WESTEND
Advisors

A VICTORY CAPITAL® INVESTMENT FRANCHISE

Mid-Quarter Macro Update

Q1 2024

20240220-3402628

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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
- Financials

Sector Avoidance

- Energy
- Industrials
- Materials
- Real Estate

* For illustrative purposes only. Allocation information as of February 20, 2024. Source: WestEnd Advisors.

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Economic & Market Backdrop

Economic Support Extended the Cycle in 2023

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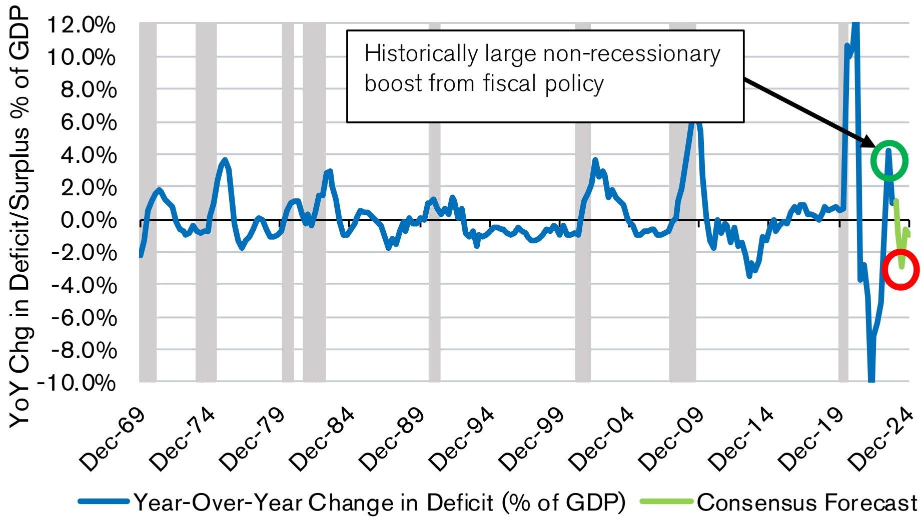
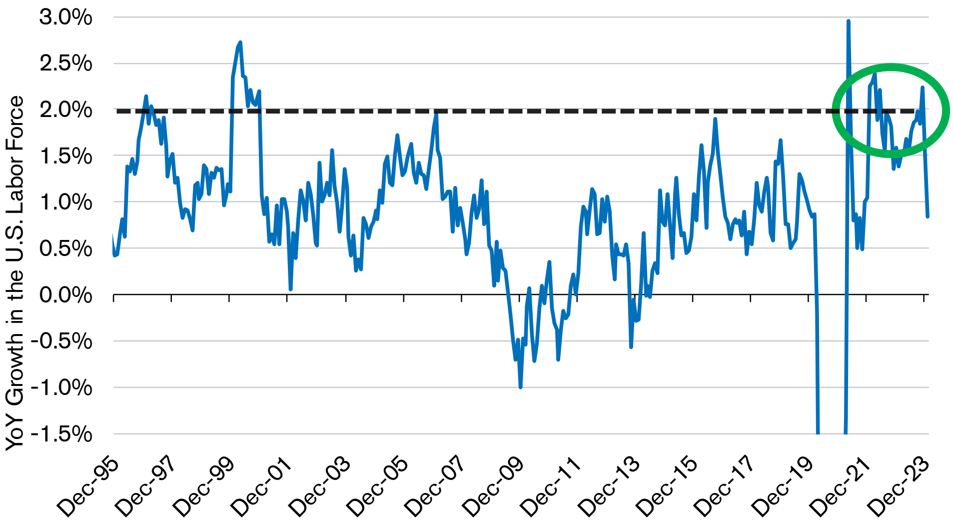
FISCAL POLICY TAILWIND TO GROWTH IS SET TO FADE



Source: U.S. Treasury Department, BBG, WestEnd Advisors

RESURGENCE IN LABOR FORCE GROWTH BOOSTED INCOME



Source: WestEnd Advisors, Bureau of Labor Statistics

Portfolio Impact: Strong government spending, workers re-entering the labor force, and other factors **provided unanticipated support to growth in 2023**. While **we see these trends waning in the quarters ahead**, and therefore are emphasizing a mix of defensive sectors like **Health Care, Utilities, and Consumer Staples**, we also believe that an allocation to more economically sensitive sectors like **Information Technology and Communication Services** is warranted.

A range of indicators had begun showing late-cycle conditions at the start of 2023. As a result, we had anticipated slowing economic growth with an elevated risk of recession last year.

While many negative trends played out, **several economic bullets were dodged** (e.g., regional bank failures, inventory reset, drop in existing home sales) as the risks to growth were at least partly **offset by developments that supported economic activity.** Looking ahead, we expect many of these developments, like government spending and above-trend labor force growth, **to prove less supportive of economic growth**.

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Consumption to Realign with Fundamentals in 2024

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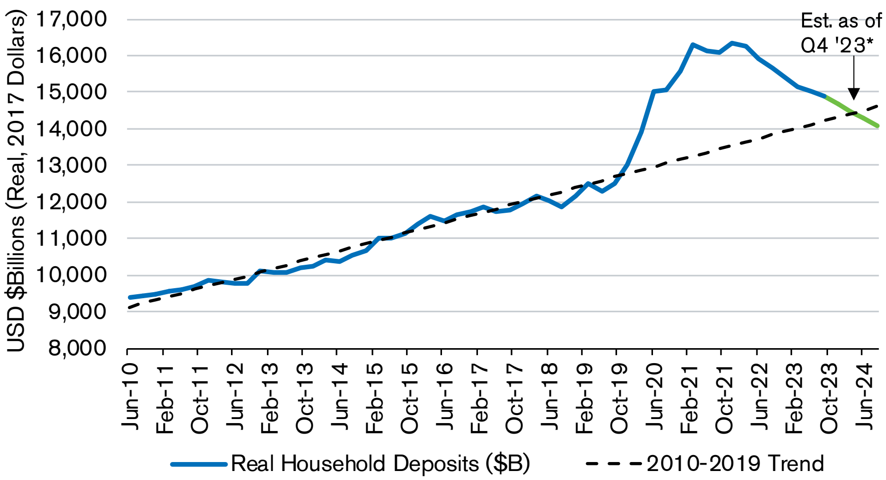
HOUSEHOLD DEPOSITS

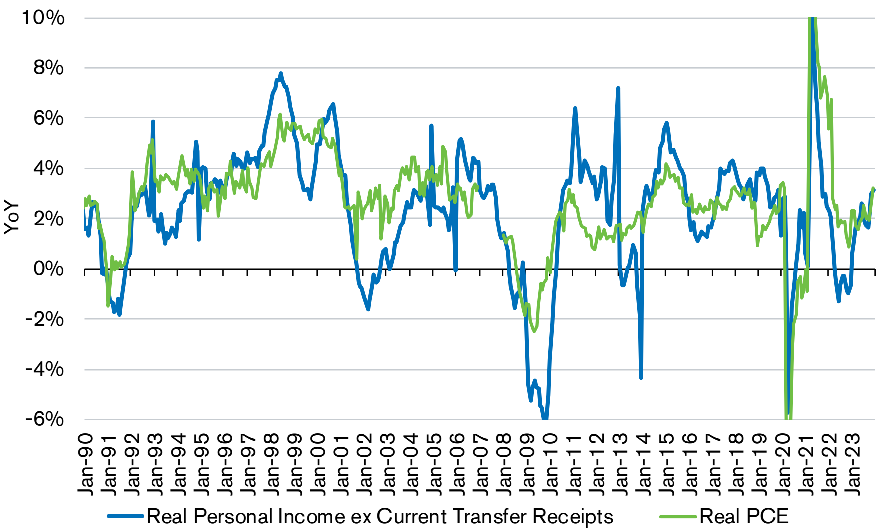
CHECKING & SAVINGS ACCOUNTS + MONEY MARKET MUTUAL FUNDS



**Green forecast data represent projection using current trend*

Source: WestEnd Advisors, Federal Reserve

REAL SPENDING GROWTH TRACKS REAL INCOMES OVER TIME



Source: BEA, Bloomberg, WestEnd Advisors

Portfolio Impact: Many of the unusual factors that supported consumption growth post-COVID are unlikely to persist in 2024, in our view. In their place, we think that **more traditional fundamental drivers of consumption are taking hold**. With job gains and nominal income growth still positive but moderating, we continue to **deemphasize or even avoid exposure to the most economically sensitive areas of the market**.

Consumers outspent their income in the second half of 2023, which drove the savings rate lower but also supported economic growth. Further "excess spending" (i.e., declines in the savings rate) should be constrained by shrinking savings (see top chart) and the now meaningfully higher cost of debt.

With less savings to tap into and reduced credit availability, aggregate consumption growth should be more reliant on aggregate income growth in 2024. **Aggregate income growth will remain positive but slow, in our view, due to conditions more typical of a late-cycle environment.**

Economic Resilience Could Lead to Cycle Extension

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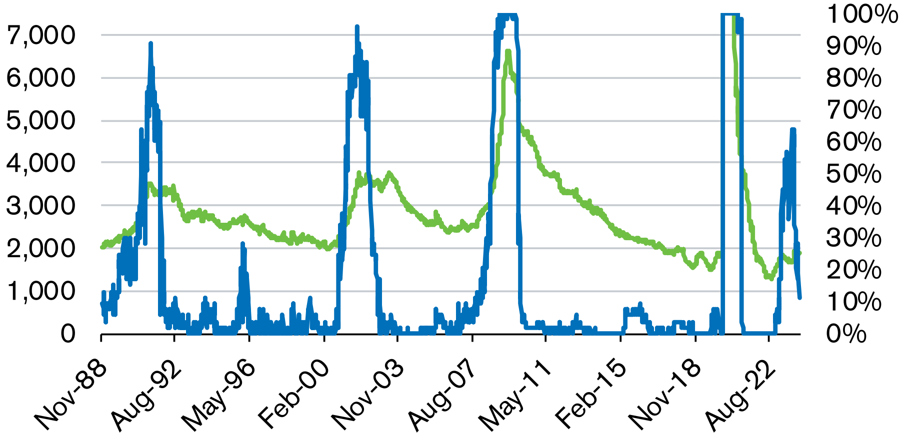
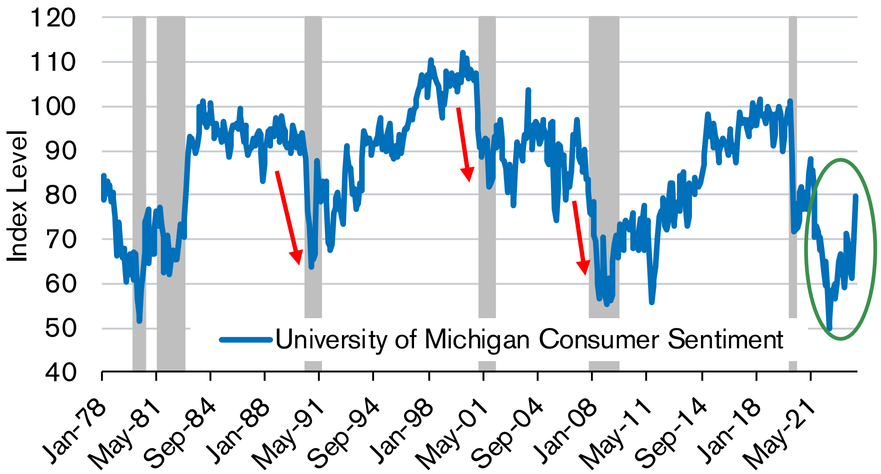
NEAR-TERM LABOR MARKET RISK RECEDING



Source: Dept. of Labor, WestEnd Advisors

ECON. RESILIENCE & DISINFLATION DRIVE OPTIMISM



Source: University of Michigan, BBG, WestEnd Advisors

Portfolio Impact: We continue to allocate to a **mix of defensive sectors**, like Health Care and Utilities, **and more economically sensitive sectors**, like Communication Services and Financials, as our outlook increasingly contemplates the prospect of continued economic resilience.

The ongoing resilience of some economic data in recent months, combined with the flexibility for the Fed to cut rates amid slowing inflation, **enhances the likelihood of an environment characterized by slowing, but sustained, economic growth**, in our view.

A sharp decline in consumer sentiment and deteriorating leading labor market data have historically preceded periods of significant economic weakness. While macro risks remain elevated, in our view, **signs of stabilization in the labor market and some other economic indicators, coupled with the near-term prospect of monetary easing, have boosted consumer and business sentiment.**

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Fed Policy is Moving Front and Center

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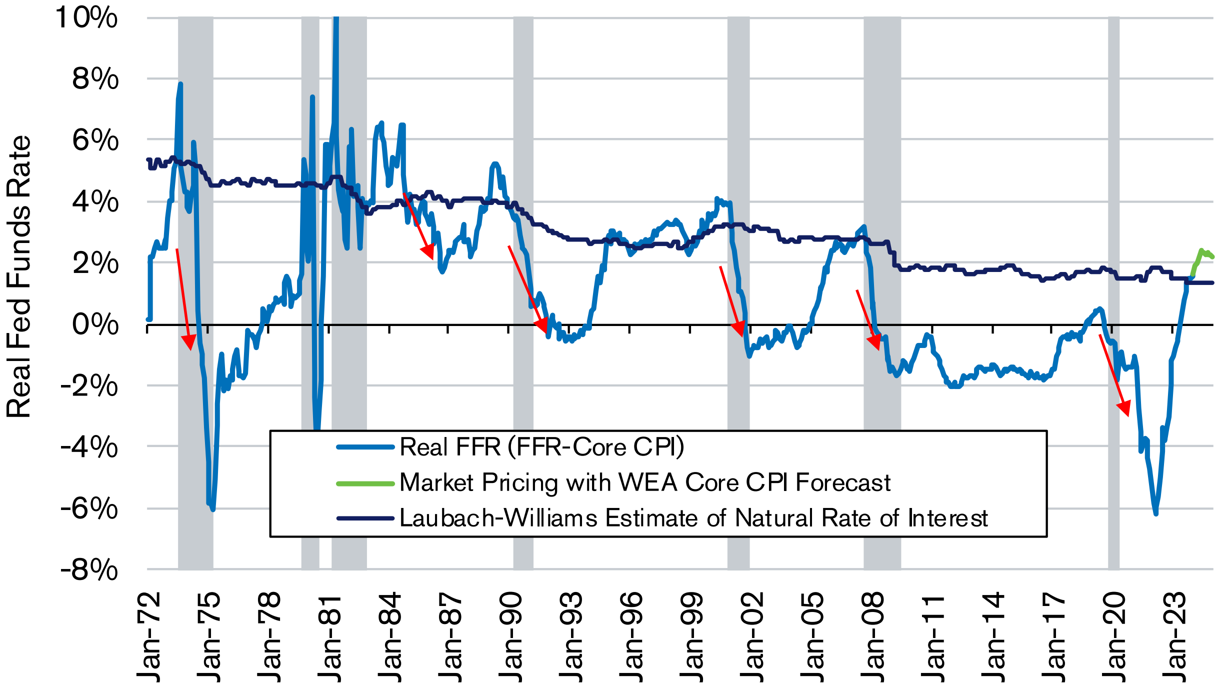
REAL RATES TO REMAIN HIGH EVEN WITH CUTS IN '24



Source: WestEnd Advisors, BLS, Bloomberg

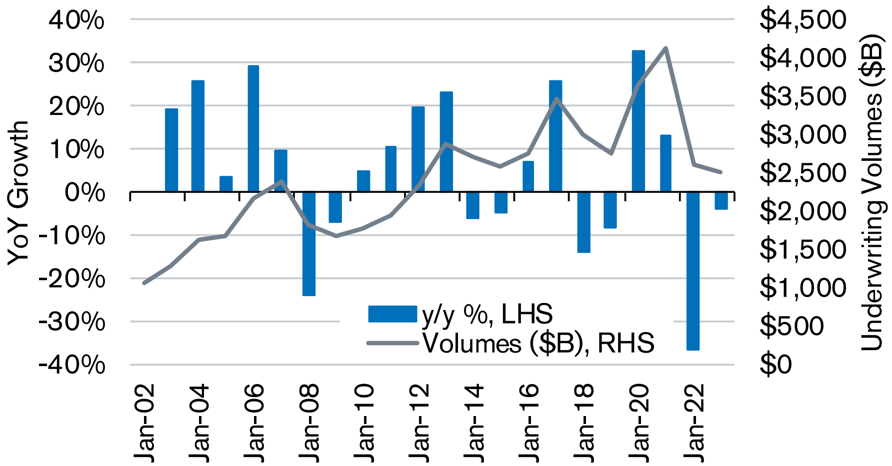
Portfolio Impact: The **Fed is done hiking**, in our view, but **without real economic weakness,** we **do not expect to see** the type of material policy easing associated with the start of **a new cycle**.

If our inflation forecast materializes, **we expect that the Fed has completed this hiking cycle**. The market seems to agree and is currently pricing in more than 100 basis points of rate cuts in the coming year.

This outlook aligns with the Fed's messaging that it may **manage real interest rates lower as inflation cools,** and less restrictive monetary policy this year could help support continued, but likely slowing, economic growth. However, this **would not equate to the degree of easing that is typically seen in response to economic weakness, which in turn helps generate a subsequent cyclical recovery**, in our view.

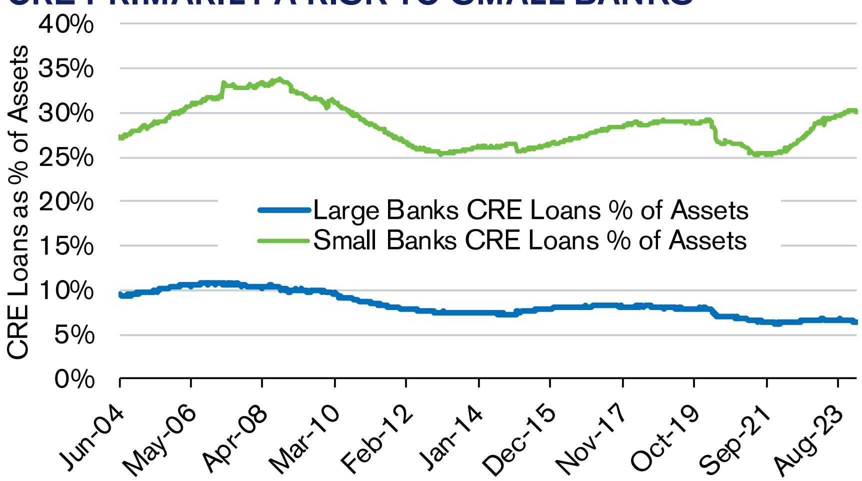
Prospect of Continued Growth Reduces Downside Risk for Financials

UNDERWRITING ACTIVITY POISED FOR A REBOUND



Source: Bloomberg, WestEnd Advisors

CRE PRIMARILY A RISK TO SMALL BANKS



Source: Federal Reserve, WestEnd Advisors

Portfolio Impact: We've added a new allocation to the U.S. Financials sector as our updated economic outlook now incorporates an **increased probability of continued economic growth**. While Financials aren't immune to macro risk, we believe easing monetary conditions, increased capital markets activity, and secular trends such as the shift to digital payments could provide upside for the sector.

Our **more sanguine outlook for the U.S. economy gives us greater confidence in current consensus estimates for Financials sector earnings growth.** The Capital Markets industry, comprising over 20% of the sector, is positioned for potential recovery, in our view, following a dearth of dealmaking and underwriting activity that led industry earnings to decline more than 20% over the last two years (top chart).

While commercial real estate (CRE) remains a hot-button topic within banking, we would note that **large banks have considerably less exposure to CRE** than their smaller peers (bottom chart) and make up roughly ~75% of the exposure in the S&P 500 Banks industry.

International Economic & Market Backdrop

Global Economic Cycle Developing As Expected

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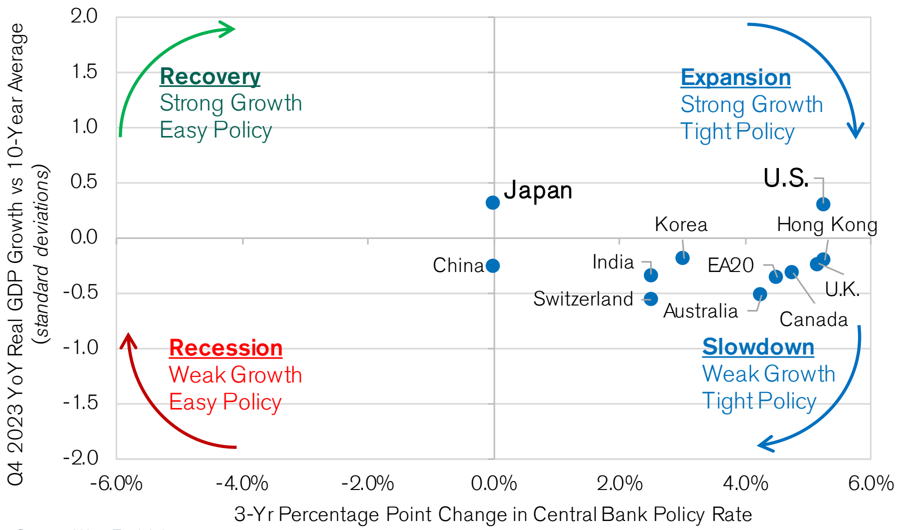
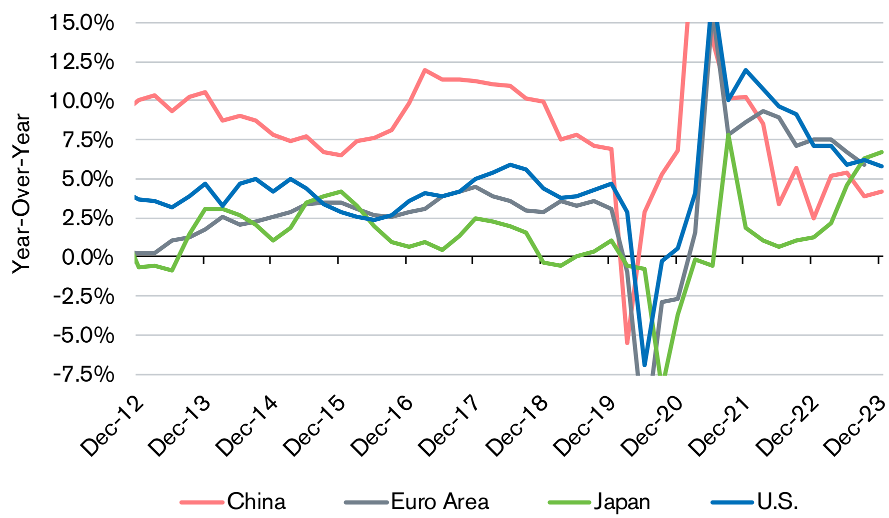
GLOBAL ECONOMIC & POLICY CYCLE IN LATER INNINGS



Source: WestEnd Advisors

NOMINAL GDP GROWTH



Source: WestEnd Advisors

Portfolio Impact: While there are pockets of strength in the global economy, **most major economies are slowing** and face late-cycle challenges. We remain **overweight some of the more defensive regions including the U.S. and Japan**, which have been bright spots in the global economy.

The U.S., the Eurozone, and the U.K. are all facing tight monetary conditions, **but there's been a clear divergence between the U.S. economy, which has proven resilient, and many major European economies**, where we continue to see slowing economic activity.

Japan is experiencing its strongest nominal growth and economic recovery in decades, and the U.S. consumer and labor market continue to show resilience. **China, which is struggling with deleveraging headwinds, has seen its growth rate drop below peers** and suffered steep equity market declines over the past several years.

Interest Rates & Credit

Elevated Rates Improve Fixed Income Risk/Reward

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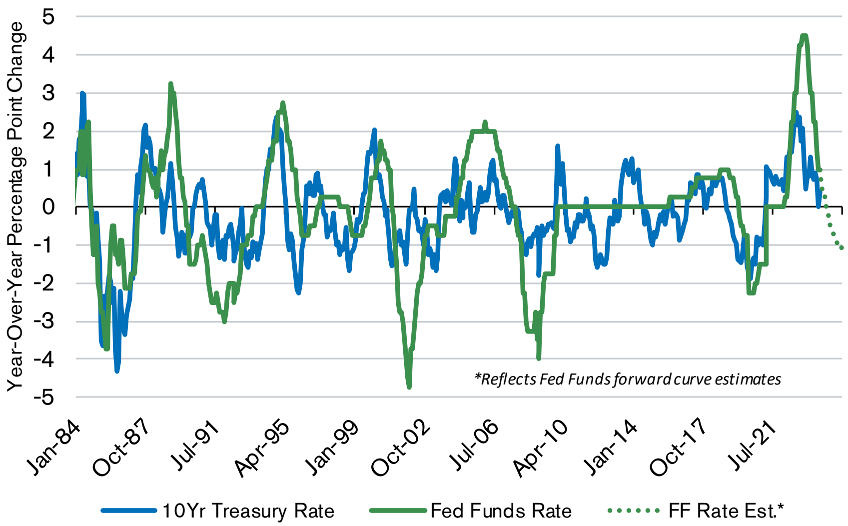
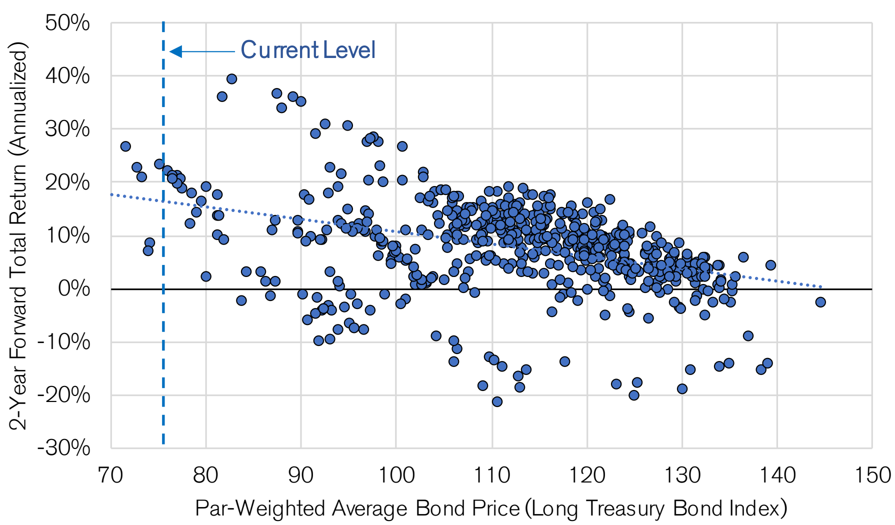
FED POLICY HEADWIND TO LONG BONDS ABATING



Source: Bloomberg, WestEnd Advisors

POTENTIAL RETURNS FOR LONG TREASURIES STILL 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, raising the potential for lower interest rates within our investment time horizon. As a result, **we find the risk/reward for intermediate and longer-term bond returns appealing** and therefore maintain an overweight allocation to longer-duration fixed income in balanced portfolios.

Following the rapid rise in interest rates since the beginning of 2022, **we believe the risk for intermediate and longer-term rates is likely skewed to the downside within our investment window,** due in part to the Fed being at 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. Though risks remain, and interest rate volatility could remain elevated, **we see attractive return opportunities in fixed income given our interest rate outlook.**

Footnotes & Disclosures

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