2017 MARKET REVIEW AND 2018 OUTLOOK

2017 MARKET EVENTS

- U.S. equity markets reach all-time highs
- U.S. Federal Reserve raises short-term interest rates three times
- International equity markets outperform their domestic counterparts
- Anticipation for tax reform boosts expectations

The past year was among the best in nearly a decade for global markets, with most major asset classes posting positive returns. Nine years after the financial crisis, economic conditions continued to improve in 2017 – in the United States as well as around the world. Global markets benefited from stability: inflation levels remained low, monetary policy abroad remained supportive, and geopolitical crises were avoided. As the tireless equity rally continued, Freedom investors benefited from substantial allocations to U.S. equity.

U.S. EQUITY RALLY CONTINUES

The S&P 500 closed above 2,300 for the first time on Feb. 17, 2017, and above 2,600 on Nov. 24. Similarly, the Dow Jones Industrial Average had 71 record closes in 2017, surpassing 20,000 for the first time on Jan. 25, 2017, and topping 24,000 on Nov. 30. For the year, the S&P 500 TR index, which reflects the performance of U.S. large-cap stocks, returned 21.83%. U.S. mid-cap stocks returned 18.52%, as measured by the Russell Mid Cap TR index. U.S. small-cap stocks returned 14.65%, as measured by the Russell 2000 TR index. Overall, growth stocks outperformed value stocks in 2017, driven in large part by earnings growth and future expectations for earnings.

FEDERAL FUNDS INTEREST RATE INCREASES

U.S. equities benefited from accommodative monetary policy, even as the U.S. Federal Reserve raised its federal funds rate three times in 2017. The Fed, which is undergoing a leadership transition, made clear its intention to take a slow-and-steady approach to interest-rate normalization after supporting the economy with years of record-low interest rates. It also announced plans to begin selling the debt it acquired after the financial crisis, which provided the economy with an infusion of cash. The fixed income and equity markets took all that news in stride. Somewhat surprisingly, the bond market remained positive for the year, as well, with core fixed income returning 3.54%, as measured by the Bloomberg Barclays U.S. Aggregate Bond TR index, with bond prices in many areas finishing the year higher. Typically, rising interest rates have a negative effect on bond prices. But the Fed does not control long-term interest rates, which barely budged. As a result, core fixed income produced total return in excess of Asset Management Services (AMS) Investment Committee (IC) expectations.

INTERNATIONAL EQUITY MARKETS RALLY, TOO

Spurred by above-average earnings growth and favorable exchange rates, international developed markets outperformed domestic equity, returning 25.03%, as measured by the MSCI EAFE NR index. Central bank policy in Europe and Japan continued to be supportive, with no indication a reversal of monetary easing policies will come any time soon. Also, negotiations for the United Kingdom's withdrawal from the European Union proceeded without negative reverberation, thus far. In fact, the British pound rallied. Emerging markets, such as China, saw even greater returns. Emerging markets large caps returned 37.28%, as measured by the MSCI EM NR index.

TAX REFORM INSPIRES CONFIDENCE

The anticipation of tax reform, especially a reduction in corporate taxes, also drove the U.S. equity market in 2017. The tax law passed in late December likely will spark a one-year bump in corporate earnings into 2018, but likely will not help long-term cash flows if the savings are paid out in dividends or used for buybacks, the purchasing of previously issued shares. To have a long-term effect on the economy, companies will need to invest the additional cash flow into projects that can deliver higher returns in the future, such as research and development, physical assets, wages and productive improvement opportunities.

2018 MARKET THEMES

- Global growth that picked up steam in 2017 is in place going into 2018
- The U.S. economy is on solid ground, with corporate earnings expected to benefit from tax and regulatory reform
- Conditions in international developed markets, especially Europe, are even more favorable than in the United States
- The U.S. Federal Reserve is expected to continue on its path toward interest-rate normalization while most other major banks are likely to hold steady

As we turn the page on 2017 – a year that saw positive returns across most asset classes in Freedom portfolios – it's time to turn our eyes toward the future. What will 2018 hold for the capital markets? While it will be difficult to top the performance of the past year, the AMS Investment Committee sees many things to look forward to, as well as a few potential issues.

EQUITY

The AMS IC believes the earnings growth rally that helped propel equity returns in 2017 should continue, all else being equal, presenting opportunities for investors in 2018. While U.S. stocks remain relatively expensive – measured as a ratio of a stock's price relative to its earnings – the tax reform passed late in 2017 and continued regulatory reform have the potential to boost earnings, helping to close the price-to-earnings gap. That said, the AMS IC sees more favorable conditions overseas, especially in the developed markets of Europe where valuations are more attractive and central banks are likely to remain more accommodative compared to the United States.

While the United Kingdom may struggle through its withdrawal from the European Union, Germany, France and others are benefiting from continued easy monetary policies, improved fundamentals and higher expected earnings growth. Central banks in the developed markets have not yet begun to raise interest rates, and are not expected to do so in 2018, maintaining supportive conditions for economic growth. Compared to the United States, Europe could be a few years behind in its recovery, so could have a few more years of improvement in the markets.

Commentary is generally written from a passive standpoint and there are limitations to this data as strategies include active management. Actively managed strategies and holdings may have reacted differently during the quarter than the markets segments discussed herein. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses, which would reduce returns. All investments are subject to risk. There is no assurance that any investment strategy will be successful.

Overall, the equity markets present an attractive opportunity, though it could be prudent to move some U.S. equity to international equity or, staying within the United States, into holdings with lower volatility levels. Such a strategy has the potential to capture a rise in U.S. equities, yet hedge some of the downside risk.

FIXED INCOME

The AMS IC views fixed income as attractive more for its diversification purposes, as a hedge against equities, than its prospects to contribute to total return. As the U.S. Federal Reserve continues to raise its short-term federal funds rate – two or three increases are forecast for 2018 – it will put pressure on bond prices. The Fed is sensitive to causing a slowdown in the economy, so likely will take a slow-and-steady approach to interest-rate normalization and the selling off of the debt it acquired to help stimulate the economy after the financial crisis.

ALTERNATIVES

If the equity markets continue to rally around new U.S. policies and improved earnings, alternative investments could be challenged. If, however, stock prices outpace earnings and interest rates continue to rise, alternative strategies may help investors mitigate some of the downside risk in their portfolios.

FINAL THOUGHTS

The AMS IC is encouraged by what 2018 could potentially have to offer investors, yet is cautious as equity valuations in the United States remain elevated compared to historical norms. The IC is watching many factors for signs of continued improvement in valuations, including corporate earnings and economic growth. Consequently, the IC is concerned about the potential impact rising interest rates could have on bond investors. While the enthusiasm for U.S. stocks has risen over most investments, the IC continues to recommend a slightly below normal weight until such time as earnings can grow into the market's elevated expectations.

Commentary is generally written from a passive standpoint and there are limitations to this data as strategies include active management. Actively managed strategies and holdings may have reacted differently during the quarter than the markets segments discussed herein. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses, which would reduce returns. All investments are subject to risk. There is no assurance that any investment strategy will be successful.

political systems that may be less stable than those in more developed countries.

- Investing in small-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. Stocks of smaller or newer or mid-sized companies may be more likely to realize more substantial growth as well as suffer more significant losses than larger or more established issuers.
- Commodities trading is generally considered speculative because of the significant potential for investment loss. Among the factors that could affect the value of the fund's investments in commodities are cyclical economic conditions, sudden political events, changes in sectors affecting a particular industry or commodity, and adverse international monetary policies. 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.
- Specific sector investing such as real estate can be subject to different and greater risks than more diversified investments. Declines in the value of real estate, economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.
- Some accounts may invest in Master Limited Partnership ("MLP") units, which may result in unique tax treatment. MLPs may not be appropriate for ERISA or IRA accounts, and cause K-1 tax treatment. Please consult your tax adviser for additional information regarding the tax implications associated with MLP investments.
- Alternative investments are generally considered speculative in nature and may involve a high degree of risk, particularly if concentrating investments in one or few alternative investments. These risks are potentially greater and substantially different than those associated with traditional equity or fixed income investments. The investment strategies used by certain Funds may require a substantial use of leverage. The investment strategies employed and associated risks are more fully disclosed in each Fund's prospectus, which is available from your financial advisor.
- Changes in the value of a hedging instrument may not match those of the investment being hedged.
- These portfolios may be subject to international, small-cap and sector-focus exposures as well. Accounts may have over weighted sector and issuer positions, and may result in greater volatility and risk.
- Companies in the technology industry are subject to fierce competition, and their products and services may be subject to rapid obsolescence.

INDEX DESCRIPTIONS:

These indices are not available for direct investment. Any product which attempts to mimic the performance an index will incur expenses such as management fees and transaction costs that reduce returns.

Bloomberg Barclays U.S. Aggregate Bond Index (U.S. Fixed Income): This index includes investment grade U.S. Government bonds, corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the index must have at least one year remaining to maturity.

Dow Jones Industrial Average: The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The DJIA was invented by Charles Dow back in 1896. Often referred to as "the Dow," the DJIA is one of the oldest, single most-watched indices in the world. When the TV networks say "the market is up today," they are generally referring to the Dow.

MSCI EAFE Index (International Large Cap): A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S & 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.

MSCI Emerging Markets NR Index: An index created by Morgan Stanley Capital International (MSCI) designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index that consists of indices in 23 emerging economies: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates.

Russell Mid Cap TR Index (U.S. Mid Cap): A market capitalization weighted index representing the smallest 800 companies in the Russell 1000 Index. The average Russell Midcap Index member has a market cap of $8 billion to $10 billion, with a median value of $4 billion to $5 billion.

Russell 2000 TR Index (U.S. Small Cap): Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

Russell 3000: A market capitalization weighted equity index maintained by the Russell Investment Group that seeks to be a benchmark of the entire U.S. stock market. More specifically, this index encompasses the 3,000 largest U.S.-traded stocks, in which the underlying companies are all incorporated in the U.S.

S&P 500 TR Index (U.S. Large Cap): The index consists of 500 of the largest stocks in the U.S. stock market. A market value weighted index (stock price times number of shares outstanding after float adjustment), with each stock's weight in the index proportionate to its market value.

RAYMOND JAMES®

880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863 // 727.567.1000 // RJFREEDOM.COM