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INVESTMENT STRATEGY QUARTERLY

Squaring Off: A High-Stakes Global Game
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RAYMOND JAMES

INVESTMENT STRATEGY COMMITTEE MEETING RECAP – HELD ON JUNE 4, 2018

Major macro factors affecting the economy and financial markets over the next six to twelve months include trade policy, interest rates, earnings growth, Federal Reserve (Fed) policy, and geopolitical uncertainty.

U.S. ECONOMY

Approximately 95% of the committee is neutral (2.3%) to somewhat positive (2.4 – 3.0%) on real GDP growth over the next six to twelve months.

- "We began the year with two key themes: strong momentum at the start of the year, and greater uncertainty in the second half. Growth is still trending beyond a sustainable rate over the long term. We know that because the unemployment rate is falling."
- "The Fed is trying for a soft landing, a task that has been difficult to achieve in the past. The Fed believes if they don't act soon enough, there will be more work to do later on. They are likely to raise rates until the economy shows definitive signs of slowing to a more sustainable pace."
- "For market participants, trade policy concerns are expected to continue. Increased tariffs raise costs for U.S. consumers and businesses, disrupt supply chains, invite retaliatory tariffs, and undermine global fixed investment."

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

- "We've had a pretty active month here in D.C., as Congress finally passed (and the president signed into law) the bank deregulatory bill. Following that, we've had trade noise. We continue to believe that this is more in the negotiating tactics, but it is absolutely going to add to volatility."
- "We are also watching the potential investment restrictions on China. Those are set to go into effect or be announced on June 30. They're holding this over China, saying, 'Hey, cut a deal, or we're really going to get pretty nasty.' The car tariffs and steel and aluminum tariffs on Canada and Mexico are all about jump starting NAFTA."

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

U.S. EQUITY

87% of the committee is neutral to bullish on U.S. equities over the next six to twelve months.

- "This is a market for active management. You can't just buy anything and expect it to do well. You have to do a little extra research."
- "There's a lot that could go wrong, but, all things considered, the U.S. stock market seems to be hanging in there about as well as we can hope for. There's still a lot going right."
- "Investors seem to be looking in very growth-oriented areas and less so in more interest-rate sensitive and defensive areas of the market, as you would expect with rising rates."
- "We're in a sideways pattern. I think it's the result of what's happening in Washington with protectionism as the administration flip-flops one day to the next as they negotiate."

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

- "There is plenty of room to expand CAPEX with cash flow strong and companies liquid with repatriated cash. Projected CAPEX spending plans have increased markedly this year, but, in general, spending has been tepid during the current economic expansion. The lack of investment may not bode well for earnings further down the road given that spending today fuels the earnings of tomorrow."
- "The underpinnings of this bull market appear fine. The global economy is growing. Earnings are advancing at a healthy clip. Technically, small caps are at a new high, and semi-conductors and transports are trading well. Despite solid underpinnings, I feel the S&P 500 is likely stuck in a trading range until the trade battle plays out. Unfortunately, the battle may continue for several more months."

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

- "Earnings growth this quarter was stellar by all accounts: 9.5% sales growth and 25% earnings growth. Yet, all people want to talk about is peak earnings. Late cycle, it is highly unlikely we will get stronger earnings growth than this, but 'peak earnings growth' should not be confused with 'peak earnings.' Fundamental momentum is attractive, and earnings growth next year is expected to be ~10% (which would be better than the 2012-2016 period)."
- "Given the monetary policy environment, financial engineering has been common throughout this bull market instead of investing in CAPEX and growing organically. So, what you're seeing this year on the heels of tax reform is a pretty sharp increase in CAPEX."

  – **Joey Madere,** Senior Portfolio Strategist, Equity Portfolio & Technical Strategy

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

87% of the committee is neutral to bullish on non-U.S. developed market equities over the next six to twelve months.

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

- "Reform is the key in Europe and in the rest of the world, too. And last year it was all about positive reform surprise: Brexit wasn't as bad as people thought and the election of Macron in France seemed to be a good sign that progress would continue. We've seen a bit of a reversal in the last few months with the Italian elections resulting in a surprise coalition between a populist party and a slightly nationalistic party - traditionally on different sides of the political spectrum. It shows uncertainty and that people want change. Otherwise, the European Union as we know it will slowly fall apart."
- "While I still see huge European potential, I also see massive skepticism, both within Europe and in the international community. Meanwhile, thinking about global trade, the view from Europe is that ultimately a deal needs to be made. Both China and the U.S. have too much to lose from blowing up the world's trade group and it's the same for Europe."

U.S. FIXED INCOME

Approximately 70% of the committee expects the 10-year U.S. Treasury yield to be about the same (2.9%) six months from now.

- "Credit is definitely extended in my opinion. Corporate bond spreads are at all-time lows if you take into account that roughly 70% of the investment-grade universe is now triple B rated. So, when we look at the income and yield space, I still favor agnostic capital structure approaches for income investment from a product design standpoint."
- "Short to intermediate bonds, including Treasuries, now yield more than the broad equity market. These are the best options in pure fixed income investment."
- "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*

- "We still have this interesting phenomenon where the Fed is moving in the opposite direction of most central banks around the world. It's also moving in the opposite direction of the administration, which is doing everything it can to promote growth, while you have the Fed calming growth with steady rate hikes."

– Doug Drabik, Senior Strategist, Fixed Income

- "As long as we have strong demand for our Treasury bonds and global rate disparity continues, we expect long-term rates to stay range bound - maybe creep up - but at a very slow pace."
- "Demographics also place pressure on rates. The baby boom generation is massive. If we can get to 4% or 5% tax free, those buyers have a lot of money to pour into those markets to meet their retirement income goals. Right now, a lot of that money's being put in other places."

– Nick Goetze, Managing Director, Fixed Income

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ECONOMIC SNAPSHOT

DR. SCOTT BROWN
Chief Economist,
Equity Research

Economic data reports have been consistent with a pickup in the pace of growth in 2Q18 (the advance GDP estimate is due, along with annual benchmark revisions, on July 27). Job growth has remained relatively strong, and labor market conditions have tightened further. The Federal Reserve (Fed) has continued to raise short-term interest rates, and further rate increases are expected (at a gradual pace) – as the Fed tries for a soft landing. Trade policy conflicts have intensified, adding risk and uncertainty to the outlook.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	GDP growth is expected to have picked up in 2Q18, but that partly reflects a rebound from a "soft" 1Q18. The pace of growth is likely to moderate in the second half of the year, partly reflecting labor market constraints.
FAVORABLE	EMPLOYMENT	Nonfarm payrolls have continued to rise at a moderately strong pace. The unemployment rate has fallen further. Shortages of skilled labor have been noted in a number of industries.
FAVORABLE	BUSINESS INVESTMENT	Sentiment remains strong, but business fixed investment is expected to be somewhat slower this year (despite corporate tax cuts).
FAVORABLE	HOUSING AND CONSTRUCTION	Builders continue to note supply constraints (lack of skilled labor, higher costs). Demand remains strong. Home prices have continued to rise, making affordability an important issue.
FAVORABLE	THE DOLLAR	Trade policy conflicts and concerns about global economic risks have led to a flight to safety.
NEUTRAL	CONSUMER SPENDING	Job gains, wage growth, and tax cuts have been supportive. Spending momentum picked up into early 2Q18. However, higher gasoline prices have reduced purchasing power relative to a year ago.
NEUTRAL	MANUFACTURING	New orders and production have been mixed, but the pace has been generally lackluster-to-moderate. Trade tariffs are a concern.
NEUTRAL	INFLATION	Increased tariffs will add to commodity price pressures. Wage gains are moderate. Consumer price inflation is closer to the Fed's goal.
NEUTRAL	MONETARY POLICY	Fed policy "remains accommodative" (according to the June 13 FOMC statement), but is close to neutral. The Fed is expected to raise rates further, partly in an attempt to move the unemployment rate higher.
NEUTRAL	LONG-TERM INTEREST RATES	A strengthening economy and increased government borrowing would normally send bond yields higher. However, trade policy concerns and geopolitical risks have led to a flight to safety.
NEUTRAL	FISCAL POLICY	Tax cuts and added spending are expected to provide support for the economy in the near term, but budget deficits are projected to be a lot higher and there's limited scope to counter a recession if needed.
NEUTRAL	REST OF THE WORLD	The global economic outlook was strong at the start of the year. However, supply chain disruptions and Fed rate increases have negative impacts on emerging economies. Italy and Brexit are concerns in Europe.

KEEP ON CARRYING ON

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

Following a stellar start to the year – with U.S. equities continuing their ascent from 2017 – a slew of 'not so stellar' headlines began to bombard global news feeds, impolitely reminding investors that equity markets are not risk free. In fact, they are far from it. Although equity risk has been around since the first stock exchange was formed, market participants spent much of this year getting reacquainted with the concept of downside risk.

There certainly was no shortage of market 'noise' contributing to the decline in positive sentiment. Stimulative fiscal policy is contending with tightening monetary policy in the U.S., incumbent governments throughout Europe are undergoing major transition, and geopolitical risks abound. Despite several significant price swings which have tested market support, equities have demonstrated remarkable resiliency thus far, and for good reason in the opinions of market pundits. As our Chief Investment Strategist Jeff Saut wrote in his June 14 *Morning Tack* commentary, "Our models show that there is plenty of 'internal energy' available to power the stock market to new all-time highs. The economy is strong, the labor market is tight, earnings are soaring, and folks remain under-invested … we continue to favor the upside."

As the aforementioned ambiguities pan out over the coming months (or years), it is likely to become more challenging for investors to 'keep calm and carry on.' However, given the favorable fundamental underpinnings of the markets, it is probable that we will indeed 'keep on carrying on' for some time.

Squaring Off: A High-Stakes Global Game

Chris Bailey, *European Strategist, Raymond James Euro Equities*,* provides an update on the state of geopolitical affairs around the globe, including developments in China and challenges facing the European economy.

If I cast my mind back to the start of the year, one of the words commonly used to describe the global outlook was 'Goldilocks' – an homage to the age old children's story reflecting a world where economies were anticipated to grow neither too fast nor too slow. Whilst headline economic growth rates have not particularly surprised, the same cannot be said about the broader global diplomatic and trade backdrop. Are such shifts a burgeoning threat to both the global economy and the world's major financial markets over the next year or two?

'G2' RELATIONS

The most powerful bilateral country-to-country relationship in the world today is between the United States and China, or 'G2' as many commentators have started to refer to it. China's singular focus on economic development over the past generation has achieved huge success. In more recent years, the Chinese have made efforts to broaden their global influence as well as their diplomatic and political roles. The recently launched Belt and Road Initiative, with the aim of creating a trade zone stretching from Western Europe back to Beijing (along with maritime trading routes to Africa and South America), is a clever move to curry favour and build economic and diplomatic friendships.

Normally, the new kid on the block would not be a concern or challenge to America's hegemony, but the heads of old allies are being turned by China's overtures. For emerging markets, often it is simply a question of basic economics: can more goods and services be exported to China or America over the next few years? For Europe, however, deeper, more existential issues are at work.

STRUGGLES IN EUROPE

Europe has generally struggled over the last decade with far lower average economic growth and financial market performance relative to the United States. The optimism felt 20 years ago about the potential of a single European currency has since been replaced by distrust and a lack of coordination. This has manifested itself in the UK's populace choosing to exit the European Union and, over the last year or so, ever-rising dissatisfaction with incumbent politicians. France elected a political high office novice, the long-standing German chancellor struggled to put a coalition government together, and Italy's recent inconclusive election raised the spectre of a more populist/nationalistic political leadership cadre.

> "It has been said that arguing against globalization is like arguing against the laws of gravity."
>
> **- Kofi Annan**

With Europe seemingly stuck in political and economic sclerosis, a range of emerging markets are progressively viewing an increasingly confident China as their natural economic partner. The more hard-nosed U.S. trade and diplomatic policies of recent months can either be viewed as a strategic masterclass to lengthen its global leadership epoch or a desperate attempt to stop an inevitable decline by any means possible. The on-off nature of talks with North Korea[1], the pulling away from global agreements with Iran, newly announced trade sanctions against Europe and China, and the extended NAFTA discussions have all made headlines in recent months. This is far from a classic 'Goldilocks' scenario.

WHAT'S NEXT?

So what happens next in this high-stakes game? Analysts of such scenarios often talk about 'credibility,' and both members of the exclusive 'G2' club have their strong positive points, as well as their Achilles' heels. America has to finance its fiscal deficit in order to keep the economic show on the road, and

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[1] North Korea - United States Summit was held on June 12, 2018

China needs relative global economic stability in order to continue its fairly seamless rapid development. A deal opening up China's domestic trade markets in exchange for a continued flood of U.S. Treasury purchases from the Middle Kingdom still remains the central and most likely outcome. However, there will be bumps in the road. In addition, in terms of long-game players, few have the foresight and focus of the Chinese.

This latter point is manifest in recent Chinese opportunism, which has paved the way to closer relationships with Russia and Iran over recent months. This is more complex than 'my enemy's enemy is my friend.' Instead, it reflects a growing pragmatism in Chinese diplomatic and trade decision making, as Russia and Iran both offer significant commodity supply potential. President Xi's January 2017 Davos speech extolling free trade is still receiving plaudits, most notably in Western Europe. Looking at a map of the world, the reasons for this start to become more obvious. The potential for Europe's economies to gain dynamic trade benefits from China remain clear, and, given the region's continued troubled backdrop, getting closer to the Chinese rather than the U.S. orbit has grown more attractive. The coordinated negative reaction by Europe, Russia, and China to the U.S. pulling out of the Iranian deal highlights an ever-closer working relationship.

HIGH STAKES

However, greater coordination is no panacea. A slow slide into a period of disruptions to global trade and diplomatic disagreements with the U.S. is highly likely to be a lose-lose for all involved. It is far better to keep full interaction with the world's number one economy today whilst pushing domestic change and reform initiatives. In Europe, planning for a lengthy Brexit transition period and measures to make the entire European economy more dynamic should continue to be top priorities. Despite all the negative headlines, this is still within the grasp of Europe's policymakers. Recent weeks have seen progress in forming the basis of a more extensive regional redistribution budgetary strategy. This is likely to be one carrot offered to the lagging Southern European countries to implement structural reforms that make labour markets more flexible and encourage risk-taking and entrepreneurship. The scope for further progress in developing China's economy continues apace, as the domestic change initiatives to encourage greater individual consumption are unveiled.

Of course, such arguments in favour of change, reform, and pragmatism apply to the United States as well. Globally, it is a time for a firm debate with calm heads. The stakes could not be higher.

THE GAME OF GLOBAL HEGEMONY

As nations vie for supremacy around the world, the U.S. continues to lead with China close behind in lockstep.

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Squaring Off: A High-Stakes Global Game (cont.)

KEY TAKEAWAYS:

- China's singular focus on economic development over the past generation has achieved huge success. In more recent years, the Chinese have made efforts to broaden their global influence as well as their diplomatic and political roles.
- America has to finance its fiscal deficit in order to keep the economic show on the road, and China needs relative global economic stability in order to continue its fairly seamless rapid development.
- In Europe, planning for a lengthy Brexit transition period and measures to make the entire European economy more dynamic should continue to be top priorities. Despite all the negative headlines, this is still within the grasp of Europe's policymakers.
- It is far better to keep full interaction with the world's number one economy today whilst pushing domestic change and reform initiatives.

International Investing: Opportunities and Considerations

Nicholas Lacy, CFA, *Chief Portfolio Strategist, Asset Management Services,* assesses the benefits and challenges of international investing.

With the U.S. representing roughly half of the global equity market, looking beyond America's borders is essential when identifying valuable investment opportunities that may offer diversification benefits. That said, one must carefully weigh the implications of adding foreign exposure to a portfolio.

COUNTRY EXPOSURE: THE MSCI ALL COUNTRY WORLD INDEX

Non-U.S. developed market equities should present opportunities over the next several years as many of these countries are in the earlier stages of the market cycle relative to the U.S. In other words, there is still plenty of room for these companies to run as favorable market fundamentals, strong economic conditions, and solid earnings growth expectations present tailwinds going forward. Investments in European and Japanese equities should continue to be supported by accommodative central bank policies, improving labor conditions, and economic growth.

However, as a note of caution, near-term volatility is possible in many of these markets, particularly in Europe. Investors should watch both policies and geopolitical events closely as potential trade disruptions and shifting political views could cause increased uncertainty in the short run. Still, these markets are poised to flourish on a longer-term basis and remain favorable in our opinion.

Another important factor to consider when investing abroad is foreign exchange risk, or the risk of currency fluctuations negatively impacting U.S. dollar-denominated investments. With the dollar expected to continue on an upward trend, (despite the possibility of a near-term pullback) international returns would be eroded by the subsequent depreciation of foreign currencies against the dollar. Exchange rates can be extremely difficult to predict, so the path of the dollar remains a wild card for international investments going forward.

Corporate Earnings: The Fuel that Powers the Stock Market

Andrew Adams, CFA, CMT, *Senior Research Associate, Equity Research,* examines the current headwinds and tailwinds facing U.S. equities in the wake of high earnings growth.

Typically, when a company's earnings rise above the market's expectations over time, the price of its shares follows a similar path higher. And when this kind of better-than-expected earnings growth occurs across the majority of publicly traded companies, a bull market is often the result. A similar environment has been in place since the end of the 2008 financial crisis, with notable improvements in both the pace and quality of earnings growth occurring over the past two years.

AN EARNINGS-DRIVEN BULL MARKET

This positive backdrop for businesses has been consistent with one of our major themes since 2016: An improving economy should transition the interest-rate and stimulus-dependent market to an earnings-driven secular bull market. Data confirm that both the U.S. economy and corporate earnings improved over this time period, which produced one of the best years on record for the stock market in 2017. The positive trend in profits does not appear to be slowing down. Twelve-month S&P 500 operating earnings growth hit its highest level since 2011 in the first quarter of this year and is projected to be even better over the next two quarters, according to consensus analyst estimates from Standard & Poor's (as of June 1). On the surface, this rosy outlook bodes well for the future, but sky high expectations have led many pundits to wonder just how much better things can get.

> "Data confirm that both the U.S. economy and corporate earnings improved over this time period, which produced one of the best years on record for the stock market in 2017."

A PAUSE IN THE ASCENT

Indeed, investors mostly scoffed at the high percentage of top and bottom line beats and impressive growth during the first quarter earnings season, a possible sign that optimistic sentiment had already priced in better profits. However, to be fair, after such a remarkable price ascent over the previous two years, including a 7.5% gain for the S&P 500 in the first few weeks of January, some sort of meaningful pause in the market was likely in order.

CRUISE CONTROL

Measuring the pace of earnings growth

Source: FactSet as of 06/18/2018

Corporate Earnings: The Fuel that Powers the Stock Market (cont.)

There has also been no shortage of headlines regarding global trade, rising input costs, tension with North Korea, and potential political landmines both in the U.S. and Europe to further discourage investors from committing capital to stocks, despite the healthy earnings landscape. However, the clear pickup in uncertainty as a result of these potential headwinds could go a long way toward lowering investor expectations for the market in the months to come, setting the stage for upside surprise potential if things do not deteriorate the way many fear they will.

> "Since the end of the financial crisis, economic growth in the U.S. has largely been attributed to additions in the labor market, as the unemployment rate has steadily decreased since 2008."

To be sure, the pace of earnings growth should slow down in future quarters. However, we believe the market understands this and does not expect 20% earnings growth to continue indefinitely. There is also a big difference between the pace of growth slowing and negative earnings growth. Even if S&P 500 operating earnings 'only' grow at 10% (the rate currently estimated for the end of 2019) instead of the more impressive pace seen in the first quarter of this year, it is still a very healthy growth rate that we believe can sustain the secular bull market. In fact, S&P 500 12-month operating earnings have grown at an average of 7.7% since 1990, so growth at a 10% clip would still be better than the recent historical average.

FUTURE DRIVERS OF GROWTH

So, what can help keep the economic and earnings expansion going? Economic growth is generally defined as an increase in the real value of products and services produced over time. In simplest terms, this growth occurs because more workers become employed and/or existing workers become more productive. Since the end of the financial crisis, economic growth in the U.S. has largely been attributed to additions in the labor market, as the unemployment rate has steadily decreased since 2008. However, productivity growth has not been nearly as impressive and will become more of an issue now that the labor pool has shrunk. It is unlikely that the U.S. will continue to add workers at the same pace of the past few years, which means companies will instead have to focus on productivity growth to keep the wheels turning.

TAX REFORM: A WILD CARD

Last year, Washington bet heavily that lowering taxes, particularly on corporations, would lead to more business investment, higher wages, and, in turn, better productivity and higher consumer spending. Perhaps, more than anything else, what companies decide to do with their tax bill-boosted cash balances will determine how the U.S. economy performs in the years ahead. If companies invest wisely in projects and M&A activities that will grow their businesses, and if wage increases translate into more consumer spending, the economy has the potential not only to keep growing, but maybe even grow at a faster pace.

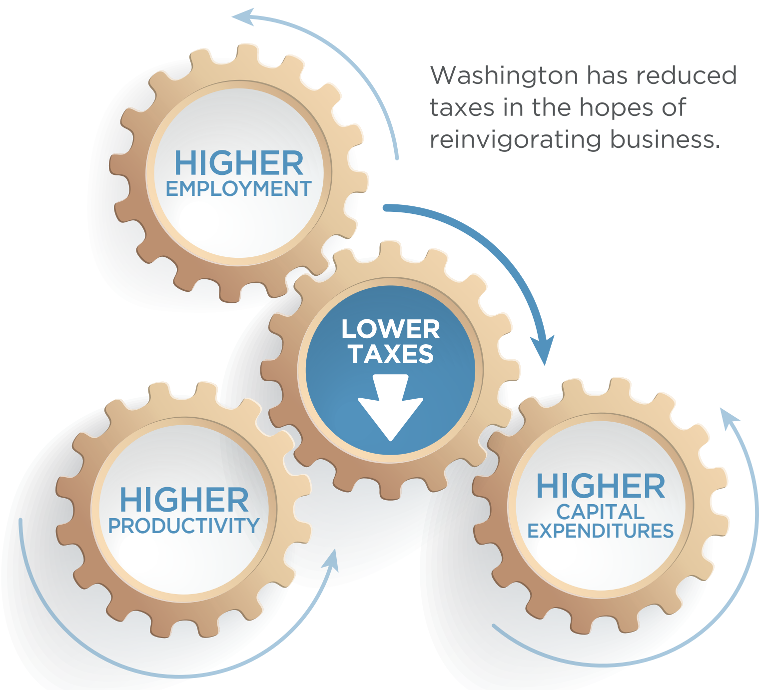
Many critics of the tax bill, however, have voiced concern that any tax savings may be merely passed on to shareholders in the form of share buybacks and increased dividends, and we do expect these options to remain popular among companies. Buybacks, in particular, draw the wrath of many individuals. It is true that a disproportionate amount of tax savings going toward share buybacks will not generate the long-term economic growth that investments in capital can. Still, keep in mind that buying back shares does help increase earnings per share and can be an attractive alternative for companies that do not feel they can generate high returns on internal or external investments.

WILL THE TREND CONTINUE?

Investors are still gathering evidence of what companies are doing with their excess cash, but preliminary signs show some pickup in both business investment and wages. According to Strategas Research Partners, capital expenditures in the first quarter of this year among S&P 500 companies increased 21% over the first quarter of 2017, after falling in the first quarter the previous two years. Moreover, the second estimate of first quarter real gross domestic product (GDP) and the May employment report show that fixed business

GREASING THE GEARS: EFFECTS OF LOWER TAXES

Washington has reduced taxes in the hopes of reinvigorating business.



investment and average hourly earnings grew slightly above consensus estimates. However, it is too early to tell if these trends are likely to continue, especially with respect to capital expenditures since many companies may have simply put off making investments until the new year in order to take advantage of the tax incentives that were included in the bill.

Early evidence is promising, but we will need to watch these metrics closely in the coming months to see if companies are investing in the future and making productivity improvements a priority. If so, it will increase the chances of continued economic expansion while helping the stock market combat rising input costs and the higher expectations of today's investors.

"Early evidence is promising, but we will need to watch these metrics closely in the coming months to see if companies are investing in the future and making productivity improvements a priority."

KEY TAKEAWAYS:

- The pace of earnings growth should slow down in future quarters, but we believe the market understands this and does not expect 20% earnings growth to continue indefinitely.
- It is unlikely that the U.S. will continue to add workers at the same pace of the past few years, which means companies will have to focus instead on productivity growth to keep the wheels turning.
- Investors are still gathering evidence of what companies are doing with their excess cash, but preliminary signs show some pickup in both business investment and wages.
- Investing in the future and improving productivity will increase the chances of continued economic expansion while helping the stock market combat rising input costs and higher expectations of today's investors.

Mid-Year Economic Outlook: The Fed's Balancing Act

Scott Brown, Ph.D., *Chief Economist, Equity Research,* analyzes the current state of the U.S. economy, its labor force, as well as the challenges facing the Federal Reserve and its policymaking.

The year began with two key themes. The first was that the economy had considerable momentum in late 2017, which likely would continue into early 2018. The second was that the outlook would grow more clouded beyond the middle of the year, reflecting the uncertainty around tax cuts, demographic constraints, and tighter Federal Reserve (Fed) policy.

We can now add the uncertainty around trade policy to this list of themes as talks on tariffs and a retaliatory backlash threaten to disrupt current trade agreements around the world. The key to our outlook is the Fed's balancing act, as it attempts 'a soft landing,' where growth slows to a long-term sustainable pace.

U.S. ECONOMY: AT A GLANCE

The U.S. economy continued to expand at a moderate rate in the first half of 2018, although growth was a bit uneven across sectors. The underlying fundamentals of the economy remain sound.

Consumer spending has been supported by job growth, though higher gasoline prices limited purchasing power to some extent. Nominal wage growth has been moderate, yet inflation-adjusted wages rose only modestly year-over-year.

Business fixed investment remained strong, but has been boosted partly by the further recovery in energy exploration (which is capital intensive). Corporate tax cuts do not appear to have fueled a significant pickup in the pace of capital spending this year. However, business investment growth has been moderate and year-over-year gains are quite strong.

Residential homebuilding has been choppy, yet reflected year-over-year strength. Higher mortgage rates have been a minor drawback, but strong housing demand and supply constraints further boosted home prices, hurting affordability.

CHALLENGES AHEAD

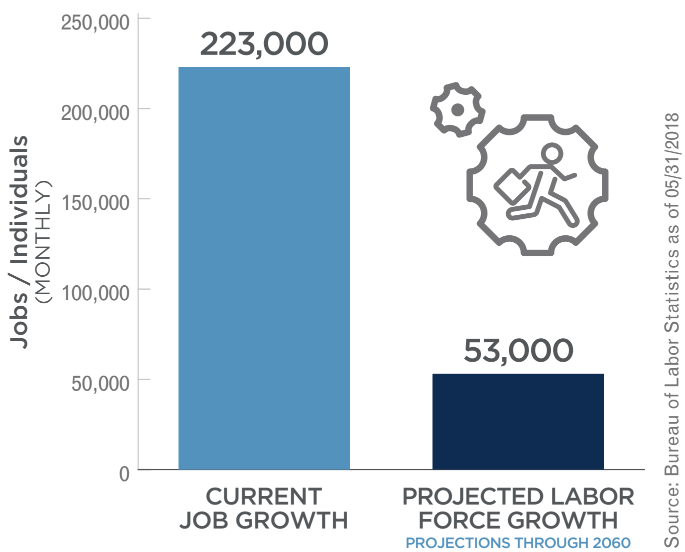
The expansion is now the second longest on record and there are no signs of a recession on the immediate horizon. However, there are some challenges for the second half of the year.

> "The U.S. economy continued to expand at a moderate rate in the first half of 2018, although growth was a bit uneven across sectors. The underlying fundamentals of the economy remain sound."

Gains in nonfarm payrolls were somewhat stronger in the first half of the year. Yet, the trend was not much different than that of the last couple of years. Job growth remains beyond a long-term sustainable pace. The unemployment rate has fallen further and measures of underemployment have decreased. That is okay in the short term, as slack continues to be reduced. However, the retirement of the baby boomers is reducing labor force growth, and demographic constraints will lead to a slower pace of job gains in the future.

Productivity growth may be picking up a bit, but the trend appears to remain relatively lackluster (a worldwide problem, not unique to the U.S.). Taken together, the slower pace of labor force growth and the soft trend in productivity growth imply that a sustainable long-term rate of growth in real gross domestic product would be a little less than 2% per year. Over time, we need less than 100,000 net new jobs per month to absorb new entrants into the workforce; job growth has been trending well beyond that, and this cannot go on forever.

DISEQUILIBRIUM: THE FUTURE OF THE U.S. LABOR MARKET



Inflation ticked up in the first half of 2018, though not by a lot. Commodity price pressures generally moderated since the early part of the year, and the stronger dollar should help. However, tariffs raised the cost of steel and aluminum, and we have seen increases in oil, lumber, and cement prices as a result.

THE LABOR MARKET AND INFLATION

Since every firm employs workers, the labor market is the widest channel for inflation pressure. The tight job market led to worker shortages in a number of skilled labor positions. Wage growth for these jobs picked up, but overall wage gains remain relatively moderate. Firms responded to labor shortages by offering signing bonuses and increasing perks (such as time off).

Left unchecked, continued strength in the job market could lead to a reallocation of labor amid higher wages, boosting

> "Fed policymakers recognize that there will be more work to do later if they do not raise short-term interest rates soon enough."

productivity growth, increasing in-house worker training, and further reducing underemployment. However, we could also see higher consumer price inflation if productivity does not increase and firms are able to pass higher costs along. The unemployment rate may fall further, leaving policymakers to move more aggressively down the line. This is the Federal Reserve's dilemma.

THE FEDERAL RESERVE

While the U.S. central bank experienced a number of personnel changes this year – including the appointment of Jerome "Jay" Powell as chair and a more hawkish policy tilt than last year – the underlying approach to monetary policy is the same as it was under Janet Yellen. Fed policymakers recognize that there will be more work to do later if they do not raise short-term interest rates soon enough. In a late-cycle economy, the risks of a monetary policy error naturally rise.

Individual Fed officials have different expectations regarding the future path of short-term interest rates, but policy decisions will remain "data dependent." A continued trend of low to moderate inflation should allow the Fed to raise short-term interest rates gradually.

There are a number of uncertainties in the Fed's economic outlook, including the impact of fiscal and trade policy, and we can expect policymakers to adjust their expectations as more information becomes available. Still, the most likely scenario is that we will get a 25-basis point increase in short-term interest rates each quarter until the economy shows

Mid-Year Economic Outlook: The Fed's Balancing Act (cont.)

more definitive signs of arriving at a more sustainable pace of growth, or if we get a major external shock (such as the three hurricanes experienced in the third quarter of 2017).

MONETARY POLICY: TAPPING THE BRAKES

In recent years, increases in short-term interest rates were about getting monetary policy back to neutral. Going forward, policy will be about tapping the brakes. Minutes of the March Federal Open Market Committee (FOMC) meeting suggested that several officials thought that it might be appropriate at some point to raise the federal funds rate above a neutral level for a period to get the economy on a more even keel (and, implicitly, the unemployment rate back up).

The likelihood of entering a recession does not depend on the length of the expansion. Economic expansions never die out on their own. Downturns are often associated with sharp increases in oil prices, but Fed policy is the usual catalyst. The Fed typically inverts the yield curve by raising short-term interest rates either too early or too late in the cycle. There is little risk of the U.S. economy entering a recession this year, though the odds are higher as we look to next year, reflecting the possibility of a monetary policy error.

THE TRADE IMBROGLIO

Candidate Trump campaigned on a platform that included calls for protectionist trade measures. Most observers thought that this was merely an election-year ploy, which President Trump would abandon once in office. In contrast, a misstep on trade policy has been a significant risk from the beginning. Recall that a trade agreement requires congressional approval. However, the president can, by himself, pull the U.S. out of existing trade treaties, including the North American Free Trade Agreement (NAFTA). Trump nearly pulled us out of NAFTA, essentially on a whim, on Day 100, but was talked out of it at the last minute by the leaders of Canada and Mexico. The decision to impose tariffs on imported steel and aluminum and letting the exemptions for our key allies lapse – including those for Canada, Mexico, and the European Union – increased trade tensions and engendered economic uncertainty. In an unprecedented move, G7 finance ministers and central bankers formally rebuked the U.S. for "undermining open trade and confidence in the global economy" in early June.

> "Financial market participants generally believe that this is all a negotiating tactic and the end result will be some minor tweaks to current trade agreements, which will avoid more substantial trade disruptions."

Increased tariffs do little to save American jobs. Any job gains for steel and aluminum workers will be more than offset by job losses in industries that use these inputs. Increased tariffs are a tax on U.S. consumers and businesses. They raise input costs, invite retaliatory tariffs against U.S. exports, risk a broader trade war, disrupt supply chains, and increase uncertainty for global investment.

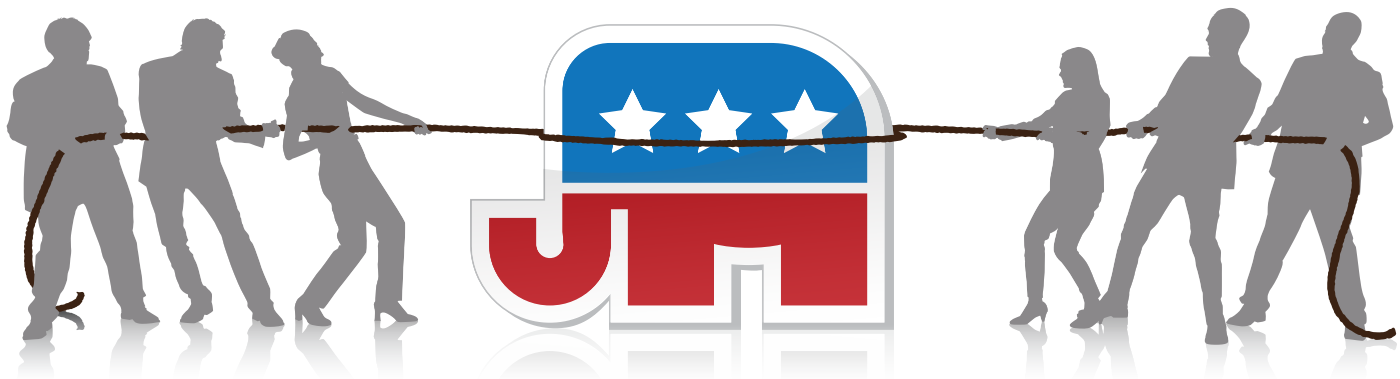
Financial market participants generally believe that this is all a negotiating tactic and the end result will be some minor tweaks to current trade agreements, which will avoid more substantial trade disruptions. However, there are downside risks. White House officials are divided. Some insist that this is simply a renegotiation among friendly countries, while others see tariffs as a tool to rebalance trade. Nobody really knows how the trade conflict will end. Investors reacted negatively to protectionist efforts, but positively to signs that they may be rolled back. We can expect this back and forth to continue, adding to financial market volatility.

A DIVIDED PARTY

The split between free traders and protectionists has divided the Republican Party. Disagreements between mainstream Republicans, who support free trade, and Trump supporters,

PROTECTIONISM: A POLITICAL PREDICAMENT

Doctrinal divisions have created a debacle amongst Republicans, causing free traders to clash with protectionists.



> "The near-term economic outlook remains optimistic."

who favor trade restrictions, likely will be difficult to manage as we head toward November's election. Democrats may flip the House, but gaining control of the Senate will be more difficult, as Democrats are defending more seats this year.

Weighing all these uncertainties will make the Fed's task of achieving a soft landing even more difficult, and the risks of a policy error are rising. However, the near-term economic outlook remains optimistic.

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. Commodities are generally considered speculative because of the significant potential for investment loss. The yield curve is a graphic depiction of the relationship between the yield on bonds of the same credit quality but different maturities. Past performance may not be indicative of future results.

KEY TAKEAWAYS:

- The key to our outlook is the Fed's balancing act, as it attempts 'a soft landing,' where growth slows to a long-term sustainable pace.
- The expansion is now the second longest on record and there are no signs of a recession on the immediate horizon. However, there are some challenges for the second half of the year.
- There is little risk of the U.S. economy entering a recession this year, but the odds are higher as we look to next year, reflecting the possibility of a monetary policy error.
- Weighing all these uncertainties will make the Fed's task of achieving a soft landing even more difficult, and the risks of a policy error are rising. However, the near-term economic outlook remains optimistic.

Q&A: Oil Prices at Four-Year Highs: What It Means for Energy Investors

Pavel Molchanov, *Energy Analyst, Equity Research,* examines rising oil prices and the effect this trend has on various stakeholders within the energy industry.

Q. OIL PRICES RALLIED THROUGHOUT THE SPRING, REACHING THE HIGHEST LEVELS SINCE 2014. WHAT'S DRIVING PRICES?

A. Basic economics holds that when demand exceeds supply, prices should rise. Well, that is precisely what has been happening in the global oil market – and for much longer than the past few months. The trough of the down cycle for oil prices occurred back in February 2016. The key fundamental metric we focus on is global petroleum inventories (not solely U.S.), which declined by an average of one million barrels per day in 2017. We are forecasting a similar decrease in 2018, with inventory levels falling below historical norms.

By definition, these inventory drawdowns mean that demand is running ahead of supply. For the fourth consecutive year, global demand is set to grow faster than its long-term average of 1.4% per year, with emerging markets continuing to drive (quite literally) the bulk of the increase. Supply is also up, but is limited by several factors. Larger U.S. oil producers are exhibiting restraint in capital allocation, meaning they are spending less on business investment, marking a shift from their historical tendency to overinvest. Additionally, OPEC's production discipline, led by Saudi Arabia, remains intact, and there are still supply declines in several non-OPEC geographies such as Mexico. Finally, supply disruptions/challenges, especially in Venezuela, continue to weigh on inventory levels.

That being said, it is worth underscoring that the oil futures curve is currently downward sloping (also referred to as 'backwardation'), suggesting that the commodity market is signaling a sharp drop in oil prices from current levels over the next three years. On the contrary, our view is that prices still have room to move higher over the next several years.

Q. WHO WINS AND WHO LOSES FROM THE HIGHER OIL PRICES?

A. As one would expect, energy investors are among the clear winners. After having underperformed the S&P 500 in six of the previous seven years (all except 2016), the energy sector is outperforming year-to-date. There have been outsized gains in higher-beta stocks with above-average leverage to oil prices, while defensive/conservative energy stocks and those with a focus on natural gas have generally lagged. More broadly, the current oil price landscape is helping to revive investment and job creation in geographies that felt the pain of the down cycle – Russia, Texas, and Alberta – not to mention many of the OPEC countries.

In general, higher oil prices are not ideal for the world's major economies since most of them are net oil importers. This is especially true for Japan, India, and most of Europe. The U.S. and China present more of a mixed picture, since they produce a sizable portion of their oil consumption. In oil importing countries, the average consumer will have to pay more for their fuel this summer than at any point since 2014. Average U.S. retail gasoline prices are already approaching $3.00/gallon, as compared to less than $2.50/gallon one year ago. This could result in a revival in sales of smaller cars, which have generally been sidelined in recent years as consumers gravitated to trucks and SUVs.

Q. WHAT ROLE IS IRAN PLAYING IN THE OIL PRICE RALLY?

A. The short answer is not much. The White House's decision in May to reinstate a range of economic sanctions against Iran is contributing to the geopolitical risk premium in the oil market, but this is mostly a matter of 'headline risk' and sentiment. The decision to impose sanctions, in and of itself, does not curtail Iranian oil

supply. For such curtailment to materialize, one of two things would need to happen. First, a significant number of European and Asian countries would have to revive their own import restrictions, returning to the 2012-2015 policies in place prior to the signing of the nuclear deal. Given how much Europe wants to salvage the nuclear deal, that's not likely, provided Iran does not escalate the situation.

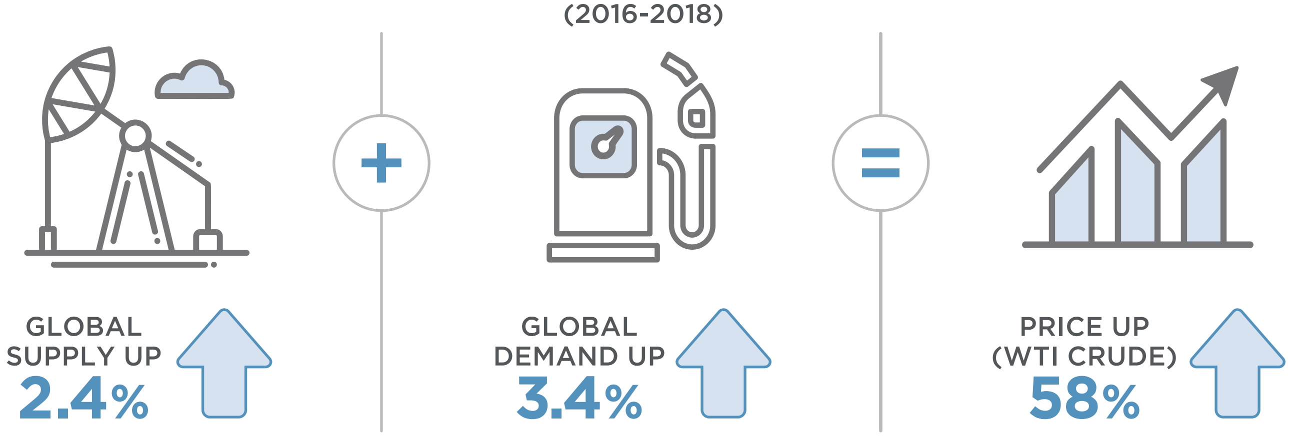
The second scenario would be a full-scale war with tankers physically blockaded – also not likely without major escalation. From a long-term perspective, the wild card will be the willingness of international energy companies to invest in Iran (bearing in mind that U.S.-based players have no operations there). The threat of U.S. secondary sanctions will create an additional barrier, but the fact of the matter is that such investments have been minimal anyway.

KEY TAKEAWAYS:

- For the fourth consecutive year, global demand is set to grow faster than its long-term average of 1.4% per year, with emerging markets continuing to drive the bulk of the increase. Supply is also up, but is limited by several factors.
- It is worth underscoring that the oil futures curve is suggesting that the commodity market is signaling a sharp drop in oil prices from current levels over the next three years. To the contrary, our view is that prices still have room to move higher over the next several years.
- Higher oil prices are not ideal for the world's major economies since most of them are net oil importers (especially Japan, India, and most of Europe). The U.S. and China present more of a mixed picture, since they produce a sizable portion of their oil consumption.

SUPPLY AND DEMAND PUSHING PRICES UP

(2016-2018)



Source: International Energy Agency and Raymond James research as of 06/18/2018

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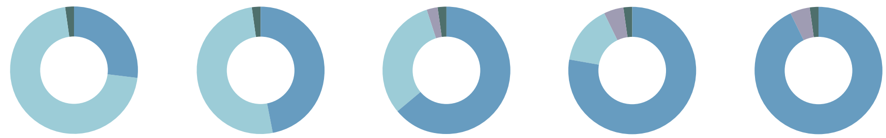
STRATEGIC ASSET ALLOCATION MODELS

Several changes were made to the more conservative strategic asset allocation models in the month of June. These changes are intended to improve the models' risk/return profiles. Given the current interest rate environment, there was a reduction in non-investment grade fixed income and a corresponding increase in short-maturity investment grade fixed income. In addition, there was an increase to non-U.S. developed market equities and a decrease in U.S. large-cap equities. This shift reflects favorable market fundamentals, solid earnings growth, and accommodative central bank policies in these regions.



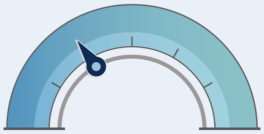
	CONSERVATIVE	MODERATE CONSERVATIVE	MODERATE	MODERATE GROWTH	GROWTH
EQUITY	**27%**	**47%**	**64%**	**78%**	**93%**
U.S. Large Cap Blend	15%↓	17%	21%	24%	29%
U.S. Large Cap Growth	0%	4%↓	6%	8%	9%
U.S. Large Cap Value	0%	4%↓	6%	8%	9%
U.S. Mid Cap Equity	2%	5%	7%	8%	10%
U.S. Small Cap Equity	1%	3%	4%	6%	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%**

 *Refer to page 22 for multi-sector fixed income asset class definition. Refer to page 23 for model definitions.

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 financial advisor can help you interpret each recommendation relative to your individual asset allocation policy, risk tolerance, and investment objectives.

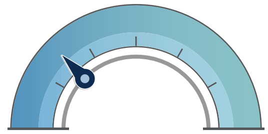
EQUITY



FIXED INCOME

Despite the rise in geopolitical uncertainty, we maintain a favorable view on equity relative to fixed income. Despite potential near-term volatility, equities should continue to outperform, supported by stable economic growth, low inflation, and positive sentiment.

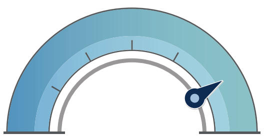
U.S. EQUITY



NON-U.S. EQUITY

U.S. equities are favored relative to non-U.S. equities as the soft patch in foreign economies and continued improvement in U.S. earnings should result in a strong year for the U.S. While fundamentals still favor foreign stocks over the long term, the near term remains unclear as geopolitical uncertainty is heightened. Opportunities may exist and active management is highly recommended.

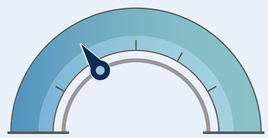
U.S. LARGE-CAP EQUITY



U.S. SMALL-CAP EQUITY

Small caps continue to produce excess returns relative to the broad market, supported by a strong U.S. dollar and tax reform. Sentiment is strong as investors look for opportunity down the market-cap spectrum. Active management is highly recommended in this space.

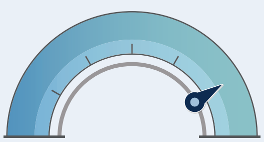
NON-U.S. DEVELOPED MARKET EQUITY



EMERGING MARKET EQUITY

Emerging market equities face several major headwinds including rising oil prices, a strong U.S. dollar, negative investor sentiment, and rising rates in some peripheral countries. These headwinds justify our favorable opinion on non-U.S. developed markets relative to emerging markets at this time. This negative trend for EM should reverse at some point. Active management is highly recommended in this space.

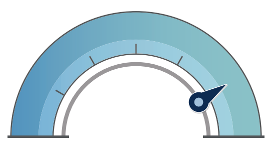
VALUE-ORIENTED EQUITY



GROWTH-ORIENTED EQUITY

Growth stocks continue to outperform value based on near-term and longer-term momentum. While we may be inching closer to a value trade in the mid- and small-cap space, growth companies should further benefit from higher earnings estimates in the short run. Rising interest rates remain a headwind for value stocks.

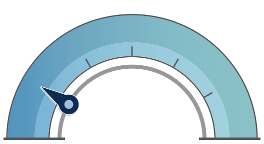
LONG-MATURITY FIXED INCOME



SHORT-MATURITY FIXED INCOME

We remain favorable towards shorter-duration bonds as the Federal Reserve is expected to continue raising short-term-rates going forward. Longer-term rates are likely to remain range bound as the lack of inflation and continued global interest rate disparity keeps foreign demand for U.S. bonds steady.

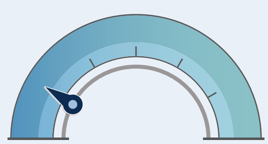
INVESTMENT GRADE FIXED INCOME



NON-INVESTMENT GRADE FIXED INCOME

Despite low default rates, high yield bond investors are not being fully compensated for the credit risk and 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.

U.S. DOLLAR FIXED INCOME



NON-U.S. DOLLAR FIXED INCOME

The U.S. dollar is likely to continue its upward trend, heightening foreign exchange risk and eroding potential returns for non-dollar denominated debt.

ALTERNATIVE INVESTMENTS SNAPSHOT

ALTERNATIVE INVESTMENTS	
EQUITY LONG/ SHORT	Equity long/short becomes more attractive in an environment that features greater dispersion in stocks, increasing the potential for managers to create alpha both long and short. In 2018, long/short equity managers have managed to outpace the S&P 500 with less volatility. The strategy represents an attractive equity replacement for clients that want to reduce equity risk while remaining invested.
MULTI-MANAGER/ MULTI-STRATEGY	Multi-manager/multi-strategy funds offer investors diversification across strategy types and asset classes. For investors seeking investments with limited correlation and beta to traditional markets, multi-manager/multi-strategy funds represent a potential solution.
MANAGED FUTURES	Managed futures attempt to take advantage of divergent price movements and trends across asset classes. While many managed futures strategies have not lived up to expectations during recent periods of volatility, historically the strategy is uncorrelated to equity and bond markets and provides investors with diversification benefits.
EVENT DRIVEN	Event-driven managers attempt to isolate idiosyncratic events that are less correlated with broader markets in order to produce returns. While the opportunity set within merger arbitrage and distressed investing is mixed, event-driven funds that focus on exploiting hard catalyst events are poised to outperform. Event-driven funds provide investors the ability to remain invested while being exposed to a differentiated return stream.
EQUITY MARKET NEUTRAL	Equity market neutral strategies attempt to maintain minimal 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.
GLOBAL MACRO	The wide variety of exposures provided by global macro strategies create the opportunity to profit from moves across different market types. Divergence in markets typically results in increased volatility, potentially offering global macro strategies with a greater opportunity set.

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*

- "The muni market is going through a significant transition this year as a result of tax reform, and supply being down in the early part of the year. For the summer, it's likely that we'll see municipals strengthen relative to Treasuries."

  – Ted Ruddock, Head of High Net Worth, Fixed Income

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

"There are two inflationary factors in the energy complex: the price of oil and the price of electricity."

- "There has been pushback recently, both social and political, to rising fuel prices. More seriously, the major strike in Brazil essentially brought the country to a halt because truckers were protesting high diesel prices. Similar social protests are occurring in India, the Philippines, even Russia."
- "With Brent Crude close to $80 a barrel (levels not seen since late 2014), we have to increasingly pay attention on the demand side since this will create headwinds to other sectors of the economy - aviation, trucking, plastics, and other types of relatively energy-intensive manufacturing."
- "This administration is on the cusp of creating an unprecedented rule that will require uneconomic, high-cost electric generation plants (coal and nuclear) to effectively be bailed out through higher prices paid by the consumer. It's very unpopular, as you can imagine, for the natural gas, wind, and solar industries. If this type of regulation is executed, it will raise electricity prices across the United States."

SECTOR SNAPSHOT

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

This report is intended to highlight the dynamics underlying the 11 S&P 500 sectors, with a goal of providing a timely assessment to be used in developing your personal portfolio strategy. Our time horizon for the sector weightings is not meant to be short-term oriented. 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.

Most investors should seek diversity to balance risk versus reward. For this reason, even the least-favored sectors may be appropriate for portfolios seeking a more balanced equity allocation. Those investors seeking a more aggressive investment style may choose to overweight the preferred sectors and entirely avoid the least favored sectors. Investors should consult their financial advisors to formulate a strategy customized to their preferences, needs, and goals.

These recommendations will be displayed as such:

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

For a complete discussion of the sectors, please ask your financial advisor for a copy of *Portfolio Strategy: Sector Analysis.*

	SECTOR	S&P WEIGHT	TACTICAL COMMENTS
OVERWEIGHT	INFORMATION TECHNOLOGY	26.4%	Healthy fundamentals are expected to continue. Technical momentum for the intermediate term remains strong. Valuations are a challenge, but, as long as fundamentals hold up, valuations should be sustainable. The biggest risk appears to be the U.S. trade battle with China.
OVERWEIGHT	FINANCIALS	14.0%	Price return for the sector is negative year to date vs. gains for the S&P 500. Despite the negative return, fundamental expectations are healthy and valuation attractive. The flattening yield curve is likely the overhang on the sector. We stay Overweight on the back of good fundamentals, attractive valuation, and solid U.S. economic growth.
OVERWEIGHT	HEALTH CARE	14.1%	We cautiously remain Overweight. Fundamental trends are reasonable, but decent projected earnings growth for 2018 and 2019 falls behind the rapid growth expected for the S&P 500. Valuation is attractive based on numerous measures, but, relative to expected growth, it is less so. Technical trends relative to the S&P 500 remain negative. Despite the negatives, there is enough opportunity at the subsector level to justify investment.
OVERWEIGHT	INDUSTRIALS	9.6%	Trade wars and fear of margin pressure (rising freight, labor, and commodity costs) are weighing on the sector. We are guarded with earnings season due to kick-off in a few weeks, but, after the extreme relative strength giveback and with valuation somewhat attractive, we feel a bounce in relative performance is likely.
OVERWEIGHT	ENERGY	6.1%	Crude prices rallied on the news of OPEC settling on production increases below levels feared by the market. We would be buyers as it is likely to post relative strength gains versus the overall market for the intermediate term. Fundamentals remain healthy, while valuation allows for upside.
EQUAL WEIGHT	CONSUMER DISCRETIONARY	13.0%	Technical and fundamental trends support a more positive opinion, but, after the recent run, prices are extended.
UNDERWEIGHT	CONSUMER STAPLES	6.8%	Earnings growth is expected to be well below the S&P 500 growth in 2018 and 2019. Recent revisions have been lower as well. Fundamental trends throughout many subsectors remain a challenge as the lack of pricing power leaves margins vulnerable to rising freight and wage costs.
UNDERWEIGHT	UTILITIES	2.8%	Overall earnings growth relative to the S&P 500 is expected to be unimpressive in 2018. Valuation is compelling. Yet, the inverse correlation to rising interest rates keeps us on the sidelines.
UNDERWEIGHT	REAL ESTATE	2.7%	Fundamental growth is less than appealing relative to growth expected for the S&P 500. Valuation is attractive, but weighing all three (fundamental, valuation, and technical) trends reaffirms of our Underweight.
UNDERWEIGHT	MATERIALS	2.6%	With expectations for the trade battle between the U.S. and China to carry on for months, we chose to lighten exposure to those sectors that appear to be most impacted in terms of stock price action.
UNDERWEIGHT	TELECOM	1.9%	The current stocks within the sector are inexpensive based on historical valuation measures, but fundamental growth is anemic and stock prices are sensitive to interest rate movements.

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 agriculturals).

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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