

### ASSET ALLOCATION UPDATE

- We recommend an overweight to Global Equities versus Fixed Income across models.
- Within the equity allocation, we recommend a mild overweight to U.S. Equities and corresponding underweight to International Developed Equities. We also recommend an overweight to Small Cap versus Mid and Large Cap Equities.
- Within the fixed income allocation, we recommend an overweight to U.S. High Yield.

#### EQUITY HIGHLIGHTS

- Global equities fell heavily in December as the MSCI ACWI IMI declined 7.24%. Elevated volatility during the month was driven by a number of factors, including increasing fears of a monetary policy mistake by the Federal Reserve and growing concerns of a material slowdown in future global economic growth. Declines were led by extensive weakness in U.S. equities, with the Russell 3000 Index losing 9.31%. Emerging markets, as defined by the MSCI Emerging Markets IMI, fell just 2.98% and represented the best performing geographic segment, while international developed markets, as defined by the MSCI World ex USA IMI, returned -5.35%.
- The environment for actively-managed equity strategies was challenging in 2018, particularly in the U.S. large-cap, international developed markets large-cap and emerging markets segments. Narrow market leadership trends, particularly in the first three quarters of the year, created significant headwinds for many active managers.
- U.S. growth equities have outperformed value by a wide margin since the global financial crisis, driven partially by a prolonged low economic growth environment and significant outperformance from large-cap information technology, communication services and consumer discretionary companies. However, value outperformed growth during a volatile fourth quarter of 2018. Stretched growth valuations could lead to continued improvement in value relative performance.

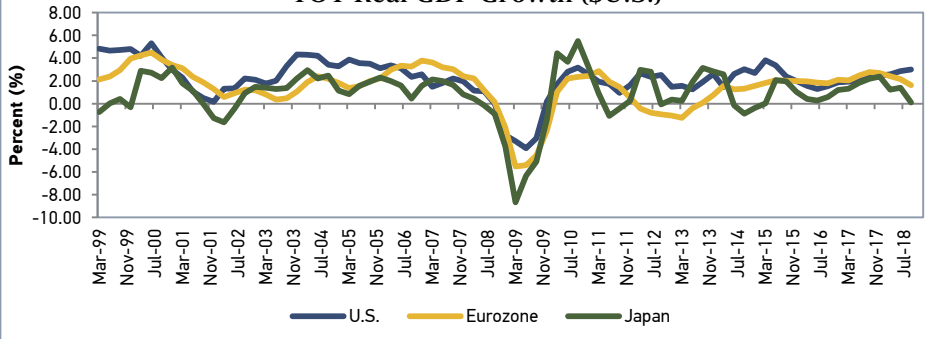
#### FIXED INCOME HIGHLIGHTS

- The bond markets were largely positive in December as investors gravitated towards fixed income during the equity market sell-off. The only asset class with the opportunity set to produce a negative return for the month was high yield, which often moves in the same direction as equities. For calendar year 2018, returns were mixed with credit sensitive areas of the market (investment grade corporates, high yield and emerging market debt) producing negative returns. Inflation-linked bonds (TIPS) were also negative for the year. Higher quality segments of the market were the top performers for the quarter and year with foreign and domestic government securities leading the way for 2018. The Bloomberg Barclays U.S. Aggregate Bond Index, a proxy for the overall bond market, returned 1.84% in December and 0.01% for the year.
- Over the month, 10-year government bond yields in most select foreign markets moved lower, led by the yield in Italy which declined by 46 bps. 10-year rates in France moved slightly higher by 3 bps. Domestic rates, as represented by the yield of the 10-year Treasury, declined by 32 bps from 3.01% to 2.69%. Over the calendar year, the yield of the 10-year Treasury increased by 28 bps.
- In a reversal from last month, Municipal/Treasury yield ratios moved higher across the curve in December, although ratios remain below historical averages.

Stock Indexes	YTD	Bond Indexes	YTD	Other Indexes	YTD	U.S. Treasury Yields	Rates/Commodities		
MSCI ACWI IMI	-10.08%	Barclays US Aggregate	0.01%	60% LgShort-40% MktNeutral	-2.40%	6-month	2.56%	Prime Rate	5.50%
Russell 3000	-5.24%	Barclays Gbl Treas xUS Hdg	3.55%	DJ Equity All REIT	-4.10%	1-year	2.63%	LIBOR (3 Mo)	2.81%
S&P 500	-4.38%	Barclays US TIPS	-1.26%	Bloomberg Commodity	-11.25%	3-year	2.46%	Oil Price (\$/barrel)	\$45.41
MSCI EAFE	-13.79%	Barclays US High Yield	-2.08%			5-year	2.51%	Gold (\$/t oz)	\$1,281.30
MSCI EM	-14.58%	Barclays EM Aggregate	-2.46%			10-year	2.69%		
						30-year	3.02%		

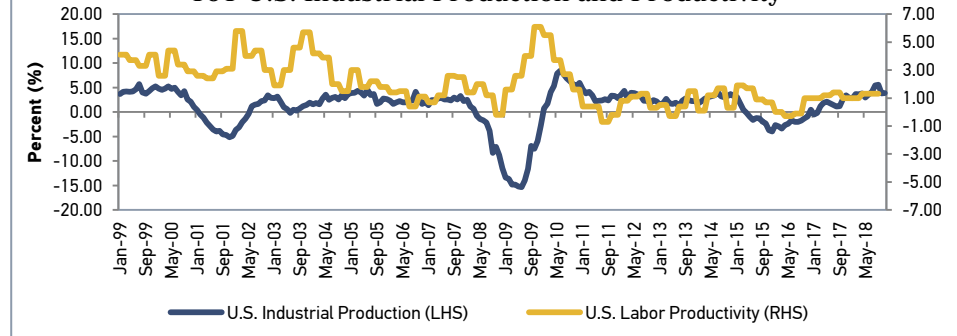


**YOY Real GDP Growth (\$U.S.)**



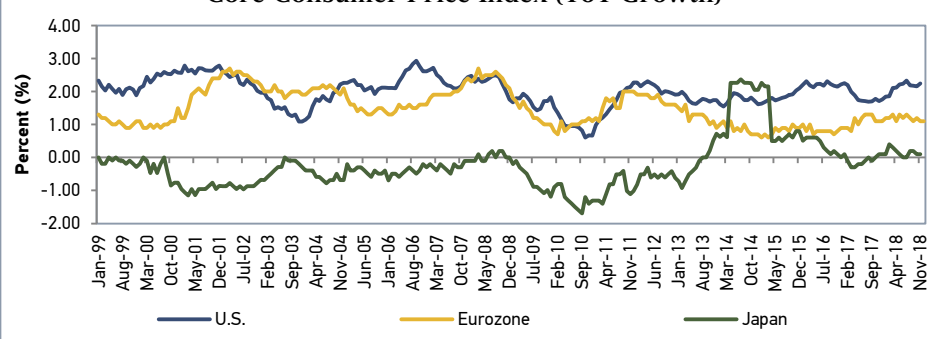
Data as of 09.30.2018; Source: FactSet

**YoY U.S. Industrial Production and Productivity**



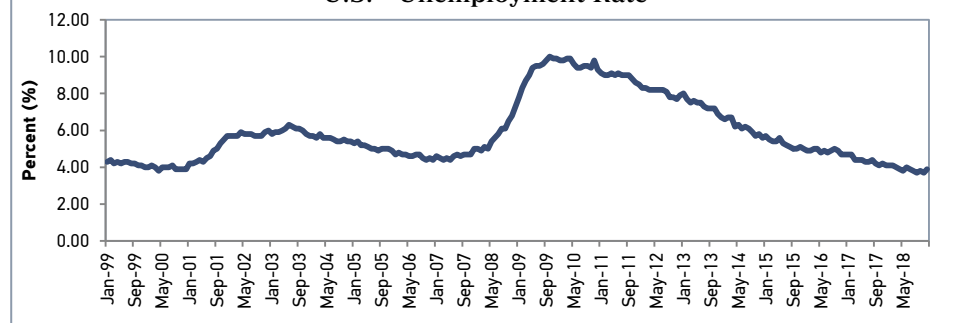
Labor Productivity as of 09.30.2018, Industrial Production as of 11.30.2018; Source: FactSet

**Core Consumer Price Index (YoY Growth)**



Eurozone data as of 12.31.2018. U.S. and Japan data as of 11.30.2018; Source: FactSet; The sudden increase in Japan CPI growth in 2014 coincided with an increase in national sales tax that impacted final price levels.

**U.S. - Unemployment Rate**



Data as of 12.31.2018; Source: FactSet

- GDP growth in Europe and Japan has moderated recently while U.S. growth has remained strong.
- Year-over-year U.S. productivity growth of 1.3% as of the end of the third quarter is an improvement over recent years. Sustained productivity growth is essential to drive long-term real growth. Year-over-year industrial production growth moderated in October and November but remains strong.
- For the second half of 2018, U.S. inflation leveled out a little above 2% while European inflation stabilized slightly above 1%. Japan inflation is positive but very low.
- The unemployment rate ticked up to 3.9% in December but U.S. employment growth remains steady.

Note: Please see Appendix for important definitions.



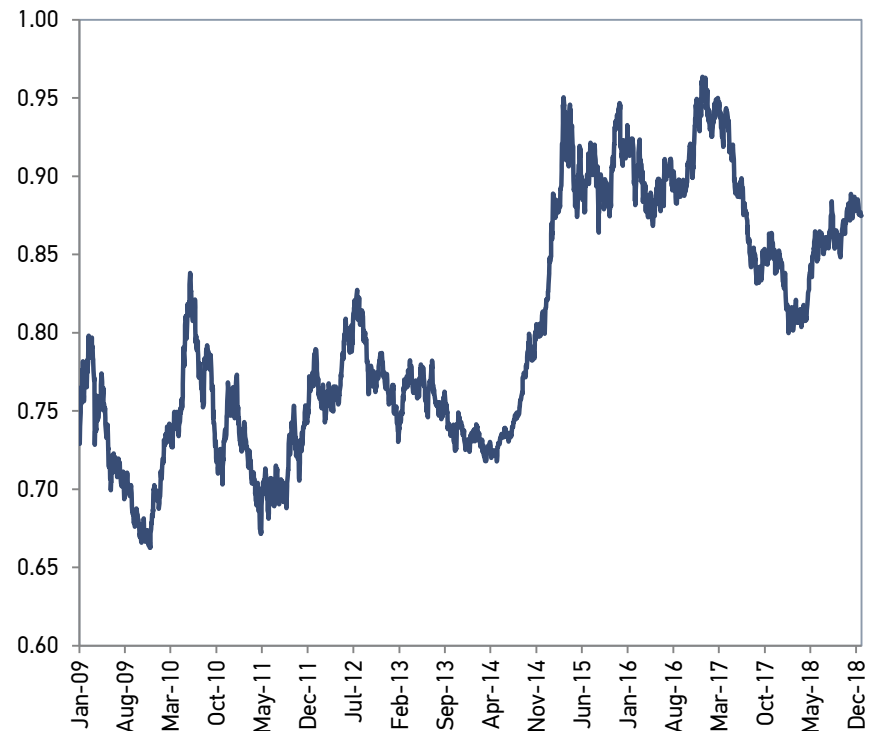
Leading	Initial Jobless Claims	<ul style="list-style-type: none"><li>In the week ending December 28th, the four-week moving average of Initial Jobless Claims was 218,750 a decrease of 500 from the previous week's revised average of 219,250.</li></ul>
	Manufacturing	<ul style="list-style-type: none"><li>ISM Manufacturing registered 54.1% in December a 5.2 percentage point decrease over the previous reading. A reading below 50.0% indicates contraction.</li><li>ISM Manufacturing New Orders registered 51.1% in December a 11 percentage point decrease over the previous reading.</li><li>ISM Non-Manufacturing registered 57.6% in December a 3.1 percentage point decrease over the previous reading.</li></ul>
	Housing/Construction	<ul style="list-style-type: none"><li>Building permits increased 5.0% in November and have risen 0.4% over the past year.</li></ul>
Coincident	Consumer Confidence	<ul style="list-style-type: none"><li>The Consumer Confidence Index fell in December to 128.10 compared to 136.4 in November.</li></ul>
	Nonfarm Payrolls	<ul style="list-style-type: none"><li>Total nonfarm payroll employment gained 312,000 in December while the unemployment rate rose to 3.9%.</li></ul>
	Industrial Production	<ul style="list-style-type: none"><li>Industrial Production rose 0.61% in November and is up 3.89% over the past year.</li></ul>
	Personal Income	<ul style="list-style-type: none"><li>Real Disposable Personal Income increased 0.18% in November and is up 2.84% over the past year.</li></ul>
Lagging	Ratio of Consumer Installment Credit to Personal Income	<ul style="list-style-type: none"><li>This ratio rose 0.1% in November and is up 0.04% year-over-year. Consumer borrowing tends to lag improvements in personal income by many months because people remain hesitant to take on new debt until they are sure that their improved income level is sustainable.</li></ul>
	Inflation	<ul style="list-style-type: none"><li>CPI (All Items) remained unchanged in November and is up 2.2% over the trailing one year period.</li><li>CPI (Core) rose 0.2% in November and is up 2.2% over the trailing one year period.</li></ul>



**Nominal Trade-Weighted U.S. Dollar  
Major Currencies**



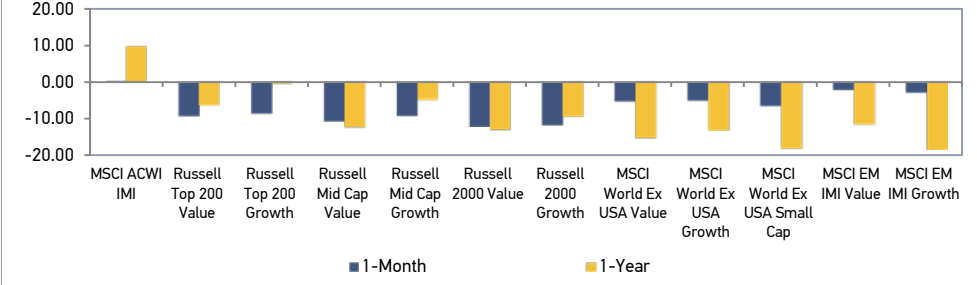
**Euro per U.S. Dollar**



- The Trade-Weighted U.S. Dollar Index (Major Currencies) fell 0.1% through December and the index is up 4.5% year-to-date. The dollar fell 1.0% versus the euro in December.



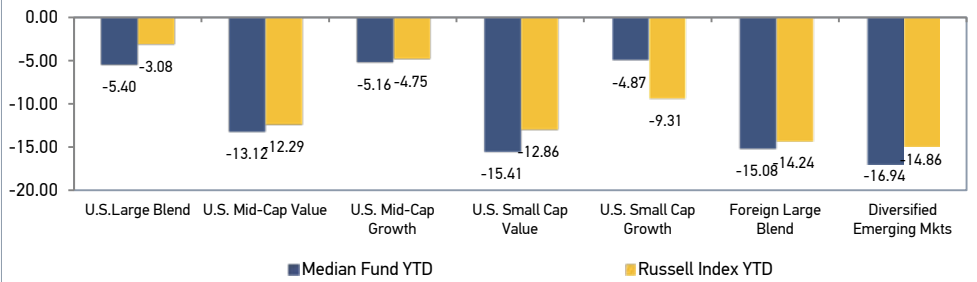
**Equity Market Performance**  
As of 12.31.2018



- Global equities fell heavily in December as the MSCI ACWI IMI declined 7.24%. Elevated volatility during the month was driven by a number of factors, including increasing fears of monetary policy mistake by the Federal Reserve and growing concerns of a material slowdown in future global economic growth. Declines were led by extensive weakness in U.S. equities, with the Russell 3000 Index losing 9.31%. Emerging markets, as defined by the MSCI Emerging Markets IMI, fell just 2.98% and represented the best performing geographic segment, while international developed markets, as defined by the MSCI World ex USA IMI, returned -5.35%.

Source: Morningstar, Russell Investments

**Active vs. Passive**  
As of 12.31.2018



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Source: Morningstar, Russell Investments

Median return of Morningstar open-end fund category (institutional share class). Russell return of U.S. categories.

**Rolling 5-Year Return Differential**  
Russell 3000 Growth minus Russell 3000 Value

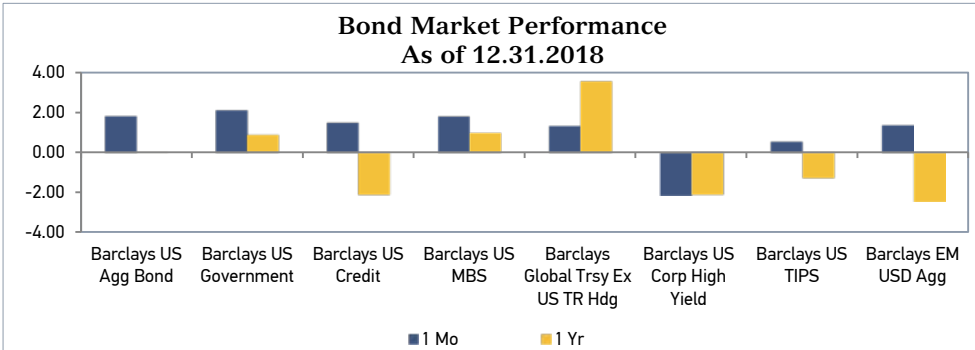


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Data as of 12.31.2018; Source: Morningstar

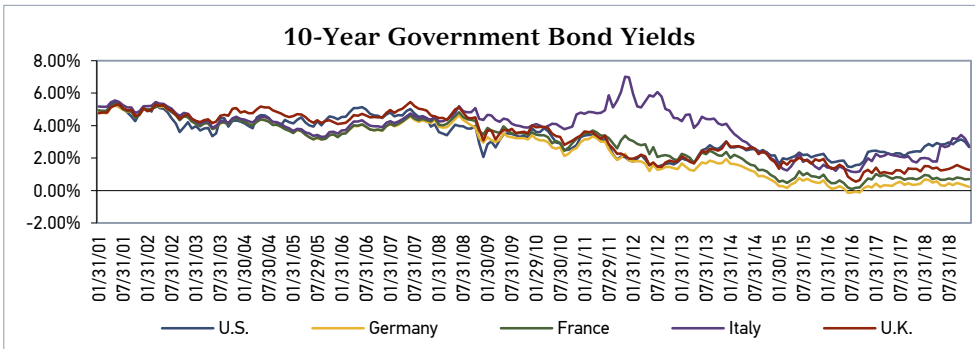


**Bond Market Performance**  
As of 12.31.2018



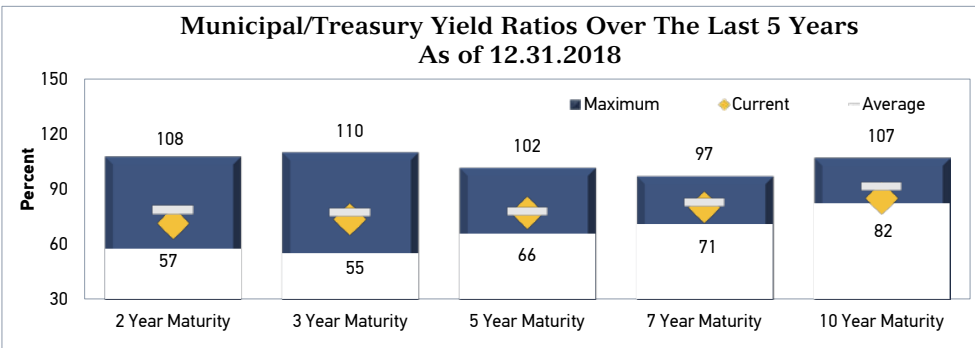
Source: Morningstar, Barclays

**10-Year Government Bond Yields**



Data as of 12.31.2018; Source: FactSet, U.S. Department of Treasury

**Municipal/Treasury Yield Ratios Over The Last 5 Years**  
As of 12.31.2018

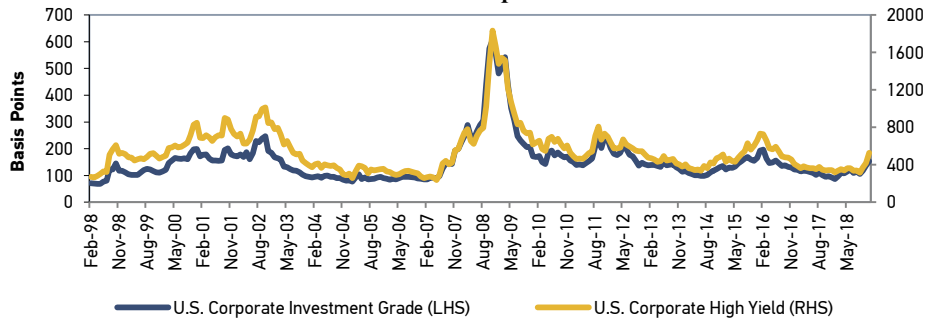


Source: Thompson Reuters; Sterling Capital Management Analytics.

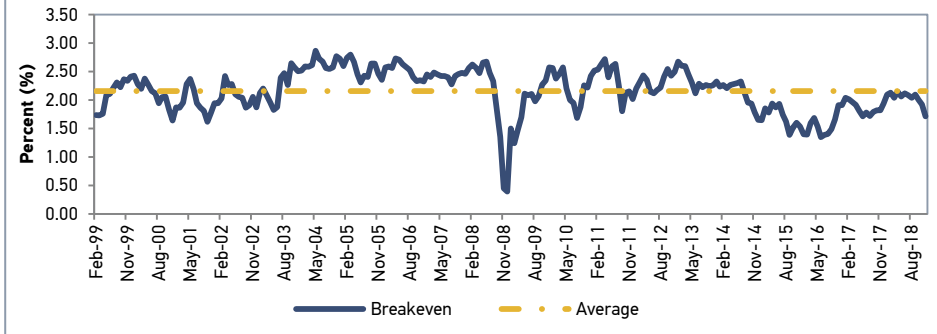
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- For calendar year 2018, returns were mixed with credit sensitive areas of the market (investment grade corporates, high yield and emerging market debt) producing negative returns. Inflation-linked bonds (TIPS) were also negative for the year. Higher quality segments of the market were the top performers for the quarter and year with foreign and domestic government securities leading the way for 2018. The Bloomberg Barclays U.S. Aggregate Bond Index, a proxy for the overall bond market, returned 1.84% in December and 0.01% for the year.
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**20-Year U.S. Corporate OAS**



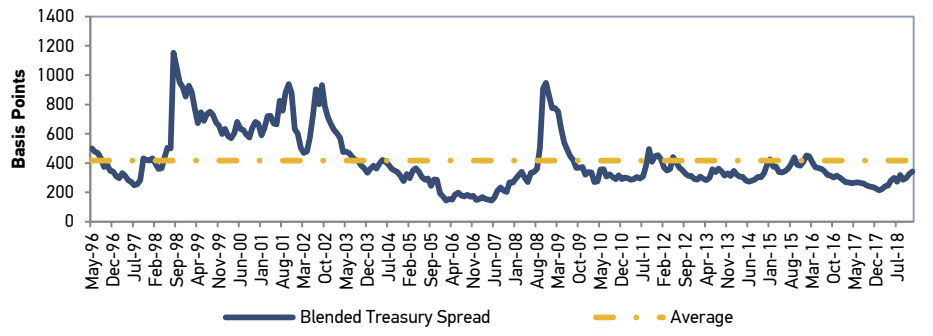
**10-Year TIPS Breakeven**



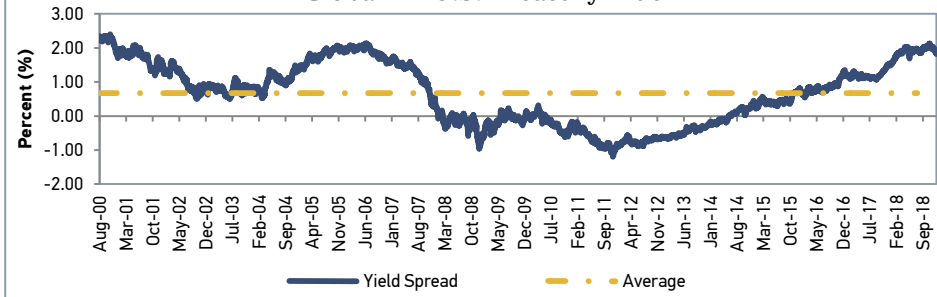
Data as of 12.31.2018; Source: FactSet

Data as of 12.31.2018; Source: Federal Reserve Board of Governors

**EM Debt OAS**



**Yield Spread of Barclays U.S. Treasury Index to Global Ex-U.S. Treasury Index**

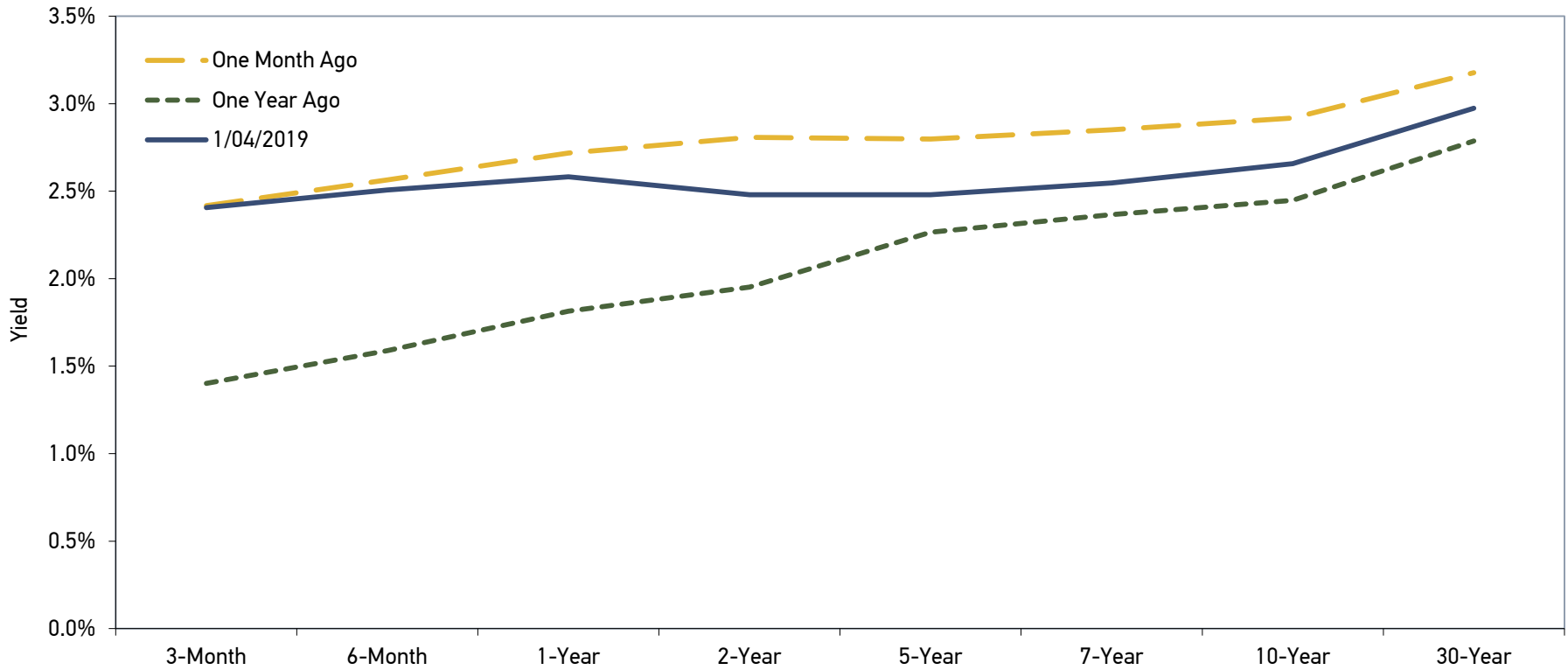


Data as of 12.31.2018; Source: Barclays

Data as of 12.31.2018; Source: Barclays

- Investment grade and high yield credit spreads moved significantly higher for the third consecutive month in December, with a particularly large move in high yield spreads. Investment grade and high yield spreads were above their 20-year median levels as of year-end.
- Market inflation expectations as measured by TIPS breakeven rates moved significantly lower again in December and are below long-run averages.
- Emerging Market credit spreads moved higher in December but are below the historical average. The yield spread of U.S. to Global Treasuries decreased in December but remains above the historical average.

Note: Please see Appendix for important definitions.

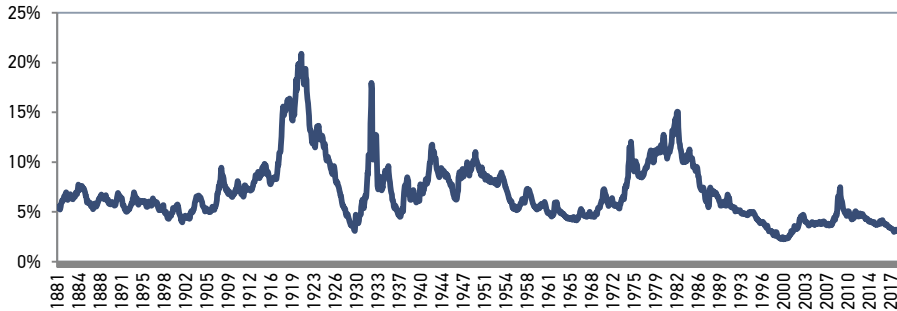


- Month-over-month, rates across the yield curve moved lower. There was a flattening bias during the month with the decline in rates most pronounced in the belly (5-10 years) and long-end of the curve.



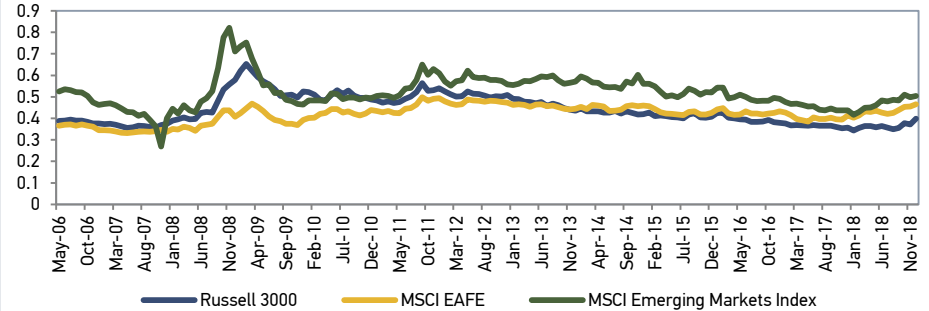


**U.S. Cyclically Adjusted Earnings Yield**



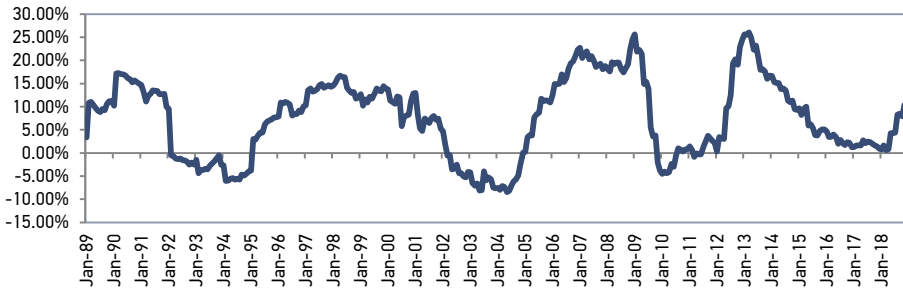
Data as of 12.31.2018; Source: Online Data Robert Shiller "US Stock Markets 1871-Present and CAPE Ratio"

**Revenue to Firm Value**



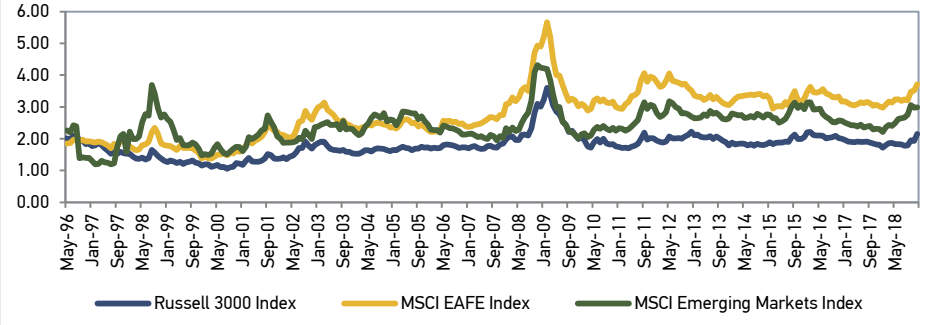
Data as of 12.31.2018; Source: Russell, MSCI

**U.S. 3 Year Real Revenue Growth –  
Russell 3000 Non-Financials**



Data as of 12.31.2018; Source: FactSet, Russell, Bureau of Labor Statistics, Sterling Capital Analytics

**Dividend Yield**



Data as of 12.31.2018; Source: Russell, MSCI

- The U.S. cyclically adjusted earnings yield increased for the third consecutive month in December but remains well below long-term averages. Long-term U.S. sales growth declined slightly in December.
- Revenue to firm value ratios have increased in recent months. The International Developed Markets ratio is significantly higher than the U.S. and is approaching the Emerging Markets ratio.
- Dividend yields have improved in recent months. International Equity Markets provide a significant dividend yield advantage over the U.S.

Note: Please see Appendix for important definitions.

# Appendix



**Core Consumer Price Index:** Core inflation is a measure of inflation that excludes certain items, usually food and energy, that face volatile price movements.

**Option Adjusted Spread (OAS):** A bond's yield spread over comparable maturity government bonds, adjusted for any embedded options.

**Real GDP:** Real gross domestic product (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year, expressed in base-year prices.

**Revenue to Firm Value:** Total Index Revenues of the past 12 months divided by the sum of equity market value and the value of total debt. This is a measure of total sales generated on the total value (debt plus equity) of firms in the index.

**TIPS Breakeven:** The inflation rate implied by the spread in yield between U.S. TIPS (Treasury Inflation Protected Securities) and nominal U.S. Government Bonds of equal maturity.

**U.S. 3 yr. Real Revenue Growth, Russell 3000 Non-Financials:** For the Russell 3000 excluding financial firms, the percentage change in trailing 12-month inflation adjusted revenue over 12-month inflation adjusted revenue three years prior.

**U.S. Cyclically Adjusted Earnings Yield:** The 10-year average of annual, inflation adjusted earnings divided by the current inflation adjusted price of the S&P 500 index. This measure is the inverse of the Shiller CAPE Ratio.

**YOY US Productivity Growth:** The year-over-year growth in real U.S. output produced per hour worked for non-farm workers.



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