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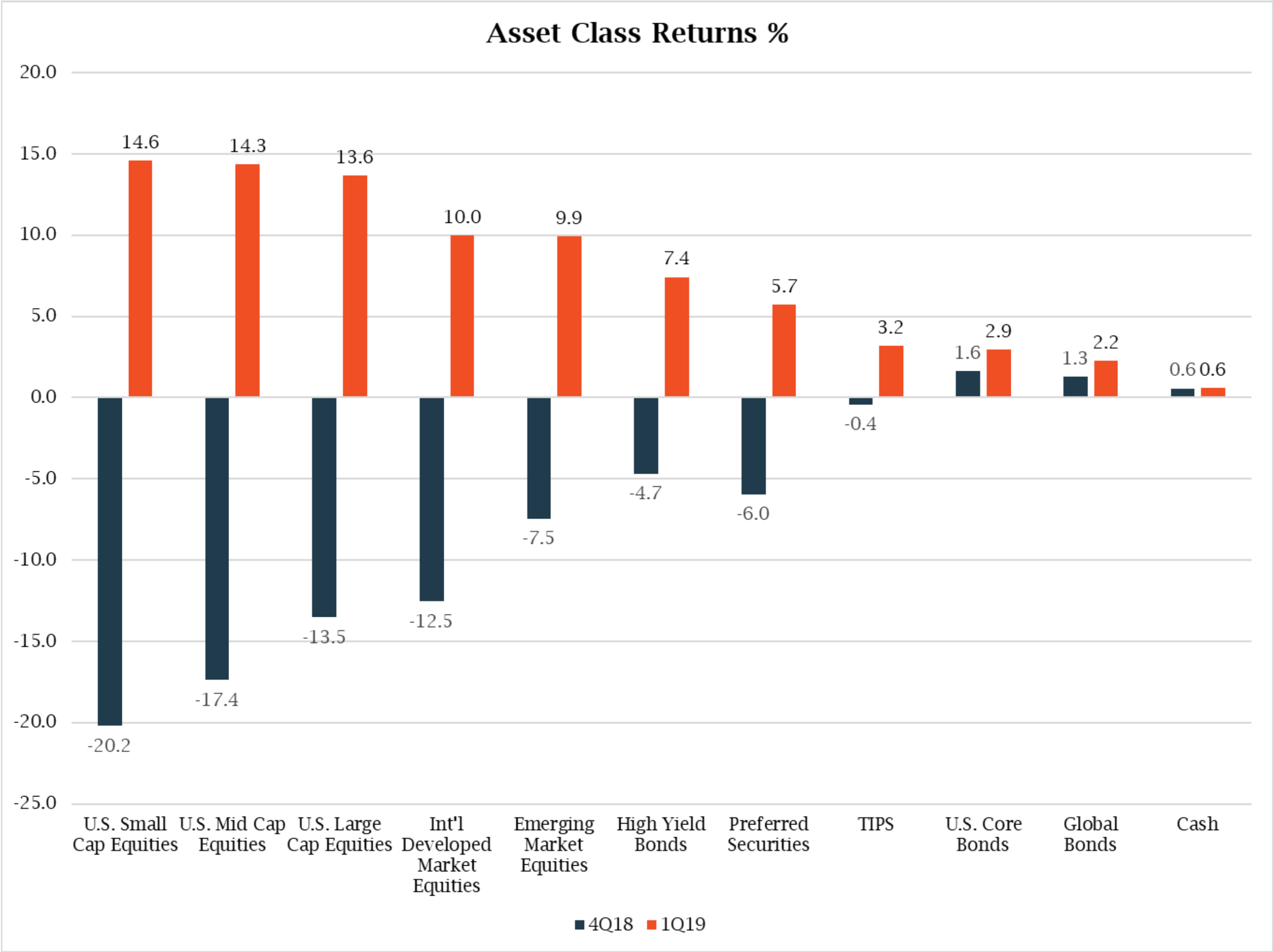
Second Quarter 2019

Market Outlook

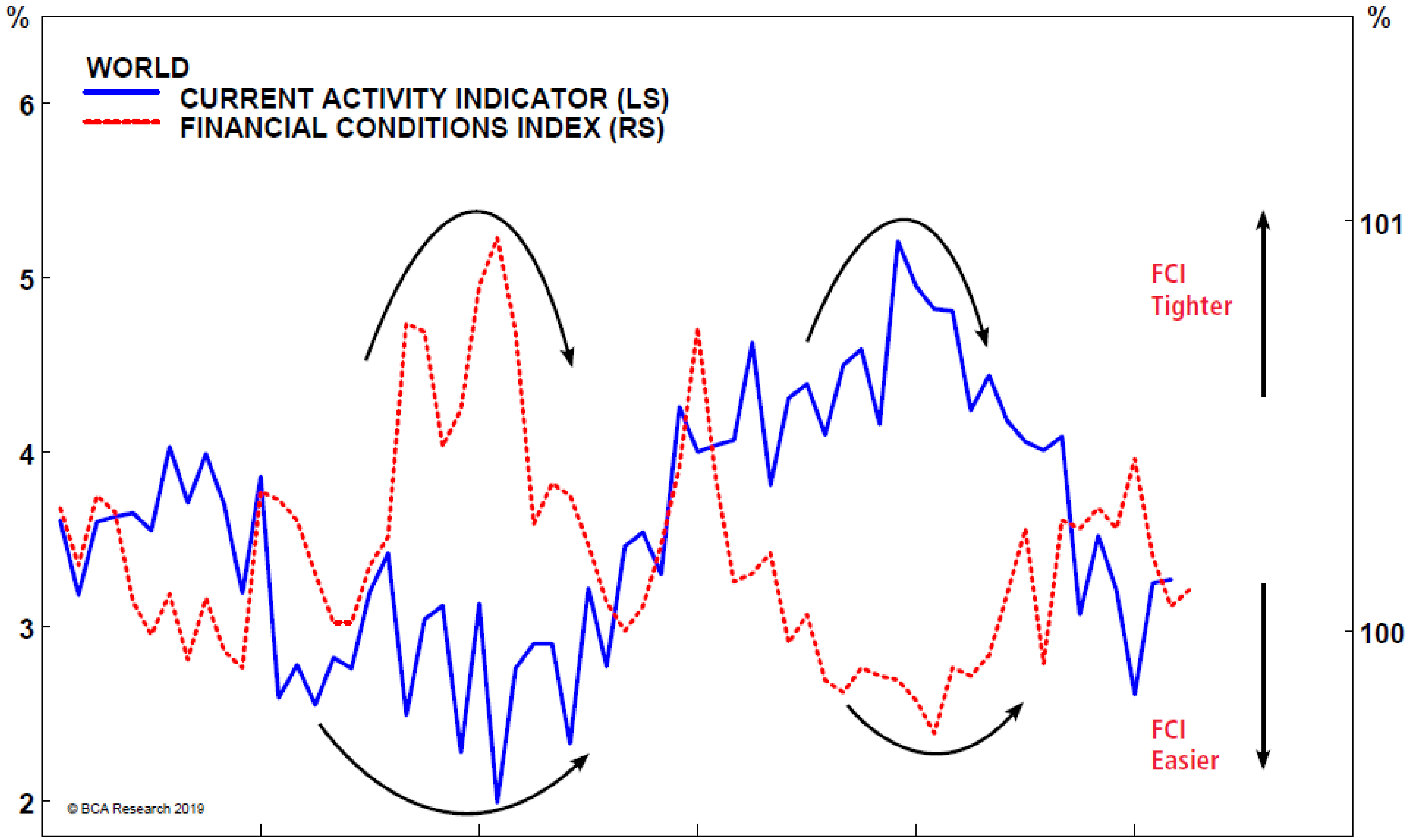
Second Quarter 2019 Market Outlook

The first quarter of 2019 was in sharp contrast to the final three months of 2018.



Source: Morningstar

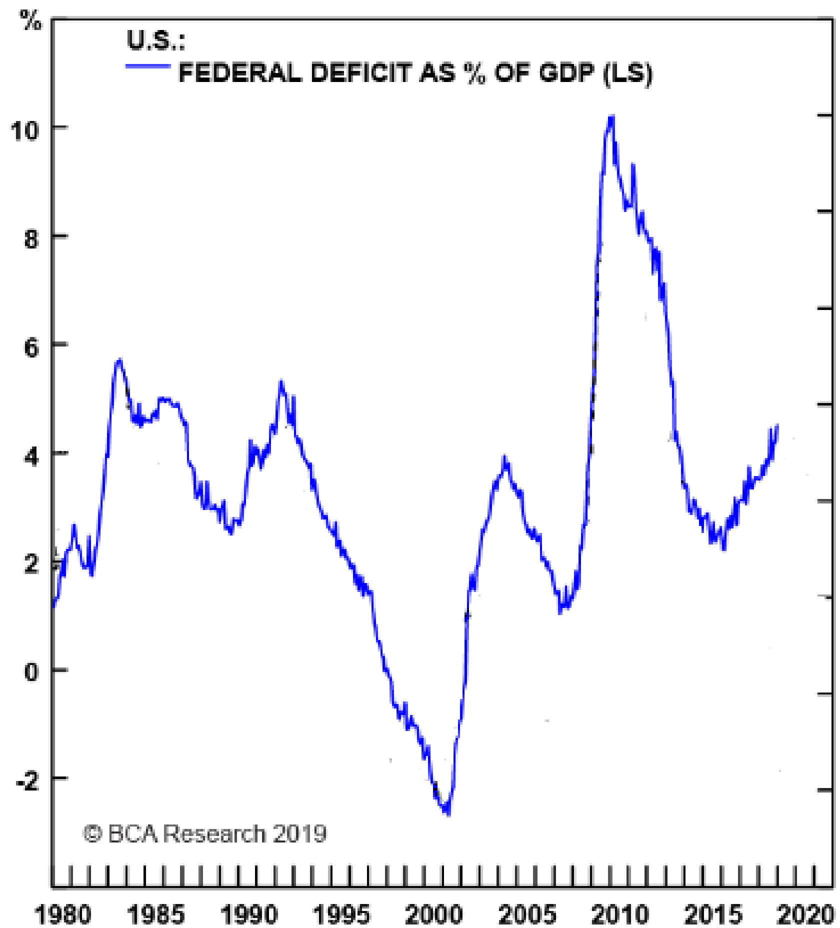
Financial conditions have eased which should provide a tailwind for economic growth in the second half of the year.



SOURCE: GOLDMAN SACHS (VIA BLOOMBERG L.P.).

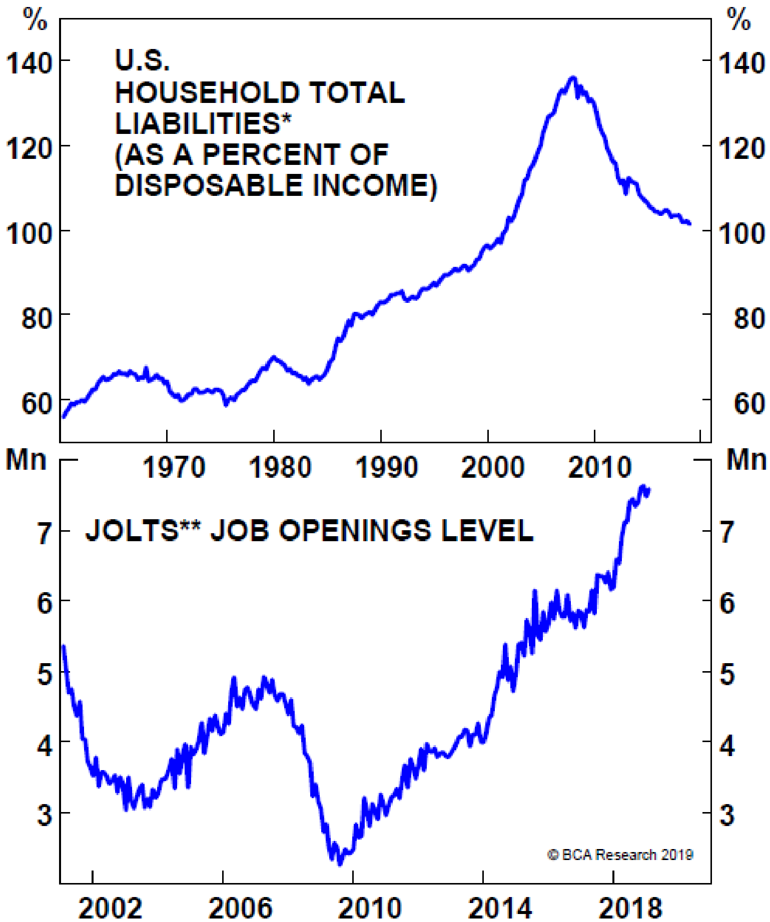
Second Quarter 2019 Market Outlook

While fiscal stimulus should support growth over the short term, rising fiscal deficits in an economic expansion potentially weaken the government's ability to use it as a tool in the next recession.

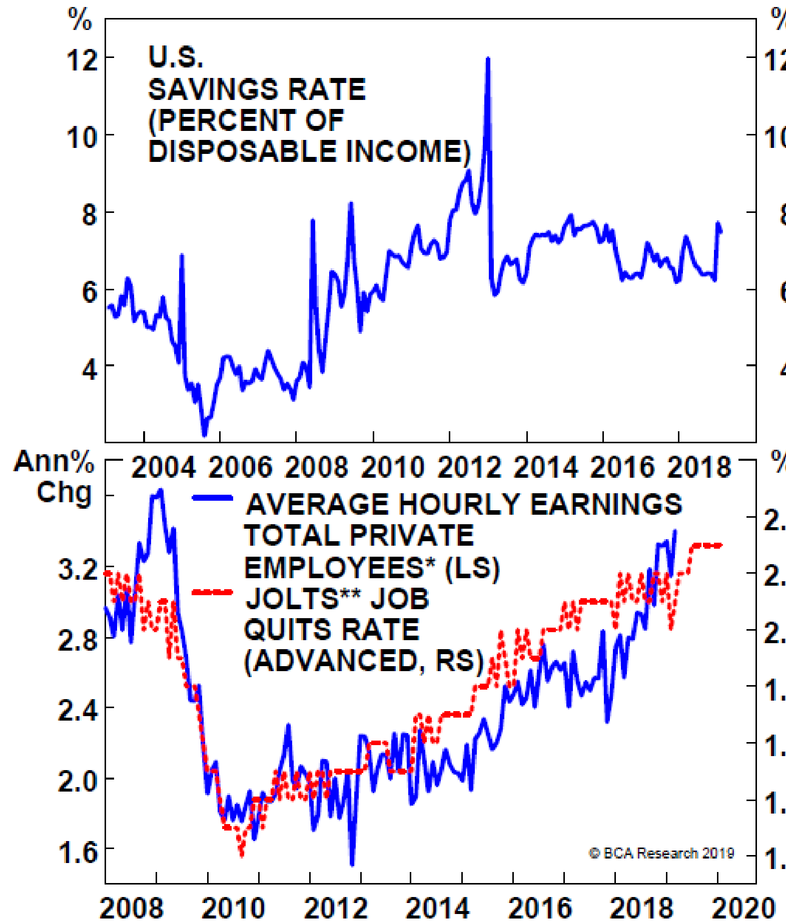


Second Quarter 2019 Market Outlook

The consumer continues to exhibit positive fundamentals: household debt-service ratio below pre-recession levels, an elevated savings rate, and increasing average hourly earnings.



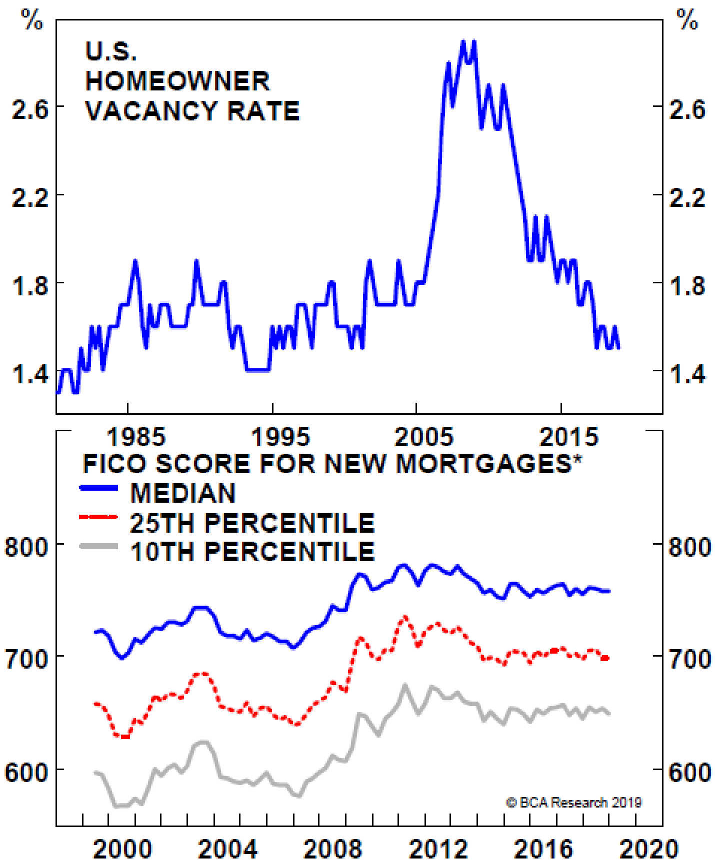
* BASED ON FLOW OF FUNDS DATA.
** JOB OPENINGS AND LABOR TURNOVER SURVEY.
SOURCE: BUREAU OF LABOR STATISTICS.



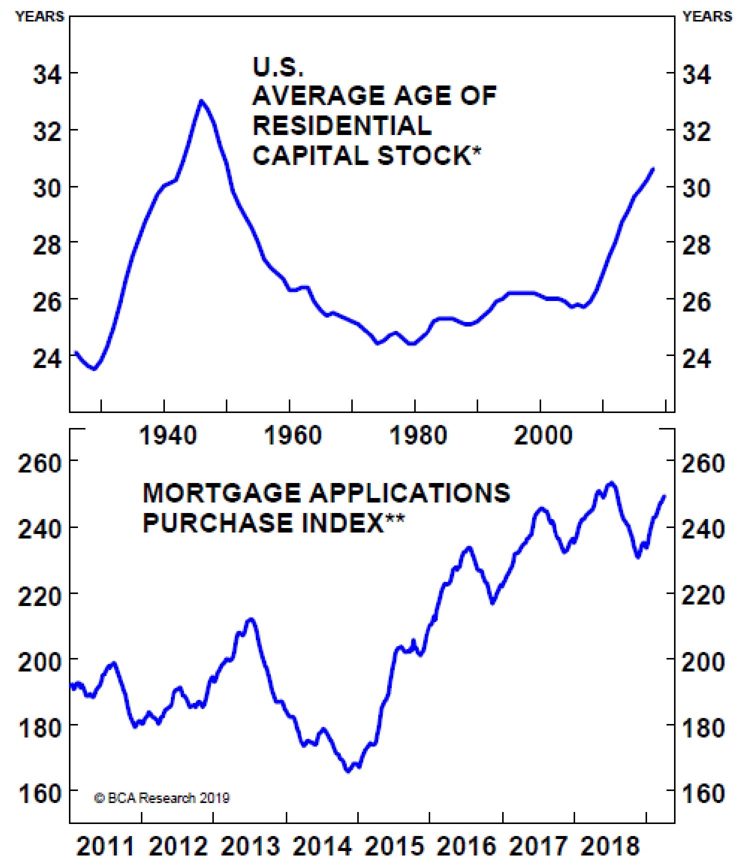
* NOMINAL EARNINGS, PRIVATE NONFARM PAYROLLS.
** JOB OPENINGS AND LABOR TURNOVER SURVEYS (JOLTS), ADVANCED BY 12 MONTHS.
SOURCE: BUREAU OF LABOR STATISTICS.

Second Quarter 2019 Market Outlook

The housing industry appears to be setting up for a recovery given declining mortgage rates, low vacancy rates, and an aging capital stock.



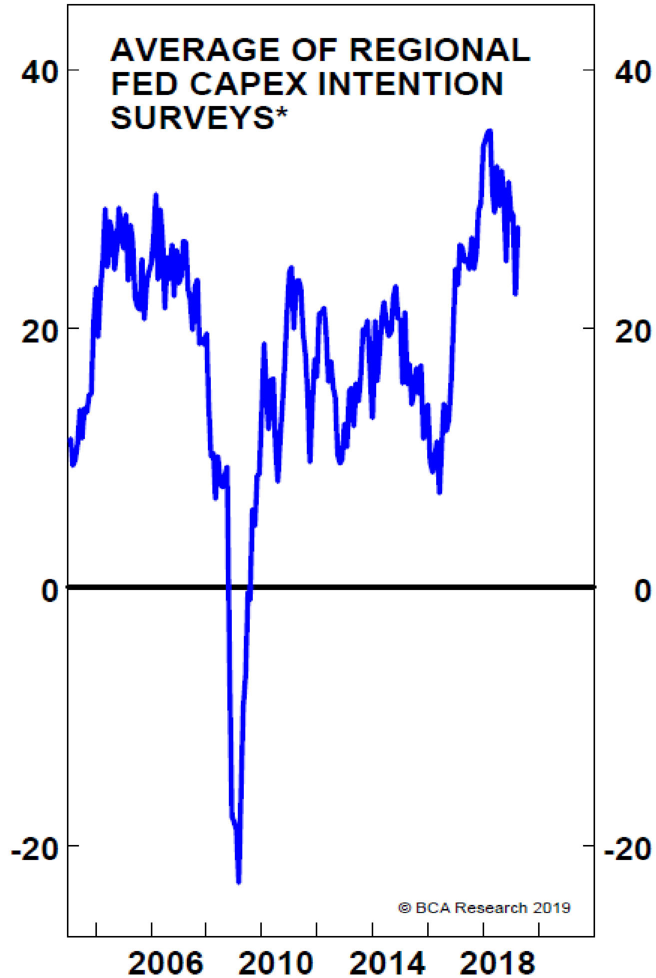
* WHERE 10% OF NEWLY ORIGINATED MORTGAGES ARE TO BORROWERS WITH CREDIT SCORES UNDER THE 10TH PERCENTILE, AND A QUARTER OF NEWLY ORIGINATED MORTGAGES ARE TO BORROWERS WITH CREDIT SCORES UNDER THE 25TH PERCENTILE.
SOURCE: FEDERAL RESERVE BANK OF NEW YORK.



* CURRENT-COST AVERAGE AGE AT YEAR-END.
** SOURCE: MORTGAGE BANKERS ASSOCIATION. SHOWN AS A 16-WEEK MOVING AVERAGE.

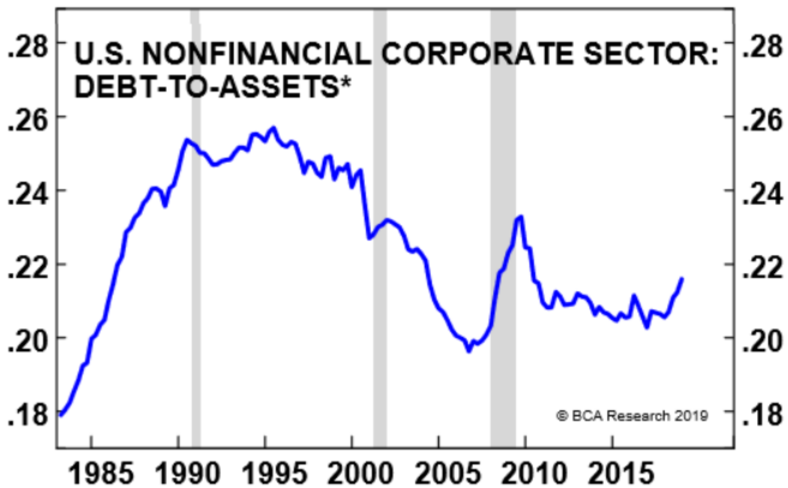
Second Quarter 2019 Market Outlook

Capital spending intentions have weakened but reside above the historical average.

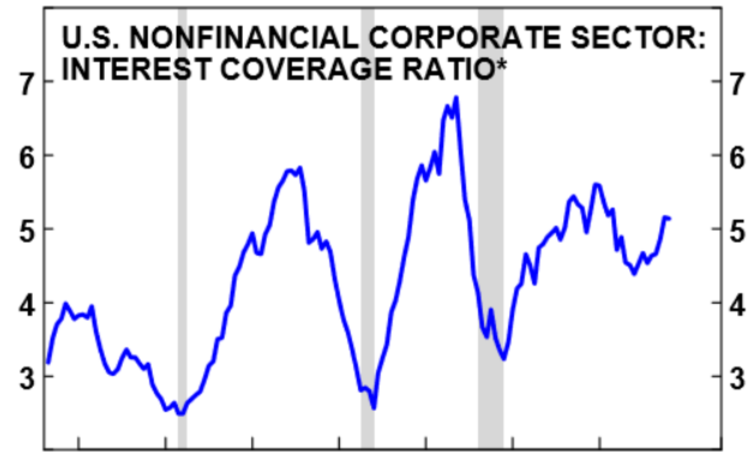


* SOURCE: AVERAGE OF CAPITAL EXPENDITURE EXPECTATIONS INDEXES (IN 6 MONTHS) FOR THE DALLAS, KANSAS CITY, NEW YORK EMPIRE, PHILADELPHIA, AND RICHMOND FED REGIONAL SURVEYS.

Corporate fundamentals remain strong, as demonstrated by aggregate debt-to-assets below pre-recession levels and solid interest coverage.

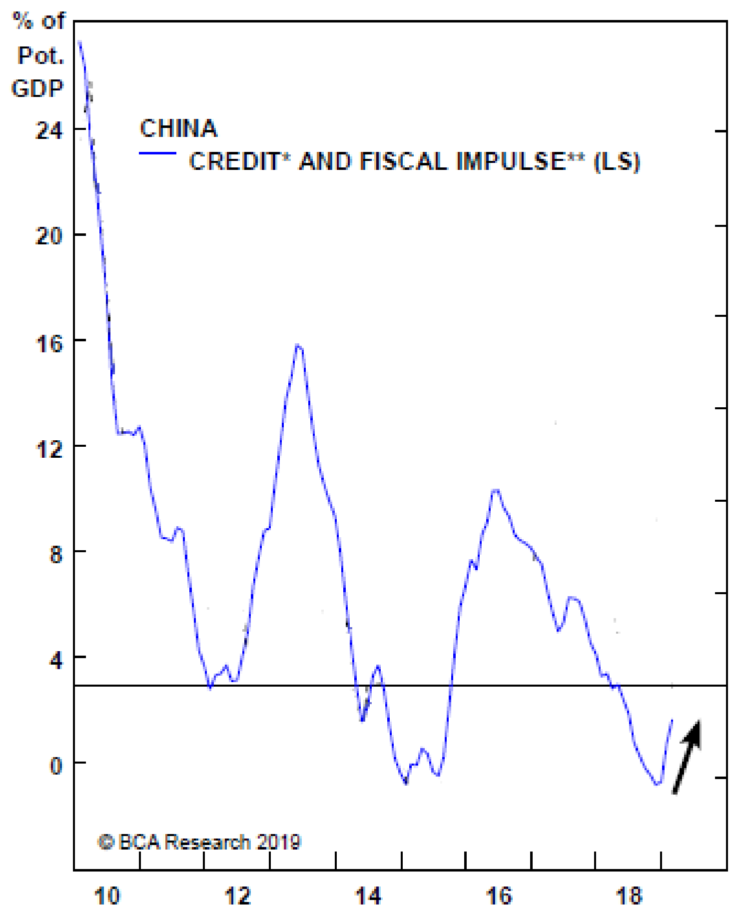


* SOURCE: FEDERAL RESERVE (FINANCIAL ACCOUNTS OF THE UNITED STATES).
NOTE: SHADED AREAS REPRESENT NBER-DESIGNATED RECESSIONS.



* EBIT-TO-INTEREST PAID.

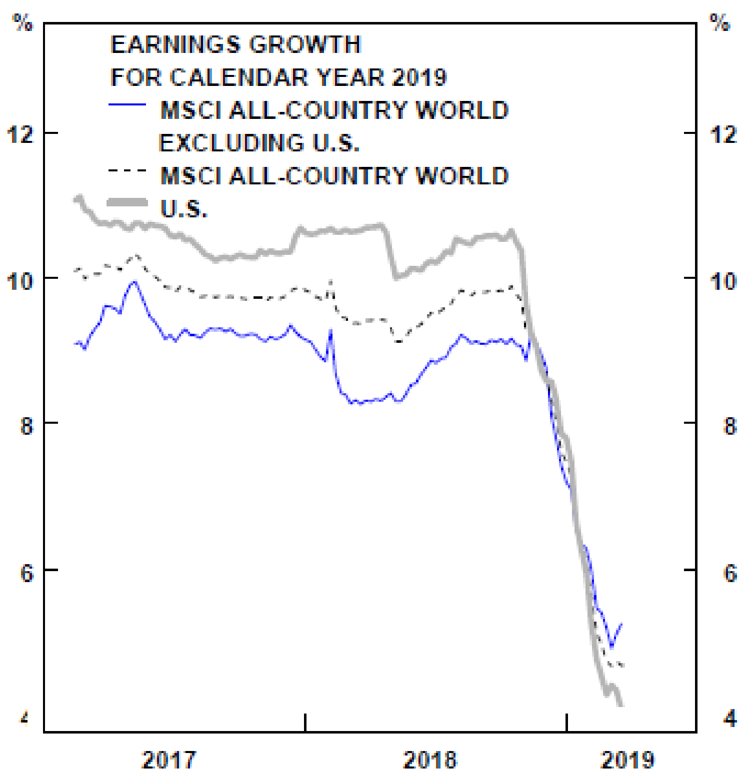
China's credit and fiscal impulse appears to have reached a positive inflection point which should offer a boost to growth.

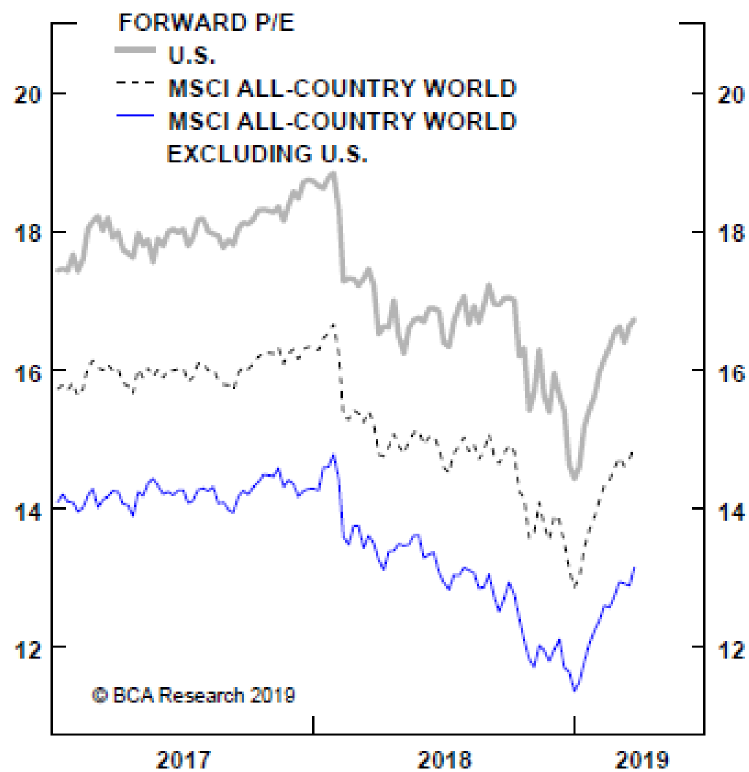


* CALCULATED AS CUMULATIVE AGGREGATE FINANCING EXCLUDING EQUITY FINANCING, LOCAL GOVERNMENT SPECIAL BONDS ISSUANCE, AND INCLUDING LGFV SWAPS FROM 2015 TO 2018.
** GENERAL (CENTRAL AND LOCAL) GOVERNMENT SPENDING, GOVERNMENT-MANAGED FUNDS SPENDING, AND SPECIAL INFRASTRUCTURE FUND FROM 2015 TO 2017.

Second Quarter 2019 Market Outlook

Earnings growth expectations appear conservative. The rebound in stocks has resulted in valuation multiples expanding back to levels that we associate with fair value.





SOURCE: IBES/THOMSON REUTERS AND MSCI INC.
(SEE COPYRIGHT DECLARATION).

Recent Tactical Shifts

December 2018: Sold out of bank loans and reduced exposure to U.S. energy master limited partnerships ("MLPs"), deploying the proceeds in U.S. equities and raising cash. Additionally, removed currency hedge on international equity exposure. Holding excess cash with the expectation of ultimately investing in emerging market equities.
Rationale: The combination of stable economic underpinnings, a data dependent Federal Reserve, attractive valuation levels, and oversold market technical indicators continue to argue for maintaining long term exposure to equities. The decline in equities coupled with relatively tight credit spreads suggest that risk is likely to be better rewarded in stocks than lower quality credit investments. While our outlook on MLPs remains constructive, the ability to shift into higher quality businesses at comparable valuations is compelling. We expect a modestly weaker U.S dollar over the intermediate term.

February 2019: Sold out of U.S. mid-cap core equities and invested proceeds along with excess cash in U.S. homebuilders industry.
Rationale: The Fed paused on rate hikes recently and 30-year mortgage rates have fallen from ~5% to 4.5%, which may be rekindling interests from potential buyers. Additionally, there appears to be pent up demand after years of under-building following the Great Recession. Household formations averaged ~1.0m per year over the past 10 years. As a percentage of total households, renters are hovering near cycle highs. Housing affordability has created challenges but remains below historic average. Some softness in prices and lower mortgage rates have helped.

March 2019: Increased exposure to emerging market equities, utilizing proceeds from the sale of global equities.
Rationale: Given the favorable trend in China's credit impulse, we believe that a modest increase in exposure is prudent, bringing the allocation closer to neutral from underweight in client portfolios. The BlackRock Global Dividend strategy has performed well in 2019, aided by particularly strong returns from its tobacco holdings. Decreasing exposure is an opportunity to capture some of the bounce in performance as well as position client portfolios for expected global growth.

March 2019: Sold out of regional bank stocks and invested proceeds in preferred securities.
Rationale: Recently, the sector has traded lower as the flattening/inversion of the yield curve suggests tighter credit availability going forward. Given this potential headwind to earnings growth, we are eliminating exposure to regional bank stocks. A unique aspect of preferreds is that they are primarily issued by banks. Unlike bank stocks which generally require expanding net interest margins and accelerating loan growth to outperform, preferreds should return their fixed payments and par value as long as credit quality remains healthy. Increasing exposure to preferreds should allow us to effectively express our positive view on corporate financial health while also driving incremental income for clients.

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Market Views

Monetary Policy	Neutral

After signaling in December an intent to be more data-dependent, the Federal Reserve indicated in March that changes to its policy rate are unlikely in 2019. This pause in monetary tightening is reflective of weaker economic data coupled with continued benign inflation. Fixed income markets are currently pricing in interest rate cuts. Consequently, financial conditions have eased which should provide a tailwind for economic growth in the second half of the year. We do not expect the Fed to resume tightening without evidence of a sustained reacceleration of growth.

Fiscal Policy	Accommodating

Lower corporate tax rates and a looser regulatory framework should continue to provide a tailwind for economic growth, albeit a moderating one. While fiscal stimulus should support growth over the short term, rising fiscal deficits in an economic expansion potentially weaken the government's ability to use it as a tool in the next recession.

Economic Fundamentals	Neutral

Although economic growth has slowed both domestically and abroad, underlying data remain healthy. The Fed is projecting annualized U.S. real GDP growth of 1.3% in the first quarter of 2019, down from 2.2% registered in the fourth quarter of 2018. While the government shutdown weighed on economic growth in January, history suggests that it will not have lasting effects. In Europe, easing financial conditions coupled with increasing trade should result in a pickup in growth. The health of China's economy has important implications for global growth, and our outlook remains constructive.

Market Sentiment	Neutral

Cautious optimism has replaced the negative sentiment pervasive in capital markets at year end as investors adjusted to the monetary policy pivot by the Fed as well as a broad reset in earnings growth expectations. Market sentiment has returned to neutral levels.

U.S. Equities	Neutral

The rebound in stocks has resulted in valuation multiples expanding back to levels that we associate with fair value. Earnings growth expectations appear conservative in the low single-digit range. Within the U.S., we favor large cap over small cap and value over growth.

International Equities	Neutral

Although stocks have bounced, valuation multiples remain below the historical average given slower earnings growth expectations. A reacceleration of global growth would likely provide a tailwind for international developed and emerging market stocks alike.

Bond Yields & Credit	Negative

The yield on the 10-year U.S. Treasury Note decreased from 2.6% to 2.4% by quarter end as the Fed indicated that changes to its policy rate are unlikely in 2019. With the yield curve flat, value lies at the short end of the curve. Global bonds serve as an expanded opportunity set to add income through country and credit selection. High yield spreads have been rising but remain meaningfully below historic average and do not appear to be appropriately compensating investors for risk.

Commodities	Neutral

Slower global economic growth combined with the Trump Administration's more laxed position on Iran oil-export sanctions transformed the threat of price spike into a price rout. OPEC's recent production cuts should stabilize the markets short-term. Global economic growth and supply side discipline should remain the drivers to prices long term.

U.S. Dollar	Neutral

The U.S. dollar appears to be extended. The divergence in growth rates across the world has narrowed, suggesting future dollar weakness. However, in the event of a recession, expect continued dollar strength as investors rotate into safe-haven assets.

Disclosures

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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.