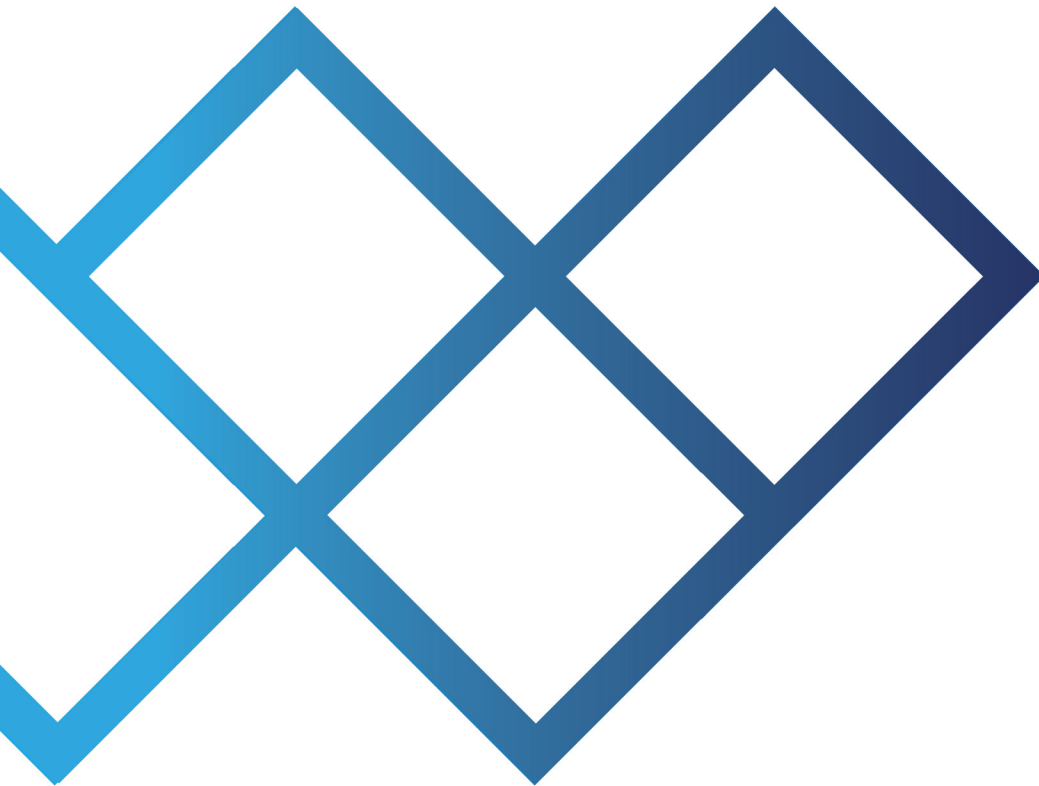




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# Macroeconomic Highlights

**Q2 2025**



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# WestEnd Outlook Highlights

- We still see late-cycle economic conditions in place in the U.S. While we believe some near-term economic deceleration is likely, tied in part to policy uncertainty, the *duration* and *magnitude* of a slowdown remain key questions for portfolio positioning. In the intermediate and longer term, we anticipate a further extension of the economic cycle is reasonably likely, even if activity slows in the near term, particularly if the policy focus shifts toward more stimulative measures like tax cuts and deregulation.
  - While employment and income trends have remained relatively stable, we see weakening among key pillars of employment that, along with declining consumer sentiment, could weigh on personal consumption. However, healthy household balance sheets could support borrowing and continued spending.
  - We still see a path lower for inflation this year, even as disinflation has slowed and tariffs present an upside risk to prices, as leading measures of residential rent prices (the largest driver of core inflation) indicate that the trend in shelter inflation has not re-accelerated.
  - With the Federal Reserve on a path toward policy recalibration, we believe the yield curve re-steepening process can continue, as resilient economic growth in the intermediate term and gradual disinflation could limit the downside to longer-term interest rates.
- Internationally, most major economies still face late-cycle challenges, in addition to risks from potential U.S. tariffs. China continues to face deleveraging headwinds while Europe also faces political uncertainty and slowing employment gains. Japan is an outlier, in our view, with positive growth trends and relatively loose monetary policy.
- We continue to position portfolios for the current risks and opportunities we see in the later stages of this economic cycle:
  - In U.S. large-cap equity allocations:
    - We are avoiding several of the most cyclical early-phase sectors, but are overweight of Financials, which we see benefitting from continued economic growth, a steeper yield curve, and a potential acceleration of loan growth.
    - We maintain a significant-but-underweight exposure to mid-phase sectors in aggregate, where valuations present risk, in our view, if financial results undershoot lofty investor expectations or the near-term benefits of AI underwhelm.
    - We also maintain material late-phase, defensive Health Care and Consumer Staples exposure that we expect can outperform as growth slows.
  - In global portfolios, we are underweight Europe, where we see continued risks from the war in Ukraine and U.S. tariffs, and where equities have significantly discounted modest fiscal stimulus. We are also underweight emerging markets, including China, as economic fundamentals do not seem to support recent equity performance. We retain an overweight of developed Asia, where we see relatively stimulative monetary policy and defensive characteristics for Japan.
  - In balanced portfolios:
    - We have a neutral allocation to fixed income in traditional balanced portfolios, as the risk/return profile we see for bonds is relatively balanced given the potential for continued late-cycle economic growth and limited downside to longer-term interest rates.
    - Within fixed income allocations, we are emphasizing Treasury securities at the long end of the yield curve, and we are focusing corporate exposure in shorter durations, as widening credit spreads could put longer-term corporate bonds at greater risk.

# U.S. Equity Sector Allocations

## WESTEND ETF STRATEGIES

Current large-cap U.S. equity sector allocation and avoidance\*

### Sector Allocations

- Financials
- Health Care
- Consumer Staples
- Communication Services
- Consumer Discretionary
- Information Technology

### Sector Avoidance

- Energy
- Industrials
- Materials
- Real Estate
- Utilities

\* For illustrative purposes only. Allocation information as of March 31, 2025. Source: WestEnd Advisors.

# International Equity and Fixed Income Allocations

## WESTEND GLOBAL ETF STRATEGIES

Current regional equity allocation positioning in global portfolios\*

### Regional Equity Overweights

- U.S.A.
- Japan/Developed Asia

### Regional Equity Underweights

- Europe
- Emerging Markets

## WESTEND BALANCED ETF STRATEGIES

Current fixed income and asset class positioning in balanced portfolios\*

### Fixed Income Overweights

- Short-term Corporate Credit
- Longer-Term Treasury Securities

### Fixed Income Underweights

- Short-term Treasury Securities
- Long-term Corporate Credit

\* For illustrative purposes only. Allocation information as of March 31, 2025. Source: WestEnd Advisors.



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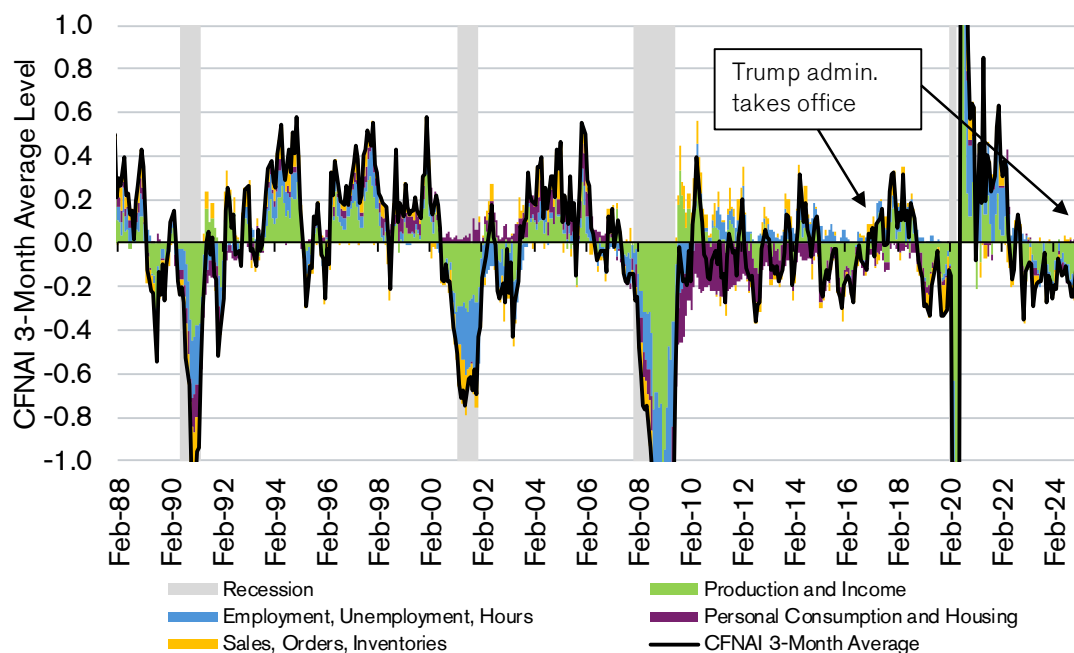
# U.S. Economic & Market Backdrop

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# Questions about Economic Growth to Persist

## POST-ELECTION BOOST EVIDENT, BUT LONGEVITY IN QUESTION



Source: Chicago Fed, WestEnd Advisors

**Portfolio Impact:** Mixed data has raised questions about the economic trajectory as the Trump administration's policies are implemented. We see little evidence of robust, early-cycle growth dynamics, which warrants an avoidance of highly cyclical sectors like Energy, Materials, and Industrials, in our view. Still, we believe a balance of exposures is warranted, and we are emphasizing market segments with strong growth opportunities, such as Communication Services and Financials, as well as sectors with defensive characteristics (Health Care and Consumer Staples).

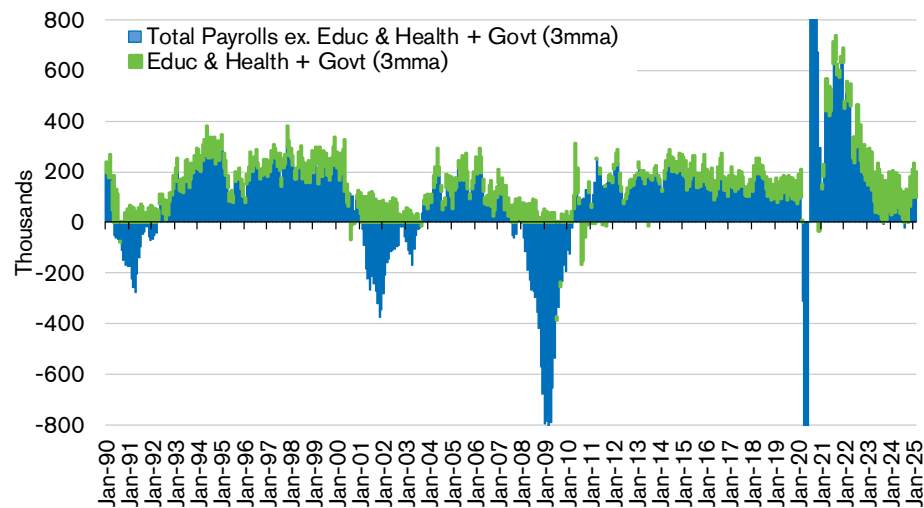
After remaining at below-trend levels for most of the past two years, the Chicago Fed National Activity Index (CFNAI), a broad measure of U.S. economic activity, has rebounded following the arrival of the Trump administration, not unlike the pattern that occurred in early 2017. The improvement has been primarily driven by the Production & Income component (also similar to 2017).

The sustainability of above-trend growth is questionable, in our view. Order front-running has likely bolstered recent data releases, while the economic impact of higher tariffs, government job cuts, and slower household wealth gains may not show up until later in the year. We expect 2025 to mark a pivotal year for the cycle, as we believe the implementation of these new policies is likely to occur against the backdrop of a late-cycle economy that is exhibiting diminished growth drivers.



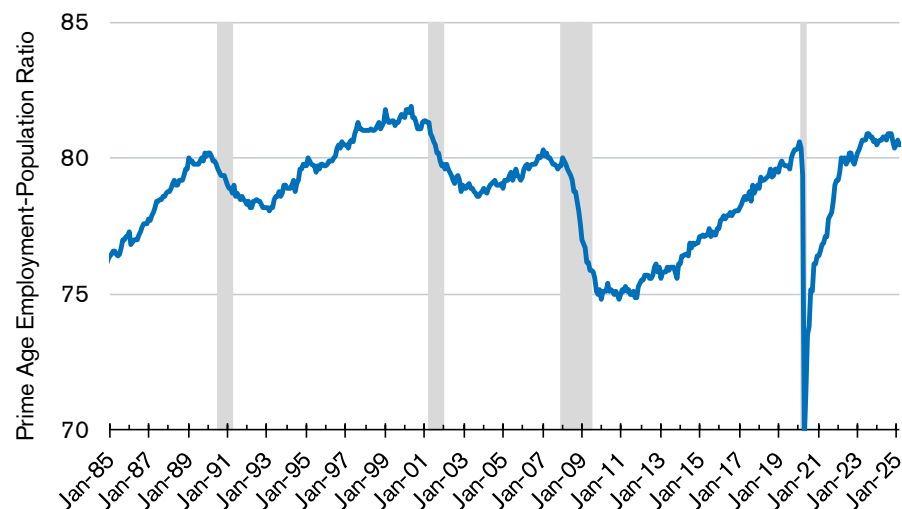
# Private Sector Hiring Needed to Sustain Growth

## KEY SUPPORTS OF RECENT JOB GAINS AT RISK



Source: BLS, WestEnd Advisors

## LABOR MARKET CONDITIONS LOOK LATE-CYCLE



Source: BLS, Bloomberg, WestEnd Advisors

**Portfolio Impact:** Softening employment trends have been percolating under the surface for several quarters. In our view, the trajectory of hiring demand relative to layoffs is likely to be a key determinant of whether the U.S. economy can sustain a soft landing, especially given areas of labor market resilience like Education, Health, and Government categories are more at risk.

As we have flagged since mid-2023, U.S. job gains have been narrowly supported by non-cyclical public-oriented industries, including Education & Health and Government. These categories comprised 77% of monthly payroll gains since June 2023 versus a long-run average of  $\approx 40\%$ .

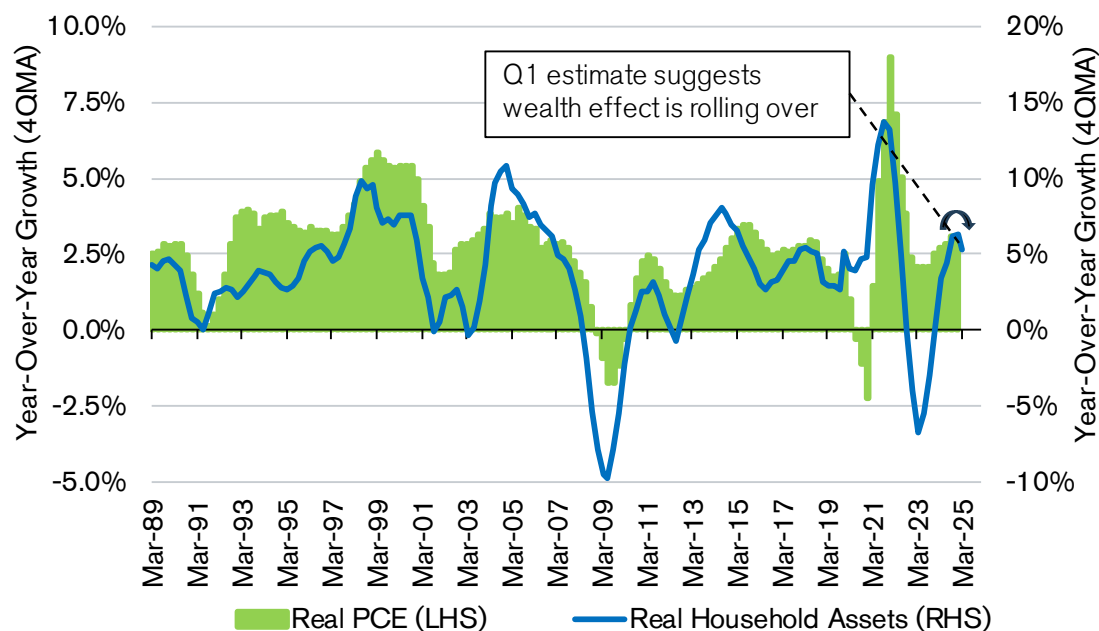
Strength in these categories was partly due to a recovery from COVID, but fiscal policy also supported growth. The post-COVID recovery is complete in our view, while some fiscal programs that supported hiring are now ending or even reversing, putting these key categories at risk.

A topping employment-population ratio indicates job gains in the rest of the labor market are likely to remain sluggish, in our view, which should lead to slower GDP growth.



# Consumption Has Been Supported by Wealth Gains

## WEALTH GAINS CAN SUPPORT CONSUMER SPENDING



Source: BEA, Federal Reserve, WestEnd Advisors

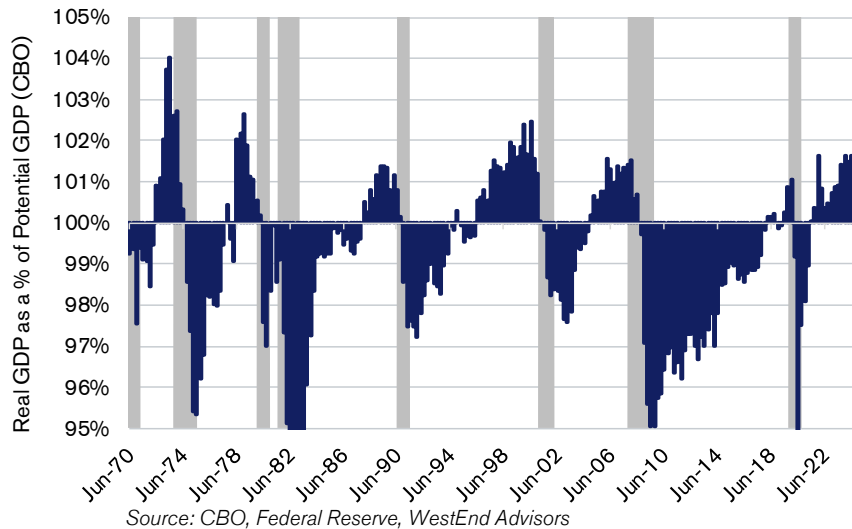
**Portfolio Impact:** Wealth gains have supported consumer spending over the past year, but appear poised to slow alongside the recent pickup in equity volatility. With hiring softening, we believe balanced exposure to the consumer is necessary. Consumer Discretionary companies could capitalize on a pick-up in goods spending if rates move lower, while Consumer Staples companies should benefit if household spending patterns rotate toward more essential items.

Growth in real consumer spending has remained healthy in recent quarters, even as real disposable income growth has slowed. Gains in household net worth, driven by appreciating home and equity prices, lifted consumer confidence through early 2025 and enabled households to drive down the savings rate and continue to spend, providing a key support for growth.

As the chart above shows, the rise in equity volatility in Q1 points to a slower pace of wealth gains relative to recent quarters. A more modest pace of equity returns moving forward is a key reason we see limited potential for consumption growth to sustainably *accelerate* from here, along with depleted excess savings and decelerating income and employment growth.

# Economic Cycle is Mature, But Sources of Economic Support Remain

## GDP OUTPACING POTENTIAL



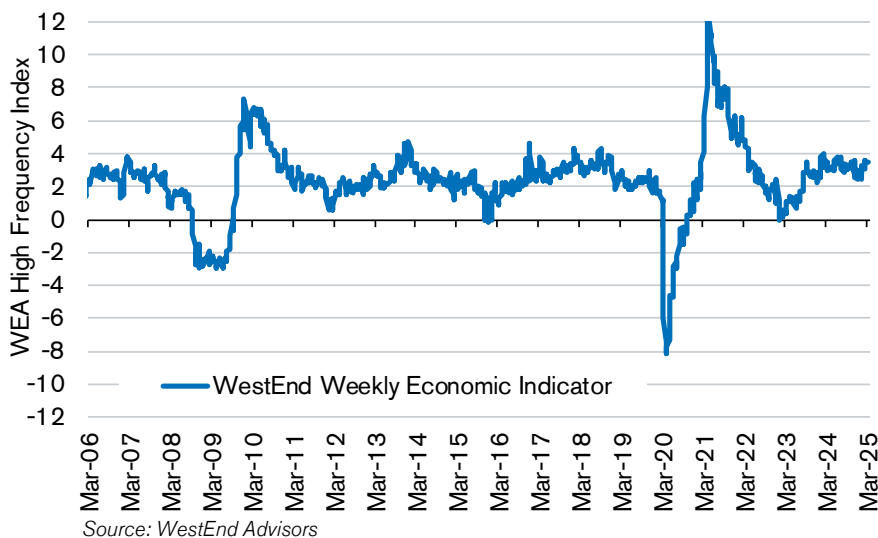
**Portfolio Impact:** Ongoing late-cycle risks in the U.S. warrant an avoidance of highly cyclical sectors, in our view. At the same time, steady economic growth and productivity gains, along with the absence of extreme excesses, could enable the cycle to tread along. In our portfolios, we have balanced our exposure between traditionally defensive sectors, like Health Care, with sectors that can benefit from a continuation of the cycle, such as Financials and Information Technology.

We continue to see late-cycle conditions for the U.S. economy, such as a tight labor market, restrictive monetary policy, and above-potential GDP (a positive “output gap”).

The output gap’s swift rebound from COVID-19 (top chart) suggests that the progression of the economic cycle has been rapid. A positive output gap is a sign that GDP has grown faster than its long-run potential, which is typically a late-cycle phenomenon.

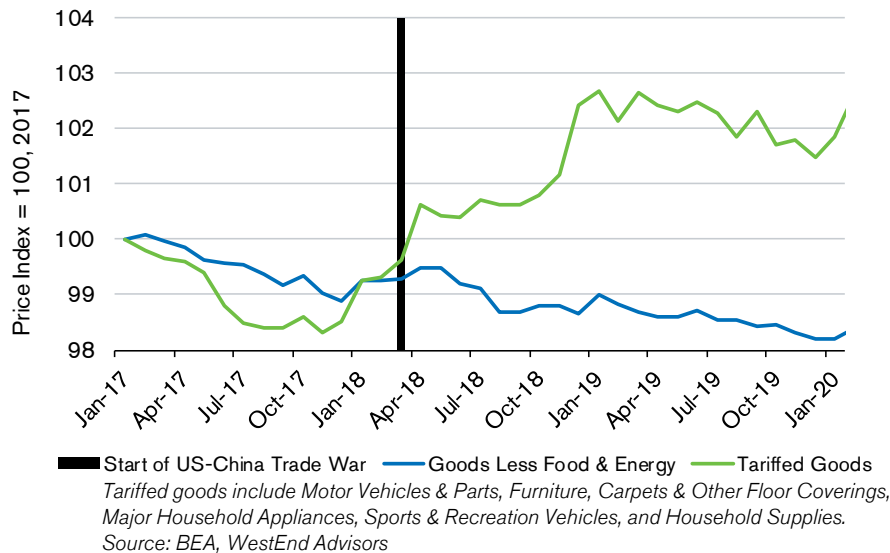
Even as sentiment readings have deteriorated in recent months, WestEnd’s measure of high frequency data has held up. We believe improved productivity (from tech, including AI) and renewed credit growth will be needed over time to extend the economic cycle.

## HIGH FREQUENCY DATA COMPOSITE HOLDING UP

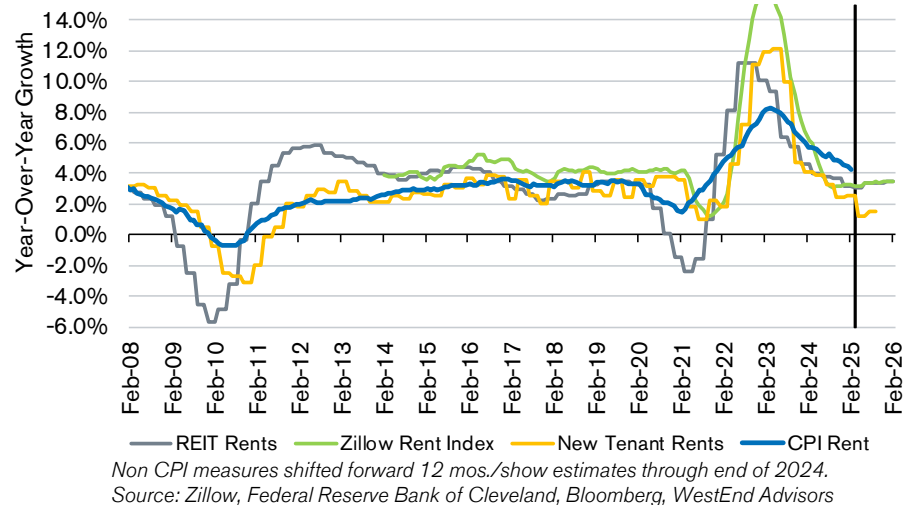


# Tariffs to Lift Goods Prices, But Services Disinflation Provides Offset

## TARIFFS A RISK TO PRICES ON AFFECTED GOODS



## FORWARD-LOOKING RENT MEASURES NOT ALARMING



**Portfolio Impact:** The base case for our inflation outlook continues to contemplate a path lower. Still, we don't expect core CPI inflation to reach the Fed's 2% target by year end, as upside risks to inflation may be more prevalent than a year ago. We are maintaining a significant allocation to the long end of the yield curve, while also avoiding long-duration corporate bonds due to risks from a potential widening of credit spreads.

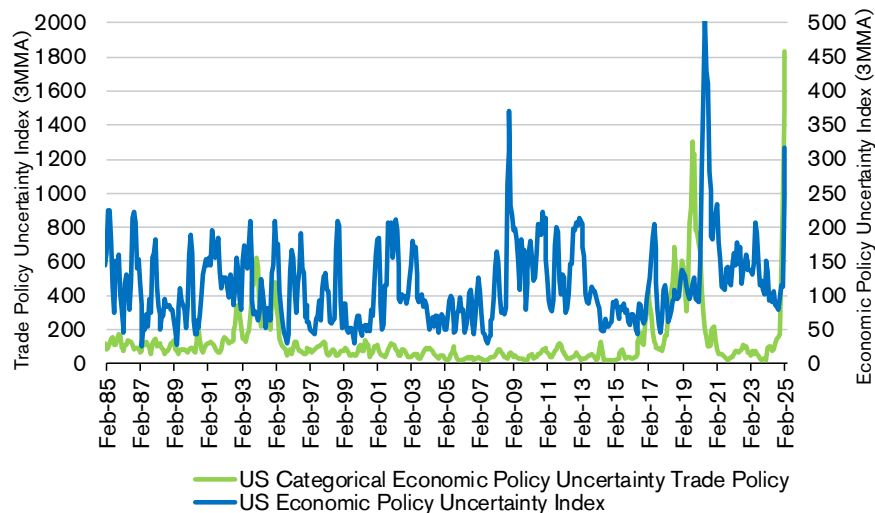
Tariffs present an upside risk to prices. During the 2018-2019 trade war, a basket of impacted goods saw higher prices following the imposition of tariffs, though goods prices overall remained on their prior trend lower. While the final levels remain uncertain, the weighted average tariff rate will likely see a much larger increase in this administration compared to 2018, in our view. Consumers are also increasingly expecting higher inflation, which could give the Fed some concern when considering their outlook.

While progress on core inflation has been harder to come by over the past several months, we are encouraged that leading measures of residential rent prices, the largest driver of core inflation, indicate that the trend in shelter inflation has not re-accelerated.



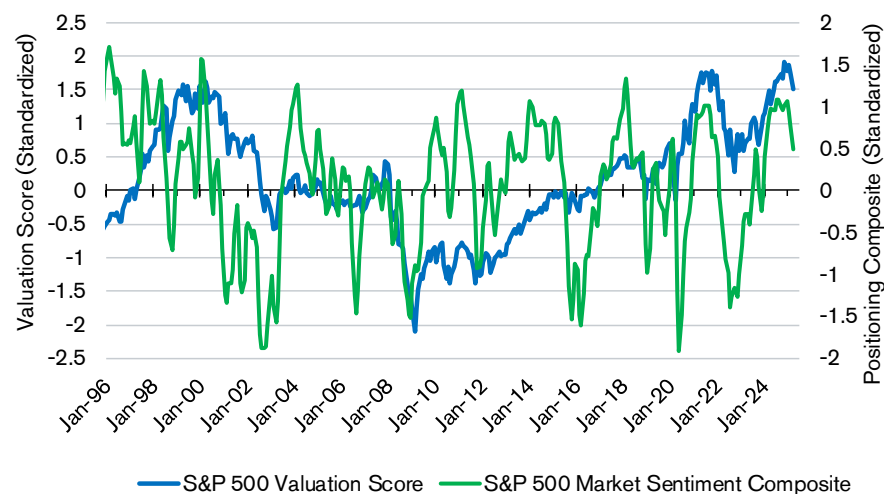
# Economic Uncertainty Highlights Elevated Market Risk

## MACRO UNCERTAINTY HAS SURGED...



Source: Baker Bloom & Davis, WestEnd Advisors

## ...VALUATION AND SENTIMENT DOWN, BUT NOT A FULL RESET



Source: WestEnd Advisors

**Portfolio Impact:** Despite trimming some exposure to late-phase sectors over the past year amid resilient economic growth, we have maintained an overweight to defensive exposures in our portfolios amid stretched valuations and investor sentiment. Looking ahead, we believe our portfolios are poised to benefit from a more normalized volatility environment and a broader sector return backdrop.

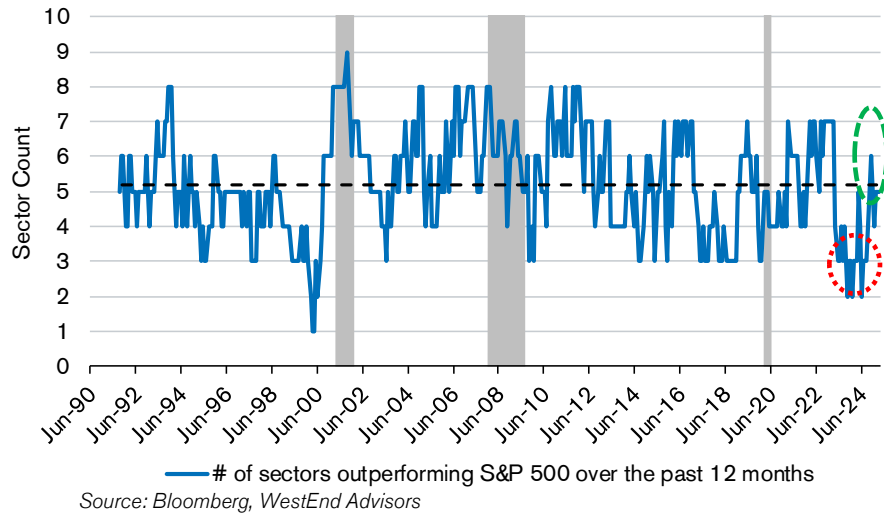
Questions around the economic impact of tariffs and federal spending cuts have led to a sharp rise in economic policy uncertainty to start the year (top chart).

The equity selloff that occurred in Q1 followed a period of strong (but narrow) market returns that lifted valuations and sentiment in 2023 and 2024. Historically, go-forward returns from elevated valuations and stretched sentiment have benefitted the more defensive parts of the market, even in positive return environments.

WestEnd's internal indicators measuring valuation and sentiment have moved lower after the rise in volatility in Q1 but remain above average levels (bottom chart).

# Sector and Market Leadership is Broadening Out

**NUMBER OF SECTORS OUTPERFORMING THE S&P 500**

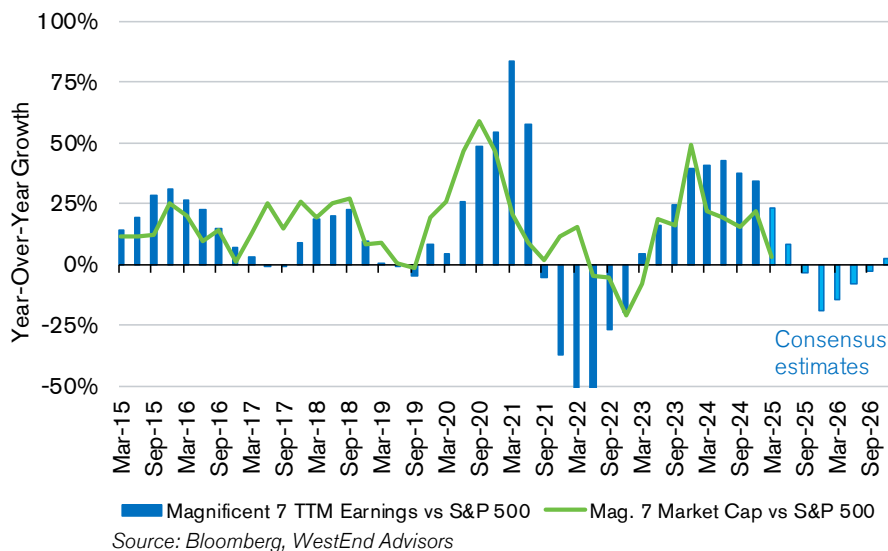


**Portfolio Impact:** U.S. Sector leadership is broadening out following a period of unusual narrowness in which a substantial overweight of mid-phase sectors would have been required to outperform the S&P 500. Looking ahead, our current exposure leaves us well-positioned for a more normalized market environment, in our view.

The S&P 500's return of ~58% in 2023-2024 was dominated by the Information Technology and Communication Services sectors, largely due to the proliferation of A.I. and above-market earnings growth expectations. The narrowness of sector leadership over the past few years was unusual relative to history (top chart), and we see potential for sector-focused investors to benefit as returns continue to broaden out.

The 'Magnificent 7' stocks have collectively demonstrated healthy fundamentals in recent years, which has supported significant relative outperformance. Momentum for this group of stocks, however, has been waning (bottom chart), as its earnings growth is expected to decelerate to below-market levels. This is likely to be a key factor in the broadening out of market leadership, in our view.

**"MAGNIFICENT 7" OUTPERFORMANCE UNLIKELY TO REPEAT**





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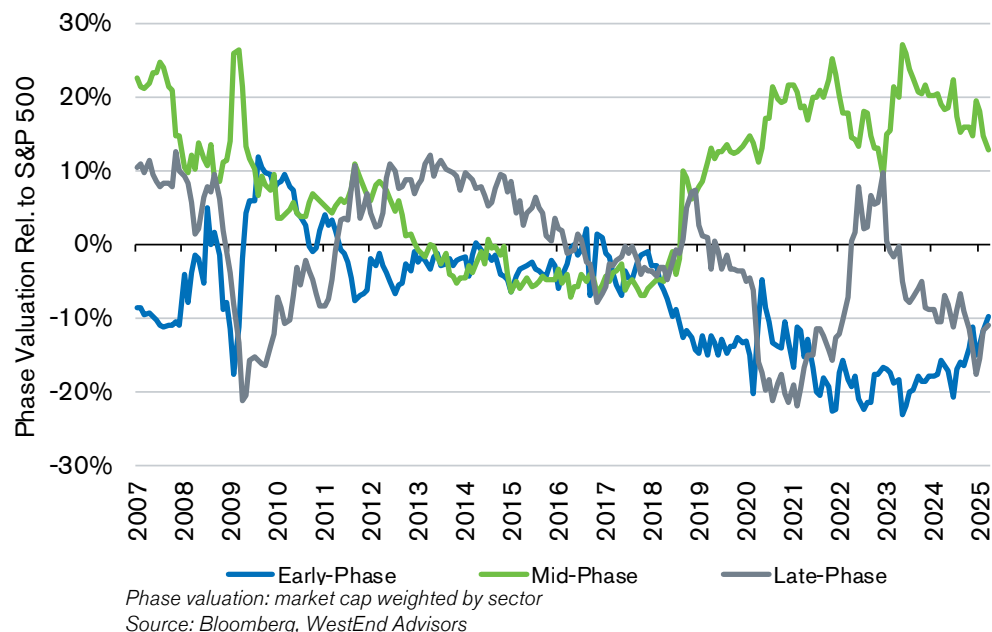
# U.S. Sector Outlook

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# Finding Attractive Valuations in a Volatile Market

## HEADROOM FOR LATE-PHASE RELATIVE VALUATIONS



**Portfolio Impact:** Exposure to late-phase sectors, such as Health Care and Consumer Staples, has provided stability for portfolios in 2025 and supported outperformance in a choppy market environment. The relative valuation of these sectors remains compelling, in our view, and could continue to improve, especially if volatility is set to persist.

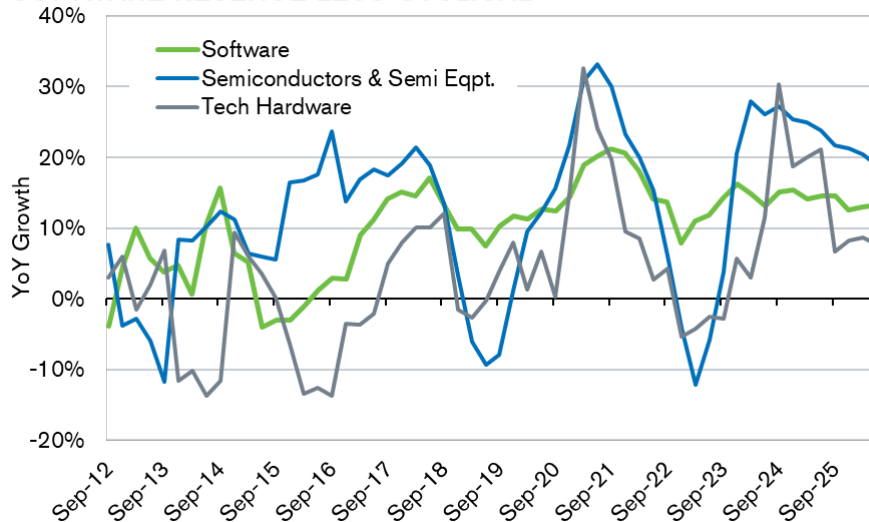
While the relative valuation picture has shifted with the strong relative performance YTD, current discounts to the market for late-phase sectors allow for further upside in a deeper risk-off environment or a broadening out of sector leadership. Additionally, earnings growth prospects for late-phase sectors remain solid, which has historically been accompanied by less volatility.

When the market prices in economic weakness or the potential for weakness, we tend to see late-phase sectors trade for a premium to the market. Reference points in the chart include 2018 and 2022. On the other hand, Health Care offers the opportunity for strong earnings growth and is a likely beneficiary from broadening sector leadership, in our view.



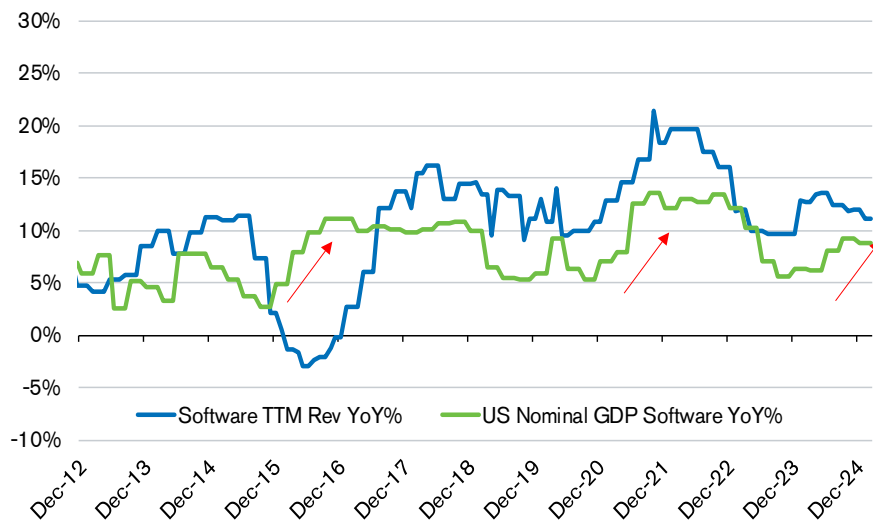
# Software Provides Stable Economic Sensitivity

## SOFTWARE REVENUE LESS CYCLICAL



Source: Bloomberg, WestEnd Advisors

## SOFTWARE INVESTMENT SUPPORTIVE OF DOUBLE-DIGIT GROWTH



Source: Bloomberg, WestEnd Advisors

**Portfolio Impact:** The Information Technology sector was a dominant driver of market fundamentals through the end of 2024. Information Technology returns have suffered YTD as elevated valuations present risk. Valuations remain lofty and while we view the sector as having robust growth and quality attributes, we are targeting what we believe is currently the most attractive industry: Software.

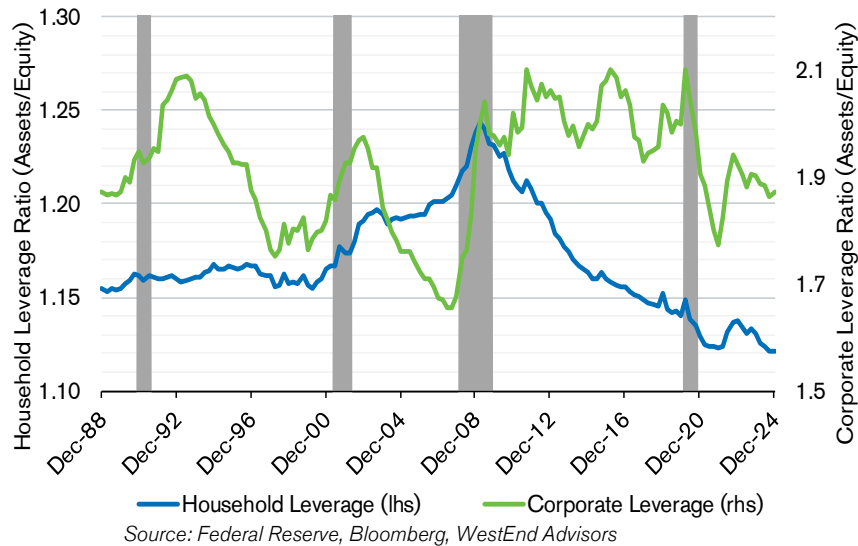
Growth expectations for the Information Technology sector have risen sharply thanks to a profit turnaround and an A.I.-driven investment cycle. We believe we are past peak growth for A.I. investment-dependent industries, which may inject further volatility in earnings expectations and valuations. In our view, Semiconductors and Technology Hardware are more vulnerable than Software due to the Software industry’s stable revenue growth characteristics and higher margins.

Additionally, we see secular tailwinds persisting for Information Technology, and we believe that Software investment can continue as companies implement A.I. into their operations. Within the broader economy, Software investment growth has remained healthy, which we view as supportive of top-line growth for the sector moving forward.

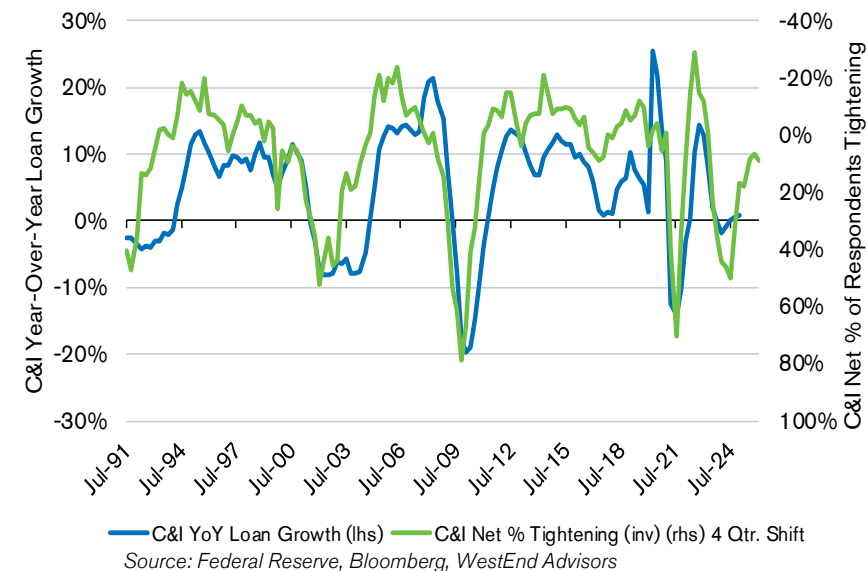


# Multiple Tailwinds for Financials Sector Fundamentals

## HEALTHY HOUSEHOLD AND CORPORATE BALANCE SHEETS...



## ...AND LOOSENING LENDING STANDARDS A POSITIVE FOR CREDIT GROWTH



**Portfolio Impact:** We have maintained an overweight to the Financials sector in our U.S. large-cap allocations, as favorable financial conditions, healthy household and corporate balance sheets, and a potentially more benign regulatory environment moving forward provide a confluence of tailwinds for the sector, in our view.

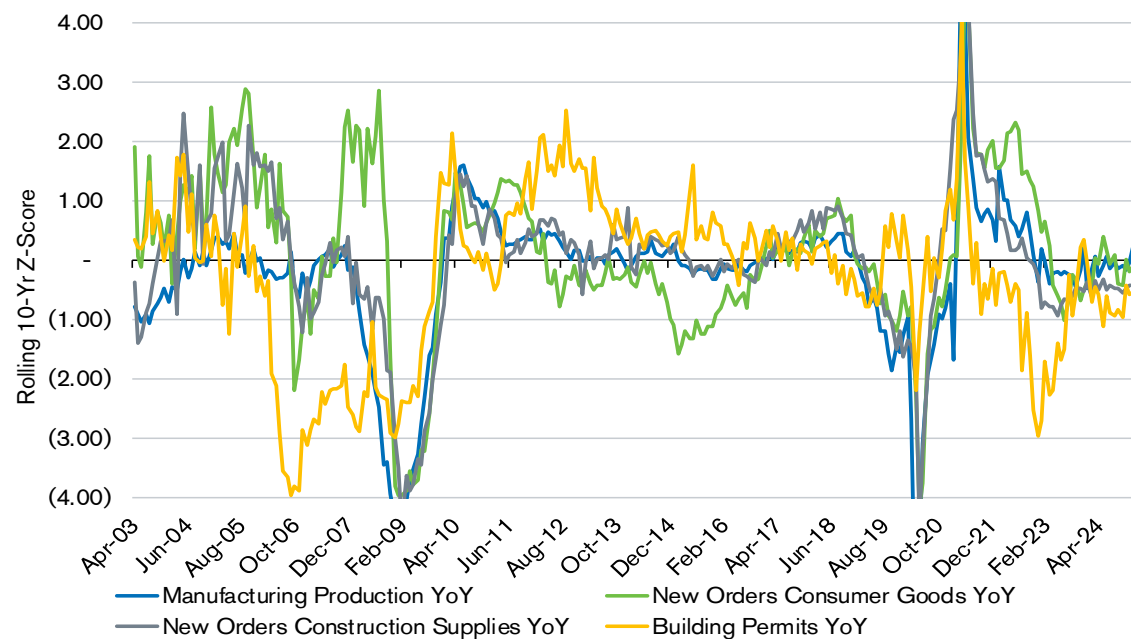
Leverage ratios for the household and corporate sectors remain benign (top chart). This suggests that households and businesses have ample room to borrow further, if needed, creating support for loan growth in the quarters ahead.

Moreover, we have noted the easing of lending standards in recent quarters, which, according to our research, has historically preceded a stronger pace of loan growth (see bottom chart).



# Cyclical Industrial Areas Still Facing Rate Headwinds

## SLUGGISH ACTIVITY PERSISTS IN RATE-SENSITIVE AREAS



Source: Census Bureau, Federal Reserve, WestEnd Advisors

**Portfolio Impact:** Although broader economic activity remains stable, the manufacturing sector and other rate-sensitive areas of the economy have experienced one of the longest periods of weakness on record, supporting our continued avoidance of the Industrials sector. Looking ahead, looser monetary policy could spur incremental activity in this space, though tariff policy remains a key risk.

Higher interest rates have had a recognizable negative impact on economic activity since 2022. More recently, activity in rate-sensitive areas has shown signs of stabilization, though growth has yet to inflect higher in a meaningful way. The chart above shows that growth rates for manufacturing, construction-related indicators, and consumer durable goods orders remain subdued. While a potential shift to looser monetary policy could stimulate increased activity in industrial end markets, the extent of policy easing remains a crucial factor, in our view. Additionally, our analysis suggests that the Industrials sector has above-average exposure to tariff-related risks.



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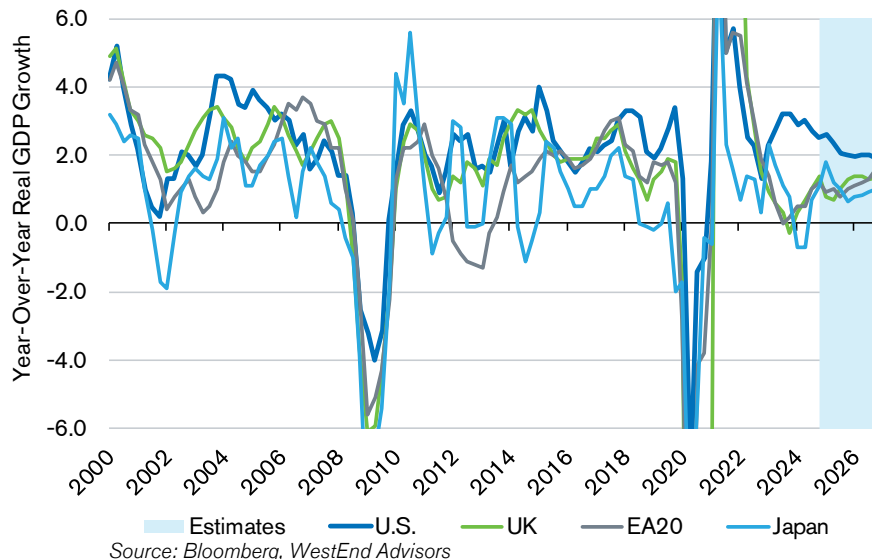
# International Economic & Market Backdrop

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# U.S. Growth Still Outpacing Rest-of-World

## U.S. GROWTH EXPECTED TO OUTPACE PEERS



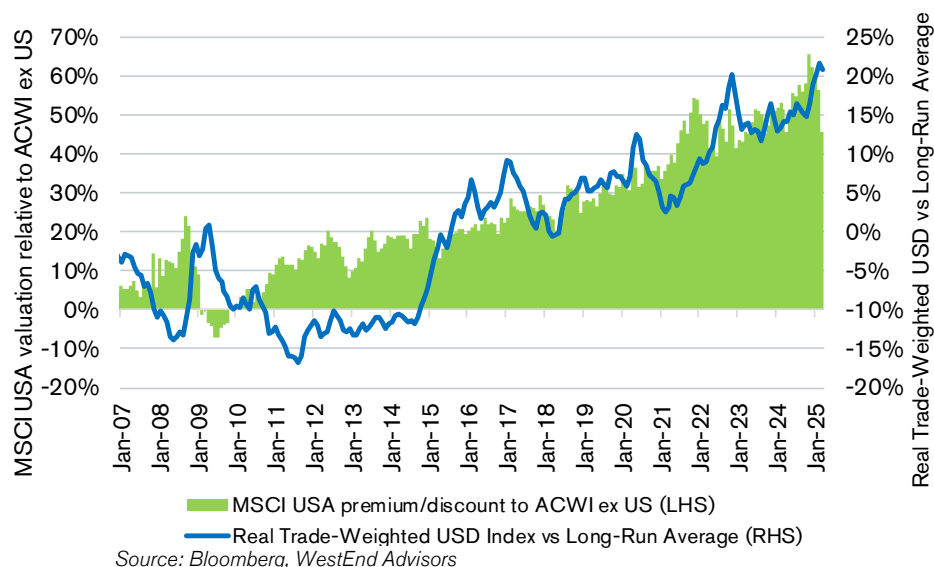
**Portfolio Impact:** Economic growth in the U.S. has continued to outpace the rest of the world and remains on a slowing-but-healthy trajectory, in our view. In global portfolios, we have maintained our overweight to the U.S., where we see attractive sector opportunities that could prove resilient in the face of slowing global growth.

Growth in the U.S. is expected to remain strong compared to other major developed economies (top chart). Historically, when economic growth in the U.S. outpaces that of other regions, relative performance tends to be favorable for domestic equities.

Over the longer-run, prospects for significant U.S. outperformance appear more mixed:

- Valuations for U.S. equities are now ~45% higher than those abroad
- Real trade-weighted USD index is ~20% above its long-term average (bottom chart)

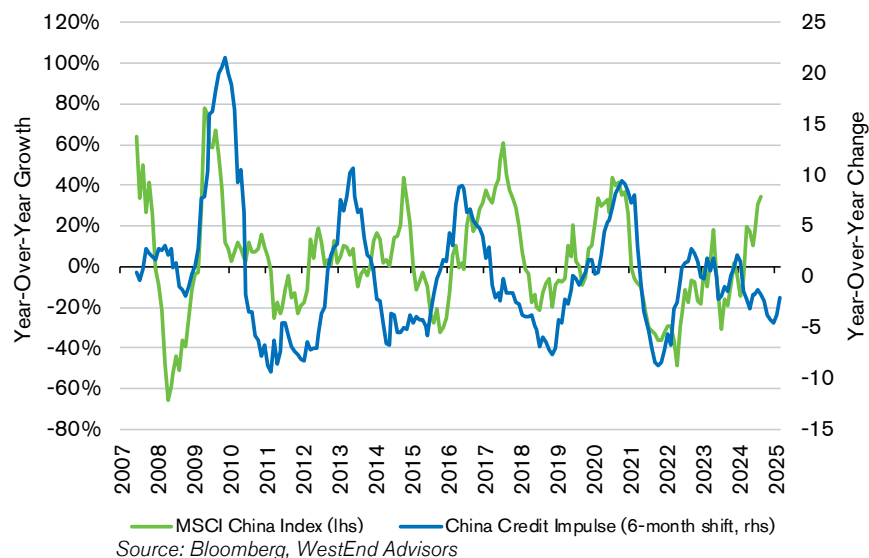
## U.S. EQUITY AND FX VALUATIONS INCREASINGLY STRETCHED



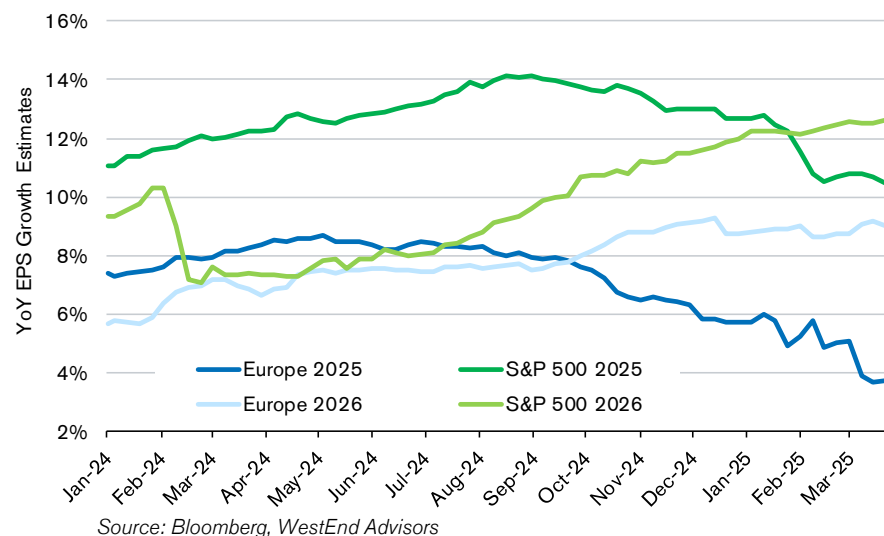


# Few Fundamental Signs of an Inflection in China and Europe

## CREDIT NOT SUPPORTIVE OF A SUSTAINED CHINA RECOVERY



## EUROPE OPTIMISM NOT REFLECTED IN EPS ESTIMATES



**Portfolio Impact:** In global portfolios, we maintain underweight positions in emerging markets and Europe. China's credit impulse, typically a leading indicator, has not yet signaled a sustainable recovery. Promises of EU defense spending have elevated market multiples, but earnings estimates for the broader index signal little benefit within our investment horizon.

China's strength is a key input for broad emerging markets to perform well on a relative basis. Prior episodes of market and economic strength have been led by new credit being injected into the economy, as measured by the credit impulse. Historically, the credit impulse in China has led market recoveries by about 6-months, but it appears this current market upturn has run ahead of the macro environment improving.

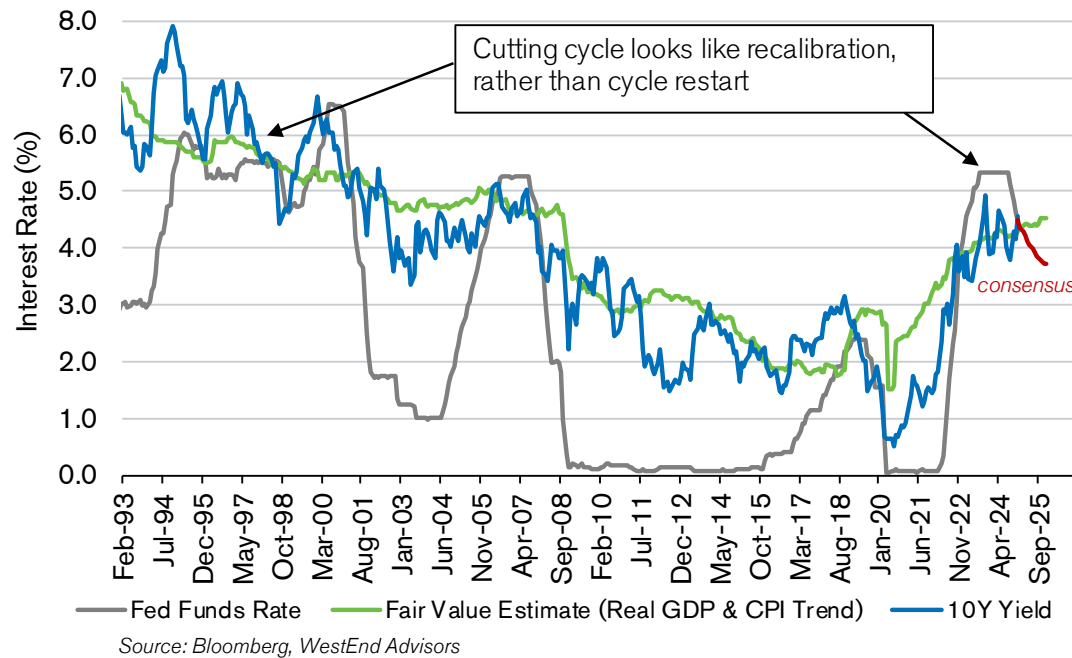
While potential shifts in EU defense spending have generated market enthusiasm for the region, we believe these initiatives will take time to implement and are likely to be narrowly focused. In our view, this warrants caution after valuation multiples in segments of the European market have moved significantly higher.

# Interest Rates & Real Assets

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# Yield Curve Steepening Has Room to Run in 2025

## YIELD CURVE RE-STEEPENING ON THE HORIZON



**Portfolio Impact:** With the Federal Reserve on a path toward policy recalibration, we believe the yield curve re-steepening process can continue. Resilient economic growth and gradual disinflation could limit the downside to longer-term interest rates. As a result, we expect fixed income returns in 2025 to be driven primarily by healthy coupon yields, as price gains could be limited. In balanced portfolios, we have eliminated an overweight to fixed income and believe a neutral allocation to bonds is warranted.

The yield curve remains inverted at the short-end, signaling late-cycle conditions. We expect the yield curve to steepen further in 2025. Historically, the method in which the curve steepens has depended on the economic trajectory:

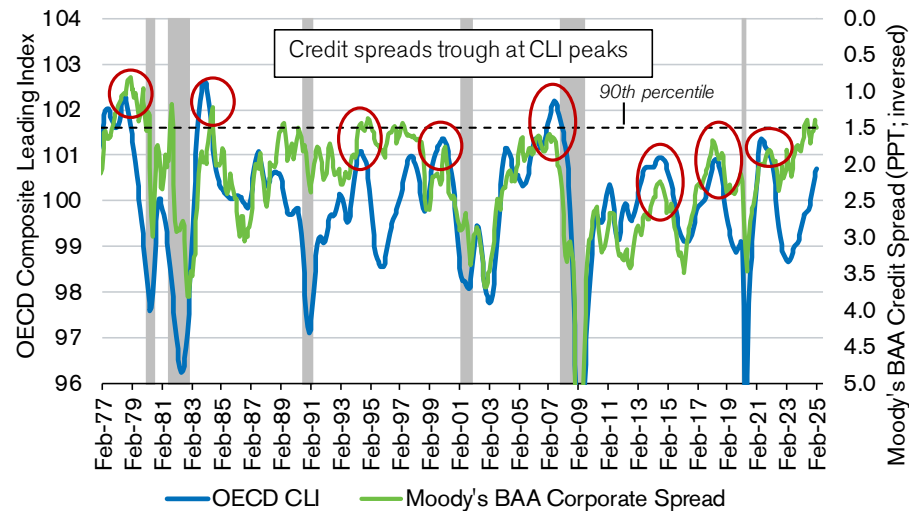
- *Bull Steepening:* Consistent with recession, in which the Fed rapidly lowers short-term interest rates
- *Bear Steepening:* Driven by the long-end of the curve increasing as the rate-cutting cycle stalls out. More consistent with soft-landing episodes and/or recalibration cuts (e.g. 1967, mid-to-late 1990s)

The 10-year yield is roughly in line with fair value, according to WestEnd’s internal model estimate based on long-run real GDP growth and CPI. Consensus economic forecasts suggests that fair value for the 10-year yield could remain between 4% and 5% in 2025, absent a sharp deterioration in growth (see chart above).



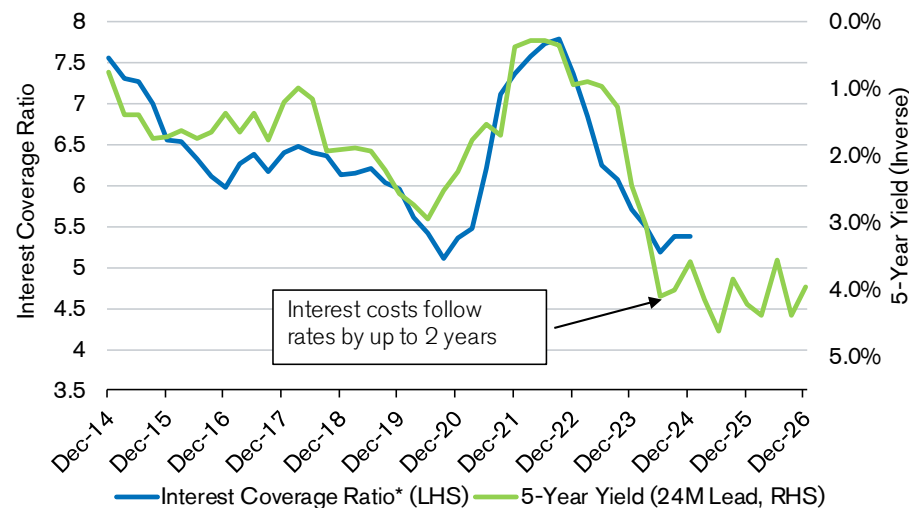
# Corporate Credit too Expensive for Slowdown Scenario

## SLOWDOWN RISK COULD SEE CREDIT SPREADS TROUGH



Source: Bloomberg, WestEnd Advisors

## NO INTEREST COST RELIEF ON THE HORIZON



\* For investment grade corporate bond universe.

Source: Bloomberg, WestEnd Advisors

**Portfolio Impact:** The potential for economic growth to slow, along with rising interest costs as debt is refinanced, has the potential to weigh on longer-duration corporate credit spreads, in our view, despite the Fed's gradual easing of short-term rates. As such, we have shifted corporate bond exposure to the short end of the curve and remain underweight corporate bonds with longer maturities.

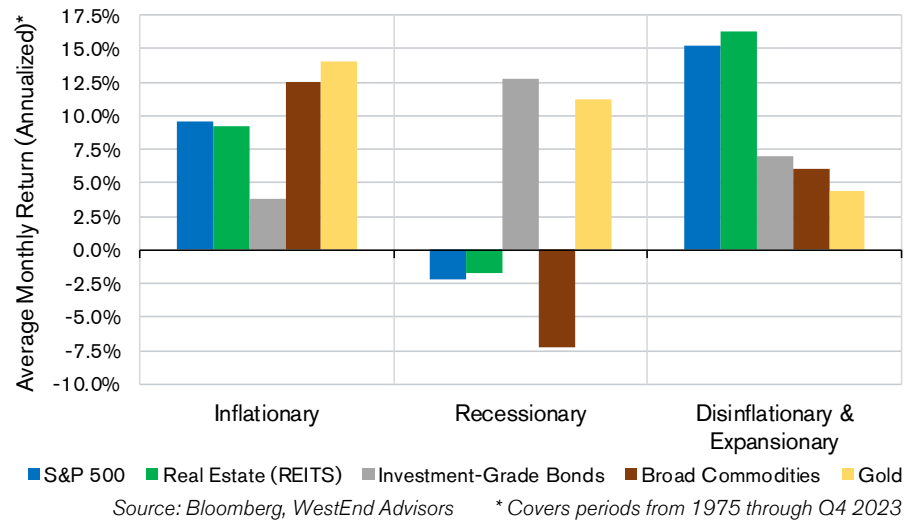
Investment grade credit spreads remain near historic lows, despite widening modestly in Q1. At this point, we view the risk/reward profile for long-duration corporate credit as unappealing. Historically, credit spreads have troughed as leading economic indicators roll over (top chart). This has tended to be neutral or negative for the performance of corporate bonds relative to Treasury securities.

Households and businesses withstood interest rate increases in the current cycle, as many borrowers were able to lock in low interest rates before or during the COVID-19 pandemic. This phenomenon may work in reverse, however, as borrowers' interest costs could rise even as the Fed gradually lowers interest rates (bottom chart). We believe maturing debt is likely to be refinanced at prevailing rates that are still higher than levels from the past decade.



# Asset Class Returns Driven by Macro Environment

## MACRO CONDITIONS DRIVE ASSET CLASS DISPERSION



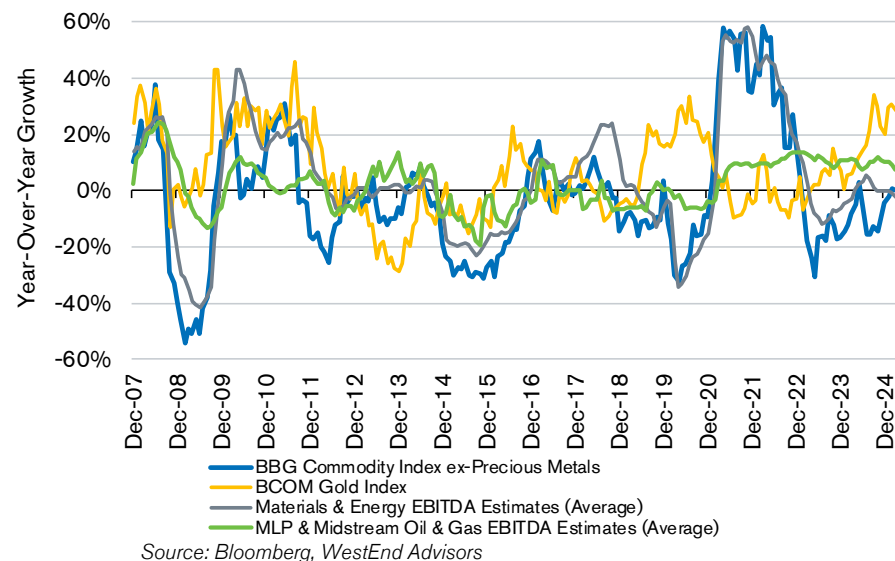
**Portfolio Impact:** Given our outlook for a late-cycle environment, we continue to avoid the most economically sensitive real asset exposures, like real estate and broad commodities. We have increased our exposure to gold, which we believe could benefit in an inflationary or recessionary environment. We trimmed our energy infrastructure exposure, as valuations became more elevated relative to fundamentals.

Our work has shown that assets outside of traditional equities and fixed income can be additive to portfolio results over the course of the economic cycle, and that characteristics of the cycle can have implications for the drivers of asset returns (top chart).

Precious metal prices and MLPs both tend to be less sensitive to price fluctuations of more cyclical commodities (bottom chart). Over the past several years, strong demand for non-USD reserve assets has supported gold despite elevated real interest rates.

Earnings estimates midstream energy companies have been robust, especially when compared to more commodity-oriented sectors like Materials and Energy.

## REAL ASSETS ACTING AS PORTFOLIO DIVERSIFIER



# Footnotes & Disclosures

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