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INVESTMENT STRATEGY COMMITTEE MEETING RECAP – HELD ON SEPTEMBER 5, 2017

Major macro factors affecting the economy and financial markets over the next six to twelve months include U.S. earnings growth, Federal Reserve policy, tax reform and interest rates.

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

The majority of the committee is neutral (2.5 – 2.9%) to somewhat negative (2.0 – 2.4%) on real U.S. GDP growth over the next six to twelve months. Inflation is expected to remain about the same at 1.5% for the same time frame.

- "Hurricanes Harvey and Irma will distort much of the economic data and possibly shave a few tenths off of 3Q17 GDP growth, but we should see a rebound in the fourth quarter."
- "Much of the economic data were looking spotty ahead of the hurricanes, with overall growth trending at a lackluster to moderate pace."
- "The showdown over the FY18 federal budget and debt ceiling has been postponed to December 8. A budget agreement is necessary before tax reform efforts can get underway. Broad tax reform (lower rates and reduced deduction) is nearly impossible, as nobody wants to give up their deductions, but lower tax rates are still expected at some point (just on a smaller scale)."

U.S. EQUITY

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

- "We've transitioned from an interest-rate driven to an earnings-driven secular bull market that has years left to run."

  – **Jeff Saut,** Chief Investment Strategist, Equity Research
- "The S&P 500 continues to sustain its momentum due to improving economic activity and earnings growth, along with renewed optimism over tax cuts. While participation in the S&P 500's advance had been narrowing (causing technical concerns), relative performance for the small and mid caps has sharply improved over the past month. This came on the heels of President Trump and Congressional Democrats agreeing on a three-month extension to the debt limit, which spurred the return of the reflation trade and was supported by the Trump administration's tax proposal."
- "The path of tax changes (timing, size, and details) will likely increase volatility now that it has been brought to the forefront of the Congressional agenda and will continue to be a significant influence on the equity market in the coming months. If we do see choppiness, the downside should be limited. We would be buyers of those pullbacks until something changes with these pillars of support – a healthy global economy, earnings growth, low interest rates, and fairly loose monetary policy around the world. They remain supportive of equities longer term."

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

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

Almost 90% of the committee is bullish to some degree on non-U.S. developed equities, while 75% are bullish on emerging market equities over the next six to twelve months.

- "There are several events coming up in the next few months. The first, and probably the least important, is the German election. Angela Merkel is going to win it." [1]
- "Emmanuel Macron has the opportunity to actually push through some proper change in France. If France moves, then you'll see the tone and the shape of the whole European debate move as well. I'm the most optimistic I've been about European reform right now. I actually do think this time it is changing."
- "The third aspect is Brexit, which remains – to be honest – totally boring. Debates continue, which is good because it means the whole timetable gets kicked out. Rather than a very hard, fixed two-year period, in practical terms it will probably be somewhere between four and six years, having less impact on economies."
- "The opportunity set in Europe remains good. I do believe in the reform process, and I believe this is the source of gains from a global asset allocation basis for European markets. I think similarly about Asia and am still really impressed by Chinese economic reform efforts."

FIXED INCOME

We don't see anything trend-wise changing in the near term, and should continue to see rates trickle down.

- "We are certainly seeing intermediate and long-term interest rates trickling down. The support on the short end of the curve has been central bank interference. We have to acknowledge that the markets are also being driven by cash. Combined, central banks are currently over $19 trillion in size now – that's the size of U.S. GDP."
- "For a lot of reasons, interest rates aren't going up quickly any time soon. Along with central bank cash, there is interest rate disparity among most other economic powers

[1] As expected, Angela Merkel and her party won a plurality of the vote in the national election held on September 24, 2017.

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, CFA, 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 & 529 Plan Product Management

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

Jennifer Suden, CFA, 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

with rates well below ours. This is seen through strong indirect participation in Treasury auctions, which is also placing downward pressure on rates."

- "We've seen a shift within some of the sectors, too. Munis have become more expensive and corporates are cheapening. But the belly of the curve is still staying whole. You've got to go out about 15 years on the muni curve to get 85% of the total value, while the corporate curve provides 85% of its value around 11 years out. At the very short end, even some short-term instruments like CDs are starting to play a role."

  – Doug Drabik, Senior Strategist, Fixed Income

- "To me, the Fed's balance sheet unwind is a non-event. The numbers that I've looked at suggest a two-year unwinding of $600 billion, maybe 25 or 30 basis points assuming the Fed sticks with their plan, which they really haven't done for the last four or five years. We were supposed to get a number of rate hikes this year. We may be done, so I think dovishness still rules the globe. Central bank balance sheets are still expanding."

- "The amount of liquidity, risk-taking, and the lack of discipline in the debt markets, at least on the taxable side, is extraordinarily loose."

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

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

As of September 30, energy was 6.1% of the S&P 500 market cap, just about the lowest level in 14 years. Our view is that this is absolutely a place that ought to be overweighted, because it's hard to see how much lower it can get.

- "In regard to Hurricane Harvey, one-fifth of U.S. refining capacity, which is 4% of the world's refining capacity, was offline. That's an extremely impactful statistic, much more impactful compared to Hurricane Katrina. However, structural damage looks very, very small. Yet, shutting down and restarting a refinery takes time. It will take a period of weeks, maybe months at the most, until these are up and running again."

- "The amount of crude production that was offline was never particularly needle-moving, which is why we didn't see a run on crude prices. At the peak, Gulf of Mexico outages were 400,000 barrels a day compared to refining, which was ten times the scale."

HOUSING – Paul Puryear, Director of Real Estate Research, Equity Research

As far as housing is concerned, nothing has changed in the past few months. We're tracking along very modestly with housing starts.

- "We need houses – the same message as last quarter. We just can't build moderate- to low-priced housing. The economics just don't work, and we don't see that changing any time soon."

- "It's a healthy environment. We've got residential fixed investment going up. That's a data point that we track very closely. Typically when it's increasing, the economy is doing well. If it turns and starts to head the other way, we're going to get very nervous. In a lot of ways, it's an indicator of what the consumer is doing. Right now, that all looks good to us."

- "We have 6 - 7% inflation in residential real estate. I'm talking 6 - 7% inflation replacement cost relative to income growth. That's not a good equation, and we don't see that changing."

Continued on page 20

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ECONOMIC SNAPSHOT

DR.SCOTT BROWN
Chief Economist,
Equity Research

While the loss of life and structural damage are tragic, the economic impact of the recent hurricanes is expected to be temporary. The loss of economic activity may shave a few tenths of a percentage point from 3Q17 GDP growth, but we should see a rebound in 4Q17. The Federal Reserve (Fed) has begun to unwind its balance sheet. The run-off will start slow, but the pace will pick up over the next four quarters, and should have a limited impact on the markets (somewhat higher long-term interest rates). Fed officials continue to expect gradual increases in short-term interest rates, with policy actions remaining data-dependent.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	Growth appears to have continued at a moderate pace, with some unevenness in retail sales, industrial production, and housing.
FAVORABLE	EMPLOYMENT	Hurricanes may distort the government's payroll data, but the pace of job growth has been expected to slow as the job market tightens.
FAVORABLE	REST OF THE WORLD	Brexit and China's economic transition remain important concerns, but the broader global outlook has improved, helping U.S. exports.
FAVORABLE	BUSINESS INVESTMENT	Business sentiment remains elevated. Outside of Hurricane Harvey disruptions, the recovery in capital intensive energy exploration is expected to continue. Capital goods shipments have been strong.
FAVORABLE	HOUSING AND CONSTRUCTION	Monthly figures on sales and construction activity have been choppy, but generally stronger than a year ago. Demand for homes remains strong, but the industry faces supply constraints.
FAVORABLE	MONETARY POLICY	Fed policy remains accommodative, but the Fed is expected to remain on the normalization path, gradually raising short-term interest rates in the quarters ahead (11 of 16 officials expect a December hike).
NEUTRAL	INFLATION	Consumer goods prices are generally falling. Inflation in non-energy services has moderated. Labor cost pressures have been moderate, but are likely to pick up. The softer dollar has contributed to some pressure in raw materials.
NEUTRAL	LONG-TERM INTEREST RATES	The balance sheet run-off ought to put upward pressure on U.S. bond yields, but low inflation expectations and low bond yields abroad may limit that.
NEUTRAL	FISCAL POLICY	Federal tax reform is virtually impossible, but lawmakers are likely to lower tax rates in the months ahead. There may be some hurricane-related rebuilding, but infrastructure spending is limited at the federal and state levels.
NEUTRAL	THE DOLLAR	The dollar has fallen against the major currencies in 2017, reflecting diminished expectations for the Trump agenda and expectations of tighter monetary policy abroad.
NEUTRAL	CONSUMER SPENDING	Job and wage growth remain supportive, but auto sales have been trending lower in 2017 and retail sales results were soft in recent months.
NEUTRAL	MANUFACTURING	Mixed orders and production, reflecting some softness in the consumer sector, but a stronger global economy is supporting exports.

Federal Reserve Policy: What's Next?

Scott J. Brown, Ph.D., *Chief Economist, Equity Research,* provides perspective on the pace of balance sheet unwinding amid the moving parts of monetary policy.

> "The near-term outlook remains constructive for the stock market."

Federal Reserve (Fed) officials continue to emphasize that monetary policy will remain data dependent. While the pace is uncertain, short-term interest rates are expected to rise gradually over the next couple of years. The unwinding of the balance sheet has begun slowly, but the pace will pick up over the course of next year.

INFLATION

Much of the recent monetary policy debate has focused on the low inflation trend. Fed officials note transitory effects on inflation, such as the sharp drop in wireless telecom services in March, and most believe that tighter labor market conditions will lead to higher wage inflation. Yet, they are also aware that longer-term structural changes may make the inflationary response to low unemployment more muted than in the past. Time will tell. Officials have signaled a willingness to wait for more information.

INTEREST RATES

While the Fed has raised short-term interest rates in the first half of the year (still very gradual by past standards), credit has generally gotten easier, suggesting that there is more work to do inorder to get the economy on a more even keel. Fed Chair Janet Yellen has said that the federal funds target rate is not far below what would be considered a 'neutral rate', a level neither contractionary nor expansionary. However, the neutral rate is expected to rise over time as the economy improves – hence, an outlook of gradual policy rate increases.

During the financial crisis, the Fed effectively hit the lower bound on short-term interest rates. Large-scale asset purchases, commonly called 'quantitative easing' or QE, were further accommodation. The balance sheet surged as securities were added to the Fed's portfolio. The Fed has now begun to unwind that. The Fed telegraphed its intentions and the pace of the reduction, so market reaction to the announcement has been limited. It's estimated that QE lowered the 10-year Treasury yield by about 100 basis points. Therefore, the balance sheet unwinding is expected to raise long-term interest rates in the quarters ahead (and this will be a multi-year process). Importantly, the Fed does not view the balance sheet unwinding as 'active' policy. Rather, it's been described as 'background.' Officials have emphasized that the federal funds target rate will remain the main policy lever.

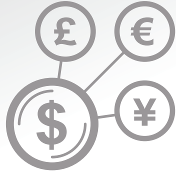
OVERALL

The near-term outlook remains constructive for the stock market. The economy continues to expand, but not so fast that the Fed rushes to 'take the punch bowl away.' However, demographic constraints (slower growth in the labor force) will restrain GDP growth and perhaps present some challenges for the markets in the months ahead.

While future monetary policy moves are always uncertain, the future appears more clouded as we look beyond the early part of 2018. Trump will have a number of Fed governor positions to fill and will be able to shape the Fed's leadership. The choice of Fed chair remains key. Ben Bernanke and Janet Yellen were the right people at the right time.

2017 Themes to Watch

EXCHANGE RATES



The U.S. dollar has recently depreciated while we've seen appreciation of the euro and other foreign currencies. What impact has a declining dollar had on markets as a whole and what does this mean for our currency outlook?

Nicholas Lacy, CFA, *Chief Portfolio Strategist, Asset Management Services*

Through September 26, the dollar has declined approximately 9% against the developed world while the euro has gained approximately 11% against the dollar.

U.S. INVESTORS ENJOY RETURNS FROM ABROAD

So far this year, domestic investors are reaping the benefits of international equity holdings, with developed markets earning almost 20% and emerging market equities nearing 28% through the end of September. To put this into context, U.S. large-cap performance has been a bit more muted, coming in at 14%, while small caps returned roughly 11%.[1] While a 14% return is nothing to shake a stick at, owning international equities has rewarded investors in recent months. To understand where this relative outperformance has been derived depends on where you were invested, literally.

THE DEVIL IS IN THE DETAILS

U.S. investors are exposed to two main drivers of return and risk when owning international equities: local market return and exchange rates. Local market returns are the total returns earned if you reside in the country in which you are investing and use that country's currency to purchase the investment. For example, a Japanese investor purchasing Japanese equities in Japanese yen, would not be impacted by exchange rates and would receive the 'local' total return.

Things work a bit differently in the U.S. Most domestic investors purchase international equities with U.S. dollars as opposed to the currencies of the countries in which they are investing. This is commonly referred to as an 'unhedged' strategy and introduces exchange-rate risk into the total return equation.

If an investor were to buy shares in a Japanese company with U.S. dollars, his returns would be eroded by a strong U.S. dollar since he would lose value when exchanging his profits (valued in Japanese yen) to U.S. dollars. In other words, he would need more Japanese yen to buy the same number of U.S. dollars. The opposite holds true if the dollar is weak; it would take fewer Japanese yen to by the same number of U.S. dollars, creating a currency 'premium' in addition to the local market return.

WHAT'S DRIVING THIS OVERSEAS RALLY?

So, what do exchange rates have to do with international equity performance this year? Everything! If you were to strip out the impact of the U.S. dollar declining this year by approximately 9%, the local total return would be more like 9% for non-U.S. developed markets – less than that of the S&P 500. This is the perfect example of exchange rates benefiting U.S. investors. This is good news as it tells us that developed markets outside the U.S. are not yet experiencing the magnitude of returns seen here at home, leaving more room for local market improvements like the U.S. has been experiencing.

Aside from exchange rate premiums, earnings growth and profitability have been key drivers, especially in Europe where they are improving more rapidly than in the U.S. When you purchase an equity, you are investing in that company's

International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. The returns mentioned do not include fees and charges which would reduce an investor's returns. Past performance may not be indicative of future results. Investing involves risk including the possible loss of capital.

[1] Morningstar data using: the MSCI EAFE Index, MSCI EM Index, S&P 500 and the Russell 2000. Performance as of September 30, 2017

corporate earnings, earnings growth, and a dividend (if available). Investors should want to own stocks in companies whose earnings are growing faster and can be purchased at a fair, or discounted price.

Emerging market equity performance this year was less about the exchange rate benefit (which was only about 5% of the 30% total return) and more about improving valuations in these markets.

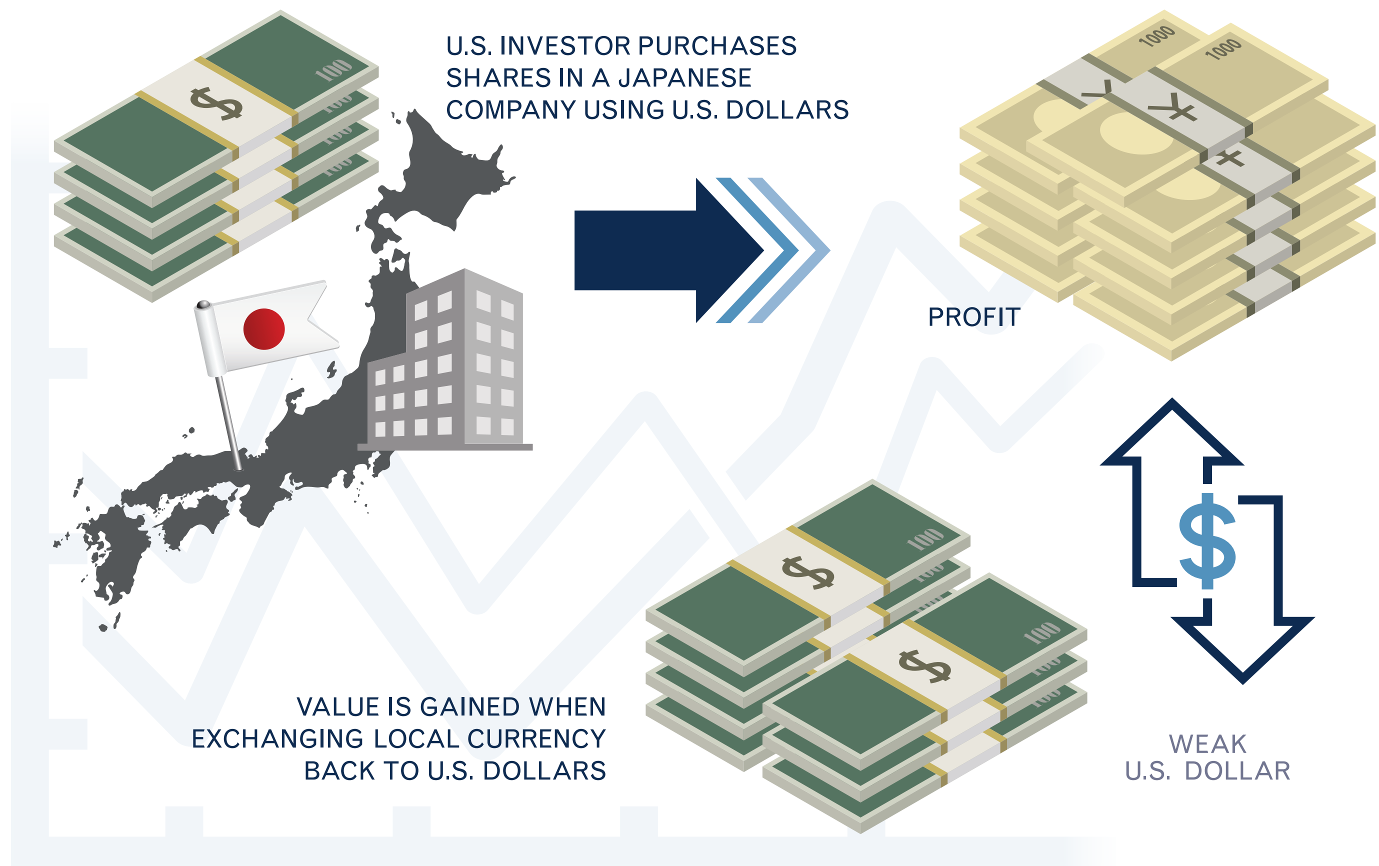
HOW LONG CAN IT RUN?

Non-U.S. developed markets still haven't experienced the improvements in valuations seen here in the U.S. Excluding exchange rates, we believe there is still room for improvement through multiple expansions to support further price appreciation.

As long as earnings continue to grow at a faster pace relative to the U.S. and fundamentals continue to improve overseas, the prospect of continued price appreciation remains quite likely, absent a rally in the U.S. dollar. While the same holds true for emerging markets, it's important to note that these markets are more expensive than their developed counterparts and selectivity is key.

THE CURRENCY 'PREMIUM'

Depending on the strength of the U.S. dollar, value can be gained when exchanging currency.



2017 Themes to Watch (cont.)

INFLATION

Are we in a permanent era of low inflation? Recent consumer price data show a low trend in inflation, leading many to conclude that the Federal Reserve (Fed) may be less aggressive in raising short-term interest rates in the months ahead. A low inflation trend would also have other implications for investors.

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

In the Great Inflation of the 1970s and early 1980s, oil price shocks boosted inflation expectations and quickly spread to wages, which were passed along in the form of higher consumer prices. It took a major recession in the early 1980s to begin reducing inflation expectations, and the Federal Reserve (Fed) worked hard to lower inflation into the 1990s and 2000s.

While the Fed has an official 2% target for inflation (as measured by the Personal Consumption Expenditure Price Index), market participants have begun to see that as a ceiling, rather than a target. If that's the case, inflation expectations ought to be somewhat below 2%. To counter this perception, officials are expected to indicate a tolerance for inflation somewhat above the 2% goal.

BRIDGING THE GAP

Inflation is driven by a combination of expectations and a measure of the output gap. This gap can be a measure of excess capacity, such as the difference between actual and potential gross domestic product, or a measure of resource utilization, such as the unemployment rate.

Many Fed officials believe that we are close to full employment – meaning that a further decline in the unemployment rate will result in higher wage inflation, which will be passed along in the form of higher consumer prices. The labor market is the widest channel for inflation pressure, but wage inflation has remained surprisingly moderate given the low unemployment rate.

This may reflect fundamental changes in the transmission mechanism of inflation. For example, union membership is a fraction of what it was in previous decades, leaving workers with less bargaining power. Also, a greater concentration of large firms and the increased use of the internet have enhanced the bargaining power of those purchasing labor.

Fed officials believe that a portion of the low inflation trend is due to transitory effects in a number of components, such as March's sharp drop in prices for wireless telecom services. However, they are aware that inflation pressures may not build as much as they have in the past. Excluding food and energy, consumer goods have exhibited a mild, steady deflationary trend over the past five years. That likely reflects an impact from global competition.

No doubt, the internet has become an increasing force in retail. Early on, the experience echoed brick-and-mortar shopping. That is, shoppers were less motivated by low prices and more by their comfort level with the online store. Currently, online shopping appears more competitive, adding downward pressure to inflation.

Services account for the majority of consumer spending, with shelter as the largest component. For homeowners, a house serves two functions: an asset and a service (shelter). However, the Bureau of Labor Statistics seeks to measure inflation in the service, not the asset. So it looks at the rental equivalent (i.e., how much it would cost to rent your home). Rents have outpaced overall inflation in recent years, but we've seen some moderation this year.

OVERALL

For monetary policymaking, officials generally have an open mind about whether inflation is on a permanently lower track. More data will tell, and the Fed is preparing a number of strategies to lift inflation if needed.

We can expect the Fed to work toward moving inflation toward the 2% target over the next several quarters. More importantly, the demographic shift implies low long-term interest rates in the years ahead.

All expressions of opinion reflect the judgment of the Research Department of Raymond James & Associates, Inc. and are subject to change. There is no assurance any estimates will be met.

Low Volatility: All Quiet on the Market Front?

Kristin Byrnes, *Product Strategy Analyst, Wealth, Retirement & Portfolio Solutions* and
Peter Greenberger, CFA, CFP®, *Director, Mutual Fund Research & 529 Plan Product Management*
share their thoughts on a prolonged lack of volatility and its effects on the market.

The equity markets are the quietest they've been in nearly half a century, prompting industry pundits and investors alike to question why this might be and what it means for the markets going forward. By "quiet," we are referring to a lack of volatility, namely the degree to which markets fluctuate (either up or down) on a daily basis. Generally, more volatile stocks and market indices are perceived to be riskier.

CONVENTION OR CONUNDRUM?

While volatility levels are by no means 'normal' from a historical standpoint, it doesn't necessarily mean they are unwarranted or unprecedented. Keep in mind that volatility doesn't drive the markets; rather, it is merely a byproduct of the market's actions. Understanding the current environment helps to explain this state of complacency.

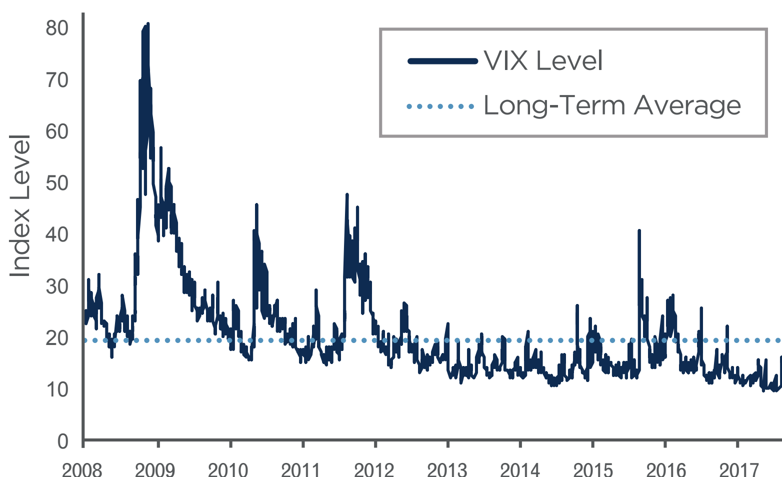
PASSIVE INVESTMENTS

Inflows to passive investments have been on the rise for years now, as longer-term investors seek out lower-cost, tax-efficient, and diversified investment strategies. Index-based strategies allocate assets in proportion to the index, irrespective of individual security analysis. Additionally, increased automated trading by computers and algorithms

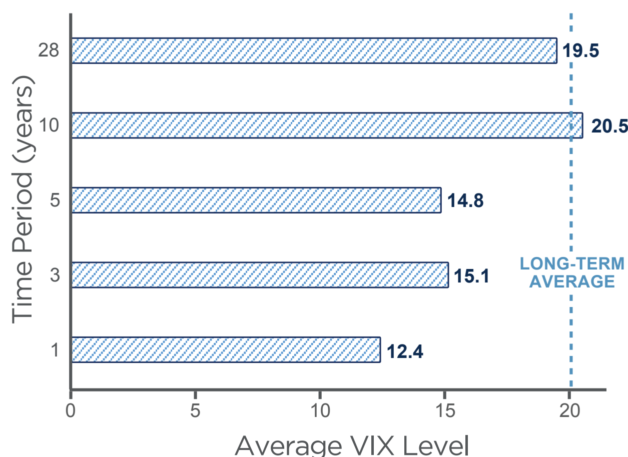
MEASURING MARKET VOLATILITY

The Chicago Board Options Exchange Volatility Index (VIX), commonly referred to as the investor "fear gauge," measures the market's expectation of 30-day volatility for the S&P 500 Index. It recently neared its lowest level ever, and recent trading has been among the quietest in history.

CBOE VOLATILITY INDEX (VIX)



AVERAGE VIX LEVEL OVER TIME



Source: St. Louis Federal Reserve and Raymond James

Low Volatility: All Quiet on the Market Front? (cont.)

has reduced the volume of trades marred by human error and emotion, thus decreasing the impact of these traditional (and sometimes irrational) forces behind market fluctuations.

Another school of thought claims that the growth of passive investing has reduced the volume of trades by ‘stock-pickers’ driven by fundamental analysis, contributing to increased correlations between securities across the board. However, given that intra-stock correlations are now at their lowest levels since the Great Recession, this theory may warrant additional scrutiny.

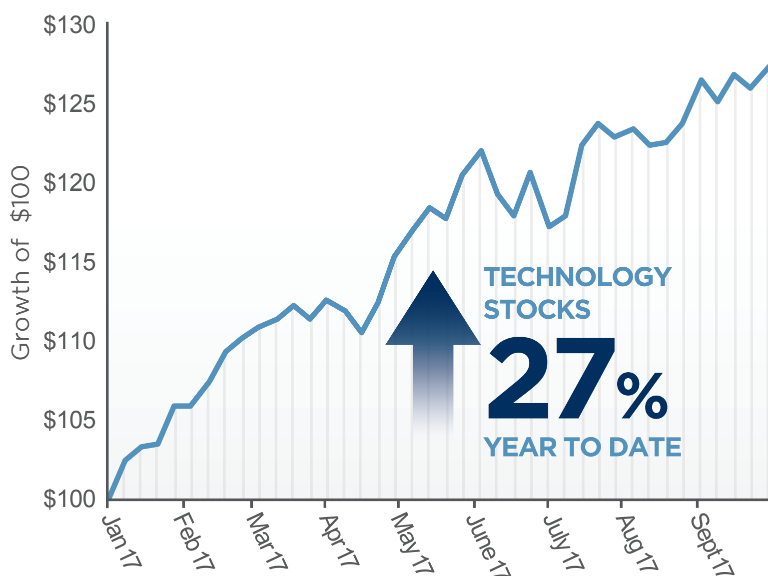
TECHNOLOGY STOCKS

It should come as no surprise that technology stocks have been one of the key drivers of recent U.S. market performance – earning over 27% so far this year.[1] Amongst other areas of the market, investors are treating price declines in this sector as investing opportunities, buying the dips before any negative impact is felt. While it has been most pronounced in the technology space, the willingness of investors to put cash to work during minor drawdowns in the market has helped stabilize and limit some downside that the market would otherwise have experienced.

MARKET FUNDAMENTALS

Despite the fear that markets are overvalued and a pullback or correction is inevitable, we can’t ignore the general health of the equity markets. Healthy earnings growth, positive economic growth, and an extended period of low interest rates have fueled the uptrend in prices for quite some time. Positive earnings estimates going forward are also supportive of further appreciation.

S&P 500 INFO TECH SECTOR PERFORMANCE



Source: S&P 500 Info Tech Sector Index

> “While it has been most pronounced in the technology space, the **willingness of investors to put cash to work during minor drawdowns in the market** has helped stabilize and limit some downside that the market would otherwise have experienced.”

The chart is not indicative of any individual security's performance. The S&P 500® Information Technology Index comprises those companies included in the S&P 500 that are classified as members of the GICS® information technology sector. The index is unmanaged and cannot be invested in directly. The companies engaged in the technology industry are subject to fierce competition and their products and services may be subject to rapid obsolescence. Past performance may not be indicative of future results. There is no assurance these trends will continue. The market value of securities fluctuates and you may incur a profit or a loss. This analysis does not include transaction costs which would reduce an investor's return.

[1] Performance as of 9/30/2017.

While equity prices certainly are not cheap at the moment, the markets seem to have experienced some structural changes that should be considered when assessing valuations. For instance, companies in the U.S. large-cap space with higher margins, more growth opportunities, and a shift from tangible to intangible assets are gaining more and more market share. This begs the question: to what degree are they overvalued? Additionally, is history the most appropriate basis to make this call given these changes?

CENTRAL BANK POLICY

Following the financial crisis of 2008, central banks around the world have been passing out healthy doses of quantitative easing (which injects cash into the system), producing an accommodative, low interest-rate environment flush with cash. Where has much of that cash gone? To the global equity markets, which has resulted in its best performance run since 1998 according to the MSCI All Country World Index.

THE GLOBAL ECONOMY

It's not just financial market volatility experiencing these summer doldrums; global economic volatility has been low as well. Key drivers in the United States include reduced volatility in the job market, smoother corporate profits, and smoother government spending, which has historically been choppy.

Increasing market share of the service sector has contributed to the longer-term trend of quieter economic growth, which has traditionally been one of the less volatile sectors. Additionally, manufacturing is experiencing more consistent growth as advancements in technology continue to improve inventory controls.

WHAT DOES THIS MEAN FOR THE MARKETS GOING FORWARD?

Some market experts do not see this extended period of complacency as the 'new norm' and warn that investors are not accurately accounting for tail risks, or 'black swan' events. While there are valid reasons which support the lack of activity, volatility is likely to return at some point. Whether due to tightening central bank policy or a major geopolitical shock, volatility tends to spike following an unforeseen event, leading to significantly more bearish market responses as opposed to a more controlled increase in activity.

The direction and timing of the markets are anyone's guess, particularly when it relates to unanticipated shocks. Since it seems likely that we just won't know until we know, it's important to manage your investments to the appropriate risk profile to ensure that proper safeguards are in place to protect your assets if and when the equity markets unexpectedly turn.

KEY TAKEAWAYS:

- While current volatility levels are by no means 'normal' from a historical standpoint, it doesn't necessarily mean they are unwarranted or unprecedented.
- Despite the fear that the markets are overvalued and a pullback or correction is inevitable, we can't ignore the general health of the equity markets.
- It's important to manage your investments to the appropriate risk profile to ensure that proper safeguards are in place to protect your assets if and when the equity markets unexpectedly turn.

Diversification does not guarantee a profit nor protect against a loss. The companies engaged in the technology industry are subject to fierce competition and their products and services may be subject to rapid obsolescence. The returns mentioned do not include fees and charges which would reduce an investor's returns. Past performance may not be indicative of future results. Investing involves risk including the possible loss of capital.

Q&A: Company Consolidation

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

Q. IS THE STOCK MARKET EXPERIENCING A CONSOLIDATION OF POWER AMONG A FEW OF THE LARGEST COMPANIES AND, IF SO, WHY?

A. The stock market is shrinking in terms of the number of publicly traded companies, a fact that is both a result of, and contributing factor to, the increasing importance of a select few, large companies. Since 1996, the total number of listed stocks in the U.S. has been cut in half – from 7,322 to about 3,600 – as annual mergers and acquisitions have doubled and the average number of initial public offerings per year has dropped considerably. Meanwhile, the share of gross domestic product (GDP) generated by America's 100 biggest companies rose from about 33% in 1994 to 46% in 2013, meaning not only are there fewer firms in total these days, but a small number of them are taking a greater piece of the pie.

The concentration at the top is, of course, primarily weighted toward the big technology companies, all of which have seen their products and services become increasingly integrated into the lives of their loyal customers. Through innovation, acquisition and the power of so-called 'network effects,' these modern-day conglomerates have built dominant, industry-controlling brands that continue to gain value as their huge user bases expand. The digital age has witnessed data evolve into the most important commodity in the world, and much of the success of these large tech companies is due to the ever-widening 'data moat' that exists between them and up-and-comers lacking that established network of billions of existing customers.

Q. SHOULD INVESTORS AND CONSUMERS BE WORRIED ABOUT THE GROWING IMPORTANCE OF MEGA-CAP COMPANIES?

A. Despite the growing importance of these technology companies, the impact of the ten largest stocks in the S&P 500 has not really changed much over the last 40 years, even if the specific names on that list have changed. The ten biggest stocks currently make up a shade over 20% of the index's market capitalization, which is right around the average since 1980 when the more cyclical energy sector helped the ten largest companies represent a dominating 25% of the S&P 500. Today's large tech companies also happen to be some of the most profitable, with Apple, Google, Facebook and Microsoft alone accounting for about 10% of the S&P 500's total profits. As such, technology's place at the top of the market is not unwarranted. Moreover, the roughly 23% of the S&P 500 that technology represents today is nothing compared to the 34% it comprised back in March 2000 at the peak of the dot-com bubble. Considering American corporate profits (as a percentage of GDP) are higher than they have been any time since 1929, elevated valuations in the stock market are warranted and investors don't appear overly concerned.

Consumers have also benefited in a big way, with technological innovation throughout history helping to bring down costs and prices, while making lives more convenient and requiring less manual labor. Per *The Economist,* tech companies provide Americans and Europeans with an estimated $280 billion-worth of "free" services per year, such as search results or directions. Even the stuff customers purchase provides tremendous bang for each respective buck. In their book *Abundance,* authors Peter

The companies engaged in the technology industry are subject to fierce competition and their products and services may be subject to rapid obsolescence. Dividends are not guaranteed and will fluctuate. Past performance may not be indicative of future results. Investing involves risk including the possible loss of capital.

Diamandis and Steven Kotler estimate that modern smartphones contain roughly $900,000 worth of applications based on each piece of technology's original manufacturer's suggested retail price in 2011 dollars (video conferencing, GPS, video camera, etc.), which illustrates the value being created by tech's game-changing companies. It's no wonder these disrupting forces are raking in the profits and the cash.

Q. HOW ARE THE BIG COMPANIES USING ALL THAT CASH?

A. The success of the mega-cap stocks has not only produced extraordinary profits, but it has also left the big tech companies with unprecedented levels of cash. As of June 2017, Apple, Alphabet, Microsoft, Amazon and Facebook together held $330 billion in cash (net of debt), and the

SMARTPHONES CONTAIN ROUGHLY $900,000 WORTH OF APPLICATIONS

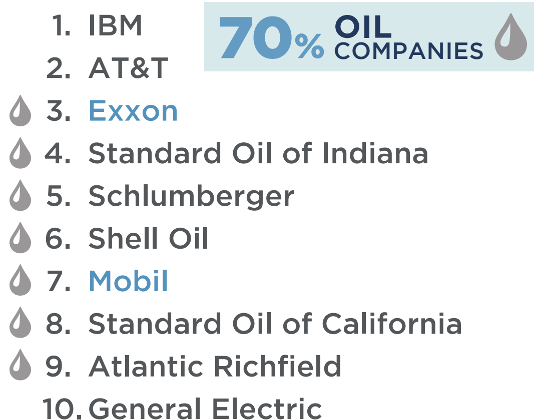
Q&A: Company Consolidation (cont.)

S&P 500's corporate cash as a percentage of current assets has basically doubled since 2000. Naturally, companies have had to find effective ways to use this cash; there has been a clear uptick in dividends, share buybacks, merger & acquisitions activity, and capital expenditures over the last several years. The share buyback policies have come under some criticism since they can help artificially boost earnings and sales per share numbers. However, buying back stock has been shown to help shareholders, and that is not the only way companies have been able to grow their businesses. The five aforementioned tech firms alone spent $100 billion last year on research and development (three times more than half a decade ago). These firms are definitely investing in the future. Finally, there is an estimated $2.4 trillion in cash held by U.S. companies overseas that is just sitting there not contributing much. Should tax reform occur next year and overseas cash comes home, Raymond James estimates share buybacks and the repatriated cash could improve S&P 500 earnings by an additional 1% - 2.5%.

KEY TAKEAWAYS:

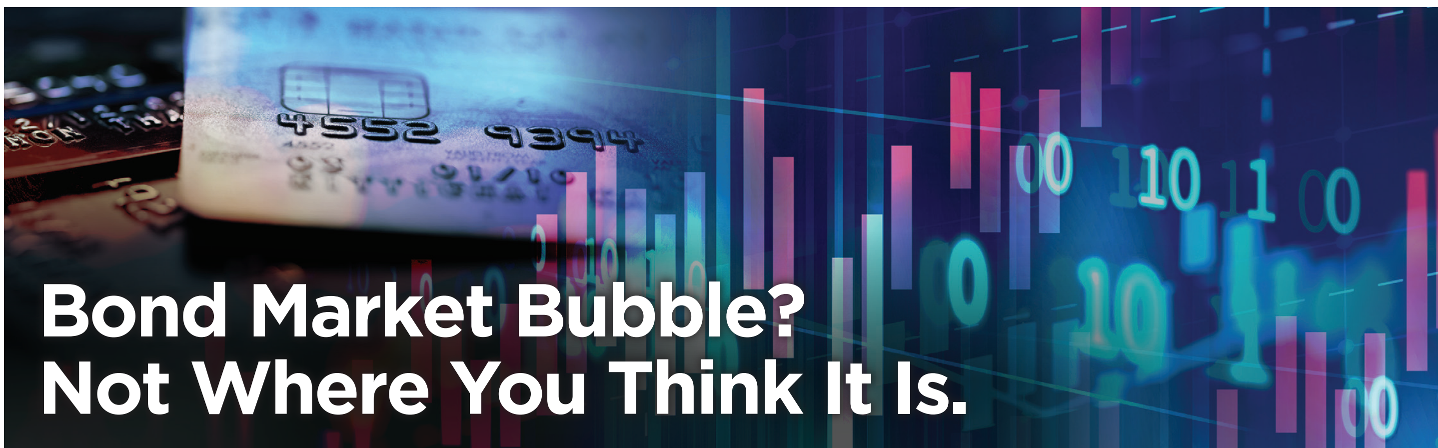
- The stock market is shrinking in terms of the number of publicly traded companies.
- Consumers have benefited in a big way, with technological innovation helping to bring down costs and prices, while making lives more convenient and requiring less manual labor.
- Should tax reform occur next year, and the $2.4 trillion in cash overseas comes home, Raymond James estimates share buybacks and the repatriated cash could improve S&P 500 earnings by an additional 1% - 2.5%.

THE 10 LARGEST COMPANIES IN 1980 VS. THE 10 LARGEST NOW (BY MARKET CAP)



Source: *Fortune* 500

[2] Merged in 1998



Bond Market Bubble? Not Where You Think It Is.

James Camp, CFA, *Managing Director of Fixed Income,* Eagle Asset Management* explores the effect of low inflation and low interest rates on credit markets and specific fixed income sectors.

Former Federal Reserve Chairman Alan Greenspan made headlines recently with his 'bond bubble' commentary. Interest rates, he explained, are as low as any point in history; thus, rates have only one way to go. Yet, persistently low inflation and continued expansion of global central bank balance sheets suggest a sharp rise in government bond yields is not imminent.

Flow of central bank money and low inflation are the key drivers of sovereign yields. The nearly $19 trillion of new money created by global central banks produces too much liquidity inertia for bond bears to overcome.

Though we suspect global rates bottomed last summer, their rapid increase after the U.S. election proved short-lived.

WE ARE 'LESS NEGATIVE' NOW, WITH NEGATIVE-YIELDING SOVEREIGN DEBT AT 17%, DOWN FROM 28% A YEAR AGO.

RATES ARE HIGHER, YET STILL EXTRAORDINARILY LOW.

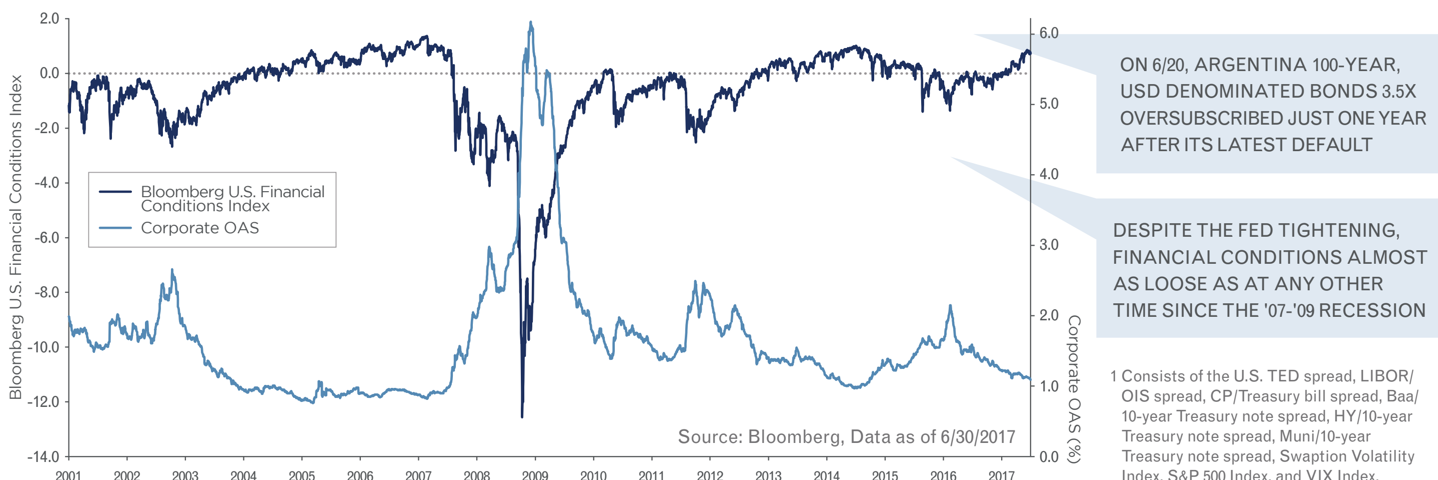
LESS THAN A QUARTER OF THE WORLD'S GOVERNMENT DEBT HAS YIELDS ABOVE 2%.

Central bank activities are fungible. Though the Federal Reserve (Fed) is suggesting a plan to unwind quantitative easing, other central bank balance sheets continue to expand. Global monetary policy is co-dependent in nature. Rates follow year-over-year changes in aggregate central bank bond buying, not just Fed activities.

Importantly, the 'unwind' in the U.S. is expected to be gradual and inconsequential from a rate standpoint. Assuming the plan is not interrupted by political or economic events (unlikely, in our view), it will take a couple of years to have any effect on rates. Even then, according to the Federal Reserve Bank of Kansas City's research, a reduction of $675 billion in balance sheet assets is equivalent to a 25 basis point hike in the federal funds rate.

BLOOMBERG CREDIT CONDITIONS INDEX[1] AND CORPORATE BOND SPREADS

As corporate indebtedness continues to climb, risk premiums grind tighter.



1 Consists of the U.S. TED spread, LIBOR/OIS spread, CP/Treasury bill spread, Baa/10-year Treasury note spread, HY/10-year Treasury note spread, Muni/10-year Treasury note spread, Swaption Volatility Index, S&P 500 Index, and VIX Index.

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

Bond Market Bubble? Not Where You Think It Is. (cont.)

WHERE IS THE RISK?

The real risk to the bond market, and capital markets in general, is the buying stampede in credit. The Fed has increased short-term rates four times since late 2015. Yet, financial conditions, a broad measure of credit availability, are as loose as any time since the Great Recession. This explains, in large part, the continued strength of risk assets across the capital markets. As corporate indebtedness continues to climb, risk premiums grind tighter.

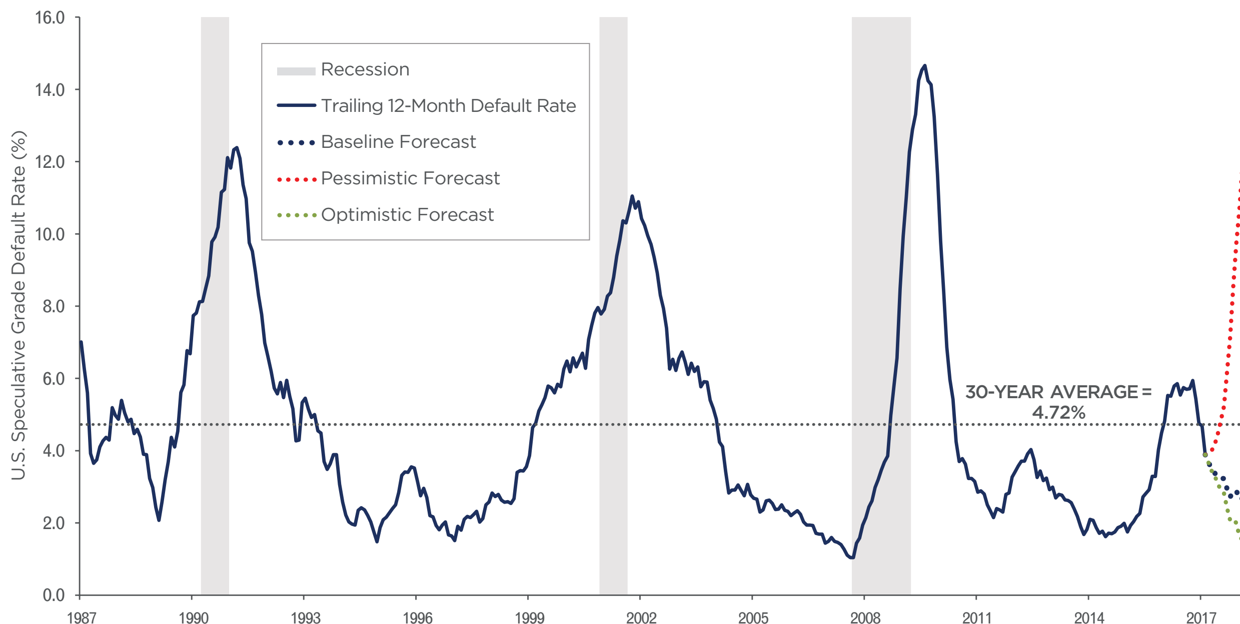
Marginal borrowers continue to tap the debt markets, at ever more dear spreads, and oversubscribed demand. Argentina, a serial defaulter, recently issued a 100-year bond with a 7% yield, which was three and a half times oversubscribed. Tesla, an automaker, has yet to make a profit, nor has it produced positive cash flow in its brief history. Despite the fact that its debt has been rated below investment grade, Tesla was nevertheless able to sell a $1.8 billion, eight-year bond at a yield of only 5.3%. In June, Banco Popular, a failed Italian bank, was the first to be bailed out under the European Union's new Single Resolution scheme. Credit spreads across the European bank sector actually tightened after the announcement.

Corporate indebtedness is higher than the 2008 peak. Corporate debt to gross domestic product (GDP) is now at 45%, higher than levels that preceded prior recessions. More troubling for the real economy is the use of cash, which is often used to buy back stock, fund merger and acquisition activity, or pay dividends. While shareholder rewarding activity continues, risks of re-leveraging are rising.

One measure, the ratio of internally-generated funds (free cash flow) to average corporate debt, is flashing warning signs. Historically, when this ratio dips below 20%, credit problems appear. Earnings growth, strong of late, is an important offset, and (if it continues) likely alleviates near-term pressure. Still, the risk/reward tradeoff for lower-rated credit is unfavorable.

MOODY'S U.S. SPECULATIVE GRADE DEFAULT RATE - SKEWED DEFAULT SCENARIOS.

The default scenarios for speculative grade debt are significantly skewed to the downside.



Source: Moody's and National Bureau of Economic Research; monthly data as of May 31, 2017.

FAVORABLE POSITIONS

On the other hand, the tax-free market is benefiting from a highly favorable supply/demand equation. Lower net issuance, an aging population, and generally positive credit fundamentals have made municipals the best performer in fixed income year-to-date. However, this is coming off the rapid selloff after the U.S. presidential election.

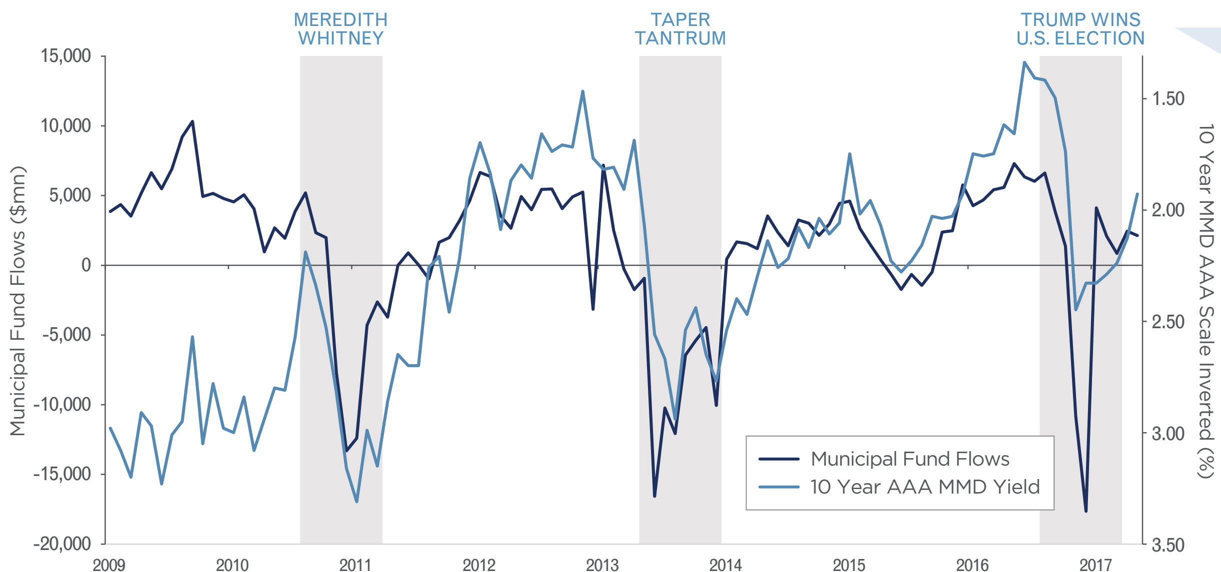
Structurally, municipals are the best positioned market within U.S. fixed income. However, it is often fickle in the short term. Retail investor fund flows continually follow trailing performance in municipals.

As most municipal investors have long-term horizons and are primarily interested in tax-free income, these behaviors are counterproductive, and amount to buying high and selling low. Those counseling tax-free investors should be proactive in buying when yields rise. Most times a headline shakes the market, but underlying demand almost always produces a rapid recovery.

KEY TAKEAWAYS:

- Persistently low inflation and continued expansion of global central bank balance sheets suggest a sharp rise in government bond yields is not imminent. Flow of central bank money and low inflation are the key drivers of sovereign yields.
- Assuming the Fed's plan to unwind quantitative easing is not interrupted by political or economic events, it will take a couple of years to have any effect on rates.
- The real risk to the bond market, and capital markets in general, is the buying stampede in credit, and, as corporate indebtedness continues to climb, risk premiums grind tighter.
- The tax-free market is benefiting from a highly favorable supply/demand equation.

MUNICIPAL FUND FLOWS TRACK INTEREST RATE MOVEMENTS

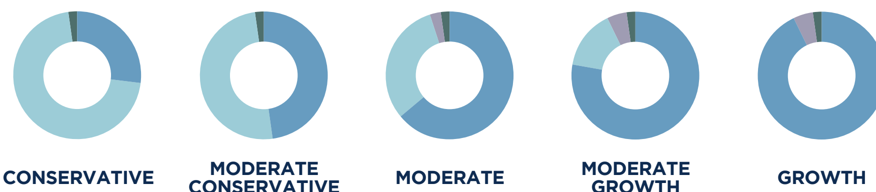


Counterproductive behavior in the tax-free market: as yields move higher (and bond values fall), municipal flows turn negative, particularly in the highlighted 'episodes.' Conversely, as yields fall (and bond values rise), money flows into the market.

Source: Municipal Market Analytics, Investment Company Institute

International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. Past performance may not be indicative of future results. Investing involves risk including the possible loss of capital. Dividends are not guaranteed and will fluctuate.

STRATEGIC ASSET ALLOCATION MODELS



	CONSERVATIVE	MODERATE CONSERVATIVE	MODERATE	MODERATE 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	U.S. LARGE CAP EQUITY	U.S. valuations remain elevated and momentum has started to slow. Still, large caps remain an attractive safe haven relative to U.S. mid and small caps. Structural changes in this space, such as increased market share for higher margin, higher growth companies, may validate elevated valuations but some near-term risk remains intact at this time.
FAVORABLE	NON-U.S. DEVELOPED MARKET EQUITY	Recent weakness in the U.S. dollar has been a tailwind for international equities. This space has yet to see multiple expansions like in the U.S., which could be a powerful total return tool in the coming months. Strong near-term momentum coupled with attractive relative valuations warrant a favorable recommendation as well as improved near-term earnings outlooks.
FAVORABLE	MULTI-SECTOR BOND STRATEGIES	This space lacks interest rate-sensitivity compared to traditional bonds yet is more spread sensitive. Opportunities exist in this space but manager selection remains critical given heavy credit exposure and equity-like risk. Know what you own and how it contributes to overall portfolio risk.
FAVORABLE	ALTERNATIVE INVESTMENTS	This asset class consists of a diverse group of strategies, each with unique risk/return profiles. Please see the Alternative Investments Snapshot on the following page for an inclusive list of the major strategies and near-term recommendations and areas of opportunities.
NEUTRAL	OVERALL EQUITY	Improving earnings growth, an improving global economy and low interest rates in the developed world continue to act as tailwinds for overall equities. Elevated valuations do warrant some caution, tactically, until the market provides clearer near-term signals, keeping us neutral at this time.
NEUTRAL	U.S. MID CAP EQUITY	Valuations are among the highest for all U.S. equities relative to long-term norms. Momentum remains slow as the "Trump Trade" fades, leaving us neutral at this time.
NEUTRAL	U.S. SMALL CAP EQUITY	Lack of significant direction, elevated valuations, and increased political uncertainties leave us neutral. Value exists in this space but it is still to early to be favorable.
NEUTRAL	NON-U.S. EMERGING MARKET EQUITY	Valuations are rising yet powerful near-term momentum and relative strength in earnings can benefit in the near term. While the effect of the weakening dollar has been a benefit for returns, most return has come from multiple expansions. There is still room to run but dislocations in this space and instability in Korea warrant some caution at this time.
NEUTRAL	INVESTMENT GRADE INTERMEDIATE MATURITY FIXED INCOME	The belly of the curve - intermediate maturities - continues to provide the best "bang for your buck," especially when paired with quality investment-grade credits. Low inflation should help stabilize yields in this space.
NEUTRAL	INVESTMENT GRADE SHORT MATURITY FIXED INCOME	The short end of the curve is crowded and provides little value at this time. However, shorter terms provide favorable rollover opportunities if the Fed decides to raise rates again.
NEUTRAL	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	REAL ESTATE	Fundamentals are somewhat unattractive at this point as adjusted funds from operations (AFFO), a key indicator for valuations, is not cheap and interest-rate sensitivity may continue to weigh on these securities. At the same time, the flattening U.S. yield curve has not been helpful.
UNFAVORABLE	OVERALL FIXED INCOME	Fixed income is currently being used as an anchor for equity risks. It is necessary from a strategic standpoint, however the near-term view is unfavorable due to the current shape of the yield curve and the impact of rate normalization on bond prices.
UNFAVORABLE	INVESTMENT GRADE LONG MATURITY FIXED INCOME	We maintain a negative near-term view on long-maturity bonds as these rates have not seen the bump from the recent Fed rate increases. With a flattening yield curve, the greatest risk now is on the long end of the curve where it was not before.
UNFAVORABLE	NON-INVESTMENT GRADE FIXED INCOME (HIGH YIELD)	High yield continues to be extremely unattractive in the near term as spreads are tight and investors may be better off in low-beta equity strategies which may present less downside risk and some upside potential.
UNFAVORABLE	GLOBAL (NON-U.S.) FIXED INCOME	Global fixed income markets are unattractive in the near term. EM debt (local currency) may have run out of steam as the U.S. dollar decline boosted returns so far this year. This return potential is not likely to repeat 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	Higher dispersion amongst stocks has aided managers in finding profitable opportunities on both the long and short sides of their books. Regardless of one's outlook on equity market valuations, long/short equity funds have the ability to capture a portion of upside market performance but also have the ability to protect on the downside due to a fund's hedges and/or alpha shorts. This strategy will not, however, outperform in continued equity market rallies.
MULTI-MANAGER/ MULTI-STRATEGY	This strategy can be thought of as more of an all-weather, lower-volatility strategy. The risk profile tends to be more akin to that of the fixed income markets than equity markets. If one is seeking a strategy to fill the lower-risk bucket, multi-manager/multi-strategy could be a relevant option.
MANAGED FUTURES	While managed futures strategies benefit from lower asset class correlations, systematic trend-following managers are dependent on continuity in trends, which continues to be difficult to rely on in this market environment. Nonetheless, it is important to note that increasing rates can be advantageous for this strategy due to a) a higher rate earned on large cash allocations and b) the ability for the fund to profit from the trend.
EVENT DRIVEN	As corporate activity remains robust, particularly as the current administration is expected to incorporate more business-friendly policies, event-driven strategies are able to profit from both soft and hard catalyst opportunities. Many funds are highly constructive on merger arbitrage opportunities as organic growth has become more difficult and high levels of cash remain on corporate balance sheets. Activism continues to drive change and companies have become more receptive than ever before to the suggestions set forth by activist managers.
EQUITY MARKET NEUTRAL	The less directional nature of equity market neutral strategies remains attractive amidst the greater uncertainty in the markets. However, if equity markets continue on an upward trend, equity market neutral managers are likely to underperform strategies with a long bias.
GLOBAL MACRO	Dislocations in global markets tend to be a fertile ground for global macro strategies. Additionally, the ability to 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.

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

INVESTMENT STRATEGY COMMITTEE MEETING RECAP

Continued from page 3

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

In terms of fee transparency, managers are responding to investors' demands and concerns. They are coming up with somewhat more creative ways of addressing fee structure concerns.

- "We are seeing allocations to global macro funds creep up. We haven't seen very much in terms of volatility and dislocations across the globe over the last few years. For those investors that are expecting an uptick in volatility levels, global macro funds tend to play well in more volatile environments and when there are those global dislocations."
- "We're also seeing allocations picking up in long-short equity, as people are looking to continue to participate in equity markets but with some sort of downside protection. The long-short equity funds have actually been doing quite well as we are starting to see an increase in alpha creation on the short side."

All expressions of opinion reflect the judgment of Raymond James & Associates, Inc., and are subject to change. There is no assurance that any forecasts will occur. Investing involves risk including the possible loss of capital. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. Small and mid-cap securities generally involve greater risks. Past performance may not be indicative of future results. Asset allocation and diversification do not guarantee a profit nor protect against loss. Companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

SECTOR SNAPSHOT

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

This report is intended to highlight the dynamics underlying the 11 S&P 500 sectors, with a goal of providing a timely assessment to be used in developing your personal portfolio strategy. Our time horizon for the sector weightings is not meant to be short-term oriented. Our goal is to look for trends that can be sustainable for several quarters; yet given the dynamic nature of financial markets, our opinion could change as market conditions dictate.

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

These recommendations will be displayed as such:

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

Equal Weight: expect in-line relative performance

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

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

	SECTOR	S&P WEIGHT	TACTICAL COMMENTS
OVERWEIGHT	INFORMATION TECHNOLOGY	23.2%	Strong fundamental trends and improved technical momentum keep us Overweight at this time. Valuation is elevated and should not go without notice. But as long as fundamental strength remains, we think valuation may not serve as a deterrent of forward returns.
	HEALTH CARE	14.6%	Improvement in earnings estimate growth trends are supportive and relative valuation is attractive. Technically, momentum continues to build as the sector recently posted a new price high.
	FINANCIALS	14.5%	Stock prices have held up despite lower interest rates. Potential tax reform, solid economic conditions, and lessened regulation are enough to support a favorable outlook for fundamentals. Failure to move tax reform forward may refocus investors on the negative impact lower rates will have on earnings and cause a shift in the bullish sentiment.
	INDUSTRIALS	10.3%	Favorable economic data for the manufacturing side of the economy in the U.S. keep us favorable. Acceptable valuation levels further boost our interest in the sector. Technical trends have improved but further improvement is necessary with relative strength still well off highs.
	ENERGY	6.0%	We remain Overweight based on the bullish stance taken by the RJ Energy Team for the price of crude. Improving technical trading should be monitored in the near term to determine if recent gains are simply a relief rally or building a new uptrend.
EQUAL WEIGHT	MATERIALS	3.0%	Technically, vast improvement transpired over the past 30 days; but after the move, we think the sector is due to pause. Earnings growth will be impressive if current expectations over the next few years transpires.
UNDERWEIGHT	CONSUMER DISCRETIONARY	11.8%	Weakening technical trends, as well as a continuation of downward revision trends, move us to an Underweight rating. The sector is oversold, so a bounce could develop soon. However, trading trends need to improve and earnings estimates need to firm for us to be favorable in this space.
	CONSUMER STAPLES	8.3%	Earnings trends for 2017 continue to move lower as the sector struggles with pricing and volume headwinds. Price performance reflects the fundamental challenges as relative strength vs. the S&P 500 has reached a new low.
	UTILITIES	3.2%	Slow earnings growth trends, elevated valuation, and negative relative strength trends keep us Underweight. The influence of interest rate movements on stock price trends in the sector solidifies our opinion based on our belief the odds are elevated that higher rather than sharply lower interest rates develop.
	REAL ESTATE	3.0%	Funds from operations for the sector have ticked up, but they still remain slow for 2017. Some improvement is expected in 2018 and 2019 but not to the degree to sway our opinion. Weak relative strength technical trends further embolden our opinion.
	TELECOM	2.1%	We are Underweight due to slow growth and weak intermediate technical trends. For the near term, the sector is likely to build on recent relative strength gains with the general market moving through a minor weak patch.

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.

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.

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

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

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

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

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