ARGUS®

WEEKLY ECONOMIC COMMENTARY

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Markets Overview and Strategic Allocation Primer

Equities continue to outpace bonds in 2017, as we have expected, and we continue to favor stocks over fixed-income investments as the market moves through the 2Q EPS reporting period. Through July, the S&P 500 Index (ETF symbol SPY) was up 10.3% before dividends, while the primary fixed income index, the Barclays US Aggregate Bond Index (AGG), was ahead by 1.5%. Global stock returns have been the strongest year-to-date, as the MSCI EAFE (EFA) has gained an impressive 16.7%.

From an asset allocation standpoint, we continue to favor stocks over bonds, as we have for the past eight years, and we favor U.S. stocks over international stocks, despite the recent underperformance. U.S. stocks have approached fair value compared to bond yields, but we think that U.S. equities can continue to rise and benefit from economic and market trends which indicate: 1) core U.S. GDP is growing at a 2.0% rate, give or take 50 basis points; 2) real interest rates will remain low on a historical basis through 2017, and 3) corporate profits are on an upswing after a period of decline in 2015-2016. Risks to our outlook include uncertain conditions in key emerging economies, including China; negative interest rates in Europe and Japan; the potential for fall-out from the UK's exit from the European Union; the volatile price of oil; moves by the Federal Reserve that are deemed too aggressive; and the potential for geopolitical tensions in Russia, North Korea and the Mideast.

We have three strategic Asset Allocation models, based on risk-tolerance levels: Conservative, Moderate and Aggressive. Within these models, we make tactical calls for asset classes based on factors such as valuation, growth and risks.

For Conservative Accounts, we currently recommend a 40% weighting in stocks (within a range of 10%-45%), 55% in bonds and cash (range of 45%-65%), 3% in commodities (range 0-5%) and 2% in real estate (range 0-5%).

For Moderate Accounts, we currently recommend a 60% weighting in stocks (within a range of 25%-65%), 32% in bonds and cash (within a range of 15%-45%), 5% in commodities (0-10%) and 2% in real estate (0-5%).

For Aggressive Accounts, we currently recommend a 70% weighting in stocks (within a range of 30%-80%), 22% in bonds and cash (within a range of 15%-45%), 5% in commodities (0-10%) and 2% in real estate (0-5%).

We further break down our Models into sub-categories, and provide a discussion of returns and additional tactical recommendations below. More analysis on asset classes, including charts and tables, can be found in our Investment Portfolio Guide, Fixed Income Strategy and Portfolio Selector reports.

EQUITIES. Small-cap stocks outperformed large-caps in 2016, but large-caps have taken the lead in 2017, as the Russell 2000 (ETF symbol IWM) has advanced 4.0% through July, trailing SPY. Longer term, small-caps have outperformed large-caps over the past 5- and 10-year periods. On valuation, large-caps appear to be the better value, based on our review of trends in P/E ratios, price/sales ratios and dividend yields. Our recommended exposure to small- and mid-caps is 15% of equity allocation, in line with the benchmark weighting. In terms of Growth (IWF) and Value (IWD), Value outperformed in 2016. We expect accelerated earnings growth in 2017, which should favor Growth, which is already out to

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an early lead. Moving to the International arena, we note that U.S. stocks, though lagging over the past year, have outperformed global stock indexes over the trailing 5-year and 10-year periods. We expect this trend to continue over the long term, given volatile global economic and currency conditions, though we note favorable near-term valuations among international stocks. We look for Emerging markets (ETF symbol EEM) to outperform in 2017, led by China, India and a recovery in Brazil. Equity-based ETFs in our model portfolios include Schwab US Dividend Equity ETF (SCHD), Powershares S&P 500 Low Volatility ETF (SPLV), Vanguard Growth ETF (VUG), Vanguard Value ETF (VTV), Vanguard Emerging Markets Stock Index ETF (VWO) and iShares Edge MSCI Min Vol EAFE ETF (EFAV), among others.

BONDS/INTEREST RATES. We look for the 10-year U.S. Government Treasury bond yield to fluctuate within a fundamental range of 2.25%-3.00% through 2017. The current long bond yield is 2.3%, up from sub-2.0% last fall but down from 2.6% earlier this year. We now expect the Fed to hike short-term rates one more time in 2017, while also beginning to reduce its balance sheet to stave off inflation. In this environment, we favor Corporate bonds, inflation-protected securities such as TIPs and shorter-duration Treasuries. We also recommend that investors seeking higher yields and willing to take on a higher degree of risk consider diversifying bond portfolios by including an allocation to preferred stocks. We recommend steering clear of emerging market and foreign sovereign rates at this time, as any potential extra yield comes along with a substantially higher degree of risk. Interest rates in countries such as Japan and Switzerland are near zero or negative. Fixed Income ETFs in our Model Portfolios include PIMCO 0-5 High Yield Corp Bond Index ETF (HYS), SPDR Barclays Short-Term High Yield ETF (SJNK), and Vanguard Intermediate-Term Corporate Bond Index ETF (VCIT), among others

COMMODITIES. Commodities as an asset class have begun to recover after a five-year downtrend, though a recent uptrend has stalled in Energy. Looking ahead, we expect weakness in the dollar to result in stability for commodities including oil, gold, metals and agriculture. We think commodities should constitute up% to 3-5% of Moderate portfolios. Commodity and Alternative ETFs in our Model Portfolios include US Commodity Index Fund ETF (USCI), iShares Gold Trust (IAU) and iShares US Real Estate ETF (IYR).

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