LANIER
ASSET MANAGEMENT LLC

Building Confidence and Security in Your Financial Future

Monthly Update

November 2017

Whack-A-Mole – D.C. Style

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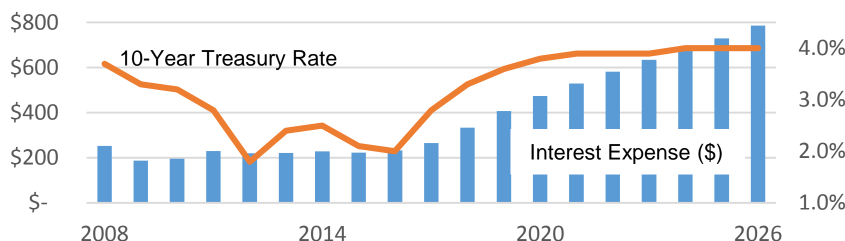
CEO, Principal

The first draft of the GOP Tax Reform plan was released on November 2. What might this look like in the end? When will something get done? Can this administration get anything done at all? With all of these grains of salt, the draft was highly positive. New, lower individual tax rates for all but the wealthiest. Great – an average household savings of $1,182/year! Lower, more globally-competitive corporate tax rates. Super – should lead to higher GDP growth! Elimination of some deductions. OK – had to give back something. A trillion dollars added to the deficit. Wait. What?

If the plan was enacted "as-is," which it won't be, The Tax Foundation estimates that the plan would add $989 billion to the U.S. deficit over the next 10 years. The House Ways and Means Committee Chair, Kevin Brady (the author of the plan) estimates that it would add $1.51 trillion to the deficit. But what's a trillion here or there? Our interest expense as a percent of GDP has fallen from 8.5% in 2008 to 6.5% in 2017. Certainly a little more debt won't hurt us, right? Those numbers are definitely deceiving.

From 2008 to 2017, the interest expense on publicly held U.S. debt remained relatively stable – $253 billion in 2008 and $266 billion in 2017. But the only reason that the expense remained stable was a declining interest rate. Over the same period, our publicly held debt more than doubled – from $5.8 trillion to $14.7 trillion. [Note: these figures only include publicly held U.S. debt. If you include debt held by government accounts and debt held by the Federal Reserve Board, the number grows to over $20 trillion.] What do you suppose is going to happen as interest rates begin to rise as they already have?



Source: Office of Management and Budget

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The Office of Management and Budget put forth their projections of interest rates over the next 10 years, which included a gradually rising rate that reaches 4% (on the 10-year U.S. Treasury) in 2024. That doesn't sound like much, but the effects on the interest expense are astounding. By 2020, interest on debt will reach $474 billion – almost 9.7% of the entire budget. By 2026, interest expense will hit $787 billion or 12.2% of the budget. Those estimates are before the $1-1.5 trillion that would get added by this tax plan. Let's put that in perspective. Here are today's four largest budget items: $948 billion on Social Security, $774 billion on defense, $592 billion on Medicare, and $385 billion on Medicaid. If those don't grow by one penny – which demographics starkly say otherwise – the $787 billion on interest expense is the second largest budget item.

Add on top of that the fact that it has been nearly a decade since the 2008-2009 financial crisis that required a HUGE amount of borrowing to get out of – debt that drove the total debt to GDP ratio from 68% at the beginning of 2008 to 107% today! If/when the U.S. economy hits a bump in the road (recession), tax revenues will plummet, new debt will undoubtedly be issued and the problem will get even bigger. Reminds me of playing Whack-A-Mole at Six Flags. But at Six Flags, after 60 seconds they stop the game and you can start over. No one is stopping this game, and the moles are popping up faster and faster.

The thinking seems to be: "If a disaster isn't going to happen today while I am in office but will definitely happen in the future (and the order of magnitude will be larger), why address it now?"

In our June newsletter, Carl laid out five quality of life influencers. #3 on the list was debt. This one is getting worse, not better. And if it isn't addressed sooner rather than later, debt service will consume our budget and compromise our standard of living for generations to come.

Mark is a co-founder of Lanier Asset Management and serves as its Chief Executive Officer. Prior to founding Lanier, he was a partner at The Boston Consulting Group. Mark is an honors graduate of The University of North Carolina at Chapel Hill with a BA in Economics, and holds an MBA from The Harvard Business School.

Key Points From Our Investment Meeting – 11/10/17

Macro Viewpoint

- Will President Trump be able to get any of his agenda passed in his first year?
- The EU continues quantitative easing, although at a slower pace.
- GOP tax plans appear positive for growth, but how much is priced into the market?

Asset Class Comments

- High yield bond spreads widen. Yellow flag!
- The markets continue higher on positive equity earnings. Historical metrics suggest the market is quite complacent.
- Please consider your risk at this stage in the cycle.

Performance Update

	Investment Vehicle	Total Return (%) October	QTD	YTD	1-Year	Annualized 3-Year	5-Year	7-Year	10-Year
TRADITIONAL ASSETS									
Cash									
Vanguard Reserve Prime Money Market		0.1%	0.1%	0.9%	1.0%	0.5%	0.3%	0.3%	0.6%
Fixed Income									
Domestic (Barclays US Agg)		0.0%	0.0%	3.2%	0.8%	2.4%	2.0%	2.8%	4.1%
Vanguard Total Bond Market	VBMFX	0.1%	0.1%	3.2%	0.7%	2.2%	1.9%	2.7%	4.0%
Eaton Vance Floating Rate	EIBLX	0.6%	0.6%	3.9%	5.6%	4.2%	3.9%	4.4%	3.9%
US Preferred Stock ETF	PFF	-0.4%	-0.4%	7.4%	4.1%	4.7%	5.1%	5.7%	4.7%
High Yield (Barclays US Corp HY)		0.2%	0.2%	6.5%	8.7%	4.7%	3.3%	3.7%	5.4%
Short Term High Yield	SJNK	0.3%	0.3%	5.8%	8.1%	3.4%	3.9%	5.2%	6.4%
Equities									
Domestic Large Cap (S&P 500 TR)		2.4%	2.4%	16.7%	23.5%	10.7%	15.1%	14.1%	7.5%
S&P Equal Weight	RSP	1.1%	1.1%	12.8%	20.0%	9.0%	15.0%	13.6%	8.3%
Domestic Mid Cap (S&P 400 TR)		2.3%	2.3%	11.9%	23.5%	10.5%	15.0%	13.6%	8.9%
Vanguard Mid-Cap ETF	VO	1.5%	1.5%	14.4%	20.7%	9.0%	15.0%	13.3%	7.9%
Domestic Small Cap (S&P 600 TR)		1.0%	1.0%	9.9%	27.9%	11.6%	16.2%	15.0%	9.1%
Vanguard Small-Cap ETF	VB	1.6%	1.6%	12.3%	24.3%	9.4%	14.6%	13.5%	8.5%
Developed Intl. (MSCI EAFE)		1.5%	1.5%	21.4%	23.0%	5.9%	8.4%	6.0%	1.1%
MSCI EAFE	EFA	1.7%	1.7%	22.6%	23.7%	5.7%	8.5%	6.0%	1.0%
Emerging Intl. (MSCI EM)		3.5%	3.5%	32.0%	26.2%	5.6%	4.8%	2.6%	0.6%
Vanguard FTSE Emerging Markets ETF	VWO	2.4%	2.4%	27.2%	21.2%	4.3%	4.4%	2.1%	0.0%
Real Assets									
Real Estate (FTSE NAREIT US REIT)		-0.2%	-0.2%	5.8%	7.9%	6.2%	9.3%	10.5%	5.7%
Mortgage Real Estate	REM	-3.0%	-3.0%	15.5%	17.9%	8.3%	6.8%	8.3%	2.0%
REIT ETF	VNQ	-1.1%	-1.1%	2.3%	5.5%	5.8%	9.5%	10.3%	5.8%
Commodities (Thomson Reuters/Jefferies CRB Index)		4.7%	4.7%	5.9%	14.7%	-12.2%	-9.1%	-6.8%	-6.2%
DBC	DBC	4.0%	4.0%	1.1%	7.0%	-9.6%	-11.7%	-7.0%	-6.4%
BlackRock	BCSAX	1.5%	1.5%	3.7%	6.8%	-4.2%	-5.4%	-4.1%	-4.4%
Gold	GLD	-0.8%	-0.7%	10.1%	-1.0%	5.4%	-4.6%	-0.5%	5.4%
DIVERSIFYING STRATEGIES									
Hedge Funds									
HFRI WCI		1.3%	1.3%	7.7%	9.6%	4.1%	5.2%	4.0%	3.0%
INFINITY*	OCEAN	0.7%	0.7%	4.7%	6.3%	5.4%	7.4%	7.1%	6.4%
Boston Partners Long/Short Equity	BPLEX	-1.0%	-1.0%	-1.2%	8.3%	5.8%	6.5%	8.0%	10.7%
QIM Tactical Aggressive*	QIM TA	9.8%	9.8%	68.3%	44.6%	37.6%	18.5%	20.7%	21.7%
Citadel*	CITADEL	1.9%	1.9%	11.1%	11.7%	10.6%	13.9%	15.3%	10.5%
Millennium*	MILLENN	0.8%	0.8%	6.2%	7.1%	8.5%	9.3%	8.9%	8.3%
Renaissance	RENAISS	4.2%	4.2%	13.2%	16.9%	18.4%	16.2%	17.4%	20.6%
Third Point	THIRD P	3.1%	3.1%	16.9%	16.5%	6.3%	10.2%	9.8%	8.6%
Hedge Fund Plus*	HF+	3.1%	3.1%	18.1%	16.4%	13.9%	11.5%	11.8%	11.9%
Boston Partners Global Long/Short	BGLSX	1.3%	1.3%	5.4%	7.0%	4.3%	5.7%	4.3%	3.2%
Managed Futures									
Barclays CTA Index		1.5%	1.5%	-0.5%	3.7%	2.1%	1.8%	0.8%	2.6%
WINTON*	WINTON	3.6%	3.6%	-1.1%	-1.7%	-1.8%	0.4%	-1.0%	1.0%
QIM*	QIM	2.8%	2.8%	4.6%	10.3%	9.2%	1.0%	1.3%	2.3%
AQR Managed Futures Strategy	AQMNX	3.0%	3.0%	-2.8%	-7.4%	0.0%	2.4%	0.8%	2.5%
Natixis ASG Managed Futures Strategy	ASFYX	4.3%	4.3%	5.7%	5.8%	2.8%	6.4%	2.9%	4.4%

= Benchmarks
= Lanier Selections

* For Accredited Investors

Our Team

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Junius V. (Trip) Beaver, III
Co-Chief Investment Officer, Principal

Carl W. Hafele, CFA, CPA
Co-Chief Investment Officer, Principal

John E. Thompson
Director, Private Client Group

Dr. Daniel L. Bauer
Financial Consultant

Sara B. Thomas, JD, CPA
Financial Consultant

Deidre M. Durbin
Chief Compliance Officer

Stephanie E. Milby
Investment Associate

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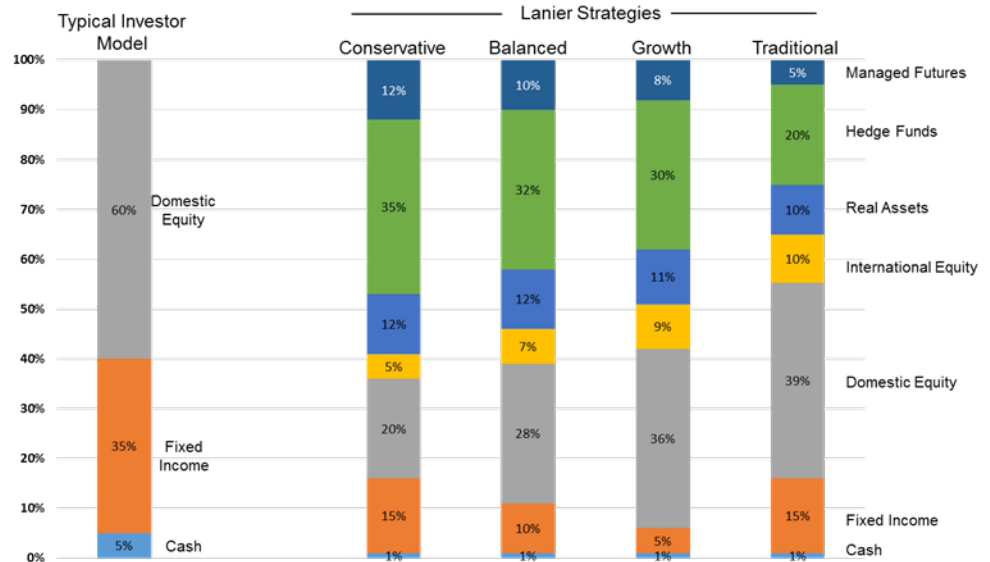
Our Approach

At Lanier, we believe that portfolios designed to deliver superior performance and lower correlation with the overall markets must decrease reliance on stocks and bonds and be complemented with a set of diversifying strategies and alternatives



Each of our clients has a unique set of needs (based on age, risk tolerance, income need, etc.) and an asset allocation model designed specifically to meet those needs. Consequently, actual client investment models can and do vary from the allocation percentages listed above.

Lanier Asset Management is an independent Registered Investment Advisory firm. Our mission: ***To Build Confidence and Security in our Clients' Financial Future***. We use an open architecture investment structure to combine the best of proprietary and independent investment strategies. At Lanier, we deliver superior service and performance to our clients as a result of four distinguishing elements:

- **People**: we are an independent firm, providing objective advice from experienced investment professionals working in your best interests
- **Investment Philosophy**: we seek to smooth investment returns, providing superior investment performance and a significantly lower correlation to the overall market
  - Focus on projected returns rather than historic for all asset classes
  - Similar to the largest U.S. endowments
- **Investment Process**: combine active and passive management in traditional asset classes; complement with diversifying strategies/ alternatives
- **Conviction**: we believe in our approach – this is how we invest our own money

Past performance is no guarantee of future results. Investing entails risk, including possible loss of some or all principal. Historical performance results for investment indices and/or categories have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges. It should not be assumed that your account holdings correspond directly to any comparative indices.

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