Third Quarter 2017

Market Outlook

FRANKLIN STREET PARTNERS

Outlook Summary

U.S. equity markets continued to make new highs during the second quarter of 2017, with the Dow trading over 21,000 and the S&P reaching 2,450. The S&P 500 gained 3.1% for the period, moderating slightly from a 6.1% return in the first quarter. In many regards, the second quarter saw a continuation of first quarter trends: growth outperformed value, large cap companies outperformed small cap peers, and global equity markets outperformed U.S. counterparts. Investors are more willing to own risk assets given the backdrop of healthy credit, improving fundamentals, and low volatility. Within U.S. equity markets, we saw a deviation from some first quarter trends. Technology leads the market YTD, but the sector's strength waned towards the end of the second quarter. The top performing sector in the period was Healthcare, followed by Industrials and Financials. Volatility continues to be remarkably low relative to historic levels, and market leadership is concentrated among a narrow group of large cap stocks. Through the first half of 2017, the top 10 largest S&P stocks have contributed 27.8% of the overall return with 4 members (FB, AMZN, AAPL, and GOOGL) contributing 23.1% - this compares with 21.5% and 6.7% in 2016, respectively. Despite the large impact of only a few stocks, the combined weight of the 10 largest S&P 500 stocks is 19% compared to the 27-year average of 20% and a peak of 27% in 1999.

Bill Thompson
President & Investment Committee Chairman

Christy L. Phillips
Director of Equity Strategies & Research

Craig Sullivan
Director of Fixed Income & External Manager

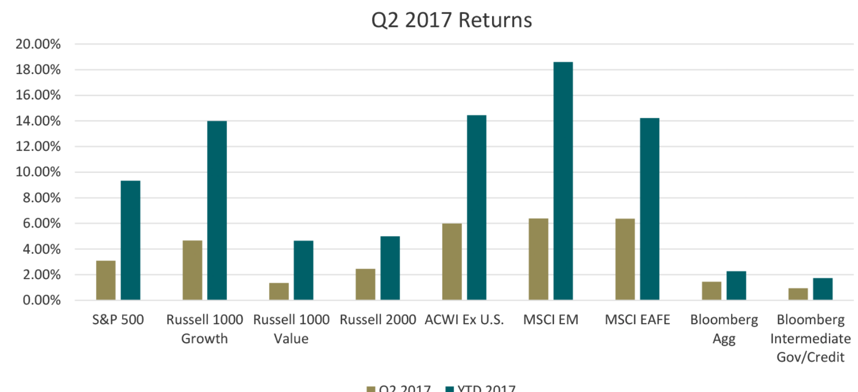
Dennis C. Greenway, II
Senior Portfolio Manager

Globally, both international developed and emerging market economic data continued its improvement. The Eurozone, in particular, delivered better than expected growth with declining unemployment rates. U.S. data was mixed, but should reaccelerate in the second half of the year. Interest rates have largely started moving higher, but remain at relatively low levels and are unlikely to slow economic growth in the near term. Within fixed income, the Bloomberg Barclays U.S. Aggregate gained 1.45% during the second quarter, as investment grade, high yield, and preferred securities all delivered solid performances.

What is in store for investors in the Second Half of 2017? Entering the second half, the fundamental backdrop remains fairly sound, as most global economies improved from the beginning of the year, inflation remained muted, and the interest rate environment continued to be largely benign despite the pullback of some accommodative policy. Equity valuations remain at above-average levels, but below historic highs and are supported by strong corporate earnings growth, lower inflation, and relatively low interest rates. In the U.S., investors will continue to focus on Washington, D.C. and the progress of pro-growth fiscal policies, while globally, attention will remain on continued improvement from most developed and emerging economies. Overall, the environment remains supportive for risk assets, as investors should expect to own equities in their portfolios for capital appreciation and income, and bonds for income.

ECONOMICS

Despite lofty economic growth expectations entering 2017, economic data in the U.S. remained sluggish, evidenced by first-quarter GDP growth of just 1.4%. Economic indicators, such as the U.S. Citi Economic Surprise Index, also showed signs of weakness during the first half of the year. One of the reasons for the weaker than expected first half growth has been the lack of progress in Washington. Heading into the year, one of the major stories in the U.S. was the potential for fiscal stimulus in the shape of personal and corporate tax reform, infrastructure spending, and/or deregulation. Clearly, progress here has been slower than most investors would have liked. However, we believe that growth in the U.S. and globally will strengthen in the



Source: FactSet, As of 6.30.2017

second half of the year, as it has each year since 2010. Stronger growth should be driven by a mix of an increase in business investment, higher consumer spending supported by a further decline in the unemployment rates and healthy consumer balance sheets, higher consumer confidence, and potentially by progress in Washington towards tax cuts in 2018. Business investment actually outperformed expectations in the first quarter and could continue to strengthen if any clarity is provided on tax legislation. The consumer, a sizable driver of GDP, remains healthy as the household balance sheet remains sound in aggregate, and the savings rate continues to trend higher, implying room remains for the consumer to spend.

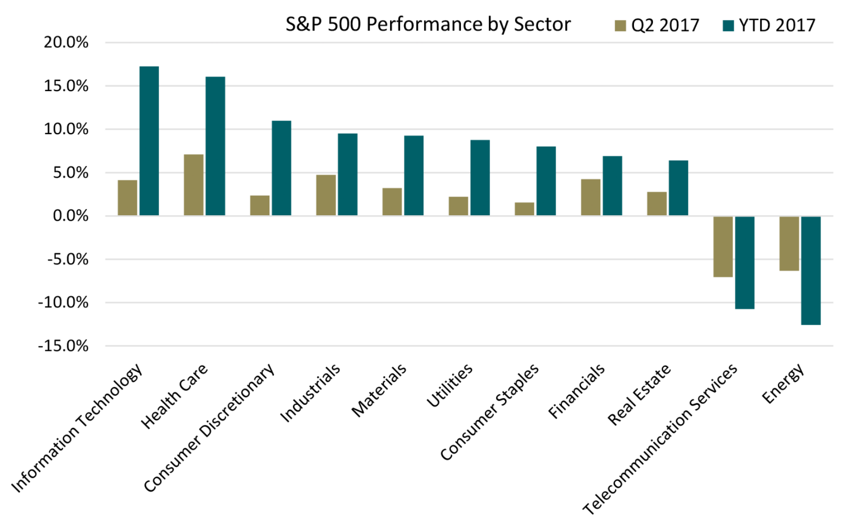
The European Citi Economic Surprise Index signaled that Eurozone economic data is faring very well versus expectations. First quarter GDP growth showed the strongest expansion in two years, and, in April, Euro area unemployment fell to its lowest level since early 2009. Political risk has subsided with the victories of pro-European Presidential candidates in Holland and in France. Moreover, Emmanuel Macron's La Republique en Marche party won a strong majority in the French parliamentary elections in June, which should enable Macron to push through pro-business reforms. Current German Chancellor Angela Merkel remains on track for victory in September elections, so the next potential political landmine could be in Italy, which must hold general elections before May 2018. In the U.K., uncertainty continues to spread, as Prime Minister May's election embarrassment will only add difficulty to the challenging Brexit process. Adding to British concerns are recent signs of weakening economic data.

Emerging market (EM) assets – stocks, bonds and currencies – have risen significantly so far this year, following a sell-off in the fourth quarter of 2016 as EMs bore the brunt of investors' fear of protectionist policies following the U.S. election. Economic data has also been improving in the first half of the year with improving trends in manufacturing and trade. Many EMs have already experienced an economic adjustment – primarily through the depreciation of currencies – and are now emerging from deep recessions. A potential tailwind to EMs is the ability of many of their central banks to cut interest rates, which should act as a further boost to economic growth. However, as always, EMs remain vulnerable to a turn in risk sentiment. Continued pressure in commodity prices could be the catalyst that leads to a reversal in the recent strength in EMs. Oil prices declined by over 15% from their peak in February to the end of the quarter caused by concerns of oversupply, weaker-than-expected growth prospects, and OPEC's ability to manage output.

In summary, the global economic environment largely appears constructive, as most of the non-U.S. developed and emerging economies have improved from the beginning of the year. Further expansion will require the extension of supportive fiscal and monetary policies, continued and improving consumer and business confidence, and the avoidance of political landmines which could affect a number of concerns including trade policies.

EQUITIES

U.S. equity indices continued their winning streak in the second quarter, as both the S&P 500 and Dow made new all-time highs during the period. Concerns over the timing and trajectory of pro-growth fiscal policy out of Washington D.C. were offset by strong corporate earnings, as S&P 500 components posted average year-over-year earnings growth of 14.0% for the first quarter, the highest growth rate since the fourth quarter of 2011. Once again, large cap equities outperformed small and mid-cap stocks, while stylistically, growth continued to outperform value for the second consecutive quarter. On a sector basis, equities were led by Health Care (+7.1% total return), Industrials (+4.7%), and Financials (+4.2%), with Technology (+4.1%) the best performer in the first quarter, also outpacing the broader S&P 500 (+3.1%). On the downside, Energy stocks (-6.7%) continued



Source: Bloomberg, As of 6.30.2017

their 2017 weakness, as investor concern regarding oversupply from U.S. shale producers has overwhelmed any perceived benefits from OPEC supply reduction, driving West Texas Intermediate (WTI) prices down nearly 15% to approximately $46 over the first half of the year.

While aggregate company fundamentals continue to show improvement, concern over elevated market valuation will likely remain a popular discussion point amongst investors, particularly given the sluggish macroeconomic data reported in the first half of the year. The S&P 500 finished the second quarter of 2017 with valuations in-line with 1Q17, but still well above historical averages, as the forward P/E multiple remained at 17.5x. As we noted in April, this elevated level is still within one standard deviation of the 25-year average P/E multiple (16x forward earnings) and has room to move higher. Currently, the S&P is pricing in little to no 'premium' for Trump's pro-growth policies and market stimulus, due to the slow pace of reform in Washington, D.C. Any developments on infrastructure, tax reform, healthcare, or financial deregulation would be likely a net market positive for equities.

A weaker U.S. Dollar has aided corporate earnings YTD in 2017. The weakness can be attributed largely to improvement in growth expectations worldwide, particularly Europe, as well as the new presidential administration's explicit focus on dollar strength and its impact on the U.S. trade deficit. We remain optimistic for the second half of 2017, and barring an external 'black swan' shock, a recession is unlikely in coming quarters. The U.S. economy is trending towards stronger real growth in the second half of the year, aided by lower near-term inflation expectations and GDP growth, a positive for equities. Non-U.S. markets remain strong, with even greater room for growth due to their high leverage to industrial production and global macroeconomic tailwinds. Overall, we believe a reacceleration of U.S. GDP growth combined with continued strong corporate earnings growth and CEO confidence will be the keys toward continued equity resilience and appreciation.

With this backdrop, FSP maintains a constructive view on portfolio allocation to global equities with an eye towards monitoring the relative valuation between U.S. equities and international developed markets. We continue to look selectively for high quality companies with distinct advantages and trading within our valuation discipline framework. Volatility has been remarkably low through the first half of 2017, and will eventually increase as investors balance the delicate tradeoff between growth and valuation. We are mindful of these potential pullbacks and view them as opportunities for our client portfolios.

FIXED INCOME

Interest Rates:

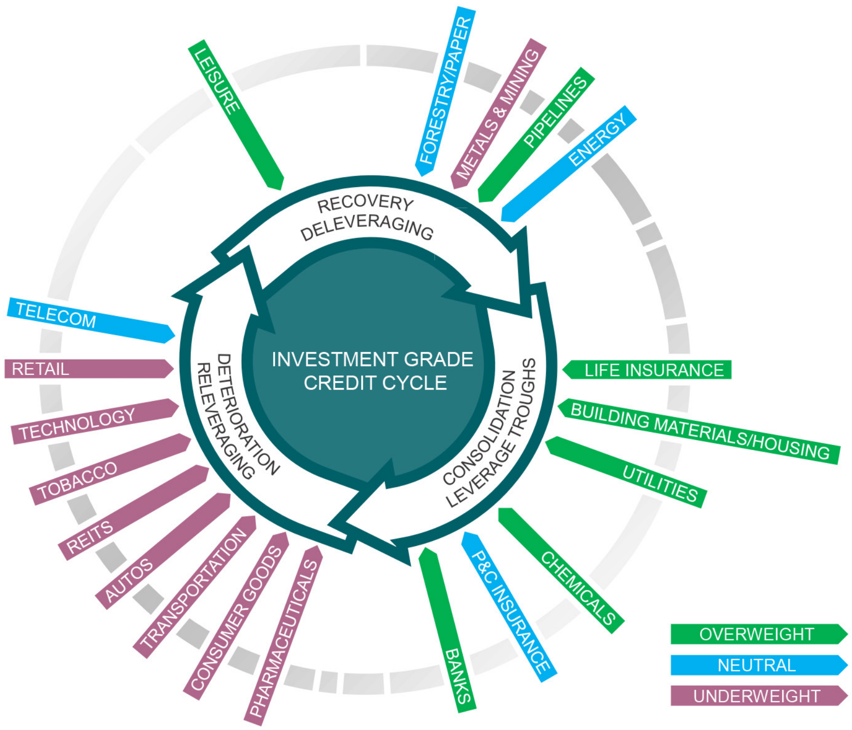
At the June Fed meeting, the Federal Open Market Committee (FOMC) raised the Federal Funds target rate by 0.25% for the second time this year and the fourth time since moving from the zero-bound at the December 2015 meeting. The median FOMC participant continues to expect policy rates to close between 1.25%-1.50% in 2017, and 2.00%-2.25% in 2018 - implying one more hike this year and three hikes next year. Market expectations derived from interest-rate futures continue to suggest that such a quick rate of increases is unlikely with the market pricing just a 50% chance of another rate hike this year and only one hike in 2018. The FOMC also provided a detailed plan to reduce the size of the Fed's balance sheet, beginning with the Fed reducing the reinvestment of principal payments. The FOMC did not state when this process will start, but many analysts believe September could be the potential start date.

One potential area of concern is the flattening Treasury yield curve, in which short-term and long-term interest rates converge toward one another. The flatter yield curve has raised some concern, as prior to the last seven recessions, the yield on the 3-month Treasury has reached a level that is higher than the yield on a 10-year Treasury. However, there are some suggestions that the flattening of the yield curve, even to the point of inverse, may not signal a recession as it historically has, but rather it may be the global search for yield, created by global Quantitative Easing (QE) programs, which is suppressing longer-term rates.

Globally, we expect the European Central Bank (ECB) to communicate plans for reducing their asset purchases in the near future. We believe the ECB will share plans at its September meeting to further taper QE, as both growth and inflation in Europe are improving, and therefore the economies likely need less stimulus than they are currently receiving.

Investment Grade:

Investment grade (IG) fundamentals improved during the most recent earnings period, reporting the strongest revenue growth since the third quarter of 2014. In addition to stronger fundamentals, IG corporate bonds continue to benefit from investor demand globally for high-quality sources of yield. We remain overweight BBB-rated bonds – a stance which has been positive for performance year to date. This segment of the bond market continues to look attractive versus higher rated issues given the current stable overall macro environment, additional yield pick-up, and improving balance sheet fundamentals of BBB companies relative to higher rated companies.



From a sector perspective, we continue to look for sectors which are in the balance sheet repair – or deleveraging – phase. While the credit cycle is often viewed as one cycle, individual sectors are actually at different points of the credit cycle. Often issuers or sectors which are in the recovery stage offer more attractive yields and have improving credit fundamentals. The diagram above illustrates the sectors we currently find attractive and where those sectors are in the credit cycle.

High Yield:

Despite occasional negative headlines, the high yield (HY) market delivered another strong quarter, exceeding most investor expectations in 2017. Default rates remain low and global demand for yield remains strong. Should recent tame volatility increase in the second half of the year, spreads could come under pressure; this should not necessarily be mistaken for a fundamental deterioration in the asset class. We see no immediate catalyst to force spreads wider for fundamental reasons outside of a geopolitical event. However, without tax reform, regulatory relief, and/or infrastructure spending, it is difficult to see a catalyst for much additional spread tightening. Our exposure for the asset class remains focused on the lower duration, higher-quality (BB/B) portion of the market.

Non-Agency Mortgages:

As of the end of April, existing home inventory, at 3.5 months of supply, reached its lowest level since 1999. New supply of homes has been slow to catch up, as housing starts are still considerably lower than in pre-crisis years, and rising land and labor costs pose headwinds to more construction, especially at the entry level. Household formation, on the other hand, has been steadily growing, with March estimates from the Census Bureau showing 1.16 million households added year over year, a 0.99% increase, exceeding the 15-year average of 0.89%. The latest Federal Housing Finance Agency U.S. house price index, which was released in April, indicated that home prices have grown 6.8% year-over-year, and 0.67% month-over-month. Compared to corporates, the residential mortgage market is still relatively early in the credit cycle, and the yield level is attractive relative to corporate bonds, attracting more investors. Given the backdrop of improving fundamentals and positive technicals, non-agency mortgages continue to offer an attractive source of risk-adjusted returns.

Preferred Securities:

Preferred securities continued their strong performance in the second quarter with both U.S. and European bank preferreds providing strong returns, driven by stronger bank earnings, a flattening of the yield curve, and virtually no net new supply from U.S. banks. The strong underlying fundamentals of U.S. banks were highlighted by the results of the Dodd-Frank Act Stress Test (DFAST), which measured a bank's ability to withstand an economic downturn. All 34 banks required to participate passed the DFAST, which means there will not be a need for these banks to raise additional capital, including the need to issue any new preferreds. Within preferred securities, we continue to favor fixed-to-float rate coupon structures and $1000 par securities over $25 par securities. Finally, we continue to find attractive securities within the Additional Tier 1 (AT1) and Tier 2 CoCo markets in select European banks.