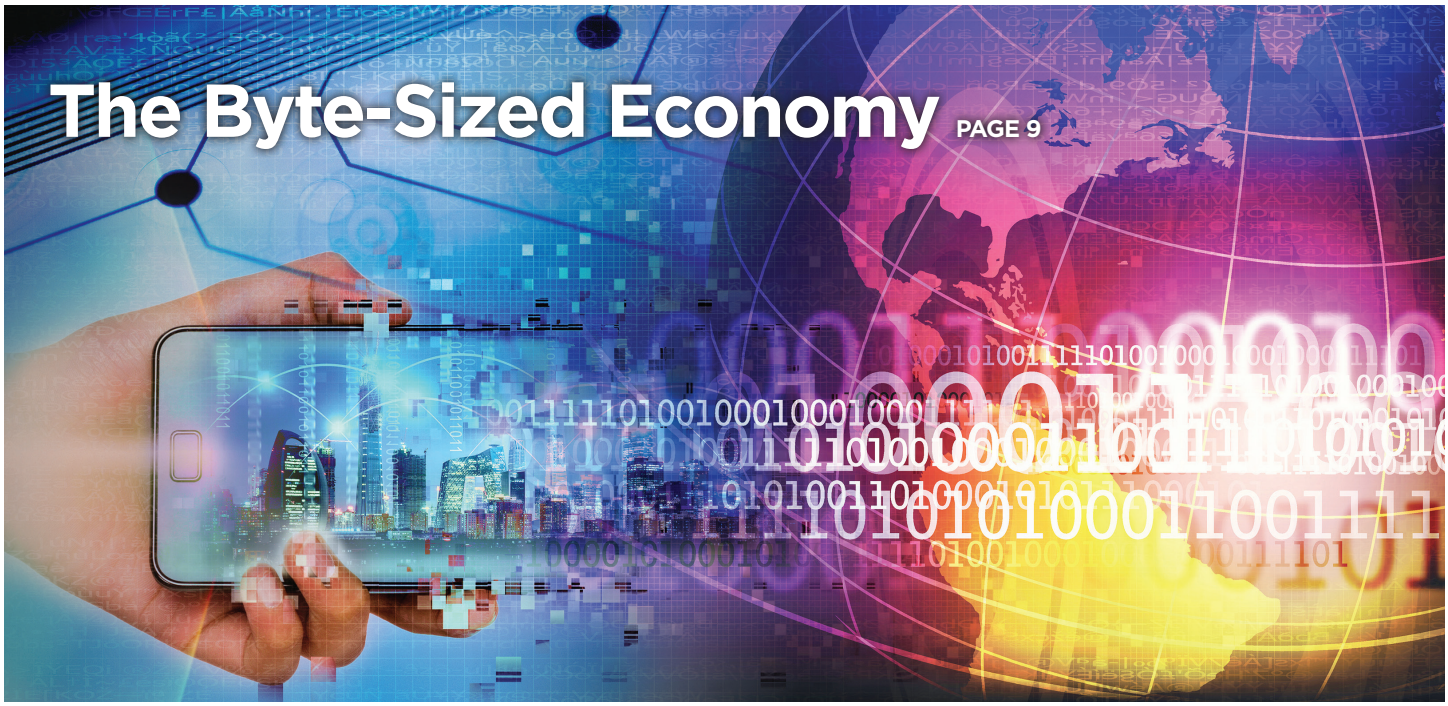
VOLUME 9 // ISSUE 3 // JULY 2017

INVESTMENT STRATEGY QUARTERLY



Frank Pickett
Branch Manager & Financial Advisor, Auro Wealth Management
3633 Inland Empire Blvd, Suite 777 // Ontario, CA 91764
T 909-931-7500 // F 909-931-7538
frank.pickett@raymondjames.com // aurowm.com

RAYMOND JAMES®

INVESTMENT STRATEGY COMMITTEE MEETING RECAP – HELD ON JUNE 7, 2017

Major macro factors affecting the economy and financial markets over the next six to 12 months include earnings growth, Federal Reserve policy, economic growth and U.S. political uncertainty.

U.S. ECONOMY – Scott J. Brown, Ph.D., Chief Economist, Equity Research

The majority of the committee is neutral (1.5 - 2.0%) to somewhat positive (2.1 – 2.5%) on real U.S. GDP growth over the next six to 12 months. Inflation is estimated to remain about the same at 1.5% for the same timeframe.

- "It looks like the big rebound in growth that we anticipated in Q2 is going to be a bit softer than we thought, particularly in consumer spending. It's still going to be stronger than in the first quarter, but not by a lot."
- "Tax reform is difficult, but Washington is still likely to lower tax rates. Even if we were to get the full Trump agenda, the job market will be a binding constraint on the pace of economic growth."
- "Nonfarm payroll figures bounce around from month to month, but there is a clear downtrend over the last couple of years. We've also had four consecutive monthly declines in retail employment, which is worrisome, but the unemployment rate continues to fall."
- "In June, the Federal Reserve (Fed) will raise the target range to 1 - 1.25%. With the 2-year Treasury yielding 1.31%, the market doesn't seem to expect many more rate hikes beyond that – a contrast to the Fed's outlook."
- "The Fed is expected to start unwinding its balance sheet by yearend, but should begin cautiously and I think the markets should be okay with that."

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

There was a significant increase in the bullishness of the committee towards foreign equities this quarter. 89% are neutral to bullish towards non-U.S. developed equities and 81% are neutral to bullish towards emerging market equities over the next six to 12 months.

- "Brexit is a multi-year event. Increasingly, it looks like a three-to-five year time horizon for the legislation to be completed. Although there is currently a two-year window for negotiations, there is increased talk of transitional arrangements driven by the perspective that Brexit will be delayed. More importantly is what's going to happen with ongoing economic reform."
- "The biggest wildcards for 2018 will be the results and impact of the German elections (held in late September 2017), the progress in reforms and if Brexit negotiators will be pragmatic."
- "In France, President Macron has all the building blocks required to start making some changes, albeit slowly. Although there are questions around his ability to implement the changes he is proposing, the circumstances are the best they've been for many years now."
- "There is a bit of momentum with positive earnings growth and money inflows to the European financial markets, which has been pushing the euro up and giving people some faith. If you are thinking about allocating to Europe, it still makes sense."
- "China's Belt and Road initiative is about more than economic growth. It's about trade and diplomacy. It's an old trade route reconfigured for the modern day world. People have noted some similarities to the Marshall Plan of the post-World War II era in terms of the size, scale and potential diplomatic influence – it's something to watch."

U.S. EQUITY – Andrew Adams, CMT, Senior Research Associate, Equity Research

The majority of the committee is neutral to bullish on U.S. equities over the next six to 12 months, a little lower than in the recent past. More than 80% of the committee thinks there is a good chance for a pullback in that same timeframe.

- "We still think it's a bull market. There's a relatively high floor to how low stocks could go."
- "We've had the best pace in earnings growth since 2011, and the market has responded very well to that. The market still seems to be shrugging off all political issues, and it's more focused on earnings despite softening economic growth."
- "Technology is expected to be one of the best areas for growth over the next few years; however, it's currently overbought and overextended. The dips are still for buying, for technology and the market as a whole."
- "It's all about earnings until proven otherwise."

FIXED INCOME – Nick Goetze, Managing Director, Fixed Income Services (unless otherwise noted)

Twelve months from now, the majority of the committee thinks that rates on the 10-year Treasury will be moderately higher.

- "Demographics are going to play a huge role over the next 10 to 15 years as baby boomers go through the natural progression of shifting from heavily allocated risk-based assets to safer, higher credit quality, income-producing assets."

INVESTMENT STRATEGY COMMITTEE MEMBERS

Each quarter, the committee members complete a detailed survey sharing their views on the investment environment, and their responses are the basis for a discussion of key themes and investment implications.

Andrew Adams, CMT, Senior Research Associate, Equity Research

Chris Bailey European Strategist, Raymond James Euro Equities*

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

Robert Burns, CFA, AIF® Vice President, Asset Management Services

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

Doug Drabik Senior Strategist, Fixed Income

J. Michael Gibbs Managing Director of Equity Portfolio & Technical Strategy

Nick Goetze Managing Director, Fixed Income Services

Peter Greenberger, CFA, CFP® Director, Mutual Fund Research & Marketing

Nicholas Lacy, CFA Chief Portfolio Strategist, Asset Management Services

Pavel Molchanov Senior Vice President, Energy Analyst, Equity Research

Kevin Pate, CAIA Vice President, Asset Management Services

Paul Puryear Director, Real Estate Research

Jeffrey Saut Chief Investment Strategist, Equity Research

Scott Stolz, CFP® Senior Vice President, PCG Investment Products

Benjamin Streed, CFA Strategist, Fixed Income

Jennifer Suden, CAIA Director of Alternative Investments Research

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

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

Kristin Byrnes – Committee Vice-Chair Product Strategy Analyst, Wealth, Retirement & Portfolio Solutions

- "An effective strategy to buffer against an equity market pullback or recession could be long duration, high credit quality, fixed income assets."
- "The Treasury curve has been flattening since 2014 and the runway is getting short for the Federal Reserve. The bond market continues to tell us that what's going on in the markets is relatively uncertain."
- "Last quarter, municipal bonds were cheap and they've rallied considerably, although there's not a lot of supply. Munis have shown the resiliency that we've come to expect out of them, which is encouraging and reinforces slow, steady, low inflation."

  – Benjamin Streed, CFA, Strategist, Fixed Income

- "The bond world is focused on the Federal Reserve. The global balance sheets are still expanding, so you've got room to run in Treasuries."

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

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

The U.S. market for credit continues to attract large flows from institutions and individuals. Record tax receipts at the state levels and pension underfunding are adding to demand in an already yield-starved environment.

- "It's hard to be bearish on equities when the credit markets are giving away money. It's just that simple."
- "The new issue bond market is frequently oversubscribed. Spreads move in from initial price talk and tighten after issuance."
- "It is an uncomfortable calm, and low interest rates have modified behavior of issuers and investors. The bull market for risk assets is, at least in part, being enabled by the credit markets. Until this appetite is satiated, risk assets will benefit and low volatility will persist."
- "At least from the credit side of the ledger, stability is inherently unstable."

ENERGY AND OIL – Pavel Molchanov, Senior Vice President, Energy Analyst, Equity Research

On the whole, commodities have been fairly soft. Energy is part of that trade, not exclusively oil. Oil demand is relatively healthy, growing at about 1% per year.

- "We have been frustrated and perplexed by the disconnect between the fundamentals of the oil market and current price levels. A classic example is oil falling 5% in response to OPEC's recent news of extending production curtailments."
- "To grow the global oil supply 1% per year, the current level of drilling activity isn't enough. Prices will have to rise to enable the industry to get to a more sustainable level of investment. Over the next three to six months, as the inventory data becomes more durable, that should happen."
- "Despite all the hype over President Trump's announcement to pull out of the Paris agreement, the actual trend of lower carbon emissions and changes in the production and consumption of energy is going to continue – in the U.S. and countries that have stayed under the Paris framework."
- "Even more influential is the change in the economics of electricity generation. Natural gas is gaining share, and wind and solar are gaining share at an even faster rate."

ALTERNATIVE INVESTMENTS – Jennifer Suden, CAIA, Director of Alternative Investments Research, PCG Investment Products

In 1Q 2017, industry net outflows, driven by the challenging environment for alternative investments when compared to equity market performance, slowed to the lowest level in five quarters.

Continued on page 20

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

ECONOMIC SNAPSHOT

DR.SCOTT BROWN
Chief Economist, Equity Research

The economy continued to expand in the second quarter, although the pace of the rebound from a "soft" first quarter appears somewhat disappointing. Consumer spending growth picked up, but with some softening in May. Business fixed investment surged in 1Q17, reflecting improved business confidence and a partial recovery in oil and gas well drilling, but the pace appears to have slowed in 2Q17. The mild winter likely shifted some homebuilding activity forward. The fundamentals of the economy appear sound, but labor market constraints are expected to restrain GDP growth in the quarters ahead.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	The economy appears to have been mixed, but generally strong, in 2Q17, with consumer spending growth falling a bit short of expectations.
	EMPLOYMENT	Job growth has remained strong, but the pace should continue to slow over time as the labor market tightens further.
	BUSINESS INVESTMENT	Post-election optimism has continued to support capital spending, but we'll need to see consumer demand pick up. An improved global economy and the turnaround in energy exploration should also add to investment.
	HOUSING AND CONSTRUCTION	Supply constraints and affordability issues should continue at the low end, and lumber tariffs won't help, but household fundamentals are sound.
	MONETARY POLICY	The Fed believes that inflation will move toward the 2% goal and fears that wages will accelerate if the unemployment rate continues to fall. Balance sheet reduction will start slow, and should not be unsettling for the markets.
	FISCAL POLICY	State and local government budgets are in better shape and spending should add a bit to GDP growth. A large infrastructure spending program is unlikely. Tax cuts are likely, but expectations have been scaled back.
	REST OF THE WORLD	Brexit and China's economic transition remain important concerns, but the broader global outlook appears brighter.
NEUTRAL	CONSUMER SPENDING	Job gains and wage growth are supportive. Higher gasoline prices reduced purchasing power in 1H17, but lower prices ought to help in 2H17.
	MANUFACTURING	Mixed, but moderate improvement in orders and production. Some concerns about a possible trade war. Auto sales are post-peak.
	INFLATION	The March plunge in wireless telecom prices is seen as "a one-off." Wage pressures are moderate, but should pick up.
	LONG-TERM INTEREST RATES	The inflation outlook remains benign and low bond yields abroad are a factor. However, the bond market seems to doubt the Fed's resolve to continue normalizing monetary policy in the quarters ahead.
	THE DOLLAR	The dollar is likely to remain range-bound, with gradual Fed tightening already priced in. The possibility of a misstep on foreign trade policy remains the biggest risk.

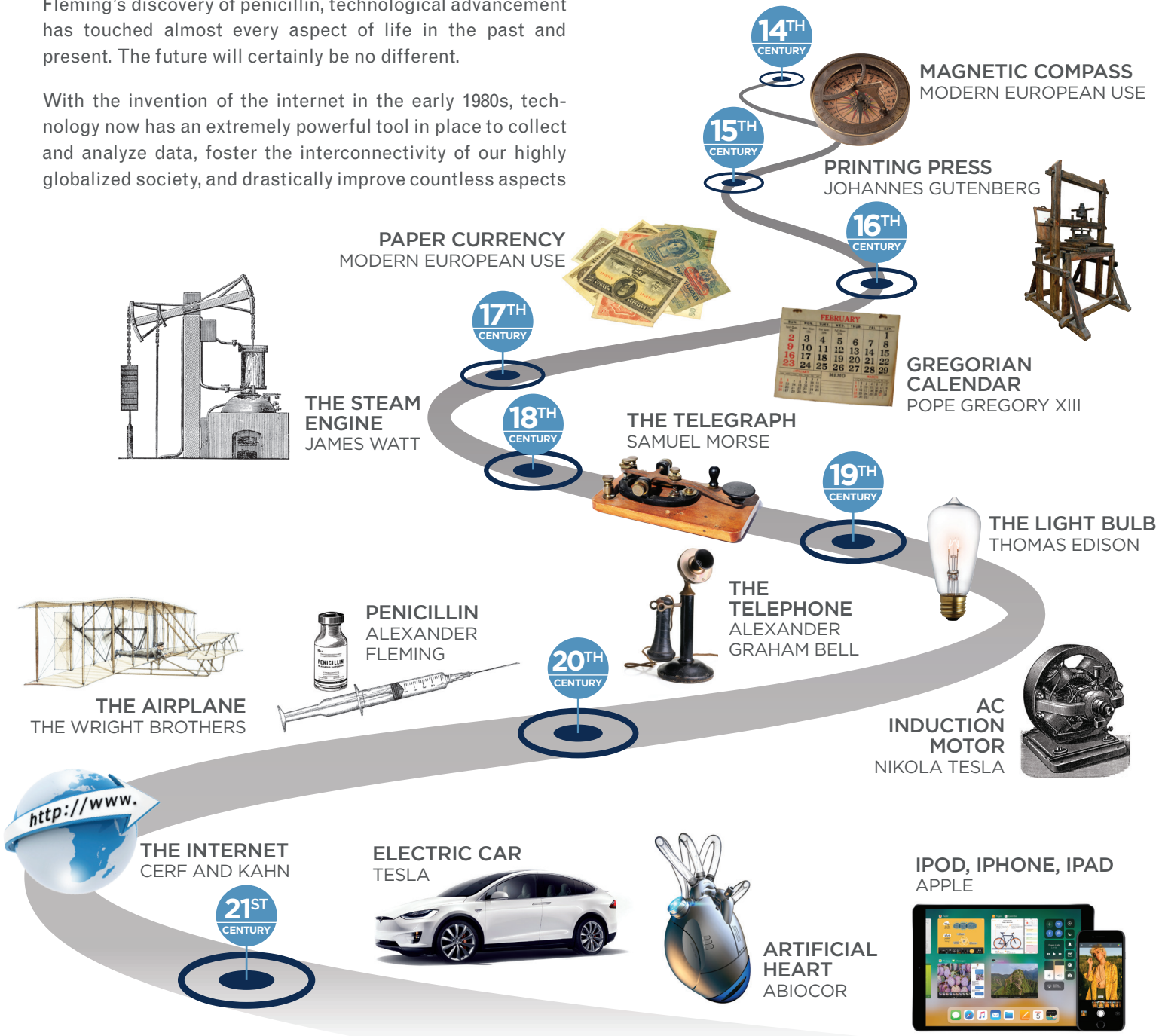
It's a Small World ...

Kristin Byrnes, *Committee Vice-Chair, Product Strategy Analyst, Wealth, Retirement & Portfolio Solutions*

Innovation and technology have been propelling society forward since the discovery of fire, as curiosity compels us to solve problems and improve efficiencies. We are naturally inclined to question the status quo, search for answers, and find solutions to challenging setbacks. This natural inclination has led to advancements throughout the history of humankind that have exponentially changed the way we live our day to day lives. Whether it's Johannes Gutenberg's printing press, Thomas Edison's lightbulb, or Alexander Fleming's discovery of penicillin, technological advancement has touched almost every aspect of life in the past and present. The future will certainly be no different.

With the invention of the internet in the early 1980s, technology now has an extremely powerful tool in place to collect and analyze data, foster the interconnectivity of our highly globalized society, and drastically improve countless aspects of life and business. Not only are great innovations on the way, but they are now being developed more quickly and more cheaply than ever before. The next couple of decades are likely to deliver some major advancements, many of which are inconceivable at the moment. This quarter's issue of *Investment Strategy Quarterly* dives into how technology is changing major industries, financial markets, and the global economy.

A LOOK BACK BY CENTURY



2017 Themes to Watch

ECONOMIC GROWTH: TRADE POLICY

Is China the new champion of globalization? They may be leading the way for the global economy, and these insights share how. China's economic development over the last generation has been staggering. The recent announcement of over 40 international-contracted projects in 60 countries along the Belt and Road Initiative route worth a cumulative $90 billion is striking ... and potentially very economically dynamic.

Chris Bailey, *European Strategist, Raymond James Euro Equities**

The Chinese people refer to their own country as "zhongguo," which directly translates to "Middle Kingdom." Around 3,000 years ago, the Chou people adopted the belief that their empire occupied the middle of the earth, surrounded by barbarians. Back then, the Chou people would have been astonished at the simultaneous development of the Greek and subsequently Roman Empires, but, in their splendid isolation, the phrase stuck.

A BURGEONING INITIATIVE

Returning to the modern world, China has steadily increased its share of global economic interaction over the last 30 years. The World Bank and International Monetary Fund now show China's share of the global economy at 17.2% (in real GDP terms), exceeding the United States' equivalent statistic of 15.7%. Such is the benefit of a population of well over a billion people and a progressive series of economic reforms over the last generation that have seen a largely agrarian economy become the world's manufacturing powerhouse. In regard to the latter, the economy has been augmented by policy initiatives designed to expand consumption and the service sector.

These changes have given the country a new political and diplomatic confidence that would have been alien to the inward-looking Chou people, or even the first 50 years of Chinese Communist Party leadership. President Xi Jinping's inaugural appearance at the World Economic Forum in Davos, Switzerland, occurred the same week as the inauguration of President Donald Trump. Xi's message of "whether you like it or not, the global economy is the big ocean you cannot escape from" has been followed up by an even bigger global economic and trade play: the Belt and Road Initiative, a modern reworking of the old Silk Road trading route between China and Europe.

> "A lot of people, including business leaders, think the future belongs to China. Globalization is not a zero-sum game, but we need to hone our skills to stay in play."
>
> – Jon Meacham

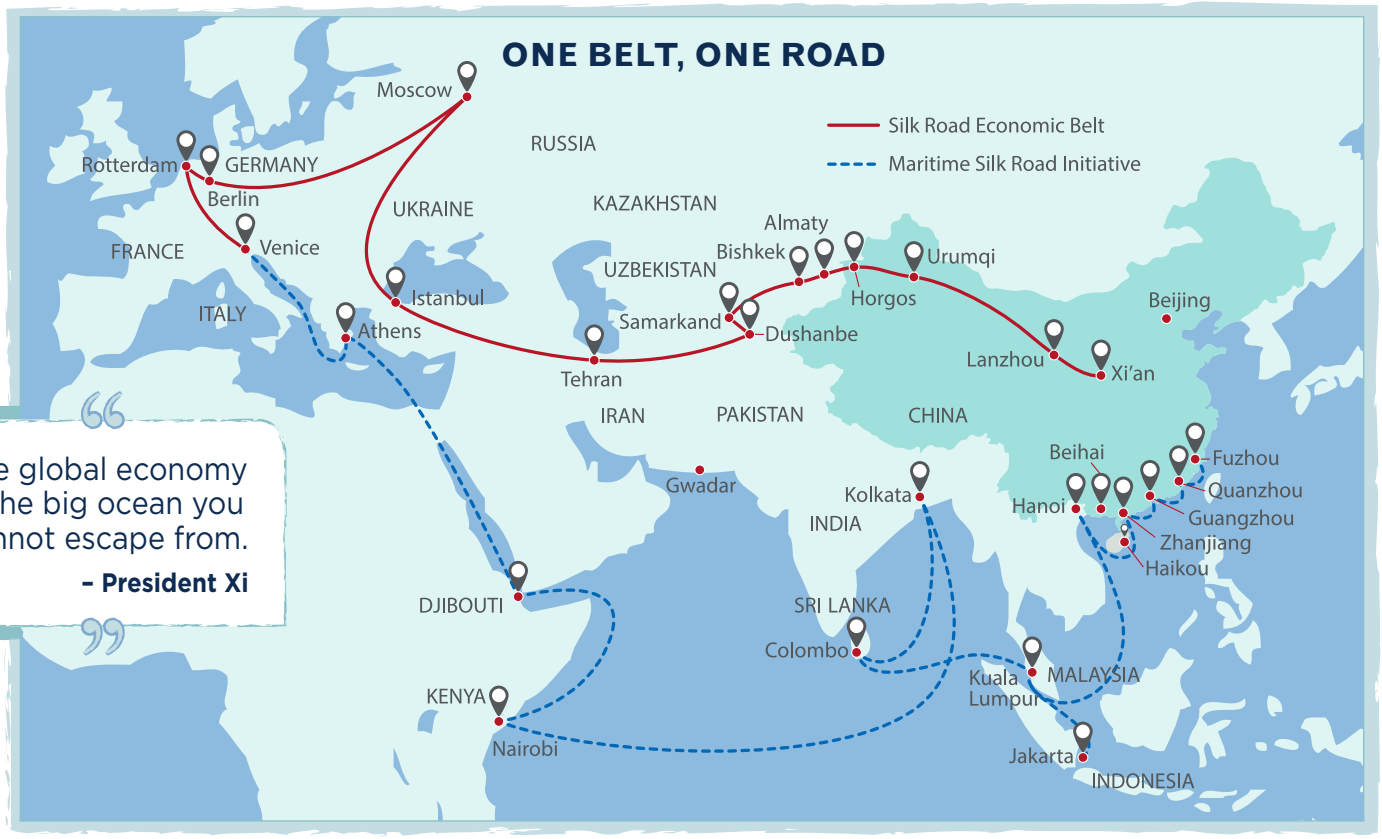
China's economic development over the last generation has been staggering. The recent announcement of over 40 international-contracted projects in 60 countries along the Belt and Road Initiative route worth a cumulative $90 billion is striking ... and potentially very economically dynamic. This was supplemented by the Middle Kingdom signing bilateral investment treaties with 104 countries involved in the Belt and Road Initiative and gives a feel for its potential medium-term significance.

The economics and politics of geography and topology are absolutely fascinating. Centuries ago, the Silk Road trading route was, for a long time, the only link between a distant Western Europe and a distant East Asia, with its path defying all terrain supremely dangerous and difficult to traverse. Modern transportation by sea and air provide alternatives, but land-based road and rail will inevitably bear the biggest burden. So, any modern infrastructure benefits that can facilitate this more easily is a win-win, and the Chinese understand this.

DEALING WITH TRADE

Of course, none of this is done out of pure charity. It makes complete sense for an evolving Chinese economy to engage with the rest of the Eurasia land mass to trade more and generate mutual wealth. The difference is China's pre-eminent role in driving such engagement ... and that I have not mentioned the United States once in the last three paragraphs.

> The Chinese are still in building mode, and this means championing, not blowing up, global trade flows.



> The global economy is the big ocean you cannot escape from.
>
> **– President Xi**

> China's Belt and Road initiative would have an underappreciated uplifting effect on many of the emerging markets.
>
> **– Pavel Molchanov,** Senior Vice President, Energy Analyst, Equity Research

There will be many twists and turns in the foreign policy initiatives of the United States, but it is likely that a "fair trade" rather than "free trade" focus will be central. A quick glance at average tariff levels shows China imposing much higher barriers than either the United States or Western Europe. Globalization by China has some distinct differences, and an expectation that tariff levels will be sharply and rapidly reduced to the levels seen in these other geographies is probably wishful thinking.

"Capitalism with Chinese characteristics" is an evolving reality, but just like the "dollar diplomacy" of yesteryear, money always talks, especially in many poorer and/or significantly smaller Asian nations that increasingly rely economically on China. Expect Chinese globalization to be suitably mercantilist in nature; to help generate surpluses, keep the domestic nation state strong, and build power and influence to support these objectives.

However, before we slide into loose talk about emerging trade blocs and material interruptions to the current level of trade flows, remember this: the Chinese economy is currently undertaking a lot of transitions, and stability remains the most prized characteristic for its political leadership. The Chinese are still in building mode, and this means championing, not blowing up, global trade flows. However, in another decade or so, matters may be different, giving the United States a window of opportunity. Is it time to force change, or just live with changes over time from the East?

2017 Themes to Watch (cont.)

CENTRAL BANK POLICY

With the job market nearing full employment and inflation showing signs of picking up, Federal Reserve (Fed) officials are more comfortable with a pace of rate increases that is still gradual, but less "glacial."

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

Since taking over as chair of the Fed, Janet Yellen's primary goal has been to normalize monetary policy. The Fed lowered the federal funds target range to 0 - 0.25% in December 2008, and held it there for seven years. As the Fed initially raised the target range in December 2015, officials generally expected to raise rates four times in 2016. A slowing in the pace of job market improvement and a more modest inflation outlook countered those expectations, and the Fed raised short-term interest rates only once that year, in December. This year, Fed officials are more comfortable raising rates, but it should still be a gradual pace.

Inflation figures are often a bit choppy in the first few months of the year. Many firms will try to raise prices to see if they stick. That may have been the case in January and February. Core inflation was mild in March and April, partly reflecting an unusually large one-time drop in the price of wireless telecom services. Reflation expectations in commodity prices have softened in the last couple of months (outside of oil prices, it takes a gigantic increase in the price of raw materials to have much of an impact at the consumer level). While factory sector activity has improved, we are seeing few signs of the type of bottleneck production pressures that would lead inflation higher; by contrast, we are still seeing mild deflation in prices of consumer goods excluding food and energy. The labor market is the widest channel for inflation pressures, and wage growth has remained generally moderate.

The job market has been the primary focus for Fed policy. It's unclear how much slack remains, but the broad range of indicators suggests that we are at or near full employment. Monetary policy is still accommodative. Hence, the Fed wants to move closer to a "neutral" policy position. The best analogy is that the central bank is not hitting the brakes so much as gradually taking the foot off of the accelerator.

During the financial crisis and its aftermath, the Fed increased the size of its balance sheet by more than $3.5 trillion through its three large-scale asset purchase programs. The Fed has been reinvesting principal payments (maturing Treasuries and mortgage-backed securities), keeping the size of the balance sheet steady, but officials expect to change the policy later this year. The Fed will set a $10 billion cap, or limit, on the dollar amounts of Treasury and agency securities that will be allowed to run off each month ($6 billion for Treasuries, $4 billion for MBS), and only the amounts of principal payments that exceeded the caps would be reinvested. The caps will be increased every three months, eventually reaching $50 billion per month. The Fed reserves the right to resume the reinvestment policy or to increase the size of the balance sheet if economic conditions warrant.

The end of the reinvestment policy should not be unsettling for the financial markets, but there is some potential for confusion. Recall the "taper tantrum" turmoil of 2013, when long-term interest rates shot up on concerns about the Fed scaling back the pace of asset purchases in the third round of quantitative easing. By starting slow, markets shouldn't become unsettled, and officials will be able to observe how the markets react as the balance sheet drawdown increases.

Of course, none of this is written in stone. Fed policy will adapt to changing conditions. There is one additional caveat. The Fed's Board of Governors will see a lot of personnel changes in the coming months, adding some uncertainty for the financial markets.

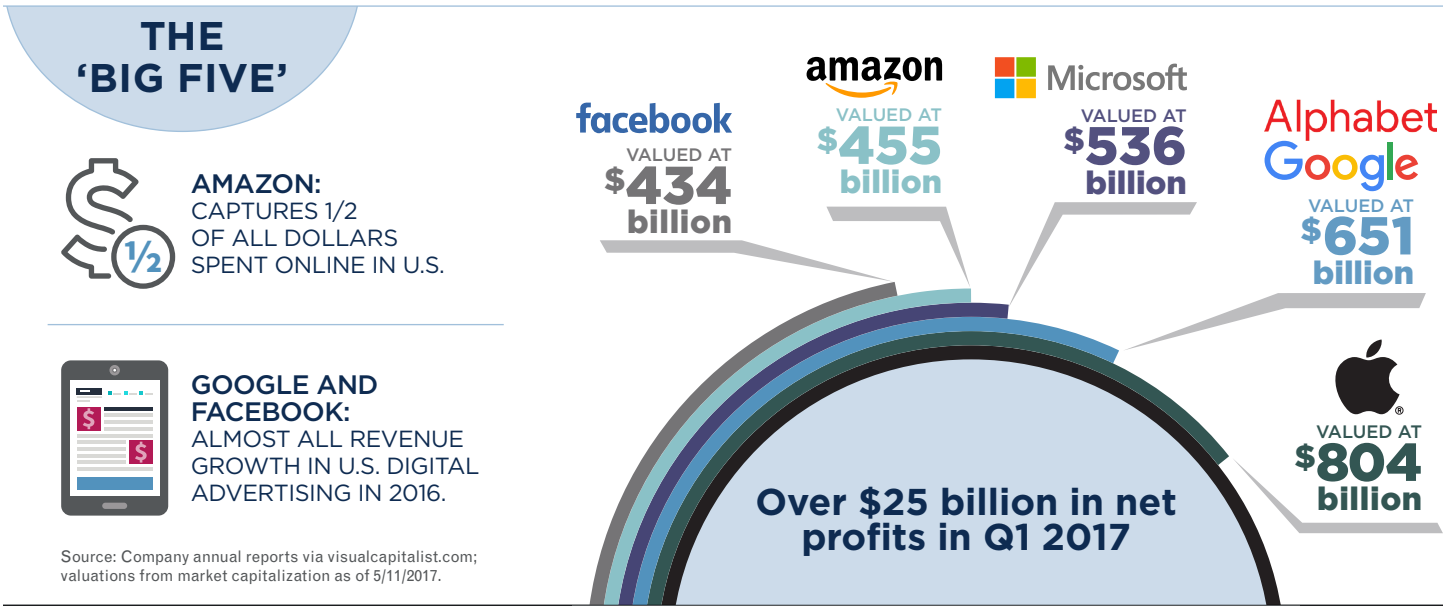
The Byte-Sized Economy

Andrew Adams, CMT, *Senior Research Associate, Equity Research,* discusses how the increasing connectedness of data and technology are shaping our economy.

The 2014 Christmas episode of Netflix's *Twilight Zone*-style series, *Black Mirror,* eerily presented a near-future world where tiny, portable devices can be implanted into the heads of willing consumers to collect all kinds of data. That data is then used to create digital 'cookies' of the participants that can automatically control many aspects of daily life – from making toast each morning just the way you like it to managing your entire 'smart home.' To some, this *Jetsons*-esque level of technological involvement is frightening, while others see it as the natural evolution of our increasingly connected society. Like it or not, it does appear to be the direction our world and, by extension, our world economy is headed – and it's probably going to happen much sooner than most believe.

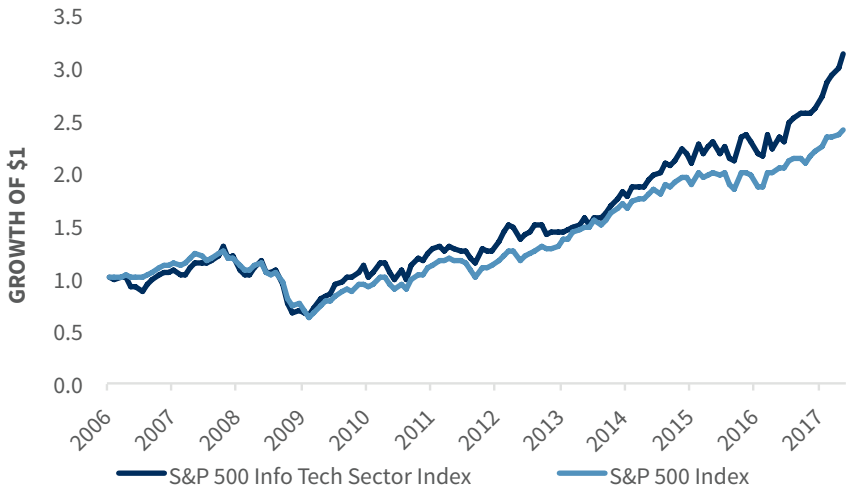
THE FUTURE, TODAY

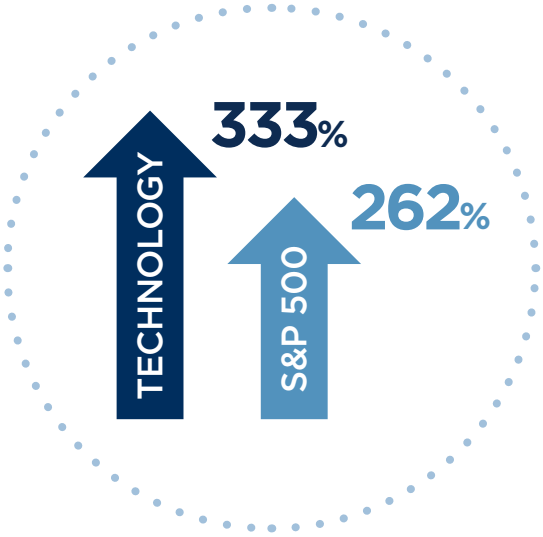
Of course, in some ways, the future is already here. The five most valuable publicly traded companies in the world from a market capitalization perspective – Apple, Alphabet (Google), Microsoft, Amazon and Facebook – are all firmly entrenched in the technology realm. In just a few short years, these tech titans have become essential, integrated parts of our lives, and that dependence is likely to become even more pronounced as their services continue to get more powerful and personalized. The tremendous growth of big tech is not a case of unjustified expectations either, since investors recognize that real value is already being produced. A recent article in *The Economist* nicely summarized the importance of the 'big five' by noting, "Their profits are surging: they collectively racked up over $25bn in net profit in the first quarter of 2017. Amazon captures half of all dollars spent online in America. And Google and Facebook accounted for almost all the revenue growth in digital advertising in America last year."



The Byte-Sized Economy (cont.)

S&P 500 TOTAL RETURN GROWTH OF A DOLLAR





Source: Bloomberg

In short, these are not the 'dot-coms' of the late 1990s for which 'eyeballs' and 'mouse-clicks' were more important than sales and profits. Instead, most tech stocks today are viable companies offering products and services that many consumers feel they can no longer function without, a dependency we are really only aware of when the internet goes down or our phone dies in the middle of the day. At the same time, these technologies used by billions of people across the globe have been constantly collecting precious data on everything we do, and that data is now worth … well … a lot.

THE DATA-DRIVEN ECONOMY

Information has become a highly sought-after resource not too dissimilar to oil or other commodities. Data already powers almost everything these days (from inventory management systems, to our healthcare system, to the financial system that supports it all) and as more data is collected and analyzed, the systems will become even better and more efficient.

> "*The Economist* recently published an article 'Data is Giving Rise to a New Economy' in which they referred to data as the fuel of the future, and that probably isn't just hyperbole."

In fact, the last decade hasn't been the computer age; it's been the *vanishing* computer age. As screens and artificially intelligent 'smart systems' have been implanted into almost everything we use and come into contact with, so the concept of a computer has become a little blurred. This gradual change nicely illustrates one unique principle of technological growth: we never really know what the world is going to look like until it happens. In the 1980s and 1990s, the conceived future was one of personal computers, just as we think in terms of smartphones and tablets today. Yet, if the past rhymes once again, our relationship with technology in just 10 to 20 years will likely be something very different than what we currently envision.

> "Exponential technologies have a long way to go before their full impacts are realized, bringing tremendous potential for growth and investment."

What is known is that investors have been greatly rewarded for their exposure to the technology sector over the last few years. Since March 2009 when stocks bottomed after the financial crisis, the S&P 500 itself is up 262% while the technology sector is up a whopping 333% (as of 5/26/17). When the modern S&P 500 was created in 1957, industrial stocks made up 425 of the 500 spots, with 60 utility stocks and 15 railroad stocks rounding out the list. Now, more than 22% of the index is defined as 'information technology,' and it would be a tough task to find an area of the market where the proliferation of data and analysis hasn't made a substantial impact. As a result, the tech-heavy Nasdaq Composite Index has finally eclipsed its dot-com bubble high after more than 15 years of largely moving sideways, and that may be just the beginning.

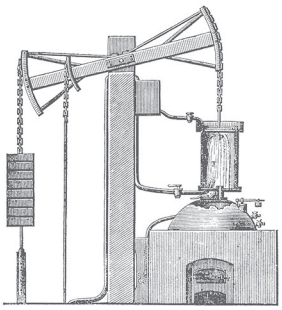
EVOLVING TECHNOLOGY

Naturally, this data-driven revolution is worrying to some, who readily recall the fallout from the dot-com bubble at the end of the 1990s that soured many investors on the concept of a 'new economy.' The market is always skeptical when someone says, "This time is different." Yet, there have been monumental occasions in the past when it really has been different – the Industrial Revolution, the advent of the personal computer, and, now, the complete integration of electronic technology into our daily lives. We usually think of 'technology' as just gadgets and gizmos, but it's simply the continuous progression of doing things better. Fire was technology. The wheel was technology. The steam engine and the assembly line were definitely technology. This is the next stage of that evolution, which is why it's sort of a misnomer to label just one sector of the market 'technology' since it's really describing the progression of humanity.

TECHNOLOGY OVER TIME

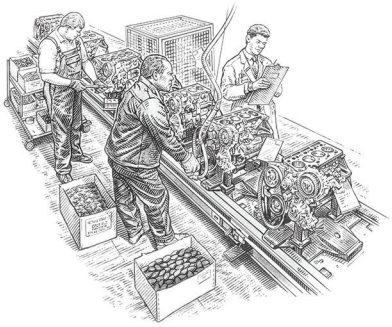
ABOUT 1 MILLION YEARS AGO
Changed the course of human evolution

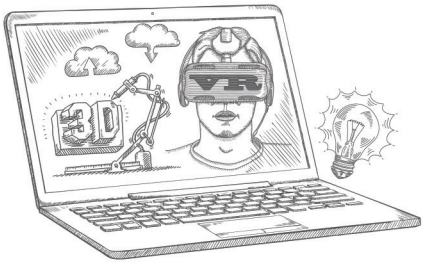
AROUND 3500 B.C.
Created initially to serve as potter's wheels



18TH CENTURY
Designed by James Watt

1913
Mass production reduced the time to build a car





TODAY
Exponential technologies continue the progression of humanity

Sources: history.com, smithsonianmag.com, popularmechanics.com

The Byte-Sized Economy (cont.)

The most exciting part, though, is that we seem to be entering a new phase of this advancement, as so-called 'exponential technologies' are only now in the infancy of their life cycles (or at the bottom of their 'S-curves' in tech parlance). We are somewhat familiar with innovations like robotics, virtual and augmented reality, 3-D printing, artificial intelligence and autonomous automobiles (however, at this point, they are mostly still in the 'Wright Brothers plane' stage of development). There is a long way to go before their full impacts are realized, which is fantastic news because this means there is tremendous potential for growth and investment. As a result, rapid progression in these and other related areas such as modern medicine, alternative energies and financial tech will, in our view, help drive this secular bull market to greater and greater heights over the next several years.

INTO THE GREAT BEYOND

Of course, there are always risks to progress. World governments are already struggling with how to regulate all this data collection and use, and cybersecurity will need to grow at the same rate as technology in order to keep pace with protecting that data. Privacy is also a concern in our modern society, and that promises to become even more of an issue as consumers push back on how their personal information is commoditized by corporations.

Because of these concerns, exponential technologies will be adopted at the speed the public and world governments will allow. Additionally, there is a threat of not having enough skilled workers to fill the employment needs of this new economy, as companies are already fighting a global war for talent. There needs to be a shift in the focus of education systems to teach the required skills of today and tomorrow, especially as automation continues to replace workers in an ever-growing number of fields. Otherwise, we run the risk of stagnating that expected growth.

However, it is very difficult to hold back progress completely, and we remain optimistic that much of the change to come will have a positive influence on our world. Technology has helped shrink the relative size of the planet, while fueling its economic development. It is unlikely that its impact is going to diminish as we progress forward. Consequently, we continue to believe it will help power this secular bull market as new technological advances further disrupt the ways companies do business and how we interact with our world and each other. The world of science fiction will eventually become science fact, but the most amazing part is that we may not even realize it is happening.

KEY TAKEAWAYS:

- Like it or not, a data-driven society appears to be the direction our world, and world economy, is headed – and it's probably going to happen much sooner than most believe.
- Information has become a highly sought-after resource not too dissimilar to oil or other commodities.
- Investors have been greatly rewarded for their exposure to the technology sector over the last few years.
- We seem to be entering a new phase of this advancement, as so-called 'exponential technologies' are only now in the infancy of their life cycles, bringing tremendous potential for growth and investment.
- Rapid progression in areas such as modern medicine, alternative energies and financial tech will, in our view, help drive this secular bull market to greater and greater heights over the next several years.

Q&A: The Future of Fuel

Pavel Molchanov, *Senior Vice President, Energy Analyst, Equity Research,* shares his thoughts on how the connection between technology and oil is shaping what's to come in the energy sector.

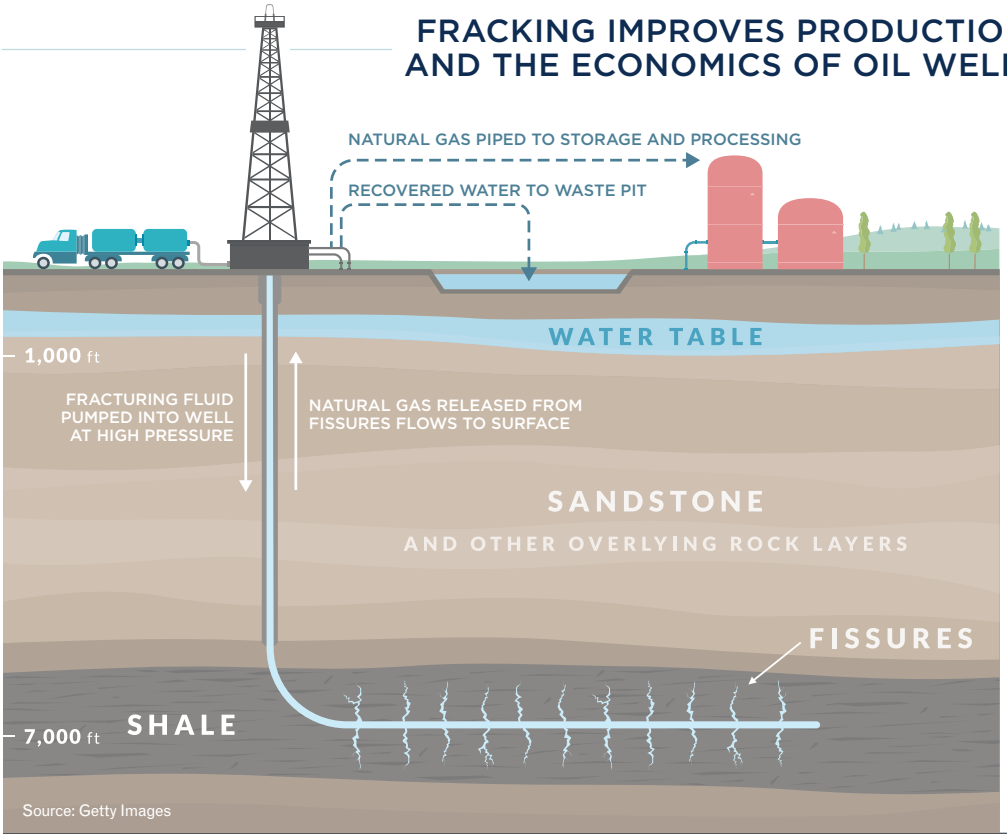
Q. HOW HAS TECHNOLOGY CHANGED THE OIL INDUSTRY OVER THE PAST DECADE?

A. As global oil supply has grown over the past century, currently reaching production levels of 100 million barrels per day, new technology has enabled production to take place in geographic locations that had not previously been accessible or economical. Significant developments include enhanced oil recovery and deep-water drilling.

Over the past decade, the most impactful new technology for extracting oil (and natural gas) has been hydraulic fracturing ("fracking") alongside horizontal drilling. This, more than anything, has enabled U.S. oil production to reverse three decades of declines since 2010. In the Bakken (North Dakota), Eagle Ford (South Texas) and Permian Basin (West Texas and New Mexico), fracking is a critical tool for the industry in improving the productivity, and thus the economics, of oil wells. Fracking is also being employed to a lesser extent in parts of Canada, and is in the early stages of implementation overseas, in places like China and Argentina.

As technology is helping make the oil supply more plentiful and cheaper, it is also contributing to slowing the growth rate of demand for oil. Strictly speaking, this isn't an oil industry

FRACKING IMPROVES PRODUCTION AND THE ECONOMICS OF OIL WELLS



Source: Getty Images

GLOBAL OIL SUPPLY

100 MILLION BARRELS PER DAY IN PRODUCTION

U.S. OIL PRODUCTION

FRACKING HAS HELPED REVERSE **30** YEARS OF DECLINES SINCE 2010.

Q&A: The Future of Fuel (cont.)

AIRCRAFT WINGLETS

Winglets reduce drag by altering the flow of the vortices created by the wing. They also increase the area of the wing, which creates lift.

4% SAVINGS IN FUEL BURNED

130,000 GALLONS OF FUEL SAVED PER AIRCRAFT PER YEAR

4% CO2 EMISSIONS REDUCED

Source: Boeing

issue, but more a matter of transportation engineering. It is hardly a secret that modern car engines are more efficient than those from 10 or 20 years ago, enabling the same distance to be traveled using less fuel (all else being equal). An example of a technology that's not as well-known would be "winglets" on aircraft. Next time you fly, check out the tips of the wings. Those add-ons make planes more aerodynamic, shaving as much as 5% off fuel consumption.

Electric vehicles ("EV") are probably the highest-profile example of new technology that can reduce oil demand, even though they will not become needle-moving for oil demand for a long time. Despite some of the EV-related hype in the media, EV adoption has actually been running more slowly than the industry had originally expected. We project that all EVs sold globally, on a cumulative basis through 2020, will displace only about 0.25% of global oil demand in that year. The earliest that EVs could single-handedly prevent global oil demand from growing would be after 2025. This is also the timeframe that self-driving/autonomous vehicles will come on the market.

Q. THE PRICE OF OIL FELL AFTER OPEC ANNOUNCED A RECENT CUT IN PRODUCTION. HAS THE CARTEL LOST ITS FORMER INFLUENCE?

A. Even without the recent decision by OPEC and Russia to extend their production curtailments, it is important to point out that global oil inventories were already heading substantially lower in 2017. The extension, all else being equal, should provide a 1.1 million barrel per day average benefit (versus our pre-extension oil model) from Q3 2017 to Q1 2018, and this is a big deal. There is nothing in the OPEC decision, as telegraphed as it had been, that should have logically resulted in a 5% oil sell-off that day. All we can say is that markets are not rational 100% of the time, and, ultimately, fundamentals are what matter. The fundamental picture for oil inventories is that they are on track to drop below normalized levels later this year. This is inherently bullish for oil prices, which is why we expect prices to reach cyclical highs over the next six to nine months.

Growth of non-OPEC oil supply has certainly made OPEC's position in the oil market less central than it had been for

OIL INVENTORIES

OPEC AND RUSSIA
PRODUCTION CURTAILMENTS EXTENDED

1.1 MILLION BARRELS PER DAY
AVERAGE BENEFIT FROM Q3 2017 TO Q1 2018

much of the past half-century. However, Saudi Arabia individually remains an important swing producer. Some of the smaller OPEC members have shown very little willingness to comply with their pledged production cuts, but Saudi Arabia has actually cut more than it was supposed to. The fact that they continue to play a cooperative role in helping rebalance the global oil market is bullish.

Q. HAS SAUDI ARABIA ATTEMPTED TO DIVERSIFY ITS ECONOMY IN THE WAKE OF LOW OIL PRICES?

A. The question of what is motivating the Saudi Arabian production discipline is a matter of speculation: we can see what's happening, but not why. One popular theory these days is the notion that the state is deliberately propping up oil prices in order to improve market conditions for the long-anticipated Initial Public Offering (IPO) of its national oil company, Saudi Aramco. That would suggest that the state will revert to a less cooperative stance if and when the IPO occurs, potentially sometime in 2018. Other variables can also be at work, however. For example, the Saudi budget – particularly given the ongoing war in Yemen – clearly cannot sustain sub-$50 oil forever. Those $110 billion arms deals don't pay for themselves! Additionally, the royal family is well aware that permanent fiscal austerity is hardly a recipe for maintaining social cohesion (i.e., keeping themselves on the throne).

Saudi and the smaller Persian Gulf states have an advantage in that they have relatively small populations and, therefore, high oil revenue per capita. The same goes for Norway and Canada. Also, Saudi has a sizable "rainy day fund" in the form of its currency reserves. The oil down cycle of the past three years has been much more damaging for the lower-income oil exporters, such as Venezuela and Iran. These countries, and to a lesser extent Russia, have struggled economically amid the austerity that the reduced export earnings have caused. On the other hand, let's not overlook the fact that cheap oil is positive for most of the world's emerging markets, which tend to be oil importers, with China and India being the most obvious examples.

KEY TAKEAWAYS:

- Over the past decade, the most impactful new technology for extracting oil (and natural gas) has been hydraulic fracturing ("fracking") alongside horizontal drilling. This, more than anything, has enabled U.S. oil production to reverse three decades of declines since 2010.
- As technology is helping make the oil supply more plentiful and cheaper, it is also contributing to slowing the growth rate of demand for oil.
- The fundamental picture for oil inventories is that they are on track to drop below normalized levels later this year. This is inherently bullish for oil prices, which is why we expect prices to reach cyclical highs over the next six to nine months.
- Let's not overlook the fact that cheap oil is positive for most of the world's emerging markets, which tend to be oil importers, with China and India being the most obvious examples.

Economic Growth: Will a "New Norm" Trump the Political Agenda?

Scott J. Brown, Ph.D., *Chief Economist, Equity Research*, outlines his expectations for economic growth.

Economic growth is an important factor in financial market performance and investors typically focus on near-term prospects while long-term trends are often overlooked.

In recent years, economists have increasingly come to accept the view that slower labor force growth will limit the trend in inflation-adjusted gross domestic product (GDP). Financial markets may have yet to fully embrace this "new normal."

TIGHTENING JOB MARKET CONDITIONS

Monthly changes in nonfarm payrolls are subject to statistical uncertainty and difficulties in seasonal adjustment. This noise can be reduced, but not eliminated, by looking at a period of months. The payroll figures have shown a clear downtrend over the last few years, which likely reflects the tightening in job market conditions. Firms are simply running out of people to hire. The recent pace of job growth is still beyond a long-term sustainable rate, which is okay since there is some slack remaining in the job market. However, that slack is being reduced, leaving us closer to full employment. The unemployment rate fell to 4.3% in May, a 16-year low. The percentage of people involuntarily working part time has fallen. The unemployment rates for teenagers and young adults are trending lower.

Tight job market conditions are normally associated with faster wage growth. In recent months, average hourly earnings were trending at around 2.5% year-over-year, better than the 2.0% pace of a few years ago, but far short of the wage growth (3.5% or more) we would expect to see at such a low unemployment rate. Moderate wage growth likely reflects labor's limited bargaining power. Union membership is a fraction of what it was in previous decades, and a higher concentration of large firms makes the job market less competitive.

Wage growth has been muted in 2017 on an inflation-adjusted basis. Gasoline prices are higher than last year. With more money going into gas tanks, households have less money to spend on other things. Rents have been rising faster than overall inflation. Healthcare costs are accounting for an increased share of household budgets. Consumer spending was weak in the first quarter of 2017. That's not necessarily a problem – a soft 1Q17 following a strong 4Q16 is not surprising – but recent data suggests that the 2Q17 rebound is disappointing.

TRUMPONOMICS AND TAX REFORM

It's no secret that U.S. politics have become more polarized. What's unusual is that this division has become more clearly reflected in economic expectations. The University of Michigan's May Survey of Consumers showed sharp differences by political affiliation, "with Republicans holding more favorable views on jobs and policies than Democrats." According to the report, "The impact of this divide led most Republicans to expect a robust expansion and most Democrats to anticipate a recession." That division may also be reflected in consumer spending. Retailers note some decrease in spending due to the crackdown on undocumented workers.

Business fixed investment rose sharply in the first quarter, largely reflecting the rise in business confidence. However, more than a third of that increase was in oil and natural gas drilling. Energy exploration contracted sharply from the end of 2014 to the middle of 2016. Oil and gas well drilling, which is capital intensive, rebounded some in the first quarter. However, beyond the energy sector, capital goods orders and shipments appear to have slowed to a more moderate pace into the second quarter.

Since the November election, financial market participants have been encouraged by the "Trump agenda" of reduced regulation, large-scale infrastructure spending and broad tax reform. However, even with one-party control of the White House and both chambers of Congress, this agenda is facing a significant uphill battle on Capitol Hill. Under broad tax reform, individual and corporate tax rates would be lowered, with lost revenue recov-

ered partly through the elimination of most tax deductions. These deductions (also called "tax expenditures") amount to $1.5 trillion per year. However, nobody wants to give up their deductions and lobbyists will vigorously defend them. Congress may still lower tax rates later this year or in early 2018, but on a much smaller scale than had been hoped for earlier.

A $1 trillion deficit-financed infrastructure spending package is a nonstarter. Members of the House are not going to vote to boost the deficit. Private-sector funding of infrastructure has been proposed, but privatization doesn't provide a boost to the overall economy and should be limited beyond airports and air-traffic control. By contrast, a rollback in regulations is easily achievable. Congress doesn't even need to change legislation. The executive branch can simply ignore the regulatory laws on the books. However, it's unclear how much restraint regulation has imposed on the overall economy.

Even if the Trump agenda were enacted in full, the economy would remain subject to labor market constraints. Indeed, consensus forecasts for GDP growth were raised only marginally following the election and have softened a bit more recently.

SLOWER GROWTH TRENDS

Slower-trending U.S. economic growth creates a number of intermediate-term concerns, and countries around the world face similar challenges. One issue is how to improve the standard of living. Another is how to fund the retirements and healthcare of aging populations. Entitlement spending (Social Security and Medicare) accounts for an increasing portion of federal government spending. Eliminating all nondefense discretionary spending, an extremely unlikely prospect, would still leave us with a budget deficit.

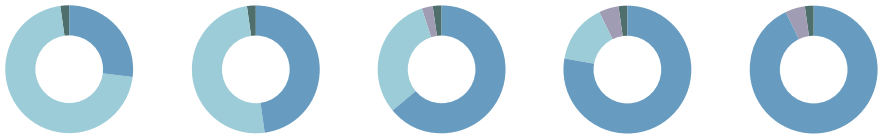
Efforts to boost growth beyond the 1.5 - 2.0% sustainable trend should be directed to two areas: adding to labor force growth and boosting productivity growth. The Labor Department projects that potential labor force growth will average about 0.5% per year over the next ten years, with immigration accounting for about 40% of that. Slower population growth could be offset by increased immigration. Instead, both legal and illegal immigration have slowed this year. Productivity-enhancing capital expenditures rose in the first quarter, but it remains to be seen whether such a strong pace will continue. Longer term, advances in technology, principally robotics and artificial intelligence, should help offset slower labor force growth. However, it's difficult to say by how much.

For the most part, we are only talking about a slower trend rate of economic growth, not a recession. However, for any given pace of GDP growth, some sectors will grow faster than others. As trend growth slows, some sectors will be in contraction. *Historically, the strength of the U.S. economy has been its ability to evolve and adapt to changing circumstances.* One hundred and fifty years ago, most of the economy was in agriculture. Sixty years ago, one out of every three jobs was in manufacturing. The future will look different to us in ways we cannot see now. However, it seems clear that the U.S. will need a more adaptive, better-educated workforce.

KEY TAKEAWAYS:

- In recent years, economists have increasingly come to accept the view that slower labor force growth will limit the trend in inflation-adjusted gross domestic product (GDP). Financial markets may have yet to fully embrace this "new normal."
- Since the November election, financial market participants have been encouraged by the "Trump agenda." However, this agenda is facing a significant uphill battle on Capitol Hill.
- Historically, the strength of the U.S. economy has been its ability to evolve and adapt to changing circumstances. The future will look different to us in ways we cannot see now. However, it seems clear that the U.S. will need a more adaptive, better-educated workforce.

STRATEGIC ASSET ALLOCATION MODELS



	CONSERVATIVE	CONSERVATIVE BALANCED	BALANCED	BALANCED WITH GROWTH	GROWTH
EQUITY	**27%**	**48%**	**64%**	**78%**	**93%**
U.S. Large Cap Equity	19%	28%	33%	36%	43%
U.S. Mid Cap Equity	3%	7%	9%	11%	13%
U.S. Small Cap Equity	2%	3%	4%	5%	5%
Non-U.S. Developed Market Equity	3%	10%	14%	18%	23%
Non-U.S. Emerging Market Equity	0%	0%	4%	4%	5%
Publicly-Traded Global Real Estate	0%	0%	0%	4%	4%
FIXED INCOME	**71%**	**50%**	**31%**	**15%**	**0%**
Investment Grade Long Maturity Fixed Income	0%	0%	0%	0%	0%
Investment Grade Intermediate Maturity Fixed Income	50%	36%	24%	15%	0%
Investment Grade Short Maturity Fixed Income	5%	0%	0%	0%	0%
Non-Investment Grade Fixed Income (High Yield)	4%	5%	4%	0%	0%
Multi-Sector Bond*	12%	9%	3%	0%	0%
ALTERNATIVE INVESTMENTS-MANAGED FUTURES	**0%**	**0%**	**3%**	**5%**	**5%**
CASH & CASH ALTERNATIVES	**2%**	**2%**	**2%**	**2%**	**2%**

 *Refer to page 22 for multi-sector bond asset class definition.

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.

	ASSET ALLOCATION	TACTICAL COMMENTS
FAVORABLE	NON-U.S. DEVELOPED MARKET EQUITY	This space is benefiting from an uptick in global growth and inflation, particularly in Europe. Strong near-term momentum combined with relatively attractive valuations compared to U.S. equities justifies a favorable position. Strong earnings growth and positive revisions are tailwinds for this space in the near term.
	NON-U.S. EMERGING MARKET EQUITY	Rising or stable commodity markets should help emerging economies going forward. Earnings growth is also likely to pick up in these economies after lagging for several years, particularly for technology companies. Potential protectionist policies from the U.S. and other developed nations are headwinds, but we remain constructive. Selectivity is key and active management is recommended in this space.
	ALTERNATIVE INVESTMENTS	Lower intra-stock correlations and heightened equity valuations present attractive opportunities in this space, particularly for short sellers. Elevated equity valuations and rising interest rates should bode well for alternative strategies if investors are looking for diversification. Arbitrage strategies benefit from a rising interest-rate environment and private equity continues to show attractive fundamentals and investor demand, particularly in Europe and Asia.
NEUTRAL	OVERALL EQUITY	Equity valuations may not be as elevated as some suggest yet they are not cheap. Strong earnings revisions and positive near-term and long-term momentum should serve as tailwinds for the time being absent an unforeseen market event.
	U.S. LARGE CAP EQUITY	Fundamentals suggest this market is still expensive relative to its own history and against other asset classes. Positive expected earnings suggest that prices may have room left to grow despite tempered investor sentiment.
	U.S. MID CAP EQUITY	Valuations have cheapened compared to large and small caps, making this area slightly more attractive. Momentum has slipped in recent months as the "Trump Trade" fades, leaving us neutral at this time.
	U.S. SMALL CAP EQUITY	Similar to large caps, small caps are relatively expensive compared to other areas of the market. While small caps stand to benefit from potential fiscal reform, weaker momentum warrants a neutral position.
	REAL ESTATE	International REITs are favorable relative to other asset classes from a valuation standpoint. U.S. REITs are still favorable to a lesser extent and pockets of opportunity in industrial and multifamily assets should offset less attractive pricing in office and retail assets.
	INVESTMENT GRADE INTERMEDIATE MATURITY FIXED INCOME	The intermediate portion of the curve provides the best "bang for the buck," especially when paired with quality investment-grade credits. Low inflation should help stabilize intermediate yields with "carry" likely to provide most of the return instead of spread tightening.
	GLOBAL (NON-U.S.) FIXED INCOME	Global fixed income has shown positive momentum. Emerging market (local) debt looks attractive, especially with a recently weakened USD. Active management is highly recommended in this space.
	CASH AND CASH ALTERNATIVES	Cash is a potential buffer against many market risks and provides funding for buying opportunities, leaving us with a neutral recommendation at this time.
UNFAVORABLE	OVERALL FIXED INCOME	Longer-term yields have declined in the face of rising short-term rates in the U.S. resulting in a flatter yield curve. Global rate disparities continue, making the U.S. a favored area compared to other developed economies. While we are unfavorable in this space in the short run, long-term strategic allocations are still warranted given the proven hedge against equity risks.
	INVESTMENT GRADE LONG MATURITY FIXED INCOME	While inflation appears to be in check (supportive of the longer-end of curve), yields continue to fall making this space less attractive and increasing the potential for reversal with rising short-term rates.
	INVESTMENT GRADE SHORT MATURITY FIXED INCOME	This area is highly susceptible to the potential for more aggressive central bank policy than what the market is currently pricing in.
	NON-INVESTMENT GRADE FIXED INCOME (HIGH YIELD)	Spreads are historically tight, leaving little margin for error. We prefer equity-like risk elsewhere where upside is more likely and we continue to strongly recommend active management/credit research in this space.
	MULTI-SECTOR BOND STRATEGIES	Non-traditional or multi-sector bonds tend to perform well in credit tightening events and changing slopes. With spreads tight across most credit bonds, risk is not being compensated unless opportunities are sought in non-conventional areas or outside the U.S. which introduces more risks and potential returns. The USD has slipped already and may provide less return opportunity in the near term.

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

ALTERNATIVE INVESTMENTS SNAPSHOT

JENNIFER SUDEN
Director of Alternative Investments Research

ALTERNATIVE INVESTMENTS	
EQUITY LONG/ SHORT	Long/short equity managers are typically long-biased; so they will generally participate in appreciating markets, albeit to a more limited degree, but also have the potential to protect on the downside. Recently, we see more alpha generated on the short side of the portfolio, as stocks are not moving in lock-step as they seemingly had been for some time.
MULTI-MANAGER/ MULTI-STRATEGY	For investors seeking a lower volatility, lower beta strategy, a broadly diversified multi-manager strategy could be a relevant option.
MANAGED FUTURES	Divergence in economic policy, uncertainty in the global markets, and elevated levels of volatility are tailwinds for the strategy. Additionally, the ability to go both long and short the various asset classes (fixed income, commodities, currency, and equities) allows the strategy to benefit even in times of financial distress. Finally, increasing rates can be advantageous for this strategy due to a higher rate earned on its large cash allocation and the ability for the fund to profit from the trend.
EVENT DRIVEN	Event-driven managers are finding numerous opportunities across the spectrum. M&A transactions are recording larger spreads, and managers with an expertise in this space have the ability to underwrite and understand the regulatory complexities that have contributed to the spread widening. While the opportunities in distressed are not widespread, these managers have been able to take advantage of pockets of opportunities within energy, infrastructure, and ongoing European bank deleveraging. Finally, activists continue to drive change at companies, which have become more receptive than ever before to the suggestions set forth by activist managers.
EQUITY MARKET NEUTRAL	As intra-stock correlations have decreased, managers have the potential to benefit from both the long and short exposure within the portfolio. For an investor who is bearish on equities, this could be a suitable option given its lack of dependence on market movements. However, if equity markets continue on an upward trend, equity market neutral managers are likely to underperform strategies with a long bias.
GLOBAL MACRO	Divergence in economic policy, uncertainty in the global markets, and elevated levels of volatility are tailwinds for the strategy, similar to managed futures. Additionally, the ability to go both long and short across the various asset classes (fixed income, commodities, currency, and equities) allows the strategy to benefit even in times of financial distress and/or rising rates.

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.

INVESTMENT STRATEGY COMMITTEE MEETING RECAP *Continued from page 3*

- "The majority of the hedge fund industry inflows (within private hedge funds) went to global macro and event driven hedge funds. I think people are realizing that dislocations are occurring across the global market environment."
- "Mainly, we are seeing continued interest in private equity, and a lot of that has to do with the return-enhancing properties of those strategies."

ASSET ALLOCATION – Kevin Pate, CAIA, Vice President, Asset Management Services

Valuations across all asset classes continue to grind higher. In the equity space, multiples are creeping up, and, in the credit space, spreads continue to narrow.

- "For implementations where we can own alternatives, we remain underweight equity. Within alternatives, we support trend-following strategies to help meet downside risk targets and protect against higher drawdowns. We remain neutral to emerging markets."
- "Within fixed income, our views continue to evolve. We remain underweight duration but want to continue to chip away at that underweight going forward."

SECTOR SNAPSHOT

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.

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

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	22.7%	Despite the recent retreat in the large-cap tech names, we are not wavering from our Overweight opinion. Fundamental trends remain healthy and are supportive of the current elevated valuation.
OVERWEIGHT	HEALTH CARE	14.7%	Earnings estimate trends have finally turned slightly higher and relative strength has gained momentum. Combining these factors with low valuation improves the risk/reward profile. Politics remains a wild card for this sector.
OVERWEIGHT	FINANCIALS	14.1%	Several factors should contribute to relative outperformance in the months ahead, including the potential for reduced regulatory constraints, healthy earnings growth, potential increases in longer-duration yields and attractive relative valuations.
OVERWEIGHT	INDUSTRIALS	10.2%	We believe that the recovery in manufacturing will continue. Despite the rollover in ISM and PMI data, both indicators remain at levels supportive of growth. Valuation is at a slight discount and the odds favor outperformance from this sector.
OVERWEIGHT	ENERGY	5.9%	Given an intermediate term outlook with our ratings, we feel the risk vs. reward is skewed in favor of share accumulation. Despite downward revisions to 2017 estimates, earnings remain impressive and we expect the earnings recovery to continue in this space.
EQUAL WEIGHT	CONSUMER DISCRETIONARY	12.2%	Despite a healthy job market, lower fuel prices and a rebound in consumption in 2Q, the industry is in flux as rapidly growing ecommerce channels disrupt traditional models.
EQUAL WEIGHT	MATERIALS	2.8%	Valuations are attractive, as is expected earnings growth. Still, with relative technical momentum lagging, we are comfortable with an Equal Weight opinion.
UNDERWEIGHT	CONSUMER STAPLES	9.1%	Lackluster relative earnings growth, valuations in line with longer-term averages, and interest-rate sensitivity keeps us Underweight. The lack of meaningful relative strength gains during the recent price rally reinforces our opinion.
UNDERWEIGHT	UTILITIES	3.2%	Interest-rate sensitivity keep us Underweight. Despite recent declines in rates, we are reluctant to believe that this trend will continue. Additionally, slow expected earnings growth in 2017 and fair (to elevated) valuations further support our opinion.
UNDERWEIGHT	REAL ESTATE	2.9%	Interest-rate sensitivity keep us Underweight as stock market cash flows are likely to channel elsewhere if rates rise. Additionally, rising rates should pressure valuations in real estate as cap rates increase.
UNDERWEIGHT	TELECOM	2.2%	We moved from Equal back to Underweight due to lack of momentum in the political agenda. Fundamental trends remain sluggish and interest-rate sensitivity remains a concern.

ASSET CLASS DEFINITIONS

U.S. Large Cap Equity
Russell 1000 Index: Based on a combination of their market cap and current index membership, this index consists of approximately 1,000 of the largest securities from the Russell 3000. Representing approximately 92% of the Russell 3000, the index is created to provide a full and unbiased indicator of the large cap segment.

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.

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.

Real Estate
FTSE NAREIT Equity: The index is designed to represent a comprehensive performance of publicly traded REITs which covers the commercial real estate space across the US economy, offering exposure to all investment and property sectors. It is not free float adjusted, and constituents are not required to meet minimum size and liquidity criteria.

Commodities
Bloomberg Commodity Index (BCOM): Formerly known as the Dow Jones-UBS Commodity Index, the index is made up of 22 exchange-traded futures on physical commodities. The index currently represents 20 commodities, weighted to account for economic significance and market liquidity with weighting restrictions on individual commodities and commodity groups to promote diversification. Performance combines the returns of the fully collateralized BCOM Index with the returns on cash collateral (invested in 3 month U.S. Treasury Bills).

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.

Global (Non-U.S.) Fixed Income
Barclays Global Aggregate Bond Index: The index is designed to be a broad based measure of the global investment-grade, fixed rate, fixed income corporate markets outside of the U.S. The major components of this index are the Pan-European Aggregate, and the Asian-Pacific Aggregate Indices. The index also includes Eurodollar and Euro-Yen corporate bonds, Canadian government, agency and corporate securities.

Multi-Sector Bond
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 Bond 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.

Relative Value Arbitrage
A hedge fund that purchases securities expected to appreciate, while simultaneously selling short related securities that are expected to depreciate.

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.

Special Situations
Managers invest in companies based on a special situation, rather than the underlying fundamentals of the company or some other investment rationale. An investment made due to a special situation is typically an attempt to profit from a change in valuation as a result of the special situation, and is generally not a long-term investment.

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.

Conservative Balanced 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.

Balanced 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.

Balanced with 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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INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER

880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863

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