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"Don't underestimate the value of doing nothing, of just going along
Listening to all the things you cannot hear and not bothering…"

A.A. Milne aka Winnie the Pooh, circa 1924

Dear Friends,

So, it has come to this…using the musings of a fictional bear as a metaphor for investment policy. If you are not alarmed, maybe you should be. But perhaps your writer has five grandchildren, all of whom love to read. And maybe great prose is just that. Great prose. Truth be told, simply doing nothing, holding the good assets you own and just going along while listening to all the things you cannot hear can actually be a quite effective investment strategy. Thanks Winnie!

Nothing Succeeds Like Excess

The most remarkable aspect of the 19% run-up the S&P 500 enjoyed last year was how peaceful it was. Wall Street has a measure for this, it's called volatility or in this case lack thereof. Numerically we have gone **438** days without a sell-off of 3% or more, the longest ever in the 65-year history of the index. The former record was set in 1995 at 388 days. Which begs the question, why?

Our best guess is that it's not just one thing. Great booms tend to have more than one impetus going for them. The past couple of years have seen a tremendous resurgence in technological innovation. Some pretty amazing stuff like self driving cars, *devices* which can tell us almost anything you want to know for $89, and this old man's favorite, a wrist watch blessed with artificial intelligence that can warn of a possibility of a heart attack, either are or are soon-to-be a part of our daily lives. As in, hop in the self-driving car and tell Siri to get thee to the ER. (It's only a matter of time before she can diagnose us, too.) Investment implications? Stocks like Apple, Intel, Micron and First Data, companies in which we have been invested and others like Netflix, Facebook, Amazon and Tesla, which did not meet our value bias, have all produced significant gains over the past 438 days. Let's call this the New, New Effect on stocks.

A second characteristic of the past 18 months that has significantly helped to boost stocks is our old friend TINA (as in, There Is No Alternative to stocks) about which we have written to you previously. If you are blessed with significant savings and have traditionally placed a meaningful portion of them in CDs and bonds, the Federal Reserve has made you pay dearly in the form of interest rates that began with a decimal point as opposed to a numeral. As in 0.75% instead of 2.75%. After nine years of yield starvation, while stocks were steadily rising, having *no alternative* eventually seemed like a good idea.

Congress managed to get a significant piece of legislation passed relating to taxes with the greatest beneficiary being corporations. The top rate fell from 35% to 21%. Not surprisingly, the stock market reacted with much enthusiasm. Peel the onion back a bit and a few issues come to light. First, most… not all, but most corporations had an effective tax rate well below 35%. We frequently see 25% mentioned in the media. Secondly, it is important to recognize that control of the White House and Congress has seldom been more tentative. What one Congress giveth can be taken away by the next. In other words, the *quality of earnings* that will come about as a result of the statutory changes in corporate tax rates is hardly the same as one which was derived from selling more widgets at improving prices.

We've saved the best for last: *Bitcoin / cryptocurrencies*. Partner Chris Klavins has penned an insightful piece on this tremendously volatile cryptocurrency phenom in his *Thoughts From Outside the Corner Office,* which is attached.

The Problem With Booms

They end. Often badly. We would prefer not to participate.

Déjà Vu All Over Again

In early 2000 with the S&P selling above 1500 we became concerned about the type of excesses to which we have just subjected you. At the time, we felt like the airline pilot who announced to his passengers, "We are lost but we're making good time." Hardly confidence inducing.

We made a decision to sell everything remotely connected with technology along with a few companies which were just richly priced in relation to earnings. We used the proceeds to buy short-term bonds (for comparison purposes, the two-year Treasury was yielding 5½%) and old economy stocks which were trading cheaply to earnings and sporting sparkling dividends. Many of you may recall the experience. Five months later the S&P peaked at 1527 and subsequently declined to 800 by October of 2002. Our accounts were generally up over 10% in 2000 and comparably up again in 2001. It was the greatest period of out-performance in the over 20-year history of our partnership. The set of metrics we are looking at today is not as extended as 18 years ago. In fact, we believe the most dangerous sector of the marketplace may be the bond market. If in two years the 30-year Treasury bond, which is now trading at par ($1,000 a bond) to yield 2.75%, is priced to yield 4.5%, its price per bond will be $723.75, a decline of 26%. Ouch!

It's The Economy, Stupid

This is the part of the Letter in which we try and pick you up after complaining about all of the things which make us grouchy. It's worth remembering that well prior to the recent attempts by Congress to stimulate the economy through cutting corporate and personal taxes, economic statistics were evidencing signs of Spring. Unemployment is approaching record lows, capital spending by corporations is accelerating, houses are selling quickly at record prices and figures on holiday sales are coming in above expectations. Paccar and Freightliner are selling trucks as fast as they can make them. On a macroeconomic level, GDP estimates are being raised left and right. Hundreds of billions of dollars are on their way home from overseas. RBC analysts are busily raising estimates for corporate earnings both because tax rates are down and because their estimates for sales in 2018 and beyond are going up. In the event the stock market is out over its skis as we expect it is, a growing economy will certainly be useful in lessening risks associated with investing in one of the most expensive stock markets we have experienced in many years. History is littered with mini-bear markets which occurred in the absence of a recession. It's hard to imagine there are better circumstances than stock prices being meaningfully down and the economy up in which to put money to work.

20/20 Foresight

Time will obviously tell how insightful these observations are, or should we say, were. You all have been tremendously patient with the increasingly cautious asset allocation we have been building. Relative safety obviously comes at a price, both with regard to the proportion of short-term bonds held and also to owning stocks with a less risky profile. The last couple of years throwing caution to the wind and buying high flying growth stocks would have been a more rewarding strategy. But, fortunately for all concerned we had some fine successes in 2017, particularly in the area of banks, large cap technology and more recently the growing rebound in energy on the back of $64 a barrel oil. Looking ahead, we remain on the prowl for bargains and hope that a correction in stocks will afford us the opportunity to add meaningfully to our holdings in stocks such as GE in the $16-$17 range down from $32 less than a year ago. GE owns some fine assets that were poorly managed and over leveraged. Both issues are being addressed. A new name for us is thinly traded Baldwin and Lyons, an insurer to the commercial transportation industry. Boxes sporting the Amazon logo have to be moved and the trucks moving them have to be insured. Patience and price discipline will be required to build a position here. This puts us in the same camp as Warren Buffett who is patiently sitting on over $100 billion in cash waiting for the stock market to go down. At least we have fine company here on the bench.

Enclosed please find a copy of your account reviews for the past year and earlier time periods. The format is new but the relevant statistics are all there. Please give us a call as you start to review the data and we will be pleased to help walk you through the materials. Our not-so-new-anymore associate Sam Manafi is the preparer-in-chief of the reviews and is also available to answer your questions. His direct line is 503-833-5231.

Please accept our best wishes for a Happy and Prosperous New Year.

Best regards,

Steven N. Spence	Marcia M. Hull	Christopher Klavins
Senior Vice President	First Vice President	First Vice President
Senior Portfolio Manager-Focus	Senior Portfolio Manager-Focus	Senior Portfolio Manager-Focus
Financial Advisor	Financial Advisor	Financial Advisor

The Klavins Report – Thoughts From Outside the Corner Office (*January 8, 2018*)

If you attended any cocktail parties over the holidays, only a couple of topics generated more excitement than a fresh platter of bacon-wrapped shrimp. No – not Hatchimals (look it up!)…cryptocurrencies.

The backdrop: Lots of money has been made, stirring dreams of crypto-riches. Some remarkable price moves have captured the imagination of investors. For example, Bitcoin, the oldest and largest cryptocurrency, started 2017 at about $970, rose to nearly $20,000 by December, and closed the year around $14,000, for a current "market cap" of about $240 billion. As a result, we are fielding questions from clients as to what we think of this phenomenon and its investment merits. While we at Spence Partners do not purport to be experts on this topic, we'll offer up our brief thoughts for your consideration.

Are cryptocurrencies an investment? Our Answer: No. By our definition investments produce or have the potential to produce a stream of earnings. We make assumptions about the future growth of said stream, and through wizardry come up with an idea (hopefully rational) as to what a company might be worth in the future. This process is what helps us to feel comfortable putting your capital to work. Cryptocurrencies generate no earnings. Once "mined," they simply exist, like a lump of coal. As such, there is no rational way we can infer a valuation.

What about the notion that certain cryptocurrencies, like Bitcoin, have limited supply? That may be true in some cases, but not all, and there is no limit to the number of cryptocurrencies. www.investing.com lists no fewer than 1,375 different cryptocurrencies already. In a December 14, 2017, Wall Street Journal article titled "Bitcoin: A Mania, Not a Currency," Greg Ip notes that, *"The surge also undermines the argument that a cryptocurrency's limited issuance protects it from inflation-prone governments. As the number of currencies grows, each becomes the digital equivalent of a limited-edition commemorative plate."*

Should cryptocurrencies be thought of as currencies (units of exchange) at all? Our answer: It's a tough sell. In another gem from the aforementioned article by Greg Ip, he writes that *"Currencies aren't supposed to have any intrinsic value other than the goods or services they can buy some time in the future."* He goes on to note that *"Consumers hold dollars and businesses accept them because their purchasing power doesn't change much. That isn't true of Bitcoin: It has moved an average of 3% a day since 2012."* We agree with this view. Producers of goods and services want to know what they're getting in exchange for their wares. On down days Bitcoin volatility could easily wipe out the profits of many businesses. It is the same reason most businesses do not accept shares of common stock as payment…too much volatility and too many "currencies."

Other points of concern:

- Digital wallets could be hacked.
- Regulation is nascent to non-existent. What, if any, investor protections exist?
- Governments are keen to control the money supply and fiat currencies, in addition to regulating and having visibility with regard to transfer of funds (has implications for taxation, money laundering, terrorist financing, cross-border capital flows, etc.). More government involvement and regulation may have a chilling effect, to say nothing about the possibility of an outright ban.

The future…

Our goal herein is not to say money can't be made in trading cryptocurrencies. It clearly can, but we believe that buying these currencies, coins, or tokens is more akin to pure speculation than investing. We therefore choose not to play. Separate and distinct from cryptocurrencies is the underlying technology, known as blockchain. Blockchain may indeed be revolutionary as a way to record transactions or execute certain types of contracts. While we have a feeling that blockchain will be important over time, we think its business effects will be incremental. Final note…over the long term it may be that a few cryptocurrencies have staying power because of blockchain, but which ones and what they will be worth in dollars, our favorite store of value, is beyond our powers of soothsaying.

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