WESTEND Advisors

A VICTORY CAPITAL® INVESTMENT FRANCHISE

Mid-Quarter Macro Update

Q1 2025

20250219-4254798

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WESTEND ETF STRATEGIES

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- Consumer Discretionary
- Information Technology

Sector Avoidance

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** For illustrative purposes only. Allocation information as of February 15, 2025. Source: WestEnd Advisors.*

International Equity and Fixed Income Allocations

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WESTEND GLOBAL ETF STRATEGIES

Current regional equity allocation positioning in global portfolios*

Regional Equity Overweights

- U.S.A.
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WESTEND BALANCED ETF STRATEGIES

Current fixed income and asset class positioning in balanced portfolios*

Fixed Income Overweights

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

Fixed Income Underweights

- Short-term Treasury Securities
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* *For illustrative purposes only. Allocation information as of February 15, 2025. Source: WestEnd Advisors.*

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Economic & Market Backdrop

Economic Risks Have Diminished as Market Risks Rise

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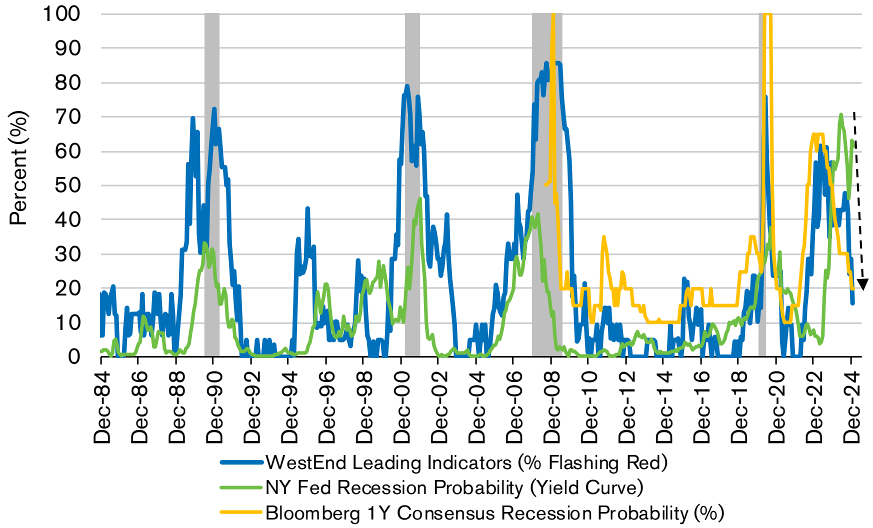
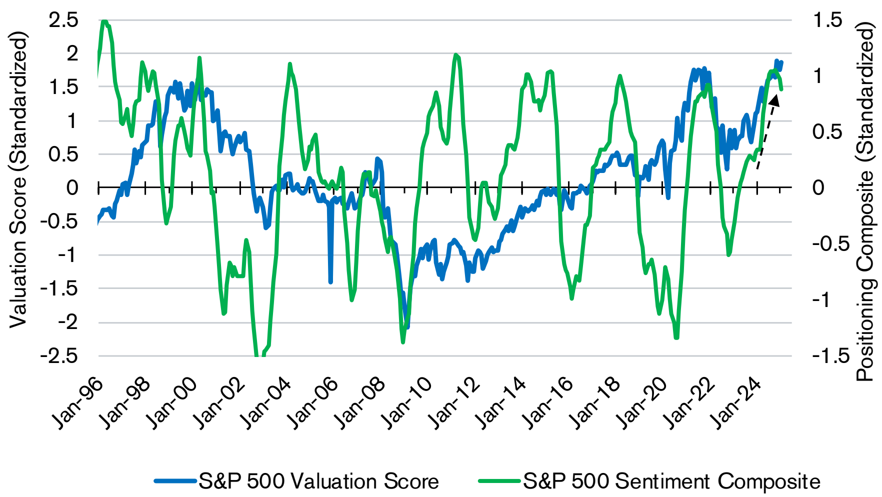
MACRO RISKS HAVE DIMINISHED OVER THE PAST YEAR...



Source: WestEnd Advisors

...AS VALUATION & SENTIMENT HAS SURGED



Source: WestEnd Advisors

Portfolio Impact: We have reduced defensive exposures in our portfolios over the past year as near-term recession risks have receded. However, late-phase sector exposures remain warranted, in our view, amid stretched valuations and investor sentiment. Looking ahead, we believe our portfolios are poised to benefit from a more normal market environment and a broadening out of sector leadership.

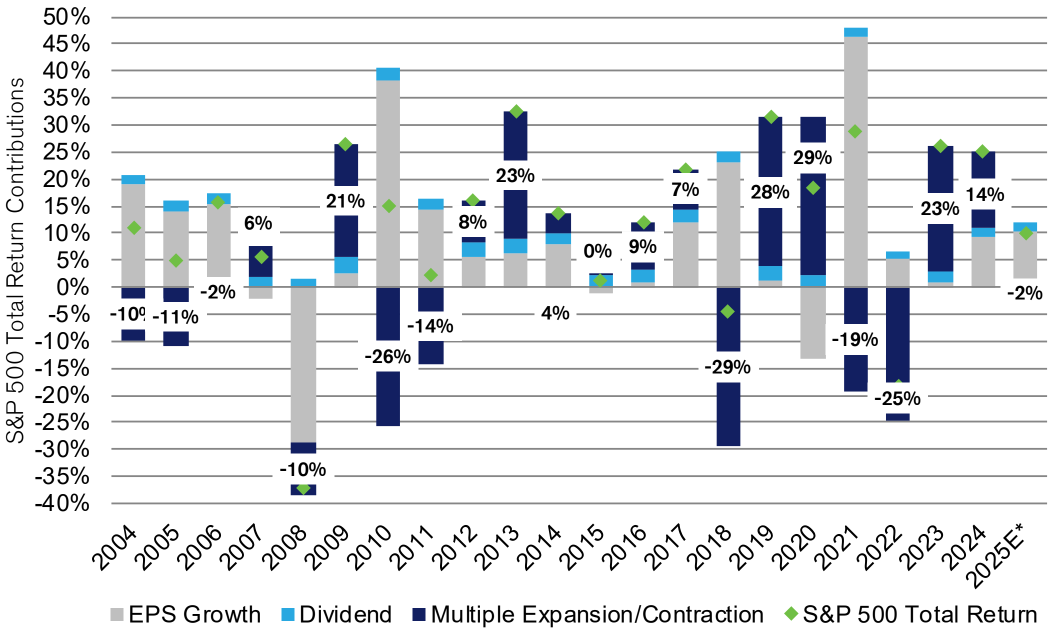
As leading economic indicators have stabilized over the past 18 months, a variety of measures of recession risk have moved lower (top chart).

At the same time, strong (but narrow) market performance has coincided with a rapid rise in valuations and sentiment over the past 18 months. Historically, elevated valuations and stretched sentiment have benefitted the more defensive parts of the market, even in positive return environments.

WestEnd's internal indicators measuring valuation and sentiment are near the highest levels in recent decades (bottom chart).

Expect Earnings to Drive Returns in 2025

CONTRIBUTORS TO S&P 500 TOTAL RETURN



** Uses consensus 2025 EPS growth. Assumes 10% return in 2025, consistent with long-run average.*
Source: FactSet, Bloomberg, WestEnd Advisors

Portfolio Impact: Our 2025 return outlook for the S&P 500 contemplates healthy returns, but valuation compression is likely to leave returns lower relative to 2023 and 2024, in our view. We believe sector dispersion will offer ample alpha generation opportunities as earnings growth becomes a larger portion of equity returns.

The trailing price-to-earnings multiple for the S&P 500 rose for the second consecutive year in 2024, alongside a high-single-digit contribution from EPS growth. Rising valuations have driven above-average equity returns since the end of 2022.

With equity valuations at the high end of their historical range, we expect market returns in 2025 to be driven primarily by an *acceleration* in earnings growth, paired with a slight degree of multiple contraction (estimated at -7% in chart). Returns over the next year are likely to hinge upon a broadening out of earnings growth, in our view, with investors expecting all eleven sectors to generate positive EPS growth in 2025.

That said, we do not expect equity returns to be as strong as they were in 2023 and 2024. Of the 12 episodes in the past century in which the S&P 500 generated consecutive 20%+ returns, only 2 instances saw a third-year return above 20%.

Sector and Market Leadership is Broadening Out

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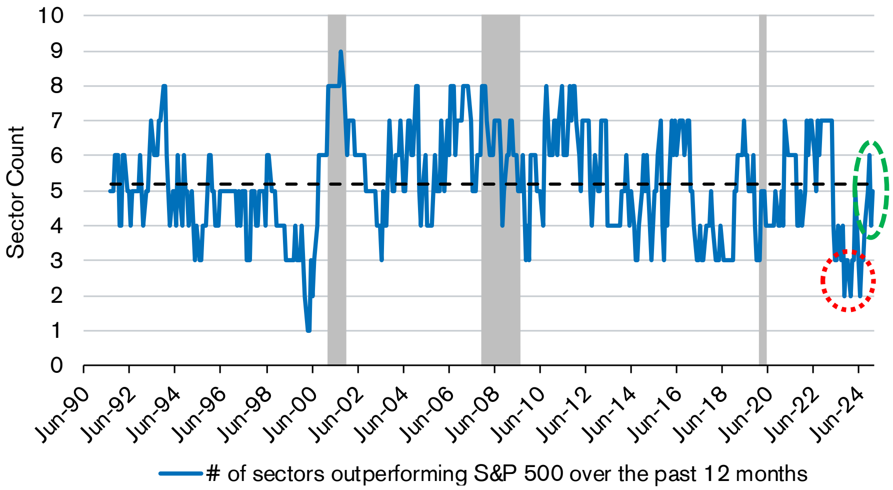
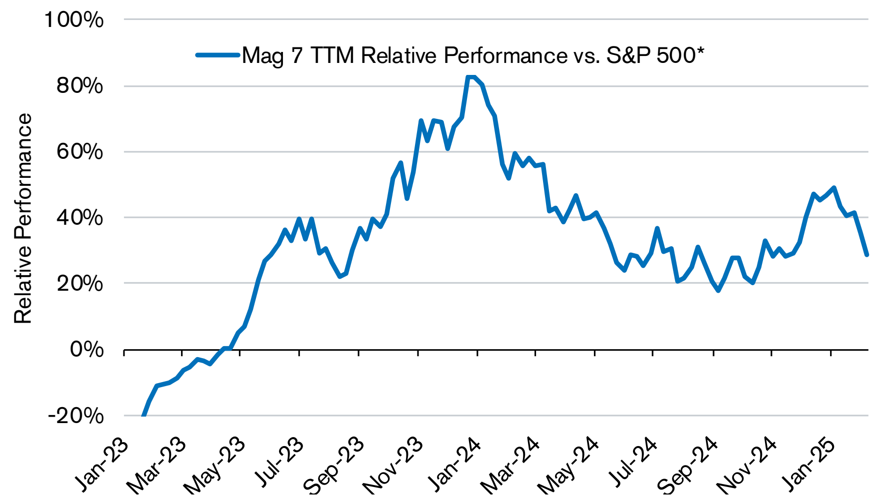
NUMBER OF SECTORS OUTPERFORMING THE S&P 500



Source: Bloomberg, WestEnd Advisors

MAG 7 RELATIVE OUTPERFORMANCE WANING



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 likely have been required to outperform the S&P 500. Looking ahead, our current exposure leaves us well-positioned for a more normalized market environment moving forward, in our view.

The S&P 500's return of ~58% over the past two years was dominated by the Information Technology and Communication Services sectors, largely due to the proliferation of A.I. and above-market earnings growth expectations. The narrowness of sector leadership over the past few years was unusual relative to history (top chart), and we see potential for sector-focused investors to benefit as returns continue to broaden out.

The 'Magnificent 7' stocks have collectively demonstrated healthy fundamentals in recent years, which has supported significant relative outperformance. Momentum for this group of stocks, however, has been waning (bottom chart), as its earnings growth is expected to decelerate, while growth for the rest of the market is expected to accelerate. This pickup will be a key factor in broadening out of market leadership, in our view.

Modest Labor Demand Still Apparent

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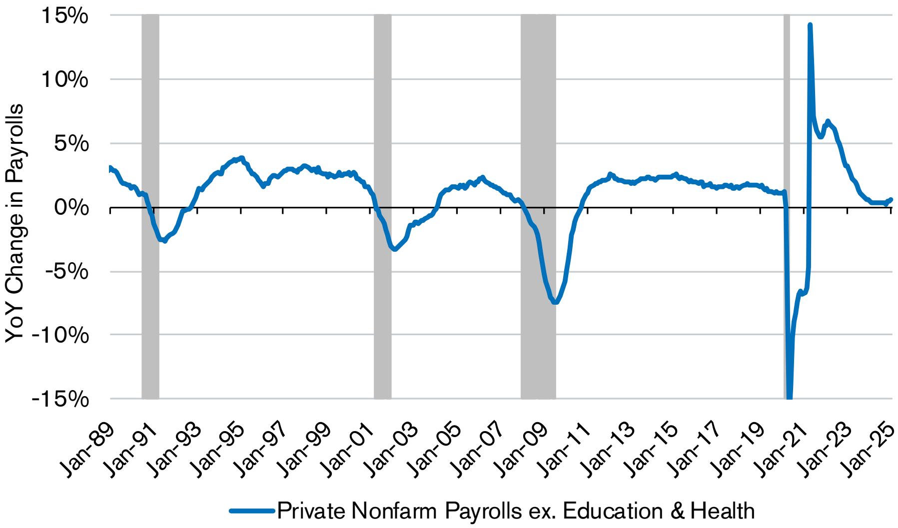
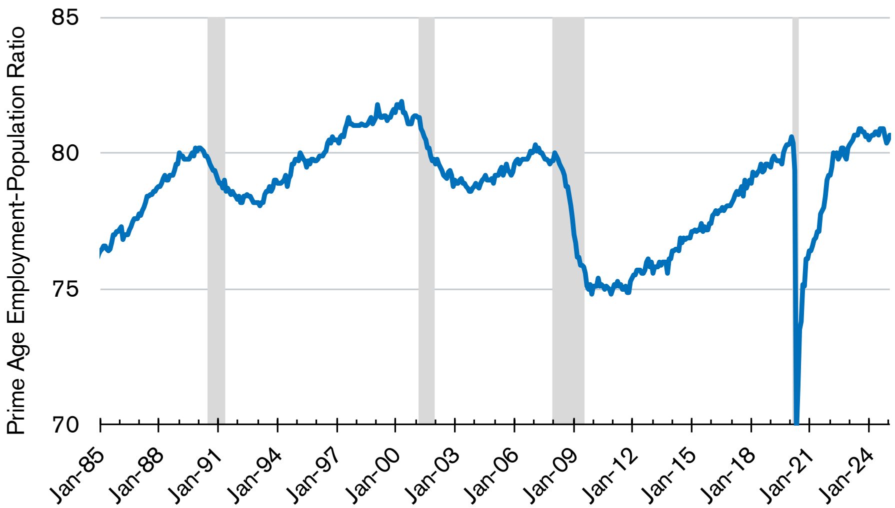
PAYROLLS GROWTH SHOWING SIGNS OF STABILIZING



Source: BLS, WestEnd Advisors

LABOR MARKET CONDITIONS LOOK LATE CYCLE



Source: BLS, Bloomberg, WestEnd Advisors

Portfolio Impact: Softening employment trends, which have been percolating under the surface over the past year, have shown signs of abating in recent months. We believe the trajectory of hiring demand relative to layoffs is likely to be a key determinant of the path of economic growth within our investment time horizon of 6-18 months.

Throughout 2024, payroll growth was unusually narrow (top chart), and the concurrent slowdown deserves attention, in our view. A swift softening of payrolls has been a common trait of prior economic slowdowns. However, those prior periods usually include increased job losses as a contributor to the payroll growth slowdown. Today, layoffs are very low, which is encouraging.

Nonetheless, the labor market is typically one of the largest drivers of broad economic growth, and we believe slow hiring is a late-cycle phenomenon. At current levels, the employment-to-population ratio suggests job gains may be at a cycle high and, thus, offer limited fuel for growth going forward (bottom chart).

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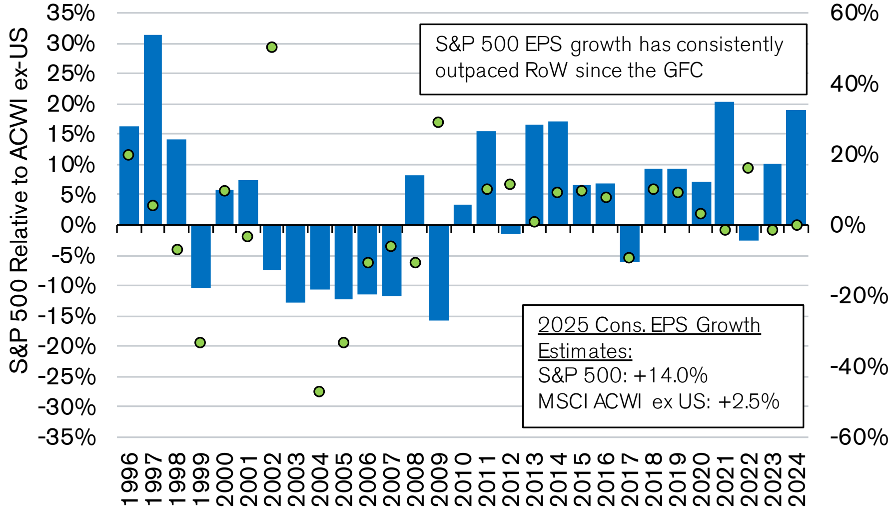
International Economic & Market Backdrop

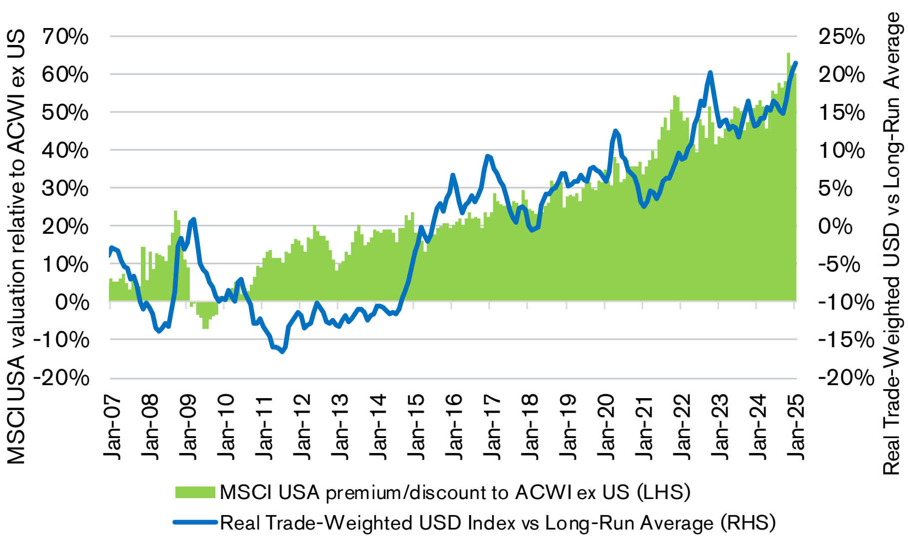
Near-Term Drivers of U.S. Exceptionalism Intact

U.S. EARNINGS A MAJOR DRIVER OF OUTPERFORMANCE



Source: Bloomberg, WestEnd Advisors

U.S. EQUITY AND FX VALUATIONS INCREASINGLY STRETCHED



Source: Bloomberg, WestEnd Advisors

Portfolio Impact: Economic and earnings growth in the U.S. remains on a promising trajectory for 2025 compared to the rest of the world, in our view. In global portfolios, we have increased our U.S. equity exposure, where we see attractive sector opportunities, to a modest overweight versus the benchmark. Still, international equity allocations can provide diversification benefits, given elevated U.S. equity & currency valuations.

At the start of 2025, we see reasons to expect the near-term drivers of U.S. outperformance to remain intact. Resilient economic growth in the U.S. has been supported by healthy consumer spending, and U.S. companies are expected to generate stronger earnings growth than most other regions in 2025 (top chart).

Over the longer-run, prospects for significant U.S. outperformance appear more mixed:

- Valuations for U.S. equities are now ~66% 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

The Outlook for Traditional Balanced Portfolios

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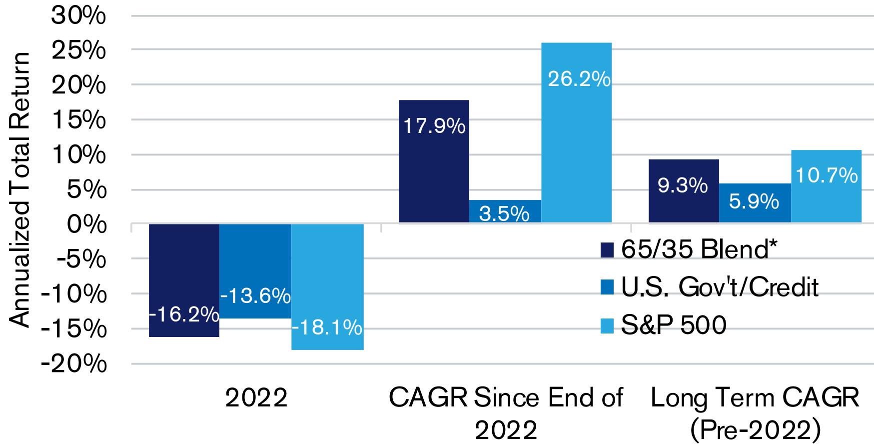
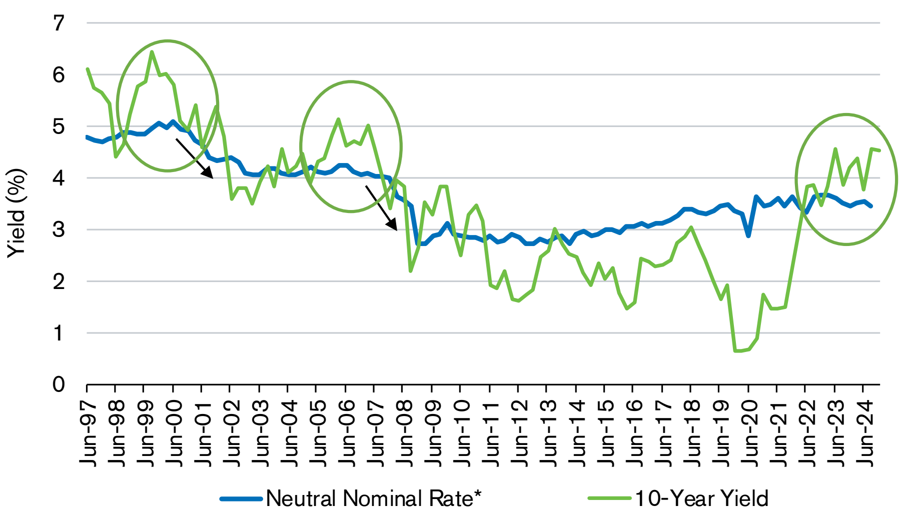
RETURNS SINCE 2022 ABOVE LONG-TERM CAGR



Source: Bloomberg, WestEnd Advisors.
**65% S&P 500/35% U.S. Gov't Credit Index, rebalanced monthly. Returns data from Sept. 1989 – Jan. 2025.*

INT. RATE NORMALIZATION PROVIDES VOLATILITY CUSHION



Source: Bloomberg, WestEnd Advisors.
**Neutral nominal rate calculated using a 2% inflation target and an average of commonly referenced neutral real yield estimates*

Portfolio Impact: We believe the risk/reward profiles for equity and fixed income are fairly balanced, given the prospect of continued re-steepening of the yield curve and potential diversification benefits of fixed income in the later stages of an economic cycle.

For investors using a balanced portfolio, 2022 was a punishing year, as the worst inflationary shock in 50 years resulted in fixed income allocations having an unusually high correlation with equity returns, and thus, failing to offer expected stability and diversification benefits during a period of heightened equity market volatility.

The long-term track record for balanced portfolios, however, has been attractive (especially on a risk-adjusted basis), and the performance rebound for balanced strategies since 2022 has also been exceptionally strong (top chart).

The bottom chart shows that, compared to a few years ago, there is now room for interest rates to decline. This prospect of bond price appreciation, together with attractive yields, means there is a path to above-average fixed income returns, even as we expect more modest equity returns in the year ahead after sizable gains in each of the previous two years.

Path Ahead For Rates: Inflation Outlook is Key

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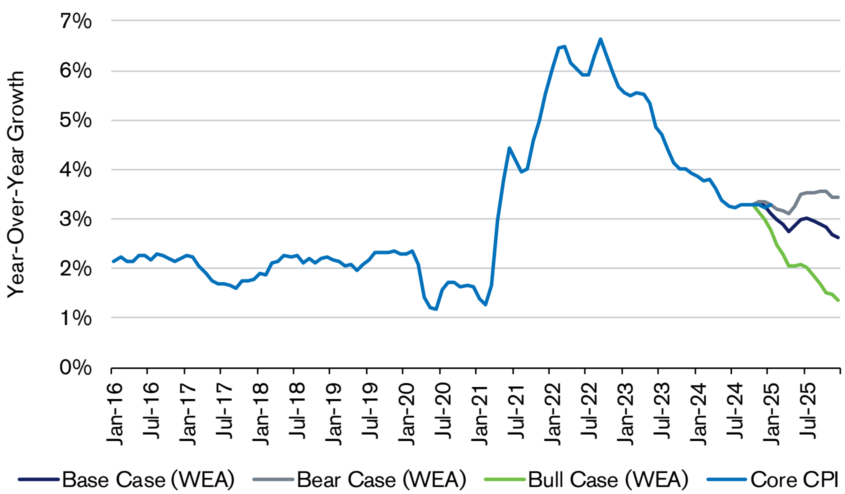
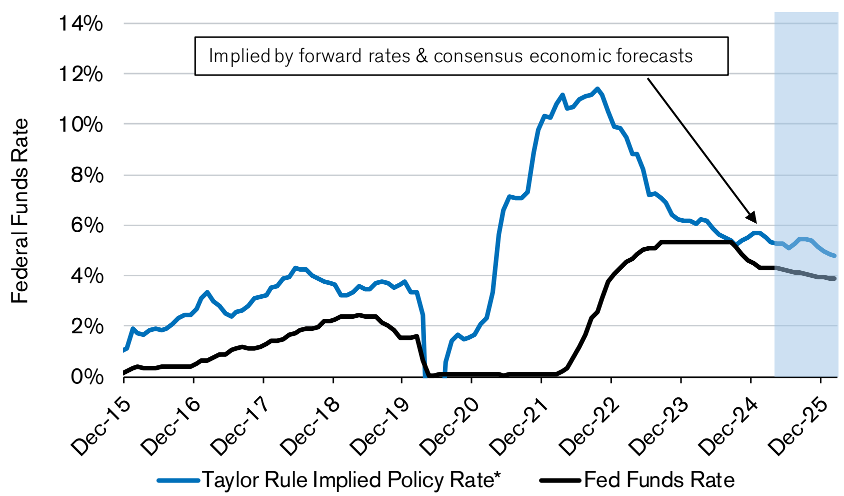
INFLATION BIASED LOWER, BUT OUTCOMES VARY WIDELY



Source: Bloomberg, WestEnd Advisors.

INFLATION & UNEMPLOYMENT TO DRIVE FED DECISIONS



Source: BLS, Census Bureau, Bloomberg, WestEnd Advisors.
**Calculation based on output gap, unemployment gap, headline & core inflation, and average of neutral rate estimates.*

Portfolio Impact: Lower inflation could provide the Fed with continued flexibility, particularly in response to further labor market softening. However, upside risks to inflation are more prevalent than a year ago. We are maintaining a significant allocation to the long end of the Treasury yield curve, while avoiding long-duration corporate bonds due to risks from a potential widening of credit spreads.

Disinflation has afforded the Fed flexibility with its dual mandate, resulting in 100 bps of Fed Funds rate cuts in 2024.

The Fed is likely to cut a few more times in 2025, in our view. The path of disinflation can deviate, however, based on how key drivers evolve, including core goods prices, shelter prices, and other services prices. Some policy wildcards, such as tariffs, could also have an impact.

As illustrated in the top chart, our base case is for Core CPI to end the year above 2.5%. The path to this level would free up the Fed to continue to ease, in our view, but the pace of rate cuts may be more measured than some market participants are expecting.

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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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