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Third Quarter 2019

Market Outlook

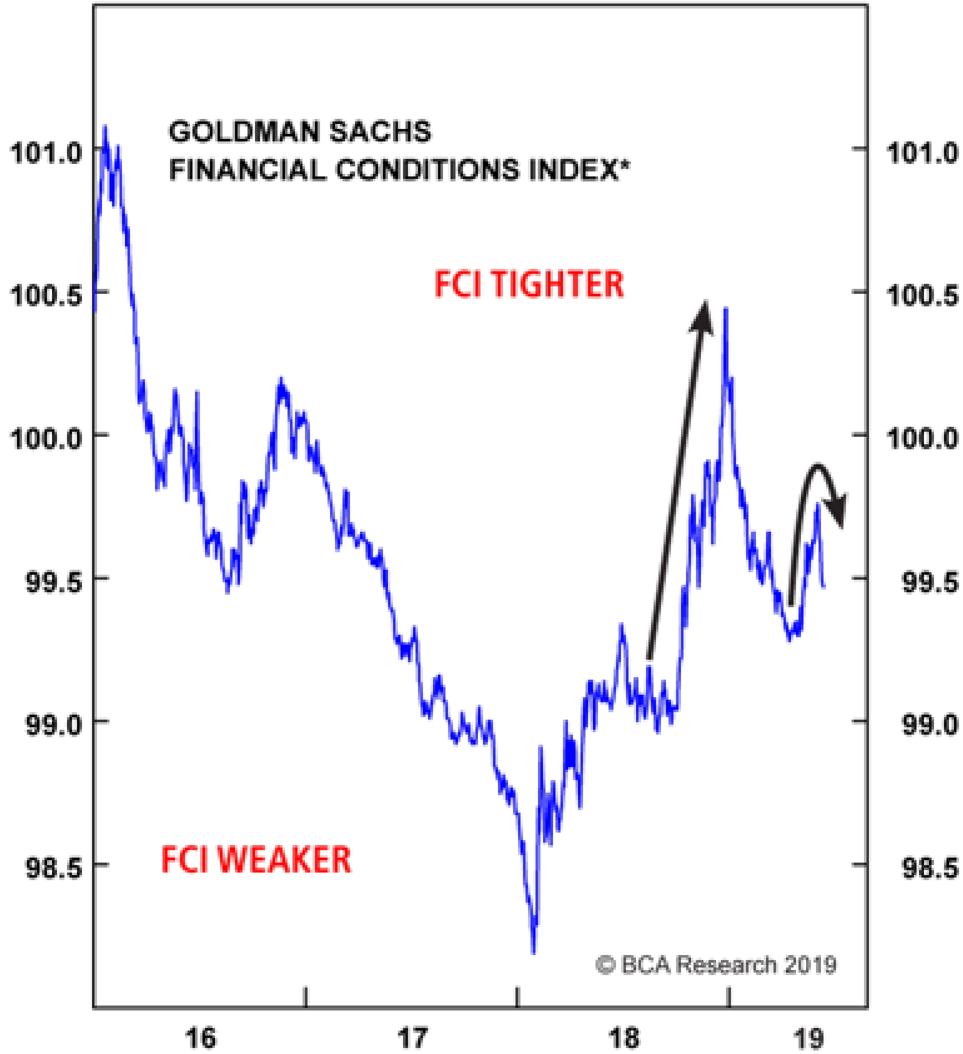
Third Quarter 2019 Market Outlook

On the heels of the strong rebound in equity markets in the first quarter, second quarter investment performance was broadly positive.

Source: Morningstar

Third Quarter 2019 Market Outlook

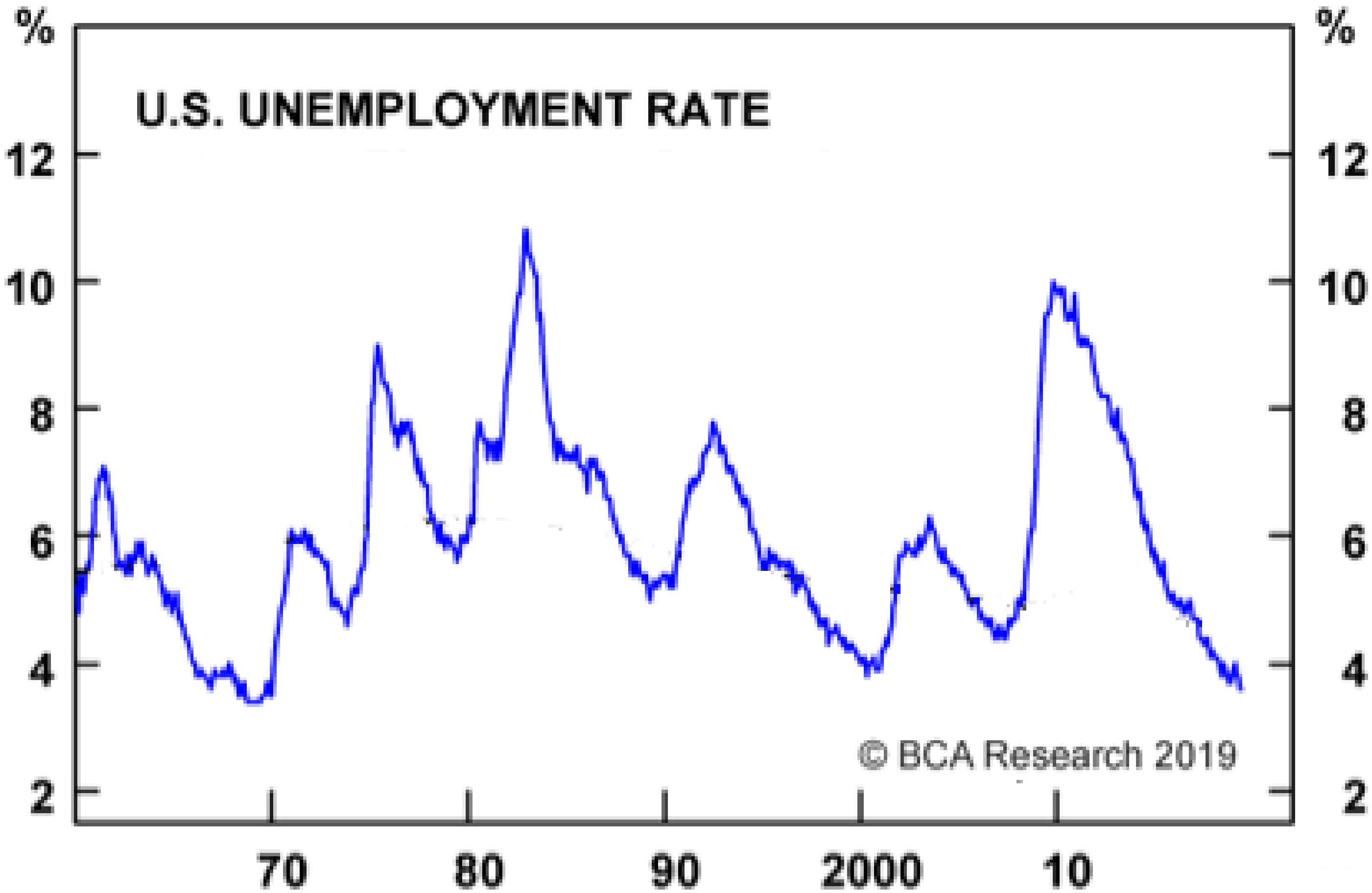
Financial conditions have eased considerably this year which should provide a tailwind to growth.



* SOURCE: BLOOMBERG FINANCE L.P.

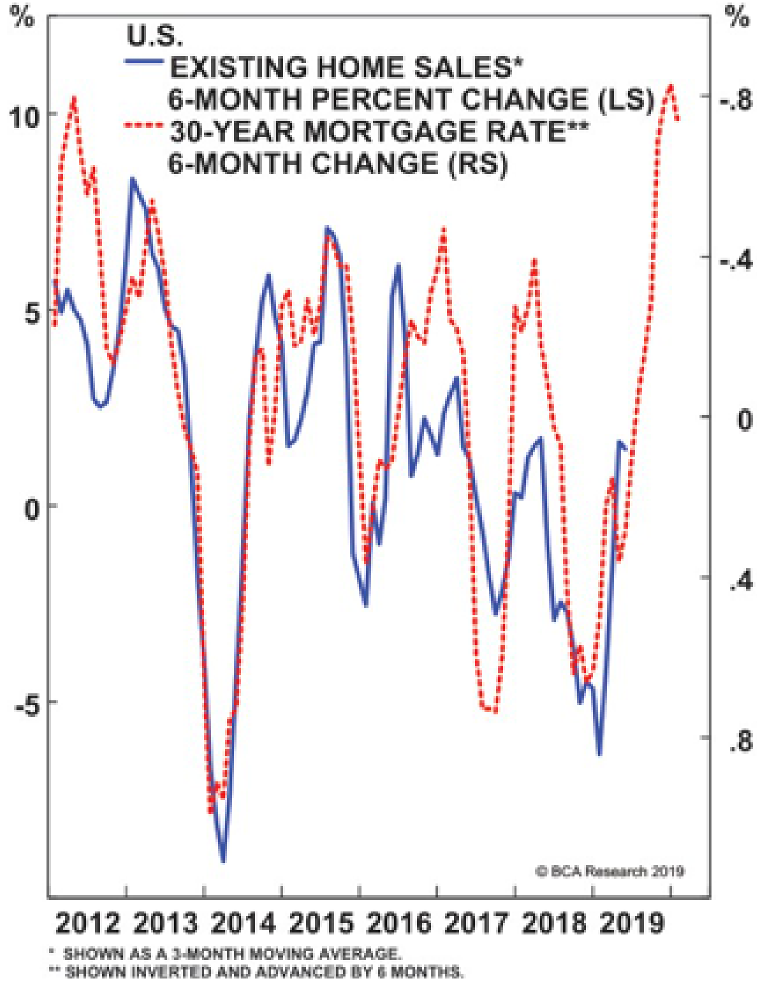
Third Quarter 2019 Market Outlook

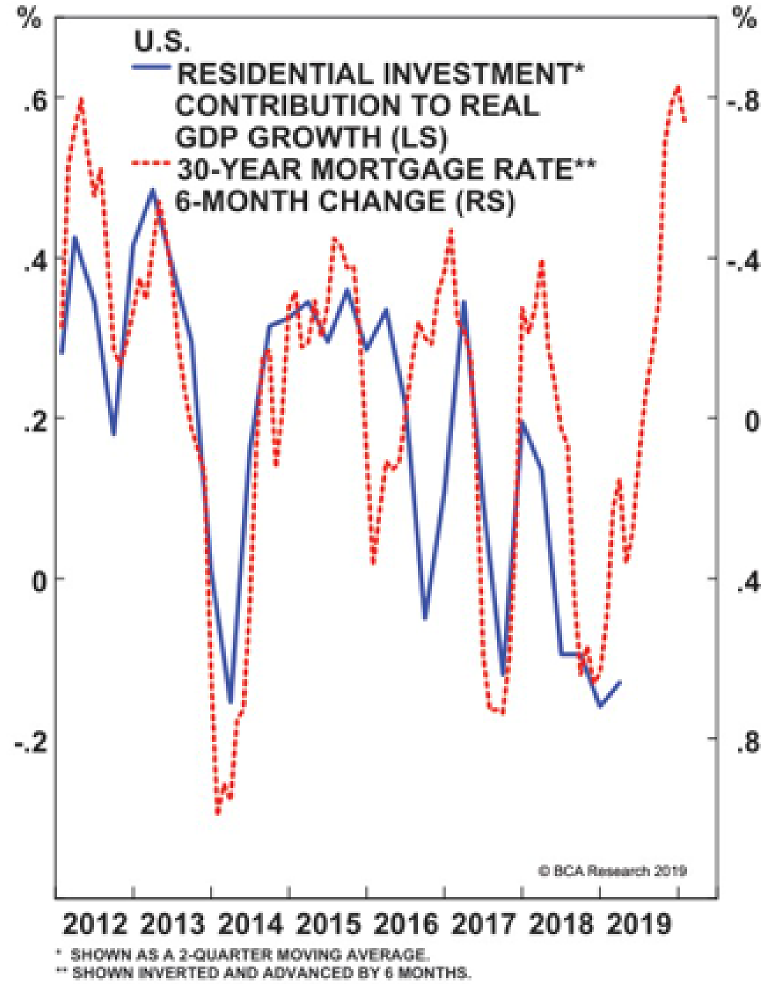
The consumer continues to exhibit strong fundamentals, supported by a labor market that remains firm.



Third Quarter 2019 Market Outlook

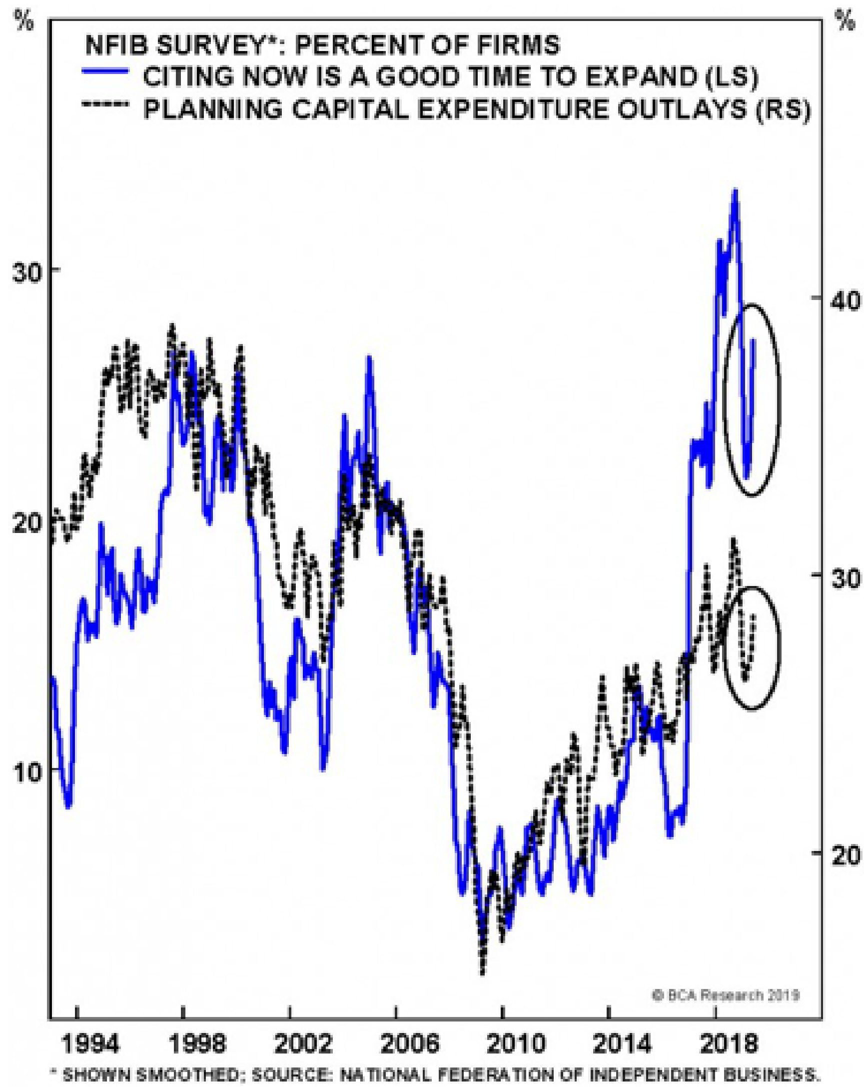
The housing industry appears to be setting up for a recovery. History suggests that the recent decline in mortgage rates should spur a rebound in home sales and construction.





Third Quarter 2019 Market Outlook

Capital spending intentions remain resilient as evidenced by an increasing share of small businesses citing that "now is a good time to expand."



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Third Quarter 2019 Market Outlook

Corporate debt appears to be the weakest link in the financial system. However, there are several potential mitigating factors, including interest coverage hovering above its long-term average and debt-to-assets modestly below its long-term average.

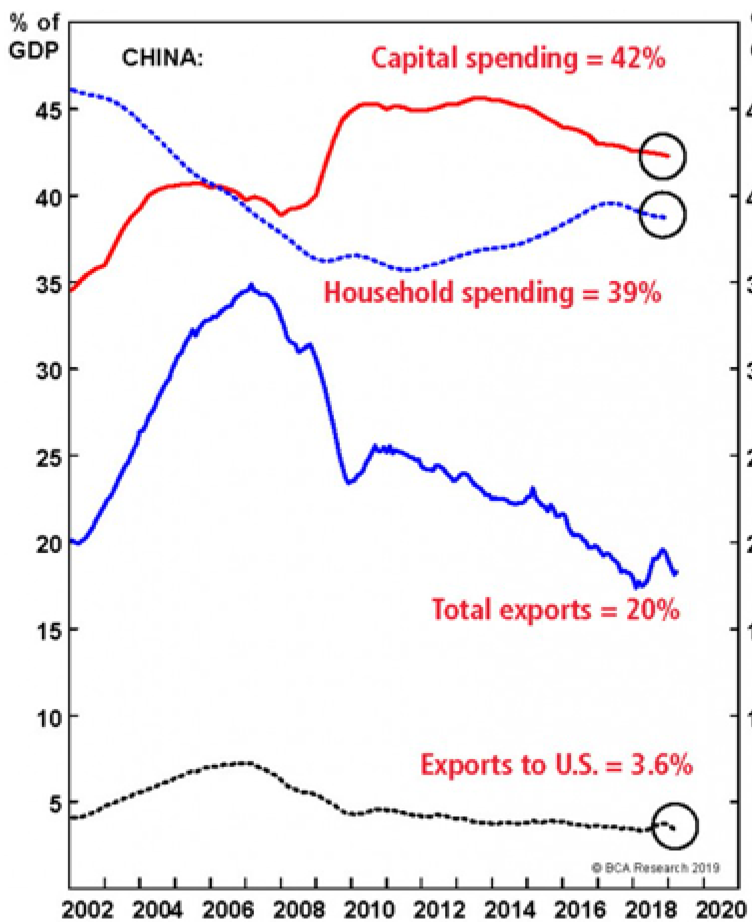
* SOURCE: FEDERAL RESERVE (FINANCIAL ACCOUNTS OF THE UNITED STATES).

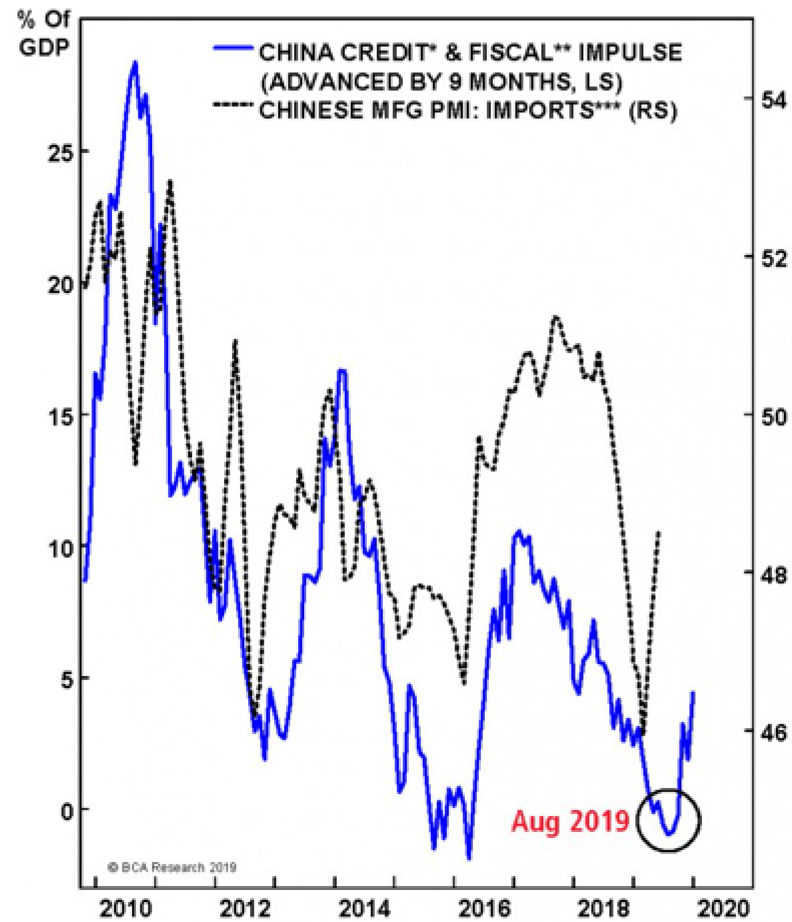
* EBIT-TO-INTEREST PAID.

** SOURCE: FEDERAL RESERVE (FINANCIAL ACCOUNTS OF THE UNITED STATES).
NOTE: SHADED AREAS REPRESENT NBER-DESIGNATED RECESSIONS.

Quarter 2019 Market Outlook

The Chinese economy is more dependent on capital spending, household spending, and exports to the rest of world than exports to the U.S. Credit and fiscal impulse has reached an inflection point which should provide a tailwind to Chinese imports and consequently global growth.

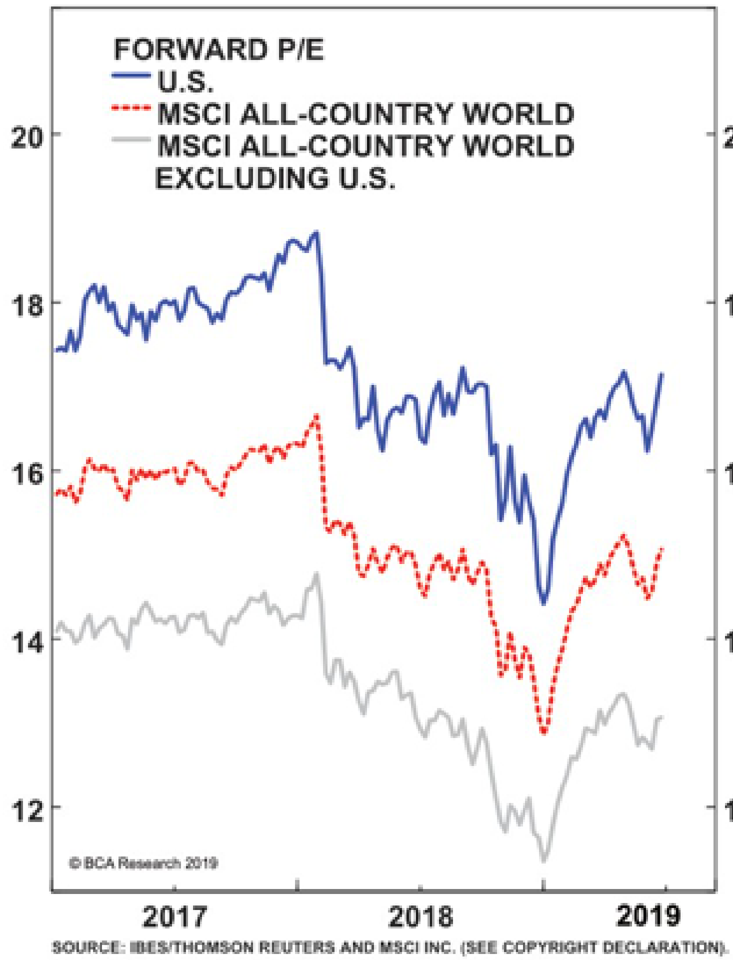


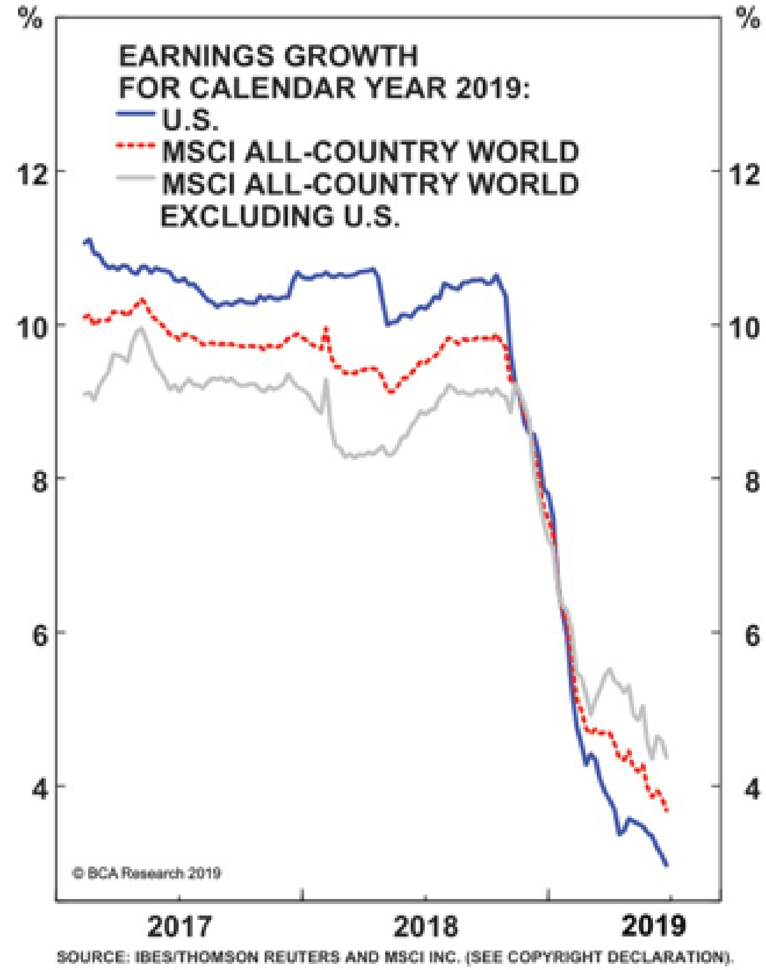


* CUMULATIVE AGGREGATE FINANCING EXCLUDING EQUITY FINANCING, LGFV SWAP FROM 2015 TO 2018 AND LOCAL GOVERNMENT SPECIAL BONDS ISSUANCE.
** GENERAL (CENTRAL AND LOCAL) GOVERNMENT, GOVERNMENT MANAGED FUNDS SPENDING AND SPECIAL INFRASTRUCTURE FUND FROM 2015 TO 2017.
*** SHOWN AS A 3-MONTH MOVING AVERAGE; SOURCE: NBS.

Third Quarter 2019 Market Outlook

Multiples have expanded to levels that we associate with fair value while 2019 earnings growth estimates have been revised down to low single digits, suggesting that expectations may be conservative.





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Summary Market Views

Monetary Policy	Accommodative

In its June meeting, the Fed left interest rates unchanged and indicated a bias toward lower rates if economic data continued to weaken. Recent statements from the Fed suggest that it stands ready to lower rates to prolong the economic expansion. Fixed income markets have responded by pricing in a 25 basis point cut at the end of July. If the Fed elects to hold rates steady for longer, a reset of expectations could negatively impact investment returns.

Fiscal Policy	Accommodative

While a lower corporate tax rate, looser regulatory environment, and increased federal spending should support growth over the short term, rising deficits and national debt create potential challenges over the long term.

Economic Fundamentals	Neutral

Presently, the Fed is projecting real GDP growth of 1.5% in the second quarter, below 3.1% reported in the first quarter and the 2.0% average pace during this expansion but positive nonetheless. In Europe, easing financial conditions should spur credit origination and business activity. Turning to Asia, the health of the Chinese economy has important implications for global growth. While China and the U.S. have reached a trade truce, the permanence of the deal has yet to be determined. Additionally, the Chinese economy is more dependent on capital spending, household spending, and exports to the rest of world than exports to the U.S. The Chinese economy actually began to weaken in 2017 (before trade tensions escalated) due to tighter monetary policy and stricter regulation. Last year, Chinese authorities reversed course and have now enacted more than 80 stimulus measures to stabilize the economy. As a result, credit and fiscal impulse has reached an inflection point which should provide a tailwind to Chinese imports and consequently global growth.

Market Sentiment	Neutral

While we are skeptical of growth expectations for next year, investors appear to share our view, suggesting that market expectations are more conservative. Sentiment surveys for retail and institutional investors remain negative while fund flows out of equities into bonds have reached extreme levels, not the traditional set up for a correction.

U.S. Equities	Neutral

While valuation multiples have expanded, they remain in line with the historical average. With respect to earnings, 2019 growth estimates have been revised down to low single digits, suggesting that expectations may be conservative. Within the U.S., we favor large cap over small cap and value over growth.

International Equities	Neutral

While valuation multiples have expanded, they remain below the historical average given weaker earnings growth expectations. A reacceleration of global growth would likely provide a tailwind to both international developed and emerging market equities.

Bond Yields & Credit	Negative

Although the yield curve has steepened recently, we continue to favor short-duration securities as investors do not appear to be adequately compensated for taking maturity risk. We continue to utilize preferred securities to drive incremental income but overall remain biased toward quality in fixed income allocations. With high yield spreads meaningfully below the historical average, investors do not appear to be adequately compensated for taking credit risk.

Commodities	Neutral

Disciplined supply constraints from OPEC and Russia coupled with moderate demand growth continue to support the price of oil.

U.S. Dollar	Neutral

The U.S. dollar appears to be extended. Slowing U.S. growth converging with international growth rate should result in a weaker dollar. However, in the event of a recession, expect dollar strength as investors rotate into safe-haven assets.

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Definitions:

U.S. Large Cap Equities: U.S. Large Cap Equities are represented by the S&P 500 Index.

U.S. Mid Cap Equities: U.S. Mid Cap Equities are represented by the S&P Midcap 400 Index.

U.S. Small Cap Equities: U.S. Small Cap Equities are represented by the Russell 2000 Index.

International Developed Equities: International Developed Equities are represented by the MSCI EAFE Index.

Emerging Market Equities: Emerging Market Equities are represented by the MSCI EM Index.

U.S. Core Bonds: U.S. Core Bonds are represented by the BBgBarc U.S. Agg Bond Index.

TIPS: TIPS are represented by the BBgBarc U.S. Treasury U.S. TIPS TR USF Index.

Global Bonds: Global Bonds are represented by the ICE BofAML Gbl Brd Mkt TR USD Index

High Yield Corporate Bonds: High Yield Corporate Bonds are represented by the ICE BofAML U.S. HY Constrained Index.

Preferred Securities: Preferred Securities are represented by the ICE BofAML Adjustable Rate Pref TR USD Index.