WestEnd Advisors

Macroeconomic Highlights

www.westendadvisors.com · info@westendadvisors.com · (888) 500-9025

Table of Contents

WestEnd Outlook Highlights.......... 2

U.S. Economic Backdrop

Quarterly GDP Variability Doesn't Redirect the Trend.......... 4
Consumer Remains an Area of Economic Strength.......... 5
Maturing Cycle and Higher Rates are Headwinds.......... 6
Industrials Sector Demands More Dynamic Growth.......... 7
Communication Services Sector Comes Online.......... 8
Communications Services: Well Positioned for a Moderate Growth Environment.......... 9

Inflation and Interest Rates

Growing Wage Pressures Support Interest Rates.......... 11
Fed's Policy Moves Impact Short-Term Bond Yields.......... 12

International Economic Backdrop

Japanese Personal Income and CapEx Pickup.......... 14
Emerging Asia Offers Secular Tailwinds and Attractive Valuations.......... 15
Trade Disputes Weigh on Sentiment, Not on Data.......... 16
European Economic Picture Weakens in 2018.......... 17

Disclosures.......... 18

WestEnd ADVISORS

WestEnd Outlook Highlights

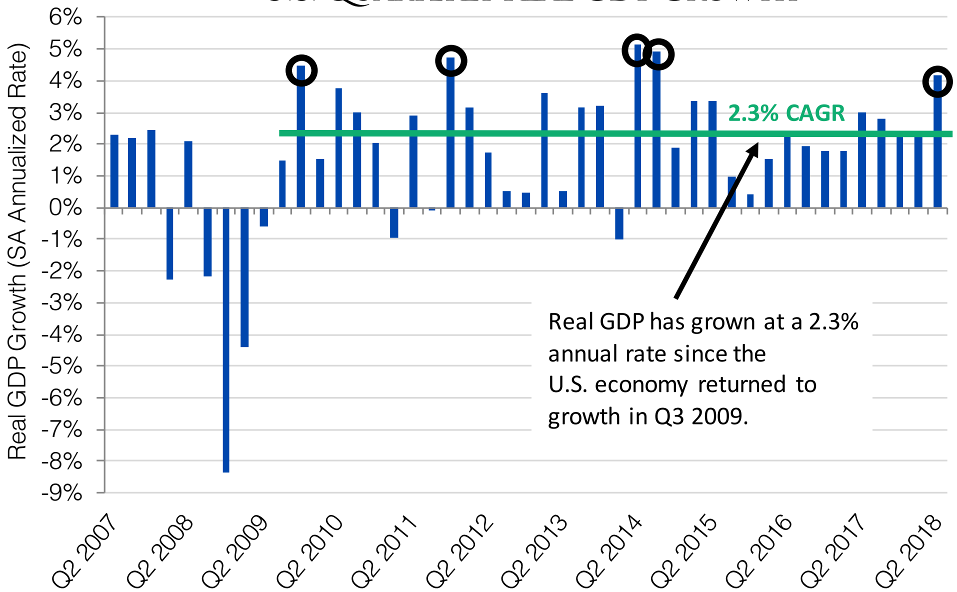
- The U.S. continues on a trend of moderate economic growth, even with a boost to Q2 GDP from temporary factors like exports.
  - Data in Q3, including core retail sales and personal income growth, reaffirmed that the U.S. consumer remains healthy and a key driver of the economy.
  - Trade disputes, along with constraints from progress already made this cycle, appear to be acting more as a governor on the economic throttle rather than an outright brake for the economy.
  - Modest inflationary pressures and a normalization of real interest rates are supporting higher nominal interest rates and creating a headwind for certain interest rate-sensitive areas of the market.
- European economies remain constrained by structural and cyclical issues, with data this year pointing to softer economic activity.
- Japan's personal income and business CapEx have improved, and Asian equity valuations have declined markedly versus the U.S.
- U.S. trade policy presents uncertainty, but short of an extended escalation of Chinese tariffs, its impacts should be limited; Asian markets, in particular, stand to benefit as tensions ease.

WestEnd Advisors

U.S. Economic Backdrop

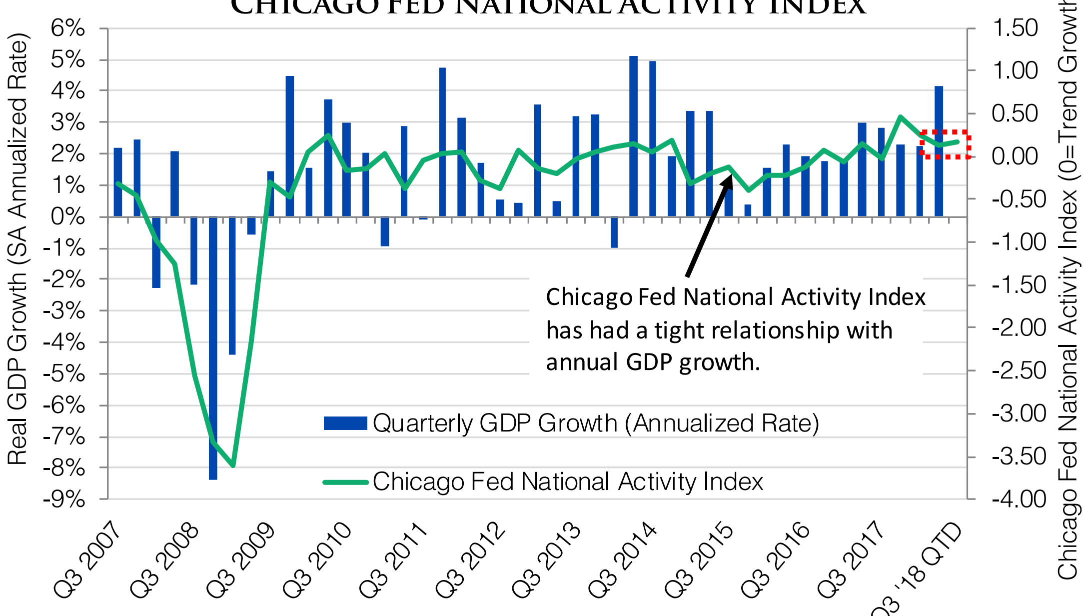
Quarterly GDP Variability Doesn't Redirect the Trend

U.S. Quarterly Real GDP Growth



Source: Bureau of Economic Analysis, WestEnd Advisors

U.S. Quarterly Real GDP Growth vs. Chicago Fed National Activity Index



Source: Bureau of Economic Analysis, Federal Reserve Bank of Chicago, WestEnd Advisors

Portfolio Impact

Technology & Health Care Sectors:

In a moderate growth environment, continue to emphasize U.S. sectors that benefit from sustained cyclical and secular growth drivers.

Energy & Materials Sectors:

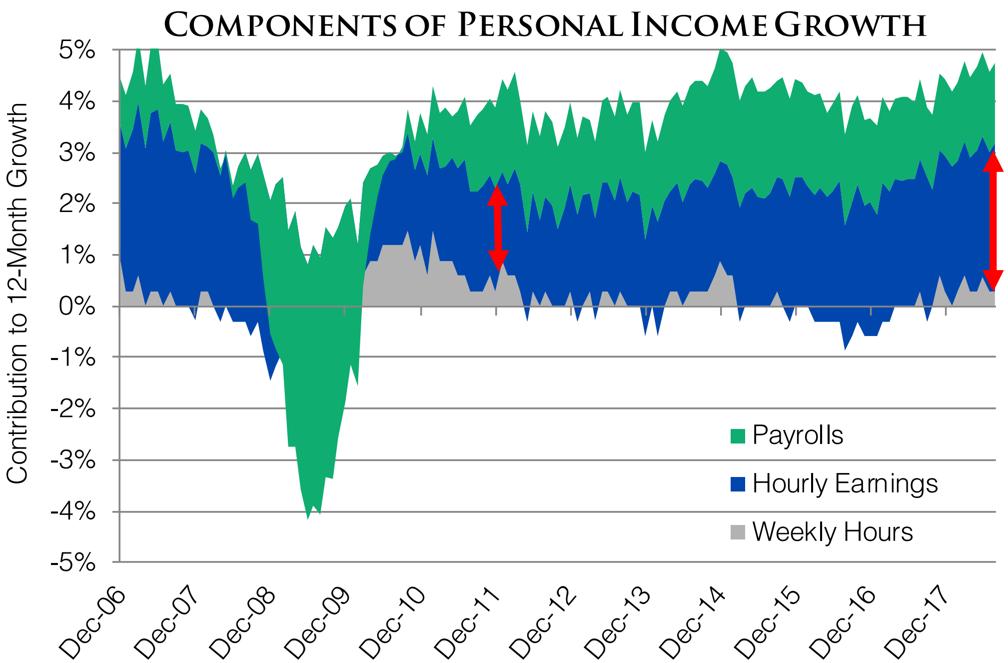
Avoid sectors that typically benefit from dynamic economic growth.

The 4.2% annualized GDP growth seen in Q2 2018 was a deviation from the recent trend of 2% to 3% readings. The top chart, however, illustrates that we have seen a number of quarterly readings over 4% during this near decade-long period of moderate growth.

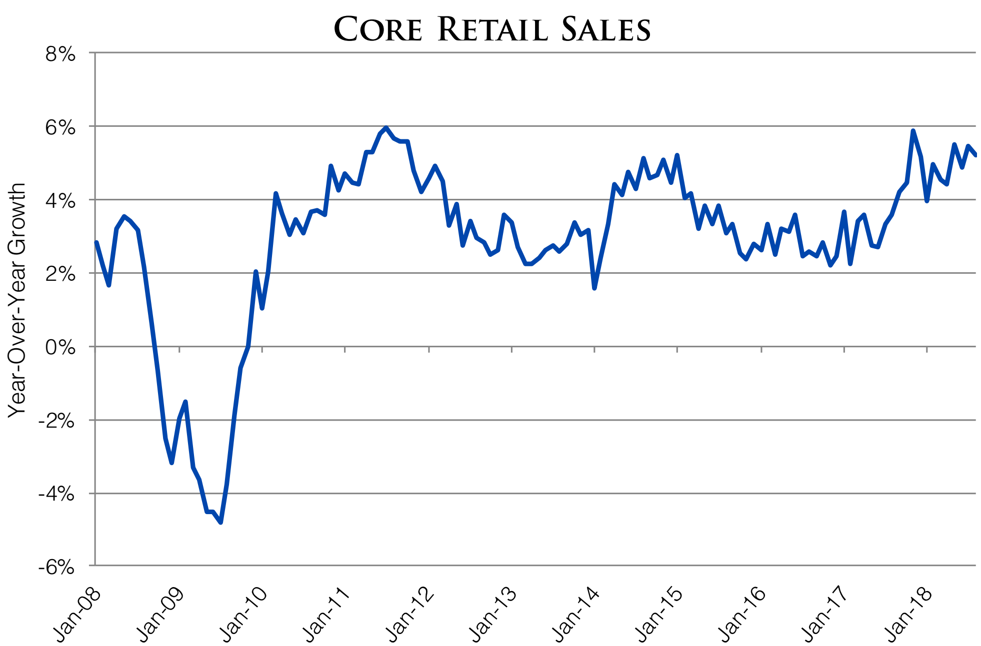
Other broad-based measures of the U.S. economy, like the Chicago Fed National Activity Index (CFNAI), continue to point to moderate growth, even as some temporary factors, like a rush to export U.S. goods ahead of trade tariffs, pushed up the Q2 GDP reading. The bottom chart indicates the CFNAI readings for both Q2 and Q3 continue to point to moderate U.S. growth, consistent with the near 2.5% GDP growth recorded during this expansion.

WestEnd Advisors

Consumer Remains an Area of Economic Strength



Source: Bureau of Economic Analysis, WestEnd Advisors



Source U.S. Census Bureau, WestEnd Advisors

Portfolio Impact

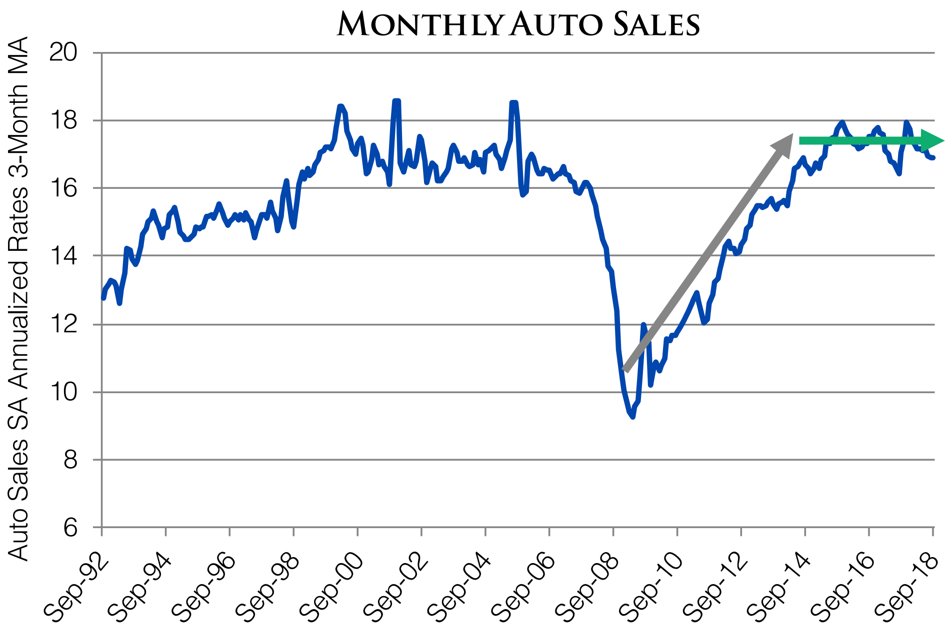
We believe continued exposure to the consumer – a key driver of economic growth – via the Consumer Discretionary and Consumer Staples sectors is warranted, particularly as income growth and an elevated sense of job security among workers supports spending growth.

Income gains for individuals are near cyclical highs. This income growth is increasingly coming from gains in hourly wages, rather than growth in hires or hours worked. As highlighted in the top chart, gains in hourly earnings today are a much larger component of overall personal income gains than they were in 2011. This shift among sources of personal income growth is not surprising given the progress we have seen in this economic cycle.

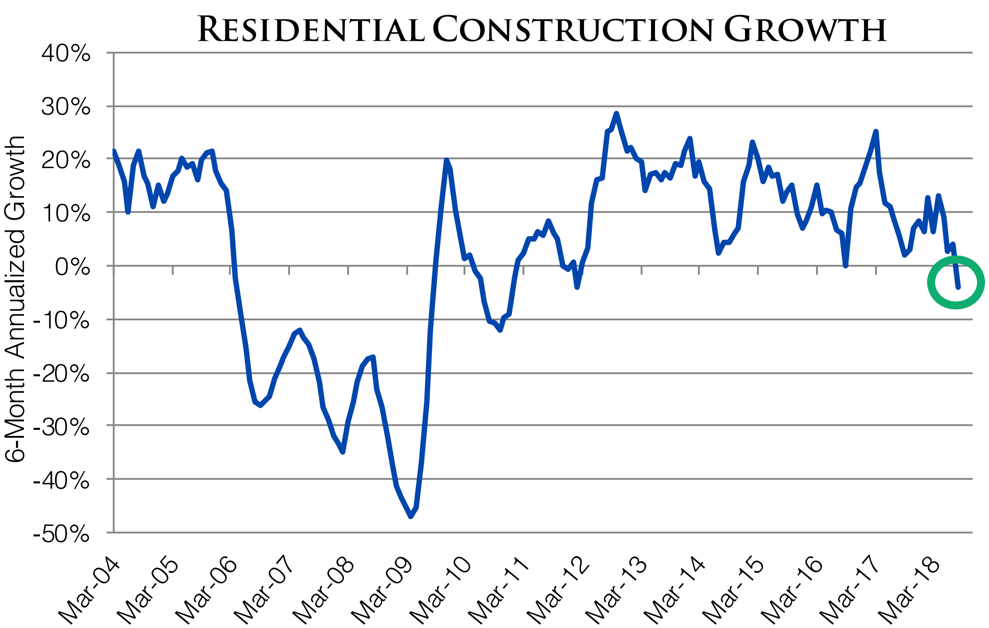
This strong income growth, together with record-low layoffs, has, in turn, driven gains in core retail sales (retail sales excluding more volatile spending categories, including cars, building materials, restaurants and gasoline).

WestEnd Advisors

Maturing Cycle and Higher Rates are Headwinds



Source: Bureau of Economic Analysis, WestEnd Advisors



Source: Bureau of Labor Statistics, WestEnd Advisors

Portfolio Impact

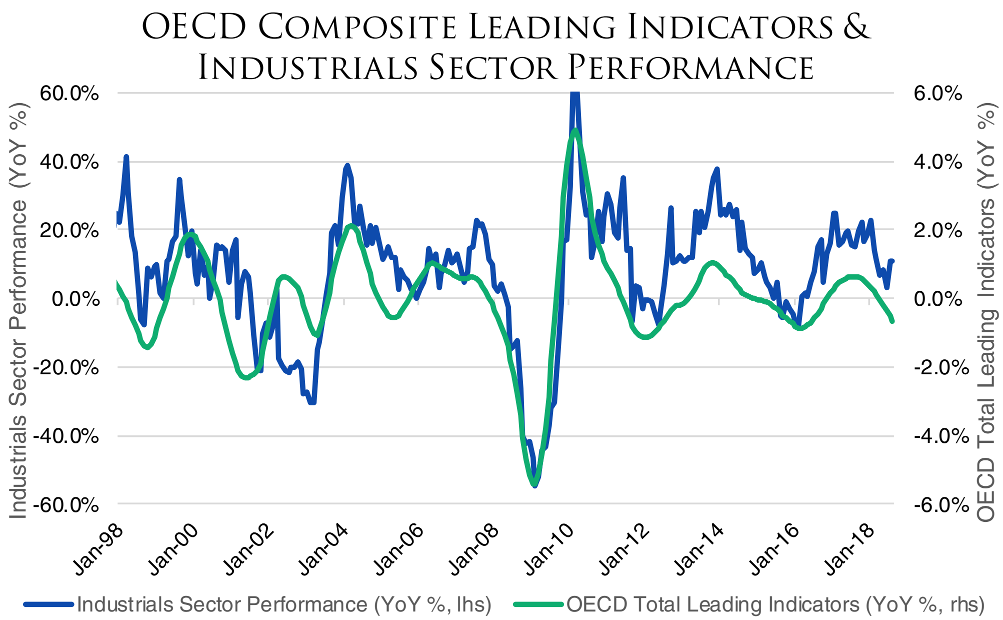
Progress in the U.S. economic cycle warrants avoiding certain segments of the financial markets, including Energy and Industrials Sector stocks, small-cap stocks and high-yield bonds.

The economy has made significant progress since the cyclical trough in 2009 as key areas like auto sales and construction spending have improved from their lows. At the same time, the degree of improvement in these and other measures indicates there is limited cyclical economic fuel to drive sustained dynamic growth going forward. For example, the top chart illustrates that auto sales remain at a high level, but have not grown in recent years.

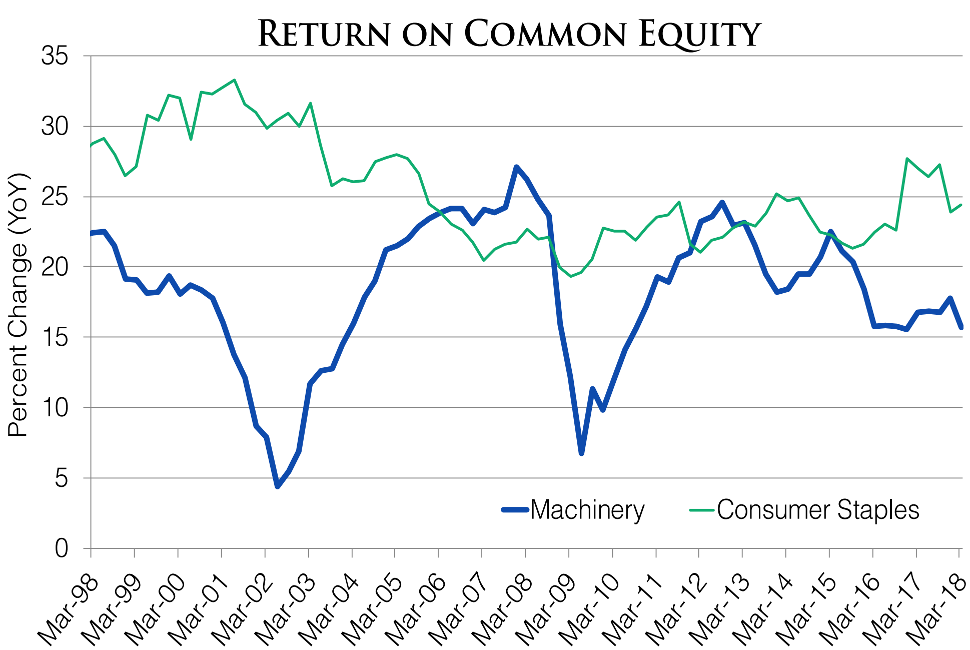
Interest rate-sensitive parts of the U.S. economy, like housing and autos, are likely to face challenges with the move up in interest rates. Residential construction spending, for example, dropped to a 4% annualized rate for the six months ended in August.

WestEnd Advisors

Industrials Sector Demands More Dynamic Growth



Source: OECD, Bloomberg, WestEnd Advisors



Source: Bloomberg, WestEnd Advisors

Portfolio Impact

Global growth trends have decelerated since late 2017. We continue to avoid the Industrials Sector in our U.S. equity exposures, as the Industrials Sector depends on robust growth not only in the U.S., but also abroad.

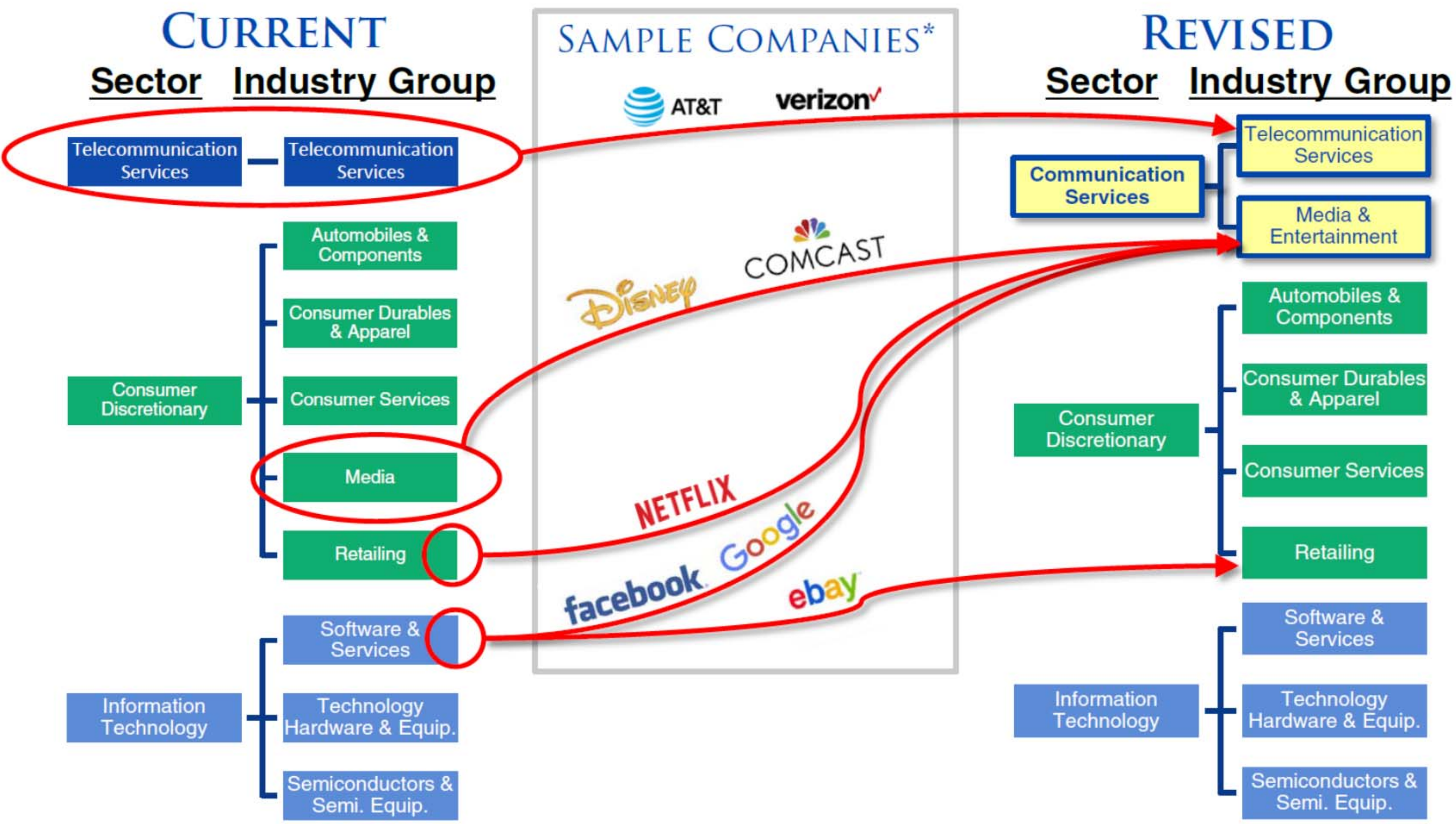
When economies are growing rapidly, we typically see increased investment in infrastructure, nonresidential construction, and housing, as well as demand for machinery and related services. Multinational Industrials Sector companies can benefit from this type of robust global demand.

Sustained and dynamic economic growth has largely been absent across the globe since the financial crisis. The OECD's Composite Leading Indicators (CLI) are comprised of various economic data series and are intended to signal inflection points in growth. The top chart illustrates that recent CLI readings signal slower global growth.

Industrials companies' earnings and return on equity have historically demonstrated a high degree of sensitivity to turns in economic growth. The Machinery Industry (bottom chart), which makes up a key segment of the Industrials Sector illustrates these characteristics.

WestEnd Advisors

Communication Services Sector Comes Online



The widely-used Global Industry Classification Standard (GICS) was reorganized to create a new "Communication Services Sector" at the end of Q3 2018.

The new sector combines the old Telecommunication Services Sector with various media, internet and entertainment companies from the Information Technology and Consumer Discretionary Sectors.

After the changes, the S&P 500 sector weights are more evenly distributed, as portions of two large sectors (Info. Tech. & Cons. Disc.) were combined with one of the smallest sectors (Telecom.). This change gives sector-focused investors more flexibility to overweight larger sectors and underweight smaller sectors.

Portfolio Impact:

We see the sector shifts as beneficial for sector-focused investment approaches as the changes better align investment opportunities with economic exposures.

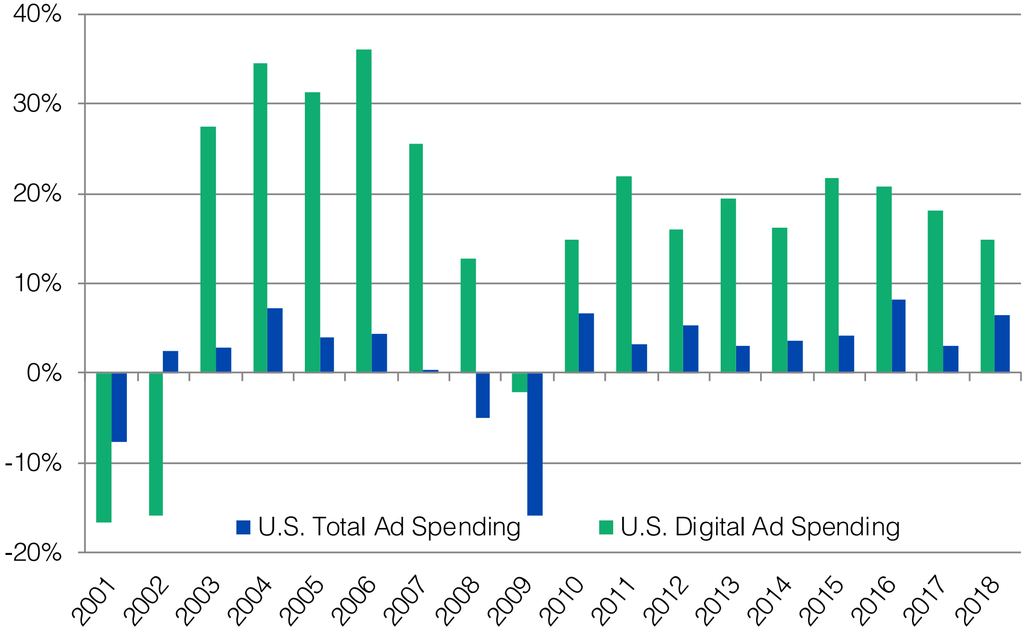
* Sample companies were selected based on a combination of size and recognizability and are for illustrative purposes only.

Sources: MSCI, Standard & Poor's, WestEnd Advisors. Information has been gathered from sources believed to be reliable, however data is not guaranteed.

WestEnd Advisors

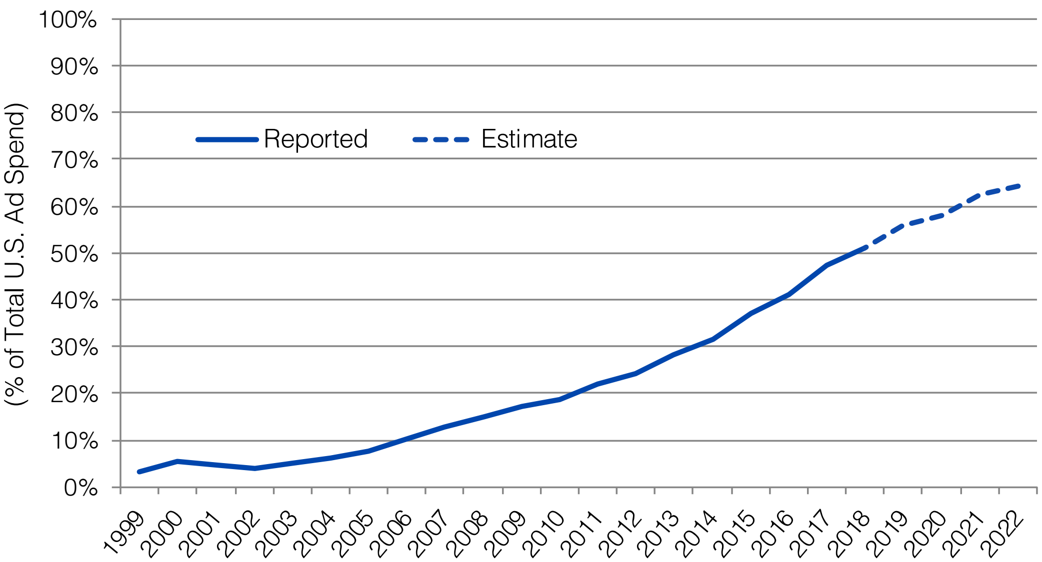
Communications Services: Well Positioned for a Moderate Growth Environment

U.S. Ad Spending Annual Growth



Source: MAGNA, Bloomberg, WestEnd Advisors

U.S. Digital Ad Spending Market Share



Source: MAGNA, Bloomberg, WestEnd Advisors

Portfolio Impact

The Communications Services Sector has an attractive profile for the moderate economic growth environment we see ahead. The sector should benefit from a mix of cyclical spending gains and secular tailwinds.

As the economic cycle becomes more advanced, businesses continue to look for ways to keep earnings growth elevated. Demand creation through spending on advertising is a typical way for businesses to boost sales and earnings.

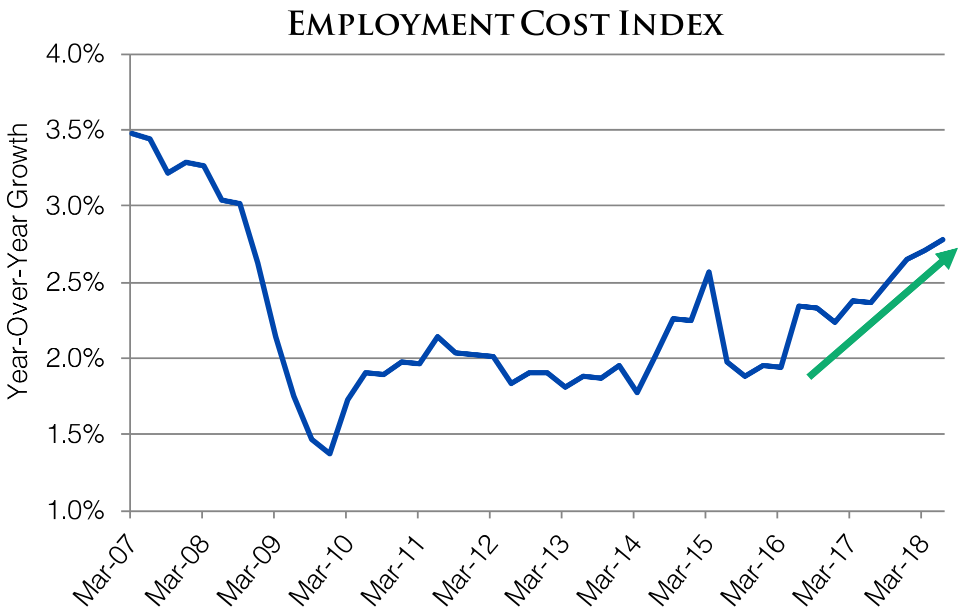
Traditional media companies in the Communications Services Sector are poised to benefit from the ongoing cyclical strength in ad spending. At the same time, other Comm. Services companies are some of the largest beneficiaries of the strong secular growth in digital advertising.

In addition, a healthy consumer spending backdrop should support sales of media content and wireless phone services.

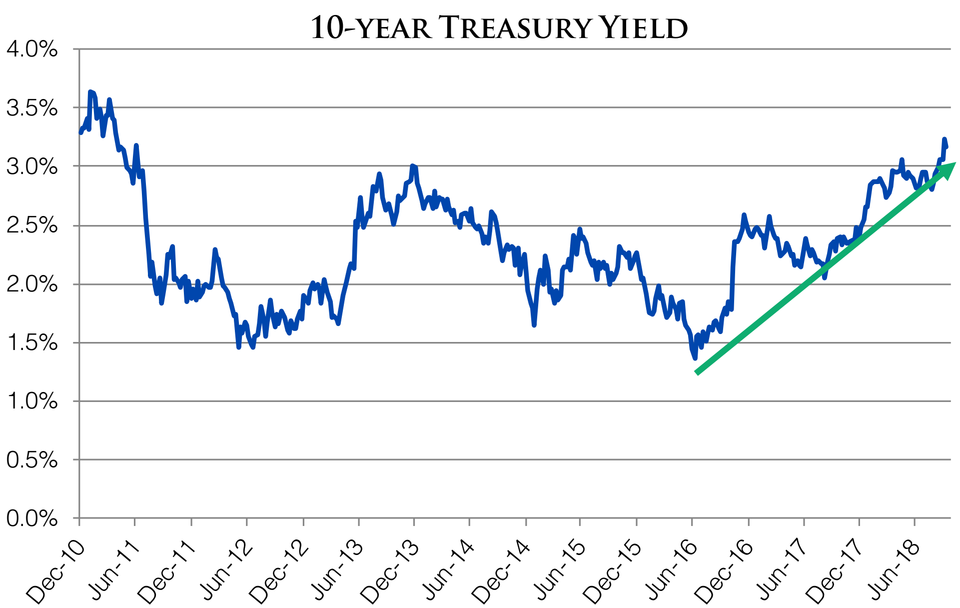
WestEnd Advisors

Inflation and Interest Rates

Growing Wage Pressures Support Interest Rates



Source: Bureau of Labor Statistics, WestEnd Advisors



Source: Bloomberg, WestEnd Advisors

Portfolio Impact

Fixed Income: Emphasize short-duration securities. Exposure to investment-grade floating rate securities and TIPS are warranted.

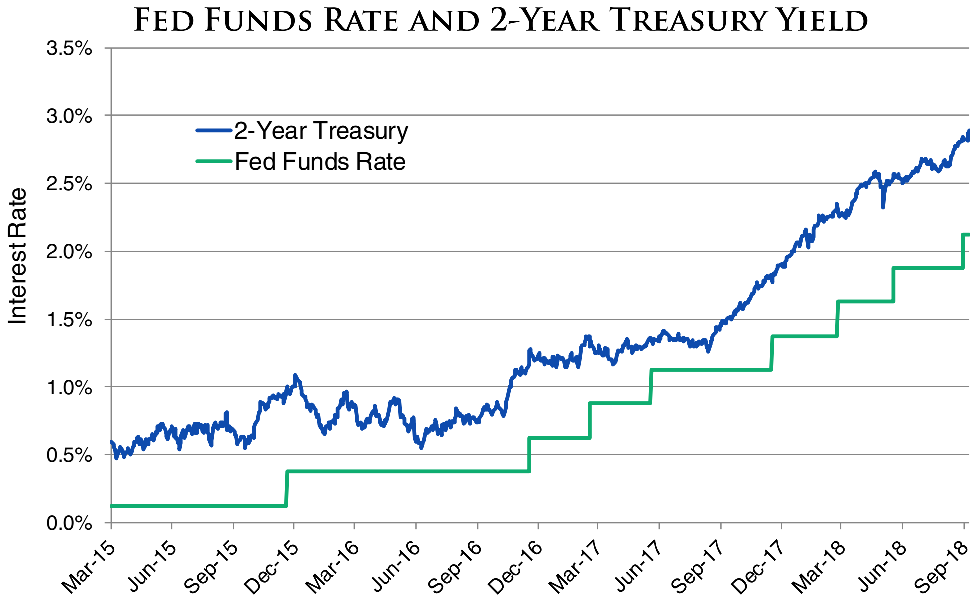
Equities: Financials Sector should benefit from higher short-term rates. Continue avoiding sectors most negatively impacted by rising rates, like Utilities and Real Estate.

Hourly wage growth had been slow to pick up during the expansion, but hourly earnings growth hit 2.9% as of August, the strongest gain since 2009. The growth in hourly earnings is contributing to the acceleration in growth for the Employment Cost Index (ECI), a measure of employment costs for companies. The top chart highlights that the ECI recorded its strongest growth of the cycle with its latest reading.

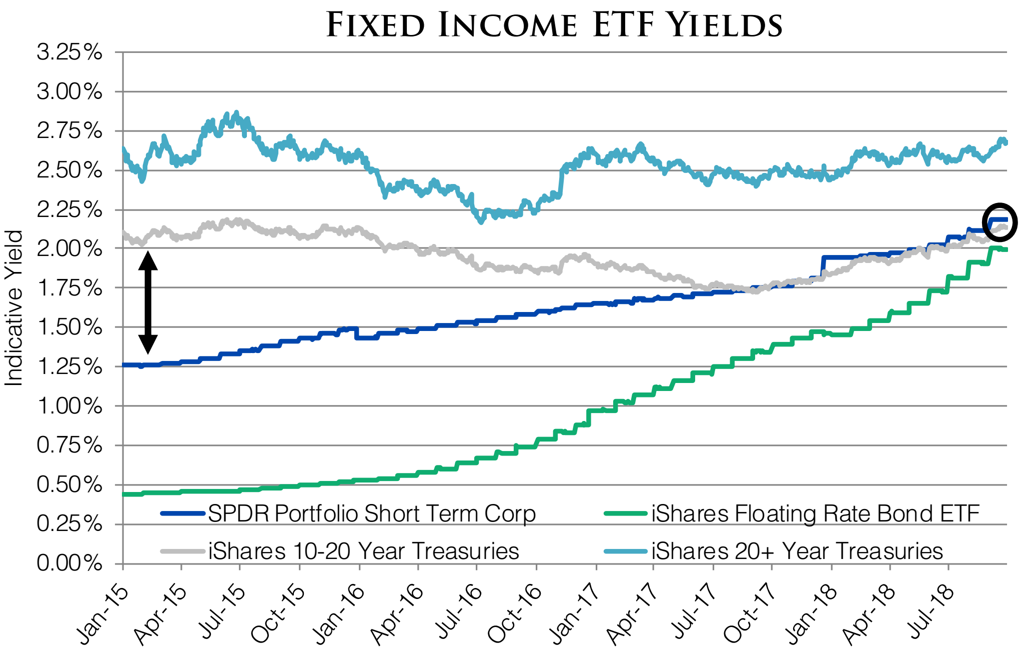
These labor cost pressures should keep inflation elevated and push long-term interest rates higher. In fact, in the early part of Q4, the 10-year Treasury yield moved to the highest level in seven years. In addition, Fed Funds hikes will put upward pressure on short-term rates.

WestEnd Advisors

Fed's Policy Moves Impact Short-Term Bond Yields



Source: Bloomberg, WestEnd Advisors



Source: Bloomberg, WestEnd Advisors

Portfolio Impact

Short duration bonds are more attractive today as the level of income sacrificed to insulate the portfolio from higher long-term interest rates has fallen as short-term interest rates have moved up.

Improved economic conditions and higher inflation readings have led to Fed Funds increases and, in turn, higher short-term interest rates.

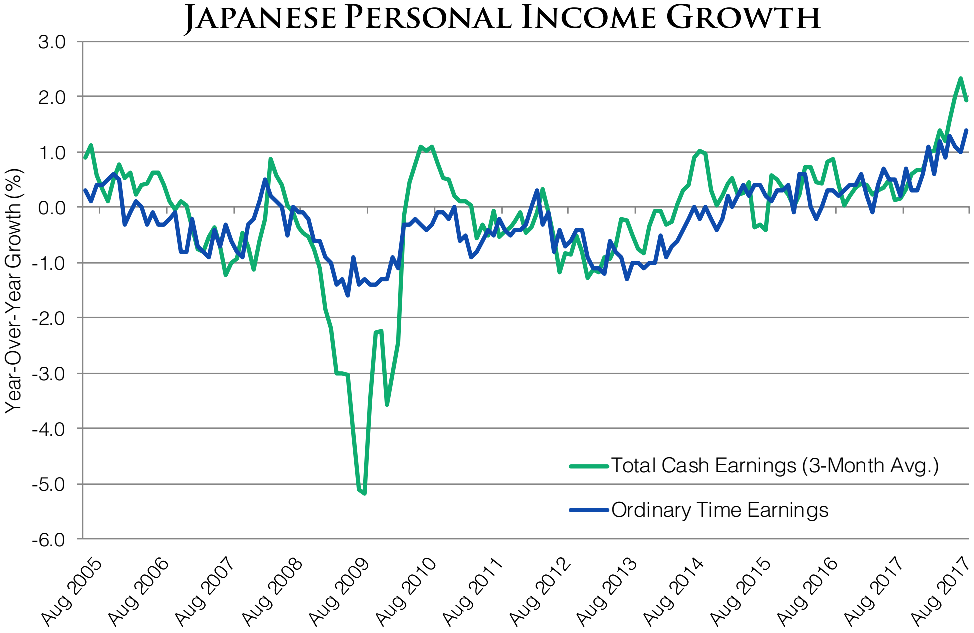
Higher short-term interest rates, along with a flattening yield curve, mean that the difference in income generation between long-term and short-term bonds has declined. For example, in early 2015, the yield on the investment grade Short-Term Corporate Bond ETF was 85 basis points *lower* than the yield on the 10-to-20 Year Treasury ETF. By the end of Q3 2018, however, the short-term corporate bond ETF's yield was 4 basis points *higher* than the long-term Treasury ETF's yield.

Looking ahead, longer-maturity fixed-income, in general, would be more negatively impacted by a continued move up in interest rates. Today, the 10-to-20 Year Treasury ETF has a duration of 10.6 years, while the Short-Term Corporate Bond ETF has a duration of just 1.9 years.

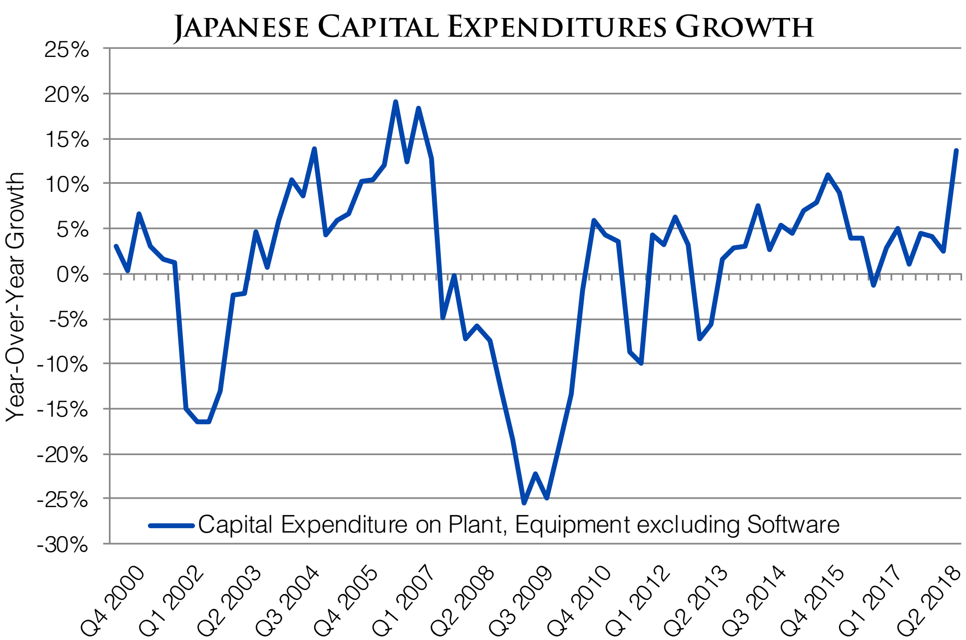
WestEnd Advisors

International Economic Backdrop

Japanese Personal Income and CapEx Pickup



Source: Ministry of Health, Labor and Welfare Statistics of Japan, WestEnd Advisors



Source: Ministry of Finance Japan, WestEnd Advisors

Portfolio Impact

Additional exposure to Asian equities is warranted as economic trends are improving, particularly in Japan, and Asian stocks trade at a near record discount to U.S. stocks.

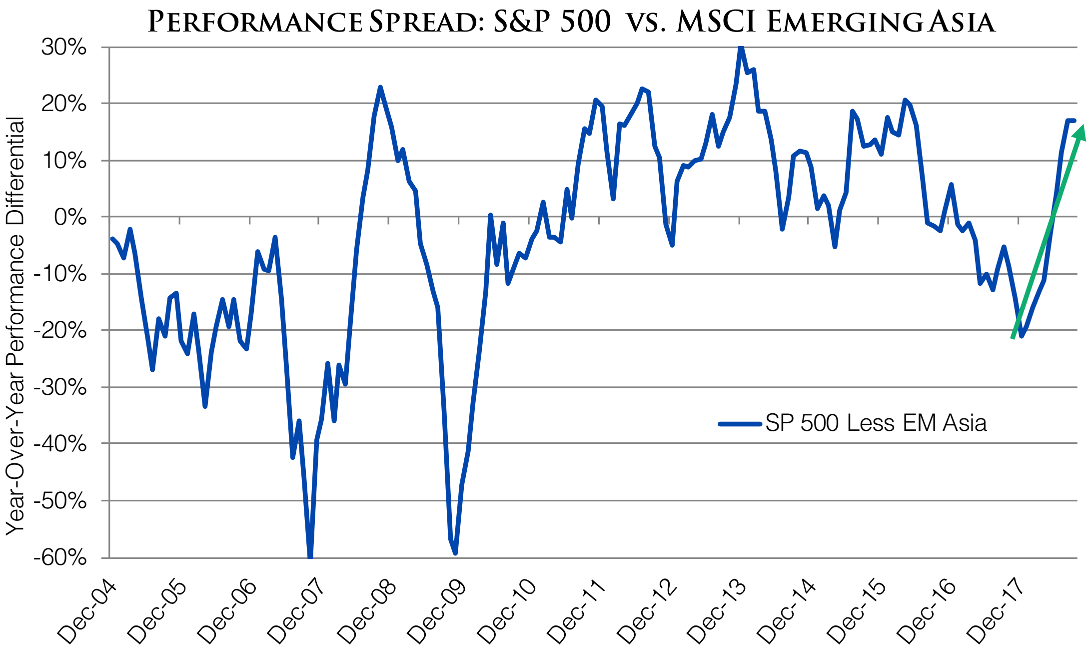
Japanese corporate profit margins reached 7% as of Q2 2018. In addition, Q2 profits as a percentage of nominal GDP were at the highest level since 1980.

The increase in corporate earnings, along with a tight labor market, has supported gains in personal income. The top chart illustrates that recent readings for Total Cash Earnings, which includes volatile bonus payments, and the more steady Ordinary Time Earnings are at their highest level of growth in over a decade.

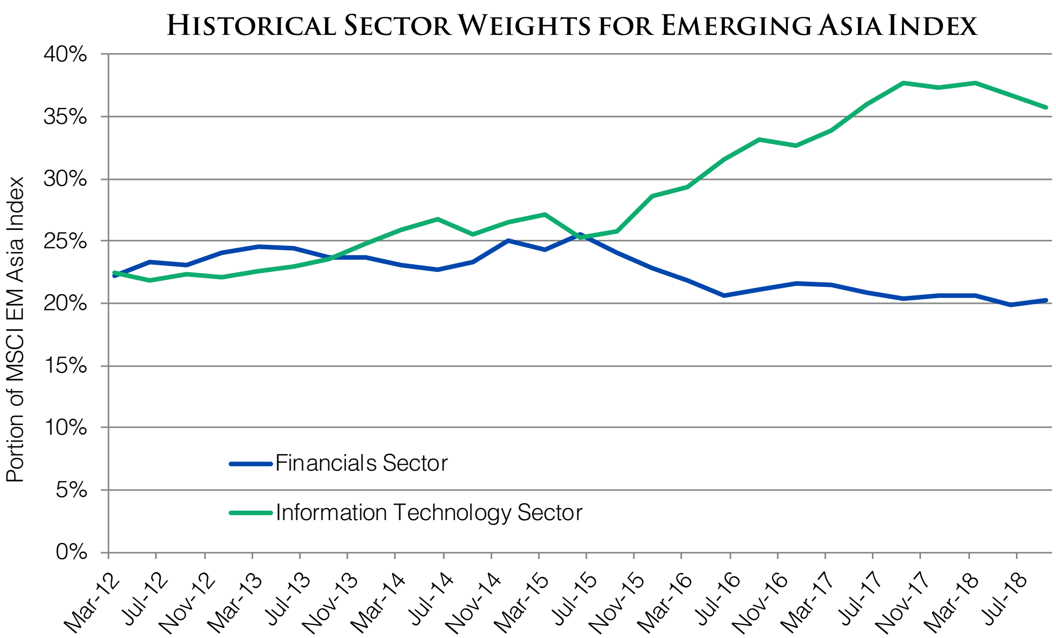
Similarly, an improved corporate profit backdrop has contributed to an improved business investment picture. Japanese spending growth on plant and equipment has reached its highest level since the global financial crisis.

WestEnd Advisors

Emerging Asia Offers Secular Tailwinds and Attractive Valuations



Source: Bloomberg, WestEnd Advisors



Source: Bloomberg, WestEnd Advisors

Portfolio Impact

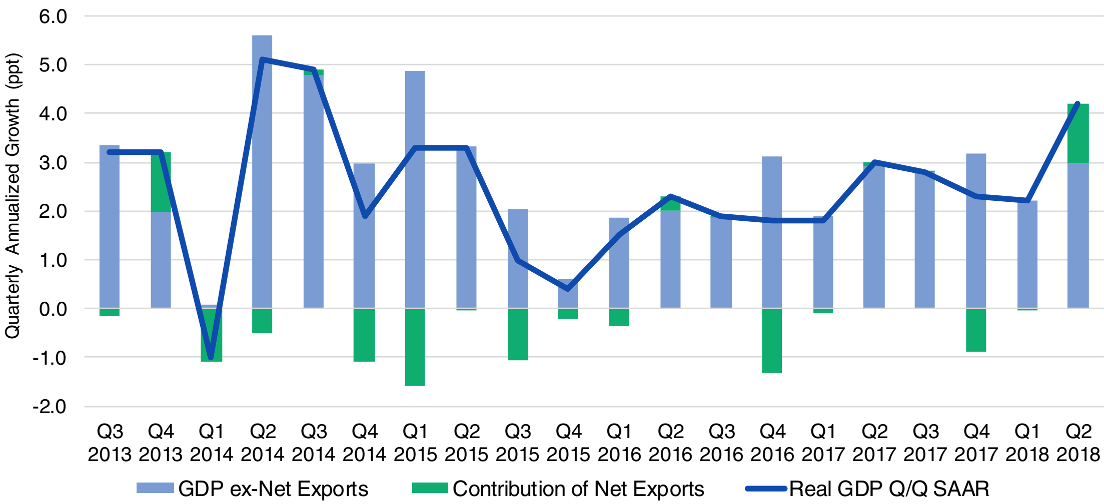
The global economic picture has not shifted dramatically this year, but a deterioration in investor sentiment with respect to international equities, especially in emerging markets, has led to a significant valuation discount of certain international equities compared to U.S. stocks.

The significant underperformance of Emerging Asian equities over the last year has resulted in EM Asia trading at a 32% P/E discount to S&P 500, which matches the largest discount since 2005.

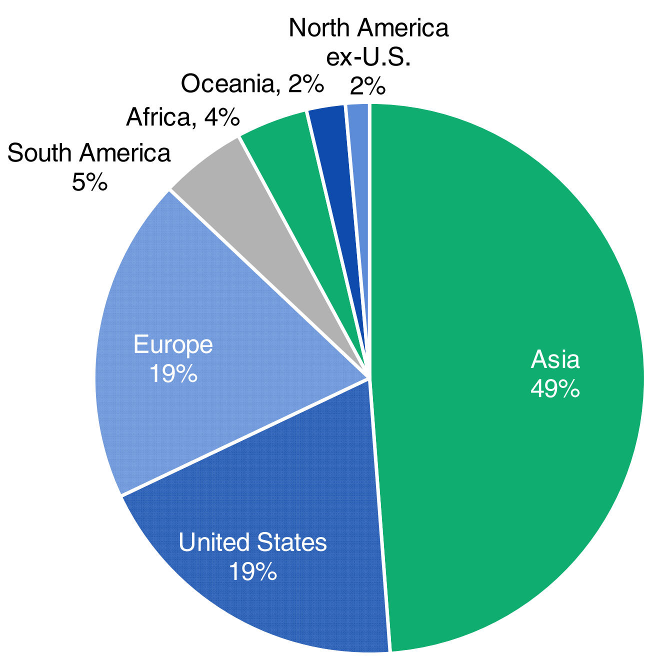
Within EM, we favor Emerging Asian stocks in part because Asia is less commodity-oriented than areas such as Latin America. In fact, Technology companies have grown to over 35% of the MSCI Emerging Asia Index. Global tech leaders from Asia are benefiting from cyclical consumer and business spending as well as from secular trends including accelerating internet penetration, rapid adoption of digital payments, and e-commerce growth. This increased exposure to secular growth drivers makes the valuation discount for EM Asia stocks even more compelling.

WestEnd Advisors

Trade Disputes Weigh on Sentiment, Not on Data



Source: Bureau of Economic Analysis, WestEnd Advisors



Source: Customs General Administration PRC, WestEnd Advisors

Portfolio Impact

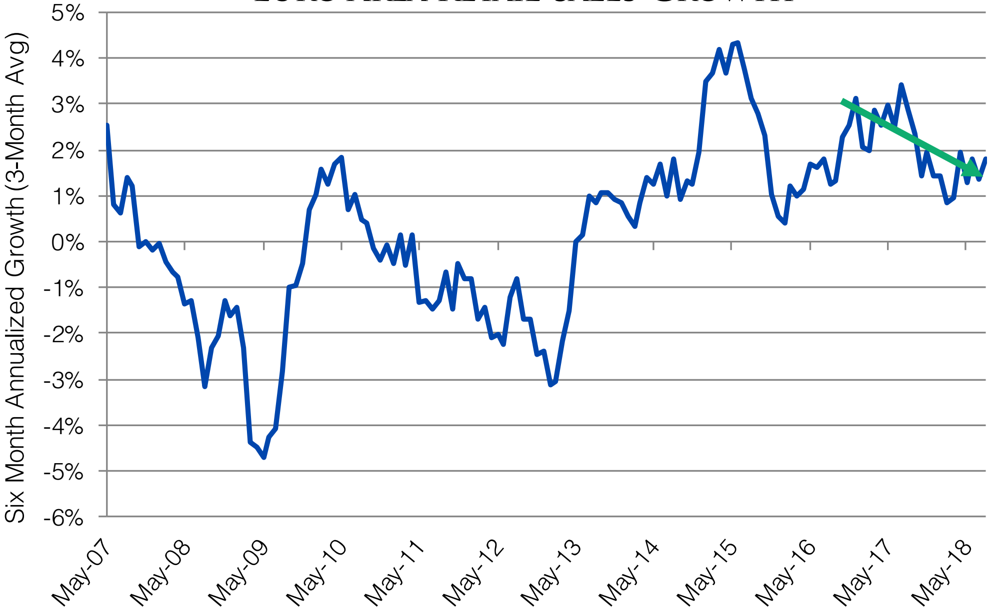
We recognize the potential for escalating trade disputes, but we currently see the U.S. impact as limited to specific segments of the economy like manufacturing and agriculture. We are also closely monitoring developments in Asia.

Trade plays an important role in global economic growth, although its impacts vary across economies.

For the U.S., exports make up 12% of nominal U.S. GDP. Disruptions from additional tariffs would heighten volatility in U.S. trade data, but immediate negative impacts to the broader U.S. economy are unlikely, in our opinion. Still, we saw volatility in Q2 when higher exports, driven by exporters front-running tariff implementation, caused the trade deficit to shrink substantially, and thus added to GDP growth (top chart).

For China, 19% of exports go to the U.S. This matches exports to Europe and is less than half of what is sent to other Asian countries, collectively. In this context, we again see the potential for trade volatility, but low likelihood of a severe economic disruption for China. There is also a good chance that other emerging Asia economies actually benefit.

European Economic Picture Weakens in 2018



Source: Bloomberg, WestEnd Advisors

Sector Weights (%)		
	S&P 500	MSCI Europe
Information Technology	20.99	5.79
Health Care	15.05	12.52
Financials	13.32	18.54
Consumer Discretionary	10.31	9.47
Communication Services	10.03	5.01
Industrials	9.71	14.35
Consumer Staples	6.71	12.21
Energy	6.00	7.92
Utilities	2.82	3.40
Real Estate	2.64	2.51
Materials	2.43	8.28

As of 9/30/2018

Source: Bloomberg, WestEnd Advisors

Data out of Europe thus far in 2018 has pointed to softer economic activity. For example, European retail sales and export growth have decelerated in recent quarters. Nonetheless, some investors continue to highlight the valuation discount for European stocks compared to U.S. stocks. This 16% P/E discount on European stocks is very consistent with history, and one explanation for this discount is the sector makeup of each stock market.

The largest sector in Europe is Financials (≈18.5%) while the largest in the U.S. is Information Technology (≈21%). Given these weightings, it makes sense that Europe consistently trades at a discount to the U.S. Those who expect European equities' valuations to rise to U.S. levels are implicitly betting on significant expansion of European Financials' valuations, a view that we question.

Portfolio Impact

An underweight of European equities is warranted, as lower valuations do not fully reflect the structural and cyclical economic headwinds faced by Europe.

WestEnd Advisors

This report should not be relied upon as investment advice or recommendations, and is not intended to predict the performance of any investment. Past performance is not indicative of future results. It should not be assumed that recommendations made in the future will be profitable. The information contained herein is not intended to be an offer to provide investment advisory services. Such an offer may only be made if accompanied by WestEnd Advisors' SEC Form ADV Part 2. These opinions may change at anytime without prior notice. All investments carry a certain degree of risk including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class. The information has been gathered from sources believed to be reliable, however data is not guaranteed.

The Standard and Poor's 500 Stock Index includes 500 stocks and is a common measure of the performance of the overall U.S. stock market. The MSCI ACWI consists of 47 country indexes comprising 23 developed and 24 emerging market country indexes. The total return of the MSCI ACWI (Net) Index is calculated using net dividends. Net total return reflects the reinvestment of dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties. The MSCI Europe Index represents a subset of the MSCI ACWI, comprising 15 developed market country indexes in Europe. An index is unmanaged and is not available for direct investment.

Any portfolio characteristics, including position sizes and sector allocations, among others, are generally averages and are for illustrative purposes only and do not reflect the investments of an actual portfolio unless otherwise noted. The investment guidelines of an actual portfolio may permit or restrict investments that are materially different in size, nature, and risk from those shown. The investment processes, research processes, or risk processes shown herein are for informational purposes to demonstrate an overview of the process. Such processes may differ by product, client mandate, or market conditions. Portfolios that are concentrated in a specific sector or industry may be subject to a higher degree of market risk than a portfolio whose investments are more diversified.

Holdings, Sector Weightings, and Portfolio Characteristics were current as of the date specified in this presentation. The listing of particular securities should not be considered a recommendation to purchase or sell these securities. While these securities were among WestEnd Advisors' strategies' holdings at the time this material was assembled, holdings will change over time. There can be no assurance that the securities remain in the portfolio or that other securities have not been purchased. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities presently in the portfolio. Individual clients' portfolios may vary. Upon request, WestEnd Advisors will provide a list of all recommendations for the prior year.