateful for initiatives like the San Francisco Green Business program for providing expert resources to help us systematically evaluate and continuously improve our sustainability practices. This impact extends beyond our footprint in San Francisco as well. We are now working to ensure that our office in New York implements the same best practices, has access to the additional resources and transitions to the new, greener products now being used in our San Francisco office.

SAN FRANCISCO GREEN BUSINESS

Best for the World Changemaker

We are pleased to highlight an additional recognition as a 2018 Best For The World: Changemaker that we received from the non-profit B Lab in September. Honorees receive this recognition based upon verified positive change across all impact areas over time and for their leadership in this movement of using business as a force for good. We are excited that we have made such significant and measurable strides in improving our impact as a Certified B Corporation® over time and look forward to opportunities to continue deepening our impact in the future.

Certified B Corporation® Best For The World 2018 Changemakers Honoree

Service Event

In late June, 14 members of the Wetherby team participated in a service event with Project Open Hand, a local non-profit organization whose mission is to provide 2,500 meals with love to critically ill neighbors and seniors every day. During an afternoon, our team sliced and diced potatoes, honeydew, eggplants and onions and packed over 500 wholesome meals for seniors and individuals battling serious illnesses and health challenges. It was an emotional experience for some – especially those who have never cut onions before – but everyone had a great time. In addition to our time, we were also pleased to provide Project Open Hand with a monetary donation to further support the work they do with our neighbors in our local communities.

Project Open Hand
Wetherby team organizing meals for delivery to seniors and the critically ill.

Project Open Hand
Wetherby team cleaning up the kitchen area after preparing meals.

Financial Planning

Important Tax Considerations Resulting from Recent Tax Reform

By Sami Managhebi, CPA, Investment Associate; and Brandon Smith, J.D., Director of Estate Planning

Standard Deduction Versus Itemizing for 2018 and the Future

On December 22, 2017, the most sweeping tax legislation since 1986 was signed into law in what was called the Tax Cuts and Jobs Act of 2017 (the Act). A key provision of the Act is a dramatically increased standard deduction for all taxpayers. According to some estimates, this increased standard deduction will encourage over 90% of households to utilize it rather than itemizing deductions. In other words, those households electing the standard deduction will no longer receive an independent tax benefit for state income taxes, property taxes, mortgage interest and charitable contributions. With the elimination of the personal exemption (previously $4,050), the 2018 standard deduction has significantly increased, up to $12,000 for single taxpayers (from $6,350 in 2017) and $24,000 for married filing jointly taxpayers (from $12,700 in 2017). Taxpayers who are 65 or older and are married filing jointly get an additional $1,300 deduction; single taxpayers who are 65 or older get an additional $1,600. Taxpayers who find themselves on the cusp of the standard deduction limit will have to monitor their deductible expenses closely so that they choose the correct deduction based on their expenditures. Fortunately, there are strategies to maximize tax savings by aggregating deductions in specific years or, as it is affectionately known, “lumping” expenses. Doing so may alleviate some of the difficulty in choosing which deduction scheme to abide by, while simultaneously benefitting taxpayers in both years of large and small deductible expenses.

Changes to Itemized Deductions under the Tax Reform

Many of the changes under the Act make it more difficult to pass the hurdle where itemized deductions exceed the standard deduction. The state and local taxes paid deduction, which includes property and income taxes, is now capped at $10,000. Previously state and local income tax and property tax deductions were uncapped amounts. Mortgage interest for mortgages established after December 14, 2017, is now deductible for only $750,000 of principal indebtedness (there are exceptions for previously established mortgages, but the principal indebtedness limit is down from $1 million prior to the Act). Miscellaneous itemized deductions subject to the 2% AGI floor, which included tax preparation fees, unreimbursed employee business expenses and investment fees, were eliminated entirely by the Act. However, the Act allows deduction of medical expenses to the extent they exceed 7.5% of AGI (down from 10%, no change for those over 65). Charitable donations of cash are deductible for up to 60% of AGI (up from 50%), and there is no phase out of itemized deductions (previously phased out for those with AGIs over $156,900).

Aggregating Deductions

Relevant for taxpayers who are quite close but do not exceed the standard deduction, the timing of certain deductible expenditures may benefit the taxpayer. Taxpayers whose deductions far exceed the new standard deduction or those whose deductions are far beneath the threshold need not worry about aggregating deductions. Those individuals will continue itemizing or taking the standard deduction year after year. It is taxpayers on the cusp of the standard deduction who will benefit most from intentional timing of deductible expenses.

Though many deductions cannot be shifted from one year to the next, taxpayers may be able to strategically accelerate or defer specific deductions to surpass the standard deduction hurdle in a particular year. Taxpayers whose state and local taxes do not exceed $10,000 may purposely underpay state estimated payments in one year and take the standard deduction. That same taxpayer may increase estimated payments in the following year to reach $10,000 of a deductible expense while also choosing to itemize that year. Though most likely immaterial, there may be small interest and late penalties with this strategy. In addition, fourth quarter estimated state payments are generally due January 15th, giving taxpayers the option to shift that payment year to year. Property taxes are also often assessed late in year, allowing taxpayers to pay in the year the bill is received or delay to the following year so that property tax payments are lumped together with the next year's property tax outlays. Medical expenses may also offer some year to year flexibility when incurred late in the calendar year.

Charitable giving provides the most flexible deductible expense from a lumping perspective. Charitable contributions have no dollar cap beyond the new 60% of AGI limit for cash contributions and the 30% of AGI limit for appreciated securities. Even if that limit is exceeded, a taxpayer can carry the tax deduction for the charitable contribution forward for five years. Taxpayers can time their large charitable donations in years where they will be itemizing to maximize potential tax benefits. If the taxpayer is not quite over the standard deduction hurdle, they can also "front-load" a Donor-Advised Fund (DAF) or create a Charitable Remainder Trust (CRT) to pass the hurdle. With a DAF or CRT, taxpayers can choose when to ultimately gift to charity (doesn't have to be the year of creation); but by lumping the initial contributions, the taxpayer can ensure an increased tax benefit in the year of creation.

Taxpayers may also receive an additional tax benefit through gifting appreciated assets rather than cash. By donating appreciated assets held for more than a year, the capital gain tax is eliminated for those donated long-term capital gain assets and the taxpayer receives a full fair market value deduction on the contribution to charity. If a taxpayer instead sold the stock and donated the remaining cash, that taxpayer would pay a capital gains tax on the sale and would only receive a deduction for the value of the cash contributed. Gifting appreciated securities avoids that capital gains tax while simultaneously providing the taxpayer an increased deduction.

An Alternative Charitable Giving Strategy

Taxpayers 70½ years old or older can make Qualified Charitable Distributions (QCDs) from their IRA accounts. These distributions of up to $100,000 per year per eligible taxpayer must go directly to charity (not to a DAF). The QCD can satisfy the Required Minimum Distributions of an IRA dollar for dollar. It is important to let the tax preparer know when a QCD has been made as the Form 1099 does not specify that some or all of the distribution was a QCD. QCDs are not reported as income on the tax return and as a result, there is not a charitable deduction allowed as an itemized deduction. QCDs allow taxpayers who do not itemize their deductions to get a tax benefit as the distribution is not reported as income on the tax return.

Each taxpayer's situation needs to be analyzed independently on its own merits. For some, it may be beneficial to pass the deductibility hurdle every year and itemize deductions, while it may be more beneficial for others to alternate between taking the standard deduction and itemizing. Nonetheless, considering tax reform and the new standard deduction, the timing element of deductible expenses should be considered regularly as it can produce significant tax savings. Your Wetherby advisor would be happy to discuss your options and help determine what is best for your situation.

Credit Freezes Now Available at No Cost

By Scott Dresser, Financial Operations Associate

Credit freezes are a useful tool for consumers to protect themselves against fraud and identity theft - and are now available at no charge.

What is a credit freeze?

By freezing your credit, you prevent the release of your credit score and detailed reports by credit agencies such as

Equifax, Experian and Transunion. This makes it so potential creditors cannot access your credit report, making it more difficult for fraudulent individuals to open new accounts in your name. Credit freezes can be easily reversed, allowing you to open new lines of credit after removing the freeze, and do not affect your credit score.

Why is it now free?

In the past, freezing credit would cost consumers around $10 per credit bureau, and consumers would also pay another $10 per bureau to unfreeze their credit. However, in September, Congress passed a law mandating that credit agencies allow consumers to freeze and unfreeze their credit for free. By banning credit agencies from charging these fees, lawmakers hope to encourage consumers to take steps to defend themselves against credit fraud.

Why might you consider freezing your credit?

You might choose to freeze your credit if you suspect you have been victim of identity theft or a data breach, or even as a precautionary and reversible hold to prevent unauthorized accounts when you yourself do not intend to open new lines of credit in the foreseeable future.

How do I freeze my credit?

You can freeze your credit by contacting each credit reporting agency directly. To be effective, freezes must be placed at all three bureaus.

- Equifax: 1-800-349-9660 or equifax.com
- Experian: 1-888-397-3742 or experian.com
- TransUnion:1-800-680-7289 or transunion.com

How effective is a credit freeze in protecting your financial security?

Please note that freezing your credit does not protect existing credit lines from unauthorized use, but can help protect against fraudulent activities that relate to new lines of credit being opened in your name. A credit freeze is one of many steps you can take to enhance your personal security. Wetherby Asset Management also recommends you use unique passwords and enable two-factor authentication for each of your sensitive online accounts.

WETHERBY

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