WESTEND Advisors

A VICTORY CAPITAL® INVESTMENT FRANCHISE

Mid-Quarter Macro Update

Q2 2025

20250513-4500642

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** For illustrative purposes only. Allocation information as of May 13, 2025. Source: WestEnd Advisors.*

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Fixed Income Overweights

- Short-term Corporate Credit
- Longer-Term Treasury Securities

Fixed Income Underweights

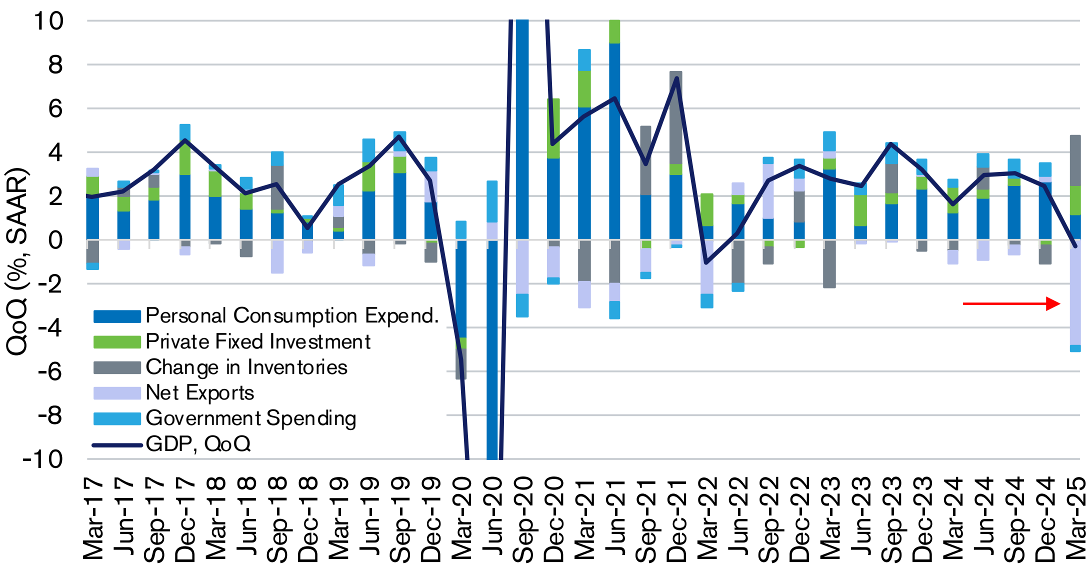
- Short-term Treasury Securities
- Long-term Corporate Credit

** For illustrative purposes only. Allocation information as of May 13, 2025. Source: WestEnd Advisors.*

Economic & Market Backdrop

Slowdown Apparent but Sources of Growth Remain

DRAG FROM TRADE EXAGGERATES SLOWDOWN IN Q1



Source: Bloomberg, WestEnd Advisors.

Portfolio Impact: Ongoing late-cycle risks in the U.S. warrant an avoidance of highly cyclical sectors, in our view. At the same time, steady consumer spending and productivity gains, along with the absence of extreme excesses, could enable the cycle to tread along. In our portfolios, we have balanced exposures between traditionally defensive sectors, like Health Care, and sectors that can benefit from a continuation of the cycle, such as Financials and Information Technology.

Late-cycle slowdown:

- Continued late-cycle conditions in the U.S. economy inform our outlook for slower-but-positive growth in 2025, even without tariffs, but tariff front-running via imports distorted the magnitude of the reported Q1 GDP slowdown, in our view.
- Final sales to domestic purchasers – which exclude trade and inventories – fared better, with growth that was in-line with historical averages, though here, too, some demand likely came ahead of potential tariffs (e.g., auto purchases).
- Looking beyond the noisy Q1 GDP report, growth for the U.S. economy outside of trade and inventories may show further signs of slowing given elevated tariff uncertainty in the 1H – however, the most extreme tariff policies now appear unlikely given average tariff rates have improved with ongoing negotiations

Mixed Data Reflects Economic Uncertainty

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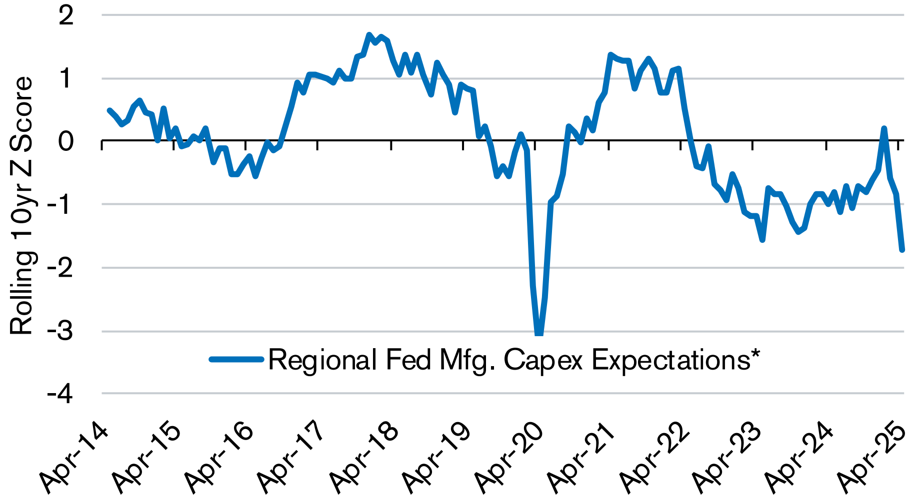
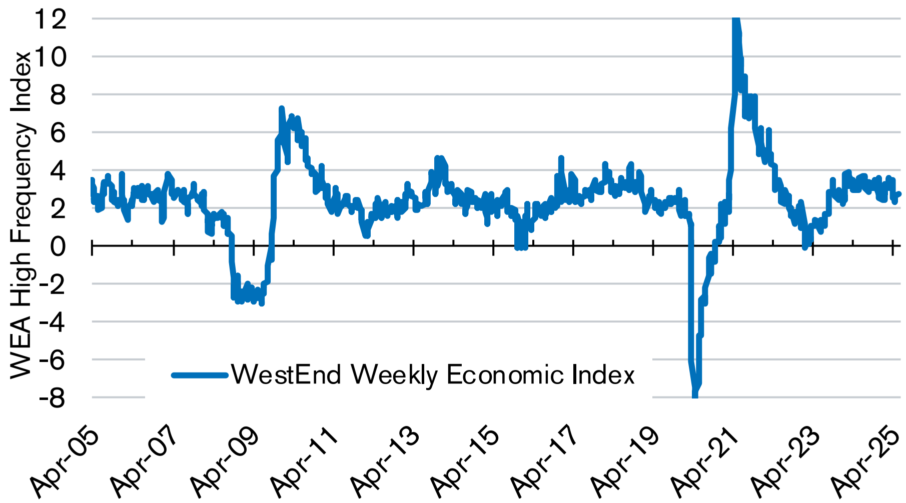
CAPEX INTENTIONS HAVE DETERIORATED…



*Source: WestEnd Advisors, Bloomberg. **
Composite of the 6-months ahead capex expectations from regional Fed manufacturing surveys.

…BUT HIGH FREQUENCY DATA SHOWS RESILIENCE



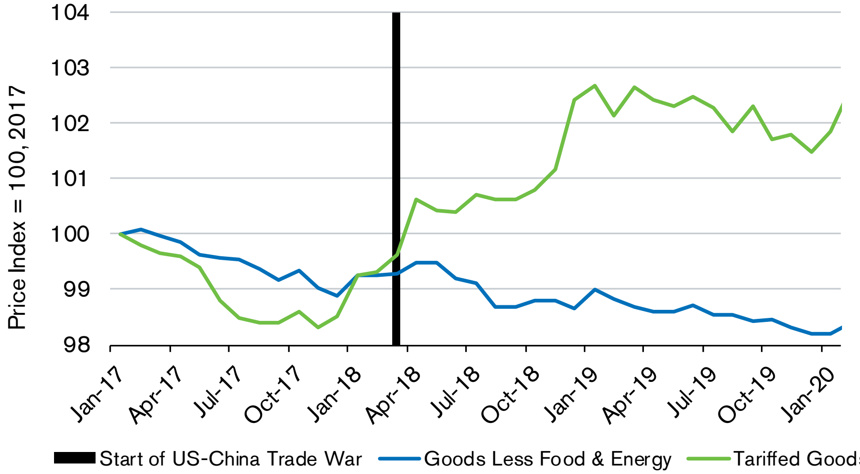
Source: Bloomberg, WestEnd Advisors..

Portfolio Impact: Mixed data has raised questions about the U.S. economy's trajectory as Trump administration policies are implemented. We see little evidence of robust, early-cycle growth dynamics, which warrants an avoidance of highly cyclical areas of the market while we continue to emphasize sectors with more moderate economic sensitivity and durable fundamentals in the slowdown phase of an economic cycle.

- **Slowing investment:** Regional Fed manufacturing surveys point to declines in CapEx plans and rising pessimism given ongoing trade policy uncertainty (top chart).
- **Trade impacts yet to hit:** Despite souring sentiment, our measure of high frequency data (bottom chart) shows real economic activity has yet to experience material negative impacts—partly due to trade lead-times, in our view.
- **Path to extended cycle:** Given late-cycle conditions, more productivity and renewed credit growth will be needed over time to extend the current economic cycle, in our view
- **Tariff headwind:** Meanwhile, we believe that an average effective tariff rate that is higher than before Trump took office raises the risk of a sharper economic slowdown.

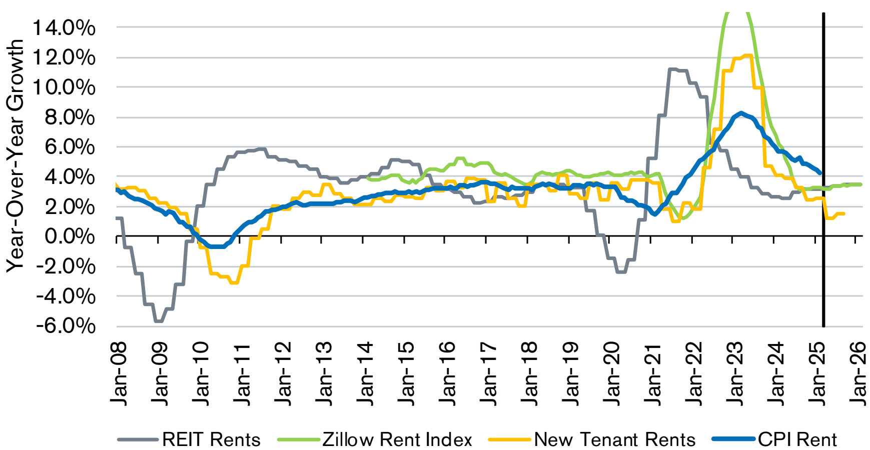
Tariffs to Lift Goods Prices, But Services Disinflation Provides Offset

TARIFFS A RISK TO PRICES ON AFFECTED GOODS



Tariffed goods include Motor Vehicles & Parts, Furniture, Carpets & Other Floor Coverings, Major Household Appliances, Sports & Recreation Vehicles, and Household Supplies.
Source: BEA, WestEnd Advisors

FORWARD-LOOKING RENT MEASURES NOT ALARMING



Non-CPI measures shifted forward 12 mos./show estimates through end of 2024.
Source: Zillow, Federal Reserve Bank of Cleveland, Bloomberg, WestEnd Advisors

Portfolio Impact: The base case for our inflation outlook continues to contemplate a path lower. Still, we don't expect core CPI inflation to reach the Fed's 2% target by year end, as upside risks to inflation may be more prevalent than a year ago. We are maintaining a significant allocation to the long end of the Treasury yield curve, while also avoiding long-duration corporate bonds due to risks from a potential widening of credit spreads.

- **Tariffs matter for prices:** During the 2018-2019 trade war, a limited basket of impacted goods saw higher prices following the imposition of tariffs, though core goods prices overall remained on their prior trend lower.
- **Larger risk this time:** In 2025, the weighted average tariff rate will likely see a larger increase compared to 2018, presenting an upside risk to prices, in our view.
- **Expectation risk:** Consumers also increasingly expect higher inflation, which the Fed considers in their outlook.
- **Core stability:** Core inflation progress has begun to flatten, but we are encouraged that leading measures of residential rent prices, the largest driver of core inflation, indicate that shelter inflation has not re-accelerated.

Sector and Market Leadership is Broadening Out

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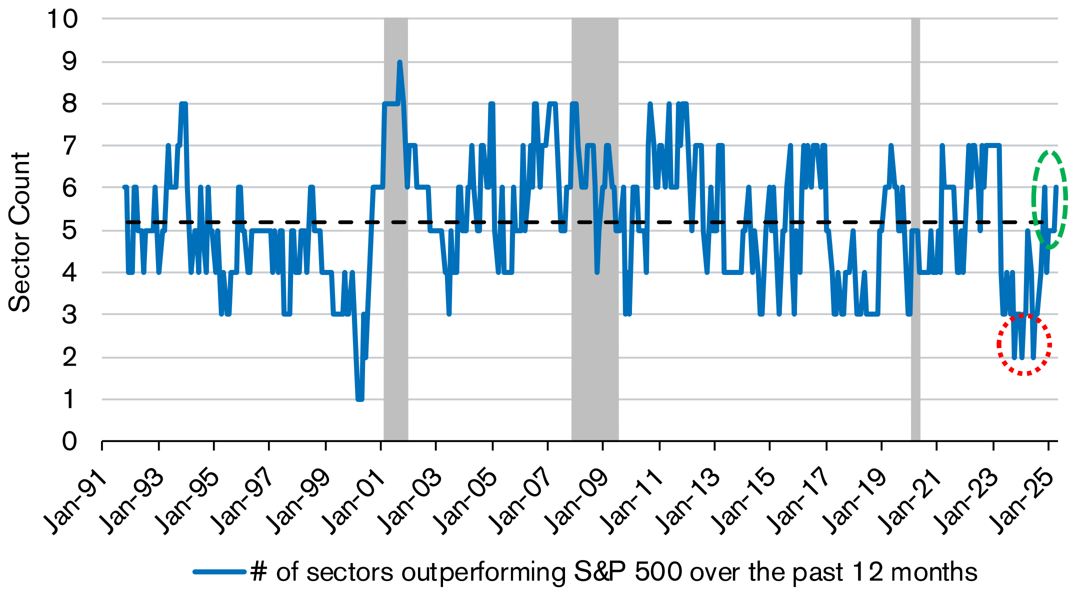
NUMBER OF SECTORS OUTPERFORMING THE S&P 500



Source: Bloomberg, WestEnd Advisors..

Portfolio Impact: U.S. sector leadership is broadening out following a period of unusual narrowness in which a substantial overweight of mid-phase sectors would have been required to outperform the S&P 500. Looking ahead, our current exposure leaves us well-positioned for a more normalized market environment, in our view.

- **Tech and Comms dominated:** The S&P 500's return of ~58% in 2023-2024 was led by the Information Technology and Communication Services sectors, largely due to the proliferation of A.I. and elevated earnings growth expectations.
- **Waning "Mag 7" momentum:** The 'Magnificent 7' stocks have collectively demonstrated healthy fundamentals, supporting significant relative outperformance until recently; however, momentum in fundamentals has been waning and earnings are expected to decelerate over the next few years to below-market levels.
- **Opportunity in broader leadership:** The narrowness of sector leadership over the past few years was unusual relative to history (see chart), and we see potential for sector-focused investors to benefit as returns continue to broaden out.

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Mid-Phase Sectors Provide Stable Economic Sensitivity

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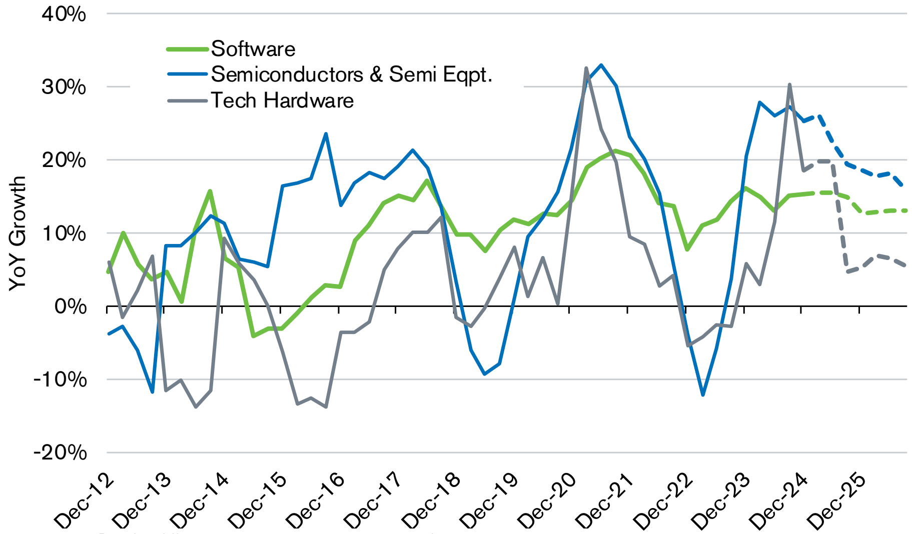
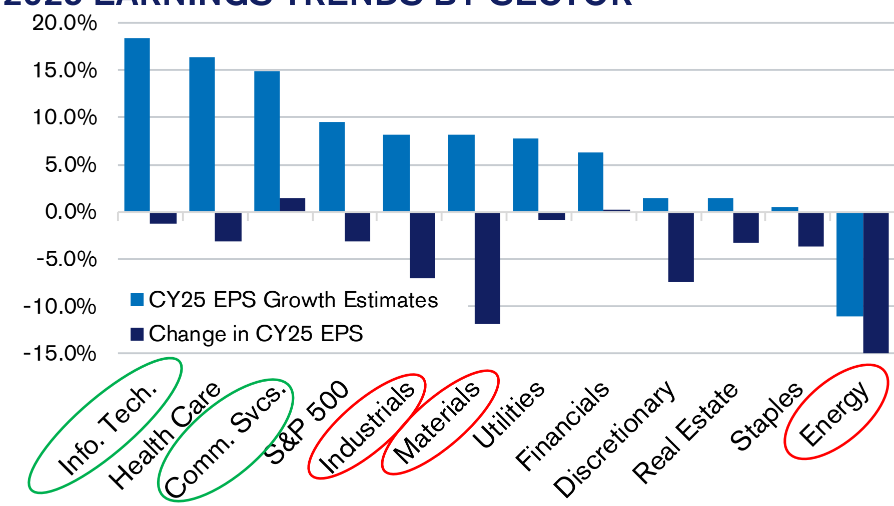
SOFTWARE REVENUE LESS CYCLICAL



Dashed lines represent consensus estimates.
Source: Bloomberg, WestEnd Advisors

2025 EARNINGS TRENDS BY SECTOR



Source: FactSet, WestEnd Advisors. Data as of 4/30/2025.

Portfolio Impact: Sectors like Information Technology and Communication Services have become more attractive, in our view, as they are poised to generate durable earnings growth during a period of likely slower growth and economic uncertainty. More cyclical sectors, such as Energy and Materials, could face greater fundamental headwinds going forward, in our view.

Software tailwind:

- Secular tailwinds persist for Information Technology, and we believe that Software investment can continue as companies pursue greater efficiency during this late-cycle environment.
- Within the broader economy, Software investment growth has remained healthy, which we view as supportive of top-line growth for the sector moving forward.

Standout earnings growth:

- Information Technology and Communication Services are expected to generate some of the strongest earnings growth in 2025.
- 2025 EPS estimates have been revised lower for most sectors, yet Communication Services has actually seen 2025 EPS estimates revised *higher* throughout this year.

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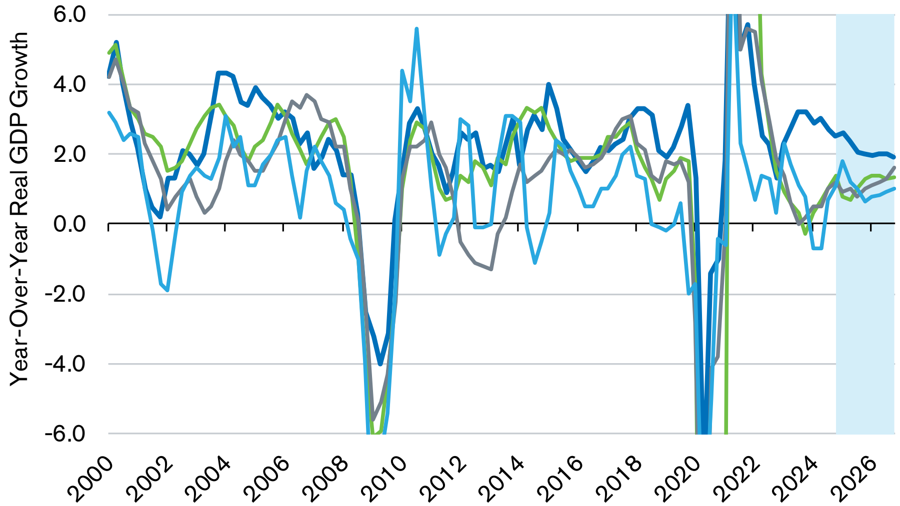
International Economic & Market Backdrop

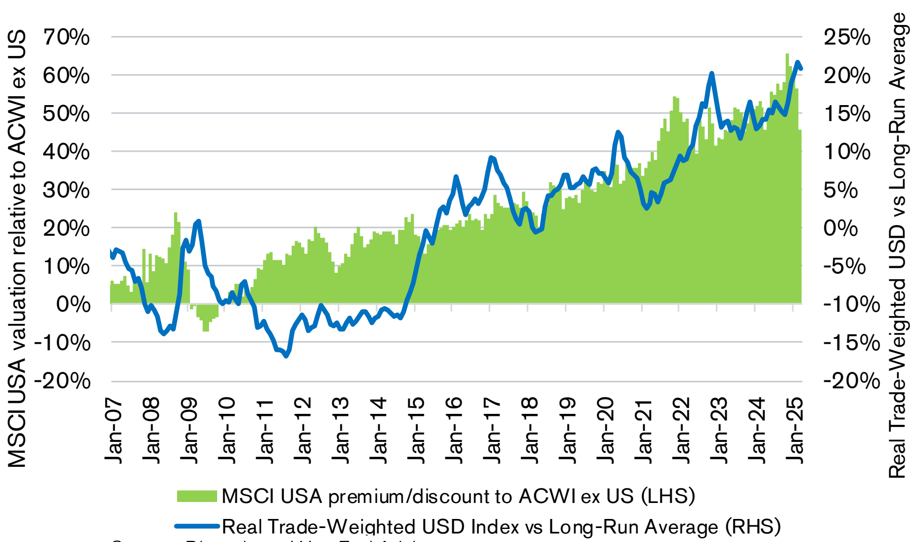
U.S. Growth Still Outpacing Rest-of-World

U.S. GROWTH EXPECTED TO OUTPACE PEERS



Source: Bloomberg, WestEnd Advisors

U.S. EQUITY AND FX VALUATIONS INCREASINGLY STRETCHED



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: Economic growth in the U.S. has continued to outpace the rest of the world and remains on a slowing-but-healthy trajectory, in our view. In global portfolios, we have maintained our overweight to the U.S., where we see attractive sector opportunities that could prove resilient in the face of slowing global growth.

Relative economic strength a U.S. tailwind:

- Growth in the U.S. is expected to remain strong compared to other major developed economies (top chart).
- Historically, when economic growth in the U.S. outpaces that of other regions, relative performance tends to be favorable for domestic equities.

Equity and dollar valuations are longer-term risk:

- Over the longer-run, prospects for significant U.S. outperformance appear more mixed:
  - Valuations for U.S. equities are now ~45% higher than those abroad.
  - Real trade-weighted USD index is ~20% above its long-term average (bottom chart).

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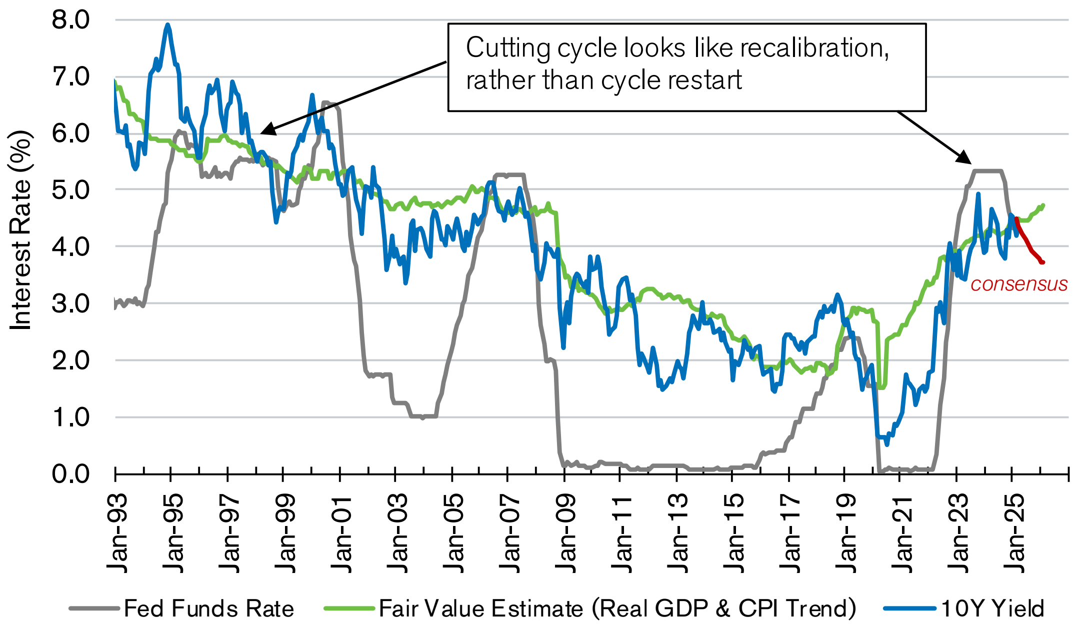
Fixed Income / Rates

Yield Curve Steepening Has More Room to Run in '25

YIELD CURVE RE-STEEPENING ON THE HORIZON



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: With the Federal Reserve on a path toward policy recalibration, we believe the yield curve re-steepening process can continue. Substantial changes to trade policy under the new administration could limit disinflation and downside to longer-term interest rates. We expect fixed income returns in 2025 to be driven primarily by healthy coupon yields, absent a sharper economic slowdown.

- **Steepening yield curve:** The yield curve remains inverted at the short-end, signaling late-cycle conditions, yet we expect the yield curve to continue steepening in 2025.
- **Attractive risk-adjusted returns:** Interest rates across most of the yield curve have fallen YTD tied to concerns of a potential economic slowdown in the U.S., resulting in attractive risk-adjusted returns for bonds relative to stocks.
- **Treasury bond pricing:** Looking ahead, the 10-year yield is roughly in line with fair value, according to WestEnd's internal estimate based on long-run real GDP growth and CPI, and consensus economic forecasts suggests that fair value for the 10-year yield could remain between 4% and 5% in 2025, absent a sharp deterioration in economic growth.

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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