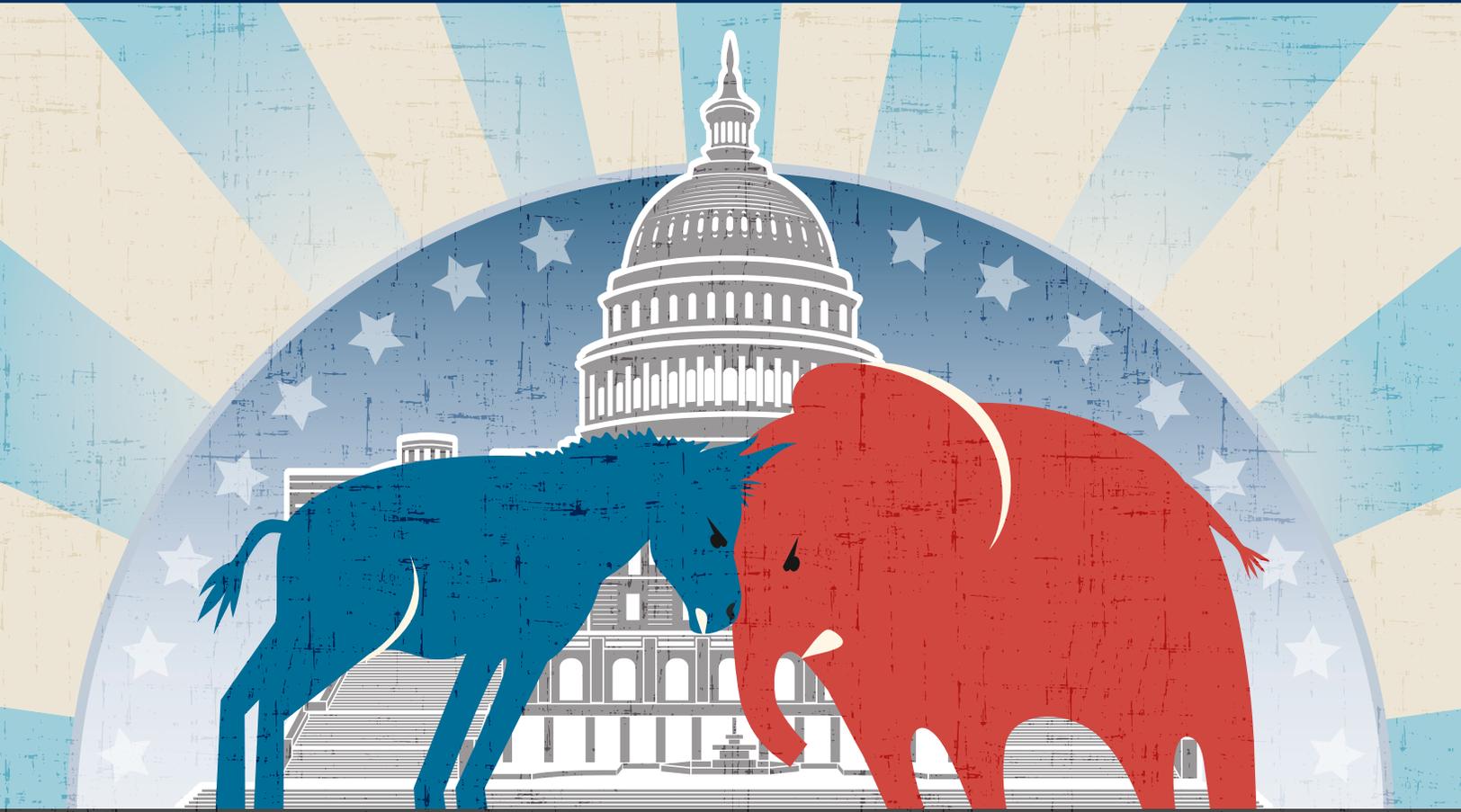


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Investment Strategy Committee Meeting Recap – held on September 5, 2018

Major macroeconomic factors that the committee believes will be most influential on investors over the next six to 12 months include trade policy, interest rates, Federal Reserve (Fed) policy, earnings growth, global economic growth, and the U.S. dollar.

U.S. ECONOMY

73% of the committee has a negative outlook on U.S. GDP over the next six to 12 months relative to the “advance” estimate of a 4.1% annualized rate for the second quarter of 2018.

- “Trade policy remains a risk to the economic outlook. To date, the impact has been small, but will worsen as trade conflicts escalate. However, even in the worst case scenario, increased tariffs and retaliatory measures shouldn’t be enough, by themselves, to push the economy into a recession.”
- “The federal funds futures market is pricing in a 98% chance that the Fed will raise short-term interest rates on September 26*, with about a 76% chance of another quarter-point move on December 19. Fed officials will no longer view policy as ‘accommodative’ and many see policy as needing to be a bit restrictive in 2019.”
- “Fiscal stimulus (tax cuts and government spending) has been larger than expected. The federal budget deficit has deteriorated much more than anticipated in fiscal year 2018 and we’re now looking at a deficit of more than \$1 trillion in fiscal year 2019. That means support for the economy in the short run, but a bigger problem in the long run.”

– **Scott J. Brown, Ph.D.**, *Chief Economist, Equity Research*

- “Key themes in my world include the upcoming election in November and trade wars. Anything that was in the bullseye of the Obama administration is now the darling of the Trump administration, and vice versa.”
- “Will we have impeachment hearings? Absolutely. Does the president get impeached? It’s increasingly likely. But does he get removed from office? That’s extremely unlikely, unless there’s some other shoe to drop.”

– **Ed Mills**, *Washington Policy Analyst, Equity Research*

U.S. EQUITY

67% of the committee is bullish to some degree on U.S. equities over the next six to 12 months.

- “With so many U.S. averages breaking out with new all-time highs, that’s not typically a sign of an unhealthy market. It’s not the same

type of breadth we saw last year, but nobody expected it to be when last year was one of the greatest runs in market history.”

- “Even investors who are believers in the bull market are still displaying negative sentiment and anticipation that we’re going to see volatility on the downside. Major concerns include elections, trade, and the seasonal September/October volatility.”

– **Andrew Adams, CFA, CMT**, *Senior Research Associate, Equity Research*

- “There are three legs in a secular bull market. The second leg, which we are currently in, is always the longest and the strongest. It’s when earnings pick up and the economy starts to improve. Once it peaks, the markets will enter another upside consolidation. Finally, we’ll come out of that consolidation and start the third leg, or the speculative leg. That’s what bull markets look like.”

– **Jeffrey Saut**, *Chief Investment Strategist, Equity Research*

- “We’ve been in the camp that the market is range bound. We’ve been saying that for months. We’ve probably been wrong in that position to a degree, and the main reason is because it’s been an absolutely perfect environment: very good earnings, and valuations have come down because earnings have outpaced stock prices. So everything checks the box there.”
- “If you look at our base case of \$168 in earnings in the S&P versus \$172 for consensus, and apply our 18x multiple, we still see 5-6% upside for the S&P 500 over the next 12 months, so we still think that’s possible. However, we think that getting there could be choppy, especially in the next few months, so I remain a cautious bull.”

– **Michael Gibbs**, *Managing Director, Equity Portfolio & Technical Strategy*

INTERNATIONAL EQUITY – **Chris Bailey**, *European Strategist, Raymond James Euro Equities**

53% of the committee is bullish to some degree on non-U.S. developed market equities over the next six to 12 months. Only 33% are bullish on emerging market equities.

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- “The view is that the midterm elections will give an opportunity for a more flexible trade policy for the U.S. administration, and therefore, neither top European nor top Chinese politicians are in any huge rush to strike a deal. Are both sides interested in doing a deal at some point? Absolutely. The Chinese crave stability, and they’ve got enough domestic changes coming that they need a stable environment to be okay. I see Europe taking the same position.”
- “Trends I am seeing are low returns in Europe relative to the U.S. People have become very pessimistic. You can see it in fund manager surveys and fund flow data. Global investment managers have been selling Europe and buying America. People are focused on the influence of the strong dollar and the influence of trade disruptions. Still, there are opportunities in Europe and emerging markets.”
- “In Europe, there’s been a lot of concern about lack of growth, immigration, political angst, etc. The good news about Europe is that France is still changing. Macron continues to do a pretty good job in France.”
- “As for emerging markets, my feeling is that the positives remain in place. Aside from the big structural factors such as rising populations, the big positive remains that China is pursuing domestic reform. It doesn’t want to engage in a trade war and that’s why I think they are up for a deal, and they are up for opening their economy a bit. But they will absolutely wait until after the midterms to see the lay of the land.”

■ U.S. FIXED INCOME

71% of the committee see the 10-year U.S. Treasury yield being about the same (~2.85%) six months from now.

- “The big issue that I see is the leveraged loan market, which is now bigger than the

subprime market. Everyone’s jumping into it. It’s a zero-duration yield, and I’m always skeptical when I hear those two terms in the same phrase, because we’re taking a credit risk, and I think that’s not quite as understood as it should be.”

- “On the pure bond side, you can dial up duration, or dial down credit, neither one of which I care to do right now.”

– **James Camp, CFA**, *Managing Director of Fixed Income, Eagle Asset Management**

- “When we talk about the yield curve and the Fed, the one thing I see that is different is perhaps the motivation of the Fed. We went through seven plus years of zero-interest rate policy. The motivation is to push rates to ‘neutral’ levels to have some room to move in the future.”
- “For the very short-term investor (inside two years), Treasuries have become a competitive alternative, especially for investors with high state income taxes.”
- “As long as portfolios are heavily weighted with growth assets, you still need the diversification benefits of fixed income with some duration as a balance to riskier assets such as equities.”

– **Doug Drabik**, *Senior Strategist, Fixed Income*

■ **ENERGY AND OIL – Pavel Molchanov**, *Energy Analyst, Equity Research*

The global oil market was undersupplied last year, it is undersupplied this year, and it will yet again be undersupplied in 2019.

- “The steel tariffs out of Washington have increased component costs for pipeline projects and other energy infrastructure investment domestically. However, with oil prices near four-year highs, the increases are manageable for companies.”
- “Oil industry investment in the U.S. is recovering from the commodity down cycle, but lagging behind the strength

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Investment Strategy Committee Members

Anne B. Platt, AWMA®, AIF®, RICP® – Committee Chair Vice President, Investment Strategy & Product Positioning, Wealth, Retirement & Portfolio Solutions

Kristin Byrnes – Committee Vice-Chair Senior Manager, Investment Strategy

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Ted Ruddock Head of High Net Worth, Fixed Income Services

Jeffrey Saut Chief Investment Strategist, Equity Research

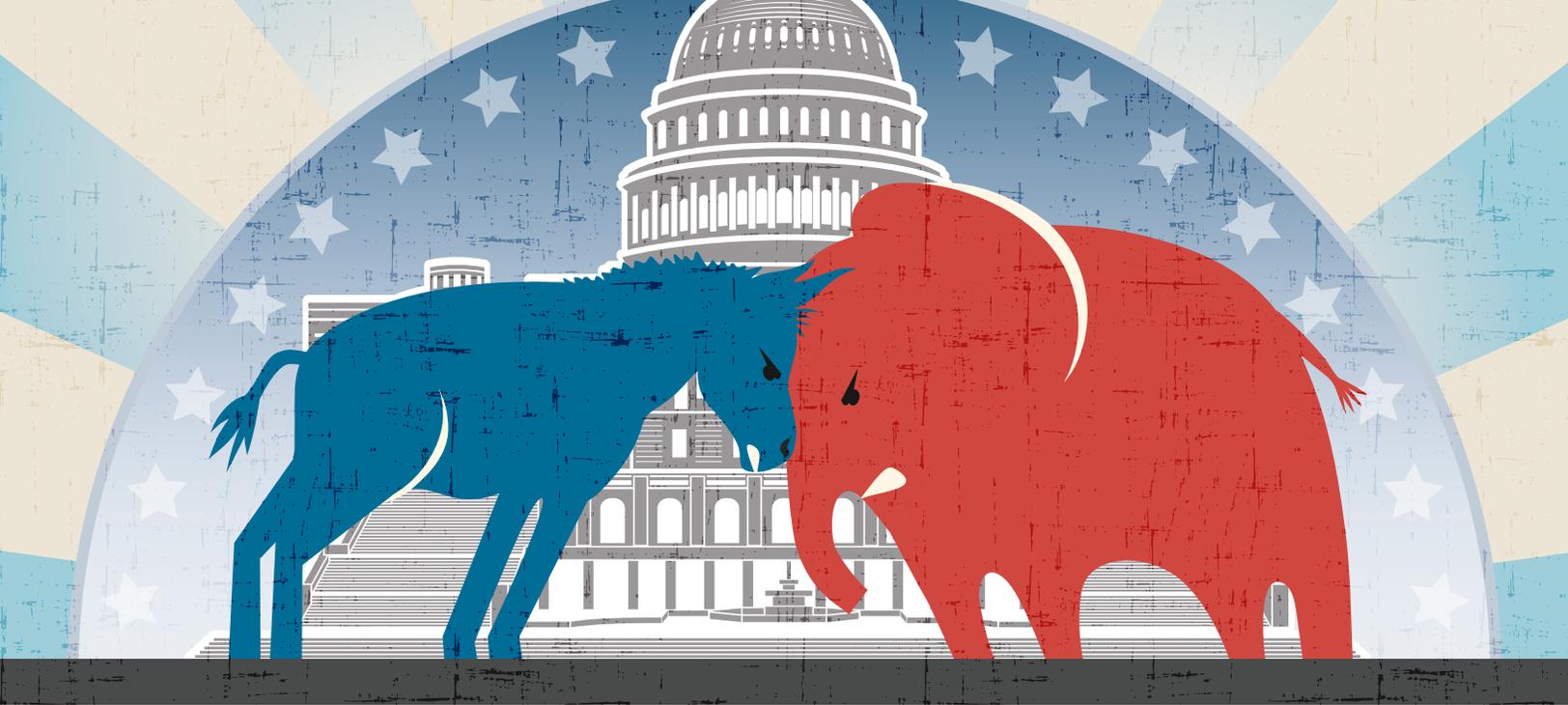
Tom Thornton, CFA, CIPM Vice President, Asset Management Services

Economic Snapshot

Recent data suggest that the economic expansion continued at a moderately strong pace in 3Q18, with moderate inflation. Trade tariffs have had a significant impact on some sectors, but only a modest impact on overall economic growth and inflation. However, the risks will increase as trade conflicts escalate. Fiscal stimulus (deficit spending) should continue to provide support into early 2019. Federal Reserve officials believe that policy is close to normal, but many believe that rates may need to become restrictive in 2019 or 2020.

DR. SCOTT BROWN
Chief Economist,
Equity Research

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	GDP growth is expected to remain moderately strong, although somewhat slower in the second half of 2018, reflecting the tight job market and the fading impact of fiscal stimulus.
	EMPLOYMENT	Demand for workers should remain strong and there may be some slack remaining in the labor market, but the pace of job growth is likely to slow as constraints become more binding.
	BUSINESS INVESTMENT	Sentiment remains strong, although there are some concerns about the negative impact of tariffs. Orders and shipments of capital goods have improved into 3Q18.
	THE DOLLAR	Trade policy conflicts and concerns about global economic risks have led to a flight to safety into U.S. Treasuries and the dollar.
NEUTRAL	CONSUMER SPENDING	Job growth remains supportive, but inflation-adjusted average earnings are trending flat on a year-over-year basis.
	MANUFACTURING	New orders and production have been mixed, but the pace has been generally moderate. Trade tariffs are a concern, disrupting supply chains and dampening expectations for exports.
	HOUSING AND CONSTRUCTION	Builders continue to note supply constraints (a lack of skilled labor, higher costs). Demand remains strong. Home prices have continued to rise, making affordability an important issue.
	INFLATION	Labor cost inflation remains moderate. Core consumer price inflation is at the Fed's target level, but officials have indicated a tolerance for somewhat higher inflation in the near term.
	MONETARY POLICY	Fed policy is close to neutral, but the neutral federal funds rate can be expected to rise over time. Some Fed officials believe that it may be necessary to raise the federal funds rate above a neutral level in 2019 or 2020 (to align the economy more closely with its potential).
	LONG-TERM INTEREST RATES	A strengthening economy, somewhat higher inflation, Fed tightening, and increased government borrowing would normally send bond yields higher. However, long-term interest rates remain low outside the U.S. and there is strong global demand for safe assets.
	FISCAL POLICY	Tax cuts and added spending have provided support for economic growth in the near term (more than expected), but budget deficit projections have risen sharply (a long-term concern given the expected strains on Social Security and Medicare funding).
	REST OF THE WORLD	Fed rate increases have had a negative impact on emerging market economies and trade policy has disrupted supply chains. Nationalistic tendencies and Brexit are concerns in Europe.



Elephant in the Room?

Ed Mills, *Washington Policy Analyst, Equity Research*, surveys the current political landscape and the upcoming midterm election.

We are in the final stretch of the midterm elections that we view as a proxy in the fight between President Trump’s agenda and the electability of Congressional Democrats. Multiple themes will be given considerable attention in the coming months. In terms of the potential electoral outcomes, we will be paying particular attention to the political environment vs. the electoral map. Adding to the uncertainty of the outcome and potential market volatility will be vigorous debates about polling – with questions of its quality (especially in House races), accuracy, and predictability.

CURRENT VIEW

The political winds are at the Democrats’ backs, but the distribution of Senate races, the partisan tilt of many House districts, and positive economic indicators could limit Republican losses. That said, we view Democrats as favored to win a majority of seats in the House of Representatives and Republicans favored to maintain control of the Senate. By historical standards an average midterm election would produce a Democratic majority in the House.

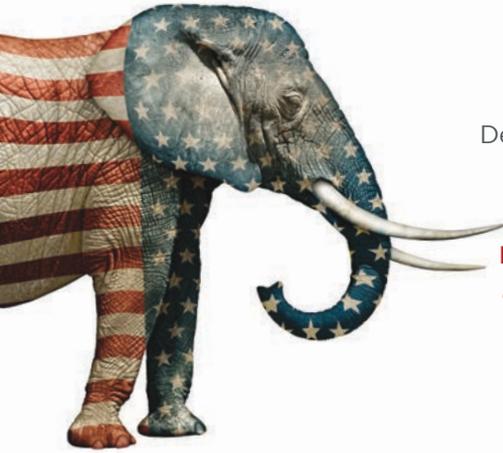
“We view Democrats as favored to win a majority of seats in the House of Representatives and Republicans favored to maintain control of the Senate.”

In the House of Representatives, “R” no longer stands for “Republican.” It stands for “retirement.” House Republicans have more retirements and open seats since at least 1930. Polling is notoriously sparse in House races, but traditional proxies (such as Presidential job approval, generic ballot test and voter enthusiasm)

all point to significant gains for Democrats, giving them the edge in the fight for a House majority.

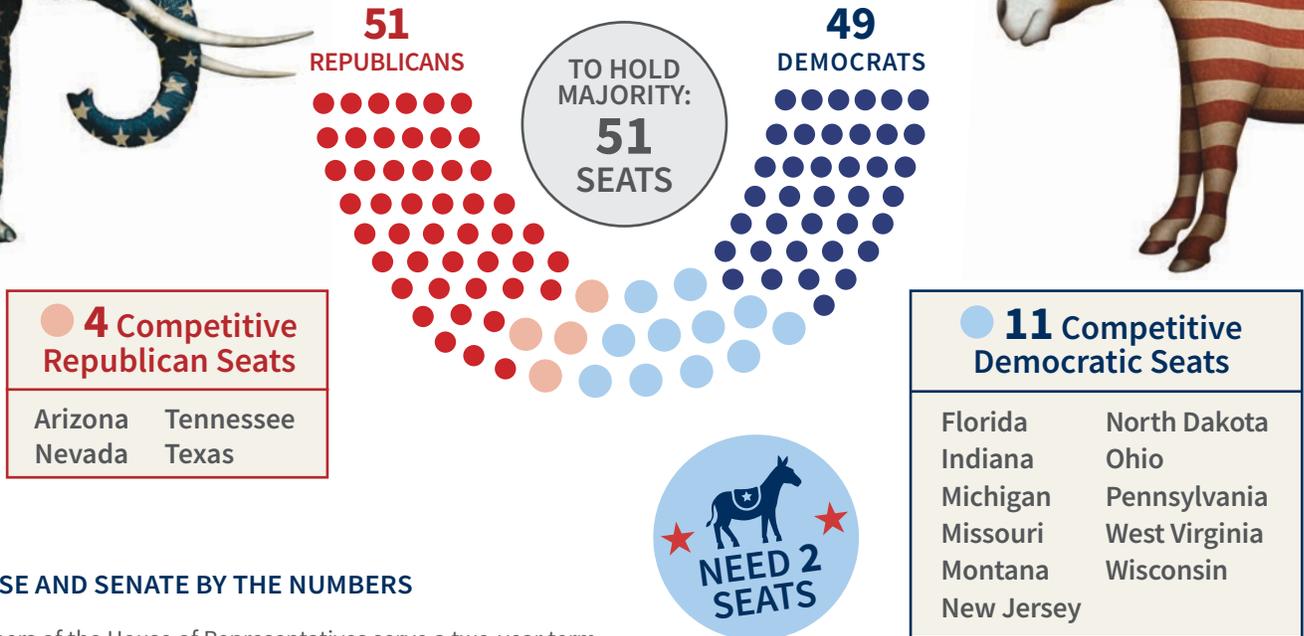
Historical midterm results and an array of surprising Democratic special election victories including Alabama (Doug Jones) and Pennsylvania (Conor Lamb) strengthen the case that Democrats are favored to retake the House.

Democrats need to net two seats for a Senate majority after November’s election. In our analysis of these races, we see 11 competitive races in seats currently held by Democrats and only four in seats held by Republicans. Wave elections (an election in which a party makes major gains) can swing these competitive seats in one direction, but Democrats face an uphill battle to retake the Senate.



The Midterm March to Majority

Due to the current composition of the Senate, Democrats face an uphill battle to obtain the majority.



HOUSE AND SENATE BY THE NUMBERS

Members of the House of Representatives serve a two-year term, and all 435 members are up for re-election in November. Republicans currently enjoy a 44-seat majority with 237 seats compared to 193 seats for Democrats. Five seats are currently vacant. The party with at least 218 seats has a majority in the House.

Senators serve six-year terms and one-third of the Senate is on the ballot every two years. This year that number is elevated to 35 of the 100 senators due to an early retirement and resignation of two senators. Republicans hold 51 Senate seats, while Democrats hold 47 (along with Bernie Sanders and Angus King, two independents who caucus with the Democrats). Given that Vice President Pence serves as a tiebreaking vote, Democrats would need to net two seats for a majority following November’s election.

Although gaining two Senate seats appears to be an easily achievable target in the current political environment that suggests a Democratic tailwind, Democrats are defending 26 Senate seats compared to nine for Republicans. Ten Democrats are running in states won by President Trump, including ruby red states like North Dakota, West Virginia, Montana, and Indiana. Republicans are only defending one seat in a state won by Hillary Clinton (Nevada). Structurally, Republicans have the advantage to maintain the majority in the Senate.

The midterm elections are historically challenging for the incumbent party. Since 1938, the party holding the White House has lost seats in Congress in all but two midterm election cycles. The average loss for the incumbent party is 26 House seats.

Generally, the lower the President’s job approval numbers, the worse the President’s party performs in the election. In 2018, President Trump has consistently polled a net disapproval rating with the latest available data showing a net disapproval rating of 9.3%. Comparatively, President Obama’s net disapproval reached a high of 5.3% at the same point in his first term leading up to the 2010 midterm elections, which saw Republicans gaining 63 House seats to claim the majority – the largest swing since 1938.

So far this year, Democrats have consistently led in the generic Congressional ballot, reaching a high of 12.1%. Comparatively, Republicans polled as high as 10% in 2010. The current Democratic advantage is 6.9%. Democrats are also showing an advantage in voter enthusiasm, particularly in toss-up states.

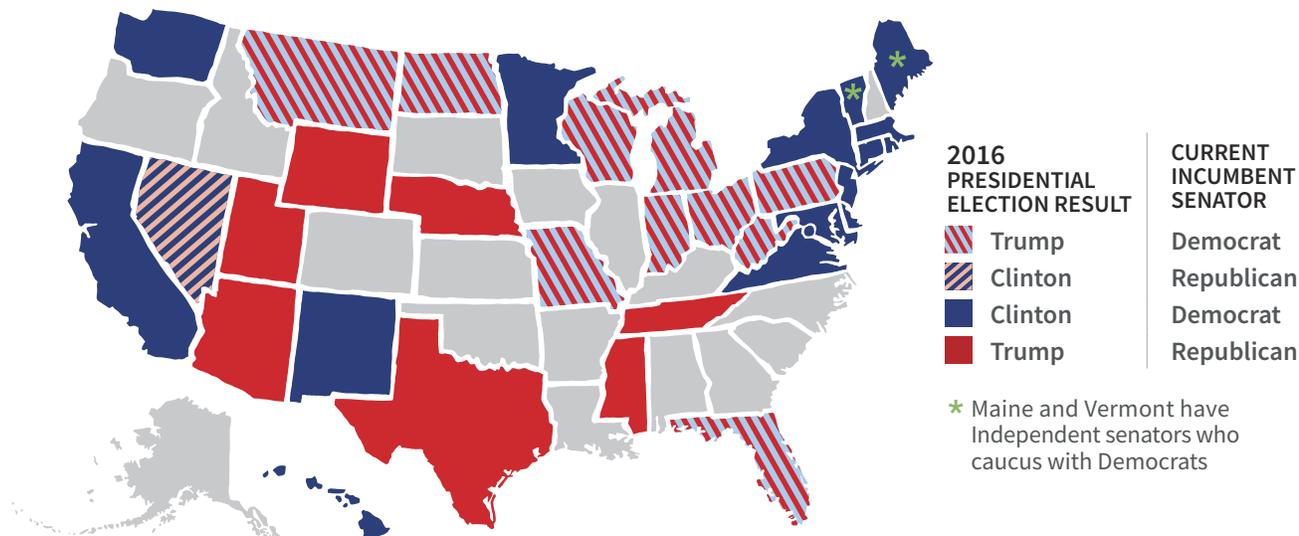
Election watchers typically pay attention to retirements and candidates seeking other offices ahead of the election cycle to gauge the candidates’ sentiment. According to Pew Research, the current number of House Republicans voluntarily giving up their seats – including House Speaker Paul Ryan – is at its highest since 1930.

PROJECTION AND OUTLOOK

Based on the current trajectory and historical comparisons, our base case for the 2018 midterms is Republicans retaining a Senate majority with the House switching to Democratic majority control.

Challengers' Trump Card

Many incumbent Democratic senators are running for re-election in states Trump won in the 2016 presidential election.



“A Republican Senate and a Democratic House could potentially create a Goldilocks scenario for the market: not too hot, not too cold.”

A Republican Senate and a Democratic House could potentially create a Goldilocks scenario for the market: not too hot, not too cold. We strongly believe that the strength of the market since President Trump's election has been tied to his deregulatory agenda. The Senate alone confirms Presidential nominees, which require a simple majority vote. A Republican Senate equals a continuation of the Trump deregulatory agenda.

In the House, we would be looking for potential breakthroughs on immigration, infrastructure, and a potential fix to the SALT¹ deductions as possible agenda items. Divided government is likely to produce spending bills that keep domestic and defense spending at or near current levels, continuing a legislative agenda that supports fiscal stimulus. Should the Democrats retake enough seats, a key concern for the market would be increased oversight by the House.

Caveats to consider to the current forecast are candidate recruiting, the strength of individual candidates, new district maps, and the strength of the economy, which could serve to limit potential Republican losses this fall. ■

KEY TAKEAWAYS:

- We view Democrats as favored to win a majority of seats in the House of Representatives and Republicans favored to maintain control of the Senate.
- We strongly believe that the strength of the market since President Trump's election has been tied to his deregulatory agenda. A Republican Senate equals a continuation of the Trump deregulatory agenda.
- A key concern for the market would be the impact of increased oversight in the House.
- Caveats to consider to the current forecast are candidate recruiting, the strength of individual candidates, new district maps, and the strength of the economy, which could serve to limit potential Republican losses this fall.

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¹ SALT: State and Local Tax



Trading Places: Value & Growth

Andrew Adams, CFA, CMT, *Senior Research Associate, Equity Research*, reflects on the rally in growth stocks over the past decade and highlights the tailwinds that are likely to keep them in the lead over value for some time.

One fundamental decision to make when investing in the equity markets is whether to favor growth strategies or value strategies. The two styles represent contrasting approaches to stock selection, and this dichotomy often divides investors who naturally gravitate toward one or the other. However, either strategy can be a better choice in a favorable underlying environment, and having a portfolio tilted toward the right style at any given time can go a long way to boost returns. First, though, it is important to distinguish between growth and value stocks.

GROWTH STOCKS

Growth stocks are companies expected to grow their sales and earnings at a high rate, typically above that of the average stock in the market. Much of the growth stock's worth is tied to its future earnings potential, which is why they tend to trade at higher than average valuation multiples. Growth companies also usually opt to reinvest profits back into their businesses instead of paying out high dividends, and investors are okay with that because they believe they'll be able to sell their shares for much more in the future as long as the company continues to grow.

VALUE STOCKS

Value stocks trade at a discount to some calculated measure of intrinsic value. They tend to have lower valuation multiples, higher dividend yields, and lower expected future growth rates compared to growth stocks. Value investors feel there is a 'margin of safety' in buying a stock that is already trading below what they believe it to be worth, but they have to be careful not to fall into the 'value trap' of buying something that is 'cheap' for a good reason.

Proponents of value stocks are quick to point out that they have outperformed growth stocks over the past several decades, but in recent years that dominance has swung the other way. Since 2006, the Russell 3000 Growth Index (a proxy for all U.S. growth equities) has consistently outperformed its counterpart, the Russell 3000 Value Index, with few notable exceptions. That 12-year advantage for growth has left many value investors wondering just when it will be their turn again. We believe there are a few fundamental reasons why growth has dominated over the past decade, and these tailwinds do not yet show material signs of reversing, which is why we continue to favor growth stocks.

FUNDAMENTALS STILL FAVOR GROWTH

The broad stock market has performed quite well over the past several years, pushing up valuations and offering fewer value

Two Sides of the Coin: Value & Growth

VALUE STOCKS

These companies are often priced based on their current value and distribute a larger portion of current earnings to shareholders.



GROWTH STOCKS

As their name suggests, these companies often reinvest their earnings into future growth opportunities.



opportunities overall. Consequently, investors have piled into stocks with greater earnings growth potential that can better justify the higher valuations. Value tends to lead as recessions near, as investors sell their high-flying growth stocks and move into more stable companies, and when coming out of a market downturn, when beaten-down stocks have more room to rise. As a result, it should not come as a complete surprise that, since 2006, the periods when value has been the better performer have mostly come after meaningful sell-offs in the broad market. We think these sell-offs help create more value opportunities when they occur, and relative performance improves while those beaten-down companies return to fair valuations. Therefore, it may require more of a significant decline in the broad market to put the wind at the backs of value stocks again.

As interest rates rise, they erode the present value of future earnings, whereas when interest rates fall, they increase the present value of future earnings.

stocks commonly used as bond proxies appears to have fallen more than demand for the high earnings growers. A stock with a 2-3% dividend that is not expected to grow at a high rate simply becomes less attractive as more competitive yields can be found in fixed income. A stock with the potential to grow earnings at a high rate is not as affected by rising rates while they are still considered to be at low levels overall.

INTEREST RATES AND EARNINGS GROWTH

Interest rates have been near historical lows for the last several years. Lower interest rates translate to a lower discount rate when valuing future earnings, which means future earnings are worth more when discounted back to the present. Relatedly, with interest rates and economic growth as low as they have been over the past few years, many investors have been reaching for returns in equity investments to make up for the lackluster yields in fixed income. A 'barbell-type' strategy has been quite common for investors, as they balance less volatile, low-yielding bonds with stocks that have potential for capital gains. As rates rose over the last couple of years, demand for the lower growth, higher dividend-yielding

PASSIVE VS. ACTIVE INVESTING

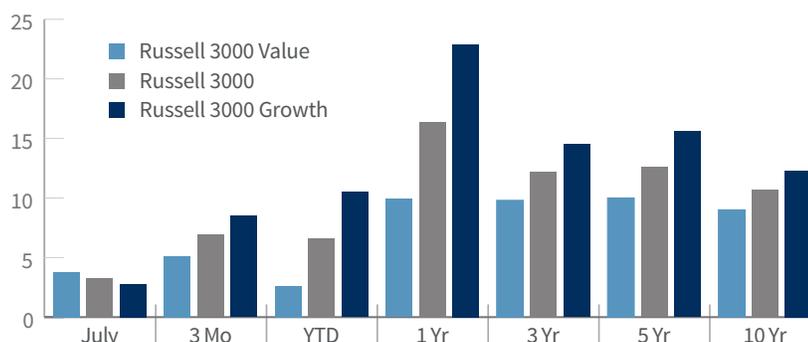
The massive shift to passive investing benefits growth stocks at the expense of value stocks. Historically, active investors and portfolio managers have generally favored value investing strategies. However, as more money flows into products that 'buy the market' or 'buy a sector,' value is largely being thrown out the window. Instead, stocks that are bid up to higher valuations rise in market capitalization and become even larger holdings within these funds, while stocks that fall become smaller holdings. In other words, there's a built-in momentum factor that doesn't exactly help stocks that are 'undervalued.' It's probably not a huge coincidence that the clear outperformance of growth over value going back to 2006 has occurred at the same time passive investing and index funds have proliferated.

TRADING: COST AND EFFICIENCY

On a closely-related note, it used to be more costly and time-consuming to research and trade stocks, and it was near impossible for the average investor to try to duplicate an index or even

Growth Outperforming Value

Over the past decade, growth has outperformed value on a relative basis.



Source: Russell, as of 07/30/2018

to hold a large basket of stocks in a portfolio. As a result, more emphasis was placed on finding the sub-section of stocks that represented exceptional value opportunities, and then holding them until they were no longer a good value (or paying an active manager to find those opportunities).

Now, online brokers offer extremely low-commission stock trades and index funds enable investors to own the majority of the world stock market's capitalization at little cost. The ability to trade so quickly and cheaply has helped to cut down on holding times and has prompted investors to chase quarterly earnings growth and whatever is hot at the moment, further skewing the market toward growth stocks. Moreover, as investing becomes easier and cheaper, more money flows directly into stocks. Since that money is increasingly going toward passive strategies and growth stocks these days, it has almost become a self-perpetuating cycle.

TECHNOLOGY AND DISRUPTION

The increasing importance of technology to our overall economy naturally favors growth strategies over value. Companies that chiefly depend on innovation and continual progress (like those predominantly found in the technology sector) often trade at higher-than-average valuations, but can still be attractive to investors because they are expected to generate higher-than-average earnings growth in the future, even if they're not currently profitable. As technology-oriented companies continue to innovate and disrupt established industries, more and more of the disrupted companies have turned into value traps that underperform for years.

THE BOTTOM LINE

The bottom line is that growth stocks have dominated value stocks for over a decade now, and it might require some sort of a recessionary environment or paradigm shift to really flip that relative

strength on a longer-term basis. There will be periods when value does better, and there will always be attractive individual value situations on the company level. However, we believe long-term investors taking a more active approach should still remain focused on the growth-type companies and sectors that have been in favor in recent years until there are clearer signs that the underlying trends have changed. ■

KEY TAKEAWAYS:

- The broad stock market has performed quite well over the last several years, pushing up valuations and offering fewer value opportunities overall.
- With interest rates and economic growth as low as they have been over the last few years, many investors have been reaching for returns in equity investments to make up for the lackluster yields in fixed income.
- Moreover, as investing becomes easier and cheaper, more money flows directly into stocks. Since that money is increasingly going toward passive strategies and growth stocks these days, it has almost become a self-perpetuating cycle.
- The increasing importance of technology to our overall economy naturally favors growth strategies over value.
- The bottom line is that growth stocks have dominated value stocks for over a decade now, and it might require some sort of a recessionary environment or paradigm shift to really flip that relative strength on a longer-term basis.

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U.S. Housing Market Update

Paul Puryear, *Director, Real Estate Research, Equity Research*, analyzes the current state of the U.S. housing market, rising input costs, and changing demographics.

The housing market continues to track our expectation of 1.2-1.3 million starts, although recent reports indicate some softness in new and existing home sales. We are not concerned about the speed or strength of the housing recovery at this juncture and view these data points as a somewhat normal reaction following the 65 basis point spike in mortgage rates from 4.00% to 4.65% at the beginning of the year.

HOUSEHOLD FORMATION

More importantly, U.S. household formation rates have been consistently below the long-term average (1.2 million) this entire housing upcycle following the peak levels reached in 2005. Structurally decelerating rates of population growth in individuals aged 26 to 64, the prime household formation years, portend below-average household formation for years to come and that scenario continues to play out.

Unless influenced by economic recessions, we believe a strong correlation exists between annual new home sales (single-family permits and starts), household formation, and population growth in individuals aged 26 to 64. The period from 1972-2000 repre-

“Positive shifts in buyer behavior, pent up demand and a strong economy continue to drive our more positive view on the housing recovery.”

sents the strongest workforce population growth in U.S. history. However, after 2017, annual population growth amongst individuals aged 26 to 64 is not projected to reach 0.7% again until 2041. The post-war Baby Boom was an unprecedented historical event shaping U.S. society. We believe ‘reversion to the mean’ in U.S. household formation, and consequently

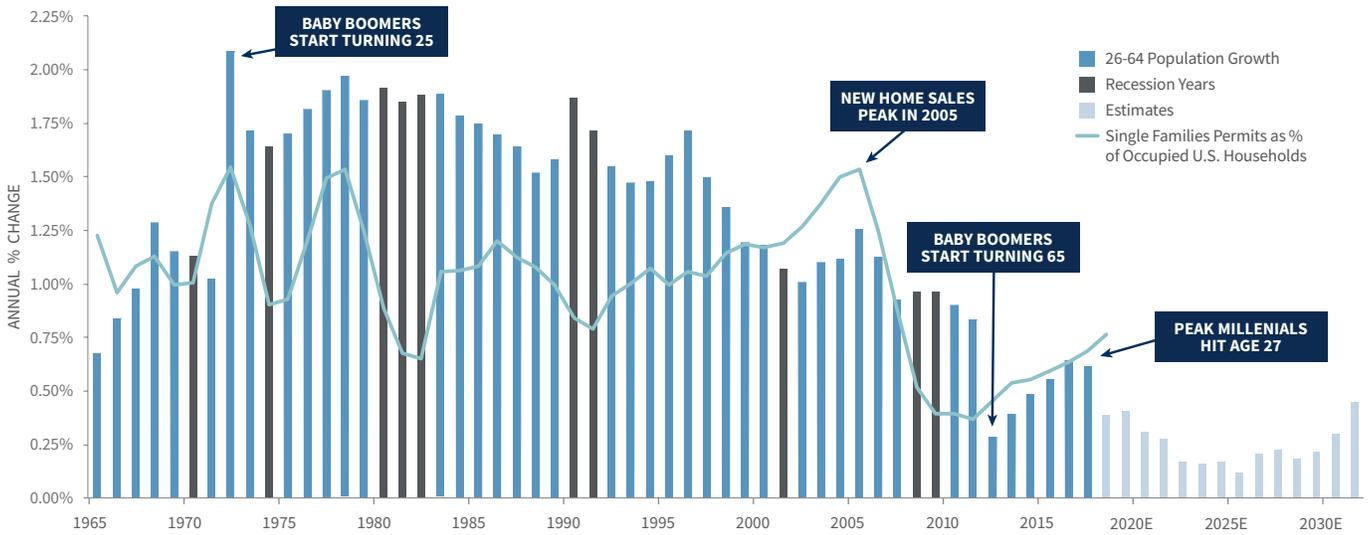
new home demand, is a flawed assumption validated by the population growth outlook. Further, we don’t expect our economy to reap benefits from new housing construction in this upcycle at the levels realized in the past two upcycles.

RISING INPUT COSTS

With regard to the most recent data points in housing sales, we note that listed inventory for sale (new and re-sale) measured as a percentage of total housing stock is tracking its lowest recorded level in over 30 years. Consequently, there is very little for the consumer/buyer to choose from. In addition, due to outsized inflation in the cost to build new housing and the slower growth in household income over the past few years, the affordability index has

Downsizing: The Demographic Debacle

Housing starts have followed declining population growth.



Source: U.S. Census Bureau; Raymond James research, as of 05/01/2018

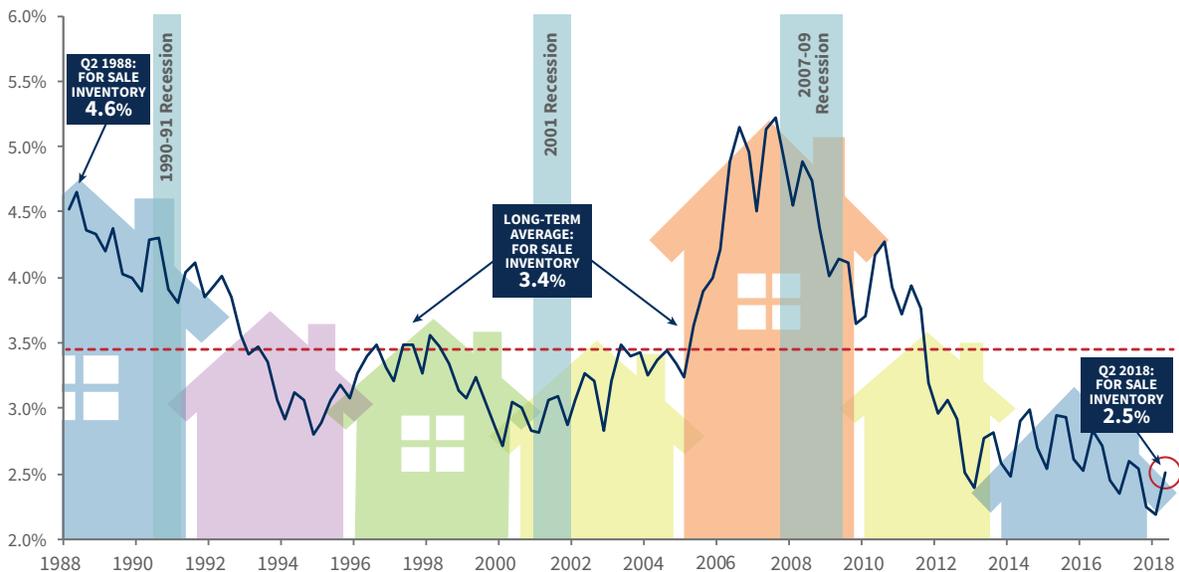
dropped below the 30-year average, despite the relatively low mortgage rate environment. Labor shortages and escalating costs continue to plague builders and have driven costs to build housing up two to three times higher than the broader CPI inflation rate. The Constant Quality (Laspeyres) Price Index¹ of new single-family houses sold has inflated at a 5.6% compounded annual growth rate since early 2012. Cumulatively, the cost to build a like-kind single family home has increased 31% over the past six years. Trade wars are not helping as materials costs are

now spiking. In some cases, they are surpassing the increasing labor and permitting costs that have been rising since the construction recovery began in 2012.

LIFESTYLE PREFERENCES

In addition to the population-driven demographic shift and affordability issues impacting housing demand this upcycle, lifestyle preferences are shifting as millennials are replacing baby boomers as the major home-buying age cohort. Millennials have very different

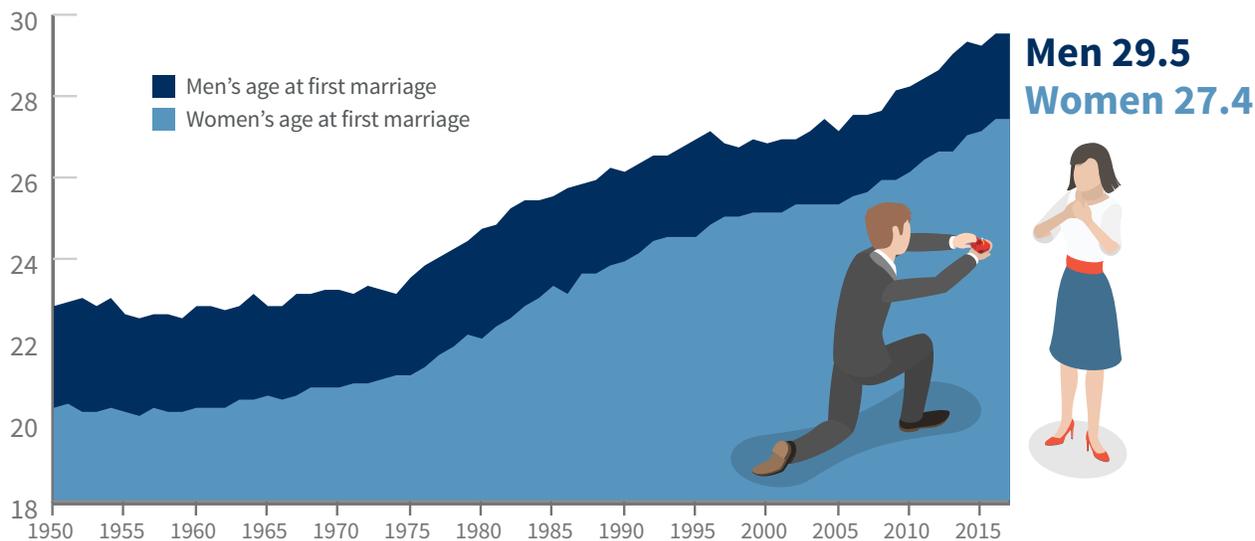
Below Average: Housing Inventory



Source: National Association of Realtors; U.S. Census Bureau; Raymond James research, as of 06/01/2018

¹ The Laspeyres method indexes current prices against those of a base period valued at 100. The value of the index at any given date indicates the value of current prices relative to the base period.

Growing Older: Marriage Ages



Source: U.S. Census Bureau; Raymond James research, as of 09/01/2018

preferences with regard to becoming home owners versus renting, along with lifestyle changes regarding marriage (more single heads of households and delaying marriage), and family formation (birth rates plummeting and fewer families with children). College graduates are entering the workforce at unprecedented levels, but with more student debt and weak credit scores that delay home ownership. For the first time among post-war American generations, living with parents is the most common household arrangement among young adults. As a result, noticeably absent this upcycle is the construction and purchase of entry-level housing, and we don't expect that to change as more and more 'new families' are opting to rent their first home.

PEAK MILLENNIALS

On a more positive note, with the first of the millennials now in their early 30s and 'peak millennials' hitting age 27, there is some renewed demand in single family housing, which will create a shift in demand from apartments to both owned and for-rent single family houses. This shift will continue to drive single family starts higher in the mid-to single-digit range and multifamily starts flat to down, and we have seen an increase in household formations over the past two quarters. Data points like this, which are driven by some positive shifts in buyer behavior, pent up demand, and a strong economy, continue to drive our more positive view on the housing recovery, but we don't see starts spiking up to the historical 1.5 million in the near to intermediate term. ■

KEY TAKEAWAYS:

- We are not concerned about the speed or strength of the housing recovery at this juncture and view recent data points indicating some softness in new and existing home sales as a somewhat normal reaction to higher mortgage rates this year.
- The cost to build a like-kind single family home has increased 31% over the past six years. Trade wars are not helping as materials costs are now spiking. In some cases, they are surpassing the increasing labor and permitting costs that have been rising since the construction recovery began in 2012.
- For the first time among post-war American generations, living with parents is the most common household arrangement among young adults. As a result, noticeably absent this upcycle is the construction and purchase of entry-level housing, and we don't expect that to change as more and more 'new families' are opting to rent their first home.
- Positive shifts in buyer behavior, pent up demand and a strong economy continue to drive our more positive view on the housing recovery, but we don't see starts spiking up to the historical 1.5 million in the near to intermediate term.

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To Invert, or Not to Invert?

Doug Drabik, *Senior Strategist, Fixed Income*, and **Nick Goetze**, *Managing Director, Fixed Income Services*, assess the current state of the U.S. yield curve and their outlook for interest rates.

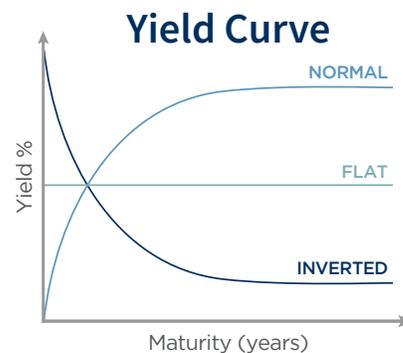
As the Federal Reserve (Fed) continues to raise short-term interest rates, the U.S. yield curve has continued to flatten. This, in turn, has prompted investors to question whether the yield curve will become inverted (a scenario in which short-term interest rates become higher than long-term interest rates) and what impact it will have upon the U.S. economy. Historically, inverted curves have often proven to be precursors to recessions. An inverted curve and recession are words that can often elicit intimidation and lead to distorted investment practices. However, maintaining appropriate portfolio balance and perspective may help investors navigate through these markets.

WHERE DID THEY COME FROM?

Record low interest rates can distort perceptions when assessing yields and fixed income in general. On July 8, 2016, the yield on the 10-year Treasury note closed at its three year low of 1.36%. The yield on the 10-year Treasury has since climbed to 3.07% at the time of this writing. On a relative basis, this constitutes a rise of over 126% when compared to its yield in July 2016. While this rise certainly appears large, it is important to keep it in context;

on a nominal basis, the yield on the 10-year Treasury has only risen 1.78 percentage points, or 178 basis points (bp). Over the past 50 years, the average yield on the 10-year Treasury has been 6.37%. It is worth noting that yields were skewed substantially higher during the first 25 years of that period as the Fed tried to tame high inflation. On the other hand, yields over the past 15 years have been skewed substantially lower as the Fed tried to spur economic growth following the financial crisis of 2008.

The yield curve is created by plotting the yields of fixed income investments of various maturities. In the case of the U.S. Treasury yield curve, the yields of Treasuries from one month to 30 years in maturity are plotted along an axis. The line connecting these points is known as the 'yield curve' due to its distinctive curved shape. Generally, short-term yields are lower than long-term yields, creating a curve which slopes up and to the right. When short-term and long-term yields are similar, the curve appears 'flat.' When short-term yields are higher than long-term yields, the curve becomes 'inverted,' sloping down and to the right.



It bears mentioning that points along the yield curve have not moved uniformly. On the contrary, short-term yields have risen while long-term rates have remained relatively unchanged. Today's yield curve shape is a product of both the Fed's methodical short-term interest rate hikes and investor sentiment, which has held intermediate and long-term rates in place. In addition, persistently low interest rates around the globe have created steady demand for U.S. Treasuries, which have relatively higher yields than most sovereign debt from around the world. Along with weaker global growth, geopolitical risk, a strengthening dollar, and low inflation, this has proven to be a strong headwind to higher intermediate and long-term interest rates.

THE ECONOMIC CYCLE

Parts of a normal economic cycle include expansions and recessions. An inverted curve signifies that shorter-term rates are higher than longer-term rates. In recent history, inversions have preceded recessions. Historically, equity markets have peaked after the start of an inverted curve. The prospect of a looming recession can incentivize investors to buy bonds with longer maturities as a safe-haven trade in the face of falling equities and/or as a method of preserving capital, potentially causing a fall in long-term yields. Since bond prices rise as yields fall, falling fixed income yields often lead to total return gains. This inverse correlation allows high-quality fixed income to potentially act as a balance to growth assets, such as equities.

It is important to keep in perspective that, on average, periods of economic expansion have been much longer than periods of recession, and positively sloped curves persist much longer than inverted curves. As a result, attempting to 'time the market' based on the shape of the yield curve is an extremely difficult technique for fixed income investors focused on total return. Since long-term planning is typically the norm, it is more of a distraction for fixed income investors seeking income and portfolio preservation strategies. Each of the last three recessions has given way to three of the longest expansionary periods in recent history: March 1991, November 2001

Alternate Sources of Yield

James Camp, CFA, *Managing Director of Fixed Income, Eagle Asset Management**, discusses the difficulties facing dividends and his outlook on future distributions.

Just as value stocks lagged growth stocks over the last couple of years, a similar trend can be seen between income-producing stocks and the broader equity markets. Non-paying larger cap stocks outpaced dividend payers by over 10% in 2017. Moreover, within the dividend-paying space, higher-paying dividend stocks experienced similar underperformance relative to their lower-paying counterparts.

While non dividend-paying stocks only make up 16% of S&P 500 companies, they have provided an outsized portion of recent returns. Conversely, returns on high-yielding dividend securities have turned negative year-to-date, despite a recovery in July. Dividend-paying stocks are sensitive to rising interest rates, due in part to the higher amount of debt typically carried by these companies. As rates rise, so does the cost of servicing debt, ultimately dampening profits and placing pressure on stock prices.

Despite a challenging rate environment, dividends continue to grow and reacceleration is occurring in many sectors, including financials, where regulatory reform is freeing up capital for increased payouts. Income investors would do well to remember that dividend-based strategies adhere to an 'objective-based' approach, and, in that context, these strategies are meeting that objective by delivering income.

Going forward, headwinds in this space include a potential market correction and rising interest rates, with higher-paying dividend stocks being the most sensitive to these events. More modest paying companies, which yield slightly more than the S&P 500 as a whole, have historically provided the best risk/return characteristics.

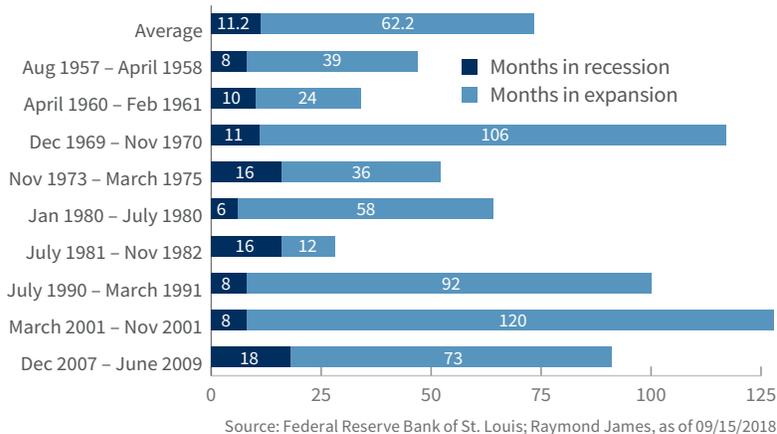
In the past 15 years, there have been nine periods when the 10-year Treasury yield had a significant move (approximately 100 basis points or more). Modest-yielding stocks suffered only two periods of negative returns, while the S&P 500 High Yield Dividend Index fell in three periods. The average returns during these periods for the two groups were 6.88% and 4.38%, respectively. ■

Source: FactSet

*An affiliate of Raymond James & Associates, Inc., and Raymond James Financial Services, Inc.

The economic business cycle goes through periods of expansion and growth, as well as periods of contraction and recession. A recession can be severe or mild. It does not mean that there is necessarily an economic collapse, but signals that economic activity has declined for several months and/or consecutive quarters.

The Calm Outlasts the Storm: Expansion and Recession Lengths



and June 2009. Over the last 60 years, expansionary periods are, on average, roughly 5.5 times the length of recessionary periods. That margin has widened in recent history. Over the last 30 years, expansionary periods are, on average, more than 8.6 times the length of recessionary periods.

Experts in the fixed income space often monitor spreads between different points on the yield curve in order to forecast economic trends and investor behavior. For example, many prefer to look at the spread between the yield on the 2-year Treasury and the 10-year Treasury. The graph on the following page illustrates the 2-year versus 10-year Treasury spread (light blue line) and the federal funds rate (dark blue line) over the past 30 years. When the light blue line falls below the horizontal '0' axis, the yield curve has become inverted. This 30-year timeline includes four periods of major Fed rate hikes, three periods of major Fed rate cuts, three recessions, and three inverted yield curves.

THE FED'S ROLE

The Fed attempts to keep the markets stable by staving off economic instability caused by inflation or deflation. At the risk of invoking the phrase 'this time is different,' one of the more dangerous mantras of our industry, this time just may be different to a certain degree. Unlike the last three periods of previous rate hikes by the Fed, this time the hikes began after over seven years of interest rates at 0%. As a result, the Fed may be less focused on an overheated market and more focused on reaching 'neutral' interest rates after a period of unusually low rates. A 3.00% federal funds rate is widely viewed to be 'neutral' by policymakers. This would entail another four or five rate hikes of 25 bp each. The Fed raised rates in September and a December hike is looming. These hikes alone could induce the yield curve to invert.

Some Federal Reserve presidents have stated that their greatest concern is inflation, not necessarily the shape of the yield curve.

They are more worried about high inflation than low inflation. These statements remind us that the Fed's mandate is to create a stable monetary environment. Given that this mandate will continue to take precedence over the shape of the yield curve, continued rate hikes increase the possibility of an inverted curve and, with it, concerns of a recession. If the Fed pushes short-term rates too high too fast, it could cause the yield curve to invert. Keep in mind that the Fed has relatively less influence upon intermediate and long-term rates. Should short-term rates rise above intermediate and long-term rates, economic models and investor sentiment may very well turn an inverted yield curve into a self-fulfilling prophecy and thereby 'will' the economy into a recession.

WHERE DO THEY GO?

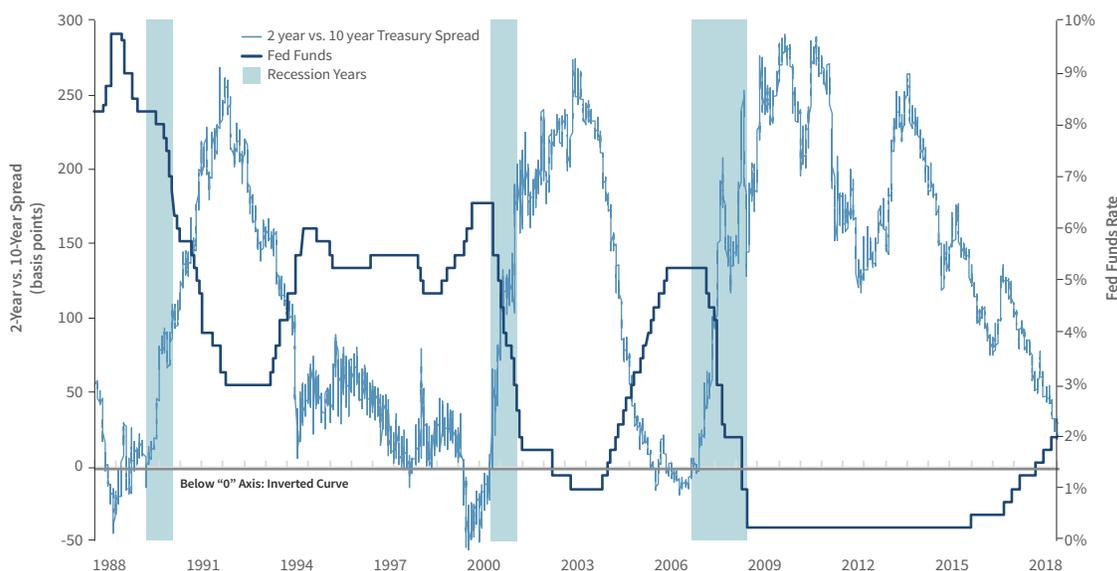
There are currently more headwinds than tailwinds for intermediate to long-term interest rates. As a result, they are likely to be range bound. We anticipate the yield on the 10-year Treasury to remain range bound between 2.80% and 3.40%. Given that the economy continues to show solid growth, there is reason to believe the Fed will continue its gradual pace of hikes and that intermediate and long-term rates will not keep pace, thus causing a yield curve inversion. With U.S. fundamentals still relatively strong, the reaction of the market will dictate where we head from there.

INVESTING AMIDST INVERSIONS

When creating a fixed income strategy/allocation, investors would do well to focus on long-term planning rather than attempting to predict future rates.

A common response to a flatter yield curve is to invest in bonds with shorter maturities. However, an inverted curve does not necessarily mean that short maturity bonds are optimal. For example, on July 3, 2000, the 2-year Treasury yield of 6.29% was higher than the 10-year Treasury yield of 5.99%. However, after maturity on

2-Year vs. 10-Year Treasury Spread vs. Fed Funds



Source: Bloomberg LP; Raymond James as of 09/15/2018

July 3, 2002, the funds from the 2-year Treasury would need to be reinvested. Here, investors faced a much different rate environment. By that time, the yield on the 2-year Treasury had fallen to 2.79% and the yield on the 10-year had fallen to 4.76%.

Investing in fixed income requires a different approach than investing in growth assets. Fixed income allocations are typically not designated as total return assets, which should remove the motivation to time the market for most investors. Disciplined, long-term planning can combat unpredictable market forces. Short-term thinking would lead an investor to buy short-term maturities when the yield curve is flat. However, hindsight shows that buying short maturity bonds turned out to be a less attractive investment, as confirmed by our previous example.

Years of general interest rate decline have dropped rates to near historic lows, making it reasonable to presume that interest rates may continue their recent mild upswing. While it is nearly impossible to accurately predict interest rate direction and reliably time the market, promoting a more engineered fixed income strategy (such as laddered maturities/duration) may mitigate interest-rate risk, optimize return, and create structured reinvestment. Fixed income allocations may create a better hedge to heavily weighted growth allocations (such as equities) with modestly higher duration bonds. Regardless of yield curve shape, asset allocation is crucial. Due to the fact that allocations to equities and fixed income depend largely on individual needs and goals, investing in fixed income assets requires disciplined, long-term planning. ■

KEY TAKEAWAYS:

- An inverted curve and recession are words that can often elicit intimidation and lead to distorted investment practices. However, maintaining appropriate portfolio balance and perspective may help investors navigate through these markets.
- Persistently low interest rates around the globe have created steady demand for U.S. Treasuries, which have relatively higher yields than most sovereign debt from around the world. Along with weaker global growth, geopolitical risk, a strengthening dollar, and low inflation, this has proven to be a strong headwind to higher intermediate and long-term interest rates.
- Promoting a more engineered fixed income strategy (such as laddered maturities/duration) may mitigate interest-rate risk, optimize return, and create structured reinvestment. Fixed income allocations may create a better hedge to heavily weighted growth allocations, such as equities.
- Regardless of yield curve shape, asset allocation is crucial. Due to the fact that allocations to equities and fixed income depend largely on individual needs and goals, investing in fixed income assets requires disciplined, long-term planning.

All expressions of opinion reflect the judgment of Raymond James & Associates, Inc., and are subject to change. Every investor's situation is unique and you should consider your investment goals, risk tolerance and time horizon before making any investment. Investing involves risk and you may incur a profit or loss regardless of strategy selected. Fixed income investments may involve market risk if sold prior to maturity, credit risk and interest rate risk. Asset allocation does not ensure a profit or protect against a loss. The forgoing is not a recommendation to buy or sell any individual security or any combination of securities.

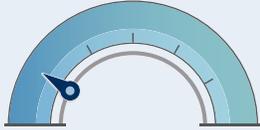
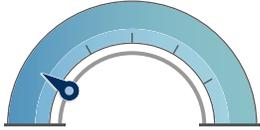
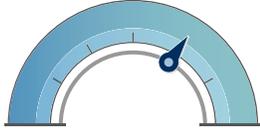
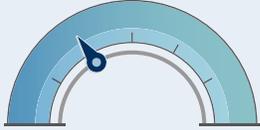
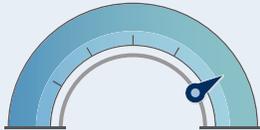
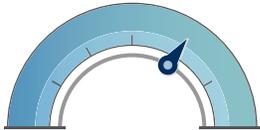
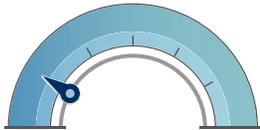
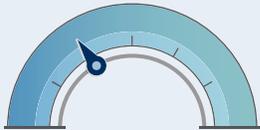
Strategic Asset Allocation Models



	CONSERVATIVE	MODERATE CONSERVATIVE	MODERATE	MODERATE GROWTH	GROWTH
EQUITY	27%	47%	64%	78%	93%
U.S. Large Cap Blend	15%	17%	21%	24%	29%
U.S. Large Cap Growth	0%	4%	6%	8%	9%
U.S. Large Cap Value	0%	4%	6%	8%	9%
U.S. Mid Cap Equity	2%	5%	7%	8%	10%
U.S. Small Cap Equity	1%	3%	4%	6%	6%
Non-U.S. Developed Market Equity	9%	14%	16%	20%	25%
Non-U.S. Emerging Market Equity	0%	0%	4%	4%	5%
FIXED INCOME	71%	51%	31%	15%	0%
Investment Grade Intermediate Maturity Fixed Income	56%	42%	27%	15%	0%
Investment Grade Short Maturity Fixed Income	7%	5%	4%	0%	0%
Non-Investment Grade Fixed Income	3%	2%	0%	0%	0%
Multi-Sector Fixed Income	5%	2%	0%	0%	0%
ALTERNATIVE STRATEGIES	0%	0%	3%	5%	5%
CASH & CASH ALTERNATIVES	2%	2%	2%	2%	2%

Tactical Asset Allocation Outlook

For investors who choose to be more active in their portfolios and make adjustments based on a shorter-term outlook, the tactical asset allocation outlook below reflects the Raymond James Investment Strategy Committee’s recommendations for current positioning. Your advisor can help you interpret each recommendation relative to your individual asset allocation policy, risk tolerance, and investment objectives.

<div style="text-align: center;">  </div> <p>EQUITY FIXED INCOME</p> <p>Equities continue to produce positive near-term returns and are supported by strengthening earnings and continued positive global growth. Headwinds for fixed income include a low starting point for yields, rising U.S. interest rates, and high currency volatility in the near term.</p>	<div style="text-align: center;">  </div> <p>U.S. EQUITY NON-U.S. EQUITY</p> <p>U.S. equities have the strongest momentum in the near term relative to non-U.S. equities as domestic companies benefit from the 2017 tax cuts. Additionally, the U.S. is currently leading the rest of the industrialized world in terms of economic growth, however, some caution is warranted as growth may be nearing its peak. Near-term tailwinds outweigh near-term headwinds and strong analysts’ outlooks should help overcome negative fund flows for the next couple of quarters.</p>
<div style="text-align: center;">  </div> <p>U.S. LARGE-CAP EQUITY U.S. SMALL-CAP EQUITY</p> <p>While short-term momentum in U.S. small-cap performance may start to ease at some point, the earnings outlook and analyst estimates should continue to favor small caps in the near term. We are less favorable than the previous quarter on small caps due to elevated valuations and less supportive fundamentals.</p>	<div style="text-align: center;">  </div> <p>NON-U.S. DEVELOPED MARKET EQUITY EMERGING MARKET EQUITY</p> <p>We slightly favor developed markets over emerging markets in the near term. Negative sentiment is present in both areas of non-U.S. equities but is heightened in emerging markets as it approaches counter trend levels. Fund flows continue to support developed markets over emerging, but, at some point, emerging markets will regain favor when long-term trends begin to play out.</p>
<div style="text-align: center;">  </div> <p>VALUE-ORIENTED EQUITY GROWTH-ORIENTED EQUITY</p> <p>We continue to favor growth stocks in the near term as momentum, fund flows, and profitability support their lead over value. Still, we are cautious as growth stock valuations are near 2001-2002 levels and analysts’ downgrades are starting to pick up.</p>	<div style="text-align: center;">  </div> <p>LONG-MATURITY FIXED INCOME SHORT-MATURITY FIXED INCOME</p> <p>The U.S. yield curve continues to flatten out and it is unlikely that we will see a spike in longer-term rates in the near future. Global demand continues to suppress yields, and the potential pick up in interest rates is not worth the duration risk. Still, duration is a primary defense against equity market risk, particularly within the 5-7 year range of the curve. Diversified portfolios should maintain fixed income allocations in accordance with each portfolio’s investment policy. There is a preference for shorter-maturity, higher-quality bonds at the present.</p>
<div style="text-align: center;">  </div> <p>INVESTMENT GRADE FIXED INCOME NON-INVESTMENT GRADE FIXED INCOME</p> <p>We continue to favor investment-grade bonds over high yield as investors are not being fully compensated for the credit risk and the equity risk they are taking on. Investment-grade bonds, while not attractive relative to equities, continue to provide ballast to equity market risk and positions should be maintained for this reason. This would also include the senior bank loan market as it tends to act like the high yield market when spreads widen.</p>	<div style="text-align: center;">  </div> <p>U.S. DOLLAR FIXED INCOME NON-U.S. DOLLAR FIXED INCOME</p> <p>Local emerging market bond prices are starting to look relatively attractive. However, it may be too soon to call for a tactical recommendation in this space. Continued appreciation of the U.S. dollar would negatively impact dollar-denominated debt held abroad. This, coupled with the additional credit risk associated with non-U.S. debt leaves us slightly favorable to U.S. dollar-denominated fixed income in the near term. This will, at some point, start to turn and favor non-U.S. dollar bonds.</p>

Alternative Investments Snapshot

ALTERNATIVE INVESTMENTS	
EQUITY LONG/SHORT	The opportunity set for long/short equity managers expands in an environment that features a greater degree of dispersion within equities, increasing the potential for managers to generate alpha both long and short. While the strategy has failed to keep pace with broader equity markets thus far in 2018, long/short equity managers would be expected to outperform should volatility spike.
MULTI-MANAGER/ MULTI-STRATEGY	Multi-manager/multi-strategy strategies offer investors diversification across strategy types and asset classes. For clients seeking investments with limited correlation and beta to traditional markets or fixed income alternatives, multi-manager/multi-strategy funds represent a potential solution.
MANAGED FUTURES	Managed futures strive to profit from divergent price movements and trends across asset classes. Managed futures strategies have generally struggled during recent periods of volatility. However, historically the strategy is uncorrelated to equity and bond markets and provides investors with diversification benefits.
EVENT DRIVEN	While the return streams produced by event-driven strategies stand to benefit investors in a late stage market environment, the opportunity set for event-driven managers is mixed. Although merger activity has remained robust, political posturing has resulted in a regulatory environment that is unpredictable. Additionally, the low default environment that has persisted for several years has limited the opportunity in distressed. Companies remain focused on streamlining their asset mix, creating special situation opportunities for managers. Given these dynamics, the current view on the strategy is neutral.
EQUITY MARKET NEUTRAL	Equity market neutral strategies attempt to maintain muted exposure to equity markets by implementing successful stock selection both long and short. The strategy will outperform during periods of volatility within equities while underperforming during periods of strength. Should volatility and dispersion in securities increase going forward, equity market neutral strategies will be poised to outperform. Should markets remain in a low volatility regime that features increased pricing, equity market neutral will underperform broader equity markets.
GLOBAL MACRO	Global macro managers take long and short positions across a variety of asset classes through the lens of current economic and political views of countries and macroeconomics. Variations in returns across asset classes and geographies create opportunities for global macro managers, and, as such, an uptick in volatility would be beneficial to the strategy.

This report is intended to highlight the dynamics underlying major categories of the alternatives market, with the goal of providing a timely assessment based on current economic and capital market environments. Our goal is to look for trends that can be sustainable for several quarters; yet given the dynamic nature of financial markets, our opinion could change as market conditions dictate.

Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

Investment Strategy committee meeting recap *Continued from page 3*

in oil prices and cash flows. This reflects the growing trend of capital discipline. Criticism from the investment community regarding their historical outspending has led many domestic oil producers to start returning cash to shareholders through dividends, buybacks, and debt reduction – versus plowing everything into growth.”

- “The global oil market was undersupplied last year, it is undersupplied this year, and it will yet again be undersupplied in 2019. Supply increases in the U.S., Saudi Arabia, and Russia are being counteracted by geopolitically driven declines in Venezuela and Iran.”

All expressions of opinion reflect the judgment of Raymond James & Associates, Inc., and are subject to change. There is no assurance any of the trends mentioned will continue or that any of the forecasts mentioned will occur. Economic and market conditions are subject to change. Investing involves risk including the possible loss of capital. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. Past performance may not be indicative of future results. Asset allocation and diversification do not guarantee a profit nor protect against loss. Companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. Changes in tax laws or regulations may occur at any time and could substantially impact your situation. You should discuss any tax or legal matters with the appropriate professional. The S&P 500 is an unmanaged index of 500 widely held stocks. It is not possible to invest directly in an index. Capital expenditure (CAPEX) are funds are funds used by a company to acquire, upgrade, and maintain physical assets such as property, industrial buildings, or equipment in order to increase capacity or efficiency. Debt securities are subject to credit risk. A downgrade in an issuer's credit rating or other adverse news about an issuer can reduce the market value of that issuer's securities. When interest rates rise, the market value of these bonds will decline, and vice versa. Legislative and regulatory agendas are subject to change at the discretion of leadership or as dictated by events.

New Communication Services Sector

The Telecommunication Services sector is being broadened to include select companies from the Media industry group (i.e., Comcast Corp.), Internet Retail sub-industry (i.e., Netflix, TripAdvisor), and Technology sector (i.e., Alphabet Inc., Facebook, Inc.) involved in communication services. The new sector will contain two industry groups - Telecommunication Services and Media & Entertainment.

The new sector will have a much different complexion than the previous S&P 500 Telecommunications sector that only included three stocks: AT&T Inc., Verizon, and Centurylink Inc.

Sector weighting (moves to 10% from 2%), growth prospects (among the highest expected growth from among the lowest), valuation (from lowest of all sectors to above S&P 500), dividend yield (goes from highest of all sectors to below the S&P 500), etc. are all significantly affected by the changes.

Moreover, there were significant changes to the Technology sector and Consumer Discretionary sector. As much has been made of the

FAANG stocks, it is important to note that the Technology sector only contains one of the FAANG stocks going forward (Apple Inc.). The new Communications Services sector will include three of the FAANG stocks (Alphabet Inc., Facebook, Inc., and Netflix) while the Consumer Discretionary sector will include one name (Amazon).

For information on these sector changes and other sector information, please ask your financial advisor for a copy of *September 2018 Portfolio Strategy: Sector Analysis*.

Overweight: favored areas to look for ideas, as we expect relative outperformance

Equal Weight: expect in-line relative performance

Underweight: unattractive expectations relative to the other sectors; exposure might be needed for diversification

J. MICHAEL GIBBS
Managing Director of Equity
Portfolio & Technical Strategy

	SECTOR	S&P WEIGHT	TACTICAL COMMENTS
OVERWEIGHT	INFORMATION TECHNOLOGY	20.9%	We think the global macro environment and earnings expectations support a positive stance. However, the risk of heightened trade tensions could hamper many companies in the space. Additionally, a slight softening technical trend should have investors on alert. We expect 3Q earnings results along with management commentary will be important for this market leading sector. A healthy earnings season could suggest recent relative underperformance is likely to reverse. A disappointing quarter could lead to a continuation of declining relative strength trends.
	HEALTH CARE	15.0%	Improving technical trends are supported by decent fundamentals and acceptable valuation. Upside to earnings in 2Q encourages us that more upside may remain in coming quarters. Valuation is mixed, with PEG one standard deviation above the 15-year average while P/E is well below the 15-year average. The continuation of an improving technical trend reinforces our Overweight opinion.
	INDUSTRIALS	9.7%	We think fundamental trends and valuation levels are attractive. Technical trends are attempting to improve. There is a risk of negative fundamentals and sentiment if the U.S. dollar resumes its climb. Additional risk would develop if the U.S. and Canada fail to reach a trade agreement. Despite the highlighted risks, current economic conditions along with attractive fundamentals and valuation justify an Overweight position, in our view.
	ENERGY	6.0%	We remain positive on the energy sector given the Raymond James Energy Team's bullish outlook for global supply and demand of crude. Short term, crude prices rallied due to bullish headlines out of OPEC. The rally has crude and the energy sector near the high of a trading range in place for six months. If price can push to a new high, we expect technical buying to extend the rally.
EQUAL WEIGHT	FINANCIALS	13.5%	We are moving to Equal Weight, influenced by the tight correlation of the yield curve spread and price movement of the sector that has developed this year. With the Fed raising the short end of the curve, lower global yields, and moderate inflation holding longer yields down, the odds seem high for a continuation of a flattening yield curve. Until the correlation of financial stock prices and the 2/10 year spread is broken, we are forced to focus on the yield spread. Sluggish technical trading trends also influence this change of opinion.
	CONSUMER DISCRETIONARY	10.3%	The sector lost visible members such as CMCSA, ATVI, DIS, CHTR, and NFLX to the new Communications Service sector. Sector heavy weight AMZN remains. Fundamental trends for this consumer-oriented sector are healthy with the U.S. consumer benefiting from robust job market conditions. Earnings growth expectations in the upper teens (2018) and low double digits (2019) reflect the positive environment. Investors recognize the sector tailwinds with valuations at elevated levels.
	COMMUNICATION SERVICES	10.0%	We are Equal Weight on the new Communications Services sector. Projected earnings growth for the new sector is expected to be in line (2018) to slightly better (2019) than the overall market. Nonetheless, weakening technical trends for key members of the index in recent months along with growing attention to the companies' business practices by government authorities keep us equal weight. Although any government action, should it occur, would likely take a long time to transpire, we believe the stocks may experience a short-term overhang with the topic drawing media attention.
UNDERWEIGHT	CONSUMER STAPLES	6.7%	Forward-looking earnings continue to move lower for this fundamentally challenged sector. After a period of price underperformance, valuation is attractive on some measures. However, valuation is less enticing with P/E to Growth (PEG) over one standard deviation above the 15-year relative average (vs. S&P 500). Technical price momentum is building, but relative to the overall market, the improvement is less favorable.
	UTILITIES	2.8%	The sector's negative sensitivity to rising interest rates influences our Underweight view with the Fed raising rates. Expectations of earnings growth in 2019 (4% and falling) is well below expectations for the S&P 500 (+9%) and solidifies our stance.
	REAL ESTATE	2.6%	Rising bond yields influenced a sharp pullback in prices over recent days and disrupted what had been an improving trend. With rates likely to trend higher with the Fed raising rates, we are comfortable with our Underweight view of this interest-sensitive sector. Valuation is somewhat attractive, but with modest earnings growth expectations vs. the overall market, valuation becomes less appealing.
	MATERIALS	2.5%	Moderating earnings expectations for 2019 and weak technical trading trends overrule somewhat attractive valuation measures to influence our Underweight opinion.

ASSET CLASS DEFINITIONS

U.S. Mid Cap Equity: Russell Midcap Index: A subset of the Russell 1000 index, the Russell Midcap index measures the performance of the mid-cap segment of the U.S. equity universe. Based on a combination of their market cap and current index membership, includes approximately 800 of the smallest securities which represents approximately 27% of the total market capitalization of the Russell 1000 companies. The index is created to provide a full and unbiased indicator of the mid-cap segment.

U.S. Small Cap Equity: Russell 2000 Index: The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The Russell 2000 Index is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

U.S. Large Cap Blend: The Russell 1000 Index. An index of approximately 1,000 of the largest companies in the U.S. equity market. The Russell 1000 is a subset of the Russell 3000 Index. It represents the top companies by market capitalization. The Russell 1000 typically comprises approximately 90% of the total market capitalization of all listed U.S. stocks. It is considered a bellwether index for large cap investing.

U.S. Large Cap Growth: The Russell 1000 Growth Index. A composite that includes large and mid-cap companies located in the United States that also exhibit a growth probability. The Russell 1000 Growth is published and maintained by FTSE Russell.

U.S. Large Cap Value: The Russell 1000 Value Index. A composite of large and mid-cap companies located in the United States that also exhibit a value probability. The Russell 1000 Value is published and maintained by FTSE Russell.

Non U.S. Developed Market Equity: MSCI EAFE: This index is a free float-adjusted market capitalization index that measures the performance of developed market equities, excluding the U.S. and Canada. It consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

Non U.S. Emerging Market Equity: MSCI Emerging Markets Index: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of December 31, 2010, the MSCI Emerging Markets Index consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.

Investment Grade Long Maturity Fixed Income: Barclays Long US Government/Credit: The long component of the Barclays Capital Government/Credit Index with securities in the maturity range from 10 years or more.

Investment Grade Intermediate Maturity Fixed Income: Barclays US Aggregate Bond Index: This index is a broad fixed income index that includes all issues in the Government/Credit Index and mortgage-backed debt securities. Maturities range from 1 to 30 years with an average maturity of nearly 5 years.

Investment Grade Short Maturity Fixed Income: Barclays Govt/Credit 1-3 Year: The component of the Barclays Capital Government/Credit Index with securities in the maturity range from 1 up to (but not including) 3 years.

Non-Investment Grade Fixed Income (High Yield): Barclays US Corporate High Yield Index: Covers the universe of fixed rate, non-investment grade debt which includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors. The index also includes Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1,

2009) are also included. Must publicly issued, dollar-denominated and non-convertible, fixed rate (may carry a coupon that steps up or changes according to a predetermined schedule, and be rated high-yield (Ba1 or BB+ or lower) by at least two of the following: Moody's, S&P, Fitch. Also, must have an outstanding par value of at least \$150 million and regardless of call features have at least one year to final maturity.

Multi-Sector Fixed Income: The index for the multi-sector bond asset class is composed of one-third the Barclays Aggregate US Bond Index, a broad fixed income index that includes all issues in the Government/Credit Index and mortgage-backed debt securities; maturities range from 1 to 30 years with an average maturity of nearly 5 years, one-third the Barclays US Corporate High Yield Index which covers the universe of fixed rate, non-investment grade debt and includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors and one-third the J.P. Morgan EMBI Global Diversified Index, an unmanaged index of debt instruments of 50 emerging countries.

The Multi-Sector Fixed Income category also includes nontraditional bond funds. Nontraditional bond funds pursue strategies divergent in one or more ways from conventional practice in the broader bond-fund universe. These funds have more flexibility to invest tactically across a wide swath of individual sectors, including high-yield and foreign debt, and typically with very large allocations. These funds typically have broad freedom to manage interest-rate sensitivity, but attempt to tactically manage those exposures in order to minimize volatility. Funds within this category often will use credit default swaps and other fixed income derivatives to a significant level within their portfolios.

Alternatives Investment: HFRI Fund of Funds Index: The index only contains fund of funds, which invest with multiple managers through funds or managed accounts. It is an equal-weighted index, which includes over 650 domestic and offshore funds that have at least \$50 million under management or have been actively trading for at least 12 months. All funds report assets in US Dollar, and Net of All Fees returns which are on a monthly basis.

Cash & Cash Alternatives: Citigroup 3 Month US Treasury Bill: A market value-weighted index of public obligations of the U.S. Treasury with maturities of 3 months.

KEY TERMS

Long/Short Equity: Long/short equity managers typically take both long and short positions in equity markets. The ability to vary market exposure may provide a long/short manager with the opportunity to express either a bullish or bearish view, and to potentially mitigate risk during difficult times.

Global Macro: Hedge funds employing a global macro approach take positions in financial derivatives and other securities on the basis of movements in global financial markets. The strategies are typically based on forecasts and analyses of interest rate trends, movements in the general flow of funds, political changes, government policies, inter-government relations, and other broad systemic factors.

Multi-Strategy: Engage in a broad range of investment strategies, including but not limited to long/short equity, global macro, merger arbitrage, statistical arbitrage, structured credit, and event-driven strategies. The funds have the ability to dynamically shift capital among the various sub-strategies, seeking the greatest perceived risk/reward opportunities at any given time.

Event-Driven: Event-driven managers typically focus on company-specific events. Examples of such events include mergers, acquisitions, bankruptcies, reorganizations, spin-offs and other events that could be considered to offer "catalyst driven" investment opportunities. These managers will primarily trade equities and bonds.

Market Neutral: A hedge fund strategy that seeks to exploit differences in stock prices by being long and short in stocks within the same sector, industry, market capitalization, country, etc. This strategy creates a hedge against market factors.

Managed Futures: Managed futures strategies trade in a variety of global markets, attempting to identify and profit from rising or falling trends that develop in these markets. Markets that are traded often include financials (interest rates, stock indices and currencies), as well as commodities (energy, metals and agricultural).

INDEX DEFINITIONS

Barclays U.S. Aggregate Bond Index: A broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. Securities must be rated investment-grade or higher using the middle rating of Moody's, S&P and Fitch. When a rating from only two agencies is available, the lower is used. Information on this index is available at INDEX-US@BARCLAYS.COM.

DISCLOSURE

All expressions of opinion reflect the judgment of Raymond James & Associates, Inc. and are subject to change. Past performance may not be indicative of future results. There is no assurance any of the trends mentioned will continue or forecasts will occur. The performance mentioned does not include fees and charges which would reduce an investor's return. Dividends are not guaranteed and will fluctuate. Investing involves risk including the possible loss of capital. Asset allocation and diversification do not guarantee a profit nor protect against loss. Investing in certain sectors may involve additional risks and may not be appropriate for all investors.

International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility. Investing in emerging and frontier markets can be riskier than investing in well-established foreign markets.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.

U.S. government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the U.S. government.

While interest on municipal bonds is generally exempt from federal income tax, they may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

If bonds are sold prior to maturity, the proceeds may be more or less than original cost. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revisions, suspension, reduction or withdrawal at any time by the assigning rating agency.

Commodities and currencies are generally considered speculative because of the significant potential for investment loss. They are volatile investments and should only form a small part of a diversified portfolio. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Investing in REITs can be subject to declines in the value of real estate. Economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of your portfolio.

Beta compares volatility of a security with an index. Alpha is a measure of performance on a risk-adjusted basis.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

The companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

The performance mentioned does not include fees and charges which would reduce an investor's returns. The indexes are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities. The Shanghai Composite Index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

MODEL DEFINITIONS

Conservative Portfolio: may be appropriate for investors with long-term income distribution needs who are sensitive to short-term losses yet want to achieve some capital appreciation. The equity portion of this portfolio generates capital appreciation, which is appropriate for investors who are sensitive to the effects of market fluctuation but need to sustain purchasing power. This portfolio, which has a higher weighting in bonds than in stocks, seeks to keep investors ahead of the effects of inflation with an eye toward maintaining principal stability.

Moderate Conservative Portfolio: may be appropriate for investors with intermediate-term time horizons who are sensitive to short-term losses yet want to participate in the long-term growth of the financial markets. The portfolio, which has an equal weighting in stocks and bonds, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. The portfolio has return and short-term loss characteristics that may deliver returns lower than that of the broader market with lower levels of risk and volatility.

Moderate Portfolio: may be appropriate for investors with intermediate-term time horizons who are sensitive to short-term losses yet want to participate in the long-term growth of the financial markets. This portfolio, which has a higher weighting in stocks, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. The portfolio has return and short-term loss characteristics that may deliver returns lower than that of the broader equity market with lower levels of risk and volatility.

Moderate Growth Portfolio: may be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which has a higher weighting in stocks seeks to keep investors well ahead of the effects of inflation with principal stability as a secondary consideration. The portfolio has return and short-term loss characteristics that may deliver returns slightly lower than that of the broader equity market with slightly lower levels of risk and volatility.

Growth Portfolio: may be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which has 100% in stocks, seeks to keep investors well ahead of the effects of inflation with little regard for maintaining principal stability. The portfolio has return and short-term loss characteristics that may deliver returns comparable to those of the broader equity market with similar levels of risk and volatility.

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