Third Quarter 2019

Market Outlook

Outlook Summary

2019 dawned with dimming prospects for global economic growth due to concerns over a Chinese slowdown, fears over global trade tensions, and the perception that the U.S. Federal Reserve (Fed) would remain committed to its plans for rate hikes and balance sheet reduction. In our January Outlook, we suggested the tone in investment markets was too pessimistic and "had created opportunities in several areas." During the first quarter, investors received positive news on all three of the aforementioned worries, and, as a result, global asset markets recovered sharply. Despite an uneven ride, the second quarter continued 2019's positive return path across most risk asset categories. As the Fed transitioned to increasingly dovish messaging, both equity and fixed income returns flourished.

For the second quarter, the S&P 500 increased 4.3%, only to be outpaced by large cap growth equities. Non-U.S. developed and emerging markets equities increased 4.0% and 0.70%, respectively, as Trump-linked trade worries eased. In fixed income, the Bloomberg U.S. Aggregate Index increased 3.1%, and the Bloomberg U.S. Intermediate Government/Credit Index increased 2.6% for the second quarter of 2019.

Outlook for the Balance of 2019

Following the outstanding performance by risk assets in the first half of 2019, we believe the push and pull of the global economic growth narrative will be the dominant driver of market returns through the remainder of 2019. We believe the chances of a recession in 2019 continue to be low, although global

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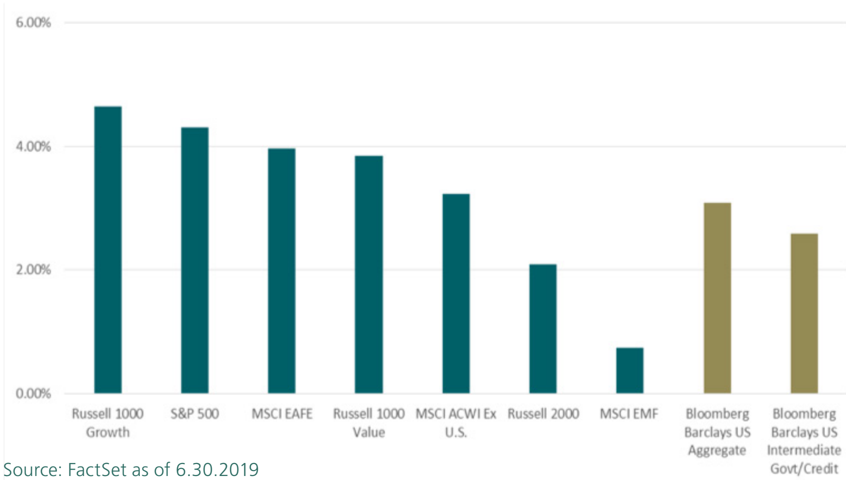
GDP growth may prove varied through the rest of the year. While global economic data remains mixed, there are expectations for improvement in corporate fundamentals in the second half of the year, which has provided fuel to investor optimism. We remain vigilant for potential risks, both political and economic, which can spur market headwinds and volatility. However, macro concerns are largely balanced by a reasonably encouraging environment.

Q2 2019 RETURNS



Source: FactSet as of 6.30.2019

We remain constructive on risk assets in general, including U.S. equities and select areas of fixed income. Though we employ a global perspective on active asset allocation, the divergence between the U.S. and the rest of the world continues to support our domestic bias. In the U.S., corporate fundamentals have slowed against difficult comparisons (peak earnings in the second quarter of 2018), but a reacceleration of earnings growth in the back half of 2019 along with a "lower for longer" rate backdrop fuels our equity confidence. In fixed income, we are beginning to add additional U.S. Treasury bonds, particularly intermediate-maturity (5-7 year) securities to client portfolios as the credit cycle matures. We also continue to like short-to-intermediate maturity BBB rated corporate bonds, structured credit, and preferred securities. We remain cognizant that one of the principal reasons for owning bonds in an investment portfolio is to provide diversification from risk markets.

ECONOMICS

At the beginning of July, the current U.S. economic expansion officially became the longest on record at 121 conservative months. However, the expansion has been like that of an old tortoise – long in years but slow in pace. During the recovery, real GDP growth has only averaged in the low 2 percent range, significantly slower than the average growth rate during prior recoveries.

First quarter GDP growth of 3.1% actually exceeded this post-crisis trend range; however, the headline number was temporary boosted by inventory building and net exports. Growth in the second quarter appears to have slowed with forward looking indicators suggesting that growth will moderate to the mid-1s.

The U.S. consumer remains resilient with household balance sheets in good condition. However, policy uncertainty appears to be impacting business confidence, resulting in a slowdown in business investment.

Over the second half of the year, U.S. growth is forecast to slow on a year-over-year basis to approximately 2%, as the beneficial impact of last year's fiscal stimulus continues to diminish. Despite the expectation for slower growth, we think that the probability of a recession remains low over the remainder of the year. Absent any major shocks, the combination of more accommodative monetary policy and the strength of the U.S. consumer should continue to support economic growth.

One recessionary indicator we are watching closely is the shape of the yield curve. Historically, the yield curve has been a very accurate predictor of upcoming recessions, turning negative (meaning the yield on short maturity Treasuries is higher than the yield on longer maturity Treasuries) prior to every recession since 1969. The 3-month to 10-year U.S. Treasury yield curve inverted for the second time this year in late May and has remained inverted since. While there has been much discussion about the significance of the inversion, we believe it remains a very important indicator, and the message that monetary policy is too tight against a slowing economic backdrop must be respected.

GLOBAL GDP GROWTH RATES

	2017	2018	2019-Forecast	2020-Forecast	2021-Forecast
Global	3.8%	3.6%	3.3%	3.3%	3.1%
U.S.	2.2%	2.9%	2.5%	1.8%	1.8%
Euro Area	2.4%	1.9%	1.2%	1.3%	1.2%
UK	1.8%	1.4%	1.3%	1.3%	1.6%
Japan	1.9%	0.8%	0.7%	0.4%	0.9%
China	6.8%	6.6%	6.2%	6.0%	5.8%

Source: Bloomberg 7.05.2019 6.31.20193.31.2019

At the conclusion of the G-20 meeting in Japan, Presidents Trump and Xi agreed to restart trade negotiations. While there was no substantive progress on key negotiation items, the outcome was perceived favorably by markets, as both sides agreed to postpone the imposition of additional tariffs during negotiations. While we are hopeful of progress, we are also mindful that this "trade war" is actually about more than just "trade," as other issues including intellectual property rights, technology transfer, and currency policies will likely be even tougher to solve.

Economic growth in Europe continues to slow, and several leading economic indicators suggest that growth could moderate further over the remainder of the year. The European economy has been weighed down by prolonged and intensifying global uncertainties, particularly the issues around global trade, to which the European economy is very sensitive. During the second quarter, the manufacturing sector appears to have entered a recession, with the Manufacturing Purchasing Managers Index (PMI) reading falling below the expansion/contraction threshold of 50.

Despite three years having passed since the U.K.'s vote to leave the European Union (EU), very little progress has been made, and currently all options – from the most economically damaging hard, or "no-deal," Brexit to a second referendum – remain on the table. Boris Johnson, the likely new Prime Minister, is currently campaigning on a promise to take the U.K. out of the EU on October 31, with or without a deal. However, this might be easier said than done given the extent of the disagreement among members of Parliament. Growth in the U.K. is expected to remain sluggish, likely attributable to Brexit uncertainty.

Given its focus on manufacturing and exports, the Japanese economy is also feeling the effects of the slowdown in global growth and trade. Both current data and leading indicators are pointing to a further slowdown, and growth for the year is forecast to be sub 1%. A further slowing in global growth or increased concerns about a global recession would likely result in a stronger yen, given the yen's safe-haven status.

While the outlook is for a gradual slowdown in Chinese growth, it may turn out to be bumpier than expected, especially if trade tensions with the U.S. continue. Thus far, authorities in China have shown a willingness to implement both monetary and fiscal stimulus to help soften the blow from the slowdown in growth.

The dovish pivot by the U.S. Federal Reserve should provide a tailwind for emerging markets since the U.S. dollar typically depreciates as the Fed begins to cut interest rates. A weaker U.S. dollar is helpful given the amount of EM debt which is dominated in dollars. In addition, a lower U.S. policy rate may provide an opportunity for EM central banks to also cut their respective policy rates to help stimulate growth, without depreciating their currencies.

We remain vigilant about risks which could pose a threat to the global economy. The most obvious of these is the on-going trade tensions between the U.S. and a number of key trading partners, most notably China. Trade tensions between the U.S. and China in particular have gone through periods of escalation and easing, with no resolution yet. Other risks we are closely monitoring include the potential for a 'hard' Brexit, political instability in Europe and geopolitical tensions in the Middle East.

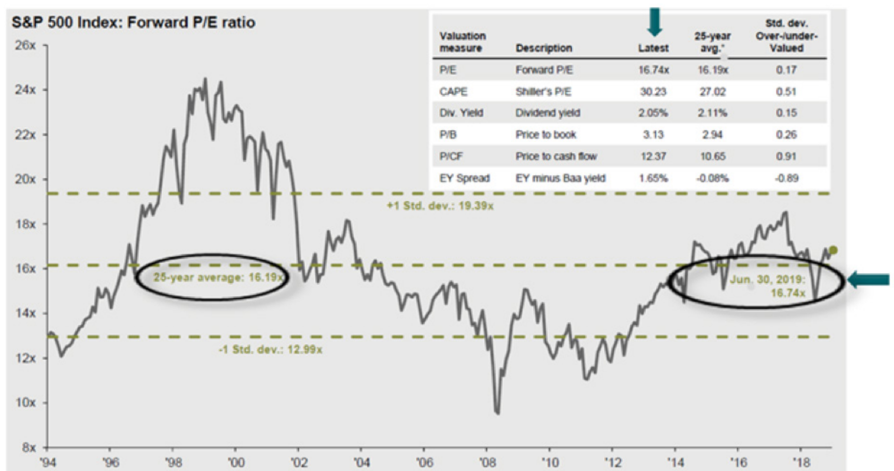
Over the coming quarters, we expect U.S. growth to slow but that a recession remains unlikely, unless there is a severe deterioration in trade negotiations. Globally, we expect muted growth in Europe and Japan, and there is certainly a risk that these economies could slip into a recession. Both the European Central Bank (ECB) and the Bank of Japan appear willing to step in to attempt to stimulate growth through lower interest rates and quantitative easing (QE). However, while we do believe monetary policy may help mitigate the downside, we are more cautious on the view that it can prevent recessions. The dovish turn by major central banks and China's stimulus programs should provide some support for economic activity in emerging markets.

EQUITIES

Global stocks once again advanced in the second quarter, extending 2019's gains following the sharp selloff at the end of 2018. The tenor of the quarter was extremely uneven; strength in April was driven by better-than-feared corporate earnings and a strong U.S. GDP reading for the first quarter, followed by an extremely challenging May due to increased international trade tensions, and ended with an outstanding June characterized by global central bank dovishness and renewed hope for solutions to the ongoing trade issues.

For the second quarter of 2019, the benchmark S&P 500 posted a total return of +4.3%, bringing 2019's total return to +18.5%. Smaller U.S. stocks trailed in the recent period, as the S&P 400 Mid Cap returned +3.0%, with the small cap Russell 2000 close behind at +2.1%. Similarly to the first quarter, as well as full year 2017 and 2018, growth stocks outperformed value counterparts, as the Russell 1000 Growth Index delivered a +4.6% total return versus +3.8% for the Russell 1000 Value Index for the second quarter. Ten of eleven GICS sectors posted positive performance during the second quarter, led by Financials (+8.0%), Materials (+6.3%), and Technology (+6.1%) with Energy (-2.8%) and Health Care (+1.4%) as the relative laggards. Year to date, Technology (+27.1%), Consumer Discretionary (+21.8%), and Industrials (+21.4%) have been the market leaders.

The top 10 stocks in the S&P 500 accounted for approximately 27% of the year-to-date total return. It's no surprise given the strength of the technology and consumer discretionary sectors this year, the top 5 contributors to the overall market in 2019 are Microsoft, Apple, Amazon, Facebook, and Visa. On an international basis, both developed and emerging market equities delivered solid absolute returns, but trailed U.S. counterparts. Germany and France led developed markets, while Russia and Brazil were the best performers in emerging markets.



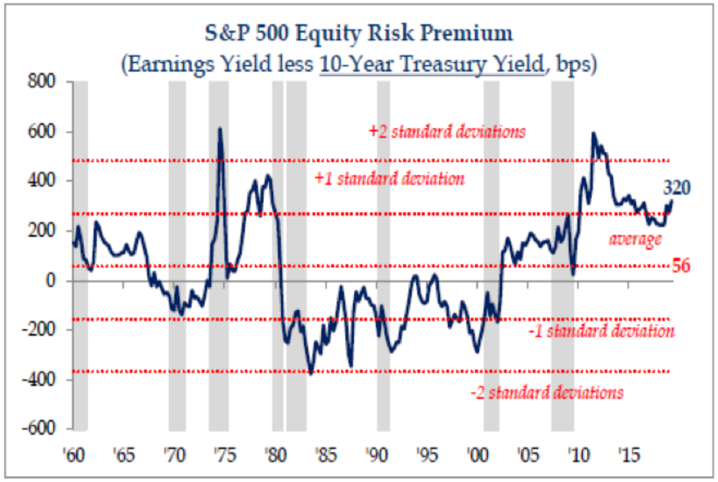
Source: FactSet, Russell Investment, JPMorgan as of 6.30.2019
Note: Indices used include S&P and Russell

We entered 2019 discussing three main issues facing equities – the direction and trajectory of global economic growth, the global trade environment, and the path for global central banks and monetary policy. Very little has changed meaningfully regarding the first two topics; global GDP estimates have remained mostly steady with expectations of an improvement in the second half of 2019, and trade issues remain a significant concern as the pattern seemingly remains "two steps forward, one step backward." However, expectations for U.S. monetary policy have changed meaningfully over 2019, moving from a period of uncertainty regarding continued rate hikes at the beginning of the year, to a current environment in which Fed Funds futures are pricing in multiple rate cuts by the of the year. Regardless of the absolute number of actual cuts forthcoming, equities no longer face tightening headwinds from the Federal Reserve for the foreseeable future.

In terms of corporate fundamentals, earnings growth has slowed from the stellar levels of 2017-2018; however, 2019 growth remains positive (estimated +3.4% for S&P 500 components as of the end of the second quarter) with estimated sequential improvement in each of the remaining two quarters of the year. Revenue growth remains the fuel for this year's earnings expansion, with current estimates of mid-single-digit growth. Equity valuations expanded considerably during the first half, as the P/E multiple on forward twelve month earnings moved from 14.5x to 16.7x. On a relative basis, the S&P 500 is trading slightly above its 25-year average of 16.2x, but we believe a premium is appropriate given both the absolute low level of interest rates and inflation expectations, as well as the expected pickup in earnings growth in 2020. Bolstering this view is the equity risk premium (defined by the trailing twelve months earnings yield of the S&P 500 minus the 10-year U.S. Treasury Yield), which remains more than one standard deviation above its long-term average.

What's left for the remainder of 2019?

We continue to believe that the dominant global topics for equities are the same three that we've mentioned ad infinitum over recent quarters – economic growth debates, trade disputes, and monetary policy. While there are other discussion topics that will percolate (the outcome of the ongoing Brexit process and the



*Using TTM EPS

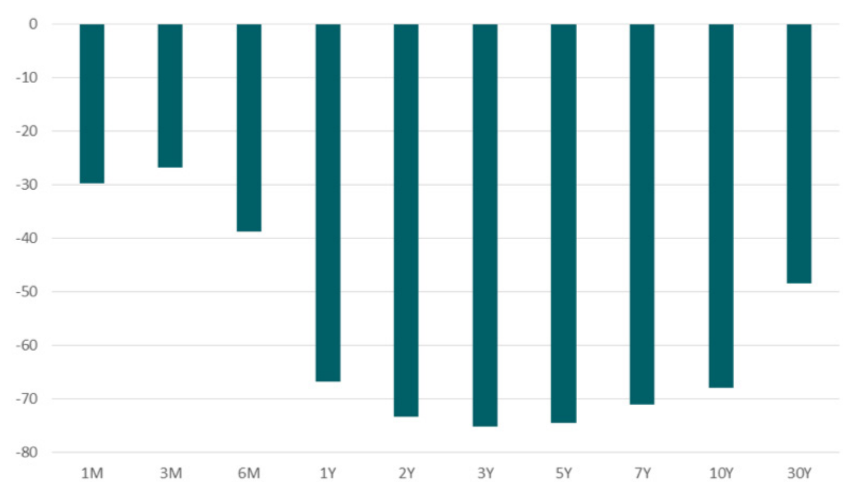
acceleration of the 2020 U.S. Presidential race noise), it appears unlikely that any of these will supersede the aforementioned three in the potential for noise and anxiety. As always, we carefully monitor these periods for signals of change that would potentially change our overall fundamental outlook We remain committed to our process that emphasizes individual business advantages (economic, structural, and competitive) and secular trends rather than impulsive reaction to potentially short-term noise. In our opinion, temporary volatility can be an opportunity to upgrade portfolios with growing and advantaged businesses, as we believe these advantaged companies are positioned to produce attractive and predictable business results over time. Active management and philosophical discipline, in our view, matter.

FIXED INCOME

Since the start of the year, the messaging from the Federal Reserve has undergone a substantial transition. At the conclusion of the December meeting, the median forecast by members of the Federal Open Markets Committee (FOMC) was for another 50 basis points of rate increases in 2019 and for the policy rate to end 2020 at 3.125%. By the most recent FOMC meeting in June, eight of the 17 policymakers now expect the policy rate to be lowered over the remainder of the year and for the policy rate to finish 2020 at 2.125%.

The change in outlook has been driven by a confluence of factors, including increased uncertainty around trade, the global slowdown in manufacturing, weaker global economic growth, and, most importantly, driven by a begrudging acceptance that inflation readings below their 2% target are not transitory. Despite 10 years of economic growth, monetary stimulus, higher financial asset prices, and strong job creation, inflation continues to remain muted. Since the Fed officially announced an inflation target of 2% on the Core Personal Consumption Expenditures (PCE) Index in 2012, inflation has averaged just 1.6% and, save one month, has never been above 2%. Both the market and the Fed appear to have accepted that inflation running below 2% is not transitory, but structural.

YTD CHANGE IN U.S. TREASURY YIELDS (BPS)



Source: Bloomberg 7.05.2019

Recently, Fed officials have been discussing the idea of targeting an average inflation rate over time. We believe this could signal a very important change that investors should be focused on. The framework would result in the Fed maintaining easy monetary policy until inflation rises; in addition, to offset sustained periods of below-target inflation, the Fed would allow above-target inflation for a period of time without raising rates.

Other global central banks have also turned more dovish. In June, ECB president Draghi adjusted guidance to suggest that policy rates would remain very low and would be unlikely to rise until the first half of 2020.

Market-based pricing has moved much further. The magnitude of rate cuts expected by the market over the next 18 months is now quite aggressive and ranges from around 10 bps for the ECB, to 15 bps for the Bank of England and Bank of Japan, to around 50 bps for the Bank of Canada, and almost 100 bps for the Fed, with nearly 2 ½ cuts (62.5 bps) priced in by year end.

Further out on the yield curve, rates also declined sharply during the first half of the year, with rates on the 2-, 3-, 5- and 7-year portions of the U.S. Treasury curve all declining by more than 70 bps.

Fixed Income Positioning

As the credit cycle matures, we are beginning to add more U.S. Treasuries to portfolios, particularly intermediate-maturity (5-7 year) bonds. We remain cognizant that one of the principal reasons for owning bonds in an investment portfolio is to provide diversification from risk markets. Although U.S. Treasury yields seem low, they could still decline further if economic growth slows or in a recessionary environment.

Agency mortgage-backed securities (MBS) have underperformed other asset classes in 2019 due to challenging supply-demand dynamics, as the Fed was declining the size of its balance sheet. More recently, the sector has underperformed on rising refinance concerns, as interest rates have declined. Today, the sector looks cheap on a relative basis to our expectations for refinancing risks.

Outside of the government-based sectors, we like investment grade corporate bonds, preferred securities, and securitized credit. The combination of lower interest rates, moderate economic growth, and ample liquidity provided by global central banks suggest a return to the “hunt for yield” environment, which should support valuations in the market. That being said, the vast majority of bond returns going forward will likely come from the income component rather than additional price gains, as we expect further spread compression to be limited.

For corporate bond investors, the low-yield environment is a double-edged sword. If issuers maintain capital discipline, choosing to focus on de-leveraging rather than using cheap debt for leveraging M&A transactions or shareholder-friendly purposes, credit fundamentals should improve, even in a decelerating growth environment. Conversely, if low rates are used to continue to increase balance sheet leverage, then further credit deterioration will occur.

Therefore, issuer selection within the investment grade market is set to become even more critical. In general, we continue to prefer BBB rated bonds due to the additional yield over higher rated issuers. Moreover, we have observed a bifurcation of balance sheet management behavior between BBB issuers and issuers in the higher tiers of the credit spectrum. Today, many BBB rated companies are being very clear about their plans to deleverage and improve their balance sheets. In terms of sector positioning, we continue to favor banks, insurance, pipelines, REITs, and select pharmaceutical and media names. Within these sectors, we are looking for issuers with healthy and improving balance sheets, strong free-cash flow and management teams who are focusing on deleveraging. Conversely, we are de-emphasizing sectors and issuers that are highly cyclical and/or are re-leveraging balance sheets through share buybacks, increased dividends, or through debt-funded M&A transactions.

The strong performance of preferred securities continued in the second quarter. Relative valuations in the preferred market should be supported going forward by strong balance sheets, attractive duration profiles, high current yields compared to other asset classes and, in certain cases, preferential tax treatment. In addition, the technical backdrop appears supportive of the market, given the growing investor base and the outlook for very limited new supply.

During the first half of the year, securitized credit performed well, but lagged the very strong performance of the corporate bond market. Securitized assets are often tied to the U.S. consumer/household, a theme we are favorable on. Consumer balance sheets are strong and continue to improve due to a strong labor market, higher savings rates, and muted inflation. Exposure to the asset class also provides some diversification to other sectors of the bond market. Compared to corporate credit spreads, securitized credit spreads have tend to be less volatile and historically widened less during recent risk-off environments. In particular, non-agency mortgages is a sector of the securitized market that we like, believing that it offers one of the most attractive risk/return profiles in fixed income.

After a challenging 2018, emerging market fixed income assets performed well in the first half of 2019. Despite the on-off again trade tensions and slowing global growth, there are attractive opportunities in the emerging market, particular in short-maturity U.S. dollar denominated sovereign and corporate bonds.

Emerging market bonds offer attractive absolute and relative yields and should benefit from dovish central banks and a weakness in the U.S. dollar.

For the fifth consecutive quarter, the municipal market contracted in size as the pace of new supply failed to keep up with redemptions and maturities. Against this backdrop, investor demand has remained strong, creating a very powerful supply/demand dynamic which has pushed valuations higher on a relative and absolute basis. In general, municipal bonds are now expensive on both a pre- and after-tax basis relative to U.S. Treasuries, particularly in the short and intermediate portions of the curve.