BAKER BOYER

QUARTERLY UPDATE

NEWSLETTER

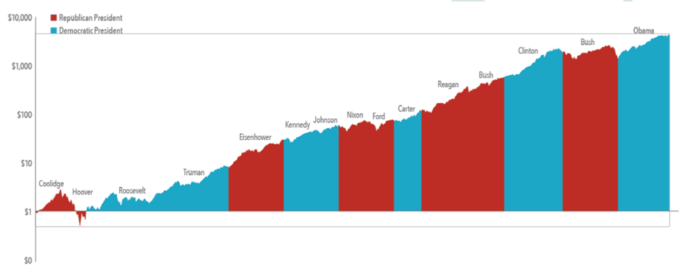
ELECTIONS AND MARKETS

What will be the impact of this November's elections on markets? This has been by far the most common question from our clients in the last few months. While the issues are increasingly complex in a globally connected world, the good news is we think the answer to the question is relatively simple. More on that in a moment.

Elections are binary events that are well telegraphed, much hyped, and the outcomes for which have the potential to shape fiscal policy for the next several years. Because of this, there tends to be a natural anxiety about them, especially in presidential election years. What's interesting is that when you look at the data behind politics and markets there is a fairly clear conclusion to draw. You may assume that conclusion is that Republican-controlled government makes for a better return environment for businesses, and ultimately markets. If you do, you would be incorrect. And the opposite isn't true either. The clear conclusion I mentioned is that for markets, election results don't actually matter. Regardless of which political party controls congress or the white house, markets have marched higher. In fact, there is no statistical significance to market return patterns and any combination of political party makeup between congress and the president. This isn't to say that elections don't matter – they very much do matter to our everyday lives, just not to long-term investment results.

But how can that be? If the Republican Party has a reputation for being pro-business and the Democratic Party has a reputation for raising taxes to fund spending programs, how can it be that Republican-controlled government does not translate to better returns in markets? We think the most plausible explanation is that a distinction needs to be made between the government policies of a capitalistic society and capitalism itself. In other words, no matter what behavior government policy attempts to dictate, companies adjust and eventually find the most efficient ways to maximize their business. For this reason, while the perception of 'Republican = good for markets' and 'Democrat = bad for markets' will likely not change, the reality is that neither has a material impact over the long run. This isn't opinion; it is supported by the data. Consider the following chart showing market movements during different presidential administrations:

Growth of a Dollar Invested in the S&P 500, January 1926-June 2016



Source: Dimensional Fund Advisors. Past performance is not a guarantee of future results. Indices are not available for direct investment. The S&P data is provided by Standard & Poor's Index Services Group.

Part of what people are really asking is more of a short-term question. What are markets going to do if the winner is Clinton vs. Trump? The data shows the answer to that question is just as difficult to predict. Below you see market movements in two time periods, (1) from the day before the election to the day after (in the outlined circles) and (2) from the day before the election to a year later (in the solid circles). Blue represents years when Democrats were elected and red represents years when Republicans were elected.

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AN IMPORTANT FIDUCIARY RULE CHANGE

I was having a conversation with my colleagues the other day and remarked that it is not often in our lives that we can actually say that a change in regulation is actually interesting. Most regulations, while intended to benefit us, take a fairly circuitous, often unintelligible, route to get there, if they ever do. So, in light of that, in the spirit of full disclosure, I hereby declare to all of you that we are about to discuss financial regulations. However, before you trade this article for the sports section of the paper, I ask that you give me a chance to tell you about a change in regulation that is thought-provoking, and may have a dramatic effect on how many firms invest their client's hard earned money in the future. I hope I have piqued your interest…

If you have been reading the financial news in the last six months or so you likely have seen that there have been significant developments in the Department of Labor's (DOL) rules on fiduciary investing for accounts governed by ERISA. ERISA (Employee Retirement Income Security Act), includes any retirement plan, including many types of IRAs (Individual Retirement Accounts). So if you have a retirement account governed by ERISA, this development may affect those accounts, depending on how they are managed. In this article, I will cover what it means to be a fiduciary, how the mechanics of the rule will change how retirement advice is provided and lastly Baker Boyer's stance regarding the fiduciary rule.

Having a fiduciary duty means that you are legally obligated to act in the best interest of another. In our Asset Management and Trust group and through our advisory investment accounts with D.S. Baker Investments, we have operated under this standard for almost 100 years. While it seems obvious that your investment advisor would be required to act in your best interest, there is actually another standard that has governed the brokerage industry for decades. The suitability standard used in the brokerage industry is based on the idea that a broker only must have a reasonable basis to believe that an investment recommendation is "suitable" for the client. This is a more lax standard than the "best interests" standard and make it more difficult to hold brokers accountable for investment recommendations they make to clients. For example, if a tailor was subject to the suitability standard he would only be obligated to tell you if the suit you tried on fit or not. If he had to operate under a fiduciary standard, not only would he have to tell you that it fit, but would be required to make sure that it looked good, was in style, and that you could afford the suit on your budget. While the tailor under the suitability standard might not be doing anything patently wrong by selling you a suit that fit, wouldn't it be better for you if they made sure that the suit is right for you and appropriate for what you are trying to accomplish? That is the difference between the suitability standard and the fiduciary standard adhered to by Baker Boyer long before the DOL required it.

The impetus for the DOL requiring the fiduciary standard for investment advice on retirement plans is that they have grown increasingly concerned with the manner in which investment advice is provided to retirees, who are arguably the most vulnerable to bad advice. According to Investment Company Institute, retirement assets in the United States totaled $24.1 trillion in the first quarter of 2016. Those assets constitute a growing percentage of Americans' total net worth and it is imperative that the advice given to those current and future retirees is thoughtful and prudent. On this, Baker Boyer and the DOL agree wholeheartedly.

Although the details of the new DOL regulations are numerous, the intended effects are fairly straightforward. The implementation of the fiduciary standard on retirement plans will not only require that advice given by investment advisors is in the best interest of the client, but will ensure that fees are disclosed and transparent and that if an advisor is compensated by commission that they sign a separate contract stating that they will act in the best interest of their clients to mitigate the conflict of interest inherent in that kind of compensation. The regulations will also protect the client by providing that clients can no longer be forced to waive their legal rights to bring suit against an advisor that fails to honor its fiduciary obligations. In short, the DOL regulations are designed to protect clients from bad actors, and have changed the standard by which an advisor's actions and advice will be judged in the retirement plan industry.

It is our opinion that this is a good development for retirees and for financial institutions like Baker Boyer. Putting our clients' best interest first has always been at the heart of what we do. While other institutions are scrambling to comply with the new rule, Baker Boyer has been ahead of the curve for decades. We will continue to monitor the implementation of the rule and can only hope the same standard is eventually adopted by more regulatory agencies to insure that all investment advice, not just retirement accounts, is subject to the fiduciary standard. Whether or not this discussion of regulations has been interesting I leave to your judgment, but the fact that it is an important development that benefits investors, especially those who are most vulnerable, is a certainty.

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INTRODUCING D.S. BAKER UNIVERSITY

An often overlooked fact by business schools, the media and many Americans is that the success of our nation's economy is largely based on the success of family businesses. You might be surprised to learn that there are less than 4,000 public companies in the United States and that total is declining annually. The hundreds of thousands of other businesses in our country are the growing number of private companies, with the bulk of those family owned.

This is especially true in Eastern Washington where family farms are so vital, but it permeates throughout our local economy with businesses like car dealers, funeral homes, wineries and so many other industries. The jobs (for both family and employee), philanthropy and services provided make Walla Walla, Yakima and Tri-Cities the thriving and sought after communities they are.

Though Baker Boyer has helped thousands of family businesses over the years, with the pace of change accelerating, the challenges of keeping these businesses successful and passing them on to future generations are tougher than ever.

Helping these families and companies succeed is something Baker Boyer has been passionate about for decades. Having led a division of my own 5th generation family business, I have significant training and personal experience with family business strengths, pitfalls and best practices.

Based on this emergent need, Baker Boyer has placed an increased focus on helping our family business clients. This past June we launched an exciting new educational initiative called DS Baker University, with the inaugural session held June 3rd, which focused on Family Business Continuity and Success for local family businesses. Other sessions of DS Baker University will begin this fall and focus on key areas of financial and life planning for all of our clients.

The June 3rd session was facilitated by renowned family business expert and Northwestern's Kellogg Graduate School of Management Professor, Ivan Lansberg. We had representation from nearly twenty local families, including both junior and senior generations. The primary focus was to give these families the tools to create action plans to address the real issues facing each family/business in the coming months/years.

We learned from Professor Lansberg that the primary reasons for the success of family businesses and their longer lifespans over public companies comes down to four strategic advantages:

1. Long-term perspective with their business strategy involving their children and their children's children.
2. Concern for quality because their name is on the door.
3. Sweat equity from family members working in the business who are literally often "cheap labor".
4. Accumulated experience of all involved (both family and non-family) helps with running the business and with serving clients.

The biggest take-away from the seminar was that while all families are unique, many of the issues and challenges facing them apply to all family businesses. The majority of these have nothing to do with the actual industry or daily operation of the business. More common are the human or more right brained type of family issues involving things like perceptions, expectations, history, spouses, etc.

All family businesses have challenges related to family dynamics which are often "elephants in the room". The most important thing is to confront issues via developed processes and communication (and at times help from outside third parties to facilitate these). This is where Baker Boyer can offer help, through discussions with our experienced team of Family Advisors.

Looking more granularly, before issues become deep fracture points, we can help explore solutions based on best practices for areas like: family goals; work policies; spousal involvement policy; board selection; sharing of information; contingency planning; transition and succession planning; amd dividend policy.

Overall, the day was a tremendous success and we are pleased with the positive feedback we have received. Much of that was thanks to the thoughtful discussion and participation from everyone involved.

Baker Boyer is committed to helping local families manage assets to build local legacies. If we can be of assistance in facilitating discussions please let us know.

Finally, look for additional D.S. Baker University sessions continuing next spring. As this newsletter goes to print, we have just completed our October session which addresses the following topics: when to utilize a trust, how to increase the value of your business and how to deal with issues related to wealth and financial planning. If you missed the October session, we invite you to call us or visit our website for more information on upcoming D.S. Baker University sessions. We believe financial education is a significant part of our commitment to the communities we serve. We also welcome any comments, questions or suggestions you have.

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The above article is an abridged version. For complete article, please visit bakerboyer.com.

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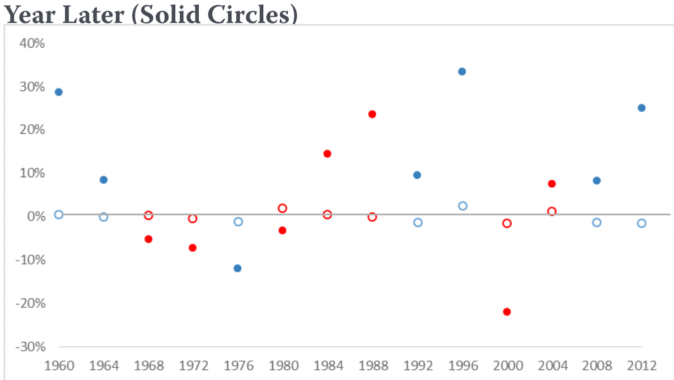
S&P 500 Returns a Day Later (Outlined Circles) and a Year Later (Solid Circles)



Sources: Yahoo Finance, Standard & Poors, Baker Boyer Bank

Sometimes markets moved nearly 2% from the day before to the day after, but more often it was 0% to 1% to the positive or negative. A year following elections markets moved to a much larger degree, both positive and negative, but neither with any statistical conclusion.

Here's the most important thing we need to remember about markets. They respond to uncertainty. When there is increased uncertainty and the news is generally more negative, markets tend to suffer, at least in the short run. When the news is generally more positive, markets tend to rise. To the extent market participants expect a certain election result and that result materializes, the election ends up being less impactful to markets. In this election, based on all polling and betting organizations thus far, expectations are that Clinton will prevail. If that result materializes, we can reasonably expect it has already been priced-in to the markets and any disruption that does occur will be short-lived.

So what do we do about investment portfolios knowing what we know about elections and markets? If we could make accurate investment predictions given upcoming events like elections, we would do it, but markets prove time and again it is not sustainable to do so. Instead, the investment plans we create for clients have much more to do with unique circumstances like their income streams, spending habits, financial wishes and legacy plans. We help clients to make one decision – how much should we put into growth investments vs. stable investments? Then we manage the risks accordingly. And we do it this way because the research on the topic of market timing combined with our own extensive experience overwhelmingly proves that this approach gives clients the best odds for a successful long-term investment experience. And that success for our clients, quite simply, is the driving force behind every decision we make as an investment team.

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