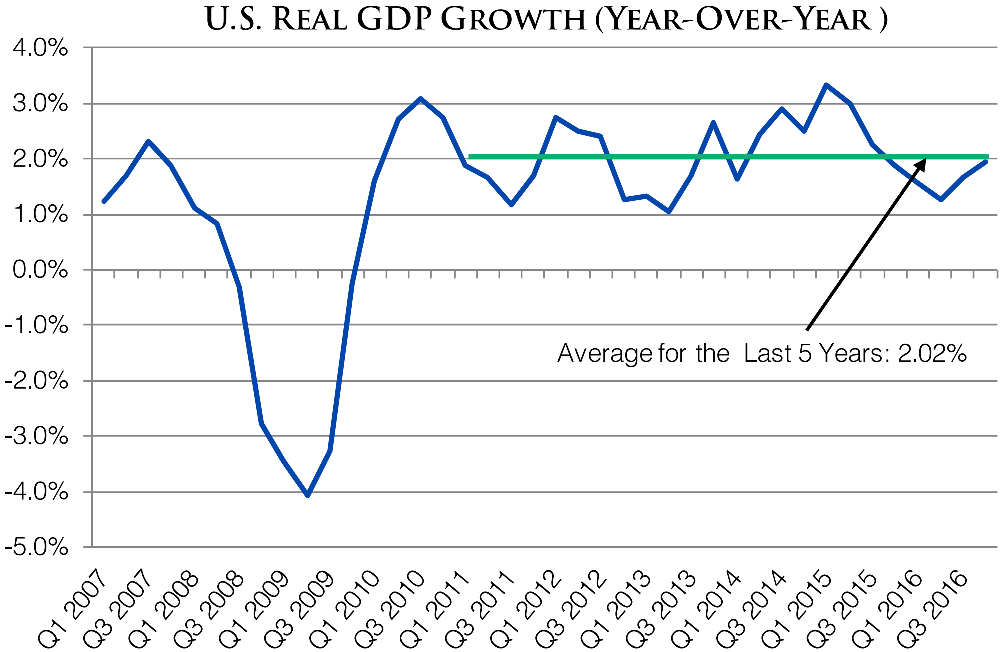
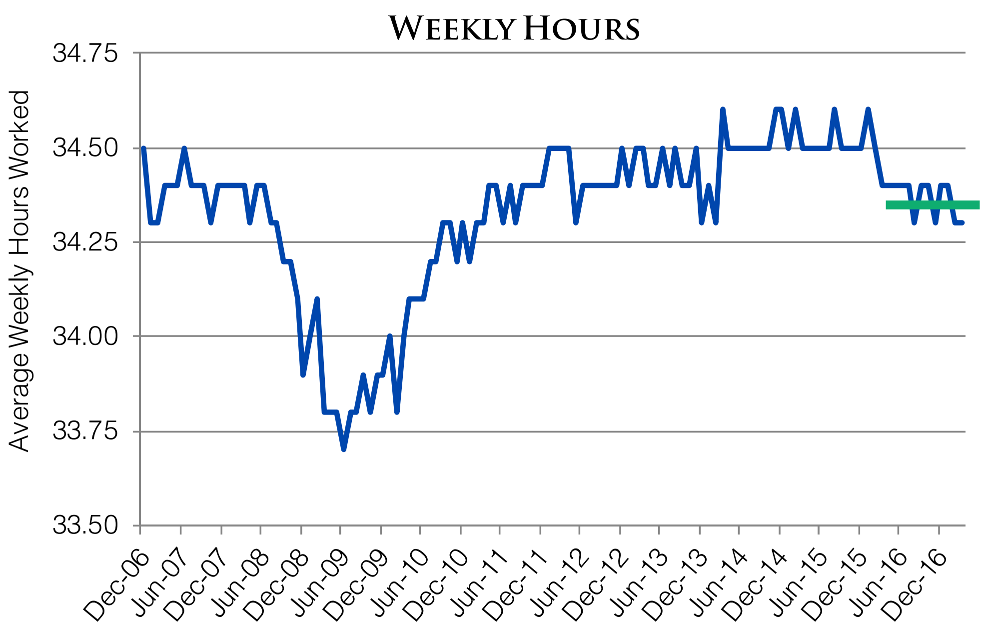
WestEnd Advisors

Macroeconomic Highlights

Growth Trends Persist as Political Winds Swirl



Source: Bureau of Economic Analysis, WestEnd Advisors



Source: Bureau of Labor Statistics, WestEnd Advisors

U.S. real GDP grew at a 2.1% annualized pace in Q4 2016 and grew just 1.6% for the full year 2016.

U.S. GDP growth has averaged about 2% over the last 5 years. While we expect that the Republican's pro-growth policies are likely to extend this period of moderate growth, we don't expect that the U.S. economy is poised to accelerate in a sustained fashion.

Many consumer and business sentiment indicators have risen after election, but the "hard" data has not improved to the same degree.

Weekly hours worked, for example, is a broad-based measure of activity across the U.S. economy. The bottom chart indicates that weekly hours shifted lower in the first half of 2016 and have remained at that level following the election and into 2017.

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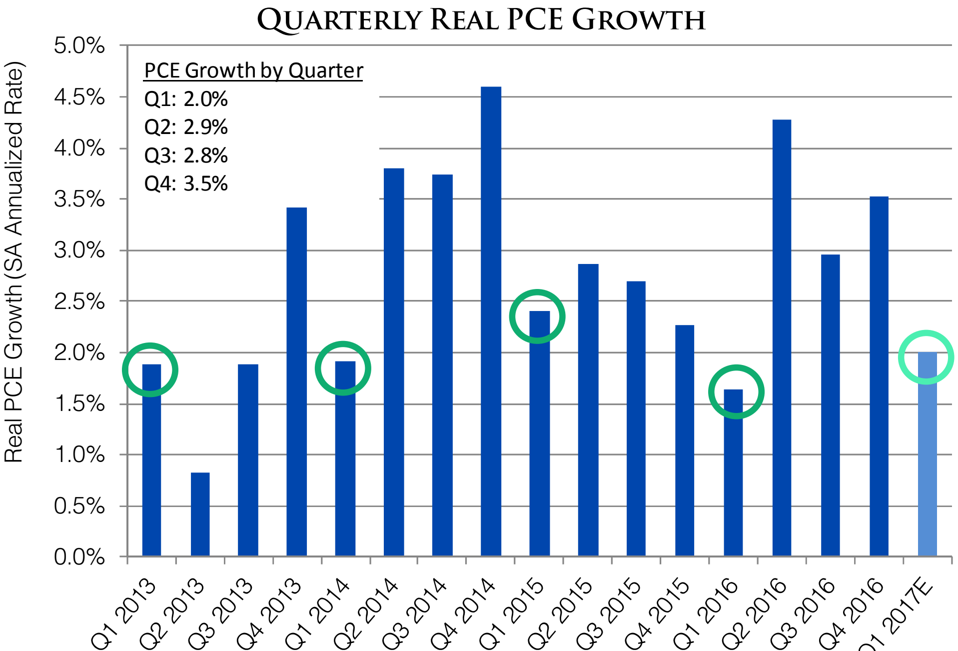
Variability within Moderate U.S. Growth



Source: Bureau of Economic Analysis, WestEnd Advisors

Source U.S. Commerce Department, WestEnd Advisors

Q1 2017 U.S. GDP growth is expected to be below the growth achieved in Q4 of last year. This follows a pattern of weaker Q1 GDP growth in recent years.

Softer personal consumption expenditures (PCE) readings in Q1 have been a driver of the slow down in Q1 GDP growth over the past few years. In fact, Q1 PCE growth has averaged 2.0% over the last four Q1s compared to an average of 3.1% for the other 3 quarters of those years.

We expected slower consumer spending growth in Q1 2017. However, given the pattern of weaker Q1 growth mentioned above, as well as positive data like healthy personal income growth and low layoffs, we continue to expect steady consumer spending growth for the remainder of 2017.

While consumer spending data was soft in Q1, manufacturing data, including durable goods orders, have improved. This improvement is tied in part to more business investment by energy companies. Even after this pickup, the dollar value of durable goods orders is still well below levels seen three years ago. Ongoing headwinds in the Energy Sector together with modest global growth overall point to continued challenges for manufacturing-oriented businesses.

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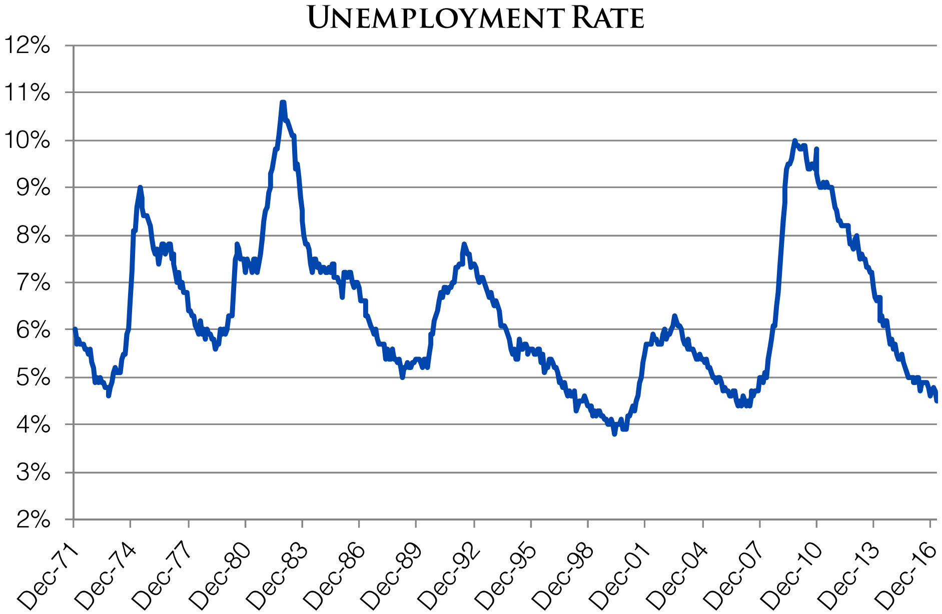
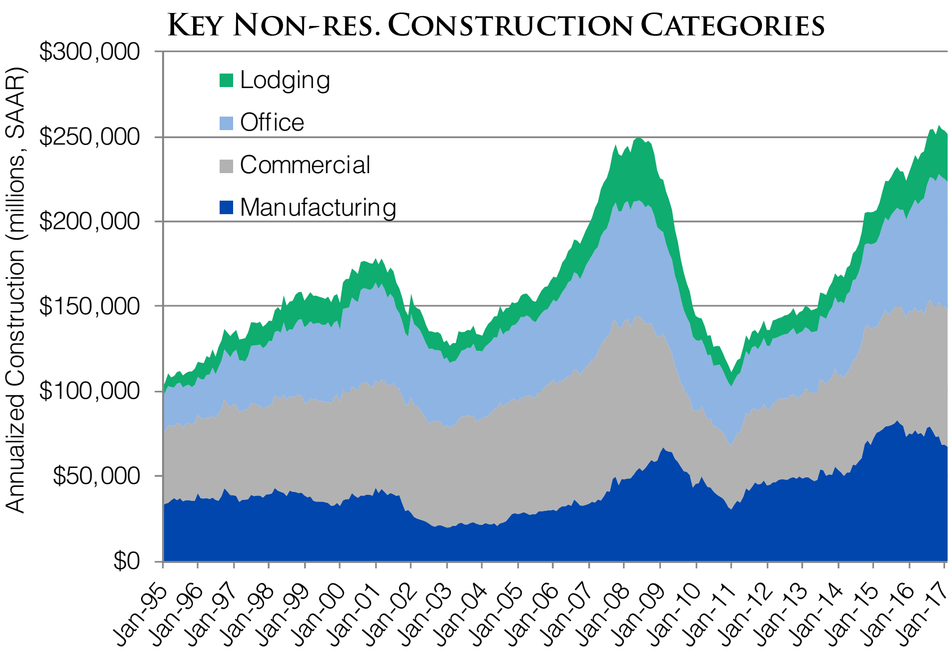
Economic Progress Leaves Less Growth Upside



Source: Bureau of Labor Statistics, WestEnd Advisors



Source U.S. Commerce Department, WestEnd Advisors

In the immediate wake of the November 2016 election, investors focused on the potential positive impacts of tax cuts, reduced regulatory burden, and other fiscal stimulus under the new administration. Only recently, however, have investors given significant attention to the challenges of getting these initiatives done, and the timing of policy implementation if they do get enacted.

In addition, the impact of these pro-growth policies is likely limited by the progress that has already been made in the current economic expansion following years of slow, but steady, economic gains.

Signs that remaining cyclical fuel is limited include the maturing of the labor market and strong gains in nonresidential construction. The unemployment rate is 4.5% and very near past cyclical lows. Similarly, nonresidential construction, which has seen strong 21% and 14% growth, respectively, in the cyclical office and lodging subcategories, is back to its pre-financial crisis peak.

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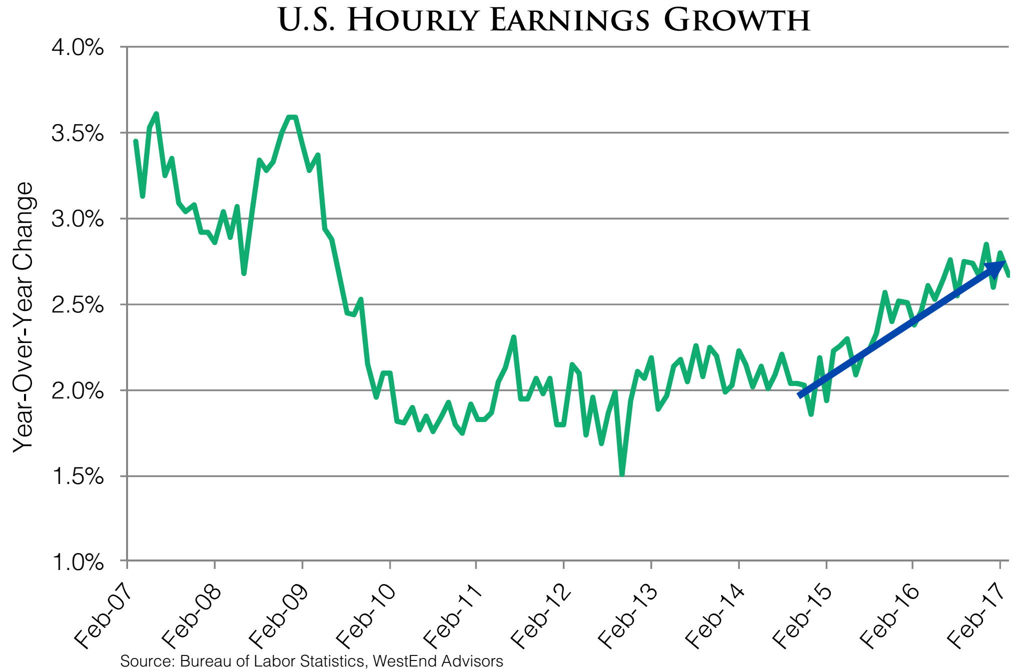
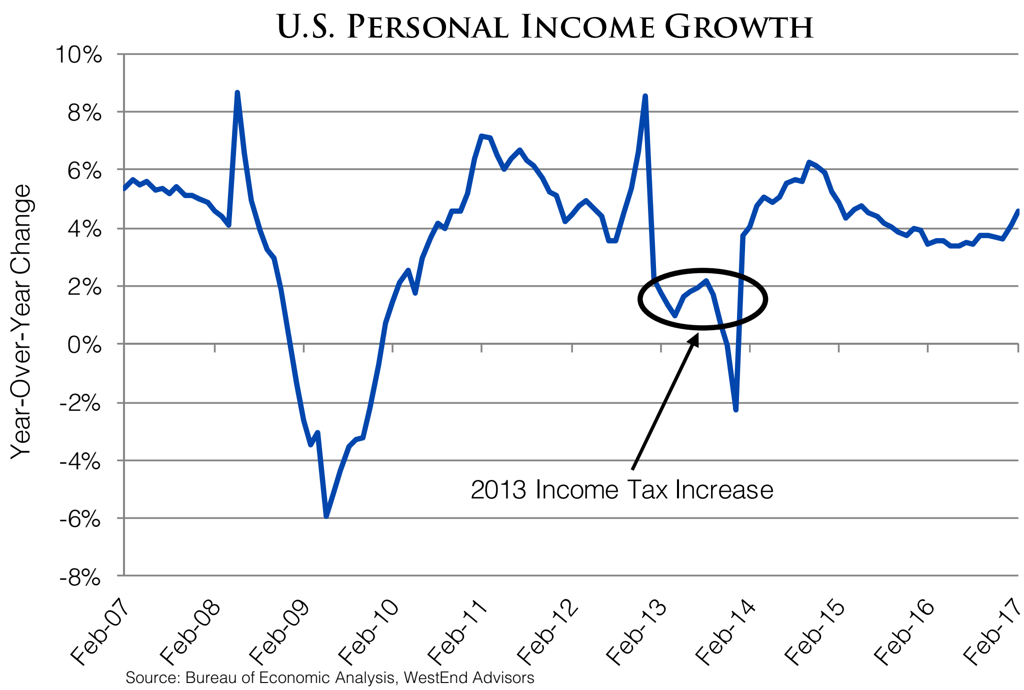
Personal Income Gains Remain Healthy





The pace of workers' hourly earnings gains moved higher in recent years, while at the same time the size of monthly payroll additions shifted lower.

After averaging near 2% per annum from 2011 to 2014, year-over-year hourly earnings growth has moved up 2.8% as of February 2017. In contrast, increases in monthly payrolls averaged 250,000 in 2014, but slipped to 226,000 in 2015, and then dropped to 187,000 in 2016.

The acceleration in hourly earnings growth kept overall personal income growth healthy even as payroll gains slowed in 2015 and 2016.

Nominal personal income growth was up 4.6% year-over-year as of February, and these strong gains helped produce a 4.8% increase in nominal consumer spending over the same twelve-month period.

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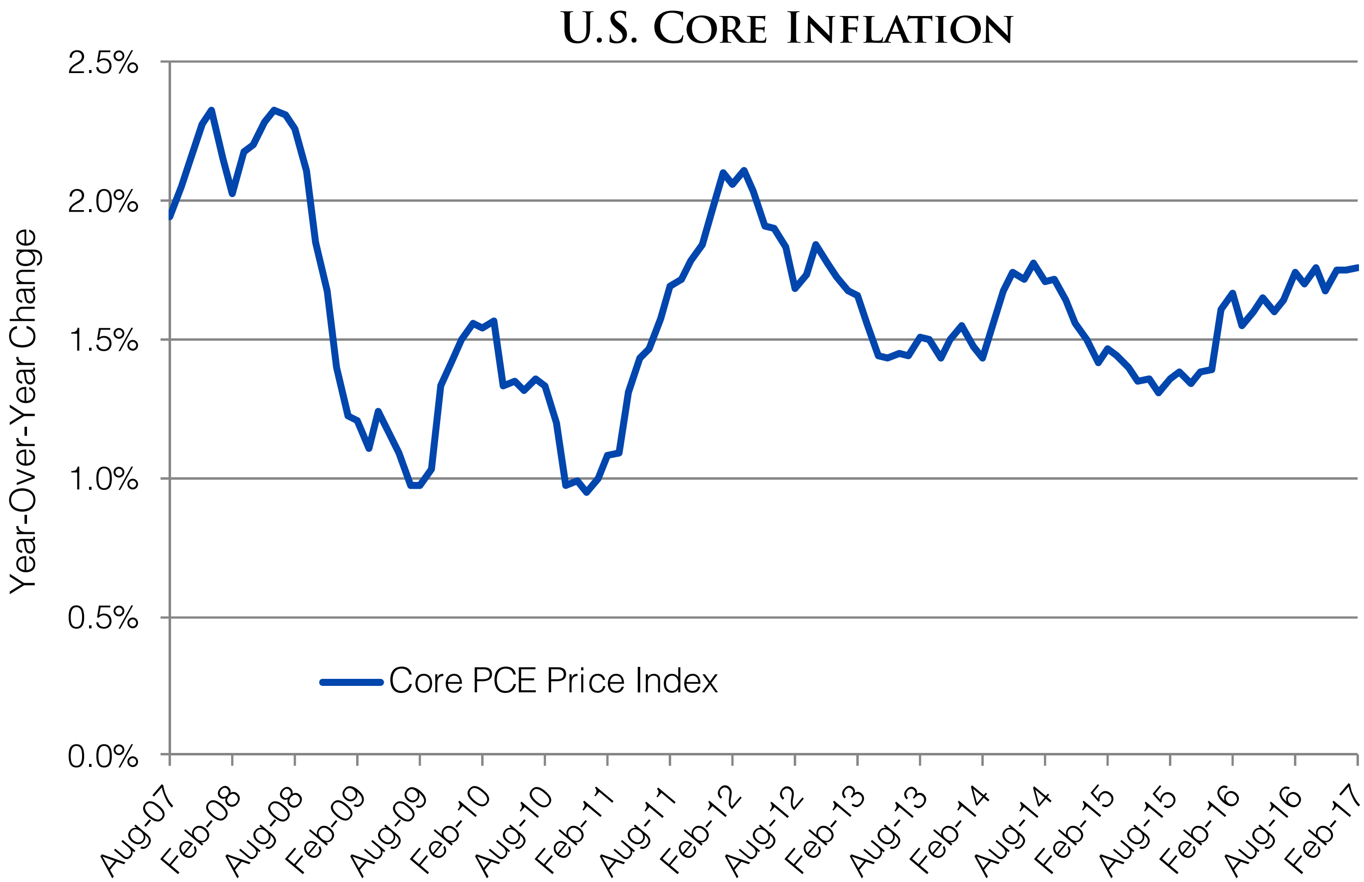
Core Consumer Inflation Moving Higher



Source: Bureau of Economic Analysis, WestEnd Advisors

Higher hourly earnings in the U.S. have supported personal income and spending growth, but increased wages also have implications for inflation. With less slack in the labor market and productivity gains low, higher employment expenses have the potential to push U.S. inflation even higher. The Core PCE Price Index, the Fed's preferred inflation measure, moved up from 1.4% at the end of 2015 to 1.8% as of February of this year.

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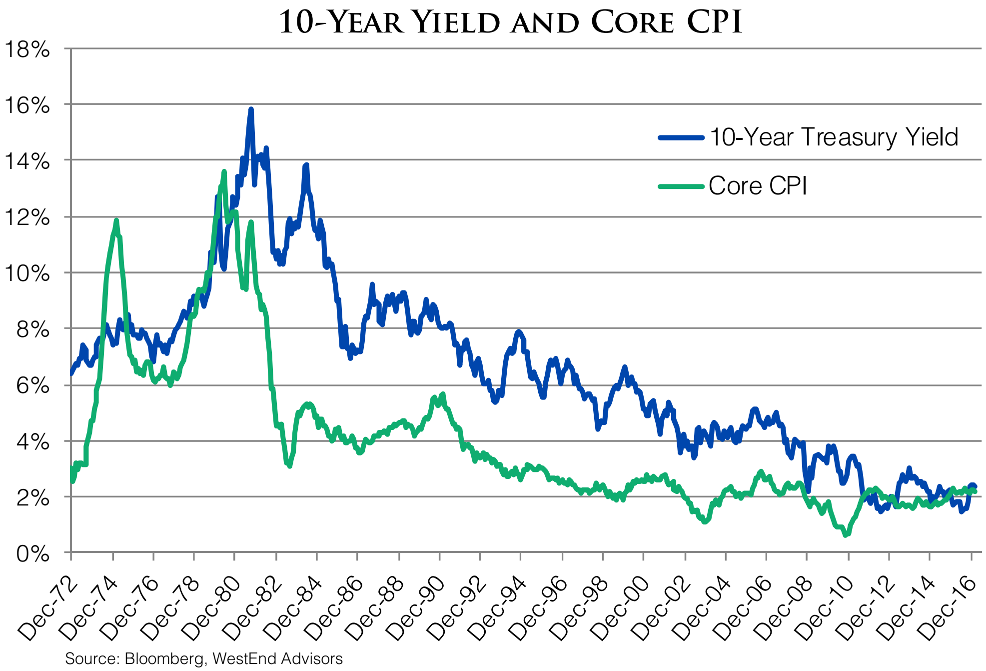
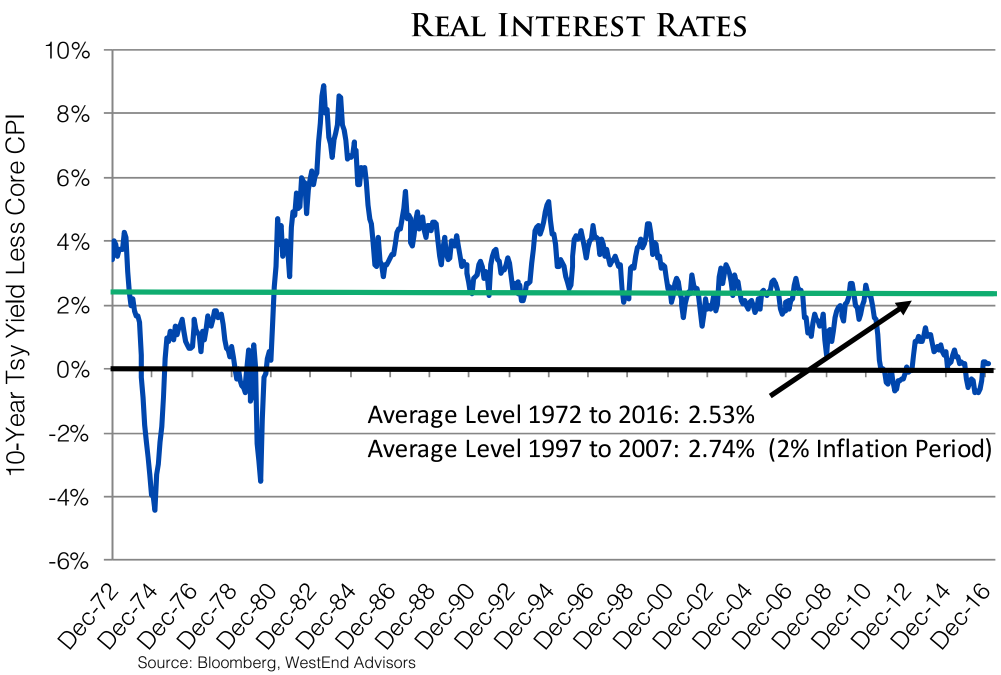
Real Interest Rates Turned Positive, But Are Still Well Below Normal





Real interest rates are nominal interest rates less inflation. Real interest rates, which compensate lenders for risks over and above inflation, have moved back into positive territory, but still have significant upside by historical standards. The bottom chart illustrates the current real interest rate is 0.2% compared to a long term average of 2.5%.

A tightening labor market, including a near-cyclical low in the unemployment rate, and the pickup in wage growth signal we are on a path to increased inflation.

Higher inflation is likely to put upward pressure on intermediate and long-term interest rates, while the Federal Reserve has signaled that it plans to continue pursuing short-term interest rate hikes in 2017.

Additionally, lower tax rates combined with increasing fiscal stimulus could widen the U.S. budget deficit, putting additional upward pressure on U.S. Treasury rates.

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Again, Investor Enthusiasm Moves Up More Than the Economic Reality

Regime Change: Monetary Policy - Quantitative Easing

Elevated Investor Enthusiasm

Q4 2010 to Q1 2011

2 Quarters

S&P 500 Sector	Return (%)
Energy	41.9
Materials	24.4
Industrials	21.6
Consumer Discretionary	17.9
Real Estate	17.7
Financials	15.0
Information Technology	14.1
Telecom	12.6
Health Care	9.5
Consumer Staples	8.8
Utilities	3.9

Reconcile with Economic Trends

Q2 2011 to Q1 2012

4 Quarters

S&P 500 Sector	Return (%)
Information Technology	20.2
Consumer Discretionary	17.5
Consumer Staples	17.3
Health Care	16.4
Utilities	14.8
Real Estate	8.3
Telecom	3.5
Industrials	1.7
Financials	-1.8
Materials	-4.0
Energy	-6.9

Regime Change: Political - Republican Takover

Elevated Investor Enthusiasm

Q4 2016

1 Quarter

S&P 500 Sector	Return (%)
Financials	21.1
Energy	7.3
Industrials	7.2
Telecom	4.8
Materials	4.7
Consumer Discretionary	2.3
Information Technology	1.2
Utilities	0.1
Consumer Staples	-2.0
Health Care	-4.0
Real Estate	-4.4

Reconcile with Economic Trends

Q1 2017 to Q? 20??

Number of Quarters?

S&P 500 Sector	Return (%)*
Information Technology	12.6
Consumer Discretionary	8.5
Health Care	8.4
Utilities	6.4
Consumer Staples	6.4
Materials	5.9
Industrials	4.6
Real Estate	3.5
Financials	2.5
Telecom	-4.0
Energy	-6.7

** Returns for Q1 2017 only.*

Source: Bloomberg, WestEnd Advisors

In late 2010 and early 2011, many investors perceived a new investing environment as the Fed launched a second round of quantitative easing (QE2). Investors weren't alone in thinking there would be a boost to economic activity. In January 2011, the Fed increased its GDP growth forecast for 2011 to a range of 3.4%-3.9%. The top-left table shows that most economically sensitive sectors led the market from Q4 2010 to Q1 2011.

In the quarters that followed, however, the Fed and investors reduced their expectations for growth. In fact, GDP growth in 2011 turned out to be just 1.6% and sector leadership shifted over the next four quarters. Reduced growth expectations, rather than full blown recession, resulted in technology, consumer and health care stocks leading the S&P 500 from Q2 2011 to Q1 2012.

We see parallels between the current situation and what transpired in 2011. Late last year, it wasn't a monetary policy regime change, but political regime change that boosted investor enthusiasm. We have started to see investors refocus on the economic realities of moderate growth in early 2017.

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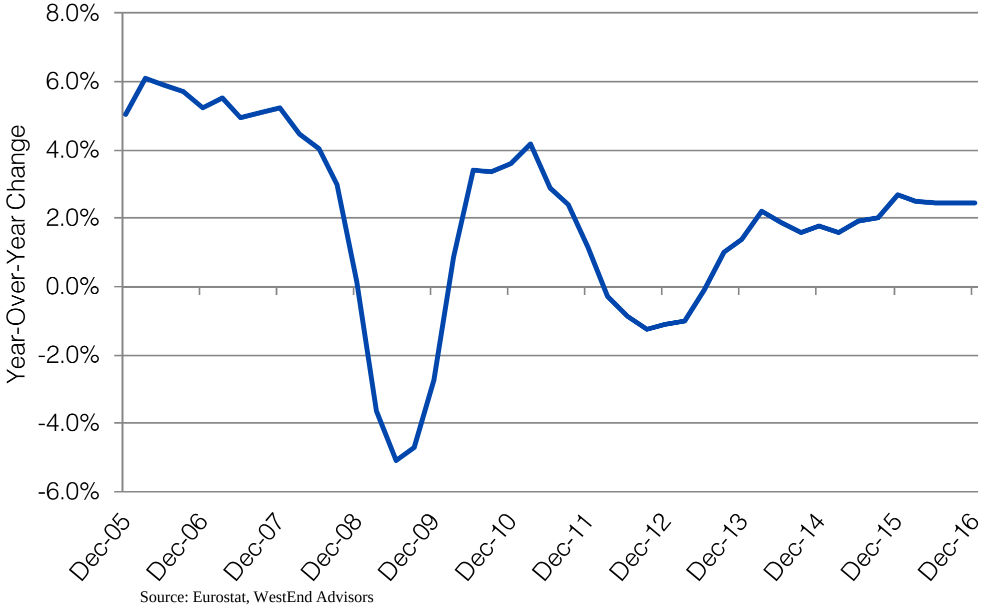
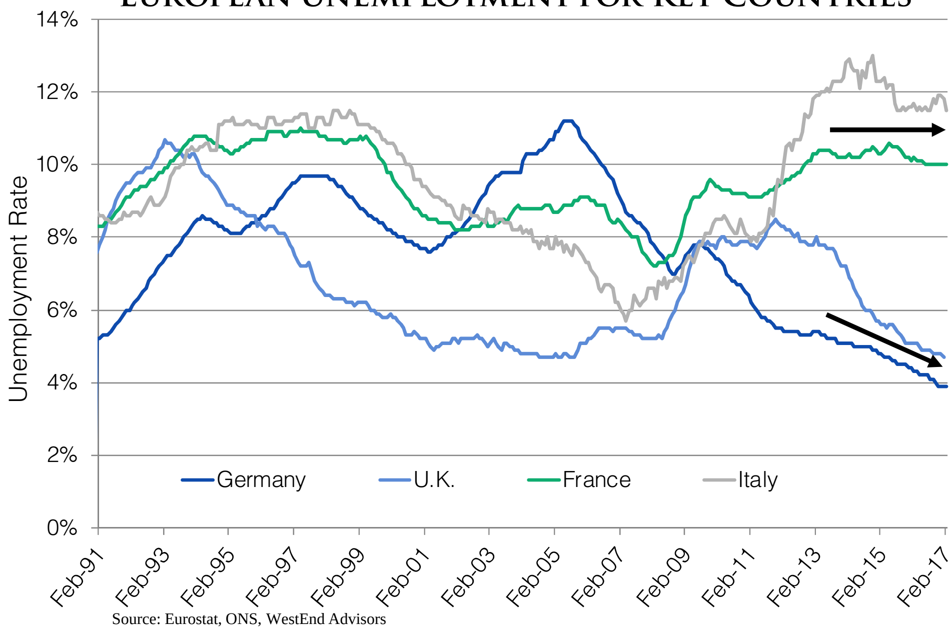
European Growth has Improved, But Structural Challenges and Cyclical Risks Remain





Euro Area real GDP growth was 1.7% in 2016. The improved GDP growth was driven by higher Domestic Demand, which includes consumer spending, investment, and government spending.

Investment, which declined in 2012 and 2013, was up 2.5% year-over-year as of Q4 2016. That gain, however, was the weakest annual increase for investment in eight quarters. Alternatively, Euro Area consumer spending growth (+2.5%) as of Q4 was the strongest annual gain since Q1 2011.

Nevertheless, some key European countries are not fully participating in the improved economic conditions. France and Italy, for example, have unemployment rates above 10%. These high unemployment rates point to the cyclical and structural challenges in each of these economies, even as Germany's and the U.K's unemployment rates are at all-time lows. In addition, the bottom chart illustrates how the unemployment rates in France and Italy are little changed over the last three years even as Euro Area economic growth has picked up.

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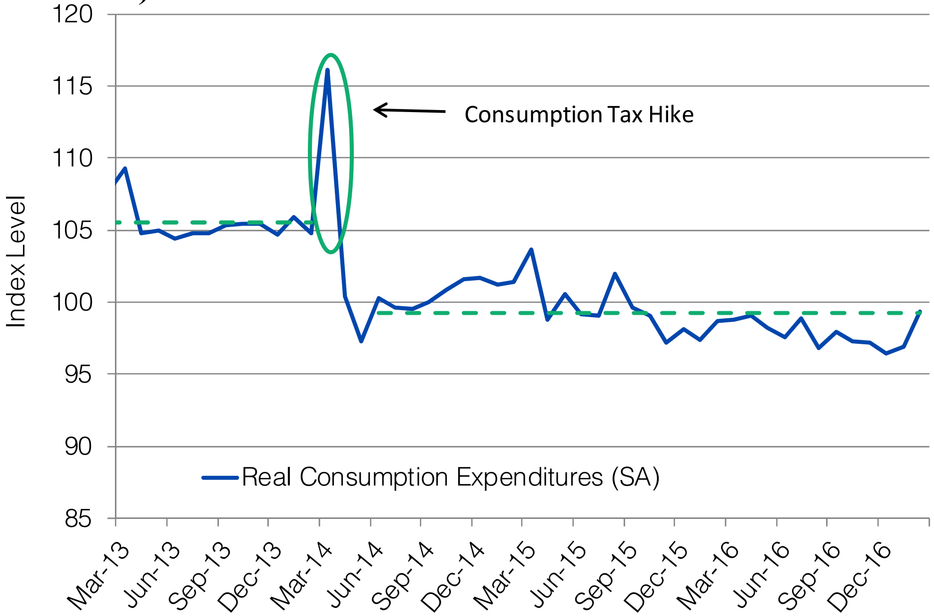
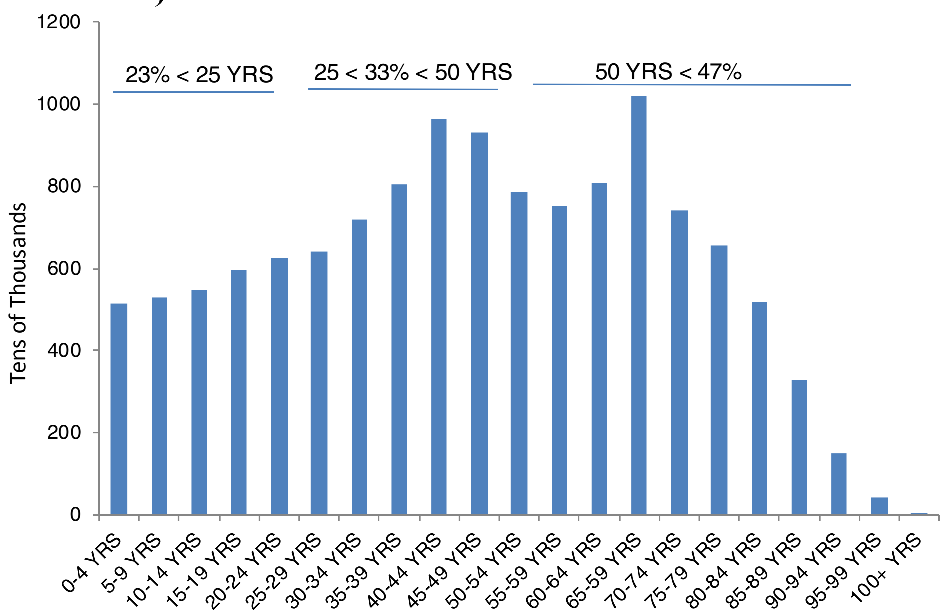
Japanese Consumers Continue to Struggle

Japanese Real Consumption Expenditures



Source: Statistics Bureau of Japan, WestEnd Advisors

Japan Population Age Distribution



Source: Statistics Bureau of Japan, WestEnd Advisors

Much like the U.S., over 50% of Japan's GDP is derived from private domestic consumption.

As illustrated in the top chart, real consumption expenditures have stepped down from the level seen prior to the April 2014 consumption tax hike.

With no end to this weakness in sight, Japanese officials have postponed additional consumption tax hikes in an attempt to spur domestic consumption.

At the same time, an aging population puts downward pressure on Japan's workforce, which also has contributed to weak domestic consumption. An additional structural challenge is that older citizens have a higher propensity to save than their younger peers.

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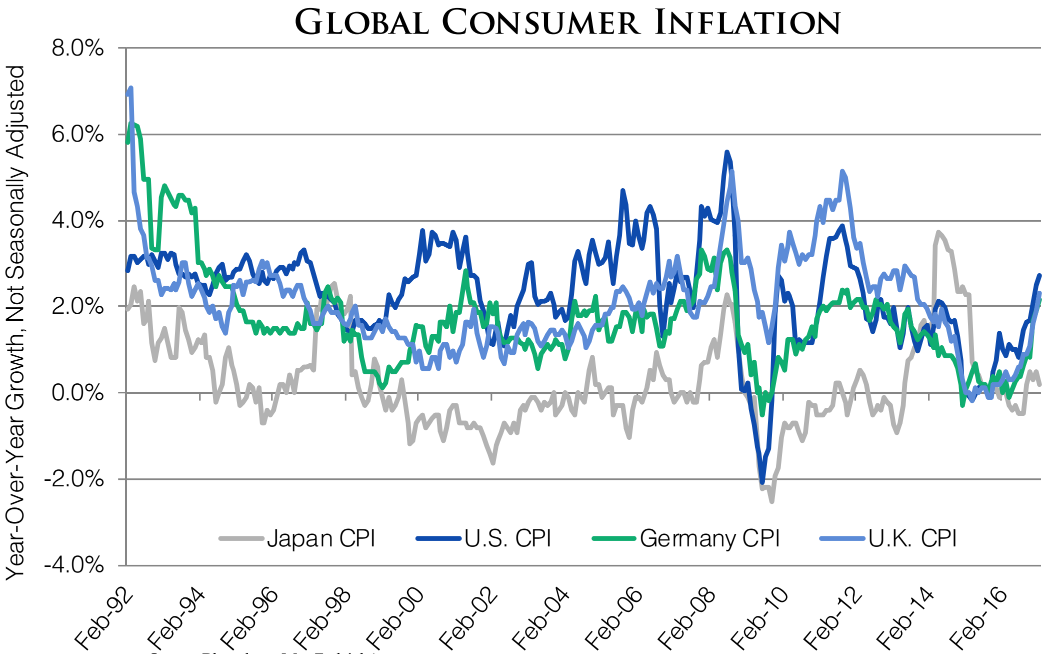
Inflation Turns Higher on a Global Basis



Source: Bloomberg, WestEnd Advisors

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Inflation moved up in the second half of 2016 and the first quarter of 2017 for many leading economies including the U.S., Germany and the U.K. After cycling through the 2015 drop in energy prices, headline consumer inflation for each of these three countries is now 2.2% or higher.

Japan's consumer inflation has increased as well, but the absolute level of the gain in the consumer price index (CPI) is less than many of its major developed market peers.

In China, the Producer Price Index (PPI) has surged to the strongest year-over-year growth in the last five years. CPI gains, however, have decelerated recently.

The increase in Chinese PPI indicates that inflationary pressures are stronger than they have been in some time. The divergence between the change in Chinese PPI and CPI is likely to close as PPI gains moderate, but also as consumer inflation moves higher.

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