WESTEND
Advisors

A VICTORY CAPITAL® INVESTMENT FRANCHISE

Mid-Quarter Macro Update

Q4 2023

20231120-3242591

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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

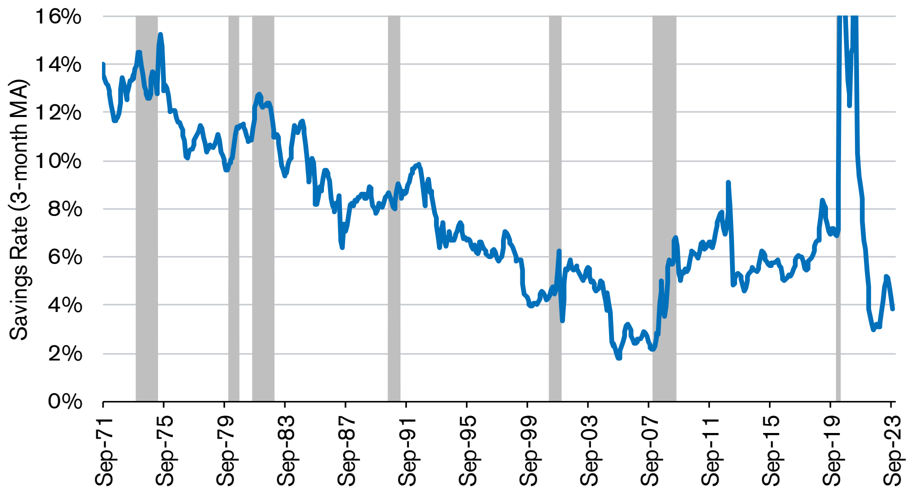
- Energy
- Financials
- Industrials
- Materials
- Real Estate

* For illustrative purposes only. Allocation information as of November 15, 2023. Source: WestEnd Advisors.

Economic & Market Backdrop

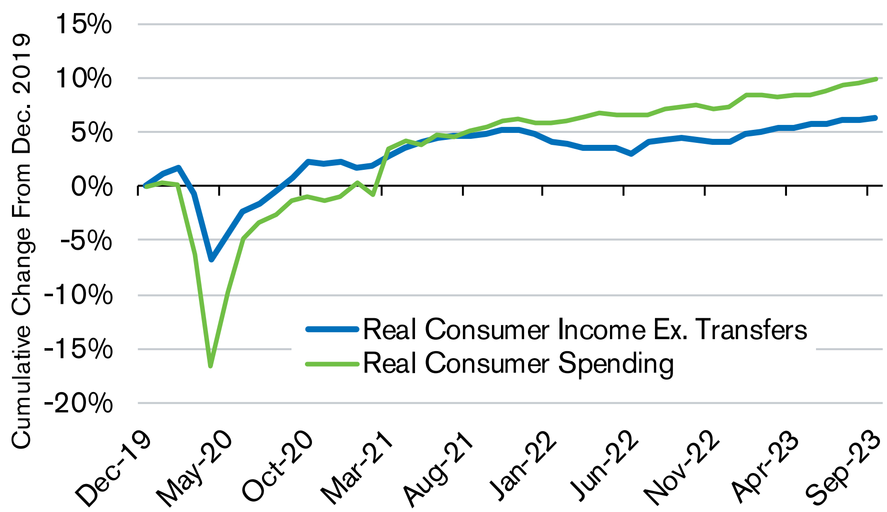
Consumer Spending Growth Unlikely to Accelerate

FURTHER SAVINGS RATE DECLINES UNLIKELY FROM HERE



Source: Bureau of Economic Analysis, WestEnd Advisors

CONSUMPTION AT RISK AS EXCESS SAVINGS DWINDLE



Source: BEA, WestEnd Advisors

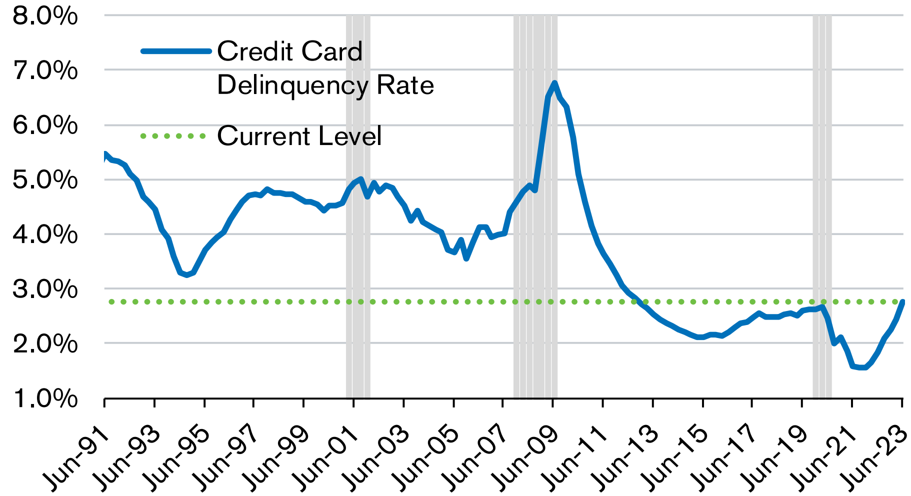
Portfolio Impact: The U.S. consumer has benefited in recent quarters from elevated savings during COVID. With excess savings diminishing, interest costs rising, and student loan payments restarting, **consumers are likely to have less spending fuel going forward**. A more challenged U.S. consumer could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

The rapid decline in the household savings rate was a key driver of robust personal consumption growth over the past two years. With the **savings rate now near the low end of its historical range** (see top chart), we believe households' ability to finance consumption via savings has largely evaporated.

Looking ahead, consumers face a growing number of headwinds, including rising interest costs and slowing nominal wage growth, **making the recent divergence between consumption and income growth unlikely to persist, in our view.**

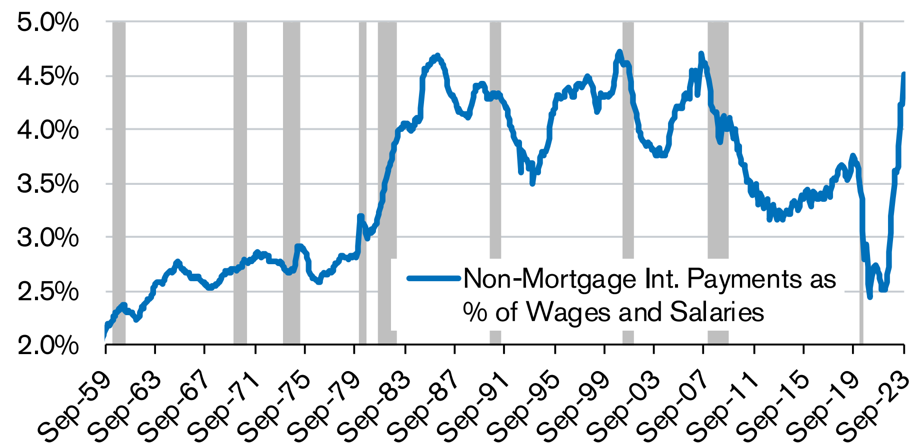
Consumers Likely to Face Increasing Pressure in 2024

CREDIT QUALITY HEALTHY, BUT RATE OF CHANGE NOTABLE



Source: Federal Reserve, WestEnd Advisors

FINANCING COSTS TO WEIGH ON CONSUMERS



Source: BEA, WestEnd Advisors

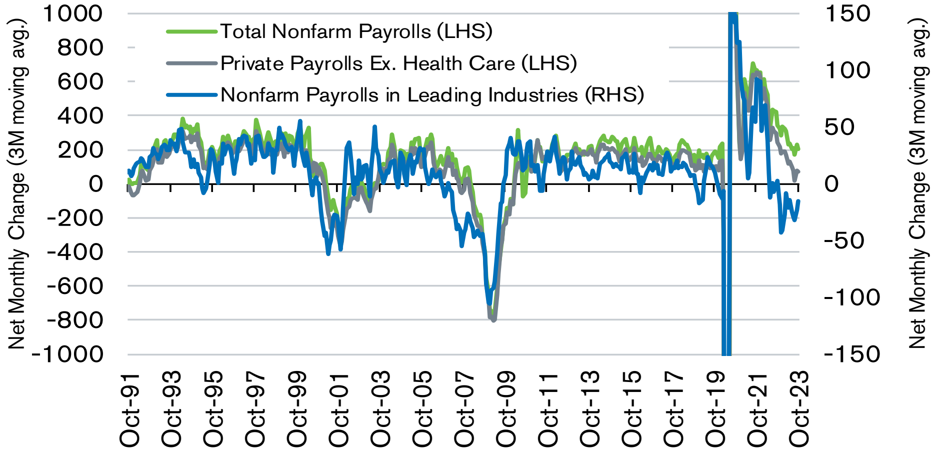
Portfolio Impact: Many of the factors that supported economic growth in recent quarters are not likely to persist next year, in our view, and **consumers may feel more pain from higher interest rates.** As such, we continue to limit cyclical exposures across our portfolios, and remain **underweight equities relative to fixed income** in traditional balanced portfolios.

Since the start of the current economic cycle, **consumers have benefitted from fiscal stimulus, a strong labor market, and elevated nominal wage growth,** which have facilitated healthy personal consumption growth and kept default rates on consumer loans at low levels.

However, our outlook for the consumer in 2024 is less sanguine, as default rates are on the rise, just as **consumers are forced to contend with a dramatically higher interest rate backdrop**. These factors portend a higher degree of risk for the U.S. economy next year, which may manifest in a variety of ways, including deteriorating credit quality for U.S. consumers.

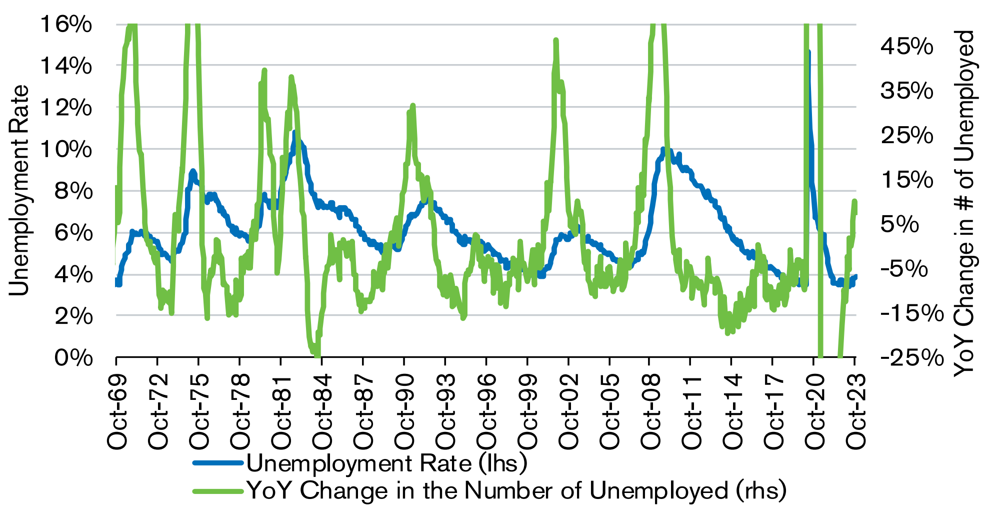
Leading Labor Market Data Starting to Deteriorate

PAYROLL GROWTH SLOWING RAPIDLY



Source: WestEnd Advisors, BLS; Covid extremes cut from chart

GROWTH OF UNEMPLOYED FORESHADOWING FURTHER LABOR WEAKNESS



Source: WestEnd Advisors

Portfolio Impact: Job growth has been 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 healthy, **signs of incremental softening in the job market have started to show up in *leading* payrolls categories** (e.g., temp workers, credit intermediation, and warehousing).

Similarly, **growth in the number of unemployed people from a year prior** is at levels that have historically foreshadowed broader deterioration in the labor market. While the unemployment rate remains low, **looking under the surface points toward a more mixed picture.**

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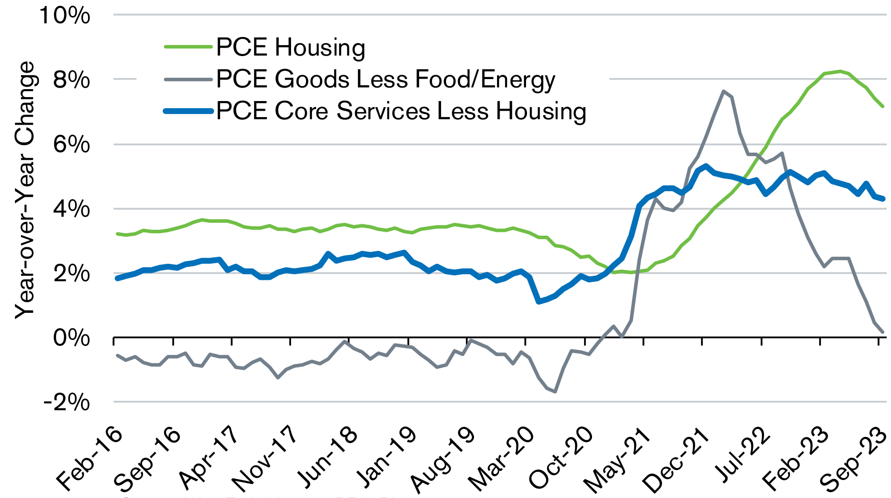
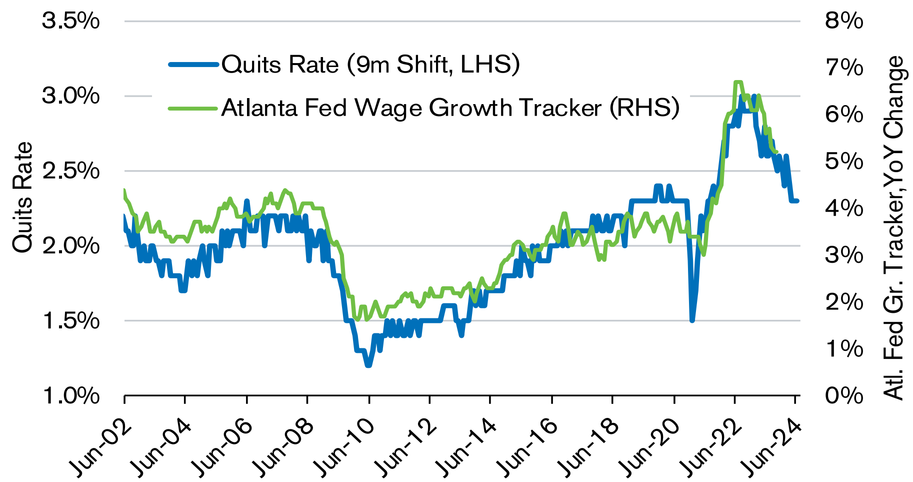
Federal Reserve May Have More Flexibility in 2024

WORK REMAINS TO BE DONE ON SERVICES INFLATION…



Source: WestEnd Advisors, BEA, Bloomberg

… BUT SLOWING WAGE GROWTH SIGNALS PROGRESS



Source: WestEnd Advisors, Atlanta Fed, BLS

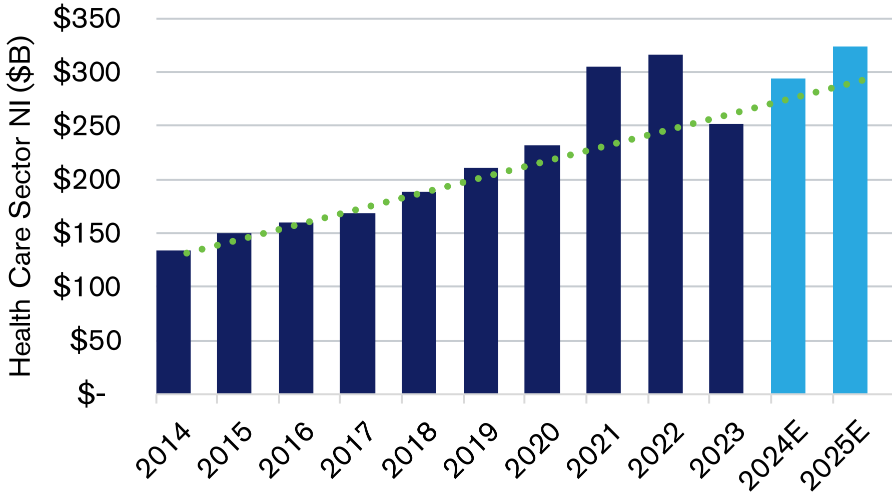
Portfolio Impact: Periods of **disinflation** have **historically benefited mid- and late-phase sectors**. Slow growth and disinflation are also catalysts for lower interest rates, in our view, which supports the opportunity in sectors like **Health Care, Consumer Staples, and Information Technology.**

Progress on services inflation remains slow, but we see core PCE inflation continuing to decelerate into 2024. Services inflation stickiness may make the Fed wary of pre-emptively cutting rates, **but signs of a more balanced labor market, including decelerating wage growth, may give the central bank more confidence that services disinflation is in the pipeline.**

With signs of labor market softening, including a lower quits rate and fewer job openings, and given the significant progress made on inflation, **we see the Fed as having more flexibility to manage policy rates over the course of 2024**.

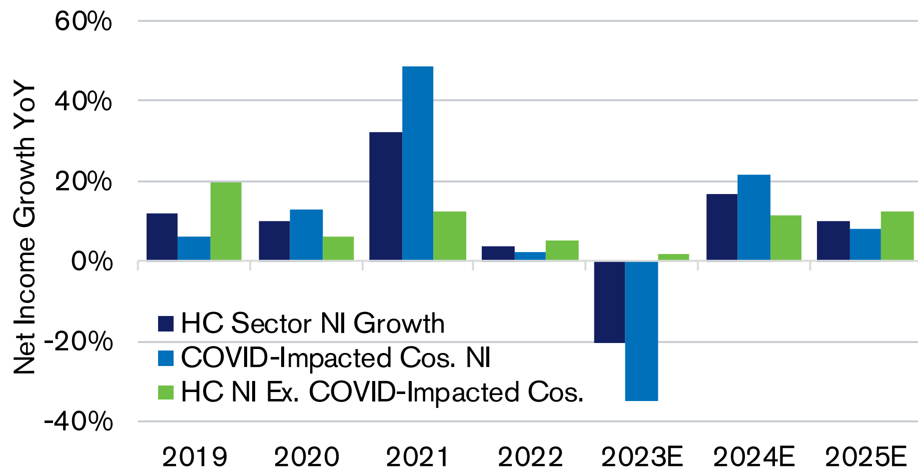
Positioned for Improving Health Care Fundamentals

HEALTH CARE NET INCOME POISED TO REBOUND…



Source: Bloomberg, WestEnd Advisors

…AFTER SIGNIFICANT COVID-DRIVEN VOLATILITY



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: We believe **Health Care sector** exposure provides attractive **defensive** characteristics with **insulation from cyclical risks** but also leaves portfolios **well positioned** for a **rebound in sector earnings growth** as COVID-related impacts recede.

Health Care sector earnings have been volatile over the last several years driven, in large part, by the impact of the COVID pandemic (e.g. vaccines, testing, treatments). **COVID-related spending led to a substantial increase in revenue and net income for the sector in 2021 and 2022,** but as we've moved past the pandemic, a slowdown in COVID-related spending and tough comparisons have led to a substantial drag on 2023 earnings.

Looking ahead, we anticipate Health Care sector earnings could grow double-digits in the next two years. This dynamic, combined with the sector's historically defensive characteristics, make it an attractive sector to own at this point in the economic cycle, in our view.

International Economic & Market Backdrop

Global Economy Remains in Slowdown Phase

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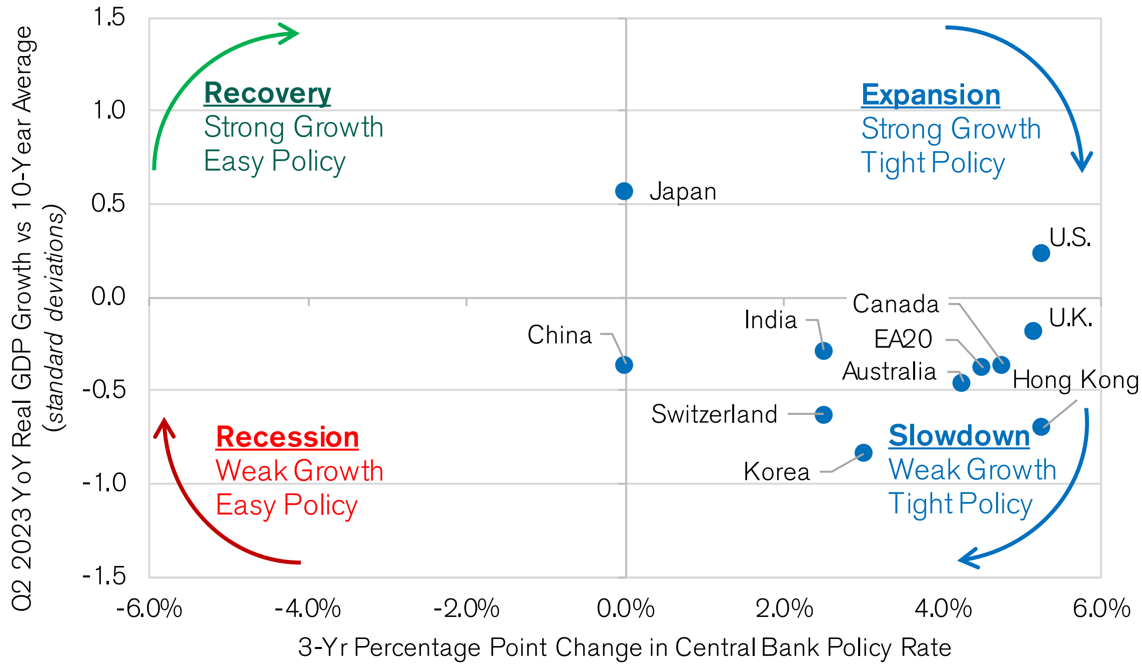
GLOBAL ECONOMIC & POLICY CYCLE IN LATER INNINGS



Source: WestEnd Advisors

Portfolio Impact: The global economy is in the later stages of this economic cycle, in our view. Growth is at-or-below trend in most major economies, and we believe the impact of the synchronized central bank tightening cycle has 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 persistently 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 nominal GDP growth rate has accelerated to one of the highest levels in the past thirty years**, and we believe a higher rate of nominal growth should translate into stronger earnings growth for Japanese companies.

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

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Interest Rates & Credit

Fixed Income Return Potential Improves with Higher Rates

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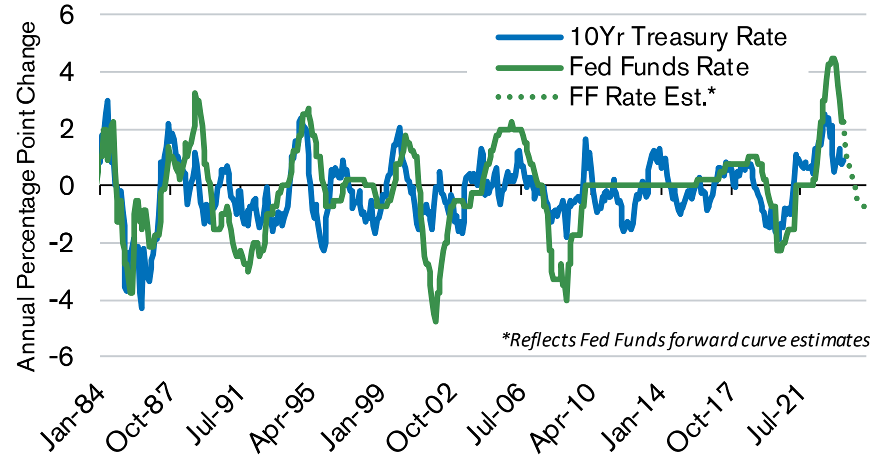
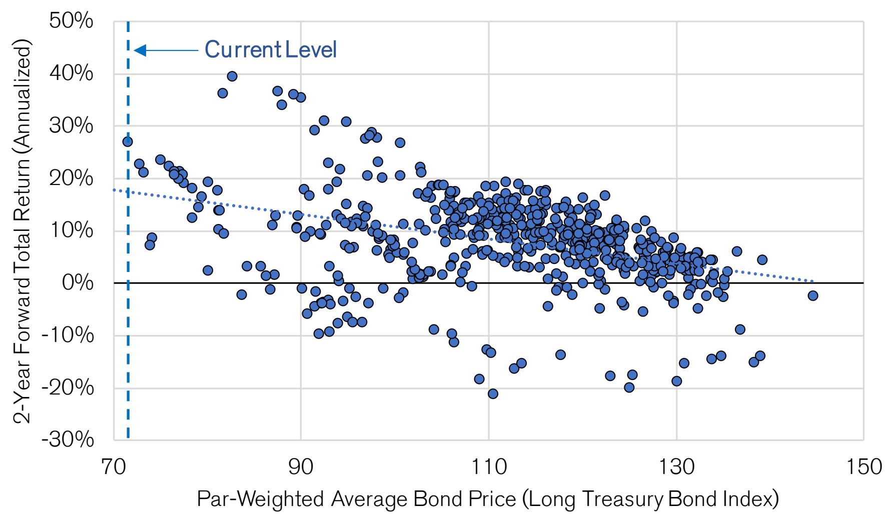
FED POLICY HEADWIND TO LONG BONDS ABATING



Source: Bloomberg, WestEnd Advisors

POTENTIAL RETURNS FOR LONG TREASURIES ARE ATTRACTIVE



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: Recent disinflationary trends are likely to provide the Fed with increased policy flexibility over the coming quarters, in our view, implying potentially lower interest rates over the course of our investment time horizon. As a result, **we find the risk/reward for long-term bond returns appealing** and, therefore, are maintaining an overweight allocation to long-duration fixed income in balanced portfolios.

Following the rapid rise in interest rates since the beginning of 2022, **we believe the risk for long-term rates is likely skewed to the downside within our investment window,** due in part to the Fed likely being at or near the end of its tightening cycle (see top chart).

Historically, when long-duration Treasury bond prices have been at-or-below current levels, returns over the subsequent two years have been consistently positive and often well above average. **We see attractive return opportunities in fixed income given our interest rate outlook**.

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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