WESTEND
Advisors

A VICTORY CAPITAL® INVESTMENT FRANCHISE

# Macroeconomic Highlights

## Q3 2023

20230705-2985822

# Table of Contents

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20230705-2985822

# WestEnd Outlook Highlights

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- We continue to see late-cycle economic conditions, with ongoing deceleration in key leading data, despite continued strength in headline employment and personal consumption. Our economic cycle analysis suggests that the delayed effects of monetary policy tightening, tightening lending standards, and the rolling over of the profit cycle are all likely to be felt more acutely in coming quarters. As such, we see significant risk to earnings for more economically sensitive sectors, but we see opportunity in select U.S. equity sectors and fixed income.
  - A long history of research suggests Fed Funds rate hikes, have a significant but lagged impact on economic growth, with a +100 basis point rate shock creating as much as a -1.5 percentage point drag on cumulative real GDP growth over the subsequent 18 months, and we believe the impacts of the Federal Reserve's 500 basis points of rate hikes over just 15 months have yet to be fully felt.
  - Along with elevated interest rates, banks' significant tightening of lending standards is likely, in our view, to be a significant headwind to growth by limiting company's access to capital. Along with declining corporate profits, this could reduce investment, hiring, and, ultimately, economic activity.
  - We believe long-term U.S. interest rates could decline in coming quarters, as economic growth and inflation slow.
- Internationally, Europe has entered a technical recession, but we believe it still faces significant risks from monetary and fiscal tightening, and it has less savings cushion to support consumers than the U.S. We also expect slowing growth to present headwinds for economically cyclical emerging markets, while developed Asia is a relative bright spot.
- We continue to position portfolios for the later stages of the economic cycle and in view of current risks and opportunities:
  - In U.S. large-cap equity allocations:
    - We are avoiding early-phase cyclical U.S. sectors in all our strategies.
    - We are emphasizing mid- and late-phase sectors that we expect will see less deceleration in earnings as economic growth slows, including overweights of Communication Services, Health Care, Consumer Staples, and Utilities.
  - In global portfolios, we remain underweight to international equities, as a whole, including underweights of Europe and emerging markets, but we maintain an overweight of developed Asia, where we see the greatest potential for economic resilience abroad.
  - In balanced portfolios:
    - Seeing reduced risk to fixed income returns and late economic cycle risks to equities, we maintain an overweight of fixed income in balanced portfolios.
    - Within fixed income allocations, we are emphasizing intermediate and longer-term securities that should benefit from declining interest rates, and we have moved to an overweight of Treasury exposure, which we believe could benefit amid a flight to perceived safe assets.

# U.S. Equity Sector Allocations

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## WESTEND ETF STRATEGIES

**Current large-cap U.S. equity sector allocation and avoidance***

### Sector Allocations

- Health Care
- Consumer Staples
- Utilities
- Information Technology
- Communication Services
- Consumer Discretionary

### Sector Avoidance

- Energy
- Financials
- Industrials
- Materials
- Real Estate

* For illustrative purposes only. Allocation information as of June 30, 2023. Source: WestEnd Advisors.

# U.S. Economic & Market Backdrop

# Slowing Economic Growth Brings Increased Challenges and Risks

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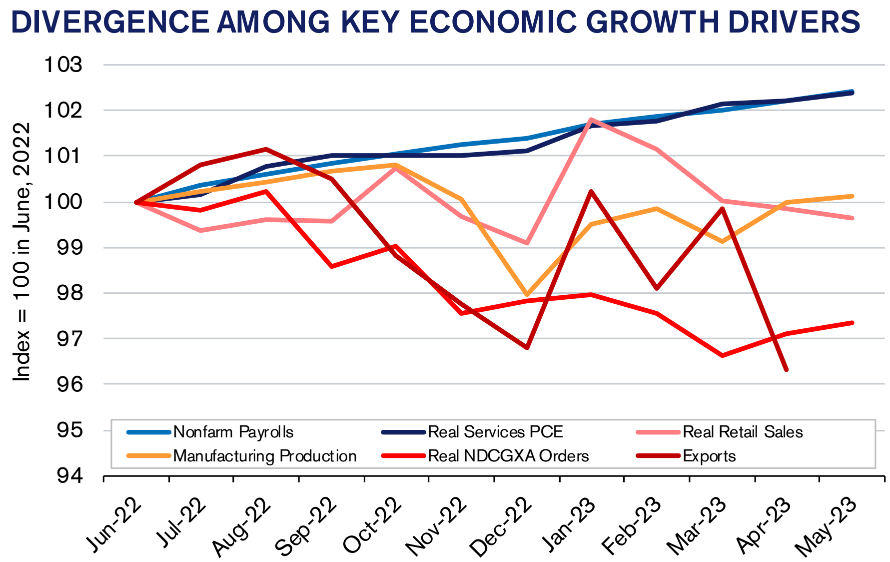
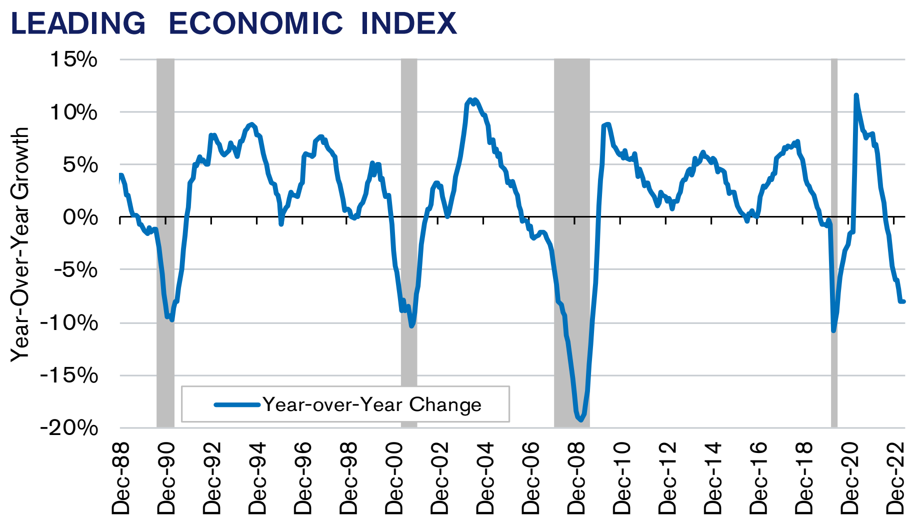



Source: BLS, BEA, Federal Reserve, US Census Bureau, WestEnd Advisors




Source: Conference Board, WestEnd Advisors

**Portfolio Impact:** Greater risks to the economy and profits in the U.S. warrant an emphasis of defensive sectors like **Health Care, Utilities, and Consumer Staples**, in our view, as well as avoidance of highly cyclical sectors like **Energy, Industrials, and Financials**.

A review of the major drivers of GDP growth (top chart) shows a **divergence between** the red data series that have weakened in recent quarters (including **goods consumer spending, manufacturing, investment and exports**) and **services consumer spending and the labor market**, which are among the few positive growers in the late-cycle environment.

Looking forward, the Leading Economic Index (LEI) has deteriorated over the last year as the Fed has tightened monetary policy and interest rate-sensitive parts of the economy have weakened. The bottom chart illustrates that LEI growth has fallen to a level that historically has coincided with recessions. We believe the prospect of economic retrenchment **increases the likelihood of earnings disappointments, particularly for companies in economically sensitive sectors of the economy.**

# Trajectory of Spending has Diverged from Income

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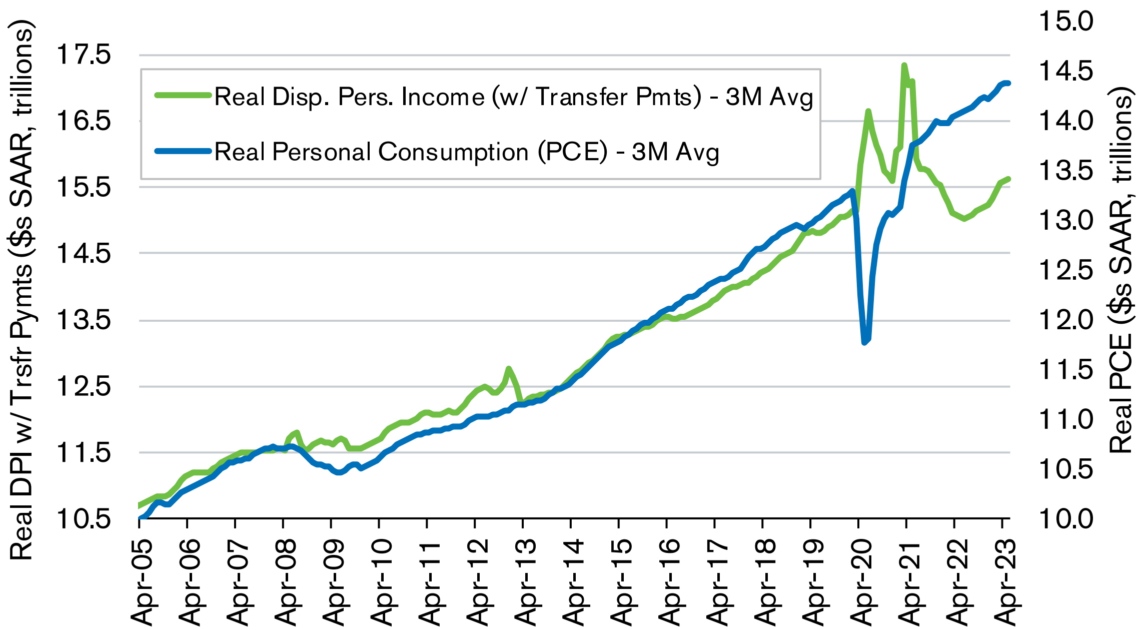
## REAL SPENDING GAINS OUTPACE REAL INCOME GROWTH



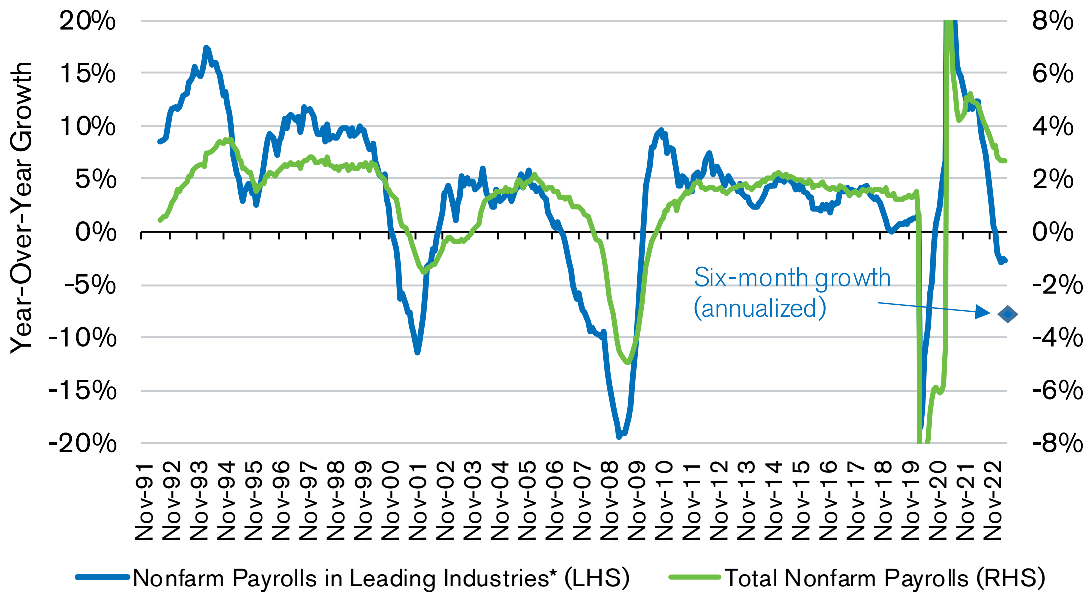

Source: Bureau of Economic Analysis, WestEnd Advisors

**Portfolio Impact:** The U.S. consumer has benefited in recent quarters from elevated savings during COVID. With excess savings diminishing and interest costs rising, **consumers are likely to have less spending fuel going forward**. A more challenged U.S. consumer would **increase risks to the U.S. economy**, in our view.

Real disposable income including transfer payments rose significantly during COVID as seen in the chart above. Consumer savings also rose over the same period due to the combination of higher income and reduced spending during the pandemic. Now, real personal consumption expenditures (real PCE) have returned to the pre-pandemic trend. In contrast, **real disposable personal income has not recovered to its trend**, which presents a **headwind to consumer spending growth** going forward.

# Leading Labor Market Data Starting to Deteriorate

## JOB GROWTH RAPIDLY SLOWING IN LEADING INDUSTRIES




*Includes temporary help services, warehousing & storage, nondepository credit intermediation, and professional employer organizations

Source: BLS, WestEnd Advisors

**Portfolio Impact:** Job growth remains a major pillar supporting economic growth in the U.S., but the **risks to the labor market have started to increase**, in our view. The trajectory of employment and layoffs is likely to be a key determinant of the U.S. economy's path and whether a recession is avoided in the intermediate term.

While total nonfarm payroll growth – a historically *lagging* indicator – remains strong, signs of incremental softening in the job market have started to show up in the more *leading* labor market data.

**Payroll growth has decelerated sharply among sub-industries that have historically provided leading signals** for the overall job market, including temp workers, credit intermediation, and warehousing & storage (see chart).

If layoffs increase and **consumers' sense of job security** declines materially, we would see that as a **serious threat to spending and the economy overall**.

# Inflation has Slowed, But Improvement Gets Harder from Here

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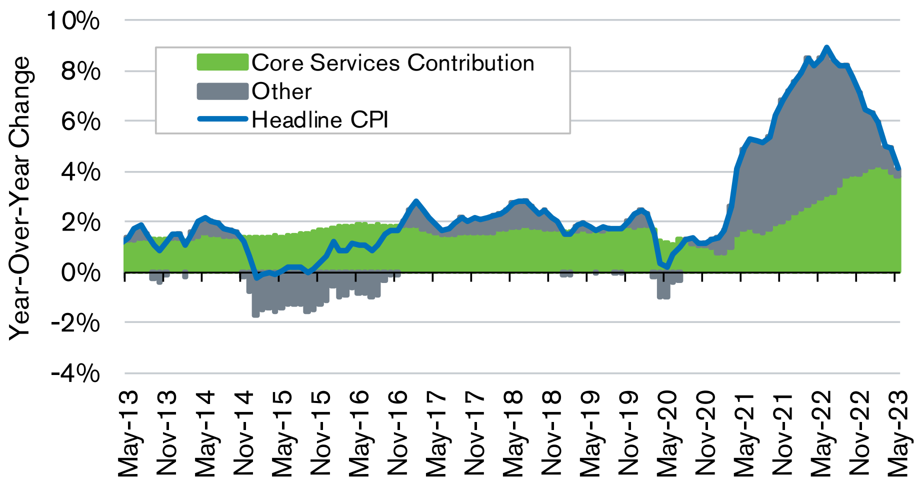
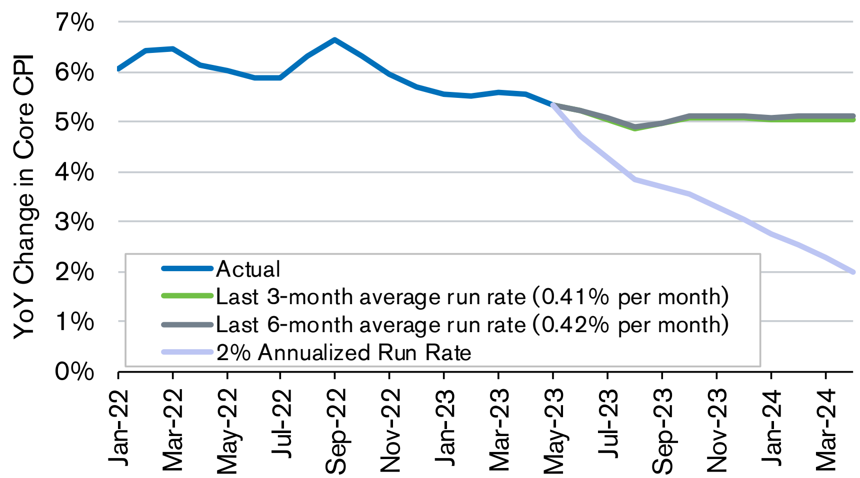
## SERVICES INFLATION REMAINS ELEVATED




Source: BLS, WestEnd Advisors

## CORE CPI TRACKING ABOVE FED'S 2% TARGET




Source: BLS, WestEnd Advisors

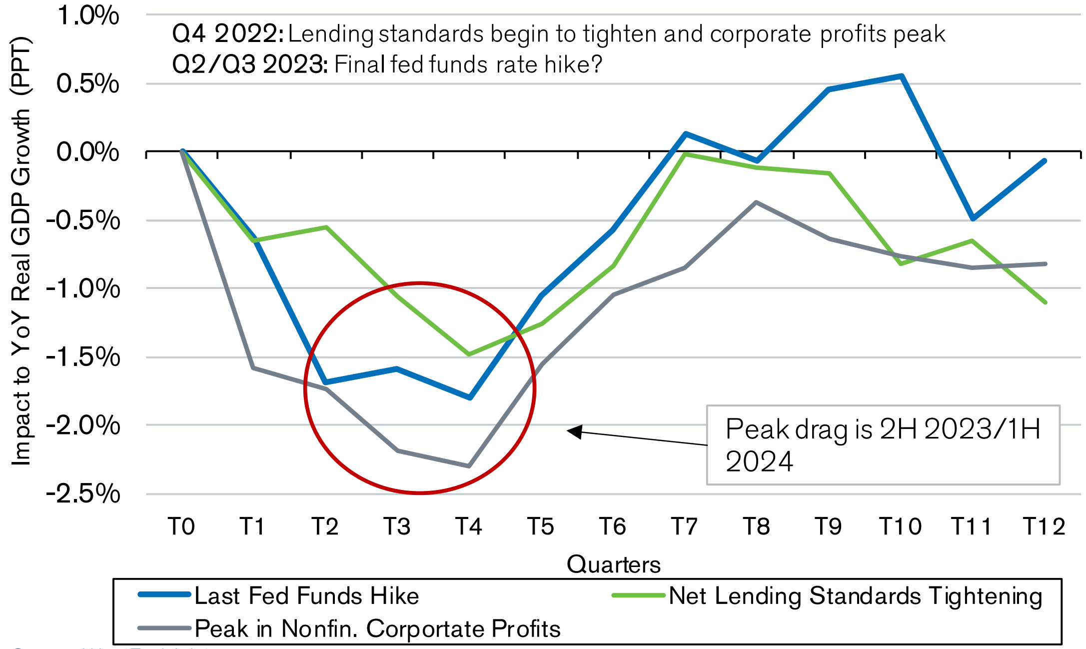
**Portfolio Impact:** Periods of decelerating inflation have historically been associated with favorable relative performance for sectors with a mix of economic sensitivity including **Health Care, Consumer Staples, and Information Technology.**

Measures of core inflation have decelerated modestly this year, while headline inflation has fallen more significantly.  Services inflation now accounts for the vast majority of overall inflation and could prove stickier than goods inflation.

Our analysis of the potential future paths for inflation suggests that **inflation may not fall as much in 2023 as the Fed expected coming into the year, let alone reach its 2% longer-run target**.  The 3-month and 6-month change in Core CPI are virtually the same, and the annualized growth for both of these shorter-term periods is still approximately 5%, as detailed in the bottom chart.

# Impending Risks to Growth Still Coming

### HISTORICAL REAL GDP GROWTH RESPONSE TO...




Source: WestEnd Advisors

**Portfolio Impact:** We believe several risks to economic growth, combined with the Fed's commitment to keeping rates elevated, warrants defensive positioning across our portfolios, given that the **economy has yet to absorb the full impact of monetary tightening.**

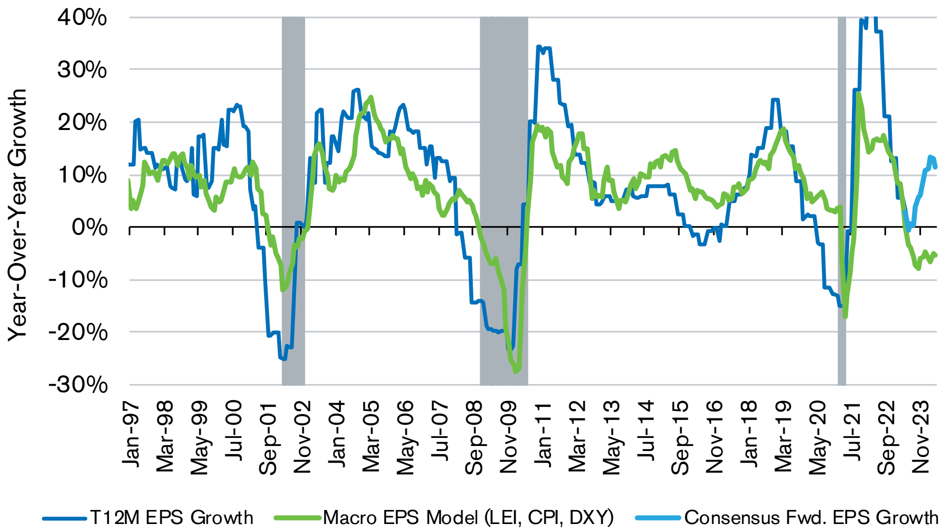
There have been several macroeconomic shifts over the past year that have *yet to fully reverberate through the economy*, including: 1) **The fastest monetary tightening cycle since the 1980's;** 2) **a significant increase in the percentage of commercial banks tightening C&I lending standards;** and 3) **rapidly decelerating corporate profits growth.**

The chart above shows the average historical impact to real GDP growth following 1) the *last* federal funds rate hike of a tightening cycle, 2) the *first* quarter of net C&I loan tightening by banks, and 3) a *peak* in the level of nominal, non-financial corporate profits.

**The lagged impact of these developments pose headwinds to economic growth over the next 6-12 months, in our view.**

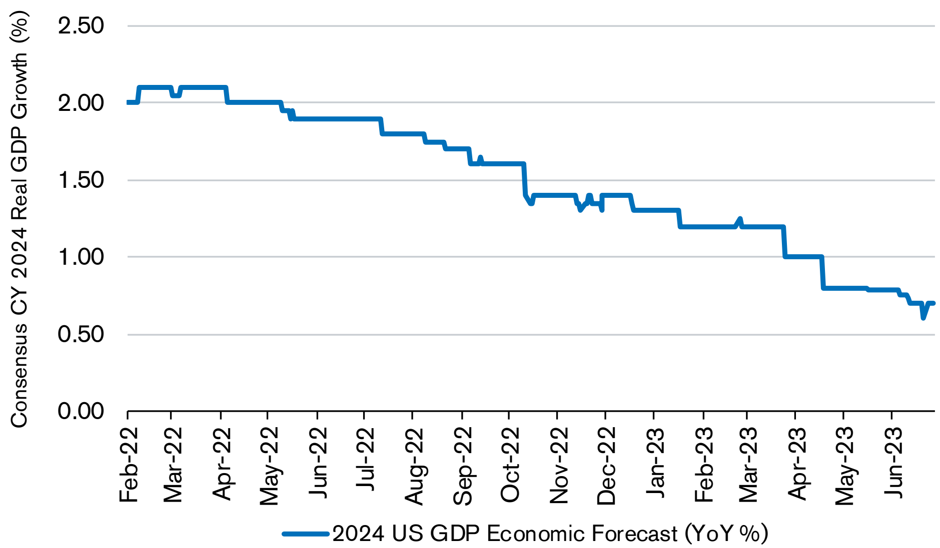
# Earnings Forecasts Look Optimistic

### MACRO CONDITIONS POSE RISK TO EPS GROWTH




Source: WestEnd Advisors, Bloomberg

### 2024 REAL GDP ESTIMATES CONTINUE TO MOVE LOWER




Source: Bloomberg, WestEnd Advisors

**Portfolio Impact:** S&P 500 EPS growth could remain subdued, in our view, even as consensus estimates appear exceedingly optimistic. As such, we are **avoiding parts of the U.S. market that we believe could see the greatest earnings headwinds** in the event of an economic slowdown, such as the **Energy, Materials, and Industrials sectors**.

Earnings growth for S&P 500 companies slowed materially in 2022 following the pandemic-driven surge. More recently, **forward earnings growth estimates have risen back into double-digits**, which could pose downside risk in a slowing economic environment.

The increase in analysts' earnings estimates stands in contrast to economists' 2024 real GDP growth estimates, which have fallen to just +0.7%, a level that has historically been consistent with recessions. **As such, we believe earnings growth could be a source of disappointment for investors in the coming quarters, particularly for cyclical sectors.**

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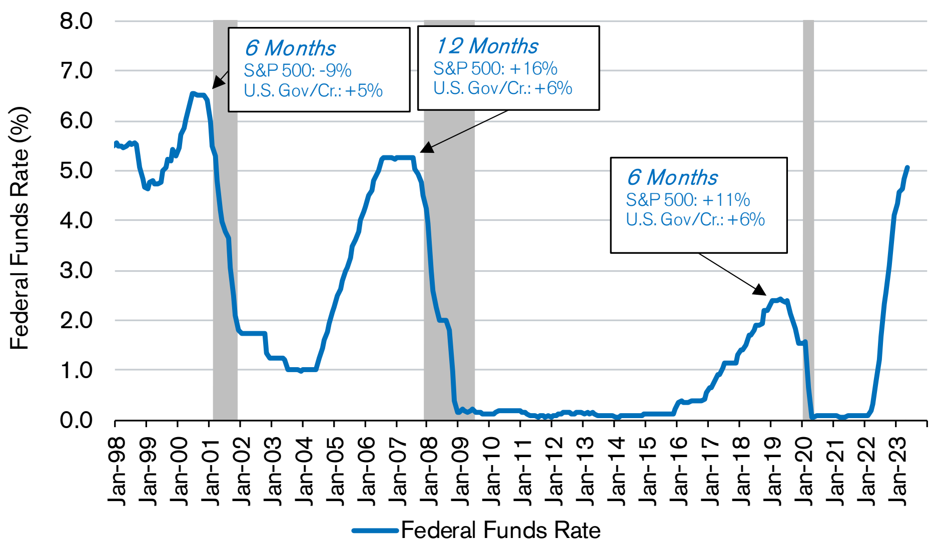
# Fed Pause Consistent with Late-Cycle Conditions

## LATE CYCLE ENVIRONMENTS CAN VARY IN LENGTH




Source: Federal Reserve, WestEnd Advisors

| Late-Cycle Core Inflation Peaks | Start of Recession | Inflation Peak to Recession (Months) | *Late-Cycle Disinflation S&P 500 Return* |
|---|---|---|---|
| *9/30/2022* | | | |
| 7/31/2018 | 2/28/2020 | 19 | *8.3%* |
| 9/30/2006 | 12/31/2007 | 15 | *12.6%* |
| 2/28/1989 | 7/31/1990 | 17 | *29.3%* |
| 6/30/1980 | 7/31/1981 | 13 | *20.9%* |
| 11/30/1966 | 12/31/1969 | 37 | *27.1%* |
| | **Average** | **20** | ***19.6%*** |

*Source: Bloomberg, WestEnd Advisors*

**Portfolio Impact: Pauses** in Federal Reserve tightening cycles **are a typical symptom of a late-stage environment and can last for several quarters.** While equities and bonds can post positive returns *during* a pause, this does not mark the beginning of a new cycle nor imply that economic growth is in the clear.

In the three most recent economic cycles, the **Federal Reserve paused its interest rate tightening cycle** during what proved to be the later stages of the cycle. In each instance, the **pause lasted between 6 and 12 months before the economy entered recession** and the cutting cycle began.

The U.S. economy has also experienced **late-cycle periods of disinflation** before (see bottom table). During these environments, the average length of **time from the core CPI peak to the start of a recession was 20 months** (16 months excluding the late 1960s outlier). Generally, **Health Care, Consumer Staples and Information Technology performed well.**



20230705-2985822

# Sector Performance Inconsistent with Sustained Economic Acceleration

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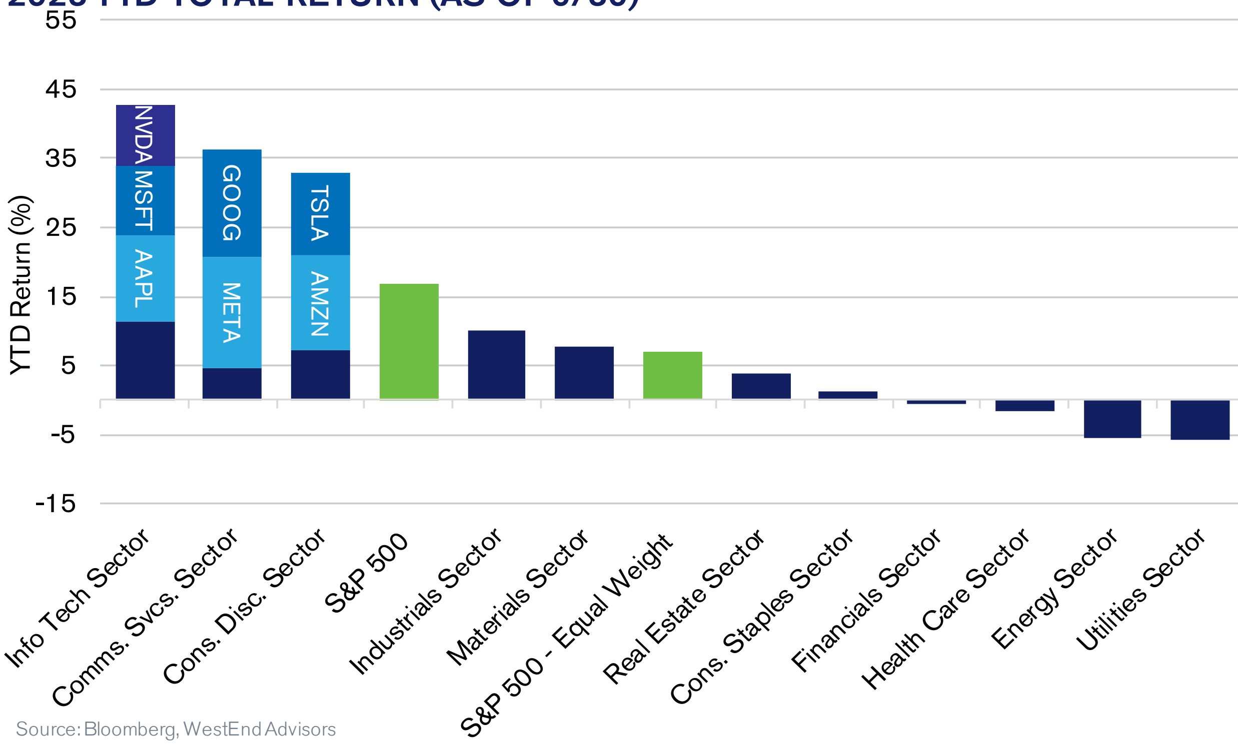
**2023 YTD TOTAL RETURN (AS OF 6/30)**




Source: Bloomberg, WestEnd Advisors

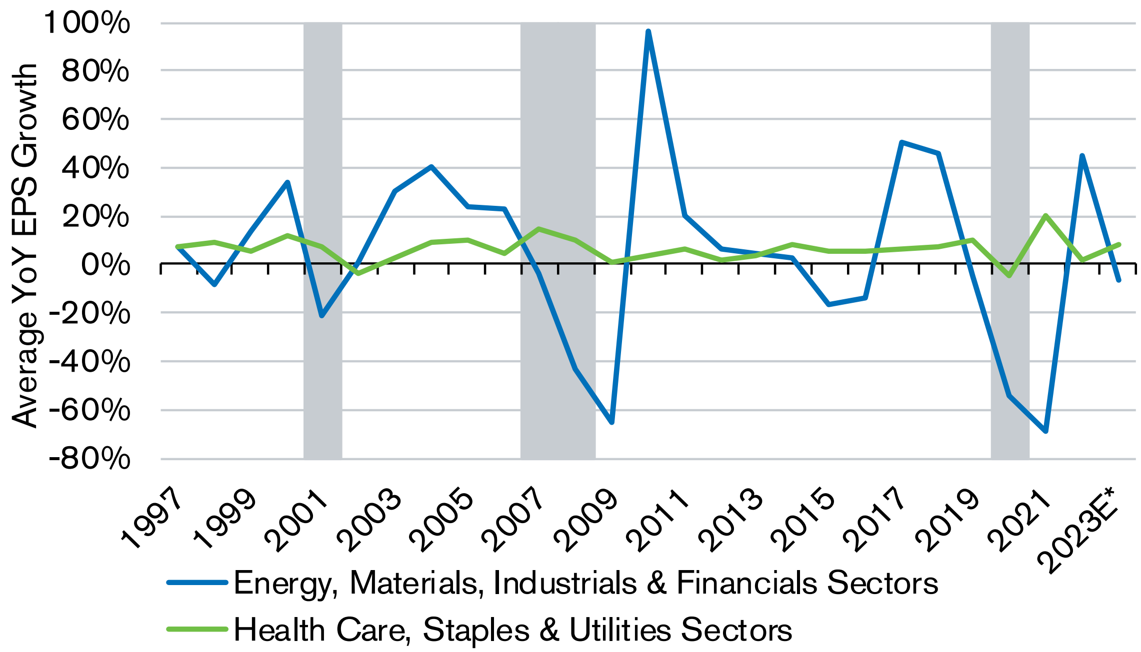
**Portfolio Impact:** The S&P 500's strong **YTD returns have been driven almost entirely by the top-heavy, mid-phase sectors that underperformed in 2022.** Disinflationary tailwinds and secular growth trends, such as the proliferation of artificial intelligence, have lifted investor enthusiasm. Notably, the more **limited market returns in early-phase, cyclical areas are not indicative of an economic growth re-acceleration**, in our view.

Market performance has been strong year-to-date, led by mid-phase sectors, and particularly the largest names within those sectors. When evaluating the performance of the remainder of the market, **we do not see signs of broad-based strength across sectors.** We believe this dichotomy between exceptionally strong mid-phase performance and more muted performance for the rest of the market **reflects disinflationary patterns (the opposite of 2022) and subdued earnings growth prospects overall**.

# U.S. Sector Outlook

# Late-Phase Sectors Provide Steady Earnings

## EARNINGS GROWTH BY SECTOR




Source: Bloomberg, WestEnd Advisors

*Consensus estimates for 2023 sector EPS.

**Portfolio Impact:** We believe exposure to defensive areas of the market – such as Health Care, Consumer Staples, and Utilities – is warranted. **Consistent and above-market profitability** makes these sectors more attractive than economically sensitive sectors at this stage of the cycle, in our view.

We see the financial stability of Health Care, Consumer Staples, and Utilities as desirable as **the economic cycle matures and the risk of a slowdown in economic growth increases**.

Defensive, **late-phase sectors have generated consistent EPS growth over time**. Alternatively, **economically sensitive sectors** like Energy, Materials, Industrials, and Financials **have much more cyclical earnings**, as illustrated in the chart above.

# Mid-Phase Sectors Have a Mix of Economically Sensitive and Non-economically Sensitive Revenue

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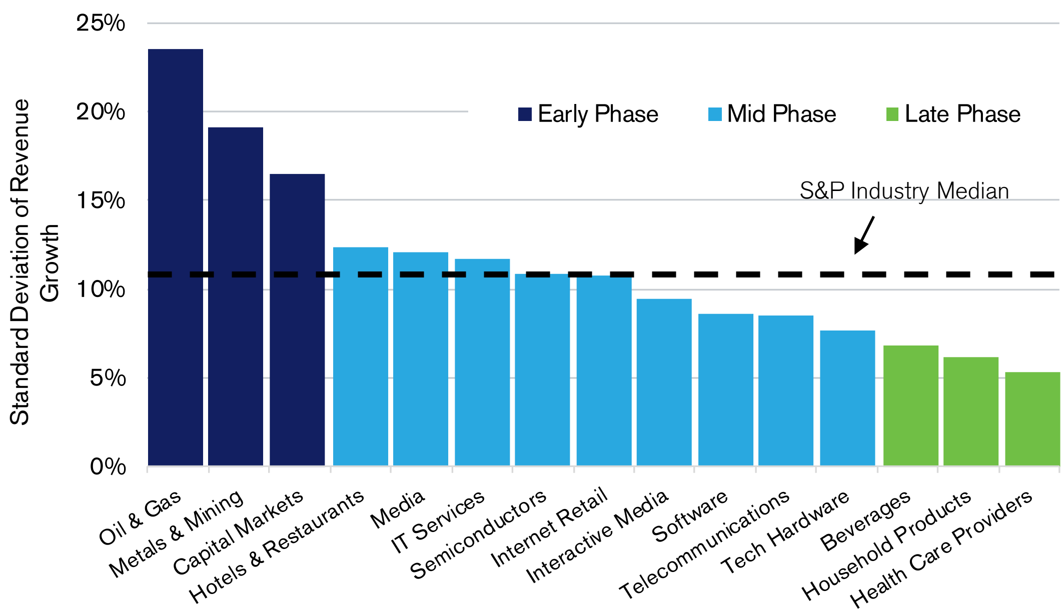
## SELECT INDUSTRY REVENUE VOLATILITY




Source: Bloomberg, WestEnd Advisors

**Portfolio Impact:** As economic growth continues to slow, **we believe Information Technology and Communication Services will see less revenue and earnings growth deceleration than other, more economically sensitive areas of the market** due to strong secular growth trends benefitting these sectors. As a result, we continue to **maintain allocations to Information Technology and Communication Services**.

The chart above highlights that the revenue variability of companies in early-phase sectors is typically much greater than those in late-phase sectors. For example, Oil & Gas industry revenue growth is nearly 5 times as volatile as Health Care Providers industry revenue growth. **Mid-phase sectors tend to have less cyclical revenue exposure than early-phase sectors**, but more sensitivity to economic growth than late-phase sectors. We see the lower revenue volatility and more secular-oriented growth profiles for these mid-phase sectors as attractive versus early-phase sectors at this stage in the cycle.

Businesses and consumers have increasingly embraced digital platforms in recent years, and **business investment spending on information processing equipment and software rose to an all-time high last year**, a trend which we expect to continue as **businesses look for ways to increase efficiency and margins in a slower growth environment.**

# Disinflation Suggests Early-Phase is Out of Favor

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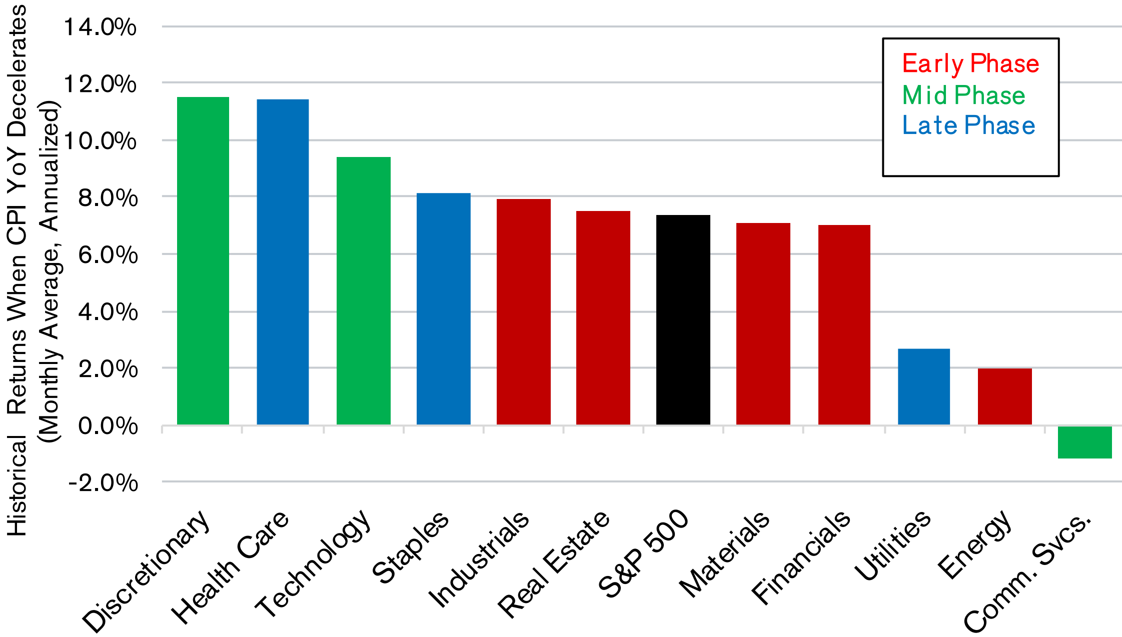
## HISTORICAL SECTOR RETURNS WHEN CPI DECELERATES




Source: WestEnd Advisors

**Portfolio Impact:** Mid- and late-phase sectors such as **Information Technology, Consumer Discretionary, and Health Care** have typically **benefitted during periods of decelerating inflation**, when economic growth is more modest. We continue to emphasize these areas within our portfolios.

Headline consumer price inflation peaked in June 2022 at +9.1% year-over-year, and it has since decelerated by about five percentage points to +4.0% year-over-year. Historically, periods of disinflation are consistent with economic activity that is either 1) expanding moderately but not overheating, or 2) contracting outright.

As shown in the chart above, key **mid-and-late phase sectors have historically outperformed during periods of disinflation**, likely due to a combination of stable or declining interest rates, easing input cost pressures, and secular growth tailwinds that can outpace a more measured pace of economic growth.

# Financials Face Challenges in Late-Cycle Environment

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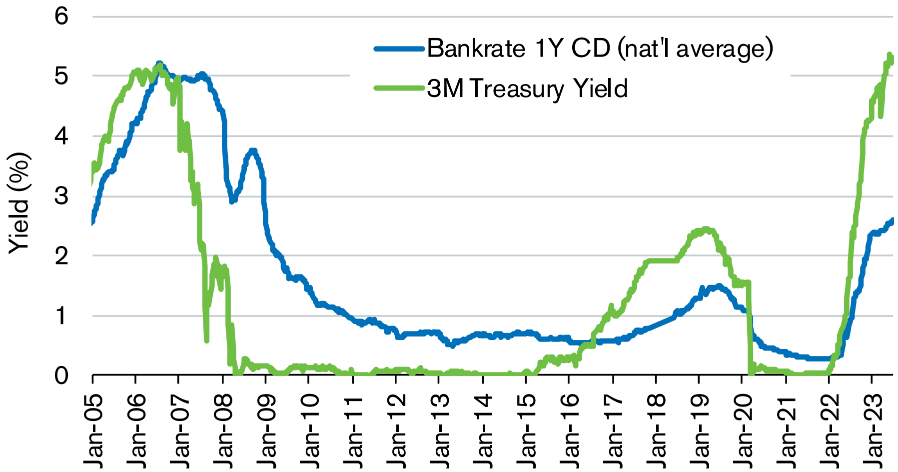
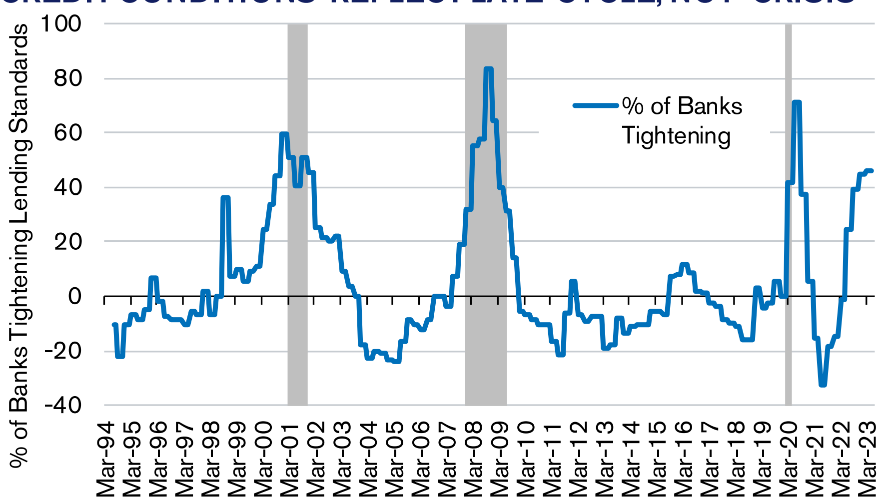
## COMPETITION FOR BANK DEPOSITS INCREASES




Source: Bloomberg, WestEnd Advisors

## CREDIT CONDITIONS REFLECT LATE-CYCLE, NOT CRISIS




Source: WestEnd Advisors, Federal Reserve, Bloomberg

**Portfolio Impact:** We are generally **avoiding the U.S. Financials sector** in portfolios as we believe the prospect of net interest margin pressure, slower loan growth in the U.S., and the building of loan loss reserves increases the likelihood of a deterioration in the earnings outlook for the sector.

Bank failures in Q1 put the spotlight on a normal late-cycle challenge for banks as short-term interest rates increase. Bank depositors now have higher-yielding alternatives for their funds, including money-market funds, which typically hold high-quality, short-term assets like 3-month Treasury bills. **Banks now need to not only increase interest paid on deposits, but also likely face additional regulatory pressure and costs** in the wake of highly visible bank failures.

In addition, as the economy enters the latter stages of the economic cycle, banks are tightening credit standards. **We expect banks to build reserves** for potential loan losses as they have done in the past. This reserve build is a **drag on bank earnings**, which are a substantial driver of the Financials sector's overall expected earnings growth.

# Expect Energy Sector Fundamentals to Remain Soft

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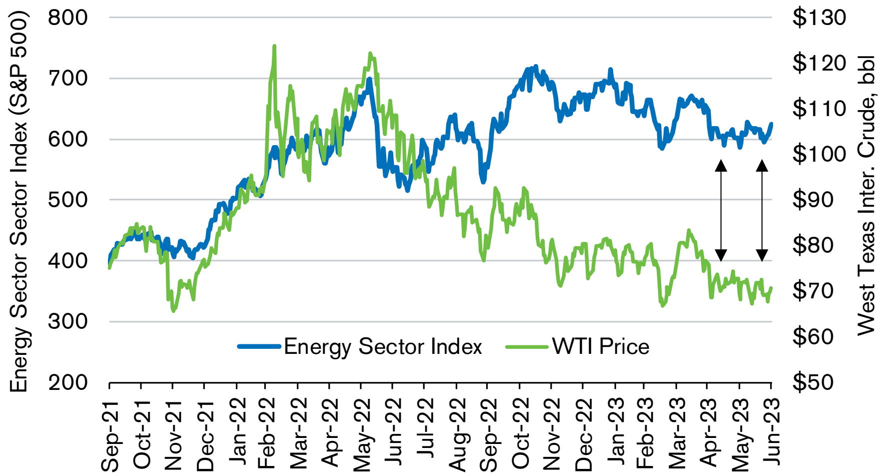
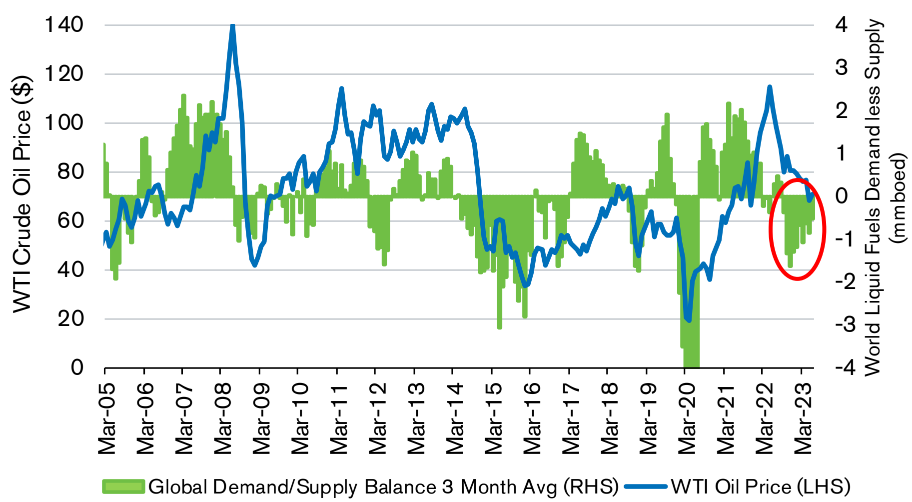
## ENERGY SECTOR INDEX VS. CRUDE OIL PRICE




Source: WestEnd Advisors, Bloomberg

## OIL MARKETS REMAIN IN SURPLUS




Source: EIA, WestEnd Advisors

**Portfolio Impact:** We continue to **avoid U.S. Energy sector exposure** in portfolios as we believe the prospect of slower growth in the U.S. and abroad, coupled with the **potential for significant margin compression**, increases the likelihood of a deterioration in the earnings outlook for the sector.

The global energy commodity complex has moved lower since mid-2022 on the back of sluggish demand and a stabilizing inventory backdrop. Still, the U.S. Energy equity sector has continued to outperform.

**The top chart shows that the price of crude oil (WTI) has diverged from the S&P 500 Energy sector**, even as oil prices present a risk for the earnings power of Energy stocks. Historically, Energy's relative performance has peaked alongside oil prices.

As the economy enters the latter stages of this cycle, we believe oil and gas demand growth is likely to subdued, in part because the post-pandemic rebound has largely played out. In fact, **global oil production has consistently outpaced consumption** since Q3 of 2022.

# International Economic & Market Backdrop

# Global Economy Remains in Slowdown Phase

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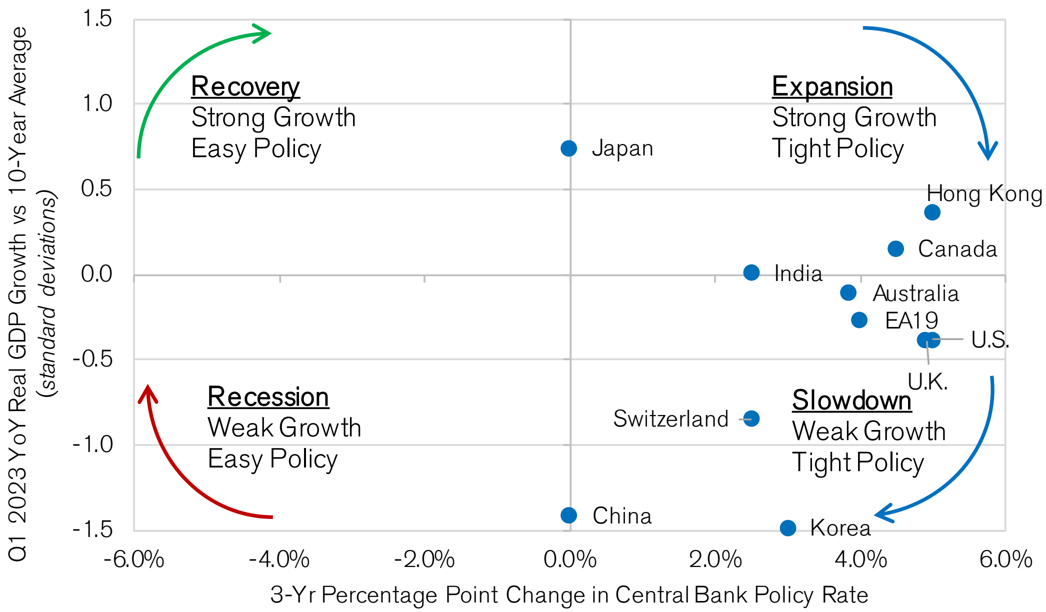
## GLOBAL ECONOMIC & POLICY CYCLE IN LATER INNINGS




Source: WestEnd Advisors

**Portfolio Impact: The global economy is in the later stages of this economic cycle**, in our view. Growth has moved below trend in most major economies, and the impact of the synchronized central bank tightening cycle is yet to be fully felt. We remain **overweight defensive regions globally, such as the U.S. and Japan.**

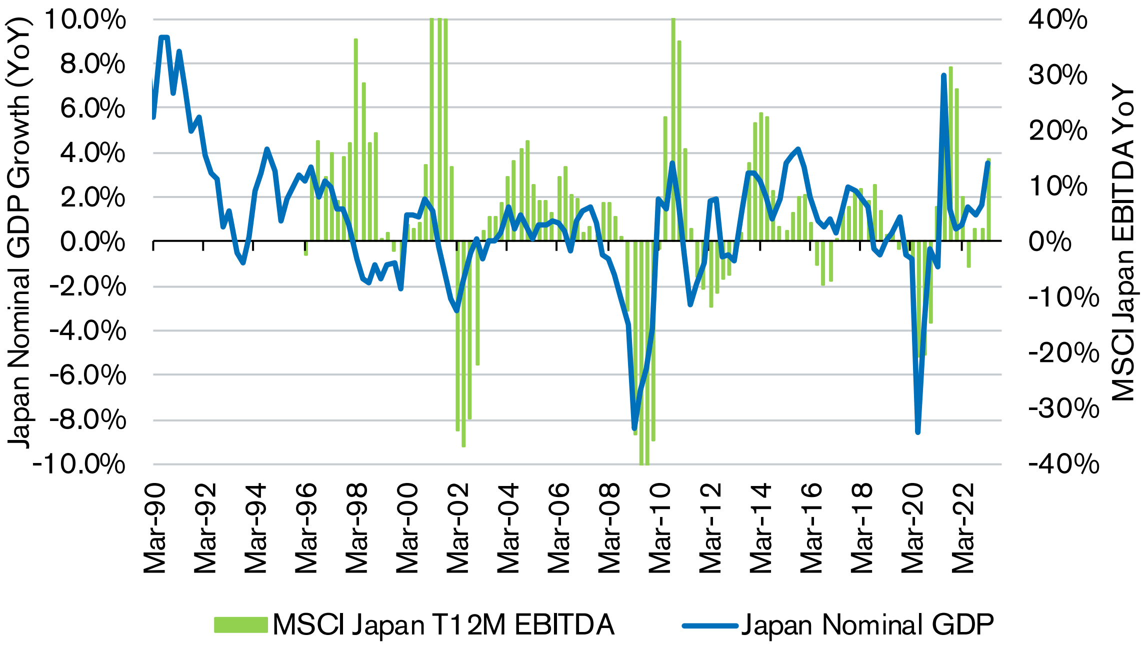
**The U.S., the Eurozone, and the U.K. are all in the later stages of the economic cycle,** in our view, amid **tight monetary conditions and still-elevated inflation**. Activity in the services sector has been resilient, but economic tailwinds (e.g., excess savings) continue to wane, and we believe **growth is at risk over next 6-18 months**.

In contrast, **Japan's economy is still transitioning from a Covid-19 recovery into a more normal expansion**, due to the gradual rebound from Covid-19 restrictions. We continue to see the potential for **healthy nominal growth,** as the BoJ has signaled it will **remain accommodative even with inflation modestly above target**.

**In China, economic headwinds have kept growth well below average levels.** The ongoing recovery in services activity has been largely offset by **soft export demand, the property sector downturn, consumer/business caution, and limited stimulus**.

# Japan's Nominal Growth Prospects Are Improving

## JAPAN'S GROWTH PROSPECTS ARE IMPROVING




Source: WestEnd Advisors

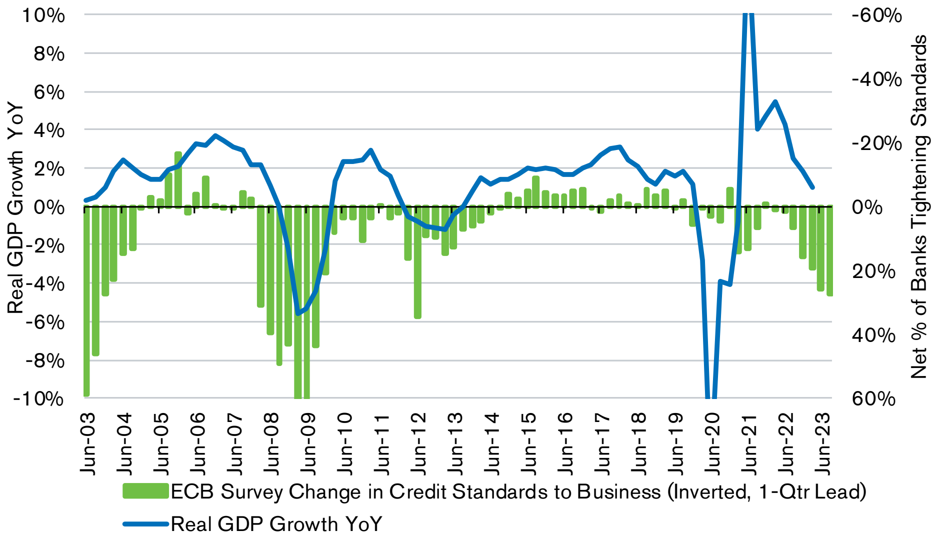
**Portfolio Impact:** We continue to overweight Japan, which not only has **fewer economic headwinds** compared to the rest of the developed world, in our view, but is also typically a more **defensive region during risk-off environments.**

The combination of expansionary real GDP growth and modestly above-target inflation has lifted **Japan's nominal GDP growth rate to one of the highest levels in the past thirty years**. Japan has been battling deflationary headwinds in recent decades, and we believe a **higher rate of nominal growth should translate into stronger earnings growth** for Japanese companies.

**We believe the BoJ is likely to remain accommodative in the coming quarters,** as it has signaled it is willing to tolerate above-target inflation in order to support the ongoing economic recovery. While the central bank is currently reviewing its yield curve control policy, we do not expect any abrupt changes in the near term, given that the BoJ has communicated its desire to achieve stable, demand-driven inflation near 2.0%.

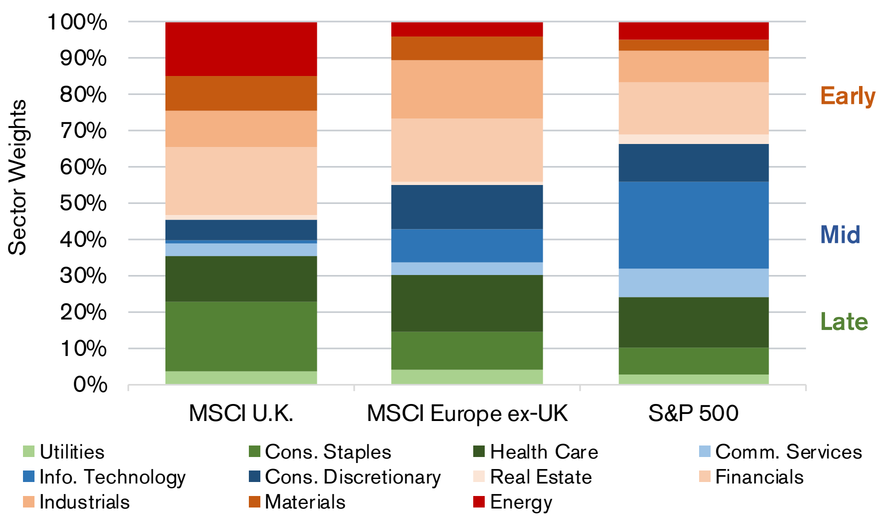
# Europe Exposed to a Cyclical Downturn

## LENDING STANDARDS LIKELY TO WEIGH ON GROWTH




Source: WestEnd Advisors, ECB, Eurostat

## …BUT EUROPE HAS MORE EXPOSURE TO EARLY CYCLICALS




Source: Bloomberg, WestEnd Advisors

**Portfolio Impact: Policy tightening, inflationary pressures, and the broad tightening of credit standards pose risks** to Europe's economic growth. As such, we continue to believe that an underweight position is warranted. The region's greater relative exposure to cyclical sectors could lead to **weaker than expected earnings outcomes**.

While the Euro area entered a technical recession in Q1 2023, **late-cycle risks have not abated**. The region continues to face several headwinds, including stickier-than-expected inflation, monetary & fiscal tightening, and banks tightening lending standards.

The top chart shows that European banks have tightened – and expect to further tighten – lending standards for businesses and consumers. **Periods of tighter lending standards have historically been associated with slower economic growth** and recession.

While recession risks also appear elevated in the U.S., **Europe has materially more exposure to cyclical sectors that are sensitive to an economic downturn** (see bottom chart)**.**

# Re-opening is a Positive for China, but Risks Remain

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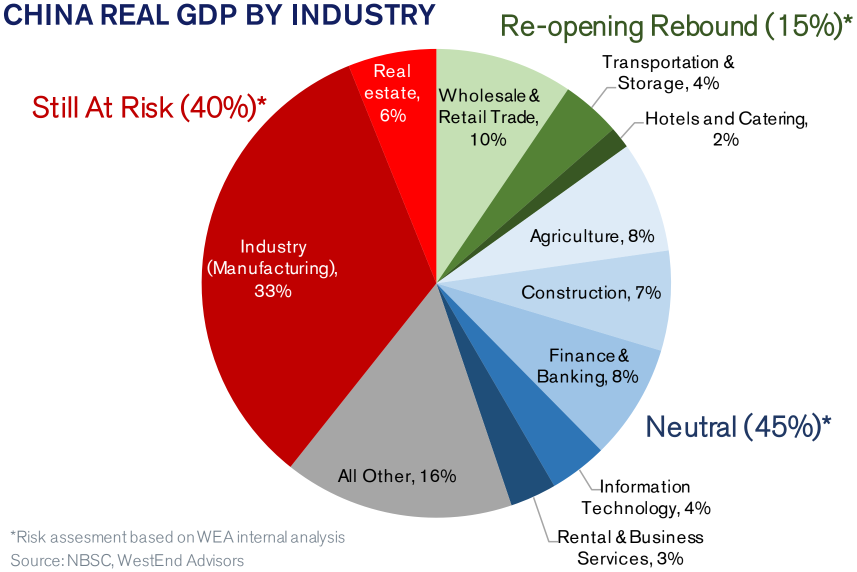
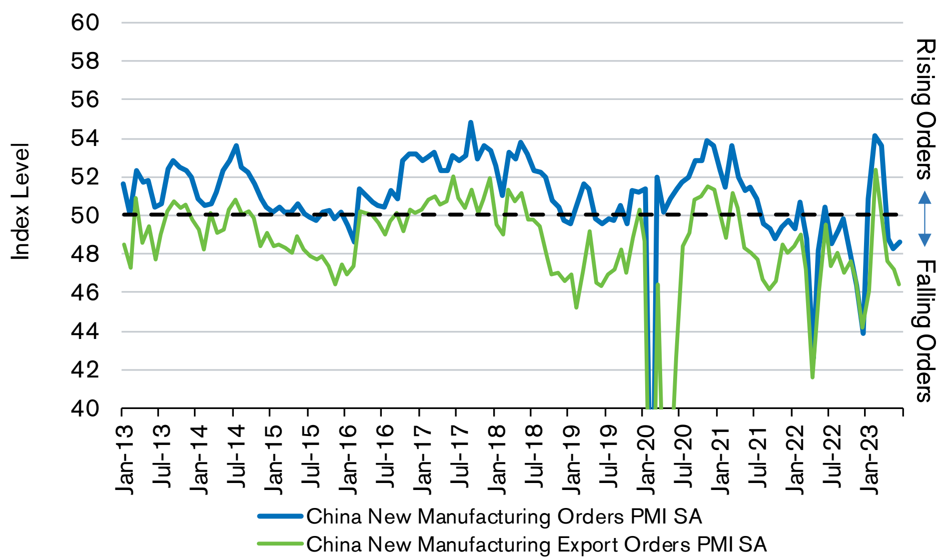
## CHINA REAL GDP BY INDUSTRY




*Risk assesment based on WEA internal analysis
Source: NBSC, WestEnd Advisors

## MANUFACTURING ORDERS IN CHINA CONTINUE TO FALL




Source: NBSC, WestEnd Advisors

**Portfolio Impact:** As the global economic cycle enters the later stages, we remain **underweight Emerging Markets (EM)** in global portfolios. We anticipate subdued near-term return potential for EM, given its dependence on exports, and do not believe that China's re-opening will generate a growth impulse strong enough to offset a global economic downturn.

While real GDP growth in China has accelerated following the removal of COVID-19 restrictions, we believe softening global demand trends are likely to dampen the country's near-term growth potential. The economic lift from **China's re-opening has been concentrated in domestic consumption-related industries, which represent a small portion of China's overall economy (see top chart).**

Slowing demand for goods in the U.S. and E.U., which account for ~40% of global GDP, should continue to weigh on production and export growth in EM countries, including China. **The bottom chart shows that the new orders sub-components of China's manufacturing PMI have moved back into contraction territory following the initial re-opening surge**.

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# Interest Rates & Real Assets

# Yield Curve Inversion Signals Late-Stage Economy

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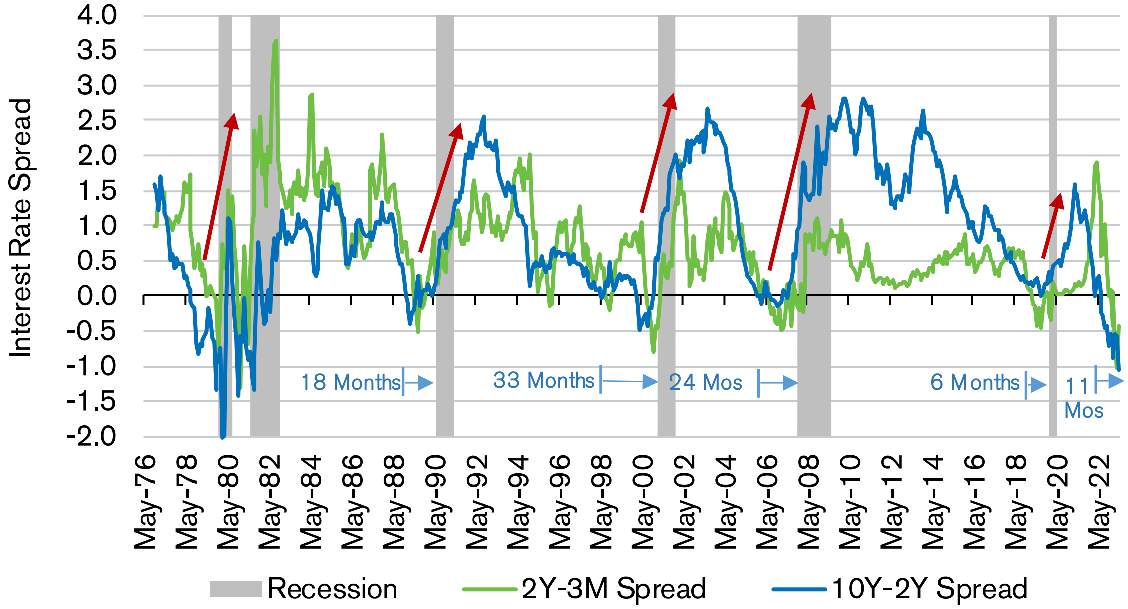
YIELD CURVE CAN STAY INVERTED FOR EXTENDED PERIODS




Source: Bloomberg, WestEnd Advisors

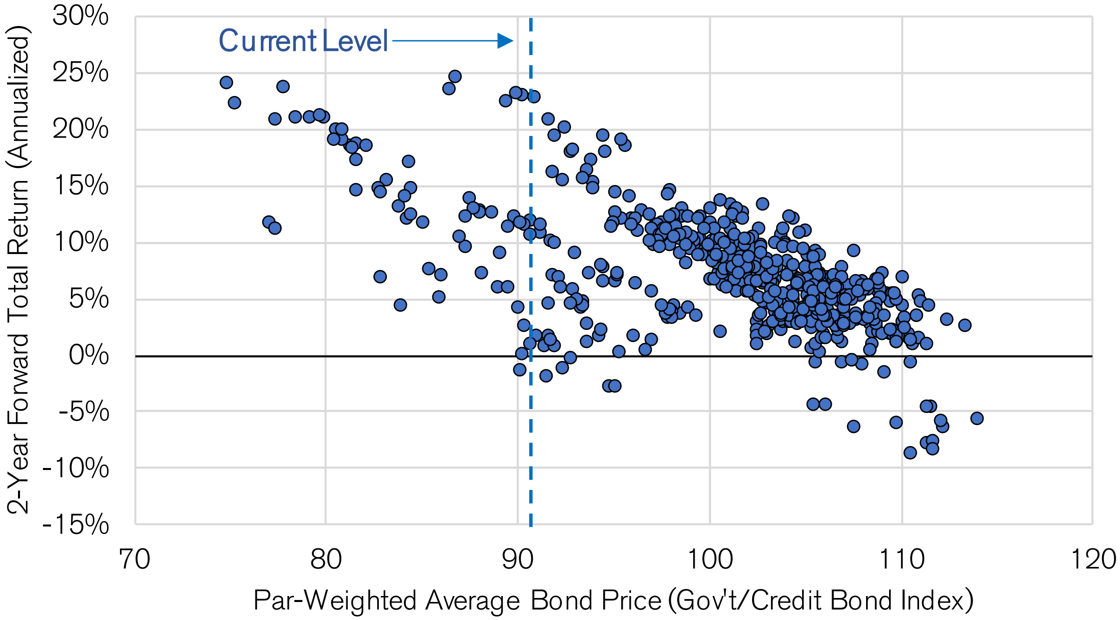
**Portfolio Impact:** With more fallout from Fed tightening and late-cycle conditions, **we see growing risks to economic growth**. As such, in balanced portfolios, we have reduced our overweight of corporate credit and **added to our defensive intermediate and long-duration Treasury exposure**, which we believe will outperform if growth and inflation surprise to the downside.

Many leading economic indicators suggest that the risk of a recession is elevated in the next 12 months, though the exact timing of its onset is uncertain. As shown in the chart above, **yield inversions typically signal that recession risk is rising, but not necessarily imminent.** We see several opportunities to position accordingly within fixed income:

- **Long-duration Treasury bonds** have historically outperformed significantly during recessionary periods, and the risk of a sustained inflationary spiral has diminished, in our view.
- **Treasury floating rate notes** are an attractive defensive allocation, in our view, as the Federal Reserve continues to raise policy rates in order to control inflation. Floating rate securities are insulated from duration risk.
- **Intermediate-and-long duration corporate bonds** are yielding ~150 bps more than the equivalent-maturity Treasury securities and, in our view, are also likely higher quality than short-duration and high-yield corporate credit.

# Downside Rate Risk Presents Potential Return Upsides

### POTENTIAL RETURNS FOR FIXED INCOME ARE ATTRACTIVE



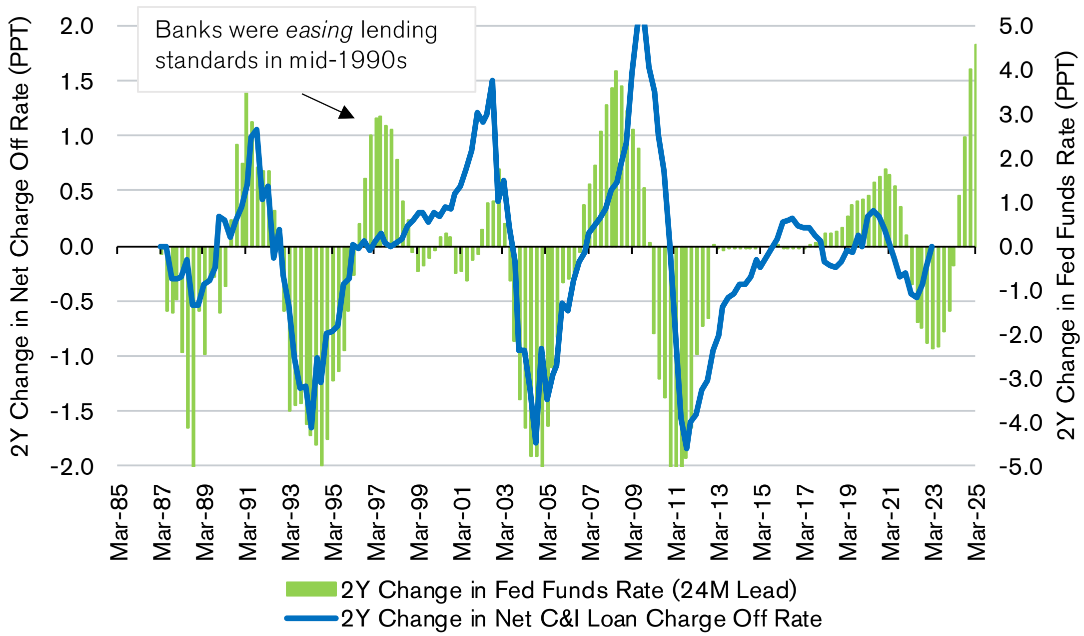

Source: Bloomberg, WestEnd Advisors

**Portfolio Impact:** Given recent disinflationary trends, which we expect to continue, coupled with mounting risks to the economic backdrop, **we see limited upside risk to long-term interest rates** moving forward. As a result, **we maintain an overweight allocation of fixed income** in balanced portfolios, and we are avoiding cyclical U.S. equity sectors **that historically have had underperformance associated with declines in interest rates** within our equity allocations.

After a surge in interest rates in 2022, **we believe the risk for long-term rates is likely skewed to the downside within our investment window,** even if the Fed maintains restrictive policy this year. Historically, when average bond prices have been at-or-below levels reached last year, fixed income returns over the subsequent two years have been consistently positive and often well above-average. **Thus, we see attractive return opportunities in fixed income given our interest rate outlook**.

# Time to Trim Credit and Build Treasury Exposure

## CREDIT DETERIORATION HAS ONLY JUST BEGUN




Source: WestEnd Advisors

**Portfolio Impact:** Rising net charge-offs for loans are typical at this point in the cycle. **Higher interest costs, lower credit availability, and decelerating profits growth** have the potential to weigh on credit markets in the next 18 months, in our view. As such, we have moved to an **underweight of corporate credit** within our balanced portfolios.

Monetary policy tightening cycles raise interest expenses for both households and businesses and are intended to slow economic growth and inflation. The chart above demonstrates that **changes in the Federal Funds Rate have historically led changes in C&I loan net charge-offs by as much as 2 years.** During the last "soft-landing" in the mid-1990s, banks were easing lending standards, unlike the rapid tightening we have experienced this cycle. As a result, we believe there is a **high probability that credit fundamentals deteriorate further over the next 18 months**.

# Asset Class Returns Driven by Macro Environment

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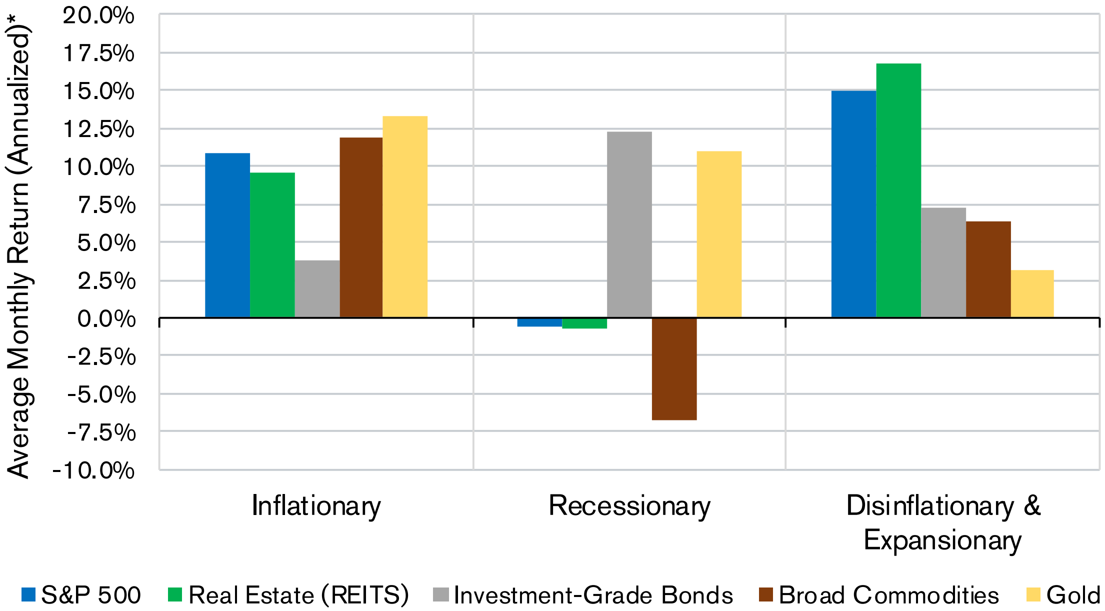
## MACRO CONDITIONS DRIVE ASSET CLASS DISPERSION




Source: Bloomberg, WestEnd Advisors *Covers all periods since 1975.

**Portfolio Impact:** Moving forward, we see a growing likelihood that recent inflation pressures fade as the risk of recession rises. As such, we are **emphasizing fixed income and gold in our multi-asset portfolios**, while underweighting or avoiding the most economically-sensitive assets, such as equities, real estate, and broad commodities.

The economic and market volatility exhibited so far this cycle have showcased that asset class performance can vary significantly depending on the underlying economic environment. During inflationary environments, which occurred in 2021 and 2022, we believe commodities can add significant capital appreciation potential and inflation protection to a portfolio.

However, as we look ahead in 2023, **we believe there is potential for the inflationary backdrop to shift into one of deteriorating economic growth**. As such, we have repositioned our multi-asset portfolios to protect capital in the event of a downturn. As the chart above shows, investment grade bonds and gold have historically outperformed other classes during recessions.

# Footnotes & Disclosures

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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 Bloomberg Barclays US Aggregate Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. The Bloomberg Barclays US Aggregate Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. An index is unmanaged and is not available for direct investment.

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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.



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