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RAYMOND JAMES

INVESTMENT STRATEGY COMMITTEE MEETING RECAP – HELD ON MARCH 2, 2018

Major macro factors affecting the economy and financial markets over the next six to twelve months include interest rates, earnings growth, inflation, monetary policy, and global economic growth.

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

The majority of the committee is neutral (2.6%) to somewhat positive (2.7 - 3.0%) on real U.S. GDP growth over the next 6 - 12 months.

- "In a late-cycle economy, the risks of a Fed policy error (raising short-term interest rates too fast or too slow) are increasing, but further gradual rate hikes are to be expected."
- "Economic data for January and February suggest a soft start to the year, but growth is widely expected to remain strong in 2018-19, supported by expansionary fiscal policy."
- "With GDP growth expected to be above its long-term sustainable pace, the unemployment rate is expected to fall further, adding to wage pressures."
- "By themselves, the tariffs on imported steel and aluminum should not have a big impact on the economy. The bigger fear is that we'll see a wider trade war develop, higher input costs, retaliatory tariffs against U.S. exports, and increased uncertainty for global investment."

U.S. EQUITY

77% of the committee is bullish to some degree on U.S. equities over the next six to twelve months.

- "I'm approaching the trade battles as noise items for several reasons. As a reminder, 'noise items' are things that cause equities to pullback but are not extensive enough to derail a bull market."
- "The tariffs are part of the negotiating process. I don't feel either side will be aggressive enough to threaten global growth. For this reason, I think the structural pillars of support for the equity markets- healthy economic and earnings growth- are the two most important variables of a bull market."
- "Other noise items joining trade that are likely to lead to higher volatility in the period ahead include inflation, wage growth, interest rates, and monetary activities."
- "Over half of February's decline was due to systematic trading programs, in my opinion. I don't think a move back to the February low will transpire but should it I don't feel stocks will stay there long. I would be a buyer of weak periods until something changes the prospects for economic and earnings growth."

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

- "As for the markets and tariffs, I think it depends on what kind of retaliatory environment we enter into. It's not a time to panic."

– **Jeff Saut,** Chief Investment Strategist, Equity Research

- "As we've said, not a lot has fundamentally changed. The market was so extended at the end of January. We had not seen any weakness in so long that the recent pullback used to just be considered a perfectly normal downturn."
- "I think the market's not sure what to focus on right now."

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

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

The entire committee is neutral to bullish on non-U.S. developed market equities.

- "I think you buy Brexit fear and anticipate some positive reform efforts across Europe led by the Macron-Merkel nexus. The corporate earnings season seemed consistent with such a view, given that 52% of reported earnings results from Thomson-Reuters, Stoxx 600 companies exceeded analyst estimates. In a typical quarter, 50% beat analyst EPS estimates. That's a good enough backdrop to stay excited."
- "A weakening U.S. dollar has helped emerging markets, and Chinese reforms are still positive. By contrast – in Asia – Japan remains a poster child for how not to do things: no reforms and a lot of sustained quantitative easing, which seems to have little impact."

U.S. FIXED INCOME

The majority of the committee sees the 10-year Treasury yield staying the same (2.9%) or increasing over the next 12 months.

- "We have a lot of different forces in the bond market. Some are pushing and some are pulling on rates, creating a little havoc. Stocks and bonds actually have been correlated lately, which is unusual, but we're in an unusual time too. Typically, corrections are prompted by a slowdown in the economy, but now there appears to be fear that the economy's doing too well."

INVESTMENT STRATEGY COMMITTEE MEMBERS

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Ted Ruddock Head of High Net Worth, Fixed Income Services

Jeffrey Saut Chief Investment Strategist, Equity 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 Senior Manager, Investment Strategy

- "You see the government trying to boost the economy through fiscal policy. At the same time, the Fed is pushing short-term rates up and is expected to continue to do so this year. There are both headwinds and tailwinds in place, so I see rates remaining range bound. Perhaps the range is slightly higher."

  – Doug Drabik, Senior Strategist, Fixed Income

- "Even though the Tax Reform and Jobs Act lowered individual income tax rates, the top tax bracket is 37% v. 39.6% previously. For investors in the top tax bracket, and especially those who reside in high tax states like California, New York, New Jersey and others, the tax equivalent yield advantage of in-state municipal bonds is highly attractive on a risk/reward basis."

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

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

"All the rhetoric about more Fed rate hikes against the backdrop of expansionary fiscal policy has started to push the dollar back up versus its recent three-year lows. On the margin, that is negative for oil prices, though declining inventories have been supporting higher prices."

- "The other issue is the new steel tariff. Drilling, extraction, and pipeline transportation of oil and gas is a steel-intensive supply chain. Pipes, drilling rigs, tubular goods – all of that requires steel in large quantities."
- "The U.S. oil and gas industry has a cost advantage over much of the world, and that advantage should still remain in place, but clearly the steel tariff is unhelpful in this regard. For example, some of the proposed Gulf Coast energy infrastructure projects may be postponed or even canceled."

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

"We still have the same issues holding back construction: inflation and labor constraints. As long as residential fixed investment isn't taking a dive, meaning that the consumer stops buying or spending on his house, we are in good shape."

- "Look, everything's good in housing. We probably have too much multi-family housing right now. In our research and outlooks for 2018, we went underweight apartments. We have a little too much supply coming at us. This will work itself out on the demand side of the equation, but this is not the year to be owning apartments. It's still the year to own the homebuilders."
- "Steel tariffs will affect the costs of commercial real estate since these buildings are made out of concrete, glass, and steel, whereas residential is primarily built with lumber."

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ECONOMIC SNAPSHOT

DR.SCOTT BROWN
Chief Economist, Equity Research

Economic data reports for January and February were mixed, but generally lackluster. That's not unusual following a strong quarter and weather may have been a factor. The economic outlook remains strong in the near term, reflecting an expected impact from fiscal stimulus (tax cuts, increased government spending). With the economy at full employment, above-trend growth should further reduce the unemployment rate and push inflation towards the Fed's 2% goal. Barring a substantial pickup in productivity growth, binding labor market constraints will eventually force GDP growth back to a sustainable trend (2% or less). Trade policy adds risk and uncertainty to the outlook.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	The economy got off to a mixed, but generally lackluster start to 2018, but near-term expectations of growth remain strong. Labor market constraints are expected to restrain GDP growth into 2019.
FAVORABLE	EMPLOYMENT	Nonfarm payrolls have continued to expand at a strong pace in early 2018, with overall labor market conditions growing tighter.
FAVORABLE	BUSINESS INVESTMENT	Business optimism remains strong. Corporate tax cuts ought to be supportive (but most of that will show up as share buybacks and dividends).
FAVORABLE	MANUFACTURING	A strong February following weather-related weakness in January (a moderate pace if you average the two months).
FAVORABLE	HOUSING AND CONSTRUCTION	The combination of strong housing demand and continued supply constraints have pushed prices higher. Affordability is expected to remain an ongoing issue.
FAVORABLE	REST OF THE WORLD	The global economic growth outlook is strong, but trade policy missteps and uncertainty have the potential to restrain world growth.
NEUTRAL	CONSUMER SPENDING	Retail sales were soft in January and February. Real hourly earnings have risen meagerly year-over-year, but tax withholding fell in February and gasoline prices have edged somewhat lower.
NEUTRAL	INFLATION	Commodity price pressures, while higher, are moderate. Wage pressures are likely to pick up somewhat as the job market tightens further.
NEUTRAL	MONETARY POLICY	The risks of a monetary policy error (moving too fast or too slow) rise in a late-cycle economy. Upcoming personnel changes add uncertainty, but the Powell Fed is expected to be more hawkish than the Yellen Fed (that is, more likely to raise rates).
NEUTRAL	LONG-TERM INTEREST RATES	Inflation fears are overdone. However, the government's borrowing outlook has shifted dramatically in the last couple of months. Rising budget deficits should put some upward pressure on long-term interest rates.
NEUTRAL	FISCAL POLICY	Decreased tax withholding should support consumer spending. The recent budget agreement will boost spending this year and next. Still, there is little scope for action should the economy stumble (later this year or in 2019).
NEUTRAL	THE DOLLAR	Tighter Fed policy is usually dollar positive, but the strengthening global economy has led to greater capital flows away from the U.S. A wider federal budget deficit is also a negative.

From Near Perfect to Near Normal

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

Equity markets extended their ascent into early 2018 with the Dow Jones Industrial Average reaching a record high on January 26, only to quickly reverse course with a sharp decline in early February. While most of this pullback can be attributed to trading algorithms and high-frequency trading systems, it resulted in a shift in investor sentiment from one of complacency to one of uncertainty. Despite various headwinds on everyone's radar – inflation, interest rates, trade policy disruption and political instability – the equity markets are actually quite healthy. Earnings expectations continue to rise, and the global economy continues to strengthen, providing plenty of support for markets to move higher.

Nevertheless, volatility is likely to reoccur throughout the year as investors awake from the peaceful slumber of 2017 and appear to be a bit confused on what exactly they should feel uncertain about. Equity markets are naturally volatile and the current market is actually behaving as it would in a 'normal' investment environment. Goldilocks may have worn out her welcome, but there is little reason to think that her departure is indicative of trouble ahead. Perhaps we can't see the forest for the trees, but if we take a step back, I think we will find that there is plenty to feel good about.

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Frenetic February & Manic March

Andrew Adams, CFA, CMT, *Senior Research Associate, Equity Research,* reflects on 2017 and the return to normality that February's market pull-back represents.

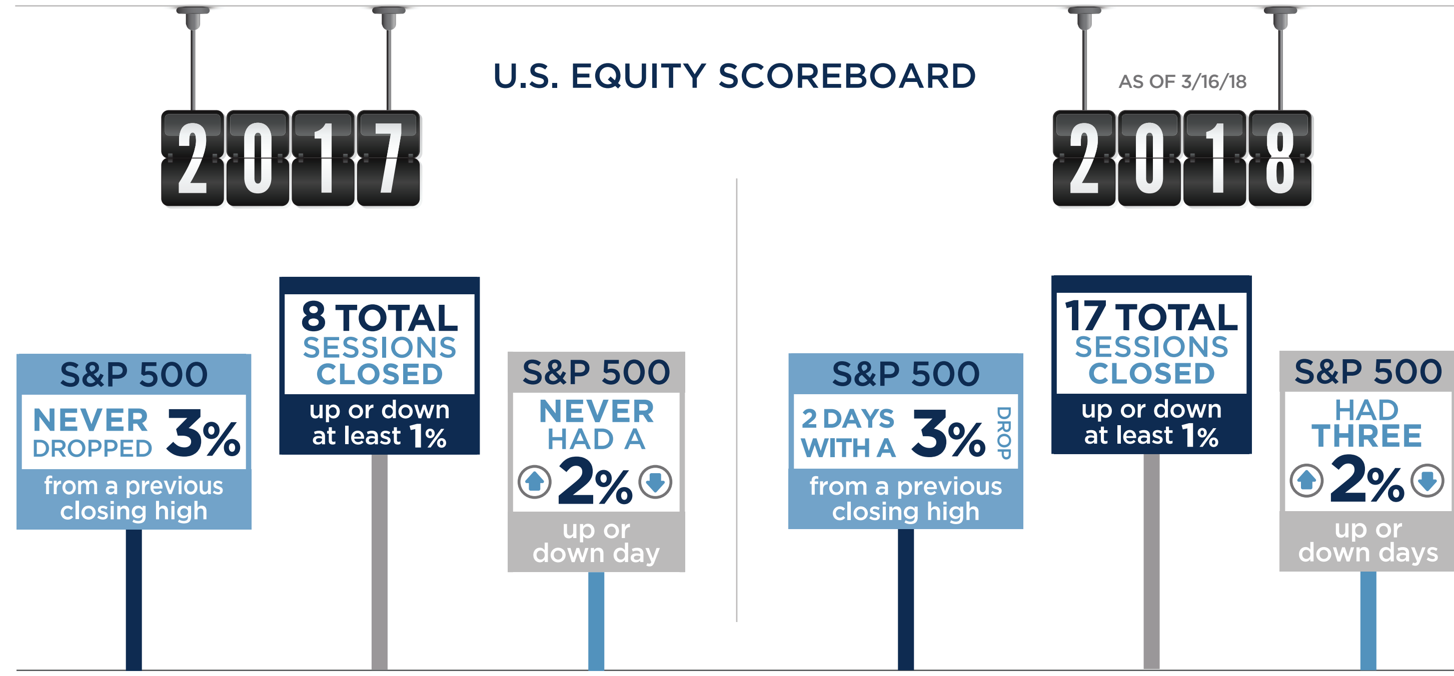
While equity investors extended a warm welcome to the quiet ascent of stock prices last year, at some point, the party had to end. 'Guaranteed' is not a word typically used in the investment business, but the expectation for more volatility in 2018 compared to the prior year was about as close to a guarantee as the stock market can offer.

By some measures, 2017 was the least volatile year for stocks in the history of the market. Investors became accustomed to the calm and quiet fluctuations of the market. However, a continuation of this record-breaking run for another 12 months was too much to ask for.

A QUIET RUN

So how tame was 2017? Well, it was the only calendar year on record in which the S&P 500 had a positive total return every single month. The index also never even dropped 3% from a previous closing high, which is quite unbelievable compared to the 16% average intra-year drawdown over the last 100 years. Moreover, only eight total sessions closed up or down at least 1%, and the S&P 500 never had a 2% up or down day.

One could even say that the stock market was downright boring at times in 2017, though most investors did not seem to mind the slow and steady ascent to a number of new all-time highs during this extraordinary run. Through March 16 of this year, by comparison, the index had already experienced 17 up or down sessions of 1% or greater, including separate 2%, 3%, and 4% down days!



THE PULL-BACK: A COMBINED EFFORT

Inflation, Interest Rates, and Reversion to the Mean

Alas, all good things must come to an end and, in early February, volatility came roaring back to quickly knock many world indices into 10% correction territory. As is usually the case during and after such declines, market participants and pundits rushed to assign a specific reason for the sell-off, and concern over inflation and higher interest rates were the most often cited explanations. Such worries likely contributed to triggering the initial drop. However, the decline can also be viewed simply as a reversion to the mean that took place at a time when the U.S. stock market was as extended to the upside as it ever gets.

Leverage and Index-based Strategies

Additionally, traders built strategies to take advantage of the low volatility we enjoyed for so long, often using leverage to do so. Many of these strategies began to unwind once volatility picked up, creating a vicious cycle of selling in the market. Tack on the indiscriminate sales of index-based investments that hold baskets of stocks representing entire indices, sectors, and themes, and it becomes easy to see how things quickly spiraled out of control. Instead of one cause, a combination of factors likely compounded and contributed to the decline.

RETURN TO NORMALITY

More important than what caused the correction is what did not cause it. It was not a situation where the market saw a deterioration in either the global synchronized economic expansion or in the strong corporate earnings data that has supported this secular bull market over the last few years.

> "Until we see the signs that have preceded the major bear markets in history, we will continue to give the benefit of the doubt to the bulls."

We believe the February correction was more of a trading event, not the kind of recessionary or systemic breakdown that has generally caused more significant declines in market history. In fact, what happened in early February was not abnormal; the preceding 15 months of persistent upside were abnormal. Since 1932, the S&P 500 experienced on average a 10% correction about every two years, and it had been almost exactly two years since the index's last such correction back in February 2016. Right on schedule.

A LOOK AHEAD: EPISODIC VOLATILITY

Now the question becomes whether we should expect more volatility to occur throughout the rest of 2018. It would, of course, be great if stocks returned to their straight climb with very little downside. However, to reiterate, movement like that has historically been much more of an exception than the rule. The odds favor further bouts of the 'episodic volatility' that can arise whenever the market begins to worry about something, though we continue to believe these should be viewed as opportunities within an ongoing secular bull market rather than a reason for significant concern. We still do not see the signs that have preceded the major bear markets in history and, until we do, we will continue to give the benefit of the doubt to the bulls.

Frenetic February & Manic March (cont.)

MAN VS. THE MACHINE

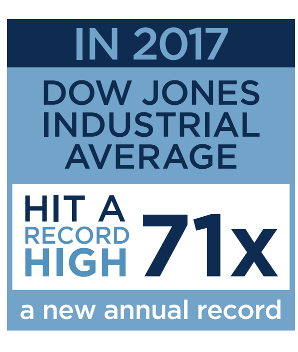
Our modern markets may also be producing more of the sharp swings that we've seen at times over the last few years. With high-frequency trading algorithms moving in and out of positions before many human traders can even open up their trading applications, it is not too much of a stretch to assume stocks will move a bit faster. More money flowing into passive investments and basket-trading strategies could also be contributing to the volatility, though it is difficult to isolate and estimate their exact impacts.

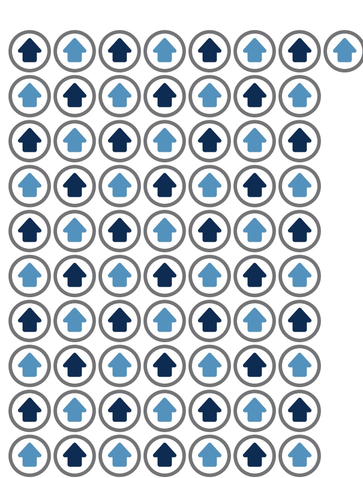
In prior decades, active investors accounted for a greater share of total trading volume and traded based on fundamentals and valuations. When stocks within indices like the Dow Jones Industrial Average were sold, we could count on other stocks within the indices to be bought, limiting the net impact on the indices themselves. Now, with more money than ever flowing to index-based products, sharp swings are more likely to happen as investors are able to effectively buy or sell shares of the entire index at the same time.

EXPECTATIONS AND OPPORTUNITIES

"Despite all the previous bouts of market volatility in history, stocks have generally prevailed."

The good news is that these spells of volatility should not require altering the investment plan for most long-term investors. By expecting price swings, and perhaps even viewing them as an opportunity to buy at lower prices, one will be less likely to panic and sell out of long-held positions at what could be very inopportune times. And remember, just last year the Dow Jones Industrial Average hit a new record high 71 times, which was a new annual record in itself. That means despite all the previous bouts of market volatility in history, stocks have generally prevailed. Going forward, we don't believe that is likely to end, despite the occasional rough patch.





KEY TAKEAWAYS:

- We believe the February correction was more of a trading event, not the kind of recessionary or systemic breakdown that has generally caused more significant declines in market history.
- The odds favor further bouts of 'episodic volatility,' though we continue to believe these should be viewed as opportunities within an ongoing secular bull market rather than a reason for significant concern.
- By expecting price swings, and perhaps even viewing them as an opportunity to buy at lower prices, one will be less likely to panic and sell out of long-held positions at what could be very inopportune times.

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WHAT IS VOLATILITY?

Peter Greenberger, CFA, CFP®, *Director, Mutual Fund Research & 529 Plan Product Management,* explains volatility – the degree to which an investment or market value changes over time.

Equity markets are inherently more risky than bond markets, meaning they are more likely to experience large price swings at any given time, whereas high-quality bonds typically see more muted price movements.

Volatility is the degree to which an asset's price fluctuates. So, how do investors measure volatility in order to identify periods of heightened perceived risk in the market?

The Chicago Board Options Exchange (CBOE) Volatility Index (VIX), commonly referred to as the 'investor fear gauge,' is a popular measure of the stock market's expectation of volatility implied by S&P 500 Index options. The index measures the expected range of price movement in the S&P 500 Index over the next 12 months. A VIX reading of 10 indicates an expected annualized change of 10%.

A high VIX reading is not necessarily a bad thing as prices can move in either direction. In other words, high VIX readings mean investors see significant risk that the market will move sharply, whether downward or upward. General consensus views a VIX reading over 30 as high perceived risk, whereas levels below 20 are viewed as low perceived risk.

U.S. Earnings: Pillars of Support

Joey Madere, *Senior Portfolio Strategist, Equity Portfolio & Technical Strategy,* reflects on the strength of earnings throughout 2017 and suggests that the coming year should see continued growth.

While there are many factors that can impact equity markets in the short term (i.e., wages, inflation, interest rates, and trade policies), earnings are the most important influence over the long term. Along with economic activity, earnings growth remains a strong pillar of support for the current market.

EARNINGS STABILITY

The fourth quarter 2017 earnings season was stronger than expected, as S&P 500 earnings grew by 15% with sales growth of 8.3%. This took 2017 sales and earnings growth up to 6.5% and 11.5% respectively, the highest levels since 2011. It is worth noting that it has been common in recent years for estimates to start high and be revised down over time, only for actual results to then beat those downwardly revised estimates. This was not the case in 2017. Estimate revisions were the most stable since 2011, further supporting equity prices over the course of the year.

A LOOK AT 2018

On the heels of tax reform, 2018 consensus estimates have been revised sharply higher (up 7.3%) since the start of the year, now reflecting earnings growth of 18.6% year-over-year. This would be the strongest level since 2010 when earnings had their initial recovery after the credit crisis. The current consensus estimate for 2018 earnings is $157.10, which assumes 6.3% sales growth and 1.08% of net margin expansion.

We use slightly more conservative estimates to achieve our 2018 year-end earnings estimate of $155.70, which reflects 17.6% earnings growth.

MARKET SECTORS

The strongest earnings growth is expected to come from Energy, Financials, Materials, Consumer Discretionary, Industrials, and Technology. Additionally, the best earnings revisions since the start of the year came from the Energy, Telecom, Financials, Industrials, and Consumer Discretionary sectors.

Following the strongest estimate revision trends of the current bull market, 2018 is expected to exhibit very strong earnings growth. In short, earnings remain a major pillar of support for equity markets going forward.

> "Earnings are the most important influence over the long term for the equity markets."

EARNINGS GROWTH	ESTIMATES
2017: 11.5% (ACTUAL)	2018 Consensus: 18.5% 2018 RJ: 17.6%

AS OF 3/15/18

S&P EARNINGS	ESTIMATES
2017: $132.41 (ACTUAL)	2018 Consensus: $157.10 2018 RJ: $155.70

KEY TAKEAWAYS:

- While there are many factors that can impact equity markets in the short term, earnings are the most important influence over the long term.
- The strongest earnings growth is expected to come from Energy, Financials, Materials, Industrials, and Technology.
- Following the strongest estimate revision trends of the current bull market, 2018 is expected to exhibit very strong earnings growth, a tailwind to equity markets.

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The Bond Market: A Tug of War

Doug Drabik, *Senior Strategist, Fixed Income Services,* and **Nick Goetze,** *Managing Director, Fixed Income Services,* share how interest rates are influenced by the competing forces of inflation, fiscal policy, global demand, and the Federal Reserve.

The bond market has not experienced volatility to the extent that the stock market has in recent months. Instead, it appears to be suspended in a tug of war between competing forces, balancing healthy economic data and uncertainty of the future fiscal landscape.

After an extended period of low interest rates, pundits have inaccurately prophesied a reversal in interest rates for years. However, current economic conditions are revealing valid factors supportive of higher rates. But how high, how quickly, and how robust of a rate movement is probable? It is very much up for debate.

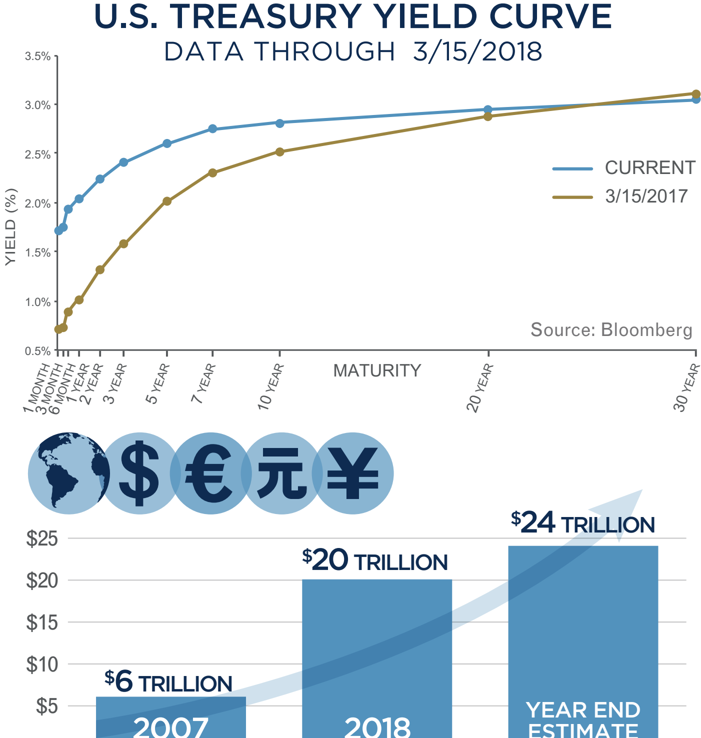
HEADWIND FORCES

Plenty of headwinds for higher interest rates still exist. If interest rates move too high, too quickly, the economy could promptly halt its healthy pace of growth. High rates will affect borrowing adversely, diminishing business and consumer participation.

CENTRAL BANK INTERVENTION

Global central bank intervention comprises over $20 trillion in assets, up from pre-recession levels of $6 trillion in November 2007. This collective sum includes the balance sheets of the four major central banks: the Federal Reserve (Fed), the European Central Bank, the People's Bank of China, and the Bank of Japan. At the current pace, aggregate balance sheet assets could top $24 trillion by year's end.

Despite the proclamations of other central banks, the Fed is the only central bank that has stopped open market purchases and is slowly reducing its balance sheet. The importance of these actions cannot be overstated. It is worth noting that the money that the Fed injected into the economy via quantitative easing and open market purchases largely did not fund the production of goods or services rendered. Rather, these sums flowed into the global stock and bond markets, fueling their rise in recent years. Even if other central banks halt their open market purchases, the significant influence of this newly created money persists.



INTEREST RATE DISPARITY

In addition, interest rate disparity continues. Five-year government bonds currently yield 0.68% in Italy and -0.02% in Germany, while they fetch 2.61% in the United States. Moreover, many bonds currently carry negative yields. As counterintuitive as it may

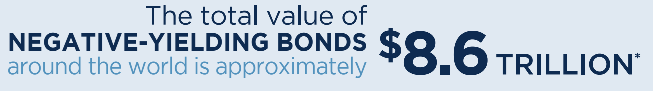
The Bond Market: A Tug of War (cont.)

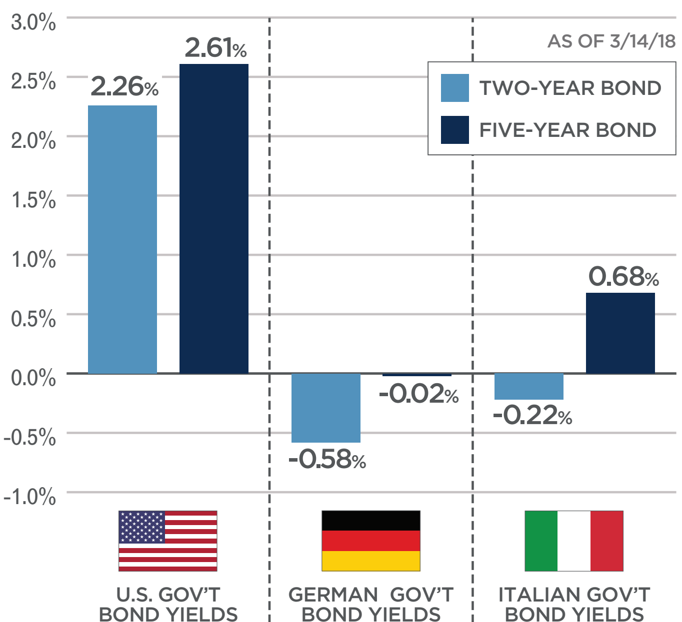
seem, investors are willing to pay to lend money to governments around the world whereas traditionally investors would receive interest from the borrowers.

For example, the yield on the two-year government bond in Germany is currently -0.58%. In other words, investors pay the German government 0.58% to hold their two-year bonds. The total value of negative-yielding bonds around the world is approximately $8.6 trillion. When investors can achieve a positive 2.61% yield from an economic leader such as the U.S., demand for U.S. government bonds will likely be a noteworthy headwind to rising interest rates.

GLOBAL SOVEREIGN BOND YIELDS

With many sovereign bonds having negative yields, demand for U.S. government bonds continues to be a noteworthy headwind to rising interest rates.





Source: Bloomberg and Raymond James

DEMOGRAPHICS

Finally, an aging population that controls a majority of wealth may prove to be less of a spirited consumer and more of a saver. If interest rates rise, it will encourage a more normalized transition from growth assets to fixed income.

TAILWIND FORCES

Unsurprisingly, the tailwinds behind higher interest rates have captured both headlines and momentum. However, investors should proceed with caution. Equities move much more on momentum than interest rates and bonds. In terms of economic metrics, inflation remains the central focus (as it has for the past several years).

INFLATION

The Fed has sought to bring inflation to 2% as measured by the Personal Consumption Expenditures Price Index (PCE). The index has been rising slowly, leading to an unbalanced amount of volatility and slightly higher interest rates. However, the most recent release on March 1 came in at 1.5%, still well below the 2% target.

The Fed is attempting to balance full employment with its long-term stable inflation target of 2%. Its belief is that by observing the data and slowly hiking short-term rates (potentially two to three more times in 2018), it can reach this balance without the economy overheating. As inflation has inched up, the market reaction has been clear: if the market believes inflation is trending up, it will drive interest rates higher.

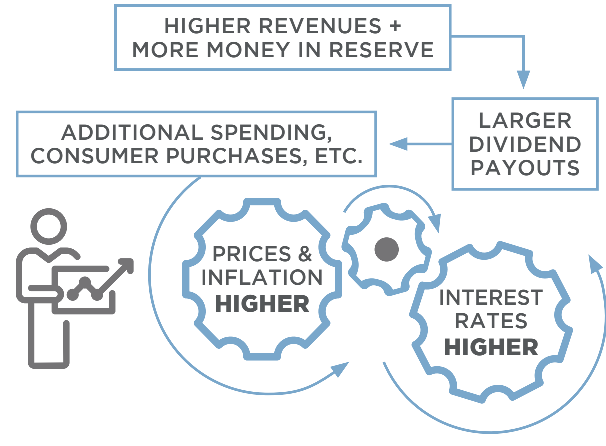
FISCAL POLICY

Fed Chairman Powell has pointed to the reversal of a headwind with fiscal policy. The Tax Cuts & Jobs Act has clearly created substantial change. The bill is likely to free up capital for both businesses and individuals. Higher revenues, larger profits, and lower price/earnings ratios are all potential benefits.

Higher revenues may show up in a variety of ways: larger dividend payouts, stock repurchases, plant or equipment

*Barclays Global Aggregate Negative Yielding Debt Index as of 3/22/18.

improvements, and consumer purchases. More money in reserve (for both individuals and corporations) may translate to additional spending, which in turn may push prices and inflation higher, eventually driving interest rates higher.



THE FED

Although central bank open market purchasing activity has clearly been a headwind to higher interest rates, the mere suggestion that this policy will change has been enough for some investors to anticipate a directional rate change. The Fed has been much more direct in communicating and executing its strategy of raising short-term rates. The Fed raised short-term rates four times since the beginning of 2017, for a total of six times since December 2015. It is anticipated that it will hike rates two to three more times this year. While these hikes only impact short-term interest rates, rising short-term rates influence overall rate sentiment.

FISCAL VS. MONETARY POLICY

The Fed's desire to raise interest rates is conflicting with the U.S. government's desire to encourage economic activity. While this tug of war between the U.S. government and the Fed continues, global interest-rate disparity and global central bank action will continue to exert peripheral influence. As long as these forces continue to clash, interest rates are not likely to be pulled dramatically in either direction. Rather, rates will likely be range bound, albeit in a slightly higher range.

RECENT FED ACTIVITY

The Fed has been more direct in communicating and executing its strategy of raising short-term rates.

KEY TAKEAWAYS:

- Global central bank intervention comprises over $20 trillion in assets, up from pre-recession levels of $6 trillion in November 2007. Even if other central banks halt their open market purchases, the significant influence of this newly created money persists in the financial markets.
- As inflation has inched up, the market reaction has been clear: if the market believes inflation is trending up, it will drive interest rates higher.
- Relative to other central banks, the Fed has been much more direct in communicating and executing its strategy of raising short-term rates. While these hikes only impact short-term interest rates, rising short-term rates influence overall rate sentiment.
- Interest rates are not likely to be pulled dramatically in either direction. Rather, rates will likely be range bound, albeit in a slightly higher range of 2.65%-3.45%.

All expressions of opinion reflect the judgment of the Research Department of Raymond James & Associates, Inc. and are subject to change. Past performance may not be indicative of future results. There is no assurance that any investment strategy will be successful. Bond investments are subject to investment risks, including the possible loss of the principal amount invested. The yield curve is a graphic depiction of the relationship between the yield on bonds of the same credit quality but different maturities.

Loud Noises: The Return of Market Volatility?

Nicholas Lacy, CFA, *Chief Portfolio Strategist, Asset Management Services,* reflects on how markets adjusted to increased uncertainty in the first quarter; not all assets performed as one would have expected.

U.S. equity markets soared to record highs at the end of January only to reverse course into a freefall over the next several days. The remainder of the first quarter was choppy as investors grappled with increased uncertainty following an extended period of steady gains against a quiet market backdrop.

The sudden increase in volatility led to the largest one-day decline in the history of the stock market on an absolute point basis with the S&P 500 dropping over 115 points on Monday, February 5. However, the move only represented a 4.16% decline on a relative basis. It was strikingly similar to the crash on October 19, 1987 (also known as Black Monday), as leveraged products and computerized trading programs, not individual investors, were triggered to sell off equities.

In fact, individual investors remained relatively calm throughout the quarter as lingering memories of the 2008 financial crisis and subsequent recovery had them thinking twice about hastily exiting the market. Backed by a healthy global economy and increasing revenues and earnings expectations for U.S. companies, the noise of the headlines seemed to be just that. Noise.

NOT SO DEFENSIVE EQUITY

While the market correction may have caught some off guard, even more surprising was the underperformance of defensive equities that have historically held up in down markets. Various sectors including Real Estate Investment Trusts (REITs), Energy, and Telecom typically pay higher dividends, which should have cushioned prices relative to the overall market. However, downward pressure on bond prices escalated losses for these stocks due to their natural sensitivity to interest rates.

WHAT DIVERSIFICATION?

While one would expect bonds to rally during a market downturn, investment-grade bond prices slowly declined throughout the quarter as interest rate pressures prevailed. We should not be surprised that bond prices are falling as interest rates have been on the rise since the end of 2015, and we have yet to see longer-term yields rise much. This can be problematic as the Federal Reserve (Fed) is expected to continue raising short-term rates this year, potentially causing further flattening of the yield curve.

A flattening yield curve has traditionally been viewed as an indicator of negative market sentiment toward long-term growth of the economy. With long-term rates inching up and the yield on the 10-year Treasury approaching the 3% mark, this issue could very well be a moot point. So, what is the market telling investors?

CONFIDENCE IS KEY

Looking ahead, the market may have more confidence in both economic growth and inflation expectations, and global equity markets appear poised for another above-average

year in market returns. A steeper yield curve (the difference in the 2-year and 10-year Treasury rates) has historically been a positive signal for equities and may help boost corporate earnings, especially within the Financials sector.

> "The market may have more confidence in both economic growth and inflation expectations, and global equity markets appear poised for another above-average year in market returns."

FIXED INCOME: DUE FOR ITS OWN CORRECTION?

U.S. investment-grade bonds have rarely lost money in the past 30 years. The most significant loss was in 1994, when the Fed unexpectedly increased the fed funds rate by 50 to 75 basis points each time. Lack of transparency in the magnitude and timing of these increases led to a negative reaction from the markets.

On the other hand, post-financial crisis policy has been openly and clearly communicated by the Fed, minimizing the surprise element of Fed actions. While it is likely that bond prices will finish the year lower than they started, fixed income remains a foundational element of a diversified portfolio and should continue to serve as a ballast amidst turbulent equity markets.

> "'Don't try to market time the diversification benefit of bonds.'[1] Investors need to understand why they own certain asset classes. Bonds are for the stability they create in the portfolio, and the cash flow they create for the investor."
>
> – **Ted Ruddock,** Head of High Net Worth, Fixed Income Services.

KEY TAKEAWAYS:

- Individual investors remained relatively calm throughout the quarter as lingering memories of the 2008 financial crisis and subsequent recovery had them thinking twice about hastily exiting the market.
- The underperformance of defensive equities was surprising. Various sectors including Real Estate Investment Trusts (REITs), Energy, and Telecom, have historically held up well in down markets since they typically pay higher dividends, which should have cushioned prices relative to the overall market.
- Global equity markets appear poised for another above-average year in market returns. A steeper yield curve has historically been a positive signal for equities.
- Fixed income remains a foundational element of a diversified portfolio and should continue to serve as a ballast amidst turbulent equity markets.

All expressions of opinion reflect the judgment of the Research Department 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 that any of the forecasts mentioned will occur. Diversification and asset allocation do not ensure a profit or protect against a 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. REITs involve risks such as refinancing, economic conditions in the real estate industry, changes in property values and dependency on real estate management. Bond investments are subject to investment risks, including the possible loss of the principal amount invested. The yield curve is a graphic depiction of the relationship between the yield on bonds of the same credit quality but different maturities. U.S. Treasury securities are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal valueThe S&P 500 is an unmanaged index of 500 widely held stocks. It is not possible to invest directly in an index.

[1] Tony Crescenzi, PIMCO

Q&A: Regulatory Reform

Ed Mills, *Washington Policy Analyst, Equity Research,* discusses the current political environment, dominated by policy and personnel turnover in Washington, and potential headwinds for the markets.

Q. REGULATORY REFORM – WHAT DOES IT MEAN FOR FINANCIALS?

A. The bank deregulatory process that was anticipated following the 2016 election is underway. Key federal banking regulators are being replaced with Trump-nominated appointees, the Board of Governors at the Federal Reserve is undergoing a near total transformation, and Congress is set to make the most significant changes to the Dodd-Frank Wall Street Reform Act since its passage. This deregulatory push, combined with the tax changes enacted late last year, will likely result in increased profitability, capital return, and M&A activity for many financial services companies.

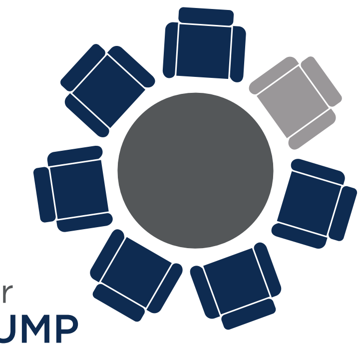
It is hard to overstate the overhaul that is occurring in the leadership of federal financial regulators. By statute, their terms are staggered to provide some continuity between administrations, but we are seeing key leadership changes occurring.

Perhaps no regulator has had more impact on the implementation of the post-financial crisis regulatory infrastructure than the Federal Reserve. The leadership of former Chair Yellen and former Governor Tarullo saw the 'gold plating' of international standards and an ever- increasing series of new capital, leverage, and liquidity standards. As six of seven seats on the Board of Governors change hands under President Trump, this represents a sea change for bank regulation going forward.

We are also anticipating action on bipartisan Senate legislation to increase the Systematically Important Financial Institution (SIFI) threshold on bank holding companies from $50 billion to $250 billion, among other reforms. This legislation is well positioned to pass into law in the first half of 2018 and would mark the most significant changes to the Dodd-Frank Act since its passage.

A sea change for
FEDERAL RESERVE GOVERNORS

change hands under
PRESIDENT TRUMP

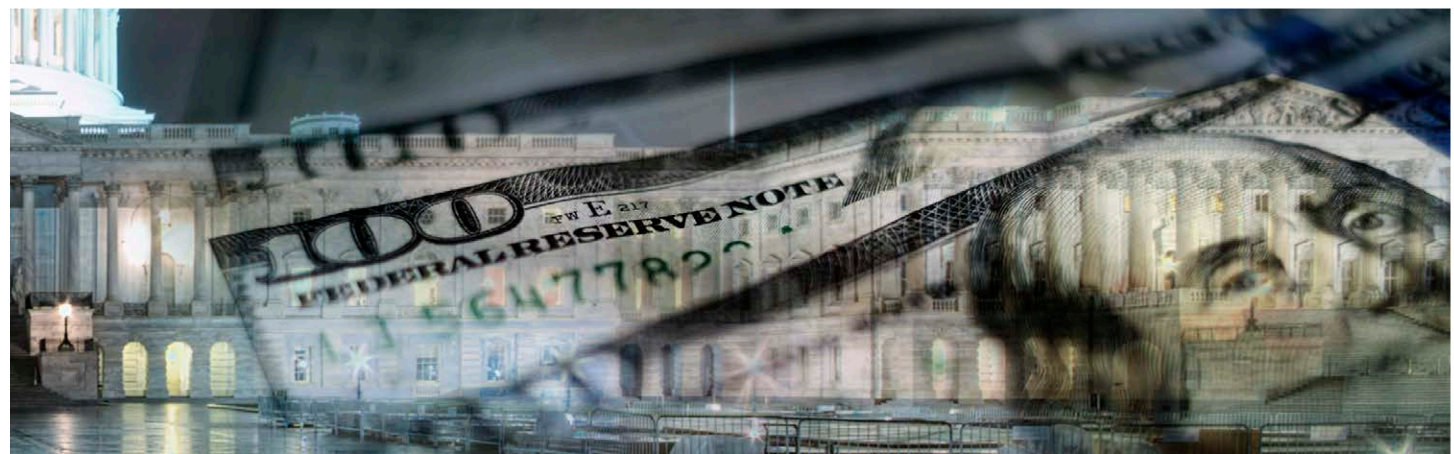


Q. WHY IS CONGRESS CHANGING THESE RULES?

A. Under existing law, banks are subject to escalating levels of regulation based upon their asset size. Key thresholds include banks at $1 billion, $10 billion, $50 billion, and $250 billion in assets. These asset sizes may seem like really large numbers, but they only represent a fraction of the assets held by some of the largest banks, with the top banks well above $1 trillion in assets.

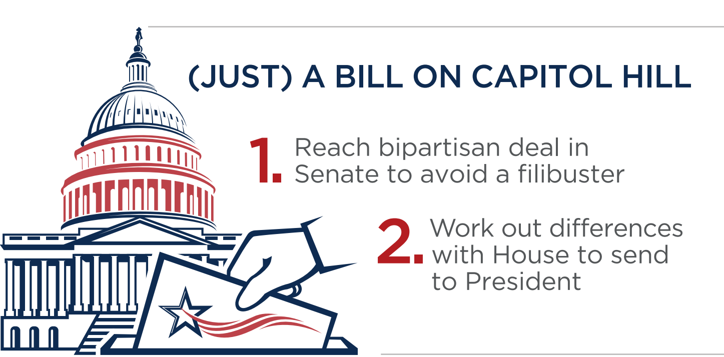
There has been concern in recent years that these thresholds are too low and have held back community and regional banks from lending to small businesses, thus slowing economic growth. There is also a belief that the regulatory framework and capital requirements put in place since the financial crisis has created a more safe and sound banking system. Now that we have entered into a more normalized economic environment, it is time to re-examine the regulatory infrastructure, especially for community and regional banks.

Responding to these concerns, a bipartisan coalition in the Senate has passed a bill to rework the regulatory framework for many community and regional banks. The bill raises the threshold for when a bank is considered 'systemically important' and is subject to increased regulations. The hope among the bill's advocates is that these



banks would see a reduction in regulatory cost, greater flexibility on business activity, increased lending, and, ultimately, a boost to economic growth.

In order to be signed into law, the bill will have to clear the House of Representatives pending potential negotiations on additional changes between the House and the Senate.



Q. WHAT REGULATORY CHANGES DO YOU EXPECT IN THE WAKE OF LEADERSHIP TRANSITIONS?

A. The 2016 election marked the high-water mark for financial services regulation. In the coming year, we expect continued changes to the stress-testing process for the largest banks (known as CCAR), greater ability for banks to increase dividends, as well as changes to capital, leverage, and liquidity rules.

As for the Fed, we expect a multi-year deregulatory push that re-examines and removes various 'gold plating' of regulations while providing regulatory relief for small- and medium-sized institutions. Tightening will shift away from regulation to normalization of the fed funds rate. This could represent a multi-pronged win for the banking industry: normalized interest rates, expanded regulatory relief, increased business activity, and lower regulatory expenses.

Another key regulator to keep an eye on is the Consumer Financial Protection Bureau, which pursued an aggressive regulatory/enforcement agenda for banks. However, the Bureau is now facing an uncertain future and is in the process of reevaluating its enforcement mechanisms. Additionally, Dodd-Frank requires review of all major rules within five years of their effective date, providing an opportunity for the Trump-appointed director to make major revisions.

"This could represent a multi-pronged win for the banking industry: normalized interest rates, expanded regulatory relief, increased business activity, and lower regulatory expenses."

Q. WITH THE ROLLBACK OF REGULATIONS, MOST OF WHICH WERE PUT IN PLACE TO PREVENT A REPEAT OF THE FINANCIAL CRISIS, ARE WE SOWING THE SEEDS OF THE NEXT COLLAPSE?

A. There is little doubt that the lack of proper regulation and enforcement played a strong role in the financial crisis. The regulatory infrastructure that has been put into place since the financial crisis has undoubtedly made the banking industry safer and sounder. Fed Chairman Powell recently testified before Congress that the deregulatory bill being considered will not impact the safety and soundness of the financial industry. The ultimate test will be the enforcement of existing rules and the extent of the regulatory rollback.

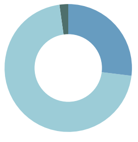
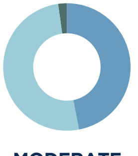
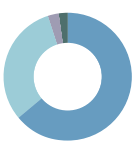
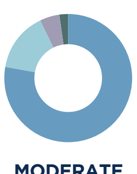
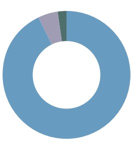
Q. IN YOUR VIEW, WHAT KIND OF POLITICAL DEVELOPMENTS WILL HAVE AN IMPACT ON THE MARKETS?

A. We are keeping our eyes on actions related to trade and the mid-term elections this November. The recent announcement on tariffs raises concerns of a trade war, which would represent a significant headwind for the economy. As for the election, many of President Trump's nominees have been selected and will be confirmed by November, limiting the impact on his regulatory agenda. The market may grow nervous over a potential changeover in the House and/or

Continued on page 20

Legislative and regulatory agendas are subject to change at the discretion of leadership or as dictated by events.

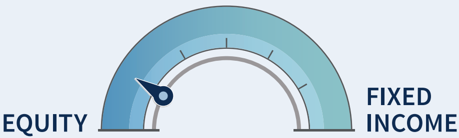
STRATEGIC ASSET ALLOCATION MODELS

	 CONSERVATIVE	 MODERATE CONSERVATIVE	 MODERATE	 MODERATE GROWTH	 GROWTH
EQUITY	**27%**	**47%**	**64%**	**78%**	**93%**
U.S. Large Cap Equity	18%	27%	33%	40%	47%
U.S. Mid Cap Equity	2%	5%	7%	8%	10%
U.S. Small Cap Equity	1%	3%	4%	6%	6%
Non-U.S. Developed Market Equity	6%	12%	16%	20%	25%
Non-U.S. Emerging Market Equity	0%	0%	4%	4%	5%
Publicly Traded Global Real Estate	0%	0%	0%	0%	0%
FIXED INCOME	**71%**	**51%**	**31%**	**15%**	**0%**
Investment Grade Long Maturity Fixed Income	0%	0%	0%	0%	0%
Investment Grade Intermediate Maturity Fixed Income	56%	46%	27%	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*	6%	0%	0%	0%	0%
ALTERNATIVE INVESTMENTS-MANAGED FUTURES	**0%**	**0%**	**3%**	**5%**	**5%**
CASH & CASH ALTERNATIVES	**2%**	**2%**	**2%**	**2%**	**2%**

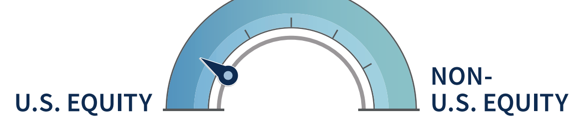
*Refer to page 22 for multi-sector bond asset class definition.

TACTICAL ASSET ALLOCATION OUTLOOK

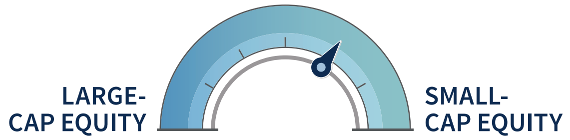
For investors who choose to be more active in their portfolios and make adjustments based on a shorter-term outlook, the tactical asset allocation outlook below reflects the Raymond James Investment Strategy Committee's recommendations for current positioning. Your financial advisor can help you interpret each recommendation relative to your individual asset allocation policy, risk tolerance and investment objectives.



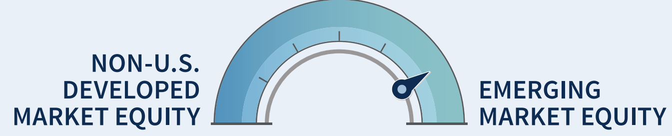
In the near term, we favor equities over fixed income based on momentum, rising interest rates and slope, and unattractive yield spreads, particularly in the high yield space. Equities should continue to outperform as above-average earnings growth and economic growth continue to support global equity markets throughout the year.



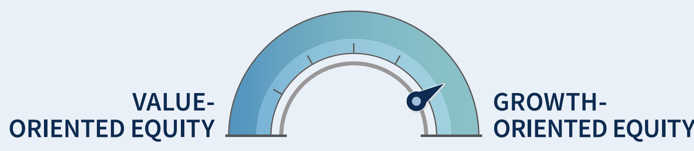
U.S. equities are favorable relative to non-U.S. equities in the near term as stronger earnings growth and longer-term momentum continue to be supportive. Corporate and personal tax cuts should lead to 15-18% in earnings growth in 2018 which is substantially higher than the long-term average. A strengthening U.S. dollar would be a headwind for non-U.S. equities.



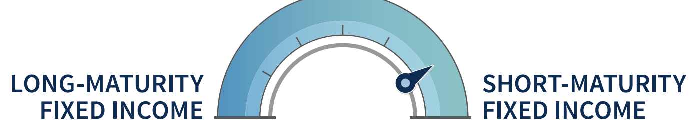
If the U.S. dollar strengthens dramatically from this point and/or trade policy disruptions take place, small-cap equities may be more attractive in the short term as they are more insulated from the negative impact of these headwinds relative to large-cap equities.



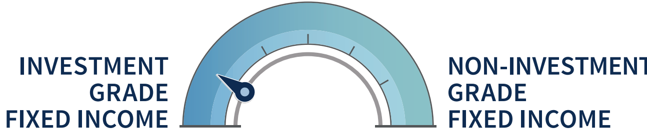
Emerging markets are favored over non-U.S. developed market equities assuming trade disruptions do not occur. It is highly recommended that investors keep an eye on these positions if trade disruptions do occur. A rise in the U.S. dollar remains a headwind for both of these markets.



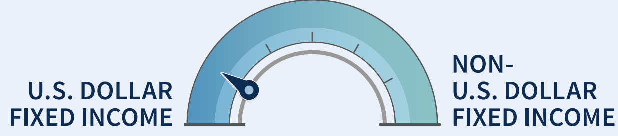
Growth is outperforming value and should continue to do so as these companies benefit from higher earnings estimates. Value is still lagging as rate sensitivity has been a drag and is not supporting profitability in the Financials sector. As long as the market continues to be willing to "pay up" for earnings, this disparity should exist.



The Federal Reserve is expected to continue increasing the fed funds rate, presenting value for the short end of the yield curve as investors can reinvest at higher rates upon maturity. Longer-term rates remain range bound due to global demand among other things. If long rates do begin to rise, shorter maturities will help mitigate duration risk.



Despite low default rates, high-yield bonds are not appropriately compensating investors for the credit risk and loss potential. Investment-grade bonds, while not attractive relative to equities, continue to provide ballast to equity market risk and positions should be maintained for this reason.



In the near term, we favor U.S. dollar-denominated fixed income as recent weakness may reverse. In addition, the European Central Bank is in favor of a weaker euro, also boding well for the dollar. We do believe there is a higher probability of dollar strength in 2018 versus further weakness.

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

ALTERNATIVE INVESTMENTS SNAPSHOT

ALTERNATIVE INVESTMENTS	
EQUITY LONG/ SHORT	Although long/short equity strategies tend to be long-biased in nature, the increased dispersion among equities and the ability to hold both long and short positions provide the potential for these managers to outperform long-only equity strategies (as they did in February). While these long/short strategies tend to lag traditional equities during "up" markets, the strategy is a viable option for clients interested in reducing traditional equity risk.
MULTI-MANAGER/ MULTI-STRATEGY	Multi-manager/multi-strategy funds that are diversified across strategies, assets classes, and geographies have the potential to generate total returns while providing low correlations to traditional assets like stocks and bonds. Investors seeking to further diversify their portfolio or reduce overall volatility may consider allocations to these strategies.
MANAGED FUTURES	Broadly diversified across geographic regions and asset classes, managed futures have the potential to efficiently capture returns in both rising and falling equity markets as these strategies are poised to benefit from divergent price movements. However, recent increases in market volatility has reduced model conviction for many managers, especially in equities, capping potential returns in the short term. Additionally, portfolio cash may provide an additional source of return if short-term interest rates continue to rise as expected.
EVENT DRIVEN	Event-driven managers focus on generating returns driven by catalysts and that are less dependent on broader market movements. Although distressed opportunities are limited, M&A activity remains robust and companies continue to evaluate their asset mix, creating opportunities for event-driven managers. With many investors concerned about elevated equity valuations, event-driven strategies may present the potential to remain invested while gaining access to a return stream that is less correlated with the equity markets.
EQUITY MARKET NEUTRAL	With lower net exposure to equities, equity market neutral may be an attractive option for investors looking to reduce overall equity exposure. The strategy is poised to outperform in a challenging market environment for equities but will likely underperform if equities continue to appreciate.
GLOBAL MACRO	The breadth of asset classes, instruments, market exposures, and trading methods utilized in global macro strategies provide the potential to capitalize on market movements regardless of the stage of the market cycle. Periods of inflection during the market cycle generally create increased levels of volatility, presenting greater opportunity for these strategies.

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.

Q&A: REGULATORY REFORM *Continued from page 17*

Senate majorities, but it could also sow optimism on the ability to see a breakthrough on other legislative priorities, especially given the need for bipartisanship and the 60 vote threshold in the Senate for legislation.

KEY TAKEAWAYS:

- This deregulatory push, combined with the tax changes enacted earlier this year, will likely result in increased profitability, capital return, and M&A activity for many financial services companies.
- The push against financial regulations has been cast as a driver of economic growth, a position that many congressional Republicans avoided in the immediate aftermath of the financial crisis.
- Tightening will shift away from regulation to normalization of the fed funds rate. This could represent a multi-pronged win for the banking industry: normalized interest rates, expanded regulatory relief, increased business activity, and lower regulatory expenses.
- The recent announcement on tariffs raises concerns of a trade war, which would represent a significant headwind for the economy.

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	24.9%	Fundamentals across most subsectors of tech remain strong. As long as fundamentals progress, the strong valuation levels ought to hold. Yet, any slowing of fundamental trends would likely result in a sharp price adjustment with elevated valuations. Technically, we believe price momentum is healthy.
OVERWEIGHT	FINANCIALS	14.6%	Fundamentals are solid as earnings growth is expected to be strong, macro conditions are healthy and regulation is less strenuous. The tightening cycle for the Fed will help boost earnings even more. The recent decline in the yield curve spread is a potential headwind if the trend continues. Technically, the sector screens as one of the most attractive.
OVERWEIGHT	HEALTH CARE	13.7%	We remain Overweight despite an expected rate of earnings growth behind the S&P 500 and soft relative strength trends. Low valuation lessens the headwind from below market earnings growth. The opportunity for outperformance at the subsector level is present in this diverse sector.
OVERWEIGHT	INDUSTRIALS	10.2%	Fundamental trends are healthy and valuations are attractive. The sector has experienced one of the sharpest upward revisions to 2018 earnings estimates since the beginning of the year. The industrial side of the economy should remain attractive due to improved economic activity as well as the ability for companies to immediately expense capex. Tariffs and trade negotiations are a headwind to potential growth and will be monitored.
OVERWEIGHT	ENERGY	5.8%	We remain Overweight and believe the lack of price recovery off the February low is unjustified. With crude prices in the $60s, we feel it is only a matter of time until the stocks catch-up. Valuation is back to 'normal' levels as fundamentals improve.
EQUAL WEIGHT	CONSUMER DISCRETIONARY	12.8%	Overall, fundamentals have improved but earnings expectations are projected to trail expected gains in the S&P 500. Valuation is respectable relative to expected growth. Selective stock picking is recommended, as not all subsectors are participating in the resurgence of the overall sector.
EQUAL WEIGHT	MATERIALS	2.9%	Global growth should support fundamental trends. Given healthy fundamentals, valuations are acceptable. We view valuation as mixed, and weakening trends with technical momentum leave us cautious.
UNDERWEIGHT	CONSUMER STAPLES	7.5%	Many companies are facing margin challenges as costs outpace price gains. Technical price momentum reflects the fundamental challenges. Valuation is somewhat attractive, but, considering slow growth trends, valuation is only average.
UNDERWEIGHT	UTILITIES	2.8%	Weak technical momentum along with expected earnings growth well below the overall S&P 500 keeps us Underweight, despite compelling valuations.
UNDERWEIGHT	REAL ESTATE	2.7%	The combination of downward revisions of expected funds from operations in 2018 along with weak technical trading trends keep us Underweight, despite attractive valuation levels.
UNDERWEIGHT	TELECOM	1.9%	Inexpensive valuations are not enough to off-set fundamental trends and weak technical momentum.

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.

Multi-Strategy
Engage in a broad range of investment strategies, including but not limited to long/short equity, global macro, merger arbitrage, statistical arbitrage, structured credit, and event-driven strategies. The funds have the ability to dynamically shift capital among the various sub-strategies, seeking the greatest perceived risk/reward opportunities at any given time.

Event-Driven
Event-driven managers typically focus on company-specific events. Examples of such events include mergers, acquisitions, bankruptcies, reorganizations, spin-offs and other events that could be considered to offer "catalyst driven" investment opportunities. These managers will primarily trade equities and bonds.

Market Neutral
A hedge fund strategy that seeks to exploit differences in stock prices by being long and short in stocks within the same sector, industry, market capitalization, country, etc. This strategy creates a hedge against market factors.

Managed Futures
Managed futures strategies trade in a variety of global markets, attempting to identify and profit from rising or falling trends that develop in these markets. Markets that are traded often include financials (interest rates, stock indices and currencies), as well as commodities (energy, metals and agriculturals).

INDEX DEFINITIONS

Barclays U.S. Aggregate Bond Index
A broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. Securities must be rated investment-grade or higher using the middle rating of Moody's, S&P and Fitch. When a rating from only two agencies is available, the lower is used. Information on this index is available at INDEX-US@BARCLAYS.COM.

DISCLOSURE

All expressions of opinion reflect the judgment of Raymond James & Associates, Inc. and are subject to change. Past performance may not be indicative of future results. There is no assurance any of the trends mentioned will continue or forecasts will occur. The performance mentioned does not include fees and charges which would reduce an investor's return. Dividends are not guaranteed and will fluctuate. Investing involves risk including the possible loss of capital. Asset allocation and diversification do not guarantee a profit nor protect against loss. Investing in certain sectors may involve additional risks and may not be appropriate for all investors.

International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility. Investing in emerging and frontier markets can be riskier than investing in well-established foreign markets.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.

U.S. government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the U.S. government.

While interest on municipal bonds is generally exempt from federal income tax, they may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

If bonds are sold prior to maturity, the proceeds may be more or less than original cost. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revisions, suspension, reduction or withdrawal at any time by the assigning rating agency.

Commodities and currencies are generally considered speculative because of the significant potential for investment loss. They are volatile investments and should only form a small part of a diversified portfolio. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Investing in REITs can be subject to declines in the value of real estate. Economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of your portfolio.

Beta compares volatility of a security with an index. Alpha is a measure of performance on a risk-adjusted basis.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

The companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

The performance mentioned does not include fees and charges which would reduce an investor's returns. The indexes are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities. The Shanghai Composite Index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

MODEL DEFINITIONS

Conservative Portfolio: may be appropriate for investors with long-term income distribution needs who are sensitive to short-term losses yet want to achieve some capital appreciation. The equity portion of this portfolio generates capital appreciation, which is appropriate for investors who are sensitive to the effects of market fluctuation but need to sustain purchasing power. This portfolio, which has a higher weighting in bonds than in stocks, seeks to keep investors ahead of the effects of inflation with an eye toward maintaining principal stability.

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

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

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

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

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