WESTEND Advisors

A VICTORY CAPITAL® INVESTMENT FRANCHISE

Mid-Quarter Macro Update

Q2 2024

20240521-3594527

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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

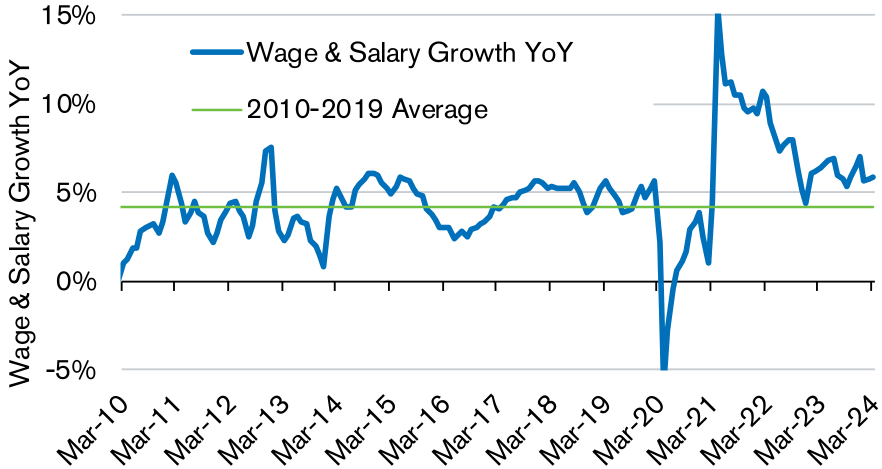
- Energy
- Industrials
- Materials
- Real Estate

* For illustrative purposes only. Allocation information as of May 20, 2024. Source: WestEnd Advisors.

Economic & Market Backdrop

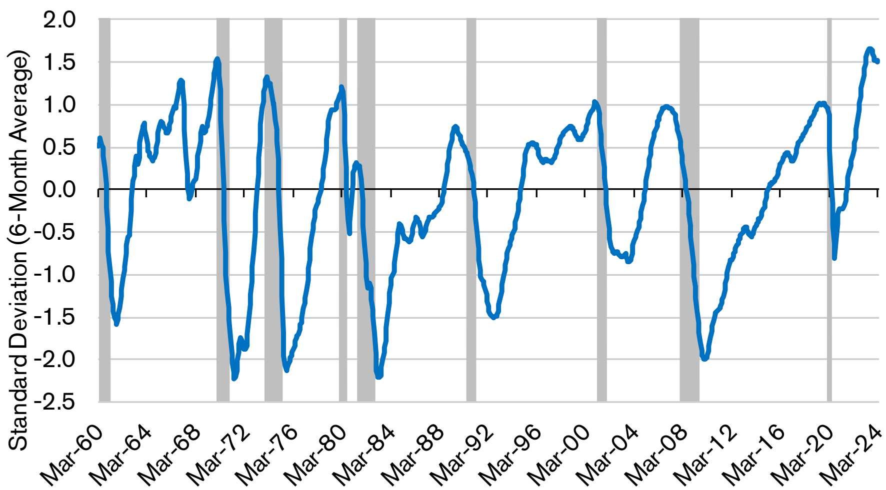
Late-Cycle Conditions Remain, But Cycle Could Extend

WAGE GROWTH ABOVE PREVIOUS CYCLE AVERAGE



Source: Bloomberg, 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: Late-cycle conditions present **ongoing risks to the U.S. economy**. Certain factors, however, such as **healthy income growth and robust consumer spending, point to a potential cycle extension** through 2024. Thus, we have exposure to a mix of both economically-sensitive and late-phase, defensive sectors.

Consumer spending remains a support for the U.S. economy, driven by strong, though decelerating, wage growth that could help fuel an extension of the cycle through 2024.

That said, we believe the prospect of economic retrenchment, while lower than last year, remains elevated, **as 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 proprietary composite of cyclical economic data, illustrated in the bottom chart, highlights that **there is very little slack left in the economy today** and that a sustained reacceleration in economic growth going forward is unlikely, in our view.

Under the Surface, Labor Market Losing Steam

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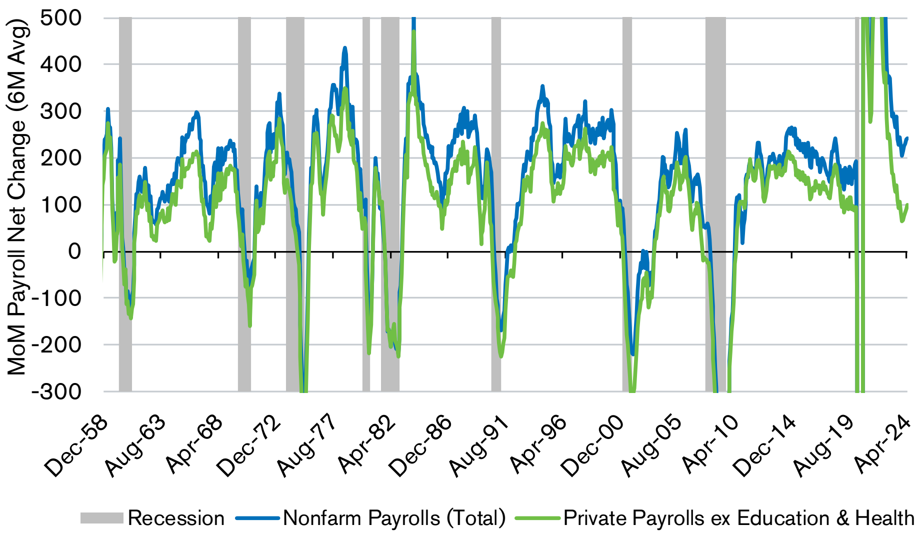
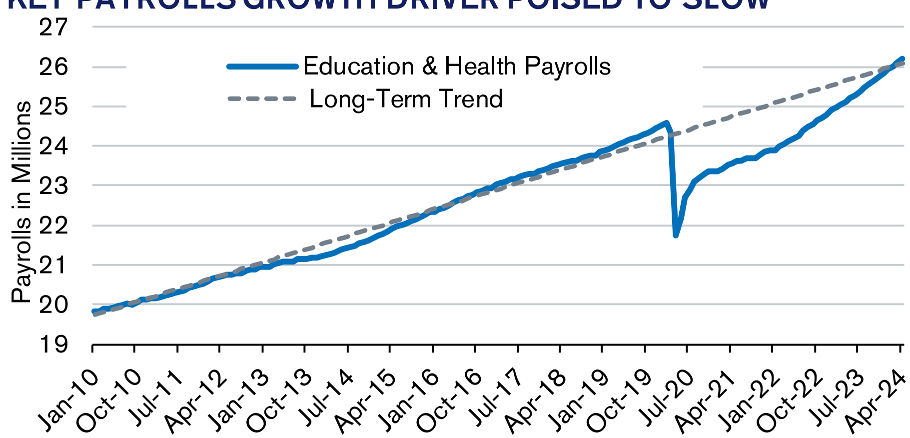
JOB GAINS HAVE BEEN SOFT AMONG CYCLICAL CATEGORIES



Source: WestEnd Advisors, BLS

KEY PAYROLLS GROWTH DRIVER POISED TO SLOW



Source: BLS, WestEnd Advisors

Portfolio Impact: Headline labor market data remain resilient, but a more detailed look at the **data suggests 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.

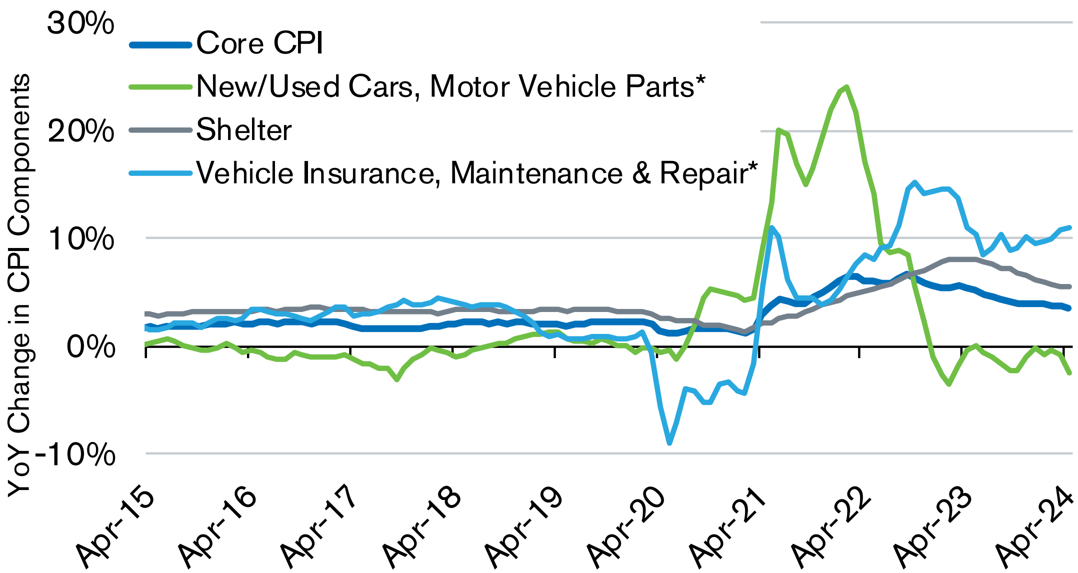
Over the last six months, **nonfarm payroll gains have averaged ~240k, an above-average pace relative to history.**

However, **job gains have been narrowing under the surface** (see top chart), as 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 ~99k, on average, a sign of tepid labor demand.

With **education and health care** payrolls now back to the long-term trend (bottom chart), **these industries are unlikely to provide the same tailwind for growth to the broader labor market going forward,** in our view.

Still Expecting Core Inflation to Slow this Year

RECENT CORE INFLATIONARY PRESSURES TO EASE



Source: Bloomberg, WestEnd Advisors. *Major components within Transportation Services and Commodities

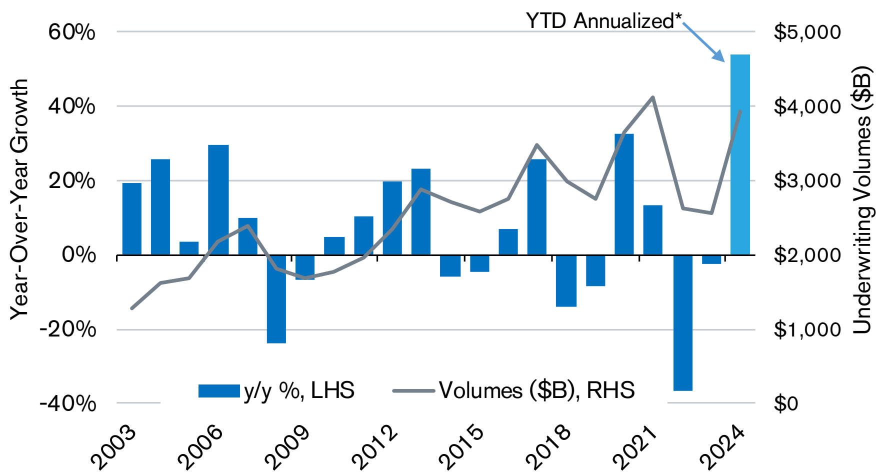
Portfolio Impact: Periods of **disinflation can support real growth** without overheating the economy, which has **historically benefited mid- and late-phase sectors**. Slow growth and disinflation are also catalysts for lower interest rates, in our view, which could provide tailwinds for a number of 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 measures of 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, while motor vehicles and parts inflation has normalized, **transportation services inflation remains on an upward trajectory due to rising prices for motor vehicle insurance**. That said, we expect these measures to moderate in the back half of the year, as insurance industry loss-ratios gradually normalize.

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 could provide a lift to real growth, but to a lesser degree than we saw in 2023**.

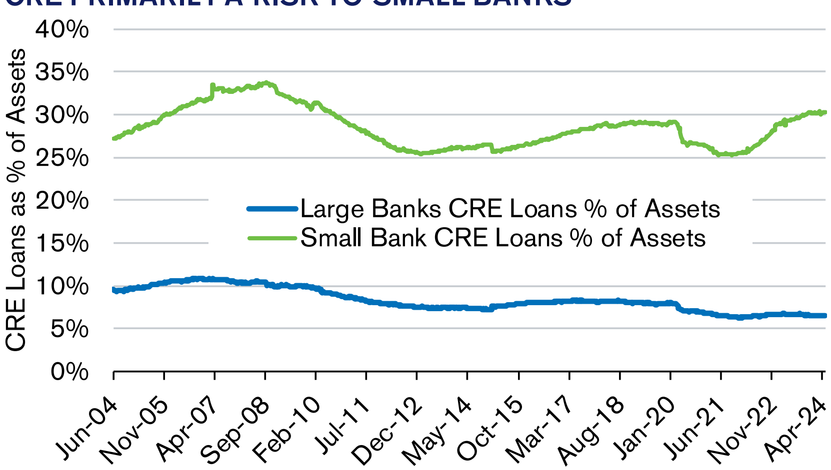
Prospect of Easier Monetary Conditions Improves Outlook for Financials

UNDERWRITING ACTIVITY OFF TO A STRONG START IN 2024



Source: Bloomberg, WestEnd Advisors
*Light blue shading represents YTD annualized underwriting volumes as of 4/15/24.

CRE PRIMARILY A RISK TO SMALL BANKS



Source: Federal Reserve, WestEnd Advisors

Portfolio Impact: We have increased exposure to the U.S. Financials sector across portfolios, given the prospect of a potential extension of the economic cycle and easier monetary policy. While Financials aren't immune to macro risk, we believe **easing monetary conditions, increased capital markets activity**, and secular trends such as the shift to digital payments could provide upside for the sector.

We maintain the view that **the Fed has flexibility to cut rates amid slowing inflation and slow-to-moderate economic growth**. In accordance with this outlook, we believe the Capital Markets industry, comprising over 20% of the sector, is positioned for a potential recovery following a dearth of dealmaking and underwriting activity that led industry earnings to decline more than 20% over the last two years. So far in 2024, **annualized underwriting activity is up more than 40% compared to last year's levels (top chart).**

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.

Opportunities From Sector Leadership Broadening Out

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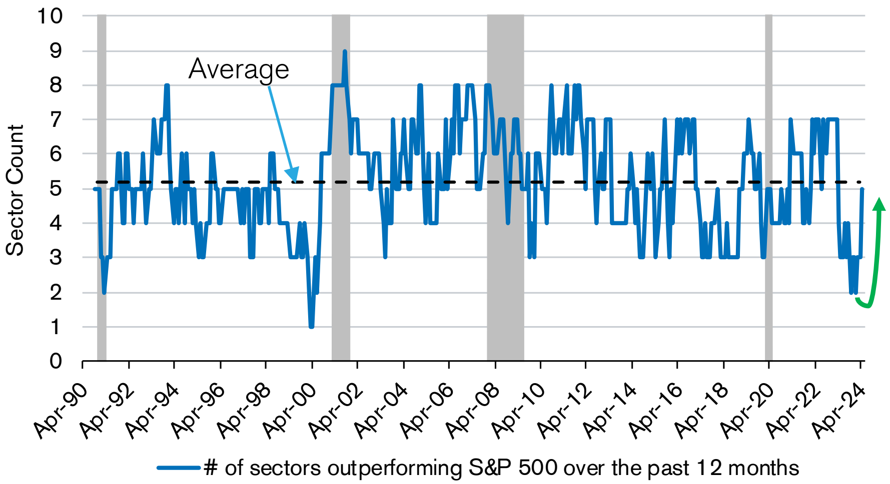
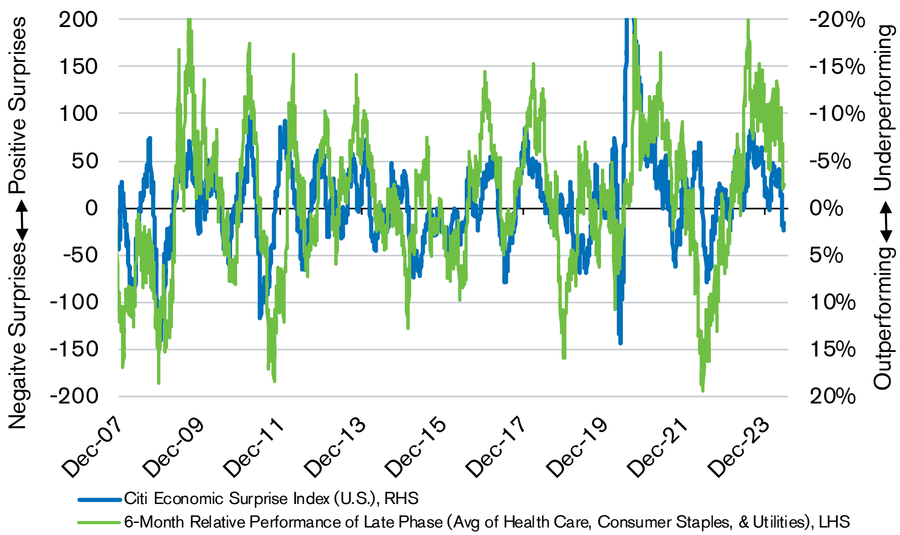
NUMBER OF SECTORS OUTPERFORMING THE S&P 500



Source: WestEnd Advisors, Bloomberg

ECONOMIC SURPRISES LOSING MOMENTUM



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: We believe **sector leadership is poised to broaden out** following a period of unusual narrowness, and this dynamic should present opportunities for sector-focused investors. While a substantial overweight of mid-phase sectors would have been required to outperform the S&P 500 in recent quarters, **our current exposure to 7 select sectors leaves us well-positioned for a more normalized market environment moving forward**, in our view.

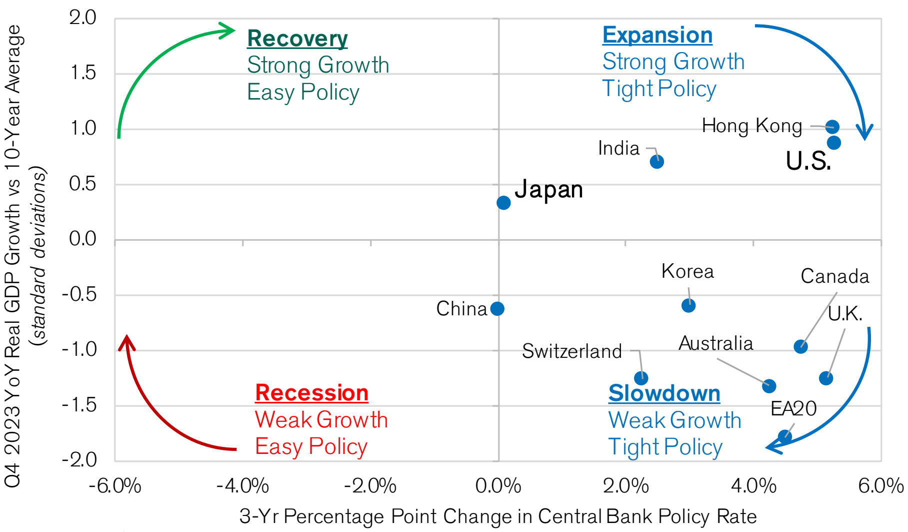
We've seen emerging signs of **broadening sector leadership in recent months**, which stands in contrast to the unusual narrowness of sector leadership observed over the past year. Looking ahead, we see potential for the distribution of sector outperformance to continue to broaden out, which we expect to **present opportunities for sector-focused investors.**

To that end, the late-phase Health Care, Consumer Staples, and Utilities sectors have continued to lag the market, even as positive surprises in U.S. economic reports have diminished. **Ongoing challenges to economic growth**, however, can **present opportunity for these defensive leaning sectors** to deliver better relative performance going forward.

International Economic & Market Backdrop

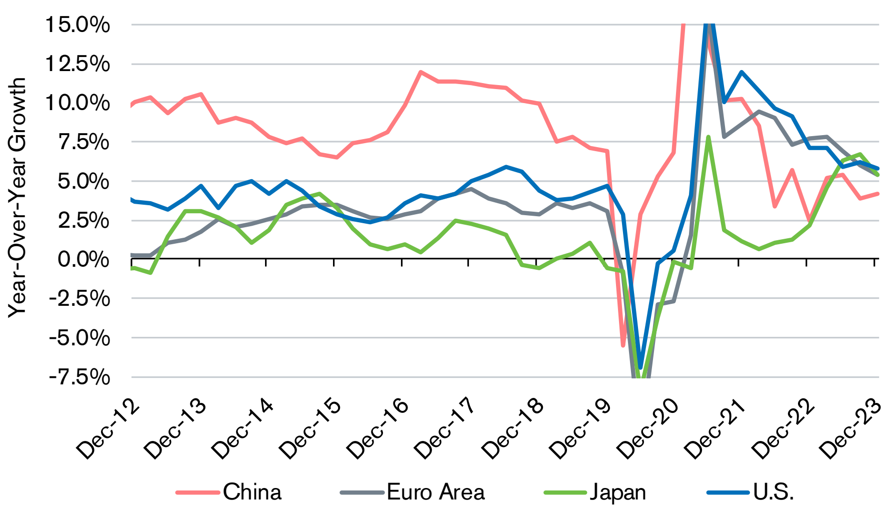
Global Economic Cycle Developing As Expected

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 we see as 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 below-trend economic activity (top chart).

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, in contrast, is struggling with deleveraging headwinds, has seen its growth rate drop below peers,** and has lagged global equity markets in recent years (though it has rebounded some YTD).

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Fixed Income / Rates

Elevated Rates Improve Fixed Income Return Potential

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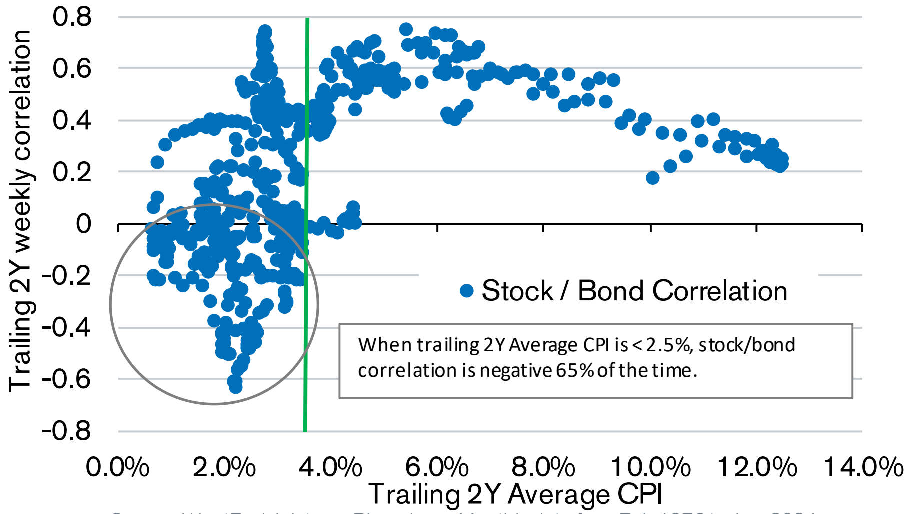
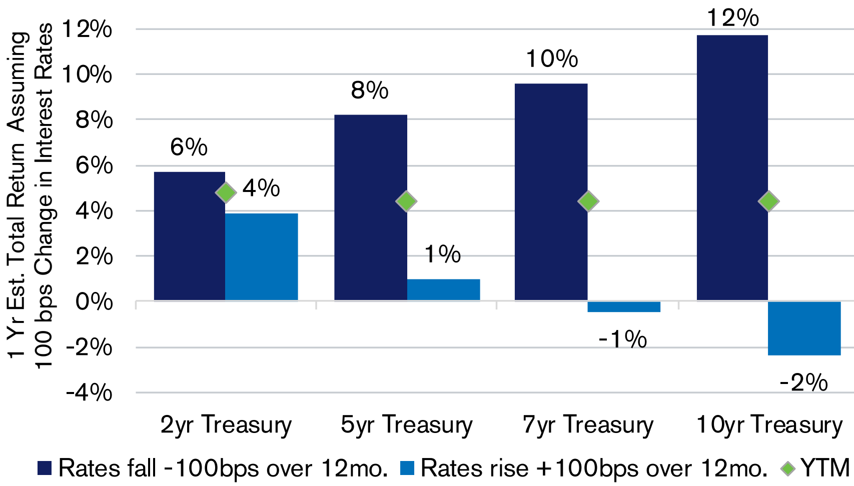
INFLATION ERODES STOCK/BOND DIVERSIFICATION



Source: WestEnd Advisors, Bloomberg. Monthly data from Feb. 1976 to Apr. 2024
*Green line denotes trailing 2yr average CPI YoY forecasted through end of 2024

ATTRACTIVE RETURN ASYMMETRY FOR TREASURIES



Source: WestEnd Advisors, Bloomberg. Data as of 5/8/24.

Portfolio Impact: We believe that **continued disinflation and slowing economic growth increase the likelihood of lower interest rates** in our investment time horizon. Therefore, we maintain an overweight to fixed income, and longer-duration Treasury bonds in particular, in traditional balanced portfolios.

Over the last few years, bond investors have had to contend with return headwinds from Fed policy and higher interest rates. Additionally, **elevated inflation eroded the typical diversification benefits of owning fixed income** in balanced portfolios. Looking ahead, we expect continued disinflation should result in a normalizing relationship between stock and bond returns.

Higher yields for Treasury bonds should help to mitigate performance headwinds from interest rate volatility, in our view. Given our outlook for slowing economic growth and disinflation, which should limit upside risk for interest rates, **we believe Treasury bonds offer attractive total return asymmetry for investors.**

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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