Q1 2018 LOOK AHEAD

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Wall Street Parlor Tricks

Market Comparison: 2017 Predictions to Present	S&P 500	S&P 500 Price Return (%)	U.S. GDP Growth	10-Year Treasury Yield
Avg. Est. (January 2017)	2358	3.94%	2.30%	2.68%
Actual*	2673.61	19.42%	2.30%	2.48%

2018 Predictions

Wall Street's 2018 Market Predictions		
Firm	Predicted S&P 500 Target	Predicted S&P 500 Price Return (%)**
Wedbush	2350	-12.10%
Wells Fargo*	2700	0.99%
Citibank	2675	0.05%
Morgan Stanley	2750	2.86%
BofA Merrill Lynch	2800	4.73%
Goldman Sachs	2850	6.60%
Deutsche Bank	2850	6.60%
BMO Capital Markets	2950	10.34%
JP Morgan Chase	3000	12.21%
Average	**2769**	**3.58%**

- Last year's predictions underestimated the market rally by 15.48% and overestimated 10-year Treasury Yields by 20 bps

2018 Projected GDP Growth	United States	China	Japan	Euro Area	Global
U.S. Federal Reserve	2.10%	-	-	-	-
IMF	2.30%	6.50%	0.70%	2.00%	3.70%
World Bank	2.20%	6.30%	1.00%	1.50%	2.90%
Average	**2.20%**	**6.40%**	**0.85%**	**1.75%**	**3.30%**

Data Source: http://phillipsandco.com/files/5014/8346/4459/2017_Q1_Look_Ahead_-_Final.pdf, http://us.spindices.com/indices/equity/sp-500, https://fred.stlouisfed.org/series/GDPC1, https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield, https://www.marketwatch.com/story/wall-street-expects-bull-market-to-make-history-in-2018-2017-12-18, https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20170920.pdf, http://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD/USA/EUQ, http://www.worldbank.org/en/publication/global-economic-prospects, Economic Research Federal Reserve Bank of St. Louis, Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented. *Actual data as of market close on December 29, 2017. U.S. GDP growth is calculated through Q3 2017. Represents the mid-point of Wells Fargo's target level. **Based on closing price on December 29, 2017

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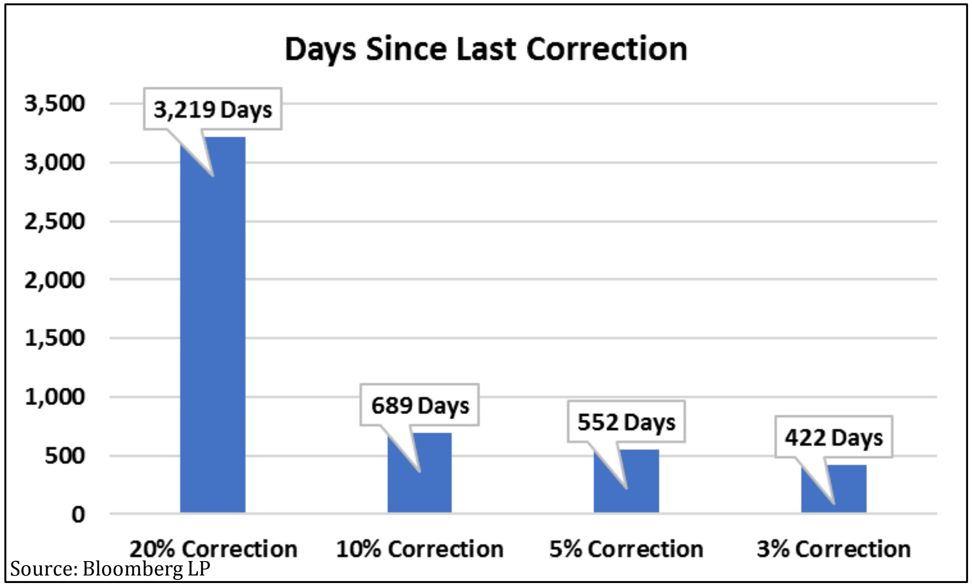
Brace For Impact



Source: Bloomberg LP

S&P 500 Price Declines (December 1945 through July 2016)

Type of Decline	Number	Average Drop From Peak (%)	Duration (Months)	Time to Recovery (Months)
Pullback (5.0–9.9%)	56	-7	1	2
Correction (10.0%–19.9%)	21	-14	5	4
Bear Market (>20%)	12	-33	14	25
"Garden Variety" Bear (20%–39.9%)	9	-26	11	14
"Mega-Meltdown" Bear (>40%)	3	-51	23	58

Source: CFRA and S&P Dow Jones Indices.

- More often than not, market corrections are too quick to time
- The likelihood of a market correction is growing greater by the day
- For the majority of market pullbacks and corrections between 5-20%, the duration of the correction and time to recovery are between 3-9 months

Data Source: Bloomberg LP, http://www.aaii.com/journal/article/stock-market-retreats-and-recoveries.touch
Economic Research Federal Reserve Bank of St. Louis, Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

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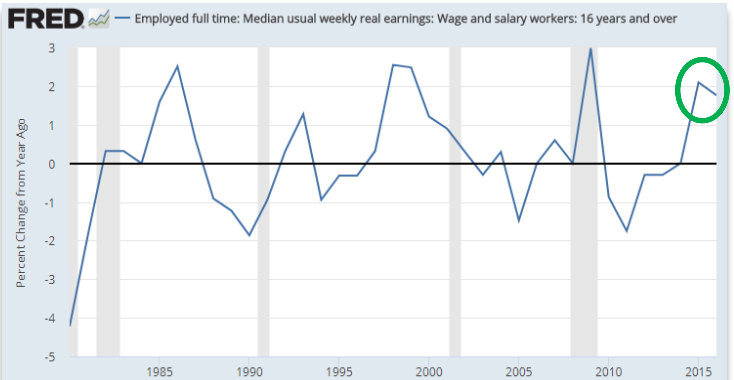
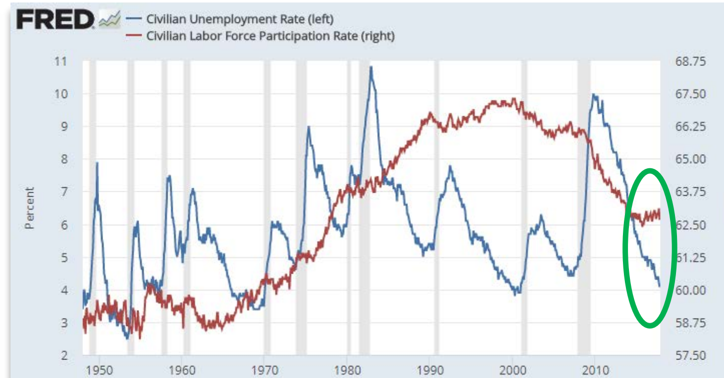
U.S. Consumer Strength

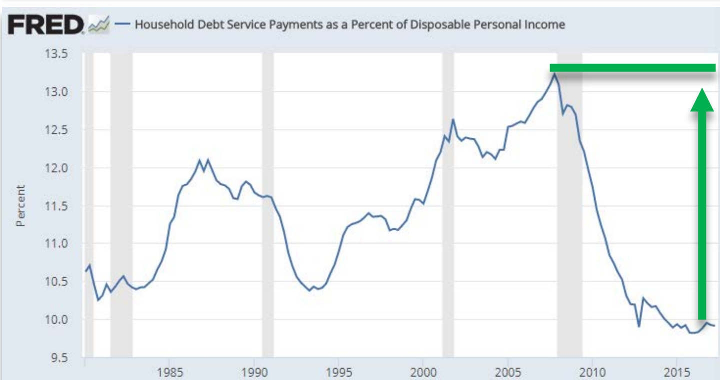
Wage Growth: 1.8%

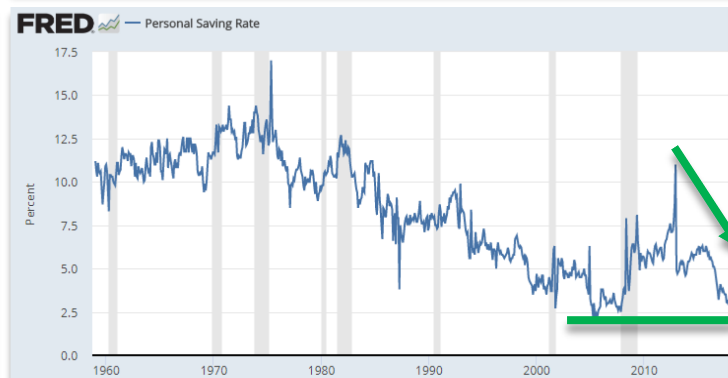




Unemployment Rate vs. Labor Force Participation Rate

Household Debt Service Payments vs. Disposable Income





Personal Savings Rate

- ❑ Low unemployment matched by low labor force participation will likely lead to continued muted wage growth
- ❑ A return to peak levels of debt service payments as a percent of disposable personal income could add as much as $5.9 trillion in consumption over the next 10 years
- ❑ As evidenced by the trajectory of the personal savings rate and pre-recession lows of 1.9%, we expect the U.S. consumer to continue spending down their savings

Data Source: Economic Research Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/LES1252881600Q, https://fred.stlouisfed.org/series/UNRATE, https://fred.stlouisfed.org/series/TDSP, https://fred.stlouisfed.org/series/PSAVERT, http://phillipsandco.com/blog/questions-for-2018/

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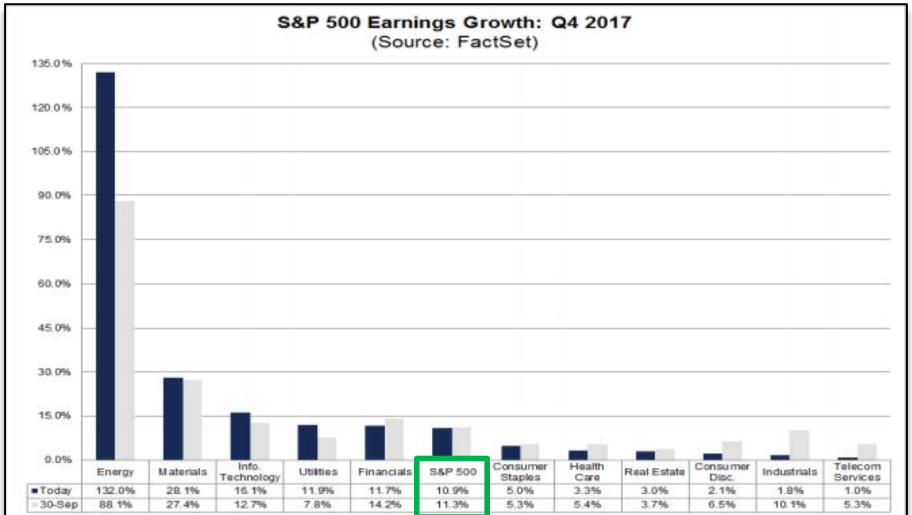
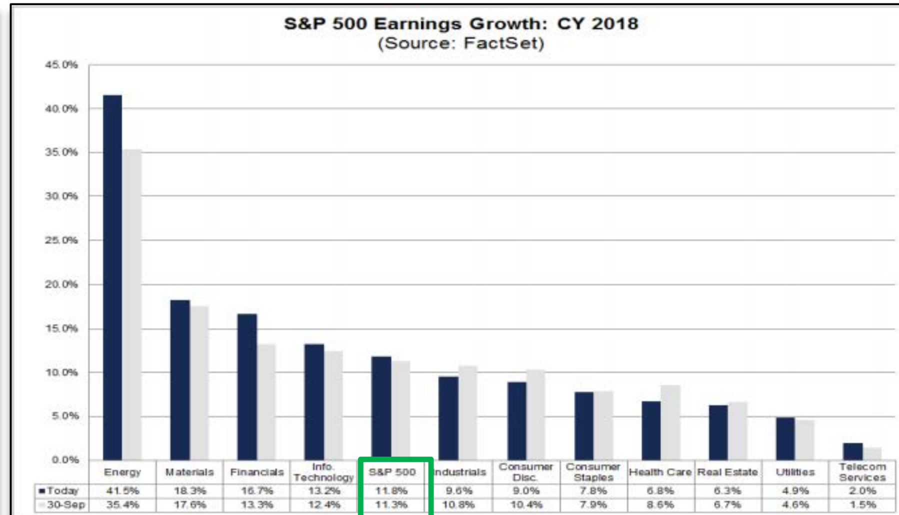
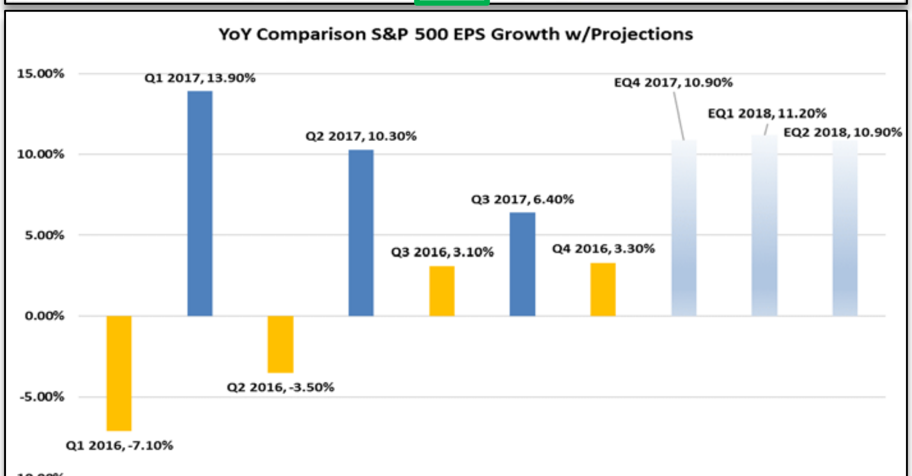
Corporate Earnings



	Energy	Materials	Info. Technology	Utilities	Financials	S&P 500	Consumer Staples	Health Care	Real Estate	Consumer Disc.	Industrials	Telecom Services
Today	132.0%	28.1%	16.1%	11.9%	11.7%	10.9%	5.0%	3.3%	3.0%	2.1%	1.8%	1.0%
30-Sep	88.1%	27.4%	12.7%	7.8%	14.2%	11.3%	5.3%	5.4%	3.7%	6.5%	10.1%	5.3%



	Energy	Materials	Financials	Info. Technology	S&P 500	Industrials	Consumer Disc.	Consumer Staples	Health Care	Real Estate	Utilities	Telecom Services
Today	41.5%	18.3%	16.7%	13.2%	11.8%	9.6%	9.0%	7.8%	6.8%	6.3%	4.9%	2.0%
30-Sep	35.4%	17.6%	13.3%	12.4%	11.3%	10.8%	10.4%	7.9%	8.6%	6.7%	4.6%	1.5%

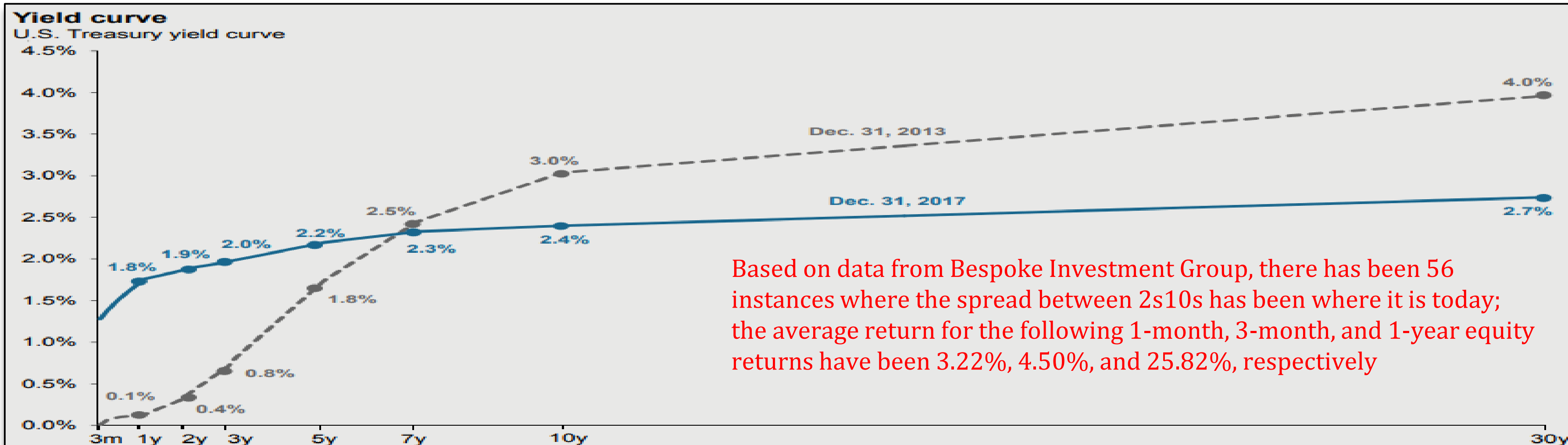


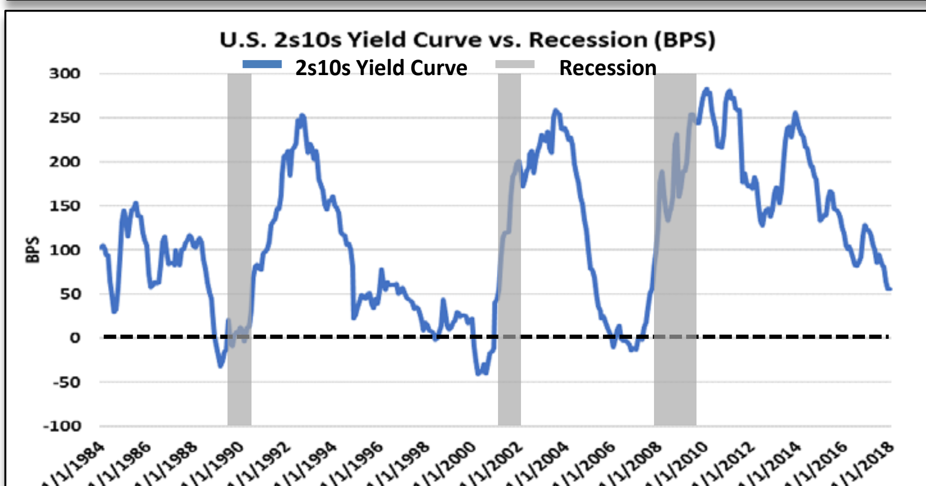
Source: FactSet

- ❑ Strong earnings growth is projected to continue:
  - ❑ Est. Q4 2017 EPS growth: 10.9%
  - ❑ Est. Q1 2018 EPS growth: 11.2%
  - ❑ Est. FY 2018 EPS growth: 11.8%
- ❑ A weaker U.S. dollar may fuel a resurgence in earnings based on export growth
- ❑ Year-over-year hurdles are becoming increasingly more difficult to exceed with expected double-digit earnings growth going forward

Data Source: FactSet - https://insight.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_122217.pdf, Economic Research Federal Reserve Bank of St. Louis, Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

U.S. Interest Rates





Source: Federal Reserve Bank of St. Louis

- ❑ It's not uncommon to experience an inverted yield curve; in fact, we have seen the yield curve flatten by 150 bps since December 31, 2013

- ❑ On average there is slightly over 20 months from the time of the inversion in the yield curve (as measured by the spread between the 2-year Treasury Yield and the 10-year Treasury Yield) until the U.S. experiences a recession

U.S. 2s10s Yield Curve Vs. Recession (BPS)	
Inversion Month	**Months To Recession**
January-1989	10
June-1998	31
February-2006	20
Average	***20.33***

Data Source: https://am.jpmorgan.com/blob-gim/1383407651970/83456/MI-GTM_1Q181.pdf?segment=AMERICAS_US_ADV&locale=en_US, http://www.businessinsider.com/fed-dot-plot-december-2017-12, https://fred.stlouisfed.org/series/T10Y2YM
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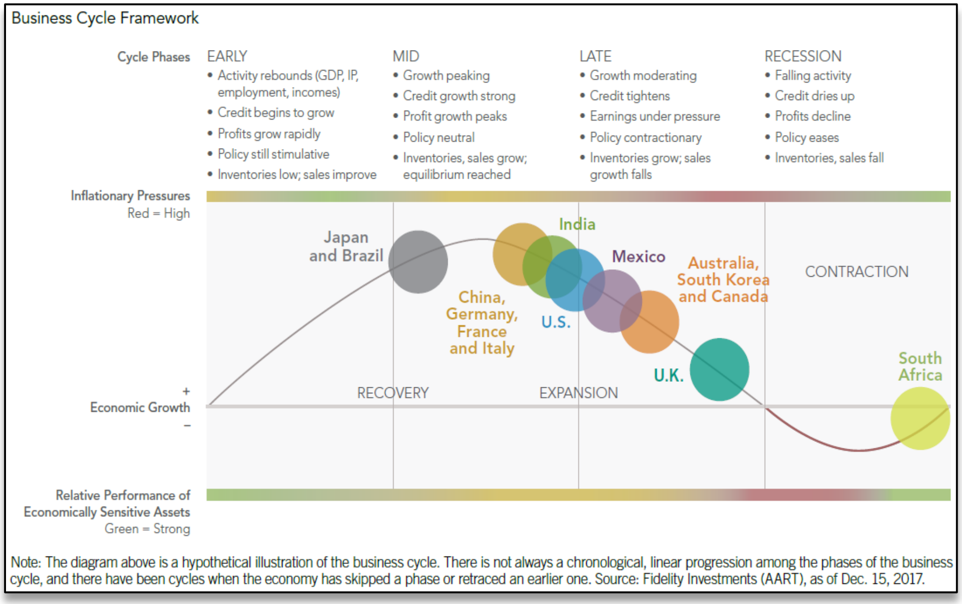
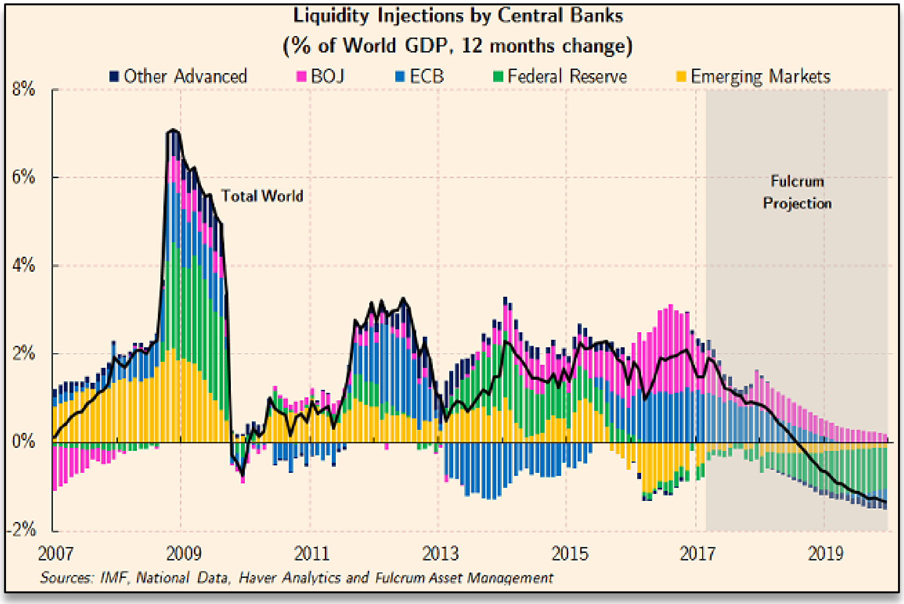
Coordinated Global Expansion

Global Economic Expansion



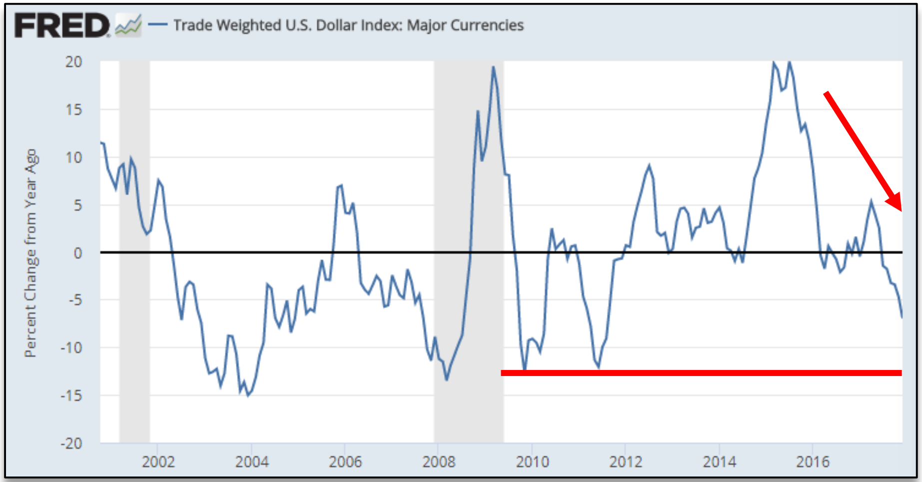
Coordinated Central Bank Action

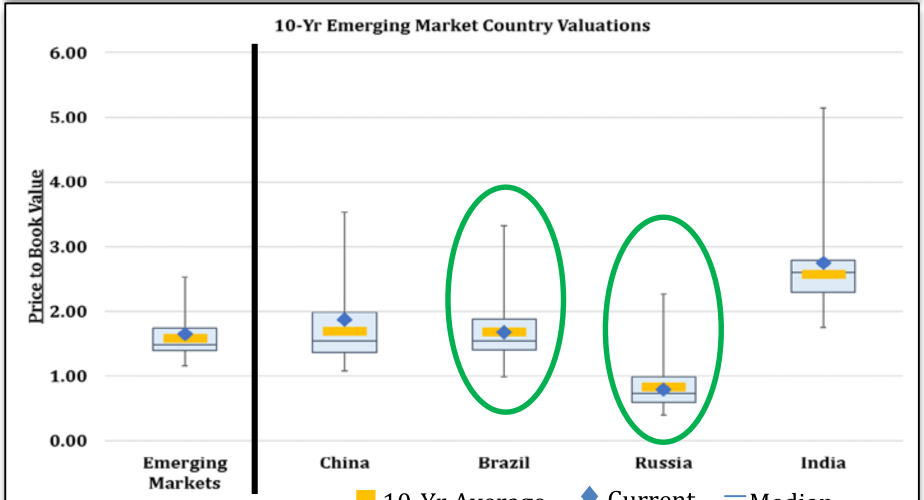


- ❑ Global Central Bank's appear to be coordinated as they all gradually move toward policy normalization
- ❑ Most of the world's major economies remain in an expansion showing positive economic growth
- ❑ Global expansion should likely enter the late stage of economic growth

Data Source: http://www.cobdencentre.org/2017/06/central-bank-balance-sheet-adjustment-a-path-to-enlightenment/, http://phillipsandco.com/files/5115/1510/3804/9887047.PDF

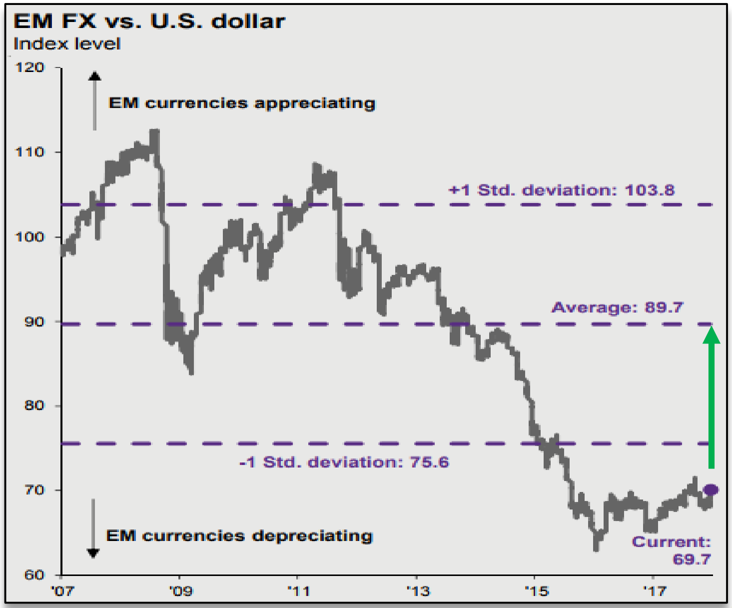
Emerging Markets (EM)





Source: Bloomberg LP

- Valuations within Emerging Markets are still within range, albeit they're approaching higher valuation levels
- Brazil and Russia remain attractive areas for opportunity
- Weakness in the U.S. dollar is likely to support continued growth in Emerging Market equities
- Emerging Market currencies are poised to continue appreciating against the U.S. dollar



Data Source: Economic Research Federal Reserve Bank of St. Louis; Bloomberg LP, https://am.jpmorgan.com/blob-gim/1383407651970/83456/MI-GTM_1Q181.pdf?segment=AMERICAS_US_ADV&locale=en_US, https://fred.stlouisfed.org/series/DTWEXM
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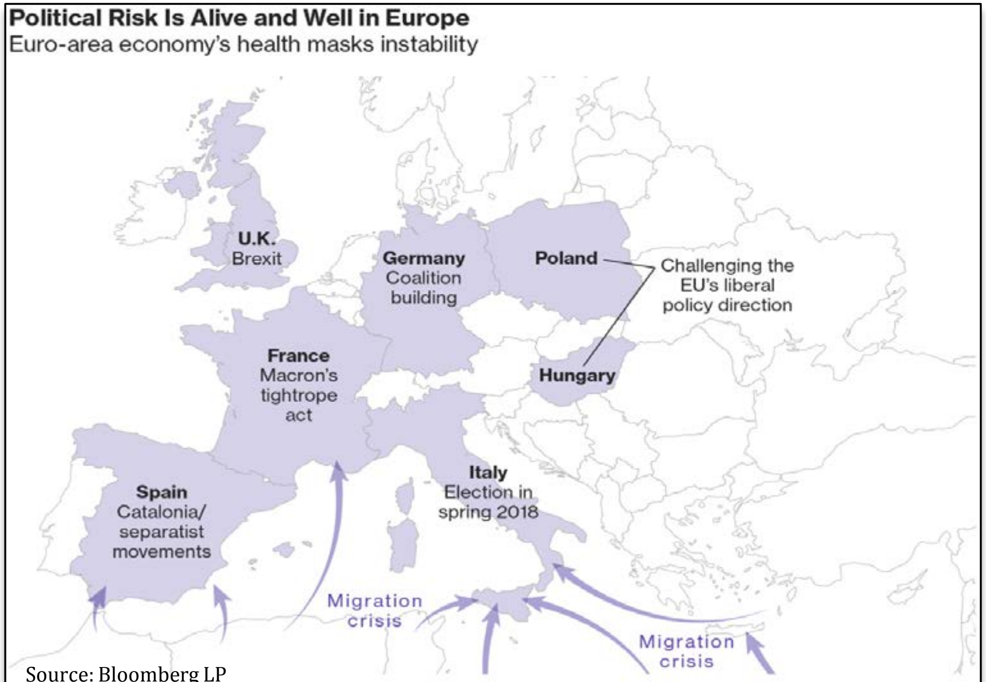
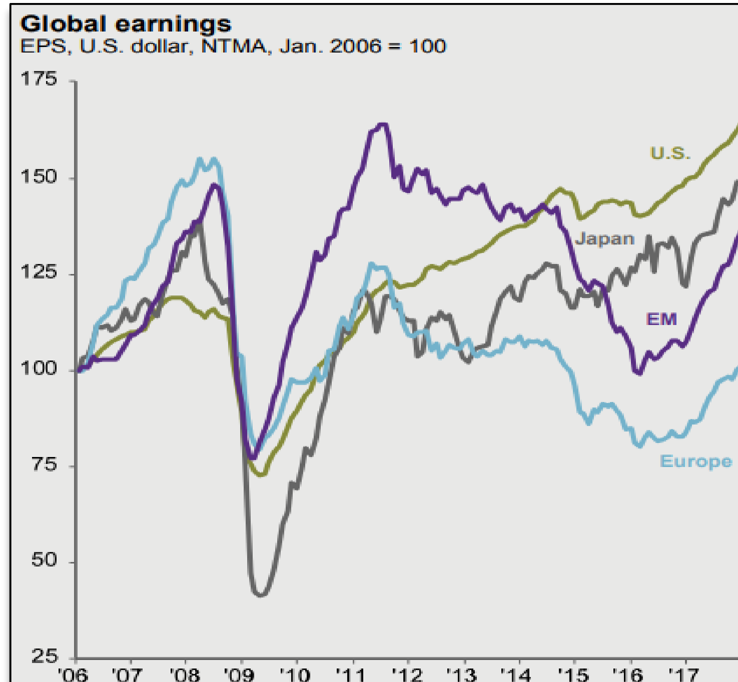
Developed Markets



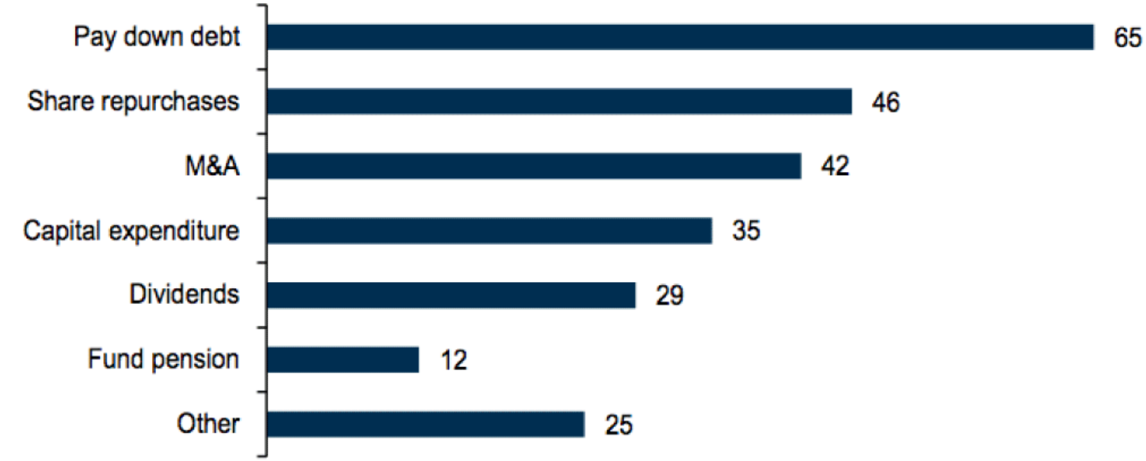


- Global earnings are on the rise alongside economic confidence throughout Europe and other developed market economies, despite rising political risks
- The ECB continues its accommodative monetary policy, which has given a boost to the economy; some say it has also made member states complacent in pursuing necessary reforms, which could exacerbate future crises
- Instability throughout Europe is quietly increasing as a result of the following: Catalan Succession, Italian Elections, German Coalition, Brexit, France's Macron, East-West Divide, and Migration, which all remain in the limelight

Data Source: Bloomberg LP, https://am.jpmorgan.com/blob-gim/1383407651970/83456/MI-GTM_1Q181.pdf?segment=AMERICAS_US_ADV&locale=en_US, https://fred.stlouisfed.org/series/DTWEXM, https://www.bloombergquint.com/politics/2017/10/31/europe-s-political-risks-fail-to-drag-on-its-economic-confidence

Tax Reform

How will the proceeds of repatriated earnings be used?



Source: 2017 BofAML Corporate Risk Management Survey, Business Insider

- Long-term tax reform should be positive for corporations, despite short-term negative impacts due to one-time repatriation taxes and write-downs of deferred tax liabilities (specifically within Financials)
- Tax reform/repatriation will likely result in corporations beginning to shore up their balance sheets by paying down debt
- In response to the new 21% corporate tax rate in the U.S. China has temporarily suspended taxes on foreign company earnings; it's not unlikely that other countries will follow suit to remain competitive

Proforma EPS impact

Sector	Lower US tax rate[1]	Minimum foreign tax rate	Interest deductibility[2]	Total Impact (ex-buybacks)	Repatriation buybacks[3]	Total Impact (incl. buybacks)
Discretionary	14.7%	-0.1%	-0.1%	14.4%	0.9%	15.3%
Staples	10.8%	-0.2%	0.0%	10.6%	1.1%	11.7%
Energy	5.6%	-0.3%	0.0%	5.3%	0.8%	6.1%
Financials	10.8%	-0.3%	0.0%	10.6%	0.0%	10.6%
Health Care	10.6%	-1.0%	0.0%	9.6%	2.1%	11.7%
Industrials	12.3%	-0.3%	0.0%	12.0%	0.8%	12.9%
Technology	4.7%	-0.6%	0.0%	4.0%	5.1%	9.1%
Materials	5.5%	-0.1%	0.0%	5.4%	0.6%	6.0%
Real Estate	0.5%	-0.2%	0.0%	0.4%	0.1%	0.5%
Telecom	12.9%	-0.1%	0.0%	12.8%	0.1%	12.9%
Utilities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
S&P 500	9.1%	-0.4%	0.0%	8.7%	1.9%	10.5%

Proforma EPS Impact From Tax Reform

Data Source: http://www.businessinsider.com/gop-tax-bill-american-companies-to-use-repatriation-to-pay-down-debt-2017-12, http://www.valuewalk.com/2018/01/tax-reform-bad/, https://www.nytimes.com/2017/12/28/business/tax-bill-china.html, BofAML US Equity & Quant Strategy, FactSet, Compustat, S&P. Data assumes 100% of the profits are competed away; excludes Utilities, Equity REITs; Interest deductibility excludes Financials, Utilities, Equity REITs. Repatriation buybacks exclude Financials, Managed Health Care, GE. A one-time hit to GAAP earnings, based on a 15.5% repatriation tax rate for cash and 8% for non-cash assets.

Mean Reversion Dashboard

Style Current P/E as a % of 15-Yr Avg. P/E

	Value	Blend	Growth
Large	123.0%	125.6%	126.7%
Mid	117.6%	117.3%	118.6%
Small	110.9%	120.6%	132.6%

Regional Fwd P/E as a % of 10-Yr Avg. Fwd P/E

ACWI	EAFE Index	EM Index	United States	Germany	U.K.	China	Brazil	India	Russia
117.5%	113.5%	110.7%	122.4%	112.8%	116.9%	121.4%	115.7%	128.0%	102.5%

Sector Fwd P/E as a % of 20-Yr Avg. P/E

Financials	Technology	Health Care	Industrials	Energy	Cons. Discr.	Cons. Staples	Telecom	Utilities	Real Estate	Materials
115.5%	117.8%	94.3%	120.2%	146.0%	117.8%	116.4%	80.6%	123.4%	117.0%	132.4%

Data Source: Bloomberg LP; JP Morgan Asset Management, https://am.jpmorgan.com/blob-gim/1383407651970/83456/MI-GTM_1Q181.pdf?segment=AMERICAS_US_ADV&locale=en_US
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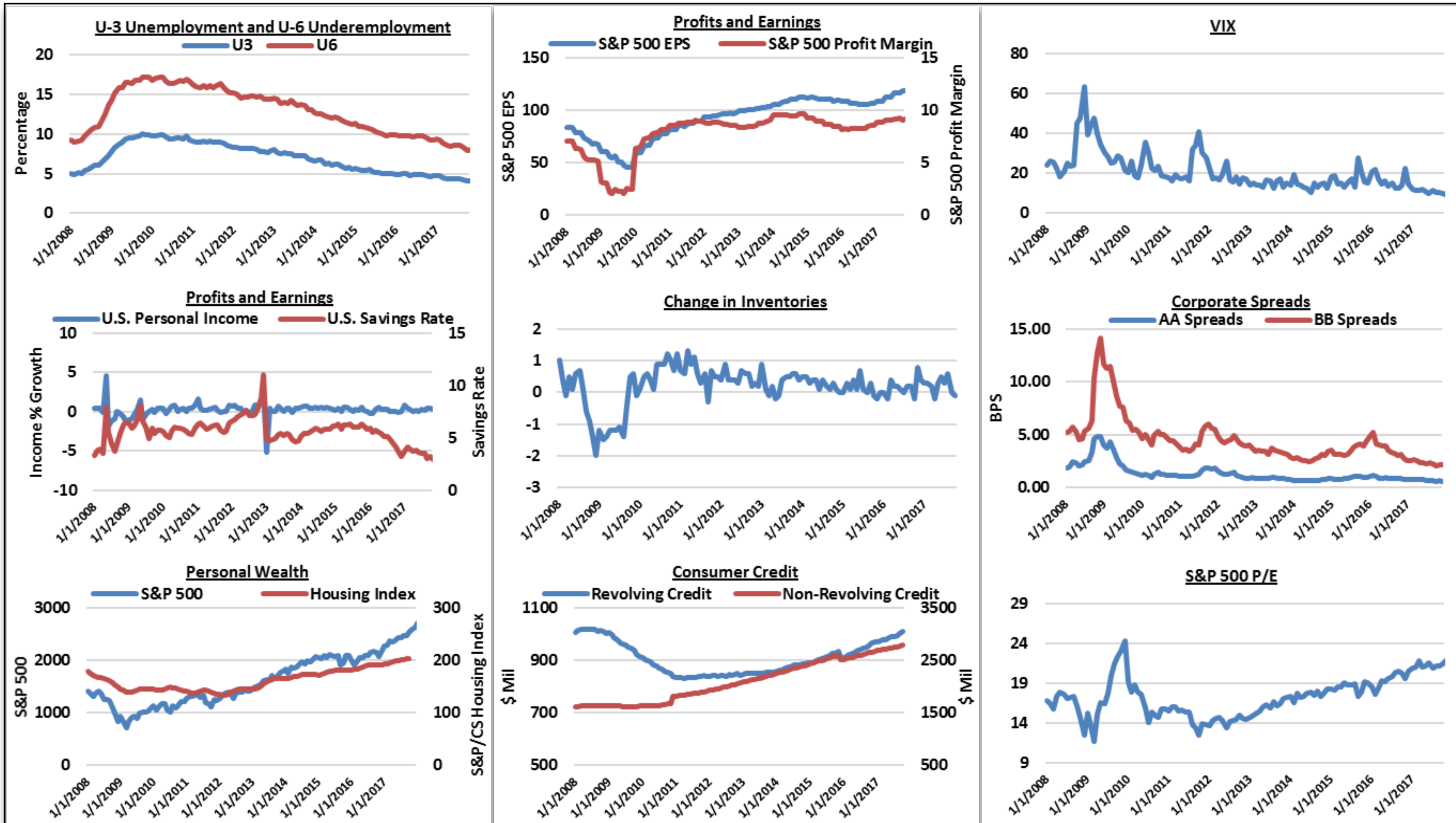
Economic Dashboard



Data Source: Bloomberg LP and Economic Research Federal Reserve Bank of St. Louis.
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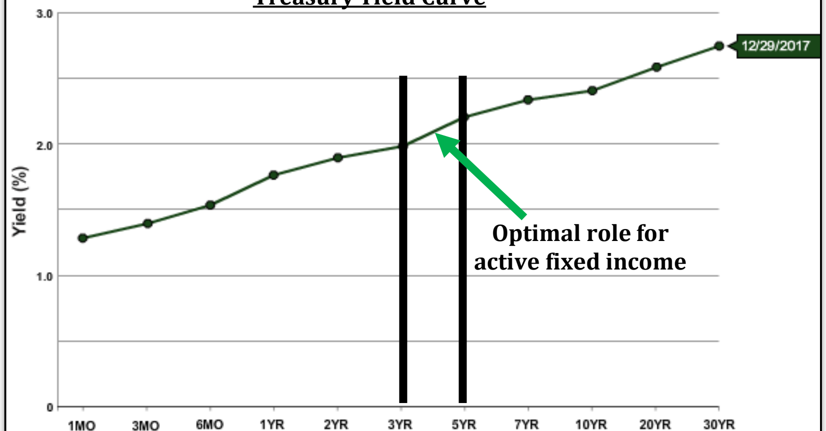
Our View and Recommendations

Our View

- U.S. Equity markets remain range-bound during FY 2018, with early rallies in Q1 and Q2 followed by a cooling off period driven by stronger headwinds to earnings growth in the second half of 2018
- Technology stocks, specifically F.A.N.G stocks, may act as a drag on broader U.S. equity valuations as they make up just over 21% of the S&P 500's market cap weighting
- Emerging Markets continues to offer the best valuations, albeit elevated since our initial overweight in 2015
- Developed Markets represent fair valuation with potential for upside above mean valuation levels in 2018
- Optimal role for active Fixed Income remains between 3 and 5-year maturities

Treasury Yield Curve



Source: U.S. Department of the Treasury

Recommendations

- Continue U.S. portfolio weightings to policy targets +/- 2%
- Reduce exposure to Technology
- Increase exposure to Energy and Financials
- Increase Emerging Markets exposure up to +3% of policy targets
- Maintain policy weightings in Developed Markets
- Continue to moderate durations around 5 years as Fed action will likely impact short-terms rates and the flight to safety will likely impact long-term rates
- Consider accepting lower short-term results to create "dry powder" as we brace for a potential market correction

Data Source: Phillips & Co., Bloomberg LP, https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield
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THANK YOU

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