WESTEND
Advisors
A VICTORY CAPITAL® INVESTMENT FRANCHISE

Macroeconomic Highlights

Q2 2024

20240402-3484017

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WestEnd Outlook Highlights

- We believe the global economy, and particularly the U.S., could maintain slow-to-moderate growth through 2024, but we continue to see late-cycle conditions overall, and risk of recession remains elevated compared to long-term history. A sustained reacceleration to early-cycle growth remains very unlikely, in our view, as the tight labor market and slowing disinflation reduce tailwinds for U.S. consumers.
  - The labor market has supported growth in the U.S., and headline job gains remain positive, but the participation rate has recovered to near pre-COVID levels, making for further improvement challenging, in our view.
  - Consumers have remained resilient, but the COVID-era savings cushion is essentially depleted and the savings rate is back near historic lows, leaving consumer spending growth more reliant on income growth, in our view, which may be at risk if payroll and wage gains slow.
  - We believe the Fed has flexibility to manage real interest rates lower given the moderating absolute level of inflation, but the 75 basis points of cuts expected in 2024 would still leave monetary conditions tight, and materially sharper policy easing is unlikely absent significant economic weakness.
- Internationally, Japan is seeing healthy nominal GDP growth, and the BoJ recently moved to begin monetary policy normalization after years of deflationary headwinds. China, in contrast, continues to face deleveraging headwinds and has seen its growth rate drop below peers. Other emerging markets also face headwinds from slowing global growth. In Europe, tight monetary conditions and elevated, albeit slowing, inflation remain among the risks we see to economic growth in the near-to-intermediate term.
- 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 largely avoiding early-phase, cyclical U.S. sectors across our strategies, but see opportunity in Financials.
    - We are emphasizing mid-phase 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 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 traditional balanced portfolios:
    - While we recently reduced fixed income exposure in traditional balanced portfolios, we retain a modest overweight, given our economic outlook and the attractive risk/return profile we see for bonds at this point in the cycle.
    - Within fixed income allocations, we are emphasizing intermediate and longer-term Treasury securities that should benefit if interest rates decline, and we have added to short-term corporate exposure, as low credit spreads could put longer-term corporate bonds at risk.

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 March 31, 2024. Source: WestEnd Advisors.

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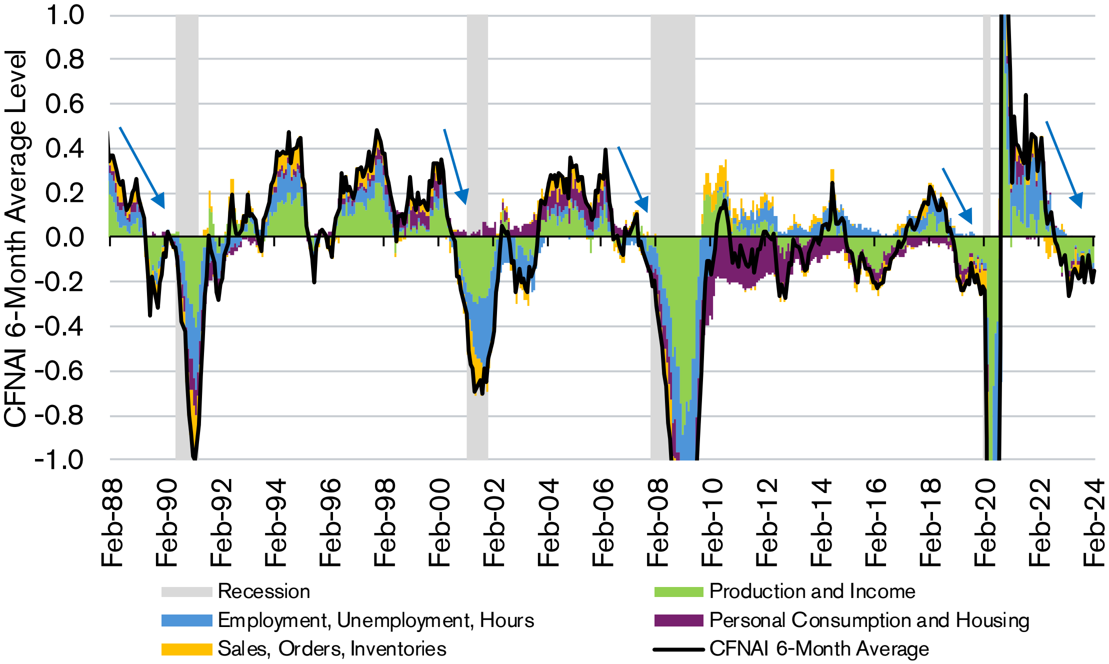
U.S. Economic & Market Backdrop

Slow-to-Moderate Economic Growth Likely

ECONOMIC GROWTH BELOW TREND ACROSS MOST AREAS



Source: Federal Reserve Bank of Chicago, WestEnd Advisors

Portfolio Impact: Late-cycle conditions and **below-trend economic growth warrant an avoidance of highly cyclical sectors like Energy, Materials, and Industrials**, in our view.

With few signs of strong demand emerging, we continue to **emphasize defensive sectors like Health Care, Consumer Staples, and Utilities**, in addition to sectors that present **strong secular growth like Communication Services**.

After declining sharply in 2022 and early 2023, **broad measures of U.S. economic activity**, such as the Chicago Fed National Activity Index (CFNAI), have **stabilized at levels that are consistent with below-trend growth**. Under the surface, we see **little evidence of building strength across the major areas of the U.S. economy**. In fact, none of the four major components of the CFNAI are growing at an above-trend pace (see chart).

Even with recent, but decelerating, strength in U.S. GDP, we believe **late-cycle conditions remain in place, and we expect 2024 to mark a pivotal year** for the economic cycle. Several factors have supported activity over the past year, including government spending, an influx of migrants into the labor force, and a disinflationary real wage growth impulse, but we expect many of these supports to fade as the year progresses.

Late-Cycle Conditions Remain, But Cycle Could Extend

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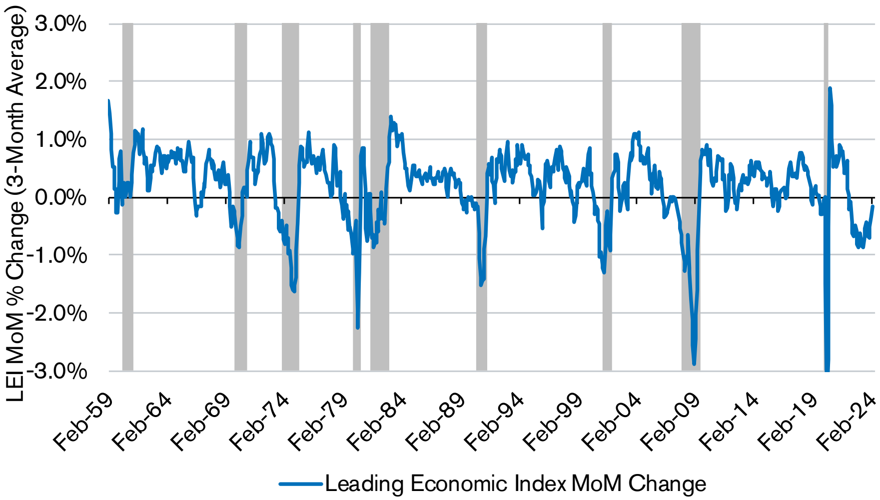
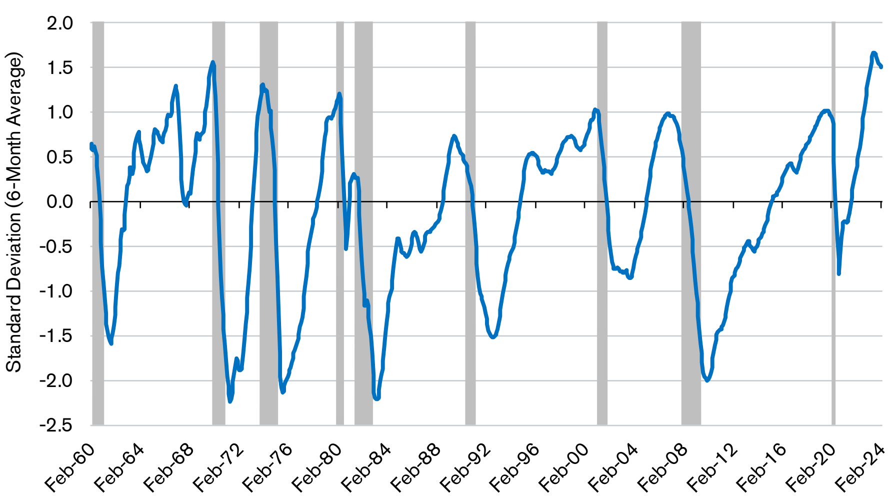
LEADING ECONOMIC INDEX AT PIVOTAL MOMENT



Source: The Conference Board, WestEnd Advisors

WEA LENGTH-OF-CYCLE INDICATOR



Source: Bloomberg, WestEnd Advisors
* Indicator represents average standardized value for four indicators: U-3 unemployment rate, output gap, confidence spread, and 10Y-3Y Treasury interest rate spread.

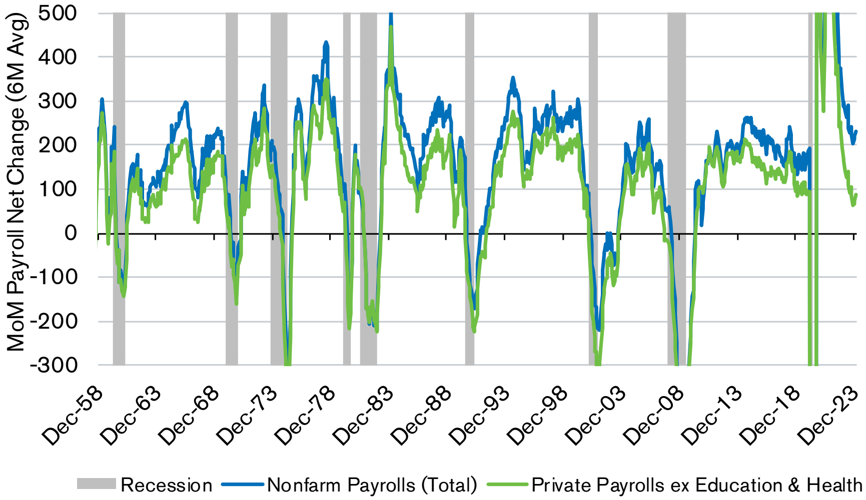
Portfolio Impact: Ongoing risks to the economy in the U.S. warrant an **avoidance of highly cyclical sectors**. At the same time, certain factors point to a potential cycle extension through 2024, and we **increased the economic sensitivity of our ETF portfolios with the addition of Financials and increased equity exposure in balanced portfolios.**

A **variety of leading economic indicators**, including the inverted yield curve, negative real money supply growth, and job losses in the most cyclical labor market categories, point to **potential challenges ahead for growth**. The chart above illustrates that the trend in the Leading Economic Index (LEI) remains negative, but the month-to-month changes have improved over the past year as disinflation has provided a key support for real activity.

We believe the prospect of economic retrenchment, while lower than last year, remains elevated, as the **classic signs of a late-stage macro environment remain in place**, including low unemployment, restrictive monetary policy, general consumer optimism, and a positive output gap. A composite index measuring the progression of the economic cycle remains at the high end of the historic range (bottom chart).

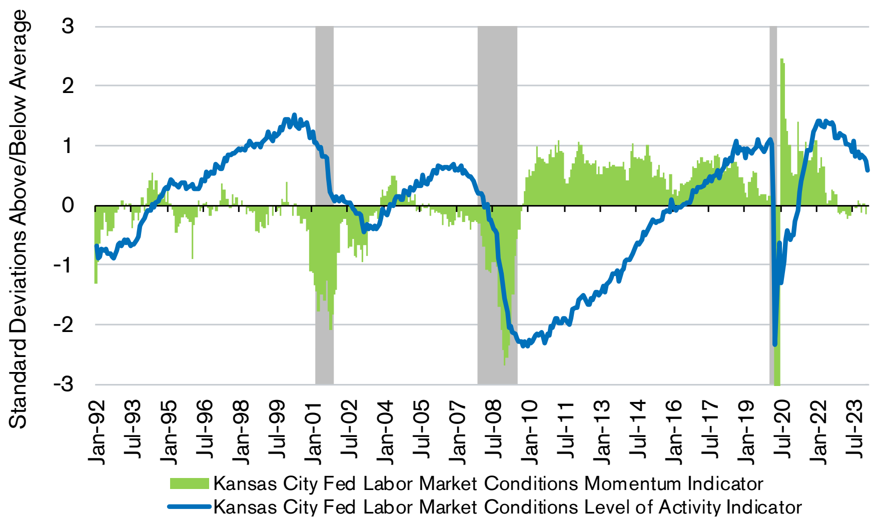
Under the Surface, Labor Market Losing Steam

JOB GAINS HAVE BEEN SOFT AMONG CYCLICAL CATEGORIES



Source: BLS, WestEnd Advisors

LABOR MARKET CONDITIONS CONTINUE TO LOOSEN



Source: Federal Reserve Bank of Kansas City, WestEnd Advisors

Portfolio Impact: The labor market was more resilient than expected in 2023, but a more detailed look at the **data points to deteriorating labor market conditions**. We believe the trajectory of employment and layoffs is likely to be a key determinant of the U.S. economy's path in 2024.

Over the last six months, **nonfarm payroll gains have averaged ~230k, an above-average pace relative to history.**

However, **job gains have been narrowing under the surface** (see top chart), as government, education, and health care have driven the majority of job creation. Outside of these non-cyclical areas, monthly payroll gains have slowed to a sluggish pace of just ~85k, on average, a sign of tepid labor demand.

A broader measure of the labor market, the Kansas City Fed Labor Market Conditions Index, has been trending lower since early 2022 (bottom chart). Typically, labor market conditions begin to loosen during the later stages of the economic cycle.

Normalizing Personal Consumption Patterns Ahead

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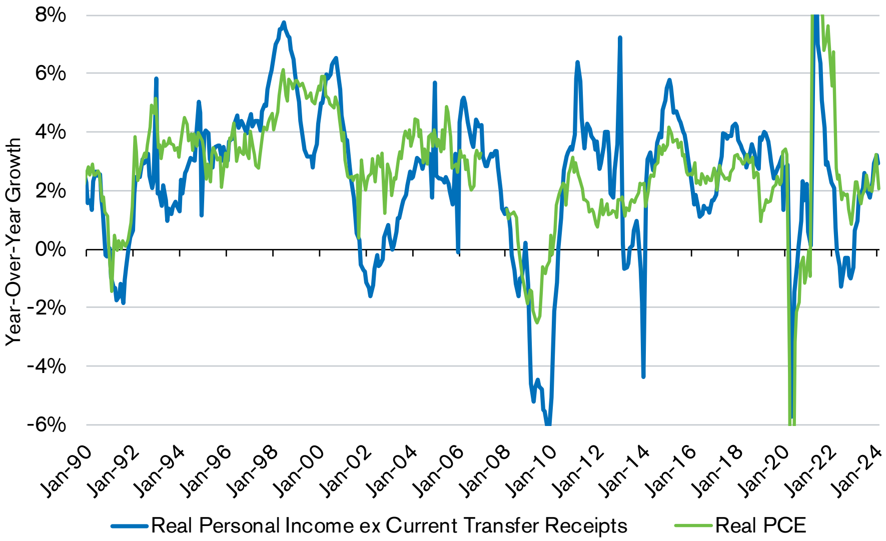
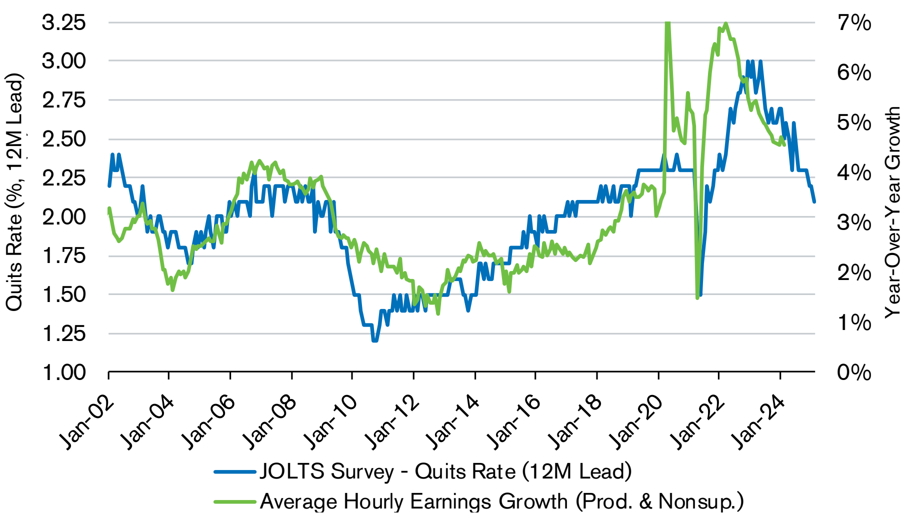
REAL SPENDING GROWTH TRACKS REAL INCOMES OVER TIME



Source: BEA, Bloomberg, WestEnd Advisors

EXPECT WAGE GROWTH TO SLOW



Source: BLS, WestEnd Advisors

Portfolio Impact: Many of the irregular factors that supported post-COVID spending growth are unlikely to persist. As a result, we think that **more traditional fundamental drivers of consumption are taking hold**. With job gains and nominal income growth moderating, we continue to limit cyclical exposures across our portfolios and are comfortable **deemphasizing or even avoiding exposure to the most economically sensitive areas of the market**.

Consumers outspent their incomes in 2022 and 2023, which supported real GDP growth but drove the savings rate lower. The capacity for further "excess spending" is limited, in our view, due to shrinking savings and a higher cost of debt. As such, we believe **real spending growth should more closely track real income growth moving forward** (top chart).

Even though *real* incomes have rebounded over the last two years due to lower inflation, we see potential for income growth to slow from here. Forward indicators for wage growth, such as the quits rate from the JOLTS report, suggest that **wage pressures are continuing to ease as the labor market cools** (bottom chart).

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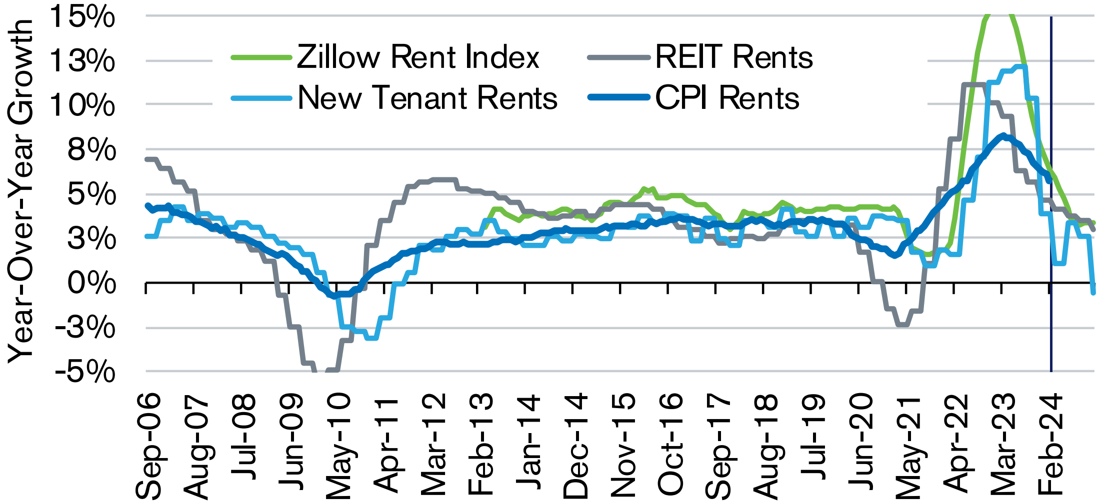
Still Expecting Core Inflation to Slow this Year

FORWARD-LOOKING RENT MEASURES



Non-CPI measures shifted forward 12 months/show estimates through end of 2024.

Source: WestEnd Advisors, Zillow, Federal Reserve Bank of Cleveland, Bloomberg. Extremes cut from chart.

Portfolio Impact: Periods of **disinflation can support real growth** without overheating the economy, which has **historically benefited mid- and late-phase sectors**. Slow growth and disinflation are also catalysts for lower interest rates, in our view, which could provide tailwinds for a number of sectors, including **Health Care, Consumer Staples, Communication Services, Information Technology, and Financials.**

The base case for our inflation outlook continues to contemplate a path lower, though we don't expect core CPI inflation to reach the Fed's 2% target by year end. The largest driver of core inflation is currently residential rent price gains. However, more leading measures, like real-time rent indices, indicate to us that the trend in rent inflation will continue to be lower. Elsewhere, supply chain normalization in the goods sector, favorable trends in commodity prices, softer aggregate demand overall, and slowing wage growth should also help the Fed on the course to normalizing inflation.

Disinflation towards normal levels is a positive for the economy. However, 2023 likely marked the peak in the disinflationary impulse, which can be thought of as the rate of change in year-over-year CPI and a tailwind to real growth. Looking forward, we believe **lower levels of inflation will provide a lift to real growth, but to a lesser degree than we saw in 2023**.

Policy Headwinds are No Longer Building, But Strong Tailwinds Unlikely to Develop

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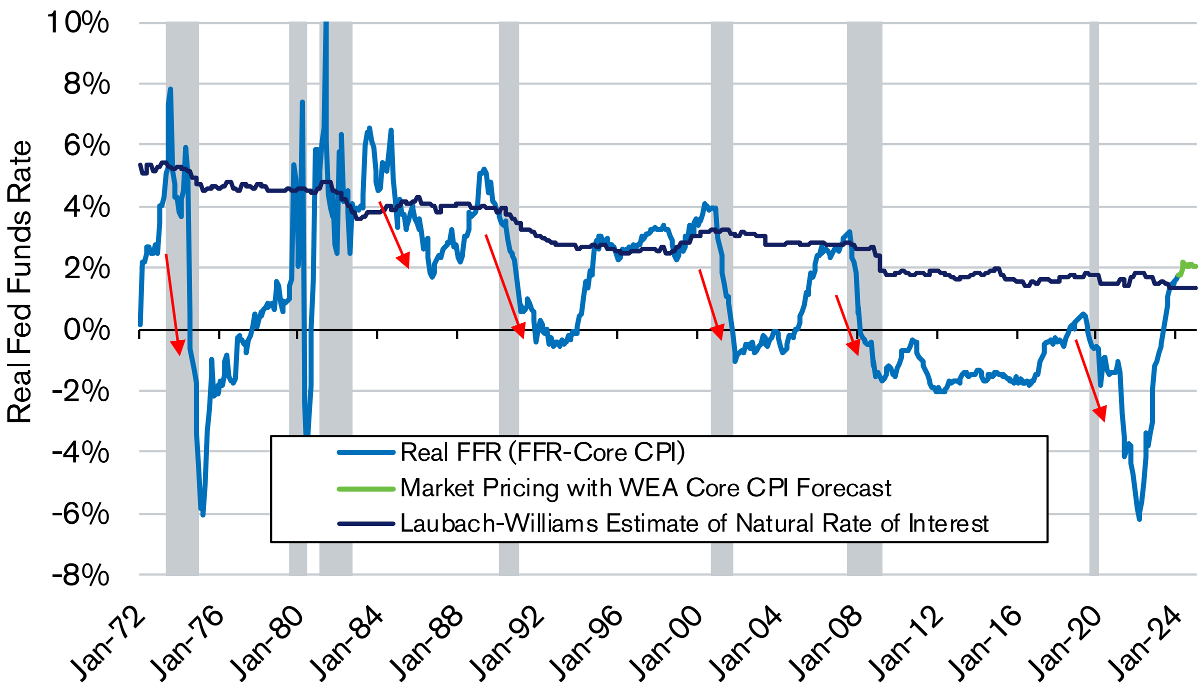
REAL RATES TO REMAIN HIGH EVEN WITH CUTS IN '24



Source: BLS, Bloomberg, WestEnd Advisors

Portfolio Impact: The **Fed is done hiking**, in our view, but **without real economic weakness, we do not expect** in 2024 to see the type of **material policy easing** associated with the start of a new cycle, when robust growth benefits economically-sensitive sectors most.

If our inflation forecast materializes, **we expect that the Fed is finished with this hiking cycle**. The market currently agrees and is pricing in ~70 basis points of rate cuts in the coming year.

This outlook aligns with the Fed's messaging that they may **manage real interest rates lower as inflation cools**. The *prospect* of rate cuts eased financial conditions meaningfully in Q1, and *actual* rate cuts should loosen conditions for borrowers on the margin, however, we do not foresee **the degree of easing that is typically seen in response to economic weakness, which in turn helps generate a robust reacceleration of growth.**

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U.S. Sector Outlook

Narrow Sector Leadership Has Potential to Widen Out

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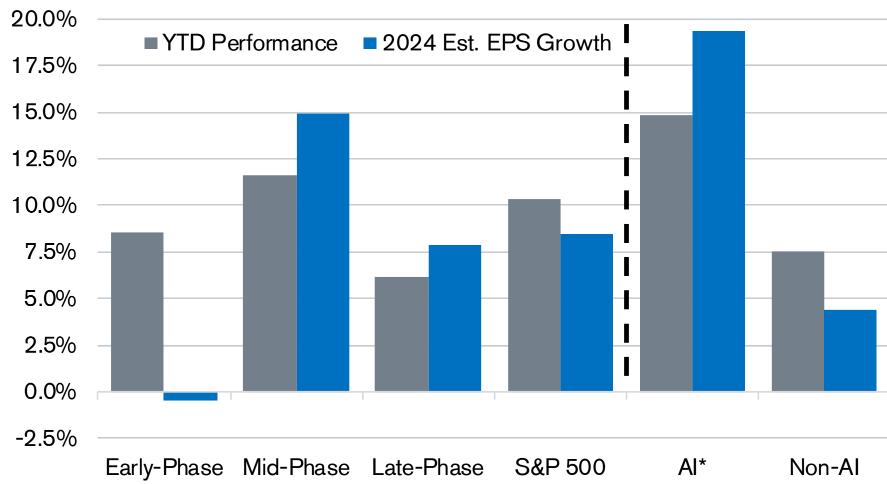
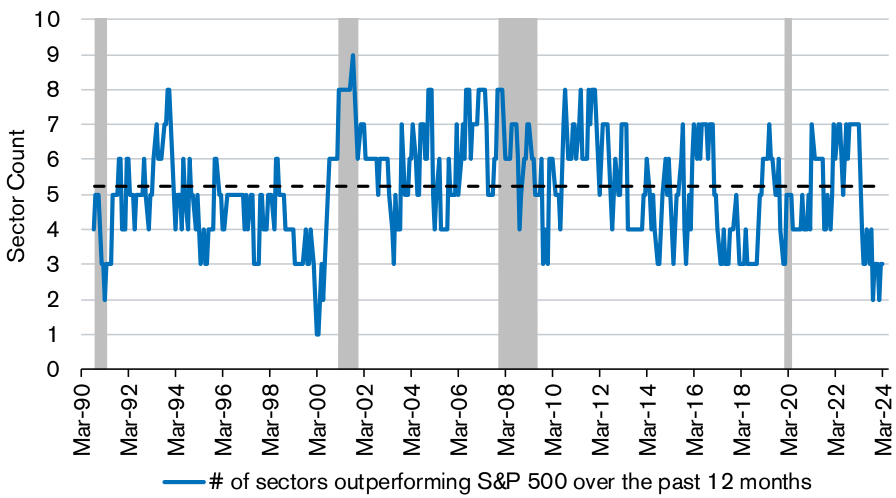
YTD EQUITY RETURNS OUTPACING PROJECTED '24 EPS GROWTH



Source: Bloomberg, WestEnd Advisors
* AI category includes Information Technology sector plus Amazon, Alphabet, and Meta Platforms.

NUMBER OF SECTORS OUTPERFORMING THE S&P 500



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: Risk management, particularly through the lens of the economic cycle, is **always key to our portfolio construction**. While a substantial overweight of mid-phase sectors would have been required to outperform the S&P 500 in recent quarters, our portfolios have captured the majority of benchmark returns. Looking ahead, we **remain constructive on sectors benefitting from earnings tailwinds**, such as Communication Services and Health Care.

The S&P 500 return of 29% over the past four quarters has been dominated by Information Technology and Communication Services, which have benefited from an anticipation of lower interest rates and the proliferation of A.I. Valuations for these **mid-phase sectors have been supported by earnings growth expectations that are well above the rest of the market** (top chart).

Still, we believe it is important for investors to recognize that **the narrowness of sector leadership over the past year is unusual relative to history** (bottom chart). Looking ahead, we see potential for the distribution of sector outperformance to broaden out, which we expect to present opportunities for sector-focused investors.

Late-Phase Sectors Provide Steady Earnings

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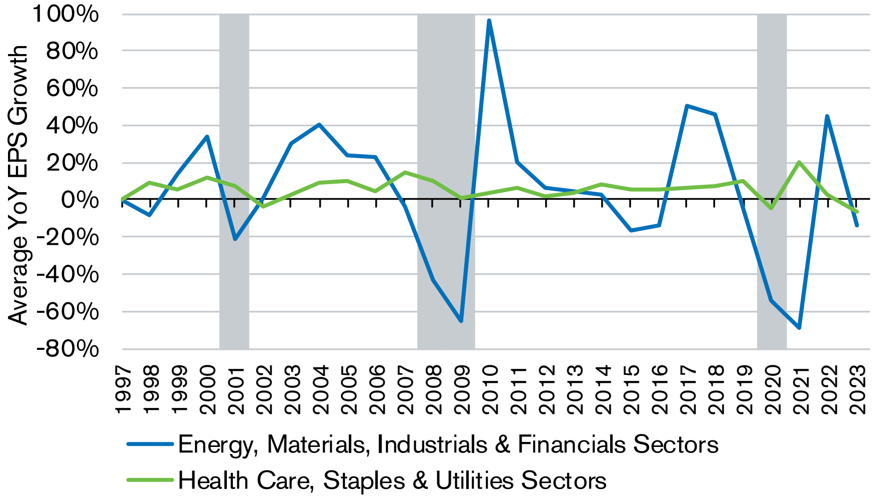
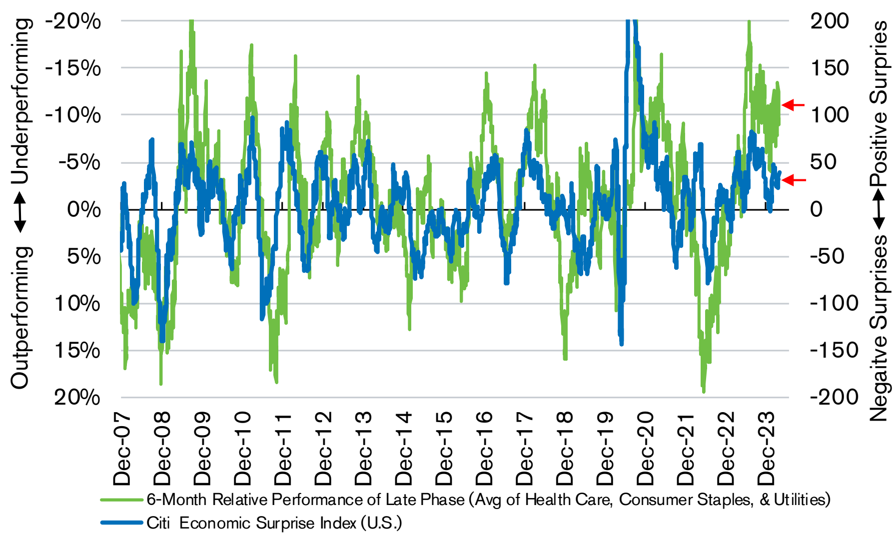
EARNINGS GROWTH BY SECTOR



Source: Bloomberg, Westend Advisors
*Consensus estimates for 2023/2024 sector EPS.

ECONOMIC SURPRISES LOSING MOMENTUM



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: We believe exposure to defensive areas of the market – such as Health Care, Consumer Staples, and Utilities – is warranted. **Consistent earnings growth and above-market profitability** make these sectors attractive 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**.

Defensive, **late-phase sectors have generated very consistent EPS growth over time**. Alternatively, the most **economically sensitive sectors,** like Energy, Materials, and Industrials, **have much more cyclical earnings**, as illustrated in the top chart, and we believe their prospects are diminished in the current late-cycle growth environment.

Positive surprises in U.S. economic reports have diminished, as seen in the bottom chart, even as the late-phase Health Care, Consumer Staples, and Utilities sectors have continued to lag the market. Ongoing challenges to economic growth present **opportunity for these defensive leaning sectors** with steady earnings growth prospects.

Positioned for Improving Health Care Fundamentals

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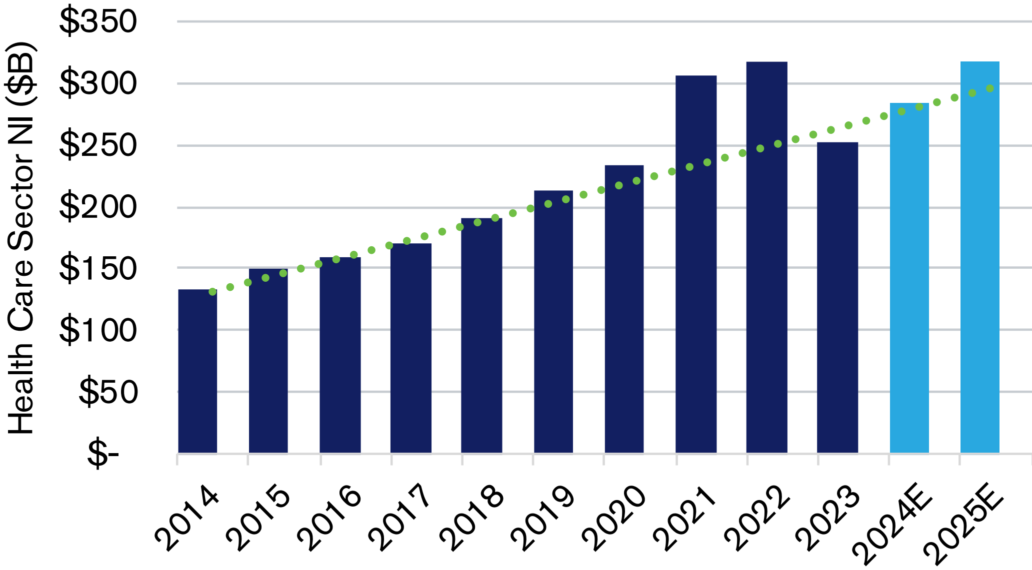
HEALTH CARE NET INCOME POISED TO REBOUND



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 the sector's 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 have moved past the pandemic, a slowdown in COVID-related spending and tough comparisons led to a substantial drag on 2023 earnings.

Looking ahead, we anticipate Health Care sector earnings could grow double-digits this year and in 2025. 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.

Prospect of Easier Financial Conditions Reduces Downside Risk for Financials

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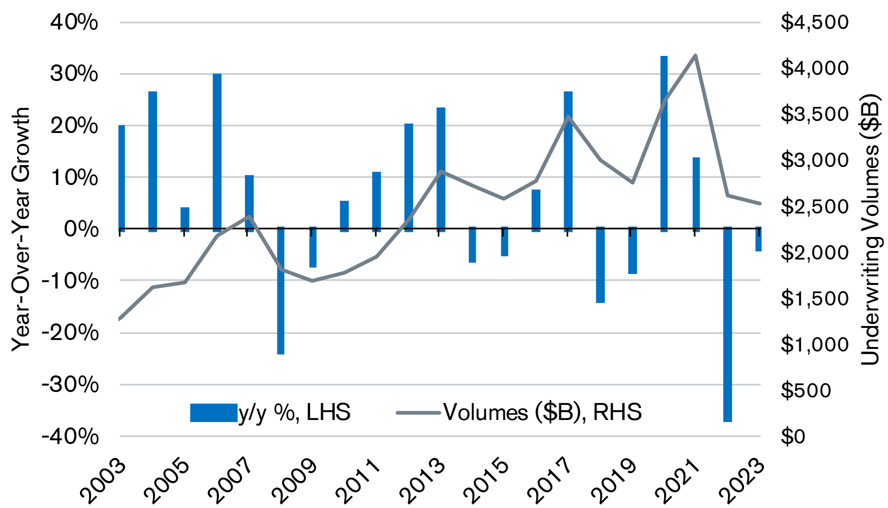
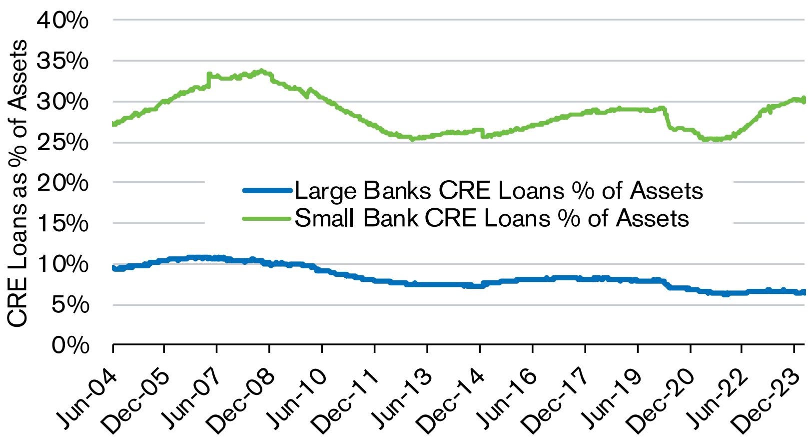
UNDERWRITING ACTIVITY POISED FOR A REBOUND



Source: Bloomberg, WestEnd Advisors

CRE PRIMARILY A RISK TO SMALL BANKS



Source: Federal Reserve, WestEnd Advisors

Portfolio Impact: We have added a new allocation, the Financials sector, in our U.S. large-cap ETF allocations, as ongoing economic resilience and flexibility for the Fed to cut rates could be beneficial for the sector, in our view. While Financials are not immune to macro risk, we believe increased **capital markets activity, easing monetary conditions, and secular trends such as the shift to digital payments** could provide earnings upside for the sector.

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). This year, in contrast, we have seen activity outpacing 2023's levels year to date.

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.

Technology-Oriented Sectors: Navigating High Profitability and Valuations

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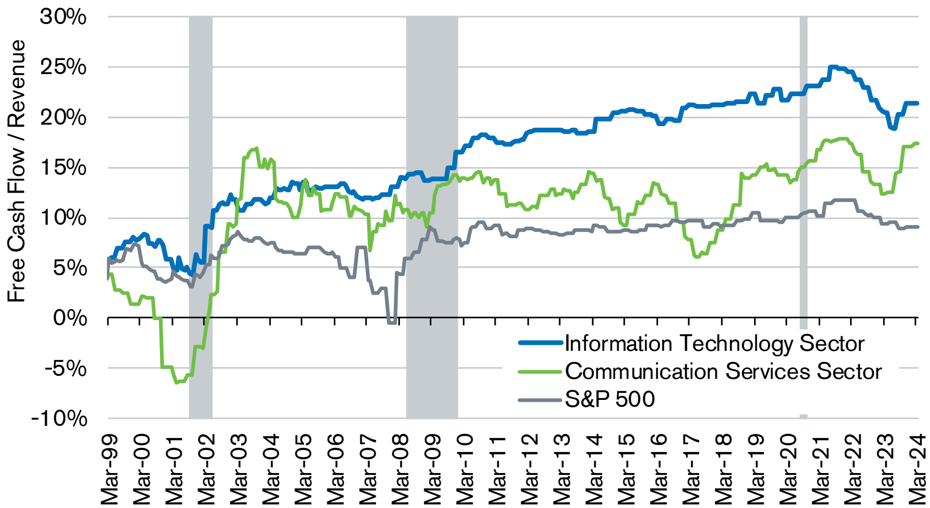
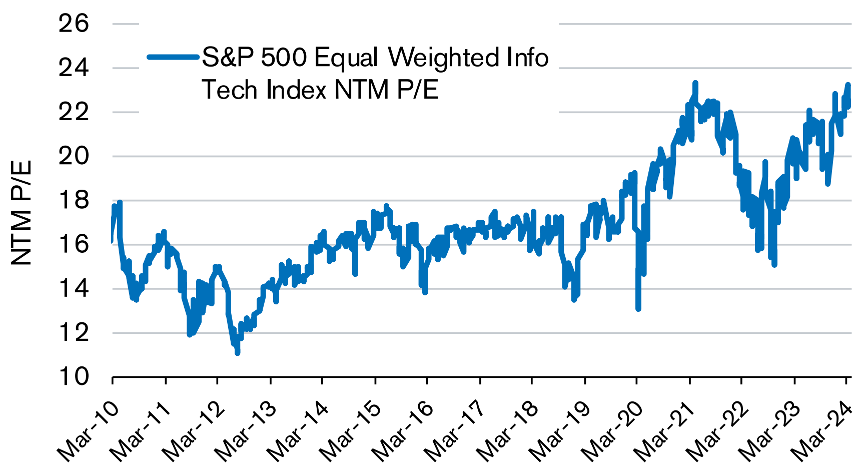
MID-PHASE SECTORS EXHIBIT STRONG PROFITABILITY



Source: Bloomberg, WestEnd Advisors

MOST OF THE TECH SECTOR LOOKS EXPENSIVE



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: As economic growth continues to slow, we believe **Information Technology and Communication Services** sector companies can maintain profitability due to the **muted cyclicality of technology business investment and high margins.** These quality attributes are favorable in the latter stages of the economic cycle, in our view.

The quality and profitability of the Information Technology and Communication Services sectors can be seen in the sectors' above-market conversion of sales into free cash flow.

These quality attributes should benefit the fundamentals of Tech and Communication Services companies, as our **outlook for strong, above-market EPS growth,** coupled with a **very low chance of Fed rate hikes over the next year, should produce less downward pressure on mid-phase valuations**, in our view.

The "Magnificent 7" have rightfully received a lot of attention over the last year, but the broader Tech sector has also risen in valuation in recent quarters.

Industrials Demand Fading as Sector Rebalances

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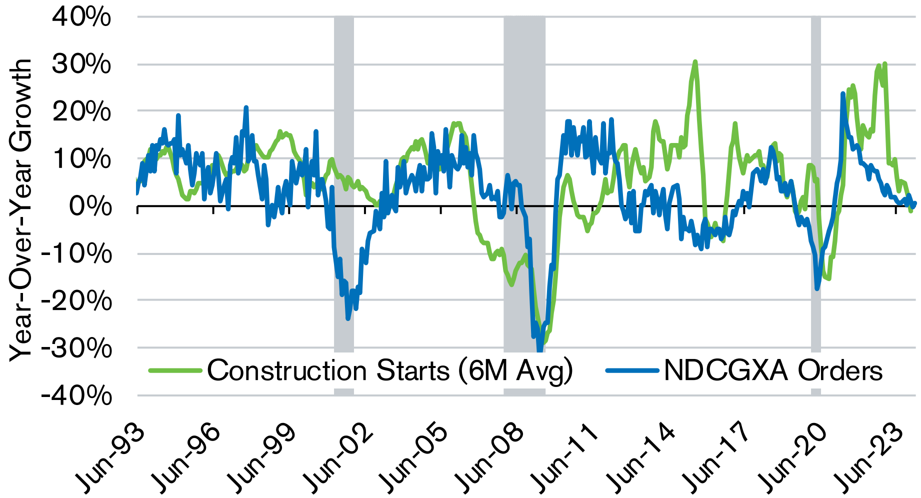
CYCLICAL MEASURES SLOWING



Source: F.W. Dodge, US Census Bureau, WestEnd Advisors

DEALERS HAVE ELEVATED INVENTORY LEVELS

Source: US Census Bureau, WestEnd Advisors

Portfolio Impact: We are avoiding the U.S. Industrials sector in portfolios, as we believe the prospects of **falling backlogs, softer pricing power, and decelerating order demand** increase the likelihood of a **deterioration in the earnings outlook** for the sector.

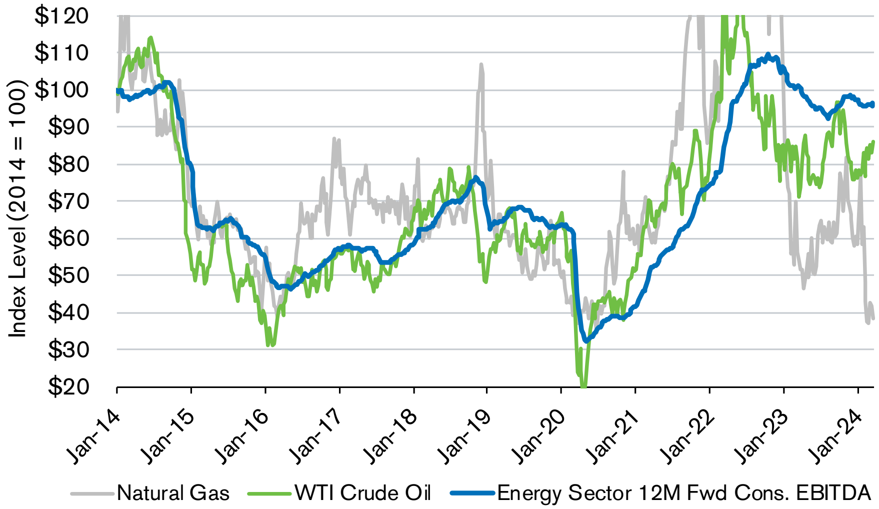
Fiscal policy and elevated backlogs helped drive the U.S industrial economy in 2023, as investment in non-residential structures and transportation equipment made the strongest contribution to growth in over a decade.

There are signs these tailwinds have begun to fade**.** **Growth in new construction starts and core capital orders has stalled (top chart).** The Industrials sector has a high degree of exposure to these areas and faces a challenging outlook, in our view.

This **slowing demand coincides with excess amount of inventory** (bottom chart). To us, this creates a scenario which degrades pricing power and margins, in-turn pressuring earnings in a manner similar to the dynamic consumer retailers faced directly post-pandemic.

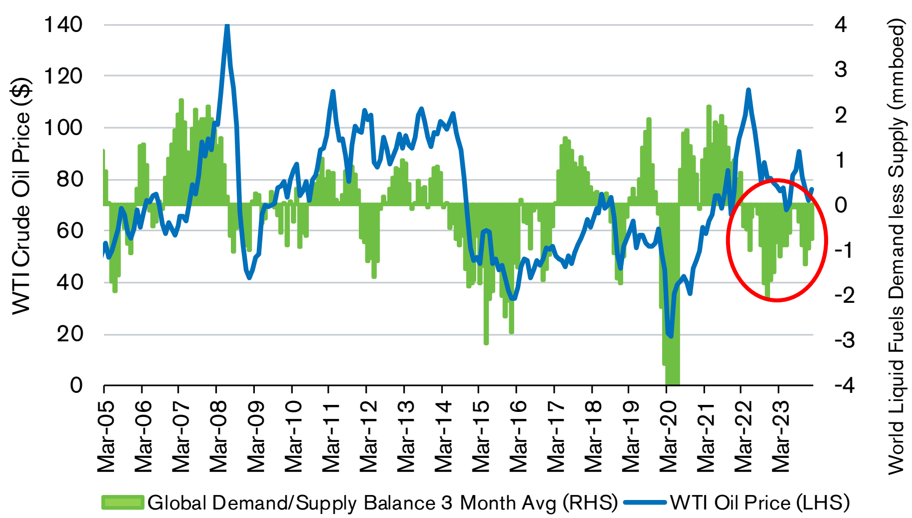
Energy Sector Fundamentals At Risk of Downgrade

ENERGY SECTOR ESTIMATES TOO HIGH...



Source: Bloomberg, WestEnd Advisors

...EVEN AS SUPPLY/DEMAND BALANCE REMAINS SOFT



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 low commodity price inflation and the **potential for significant refining margin compression**, increases the likelihood of a deterioration in the earnings outlook for the sector.

Pricing for the global energy commodity complex has moved lower since mid-2022 on the back of sluggish demand, even in the face of fragile OPEC+ supply cuts.

Still, **forward earnings estimates for the Energy sector appear too optimistic, in our view** (top chart). While elevated refining margins have been a tailwind for Energy sector earnings over the past two years, industry capacity is expected to rebound in 2024, which should put downward pressure on margins.

As the economy remains in the latter stages of this cycle, we believe oil and gas demand growth is likely to remain subdued, in part because the post-pandemic rebound has already played out. Further, **global liquids production has consistently outpaced consumption** since late 2022 (bottom chart).

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International Economic & Market Backdrop

Global Economic Cycle Developing As Expected

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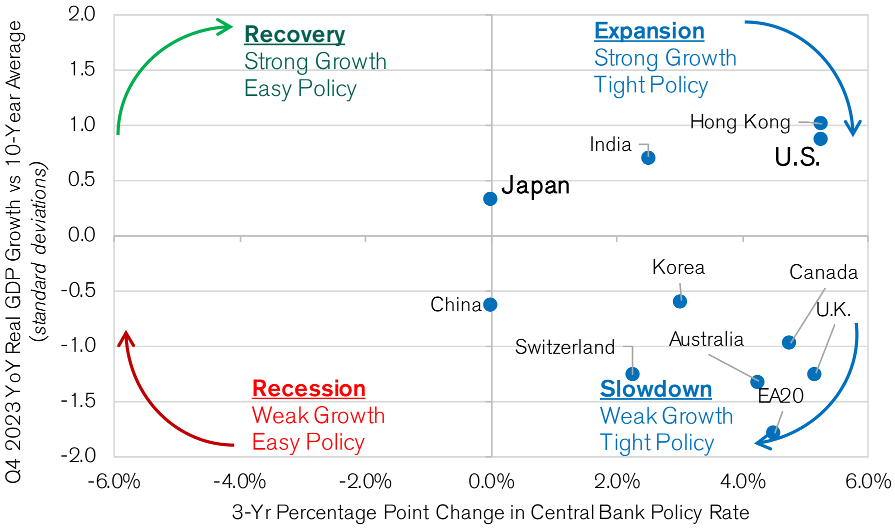
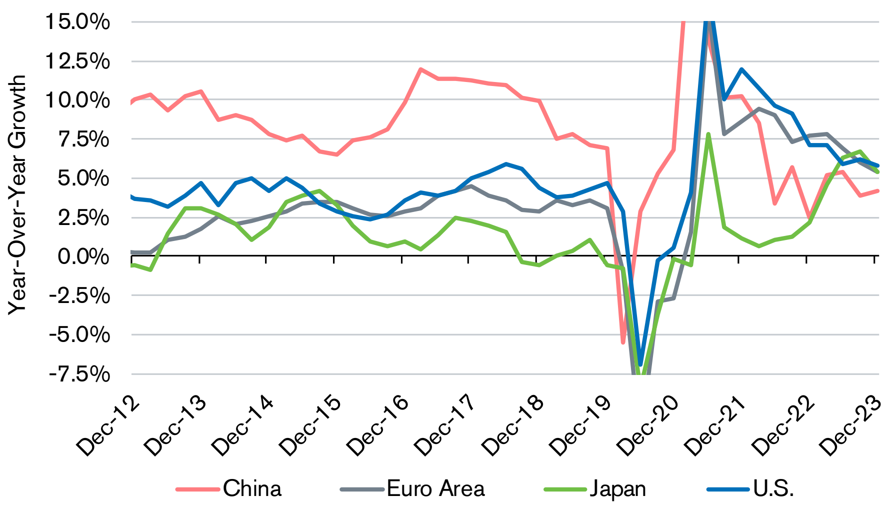
GLOBAL ECONOMIC & POLICY CYCLE IN LATER INNINGS



Source: Bloomberg, WestEnd Advisors

NOMINAL GDP GROWTH



Source: Bloomberg, 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.

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Relief on the Horizon for Households in Japan

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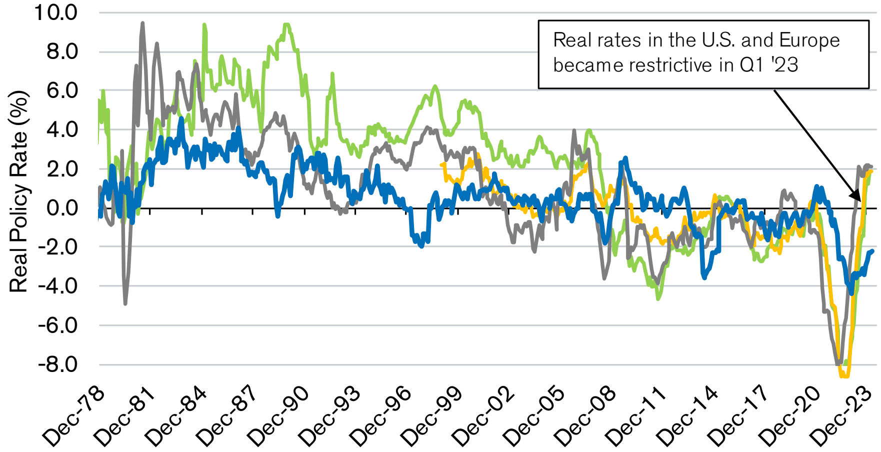
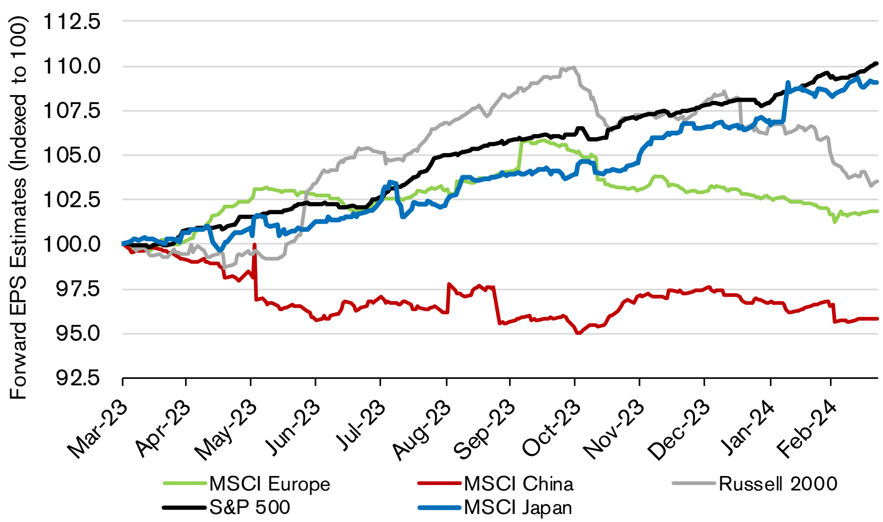
REAL RATES REMAIN HIGHLY ACCOMODATIVE IN JAPAN



Source: Bloomberg, WestEnd Advisors

SUPPORTIVE POLICY DRIVES EARNINGS HIGHER



Source: Bloomberg, 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 benefiting from a step-up in nominal growth and has the potential to be a more **defensive region** during risk-off environments.

The Bank of Japan has messaged its intention to normalize interest rate policy, primarily due to the country's positive economic trajectory and signs that wage inflation has moved sustainably above 2%.

Monetary policy in Japan is likely to remain accommodative for the foreseeable future, in our view. The real policy rate in Japan remains firmly below those of other developed nations (see top chart) and at one of the most stimulative levels on record.

Supportive monetary and economic conditions have contributed to strong earnings growth. Since early 2023, when real rates became restrictive in other parts of the world, **forward EPS estimates for MSCI Japan have consistently outpaced those of other regions** (bottom chart).

No Signs of an Economic Rebound in China

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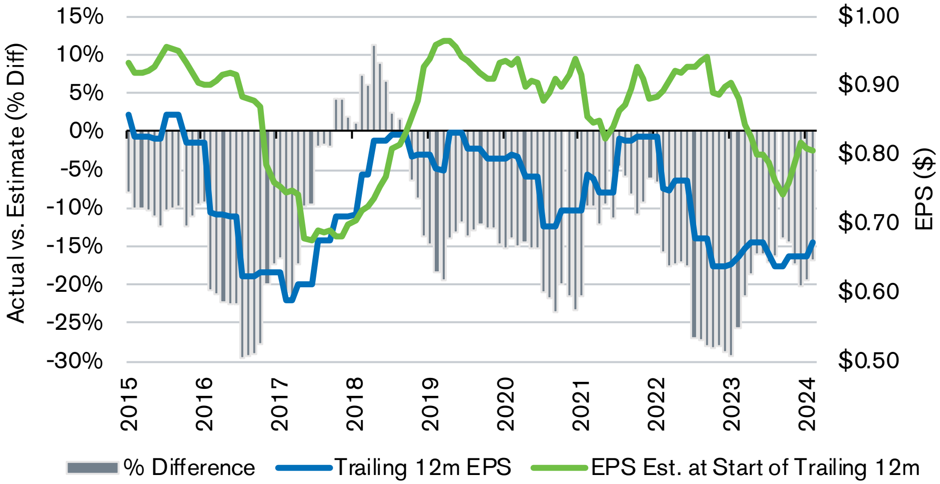
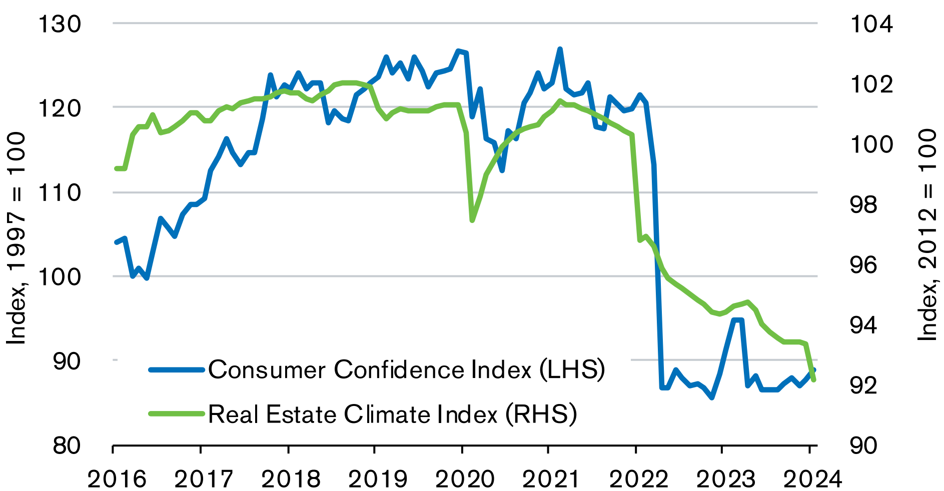
EARNINGS HAVE DISAPPOINTED FOR OVER 5 YEARS



Source: Bloomberg, WestEnd Advisors

CONFIDENCE DENTED BY REAL ESTATE SLOWDOWN



Source: NBS of China, WestEnd Advisors

Portfolio Impact: China's economy has struggled to find its footing, partly due to **challenges in the real estate sector, which has weighed on consumer confidence.** Without proper support, we see potential for Chinese earnings to continue to disappoint relative to expectations and to other regions, which supports an **underweight to Emerging Markets (EM)** in our global portfolios.

Earnings generated by companies in China have consistently fallen short of initial estimates over the past decade (bottom chart). Factors including **stringent regulation, insufficient government support, weakness in global manufacturing, and reluctant consumers have weighed on earnings growth in China.**

China's central government has focused on targeted monetary and fiscal support in an effort to limit the country's debt burden, but **insufficient stimulus paired with the downturn in real estate has had an acute impact on consumer confidence.** As such, we believe the economy and earnings could continue to stumble.

Activity in Europe Has Slowed, but Risks Remain

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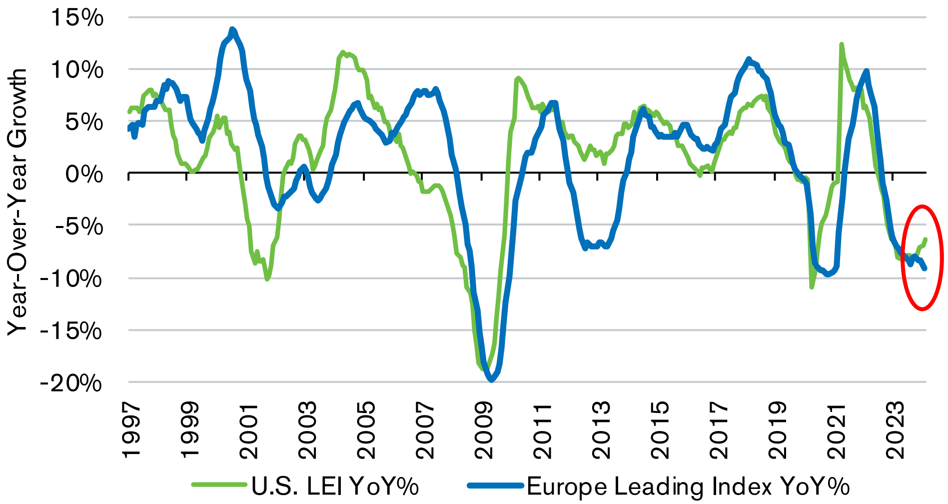
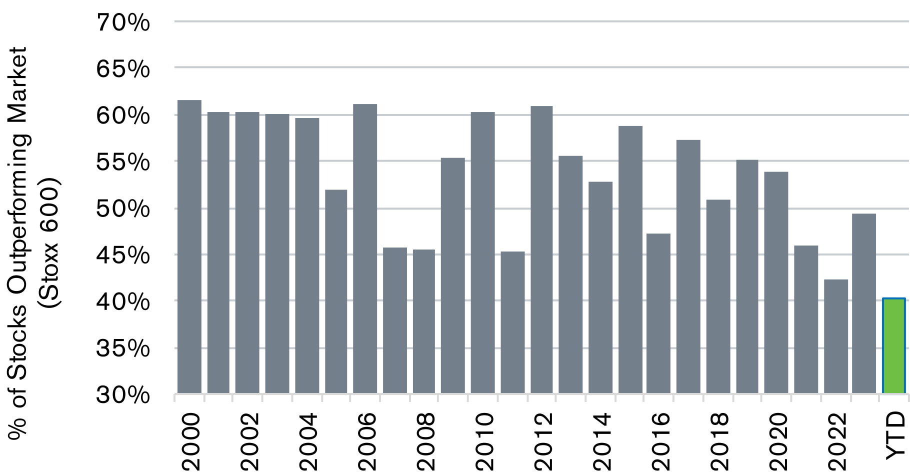
DIVERGING TRENDS BETWEEN THE U.S. AND EUROPE



Source: The Conference Board, WestEnd Advisors

LOWEST MARKET BREADTH SINCE 2000



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: Macroeconomic headwinds, including elevated interest rates, quantitative tightening, softening industrial demand, and tight credit standards, lead us to **underweight Europe**. The economy has struggled in the face of high interest rates. Given Europe's economic sensitivity, we expect slower earnings growth relative to other regions.

Leading indicators have shown signs of diverging trends between Europe and the U.S. (top chart). In terms of components, consumer expectations, building permits, and the volume of orders point to **continued challenges for the European economy**. While risks remain to the downside, Euro Area stock market performance has been relatively resilient to start the year, albeit with narrow leadership.

Europe's market breadth year-to-date, measured by the number of stocks outperforming the index, shows the **lowest reading since 2000** (bottom chart). Given the narrow market leadership and the headwinds that face the economy, we view market risk as elevated relative to other regions.

Interest Rates & Real Assets

Yield Curve Unbroken, Signals Late-Stage Economy

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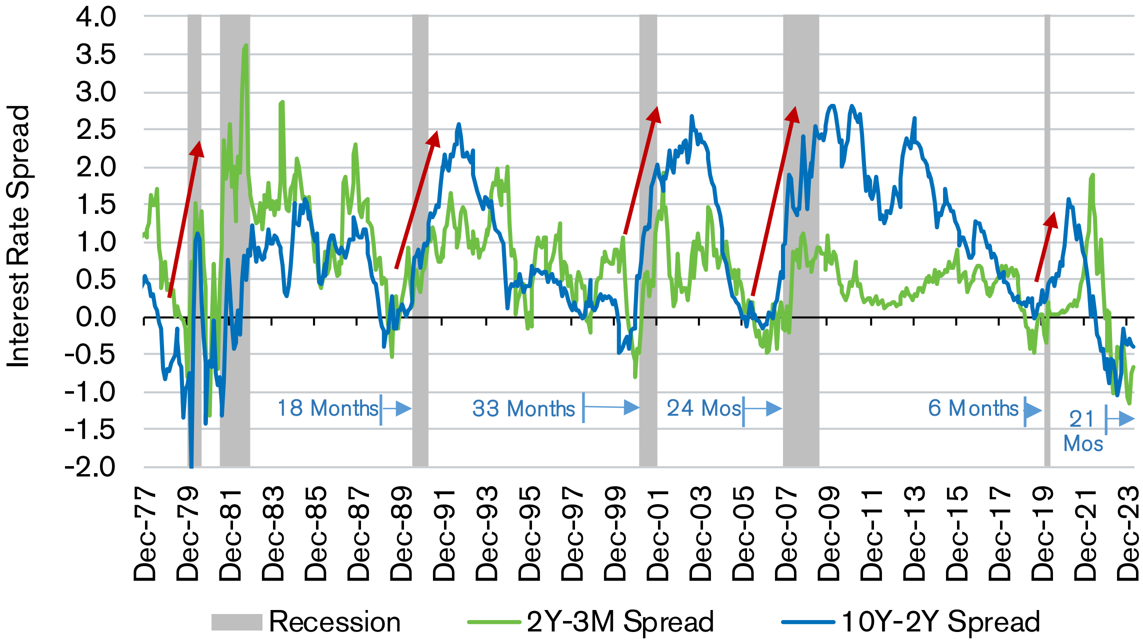
YIELD CURVE CAN STAY INVERTED FOR EXTENDED PERIODS



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: Due to potential fallout from Fed tightening and late-cycle conditions, **we see limited upside to economic growth**. As such, in balanced portfolios, we are underweight corporate credit and **are overweight 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 in the next 12 months remains elevated, though the exact timing of its onset is uncertain. As shown in the chart above, **yield curve inversions typically signal that recession risk is elevated, but not necessarily imminent.**

The current cycle's 21-month long inversion is longer than in the pre-Covid cycle, but it is not atypical by historical standards (top chart).

Importantly, the key **driver of the inversion has shifted** from inflation expectations, which correctly foreshadowed disinflation in 2023, **to real yields**, which we believe is illustrative of the market's outlook for slower growth.

Narrow Spreads Limit Credit Upside

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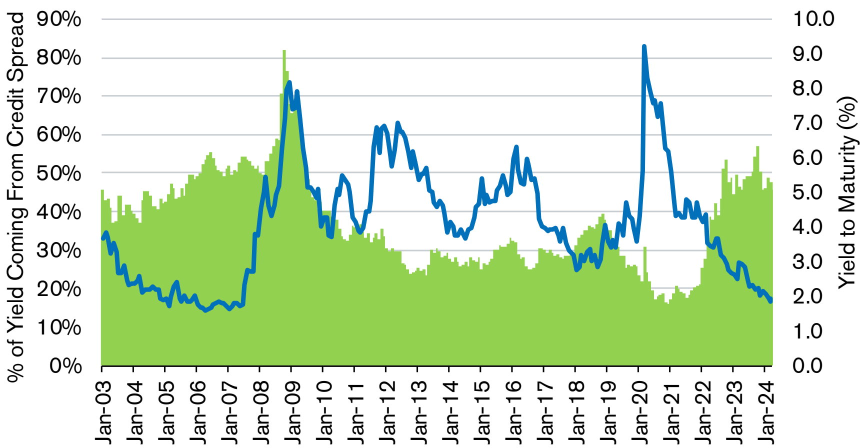
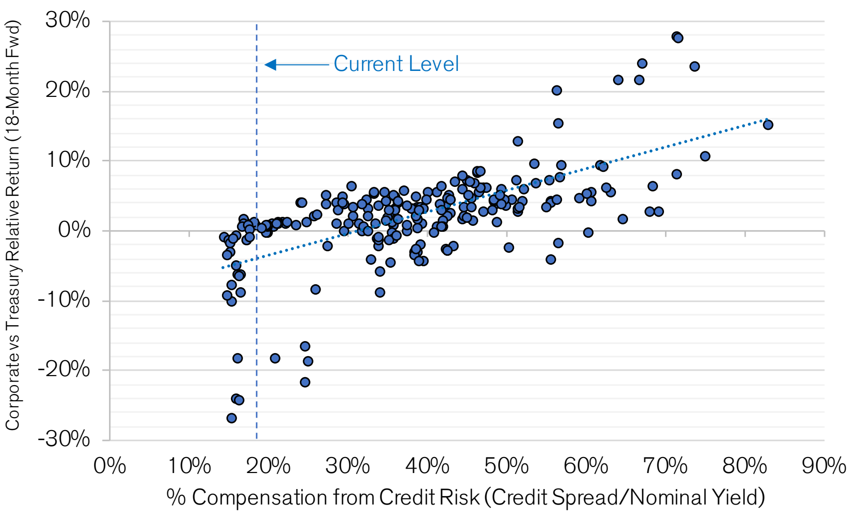
CREDIT UPSIDE LIMITED AT CURRENT LEVELS



Source: Bloomberg, WestEnd Advisors

CREDIT OFFERS LITTLE COMPENSATION FOR RISKS



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: Corporate spreads are providing limited compensation for taking on credit risk, despite late-cycle economic conditions. **Higher interest costs, growing net charge-offs, lower credit availability, and rapidly approaching maturities** have the potential to weigh on credit markets in the next 18 months, in our view. As such, we are **underweight corporate credit** within fixed income allocations.

Investment-grade credit spreads, which narrowed in 2023 as the economy proved resilient, currently sit near the low end of historical ranges. As a result, the **risk/reward profile for corporate credit has become less attractive**, in our view, even as overall yields remain elevated (top right chart).

At current levels, **credit spreads represent less than one-fifth of the total compensation potential for investment-grade corporate bonds**. Historically, credit compensation at these levels has been associated with limited outperformance, or even outright underperformance, compared to Treasury bonds (bottom chart) over the subsequent 18 months.

Elevated Rates Improve Fixed Income Return Potential

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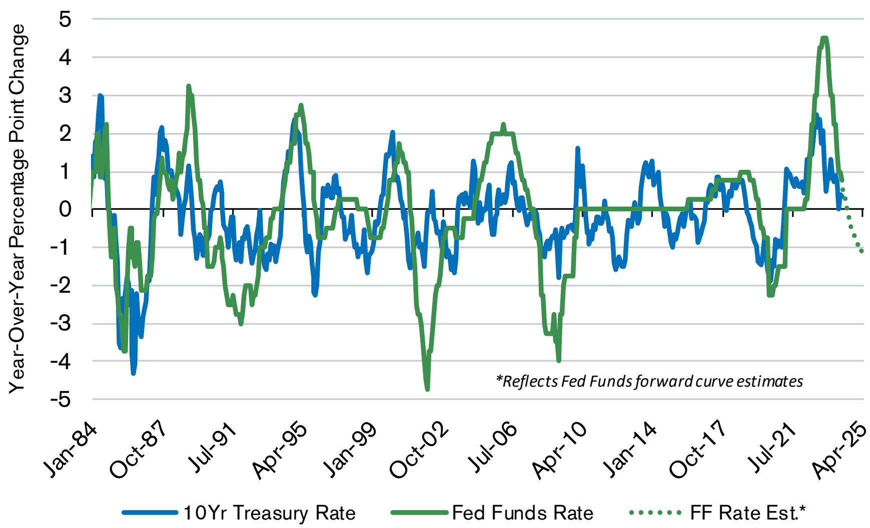
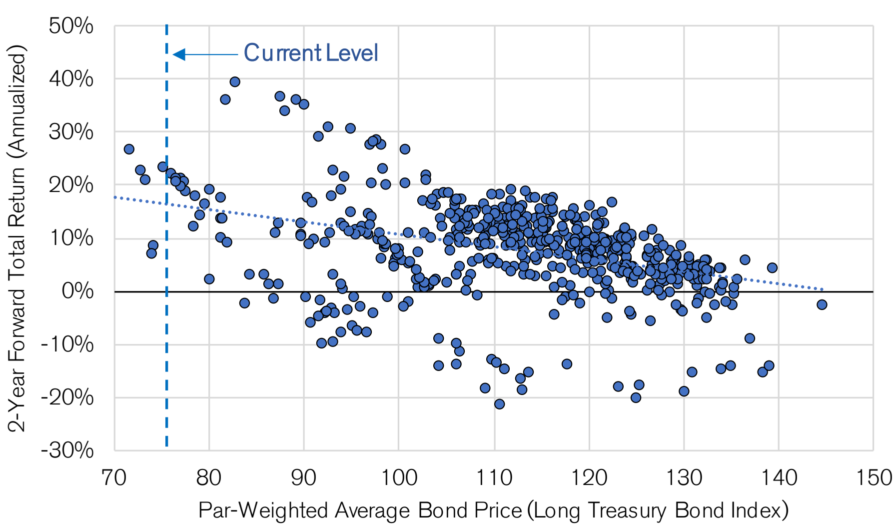
FED POLICY HEADWIND TO LONG BONDS ABATING



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 over the course of our investment time horizon. As a result, **we find the risk/reward for longer-term bond returns appealing**, and we are therefore maintaining an overweight allocation to long-duration fixed income in traditional 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 finished with 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, **we see attractive return opportunities in fixed income given our interest rate outlook**.

Asset Class Returns Driven by Macro Environment

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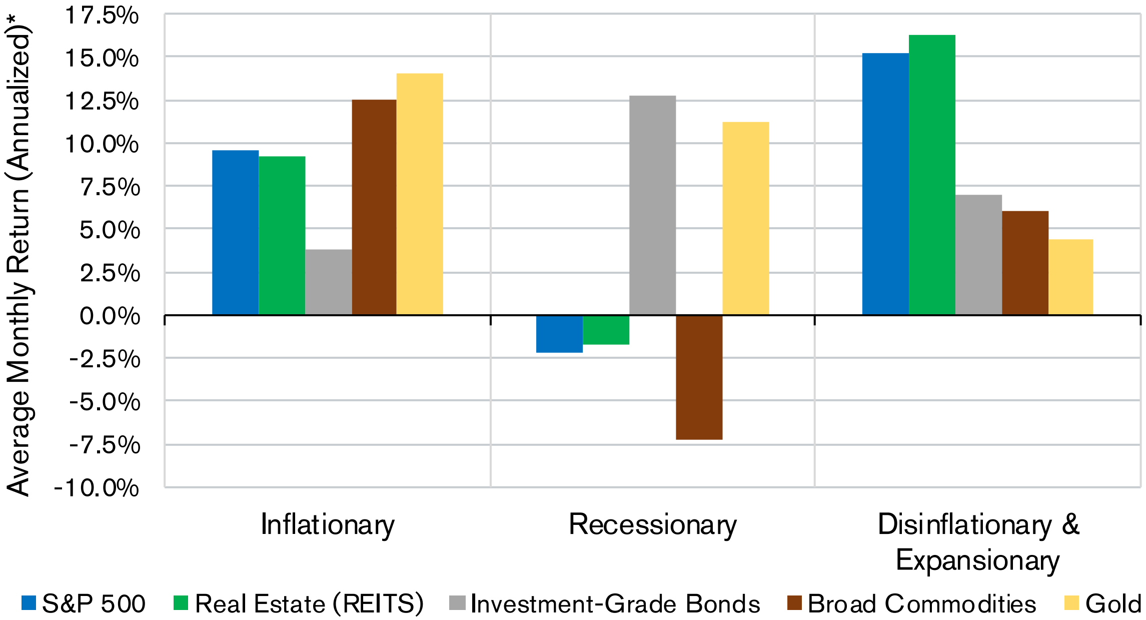
MACRO CONDITIONS DRIVE ASSET CLASS DISPERSION



Source: Bloomberg, WestEnd Advisors * Covers all periods from 1975 through Q4 2023.

Portfolio Impact: Moving forward, we see a growing likelihood that inflation pressures continue to fade as the risk of recession rises. As such, we are **emphasizing high-quality 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, such as we experienced in 2021 and 2022, we believe commodities can add significant capital appreciation potential and inflation protection to a portfolio.

However, as we look ahead to 2024, **we see potential for recent disinflationary trends to continue alongside slower growth**. As such, we have positioned our multi-asset portfolios to benefit from more modest economic growth as well as to protect capital in the event of a downturn. As the chart above shows, investment grade bonds and gold have historically generated positive returns during both recessions and disinflationary expansions.

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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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