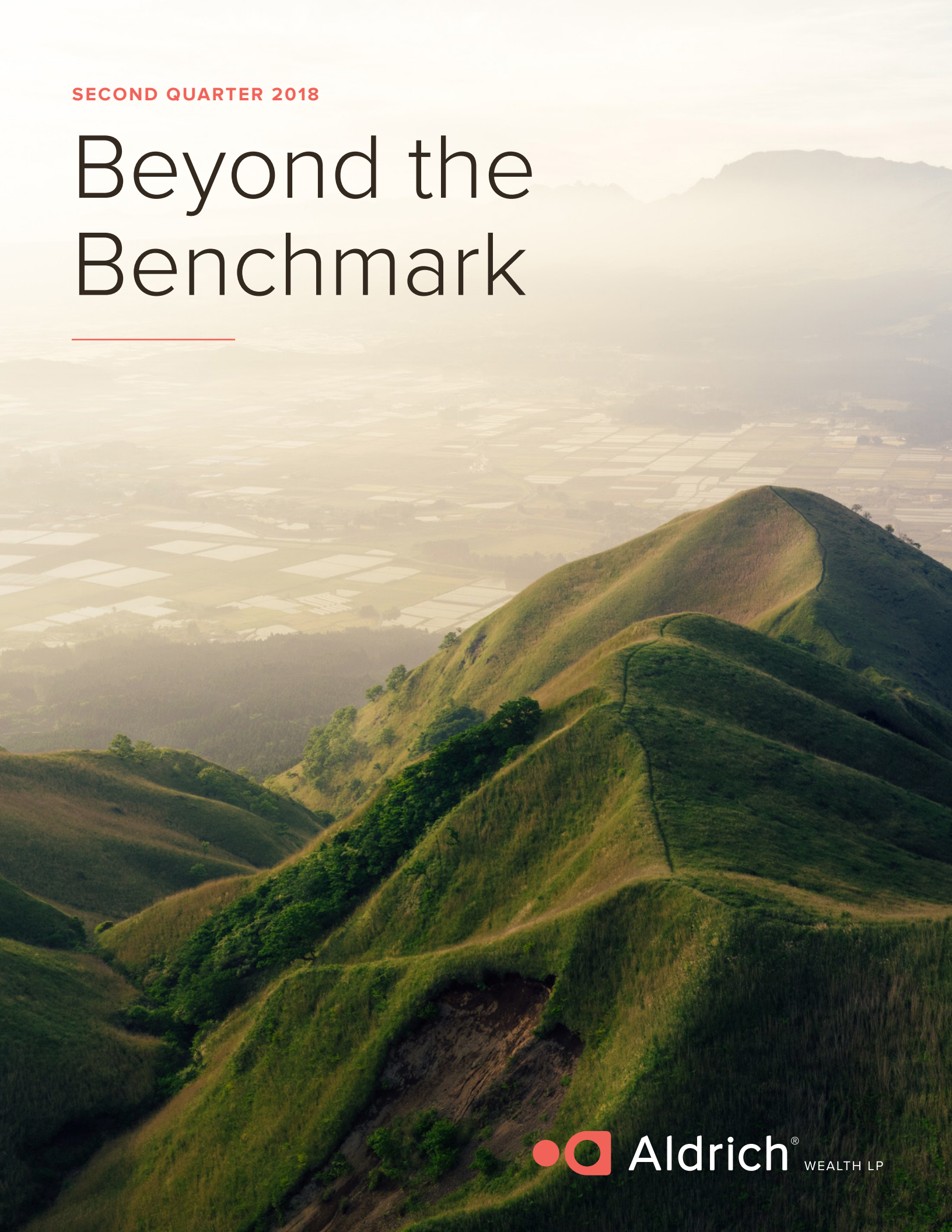
SECOND QUARTER 2018

Beyond the Benchmark



Aldrich® WEALTH LP

QUARTERLY MARKET SNAPSHOT

	VALUE	CORE	GROWTH
Large	1.18%	3.43%	5.76%
Medium	2.41%	2.82%	3.16%
Small	8.30%	7.75%	7.23%

This matrix illustrates U.S. equity benchmarks provided by Russell with the exception of Large Core, which is the S&P 500 Index.

	VALUE	CORE	GROWTH
Global	-1.29%	0.53%	2.26%
Non US	-2.64%	-1.24%	0.11%
EM	-8.94%	-7.96%	-7.01%

This matrix illustrates international equity benchmarks provided by MSCI.

	SHORT	INTER	LONG
Gov	0.21%	0.10%	0.26%
Corp	0.47%	-0.98%	-2.83%
Hi-Yield	1.46%	1.00%	1.92%

This matrix illustrates the fixed income benchmarks provided by Barclays and B of A Merrill Lynch.

Executive Summary

The tension between pro-growth and protectionist policies controlled investor sentiment throughout the quarter. Strong domestic growth and expectations of further Fed tightening were met by an escalating trade war and fears of an imminent recession.

Despite the pronounced volatility, domestic market equities, as measured by the S&P 500 Index, ended the quarter in positive territory with a 3.4% increase. Small-cap stocks outpaced their large-cap brethren while growth generally bested value. Smaller companies with their U.S. centric orientation have been supported by strong earnings, protectionist rhetoric and a strengthening dollar.

Trade tensions reverberated across non-U.S. markets as well, inflicting the greatest damage on the emerging markets. Non-U.S. markets, as measured by the MSCI EAFE Index, declined 1.2% amid weakness in Japan and Germany. Emerging markets, as measured by the MSCI Emerging Markets Index, dropped nearly 8.0%, with significant weakness emanating out of Latin America. With trade retaliation between the U.S. and China heating up, China's currency and stock market dropped to fresh lows. The Fed hiked rates again, and the European Central Bank (ECB) announced it would stop bond purchases by year-end, signaling the end of an era of unconventional and accommodative monetary policy.

Domestic Equities

The strong economic and earnings environment seemed to compensate for the persistently turbulent geopolitical backdrop. The ups and downs ultimately resulted in the S&P 500 erasing first-quarter losses with a 3.4% return, putting the index up nearly 2.7% for the year. Small-cap stocks continued to outperform large-cap stocks, and growth generally bested value. Escalating trade tensions remained one of the strongest forces driving the market. The summit between North Korea and the U.S. in June seemed to have little impact on the domestic markets as specific details surrounding the promised denuclearization failed to materialize.

Although the Fed increased the overnight lending rate in June, a move largely anticipated, sectors that are sensitive to such moves, including Telecom and Consumer Staples, struggled in the quarter. The U.S. market was led by Energy, Consumer Discretionary and Technology. Energy was the strongest performing sector with returns exceeding 13.4% during the period. This was fueled by crude prices which exceeded $74/barrel in June, the highest levels since 2014. The first quarter earnings growth rate exceeded 24.0%, as tax cuts bolstered already strong results. In total, nearly 80% of the S&P 500 Index constituent companies exceeded earnings expectations, with a similar percentage reporting better than expected revenue figures.

International Equities

International equities weathered a volatile quarter as trade hostilities between the U.S. and several countries prompted investor sentiment to vacillate between optimism and pessimism about the prospect of a global trade battle. The MSCI EAFE Index fell 1.2% in the second quarter, dropping the total decline for the year to 2.8%. That said, in local terms, the Index narrowly exceeded its developed counterpart, with a positive 3.5% return as the U.S. dollar strengthened significantly during the period. The Japanese and European indexes saw similar drops of 2.2% and 1.3% during the three-month period. Political turmoil in Italy following a disruptive election outcome forced investors in Europe to recalibrate the risks associated with the still-fragile state of the European Union. That said, Italy has struggled to establish a consistent government for decades, and while the elections were certainly troublesome to the fabric of the EU, it is not a new development.

After leading the way for five consecutive quarters, the MSCI Emerging Markets Index saw the steepest decline, dropping 7.9% in the period. Emerging market stocks were pressured by escalating tariff fears, U.S. interest rate hikes, a stronger dollar and higher oil prices. Fears of a global trade war are growing as the U.S. forges ahead with tariffs on Chinese imports and limits on Chinese investment in domestic tech companies. Canada and the European Union have produced a joint collaboration as they announced tariffs on billions of dollars' worth of U.S. imports. This will likely be most impactful for the large-cap segments of the market, given their higher exposure to revenue generation across the globe.

Fixed Income

The Federal Reserve raised the Fed Funds rate another 25 basis points in June and remain on pace for a total of four hikes in 2018. Additionally, the Fed has outlined plans for three more hikes in 2019 as economic activity and unemployment data remain robust. The Fed expressed its favorable view on the economy, noting that solid gains in employment, household spending and business investment could continue. The yield on the benchmark 10-year Treasury note briefly broke through the 3% threshold following the Fed meeting but failed to hold above that psychologically significant level. For the quarter, the yield on the ten-year Treasury moved only modestly higher, from 2.74% to 2.85%.

Yields took a dive mid-quarter but steadily trended upwards. The Barclays Universal Bond index ended the second quarter down nearly 0.3%, while three-month U.S. Treasury bills saw a modest 0.45% increase. Municipal bonds have performed well year-to-date, exceeding the returns of U.S. Treasuries and corporate bonds. The relatively strong results of the municipal bond market have centered on continued supply constraints and ample demand. High yield and bank loans turned in healthy returns in this rising interest rate environment. With the ability to reset quarterly coupons, bank loans are able to take advantage of short-term interest rate hikes.

The European Central Bank struck a dovish tone with an announcement near quarter-end that they intend to reduce asset purchases from €30 billion to €15 billion at the end of September and stop them by the end of December. Conversely, the ECB also vowed to wait until at least the middle of 2019 to begin hiking interest rates.

Economy

The steady undercurrent of healthy economic data continued with a robust jobs market, and rising housing prices providing ample support for a constructive investment narrative. Growth in the U.S. economy, as measured by changes in the Gross Domestic Product, increased 2.0% during the first quarter after recording 2.9% growth in the prior quarter. The final figure was revised lower, as inventory and net exports provided downward pressure. The unemployment rate remains at an 18-year low of 3.8% as the employment situation domestically remains stout.

Domestic job growth and employment have been strong, while wages have seen only small growth, which suggests there may still be some slack in the labor force. The University of Michigan's Consumer Sentiment Index dropped to 98.2 in June from an initial estimate of 99.3. Still, the reading was higher than the 98.0 level recorded in May and remains well above its historical average, 86.3. The revision was due to uncertainty about the impact of the proposed trade tariffs and burgeoning inflationary pressures.

Global growth has moderated somewhat amid currency headwinds and escalating trade war rhetoric. However, most economists are projecting global GDP will accelerate further in the back half of the year. Growth across much of Europe and emerging Asia has been particularly encouraging and contributed to the improving global growth and an optimistic outlook. Interest rates remain very low globally, and this has contributed to increased business and consumer spending, but thus far hasn't notably increased inflationary pressures.

Therefore, governments across the globe are maintaining low interest rates and are more focused on generating growth than taming inflation. The pro-growth posture of so many countries and regions has contributed to the global rebound in growth and is projected to provide additional fuel in 2018.

Market Outlook

Investment markets globally remain constrained by the escalating trade war rhetoric, despite a healthy economic backdrop. Earnings are likely to give investors some reprieve. Investors will get a second look at the benefit from the tax cuts, with the latest estimates suggesting S&P 500 earnings could surge another 20% in the quarter and over 20% for all of 2018.

The Tax Cuts and Jobs Act increased earnings expectations for domestic stocks and is projected to add about 8% to earnings in 2018. Improving global growth, exceptionally low global interest rates, accommodative central banks, and attractive valuations relative to bond yields suggest international equities should rebound.

There is some concern that the economy is peaking and that margins will begin to deteriorate as interest rates rise. A more aggressive Fed would likely weaken equity investor enthusiasm and negatively impact returns. While we anticipate lower returns for U.S. stocks in 2018 compared to 2017, rapid earnings growth should be supportive of modest gains in 2018. However, we believe international equities could outperform domestic stocks in 2018.

Although domestic and international developed market equity returns were similar in 2017, nearly half of the performance for international stocks was attributable to currency appreciation, particularly the euro (€). European earnings growth exceeded equity index appreciation before adjusting for currency movement. Therefore, valuation metrics for equity indices in the Eurozone actually improved and look compelling.

Economic growth is accelerating domestically and is stable internationally. The U.S. dollar depreciated notably in 2017 and has helped larger-cap companies more than domestically focused small-caps. The opposite has occurred in 2018, as U.S. interest rates have moved higher relative to global rates. Emerging market currencies have fallen in 2018, and a rising U.S. dollar is seen as a potential headwind for countries that issues a substantial amount of U.S. dollar-denominated debt. International bonds offer some diversification benefit but offer very little in terms of yield. The cost of hedging has added to return as borrowing in euros (€) and buying short-term dollar securities has generated income.

U.S. shorter-term interest rates increased in the second quarter as relatively strong economic growth prompted the Fed to raise the overnight rate in June. The Fed is projecting four rate hikes of 0.25% in 2018 based on rising inflation and solid economic growth forecasts. The recently passed tax cuts are projected to further strengthen an already strong economy. We believe strong global growth will help push interest rates higher as inflation increases. Given this outlook, we continue to emphasize shorter duration bonds and floating rate bonds, which generally perform relatively well when interest rates rise.

We continue to overweight growth stocks relative to value stocks due to the strength of earnings within the growth sectors. The prospect of higher interest rates also makes value-oriented stocks less attractive. We have lower return expectations for domestic stocks relative to 2017 and international developed and emerging markets.

Decision Making in the Face of Uncertainty

By Darin Richards, CFA®

I recently attended a conference where we heard from former World Series poker champion, Annie Duke. In addition to being a poker legend, Duke also authored a bestselling book titled Thinking in Bets: Making Smarter Decisions When You Don't Have All the Facts. I found her presentation extremely interesting and enlightening, both personally and professionally. The crux of Ms. Duke's presentation was that most decisions we make are made without having all the facts, and thus the outcomes are uncertain.

However, by accepting that the outcome is uncertain, we should use as much information as is feasibly available and focus on estimating the probability of an outcome rather than making decisions based on gut feelings or emotions. She contends that the best decisions are made when the decision-making process is structured and that the result should not be used to evaluate the decision.

Ms. Duke used the Seattle Seahawks' loss to the New England Patriots in Super Bowl 49 as an example of what she terms "resulting." She defines this as looking at the results to determine if the decision process was good or bad. As you may remember, the Seahawks were trailing the Patriots by four points with 25 seconds left in the game and had the ball just outside the Patriots' one-yard line. The Seahawks had a second down and goal and one timeout left. Instead of running the ball, they threw a quick pick route that was ultimately intercepted, and the Patriots went on to win the game. The next day, the Seattle Times headline read, "Seahawks Lost Because of the Worst Call in Super Bowl History." The sentiment was universally shared, and the press relentlessly ripped head coach Pete Carrol and his coaching staff.

Although the outcome of the decision was clearly not what the Seahawks and their fans wanted, the decision-making process was actually very sound. The Seahawks had one timeout left and if they ran and didn't score, they would need to use the timeout to stop the clock and would likely only be able to run one more play. However, if the pass was complete for a touchdown, they would almost certainly win. If it was incomplete, it would stop the clock, and they could still run two more plays since they preserved their timeout.

In addition to the benefit of saving the timeout, historically, the percentages of touchdowns scored from the one-yard line were essentially equal between running and passing. Therefore, based on percentages, the Seahawks were equally likely to score if they ran or threw. But throwing, even if it wasn't completed, would save a timeout and allow for two more plays. Historically, only three percent of passes from the one-yard line had been intercepted. Clearly, the decision to pass wasn't risky based on historical data.

Did Pete Carrol and his staff make a bad decision when they called the pass play? The data indicates it was a good decision. But clearly, the result was not good. We tend to evaluate the decision process based on the results. If the Seahawks had scored, the press and Seattle fans would have likely said the coaching staff made a great call. Should the result of the same decision really decide if the decision was good or bad?

As investment professionals, we operate in an environment that is very unpredictable and has almost unlimited factors that can impact investment returns. Given the high level of uncertainty and ever-changing economic environment, it is difficult to consistently predict market outcomes. At Aldrich Wealth, we believe that using data to drive our decisions prevents us from making decisions based on hunches or market emotions. We had plenty of clients asking about Bitcoin when it traded at $20,000, but the calls subsided as the price fell sharply. We have no quantitative methodology of valuing cryptocurrencies, so rather than speculate, we elected to pass. Hopefully, our decision to pass will provide a better result than the Seahawks' decision to pass.

Our structured and data-driven decision process allows us to review our processes to determine if we didn't identify a risk or opportunity, the environment changed, or if the outcome was simply a lower probability event occurring. When we evaluate the results of our decisions, we look for ways to further improve the process, regardless of the outcome.

Our investment decisions are vetted and ultimately made by our seven-member Investment Committee. Having a diverse group of individuals supports our objective of considering multiple scenarios and reduces the likelihood of us making emotional decisions. We believe the application of our data-driven decision-making process gives our clients the highest probability of earning optimal results.

DARIN RICHARDS, CFA®

Partner + Chief Investment Officer

Darin joined the Portland wealth management firm in 2004, bringing more than a decade of investment and financial consulting experience with him. As chief investment officer for Aldrich Wealth, Darin is responsible for developing and implementing our investment philosophy and leading the investment committee. He works directly with some of our most complex and largest clients and also co-manages the private wealth team, providing investment management, tax planning and financial planning services.

Tax Reform: What to Consider Now

By Elizabeth Hutchison, CPA, CDFA™

This year has certainly been a year of change from a tax standpoint. President Trump signed the tax reform bill in December 2017, representing the most significant tax changes in more than 30 years. As you can imagine, our tax and financial planning professionals have been digesting the implications of the new laws and are looking for opportunities to maximize after-tax returns as the changes go into effect this year. The following are some key tax planning considerations we wanted to bring to your attention.

Payroll or Pension Withholding

If you are currently receiving income subject to withholding, adjustments might be beneficial. In early 2018 withholding tables were adjusted for the reduced tax brackets. You may have noticed a larger paycheck but are unaware of how much of that change is related to federal tax withholding. Due to the withholding adjustments, your withholding might not cover your tax obligation as it has in the past.

Additional withholding or quarterly estimates might be necessary to cover your 2018 tax liability. We recommend having your tax advisor review a recent paystub as well as earning expectations for the remainder of the year to determine if any changes would be advisable. Planning now may help you avoid an unpleasant tax surprise next April.

Retirement Account Distributions Withholding

If you elect to withhold via percentages or flat dollar amounts on your IRA or 401k distributions, it's possible that a reduction in the withholding rates could be prudent. In these situations, it is common to select the withholding level and not adjust it again. You may have withholding rates in place that were determined under

the prior tax law. If your withholding can be reduced, you may want to consider the following:

- Reducing the withholding and enjoying more cash from each distribution. Funds can be used or reinvested, rather than waiting for a tax refund the following year.
- Reducing the total distribution, assuming you still meet your required minimum distribution. This can help maintain the principal of the retirement account, allow the money to grow tax-deferred and possibly keep you in a lower tax bracket.

State Credit Programs

In response to tax reform, several of the high-income tax states, including California and Oregon, have released legislation designed to establish credit programs to essentially convert state income tax payments into charitable deductions. With the new Federal $10,000 cap on the state tax itemized deduction, individuals in high tax states are losing a historically important income tax deduction. These programs may provide you with a state tax credit in exchange for your donation to a charitable fund.

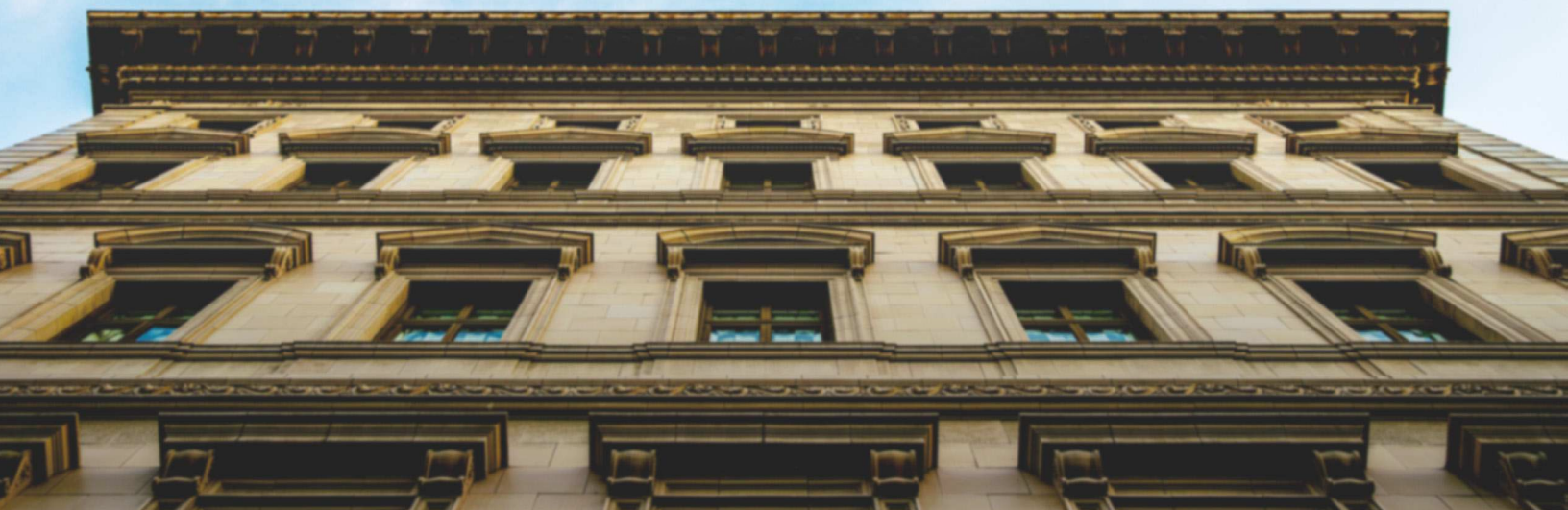
We are waiting for further clarification from the IRS as to if any of the state programs will qualify as a charitable deduction. The IRS put out a notice indicating that clarification regarding this matter will be issued in late July.

We're keeping an eye out for further clarification and to see if state credit programs will be beneficial to our clients across our geographies. The team at Aldrich Wealth is happy to help you evaluate strategies to best position your financial life in the current environment.

ELIZABETH HUTCHISON, CPA, CDFA™

Senior Tax Manager

Elizabeth goes beyond compliance and is a problem solver and strategic tax planner. Her expertise allows her to help clients navigate the complex nature of tax laws. With her most recent designation as a Certified Divorce Financial Analyst, she has the ability to help her clients understand their financial picture during significant life changes.



Aldrich Locations

ANCHORAGE
907.522.2130

CARLSBAD
760.431.8440

ESCONDIDO
760.746.1560

PASADENA
626.397.4600

PORTLAND
503.620.4489

SALEM
503.585.7774

SAN DIEGO
619.810.4940

About Aldrich Wealth

Aldrich Wealth LP is an investment advisor registered with the U.S. Securities and Exchange Commission. Aldrich Wealth provides wealth management services where it is appropriately registered or exempt from registration and only after clients have entered into an Investment Advisory Agreement confirming the terms of the client relationship, and have been provided a copy of Aldrich Wealth ADV Part 2A brochure document. The information contained in this document is provided for informational purposes only, is not complete, and does not contain material information about making investments in securities including important disclosures and risk factors. Under no circumstances does the information in this document represent a recommendation to buy or sell stocks, bonds, mutual funds, exchange traded funds (ETF's), other securities or investment products.

Recognized as Financial Times Top 300 Financial Advisors

The 2015 Financial Times Top 300 Registered Investment Advisors is an independent listing produced by the Financial Times (June, 2015). The FT 300 is based on data gathered from RIA firms, regulatory disclosures, and the FT's research. Applications were solicited from more than 2,000 independent RIA firms that had $300 million or more in assets. The 630 RIA firms that applied were then graded on six criteria: AUM; AUM growth rate; years in existence; advanced industry credentials; online accessibility; and compliance records. To make sure the list was relevant to Financial Times readers, the paper required that no more than 75% of a practice's assets be institutional. Only those who completed an application were considered. Neither the RIA firms nor their employees pay a fee to The Financial Times in exchange for inclusion in the FT 300. This is the second annual FT 300 list, produced independently by the FT in collaboration with Ignites Research, a subsidiary of the FT that provides business intelligence on the investment management industry.

Recognized Five Star Professional's "Five Star Wealth Managers"

Five Star Professional, as a third-party research firm, identified pre-qualified award candidates based on industry data and contacted all identified broker dealers, Registered Investment Advisor firms and FINRA-registered representatives in the Portland area to gather wealth manager nominations. Award candidates were then evaluated against 10 objective eligibility and evaluation criteria: 1) Credentialed as an investment advisory representative (IAR), a FINRA-registered representative, a CPA or a licensed attorney; 2) Actively employed as a credentialed professional in the financial services industry for a minimum of five years; 3) Favorable regulatory and complaint history review; 4) Fulfilled their firm review based on internal firm standards; 5) Accepting new clients; 6) One year client retention rate; 7) Five-year client retention rate; 8) Non-institutionalized discretionary and/or nondiscretionary client assets administered; 9) Number of client households served; 10) Educational and professional designations. 1,107 wealth managers in the Portland area were considered for the award. 224 were named 2015 Five Star Wealth Managers which represents approximately 21 percent of the total award candidates of the area. Wealth managers do not pay a fee to be considered or placed on the final list of 2015 Five Star Wealth Managers. The Five Star award is not indicative of the wealth manager's future performance. For more information on the Five Star Wealth Manager program and the research/selection methodology, go to www.fivestarprofessional.com/wmsummaryandresearch.pdf. To view AKT Wealth Advisors, LP award document, go to http://www.pageturnpro.com/Five-Star-Professional/64888-PORWM15-Heather-Wonderly/puredefault.html.

Aldrich® WEALTH LP

Alaska | California | Oregon

wealthadvisors.com