



Economic & Capital Markets Outlook

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2018 Investment Themes

Positives:

- The global economy continues to stabilize
- U.S. economic growth is increasing
- U.S. manufacturing and consumer sentiment is improving
- Tax reform is good for overall growth, but mixed for individual industries
- Higher yields are a net positive for the life industry

2018 Investment Themes

Challenges:

- Volatility is returning to the capital markets
- The credit cycle is in its later stages but tax reform has extended its lifespan
- Expect an increase in stock buybacks & mergers / acquisitions

Events that could change the trajectory:

- Increase in geopolitical risk
- Trade war
- Central bank overshoot
- Expansion of populism

Historical Returns

Fixed Income (Excess)	YTD*	1 Year	3 Years	5 Years
Aggregate	-0.02%	+1.03%	+0.65%	+0.61%
IG Corporates	+0.10%	+2.91%	+1.98%	+1.77%
Structured	-0.22%	+0.54%	+0.24%	+0.39%
High Yield	+0.97%	+4.55%	+4.53%	+4.41%
Emerging Markets	+0.59%	+4.29%	+4.86%	+2.83%

Equity (Nominal)	YTD*	1 Year	3 Years	5 Years
S&P 500	+1.83%	+17.09%	+11.13%	+14.72%
EAFE	+0.32%	+20.76%	+6.23%	+7.66%
Asia ex Japan	+2.16%	+32.24%	+10.23%	+8.39%
BRIC	+5.57%	+36.64%	+11.45%	+6.68%
Nikkei	-3.00%	+17.58%	+7.46%	+15.85%

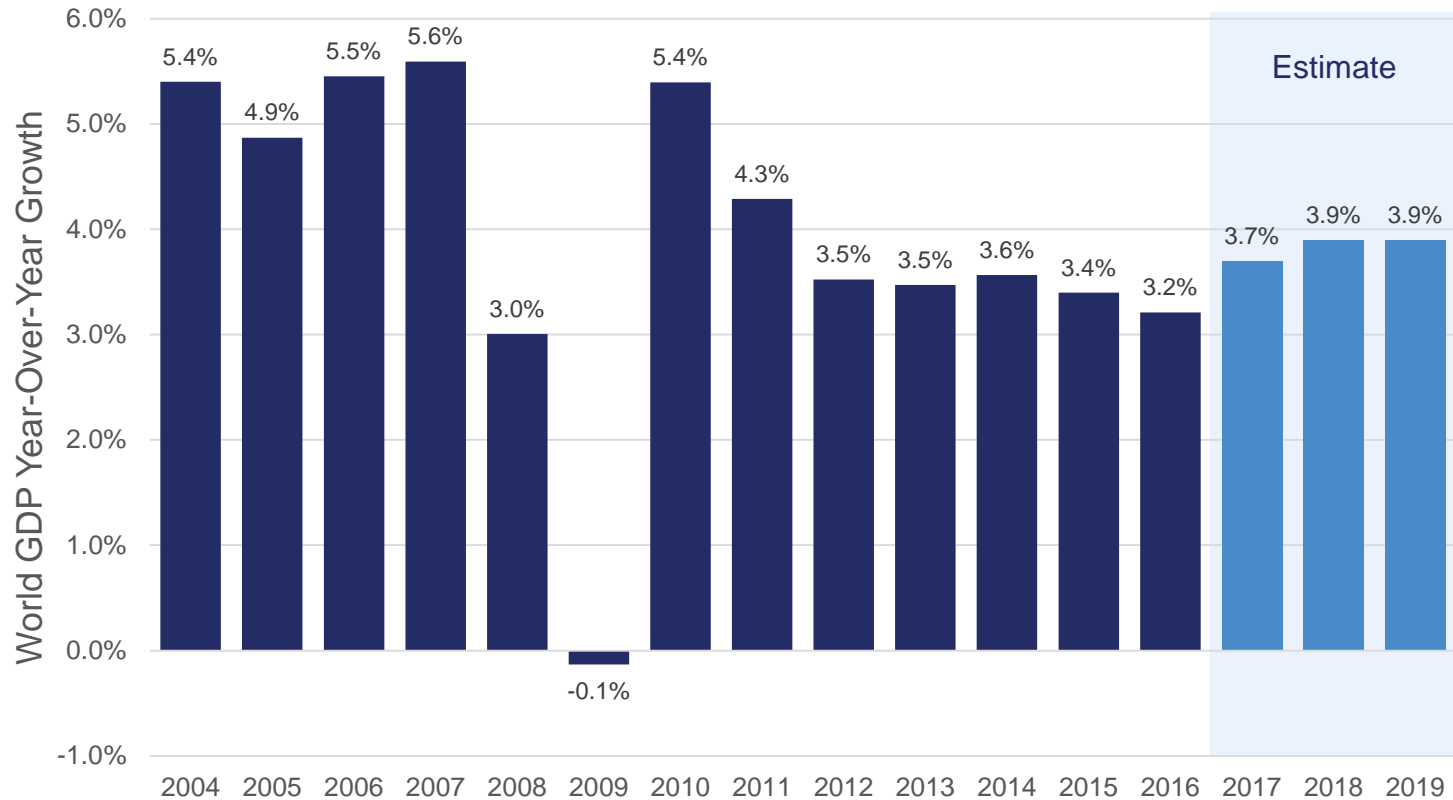
As of February 28, 2018

*All returns stated are rolling period with the exception of year-to-date

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Global Growth

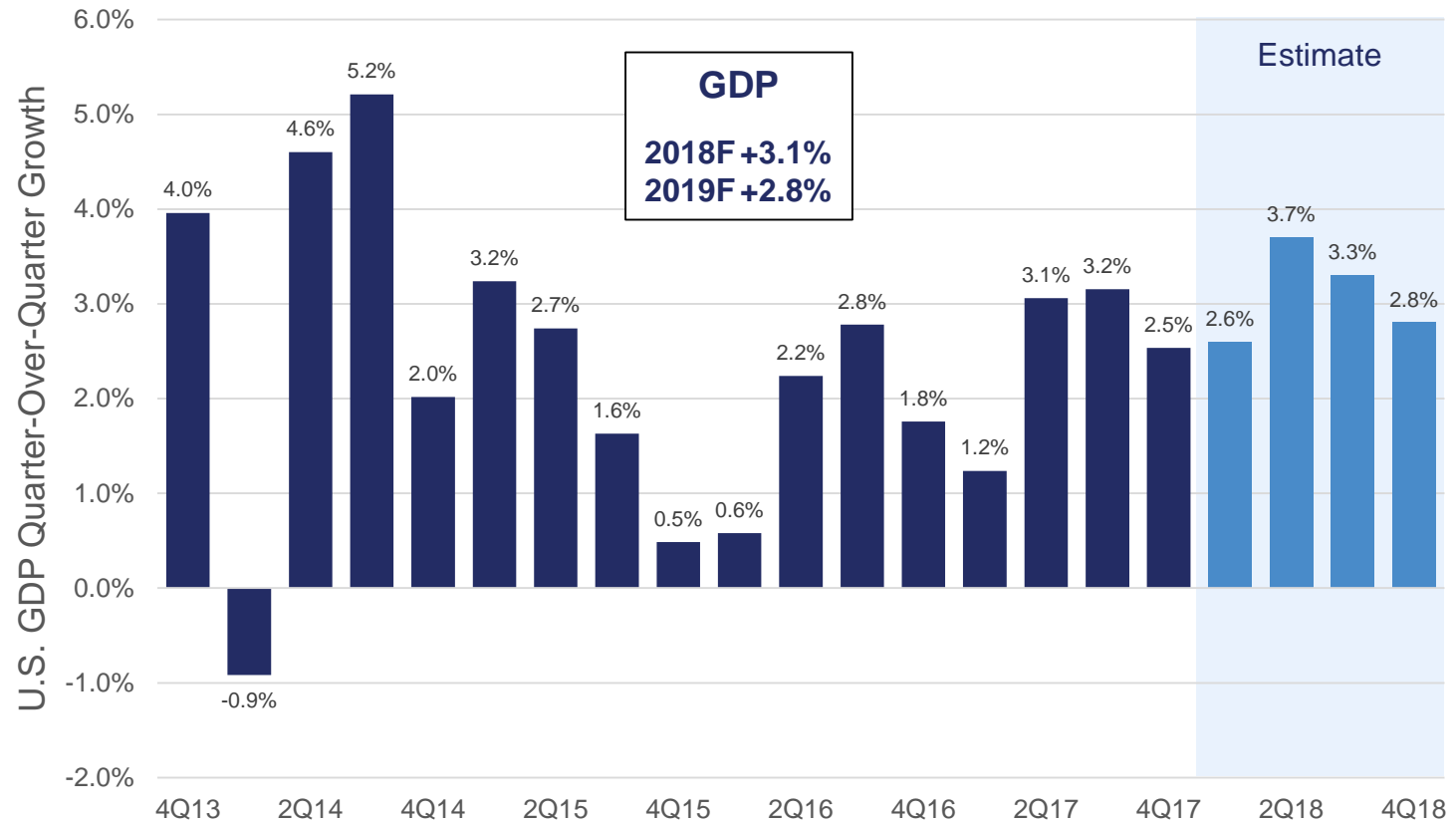
World GDP Year-Over-Year Growth



Prepared by Conning, Inc. Sources: 2018 International Monetary Fund (IMF) World Economic Outlook (WEO). Update January 2018. Used with permission.

Domestic Growth

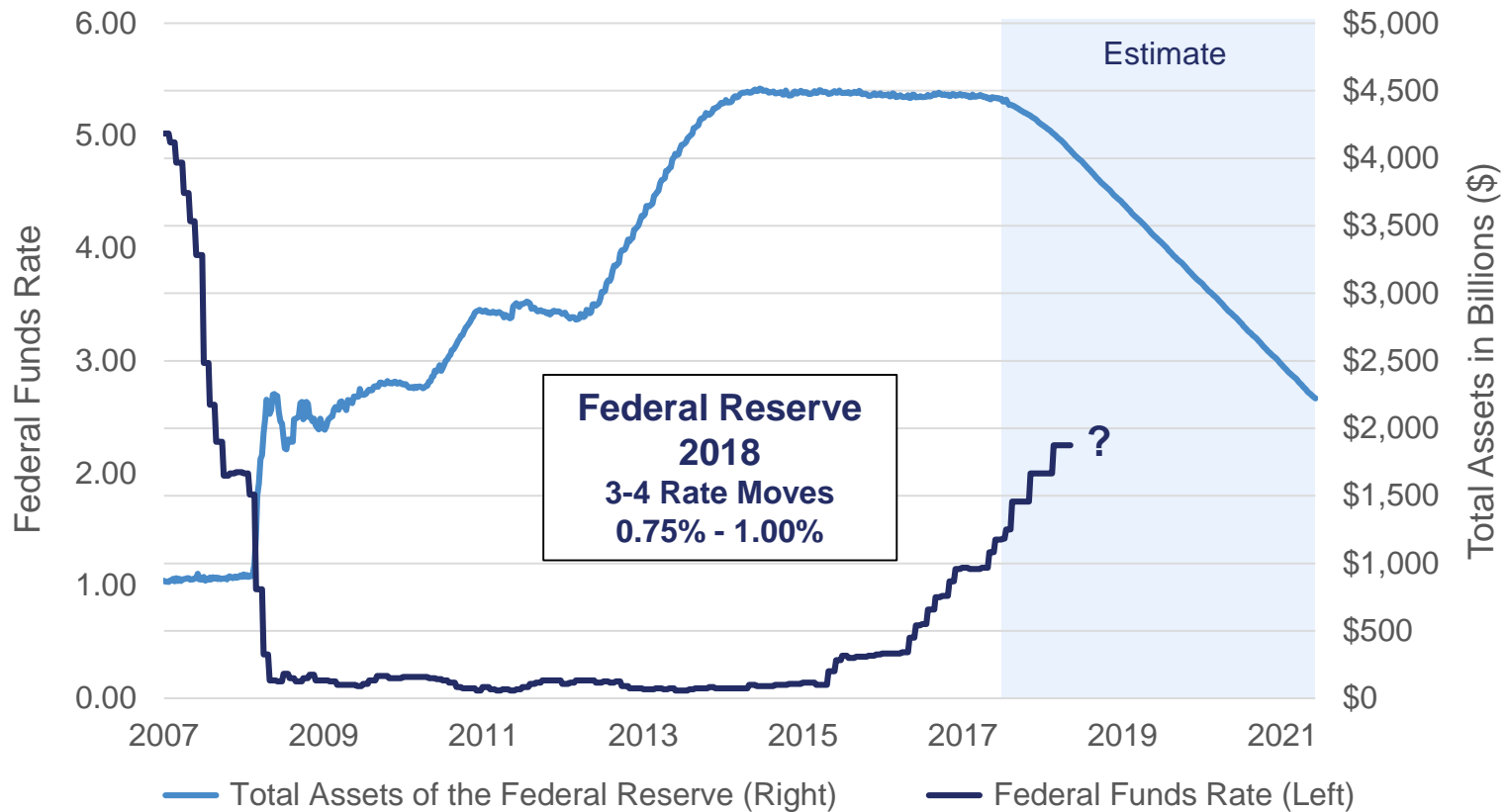
U.S. Real GDP Quarter-Over-Quarter Growth



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Monetary Policy

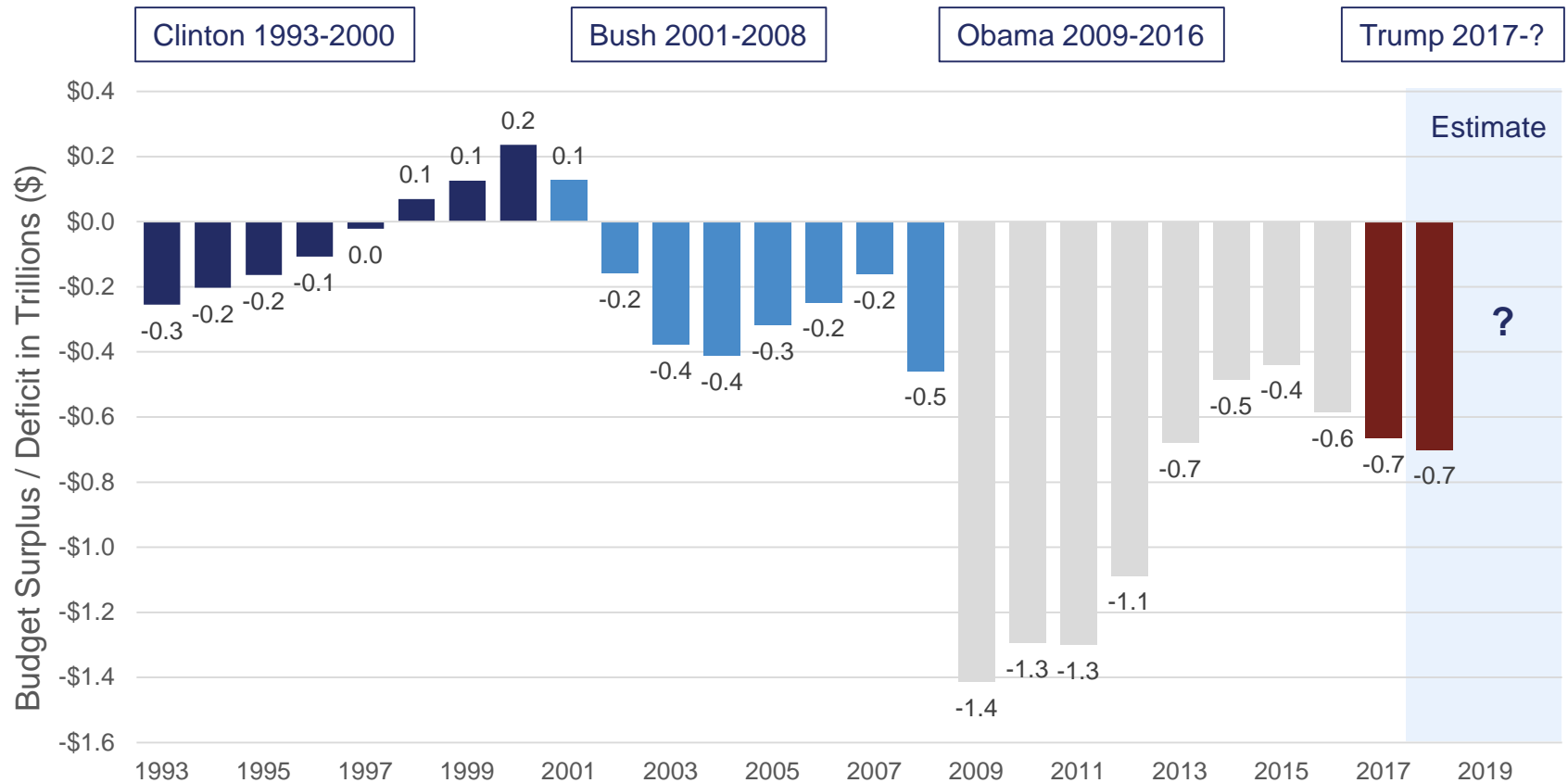
Federal Funds Rate Compared to Federal Reserve Balance Sheet



Prepared by Conning, Inc. Source: Board of Governors of the Federal Reserve System (US), Total Assets of the Federal Reserve, http://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm (August 2007-February 2018).

Fiscal Policy

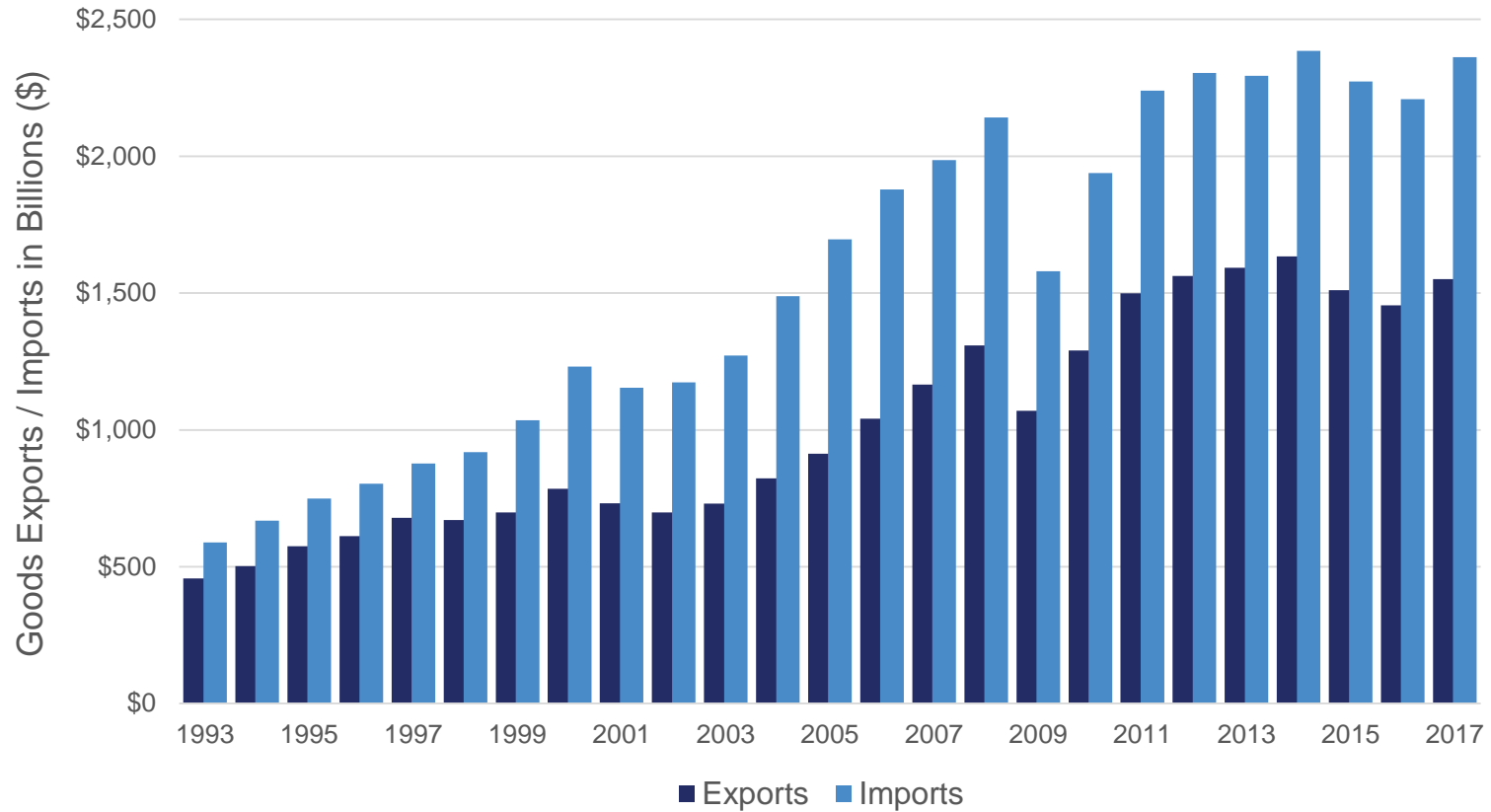
Annual Budget Surplus / Deficit by Presidential Terms



Prepared by Conning, Inc. Sources: Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2017 to 2027* (June 2017), *The Federal Budget in 2017: An Infographic* (March 2018).

Trade Policy

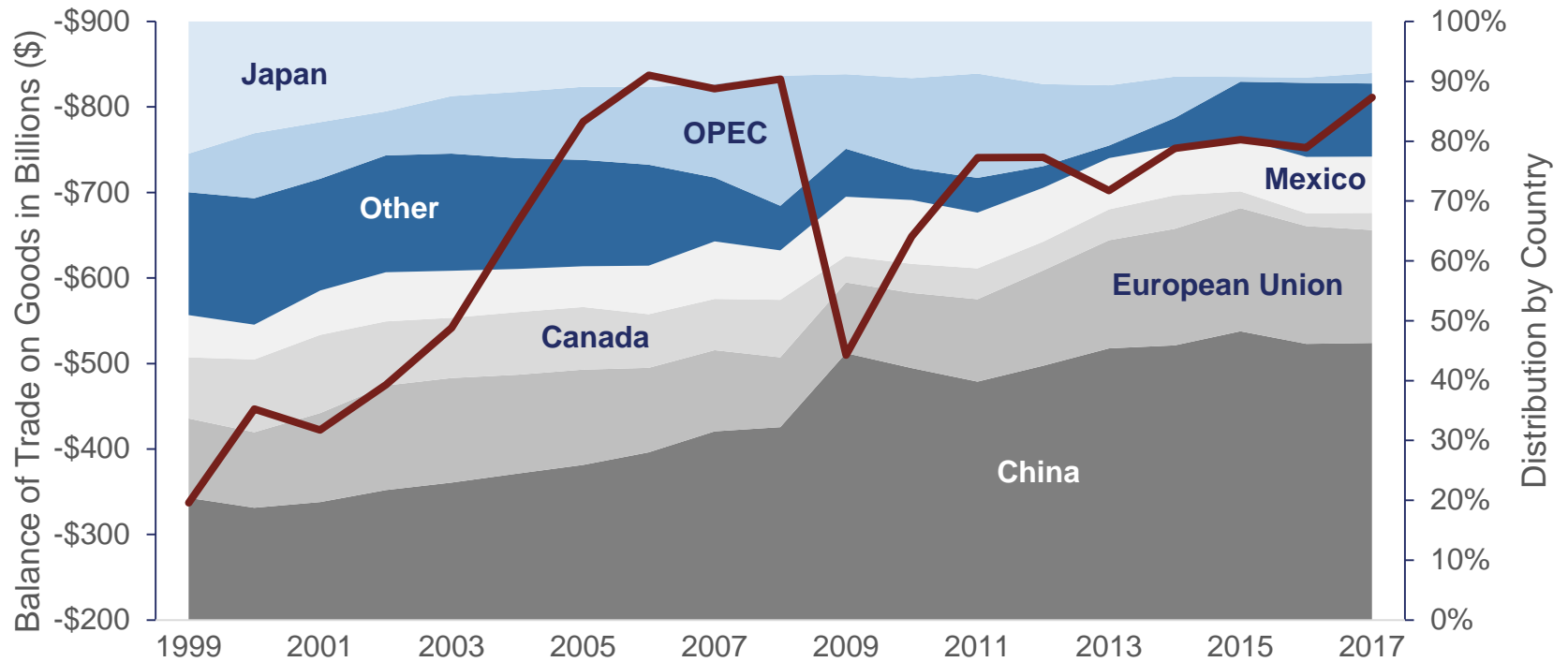
U.S. International Trade in Goods



Prepared by Conning, Inc. Source: Bureau of Economic Analysis, U.S. Department of Commerce (2018)

Trade Policy

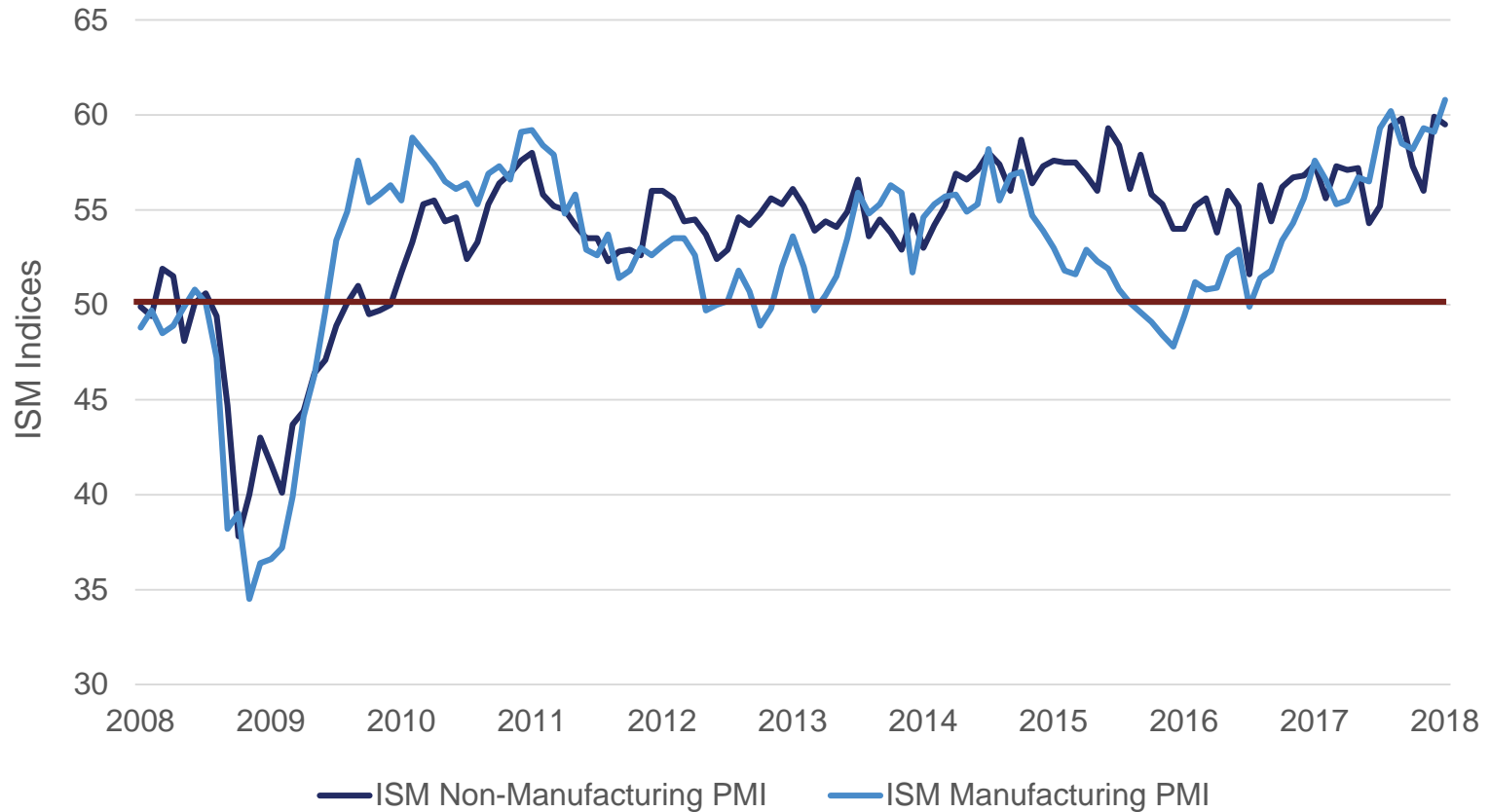
U.S. International Trade Deficit in Goods – By Region / Country



Prepared by Conning, Inc. Source: Bureau of Economic Analysis, U.S. Department of Commerce (2018)

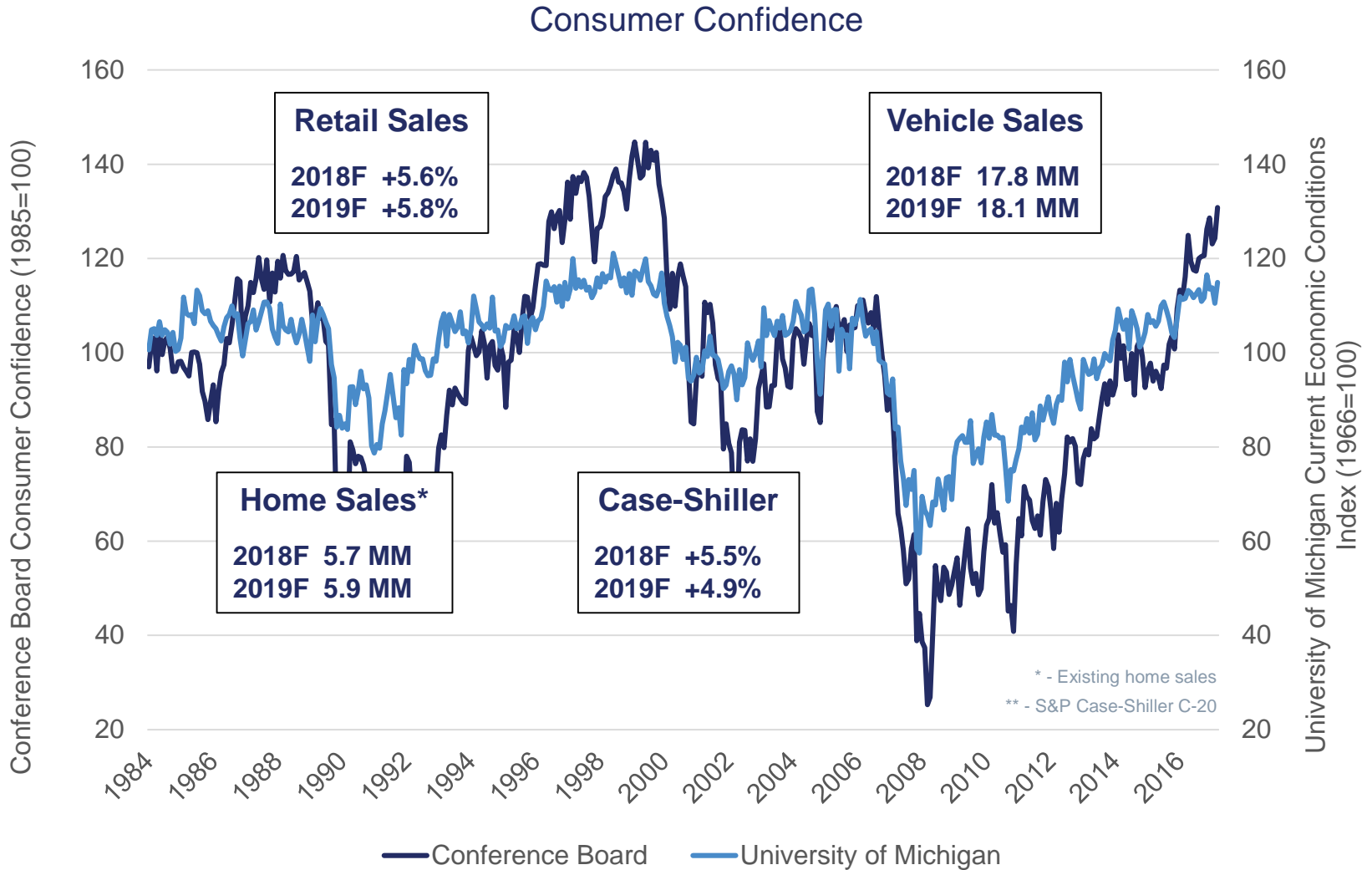
Business Sentiment

The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers Index (PMI) and ISM Manufacturing PMI Index



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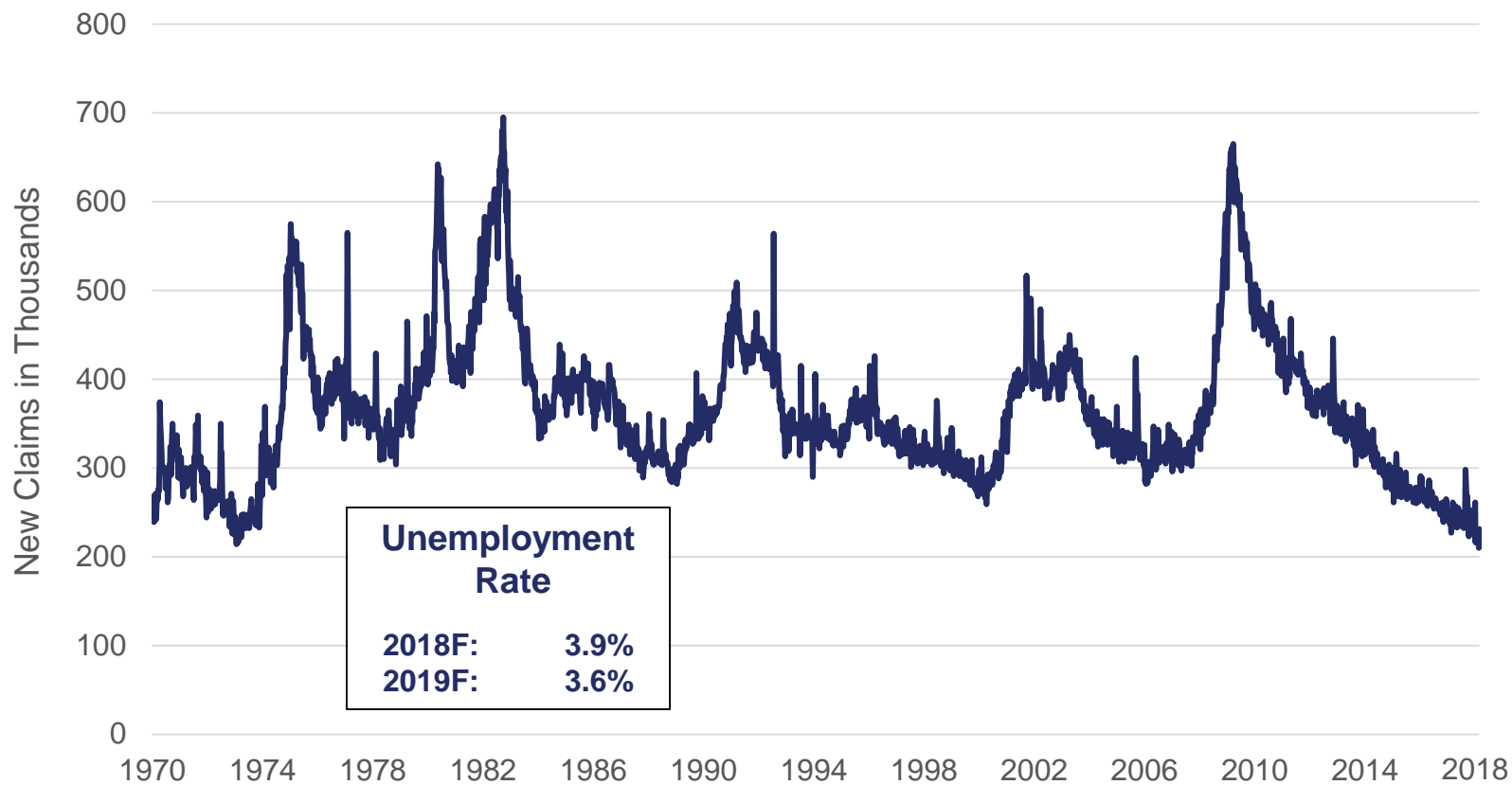
Consumer Sentiment



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Employment

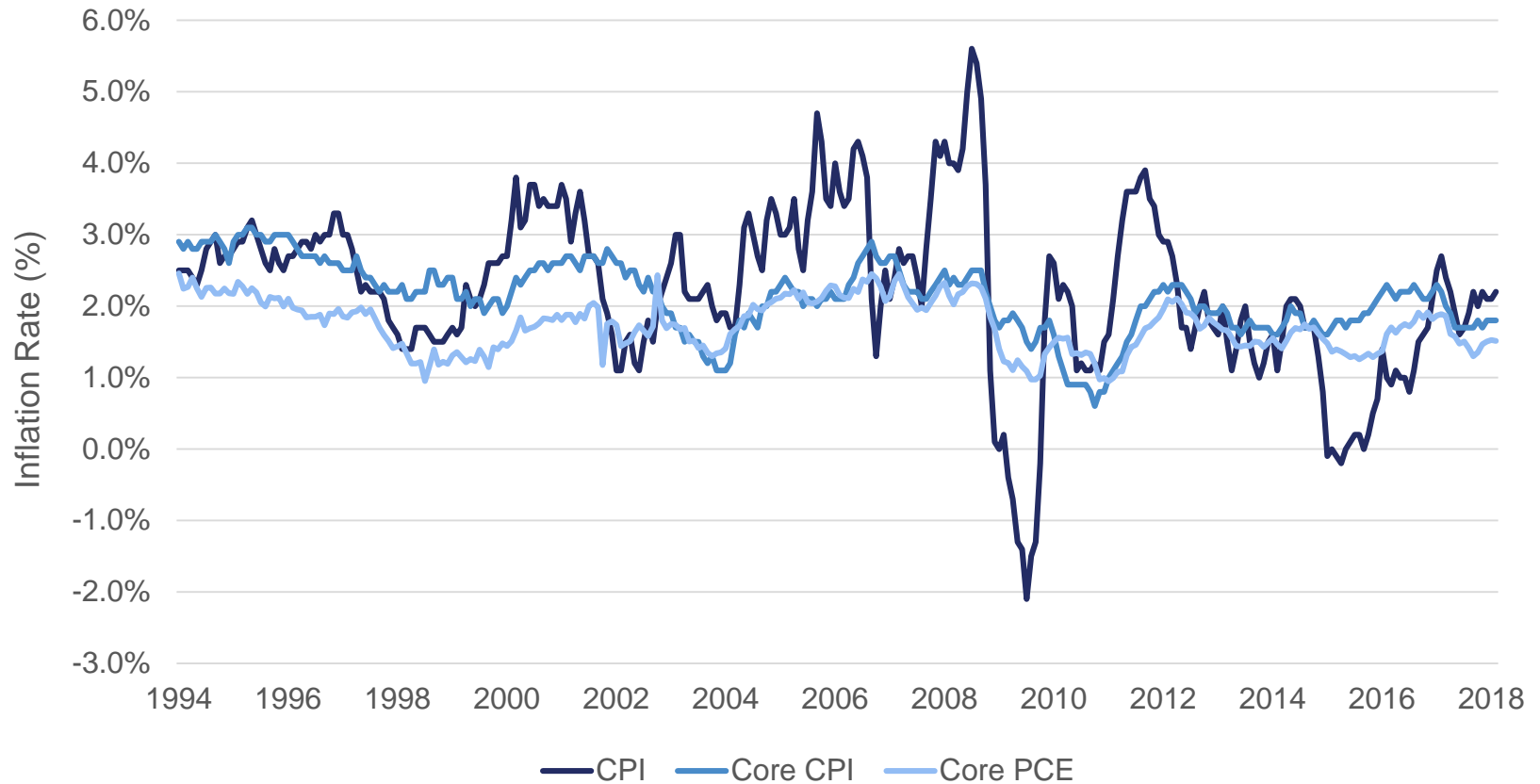
Initial Jobless Claims



Prepared by Conning, Inc. Sources: U.S. Department of Labor and © 2018 Bloomberg L.P.

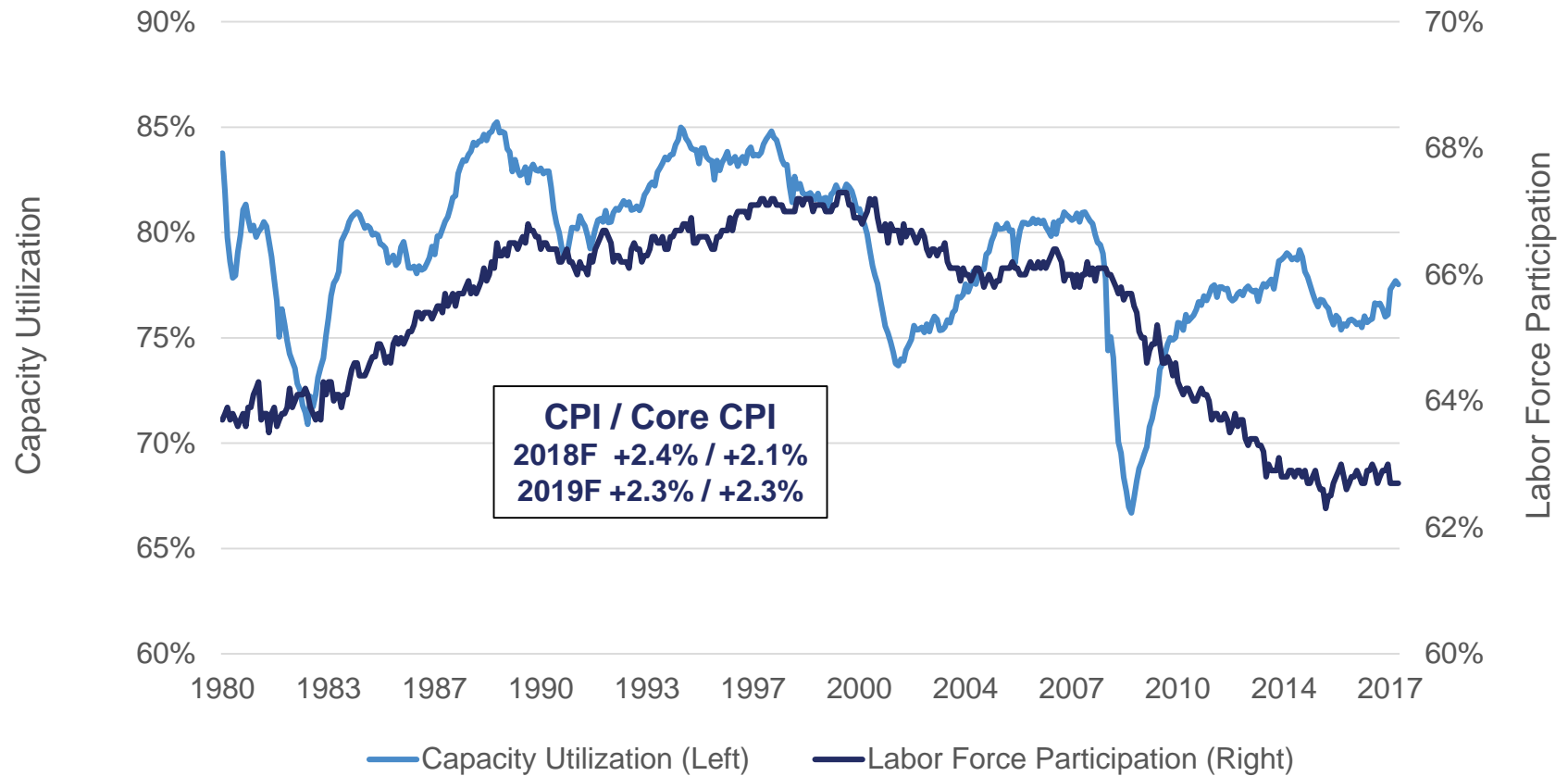
Inflation

Consumer Price Index (CPI) , Consumer Price Index Less Food & Energy Personal Consumption Expenditure (PCE) Core Price Index



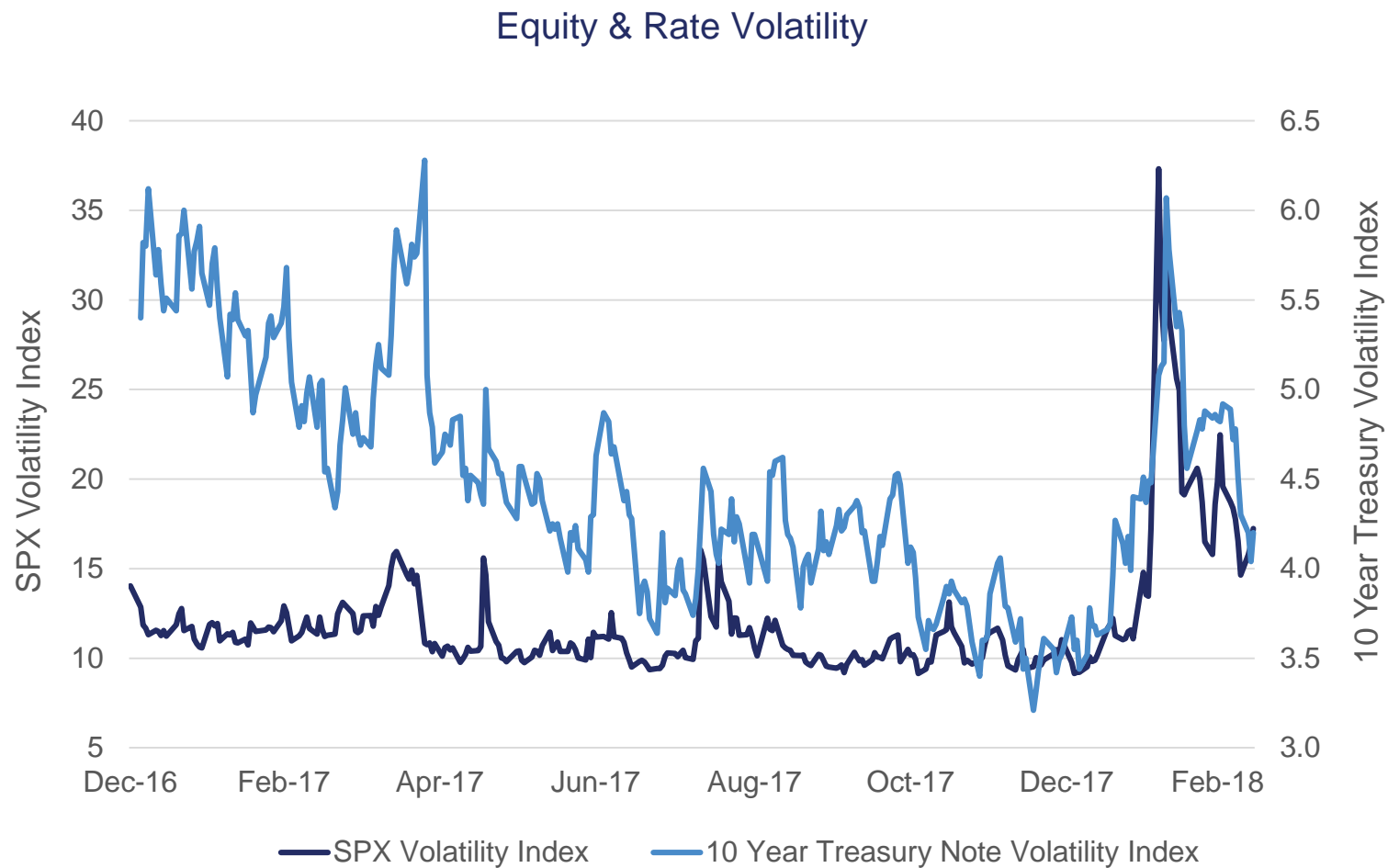
Prepared by Conning, Inc. Sources: Bureau of Labor Statistics, U.S. Department of Labor (2018), Bureau of Economic Analysis, U.S. Department of Commerce (2018) and © 2018 Bloomberg L.P.

Workforce Participation & Capacity Utilization



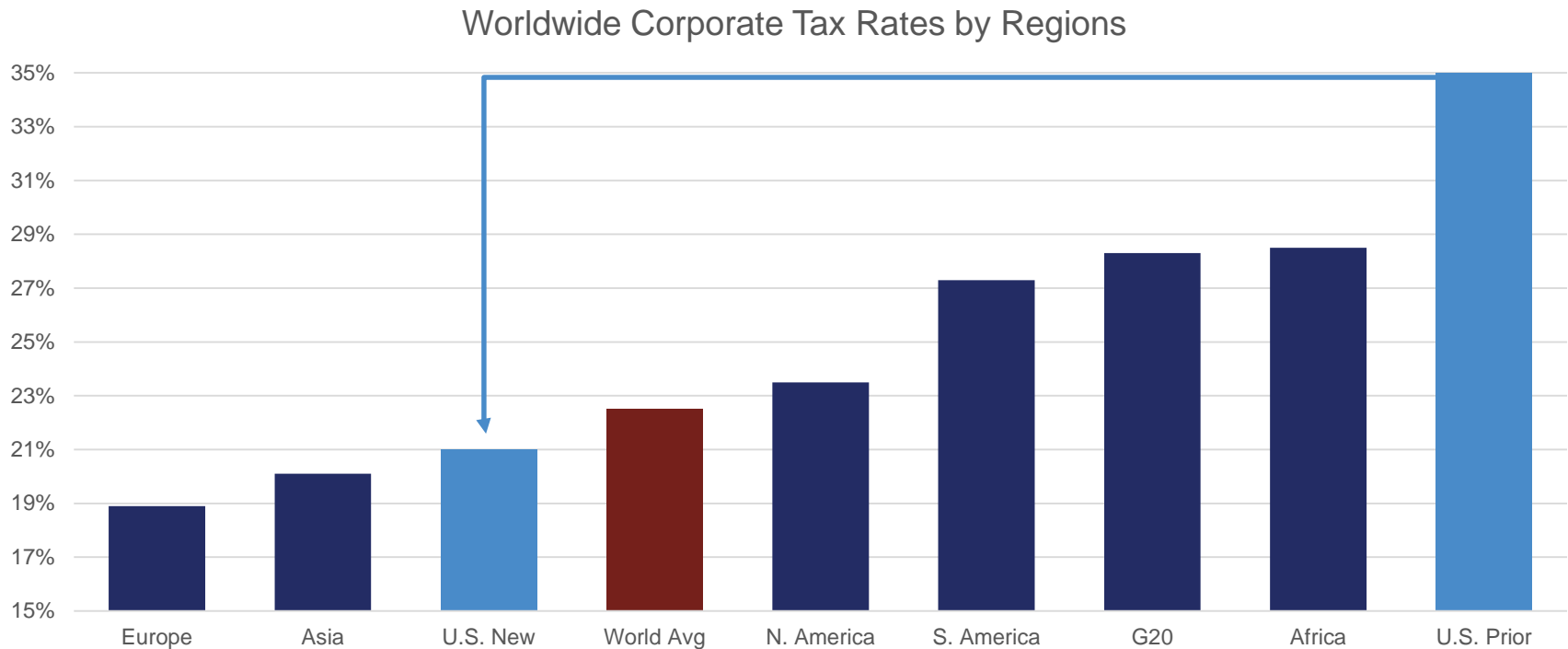
Prepared by Conning, Inc. Sources: Bureau of Labor Statistics, U.S. Department of Labor (2018), Board of Governors of the Federal Reserve System (US), and © 2018 Bloomberg L.P.

Volatility



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Lower Corporate Tax Rate Enhances Competitiveness of U.S. Firms



New tax rate places U.S. below world average rate

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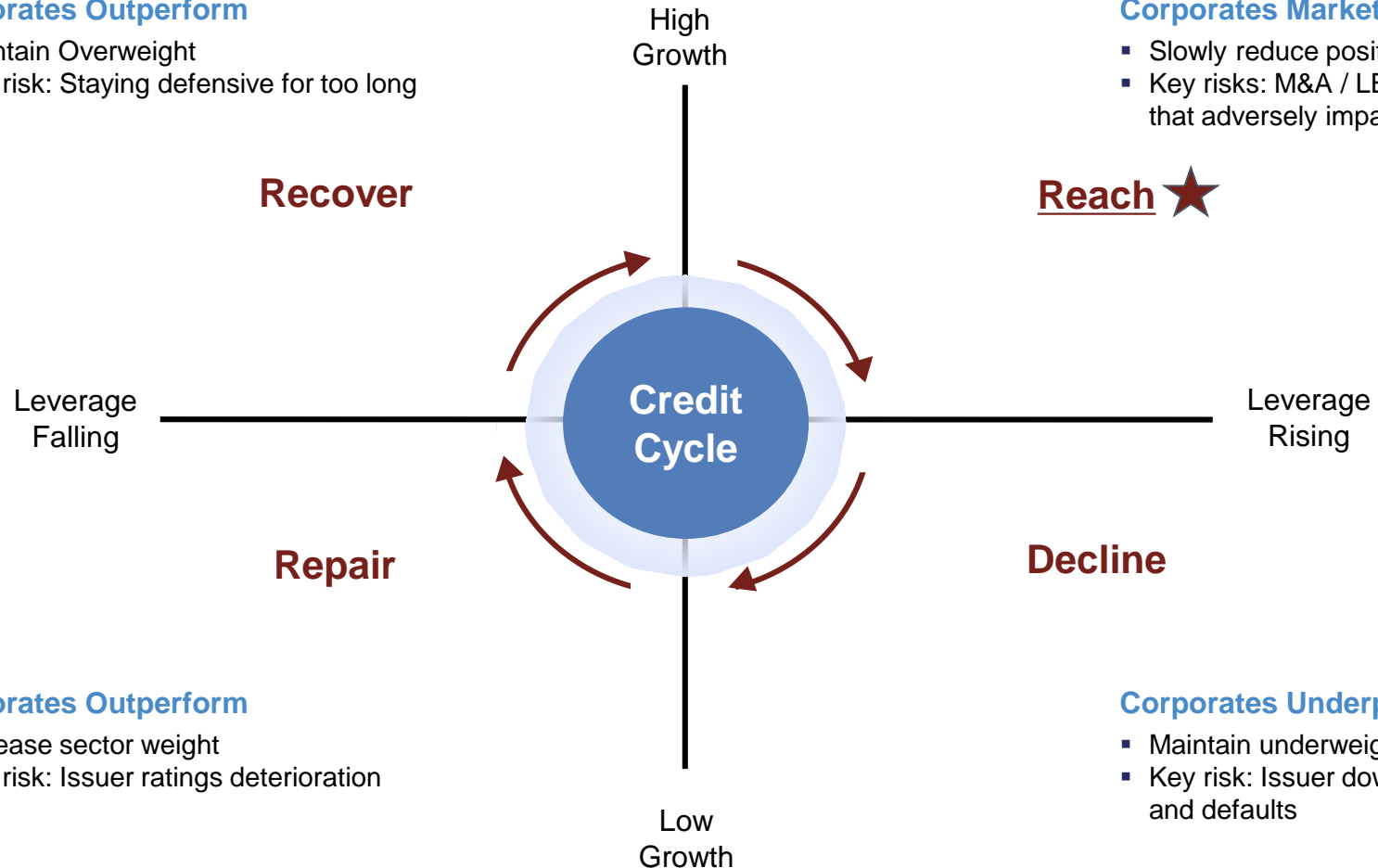
Credit Outlook

Corporates Outperform

- Maintain Overweight
- Key risk: Staying defensive for too long

Corporates Marketperform

- Slowly reduce positions
- Key risks: M&A / LBO events that adversely impact credit profiles



Corporates Outperform

- Increase sector weight
- Key risk: Issuer ratings deterioration

Corporates Underperform

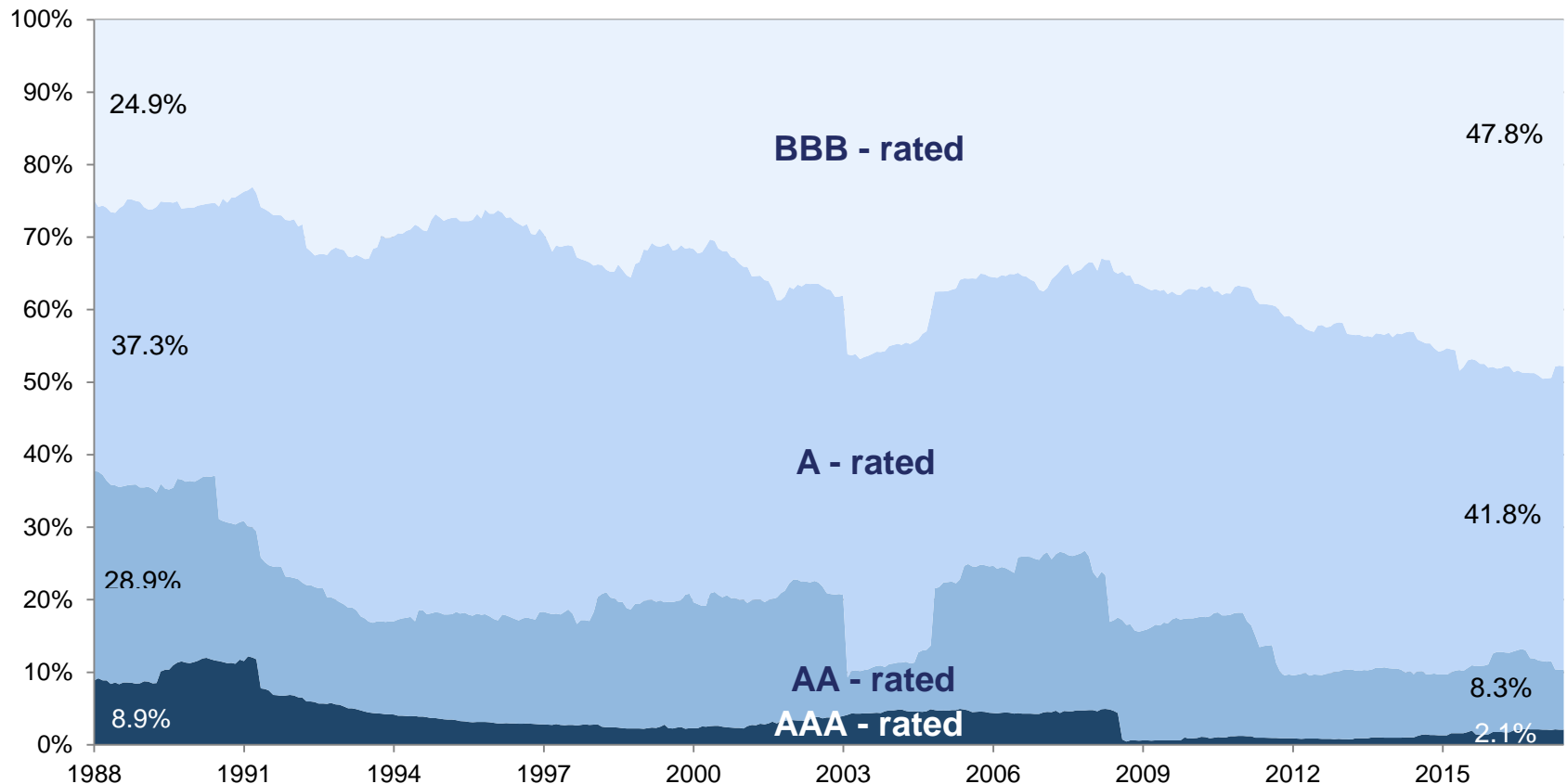
- Maintain underweight
- Key risk: Issuer downgrades and defaults

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Credit Outlook

Barclays Corporate Index: Rating Category Weightings

August 1988 through January 2018



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Impact of Tax Reform on Credit

Effect	Implication
Corporate tax rate from 35% to 21%	Positive
Deemed repatriation of foreign profits at lower tax rates	Mixed
Full expensing of capital expenditures	Mildly Positive
Limitation on interest deductibility to 30% of EBITDA	Negative for low grade HY

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Options to Deploy Additional Earnings and Repatriated Funds

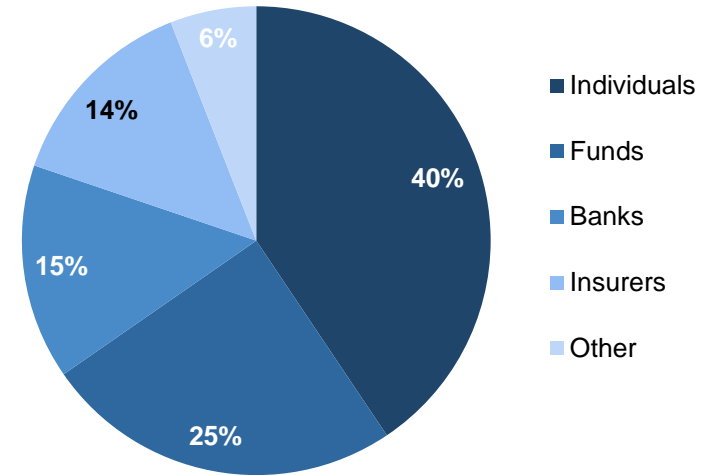
Alternative	Implication
Reduce prices	Faster growth, lower prices passed on to customers
Invest in people & processes	Accelerate efficiency gains
Expand operations	Organic growth
Re-evaluate M&A strategy	Potentially more attractive targets and stronger buyers
Capital management	Dividend and share repurchase programs

Municipal Outlook

Status of the Municipal Bond Market

- Reduced issuance
- Stable to improving quality
 - Growing economy
 - Increasing home prices
 - Reduced debt issuance
- Continued retail demand
 - Little change in individual marginal rates
 - Limit on SALT deductions

Holders of U.S. Municipal Bonds 3Q17



Individual market drives tax-exempt muni pricing and yields

Insurers hold 14% of \$3.8 trillion muni market – life / health only 1%

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Municipal Outlook

Tax law changes affect life investment strategies – Fixed Income

- Reducing corporate tax rate from 35% to 21%
- Changing proration policyholder share from formula to fixed 30%

Stated muni yields ignore tax benefits, tax equivalent yields (“TEY”) are comparable to taxable yields

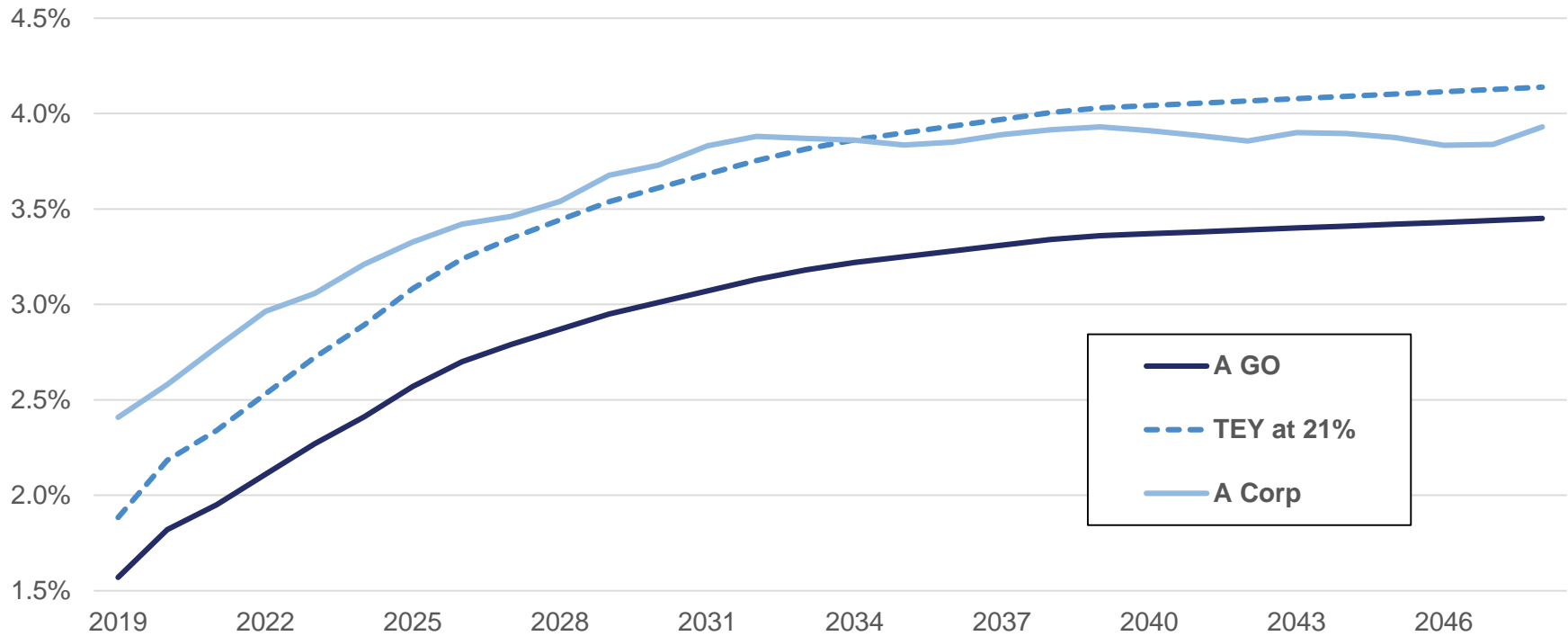
Year	Stated Municipal Yield	Corporate Tax Rate	Eff. Tax on Municipals*	TEY Multiplier*	Tax Equivalent Muni Yield*
1987-2017	3.0%	35%	24.5%	1.16	3.48%
2018	3.0%	21%	6.3%	1.19	3.60%
Change	NC	↓14 points	↓18 points	↑3%	↑12 bps

*Assumes 70% company share for 1987-2017 & 30% company share for 2018

Municipal Outlook

Representative Yields By Maturity

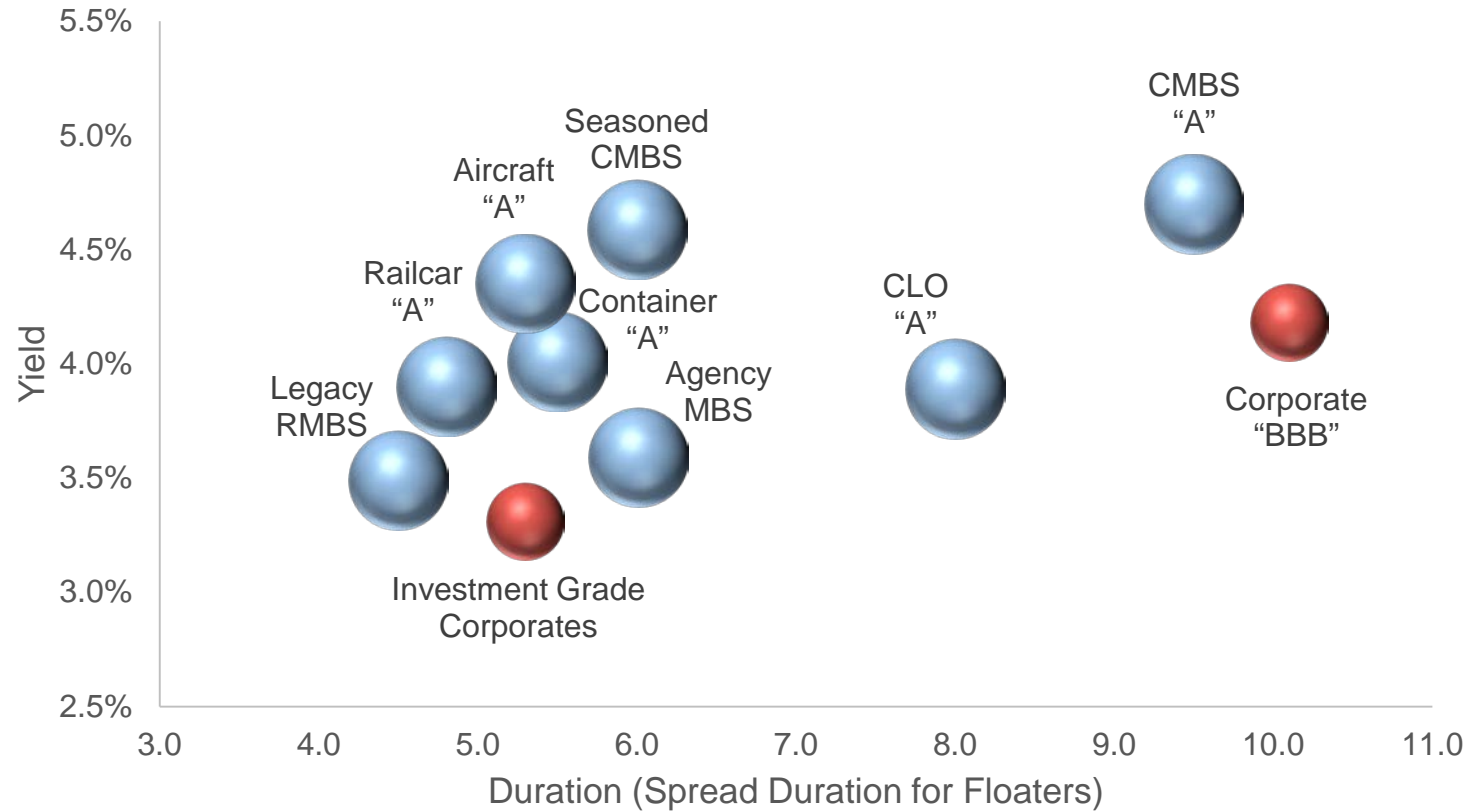
Yield Curves as of 1/31/2018



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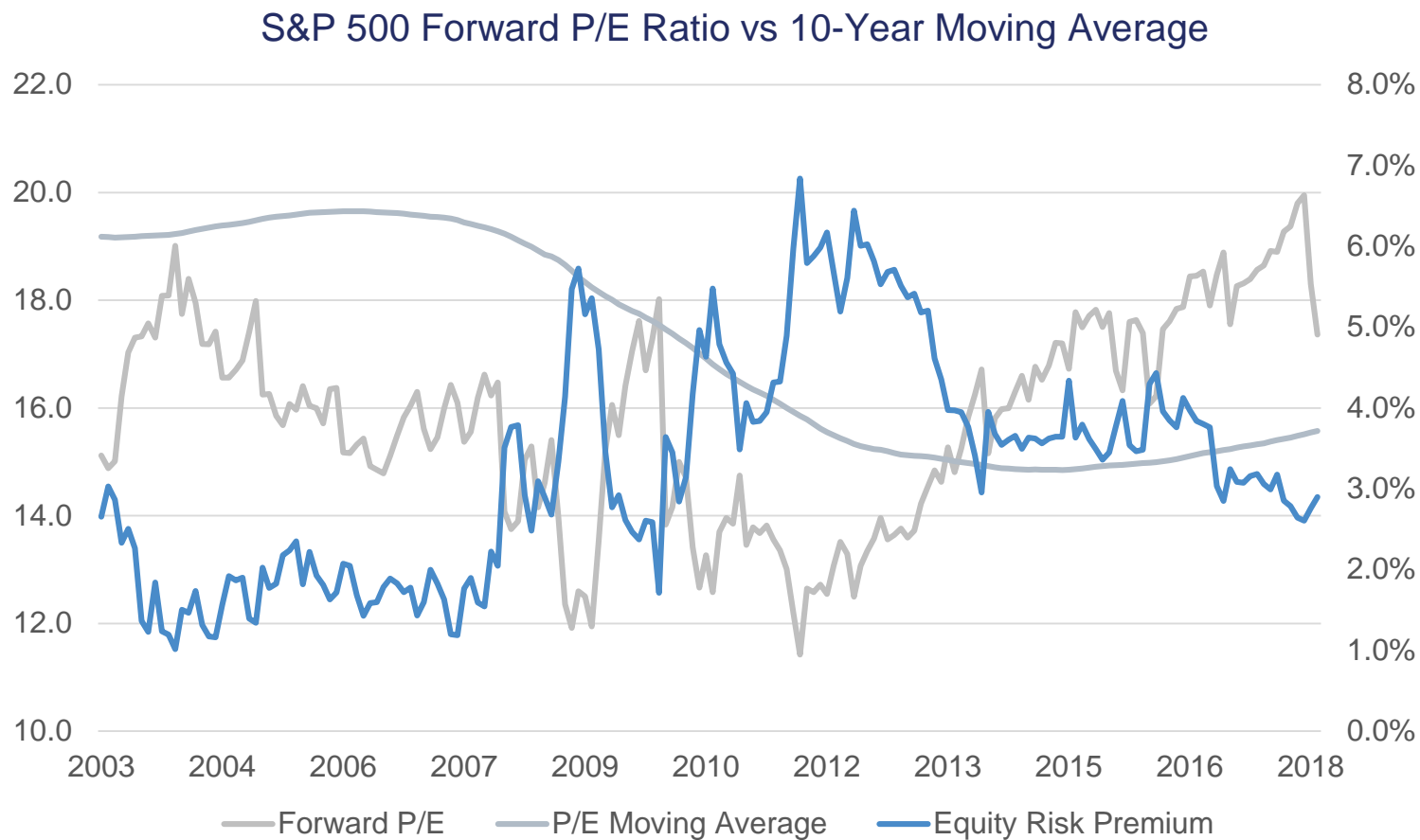
Structured Securities Outlook

Investment Grade Structured Products vs Investment Grade Corporates



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Equity Outlook



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Equity Outlook

Tax law changes affect life investment strategies – equities

- Reducing corporate tax rate from 35% to 21%
- Reducing the dividends received deduction from 70% to 50%
- Changing proration policyholder share from formula to fixed 30%

A higher company share, but lower tax rates and smaller dividend received deductions

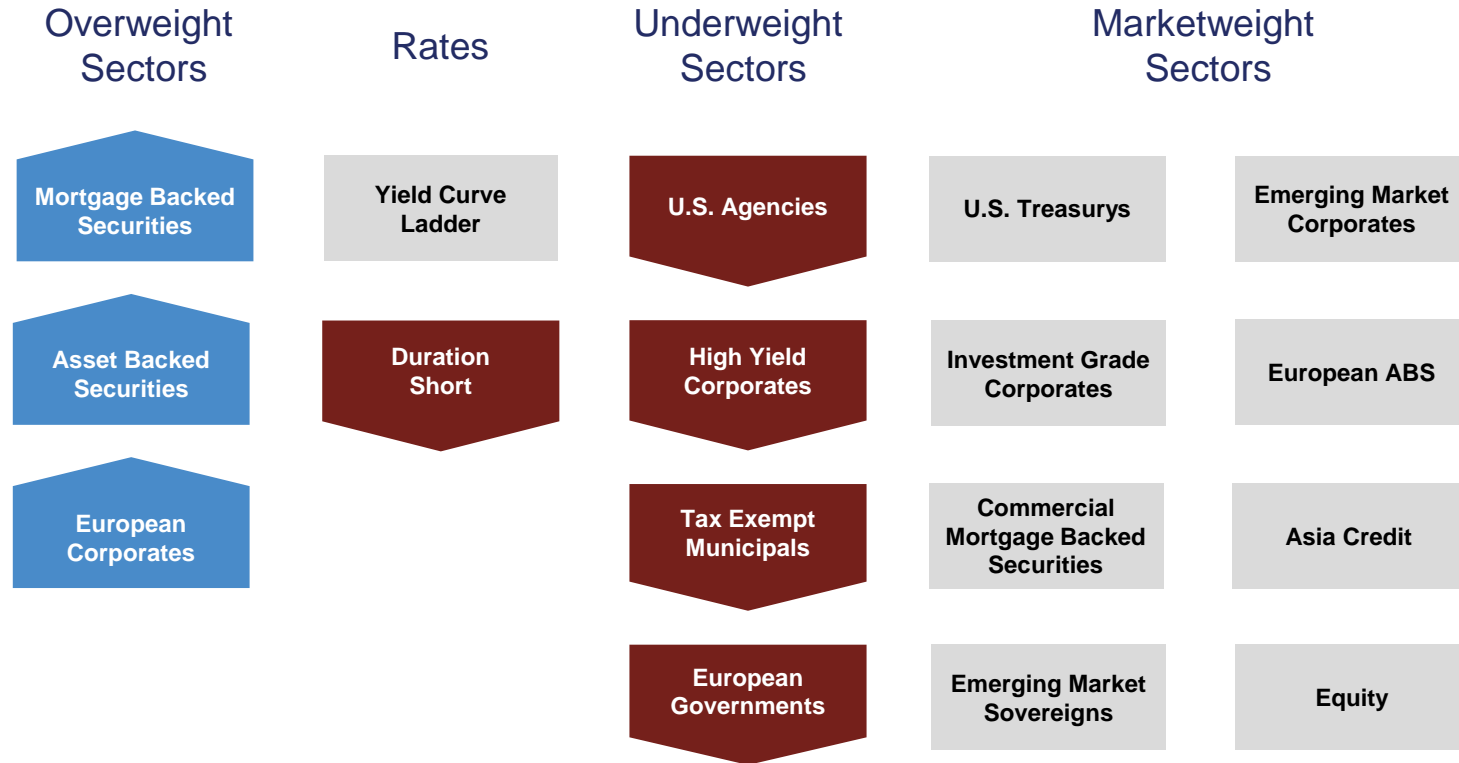
Year	Stated Equity Yield	Corporate Tax Rate	Eff. Tax on Dividends*	TEY Multiplier*	Tax Equivalent Yield*
1987-2017	2.5%	35%	27.7%	1.11	2.78%
2018	2.5%	21%	13.7%	1.10	2.75%
Change	NC	↓14 points	↓14 points	↓1%	↓3 bps

*Assumes 70% company share for 1987-2017 & 30% company share for 2018

Results in no material impact on life insurers' equity allocations

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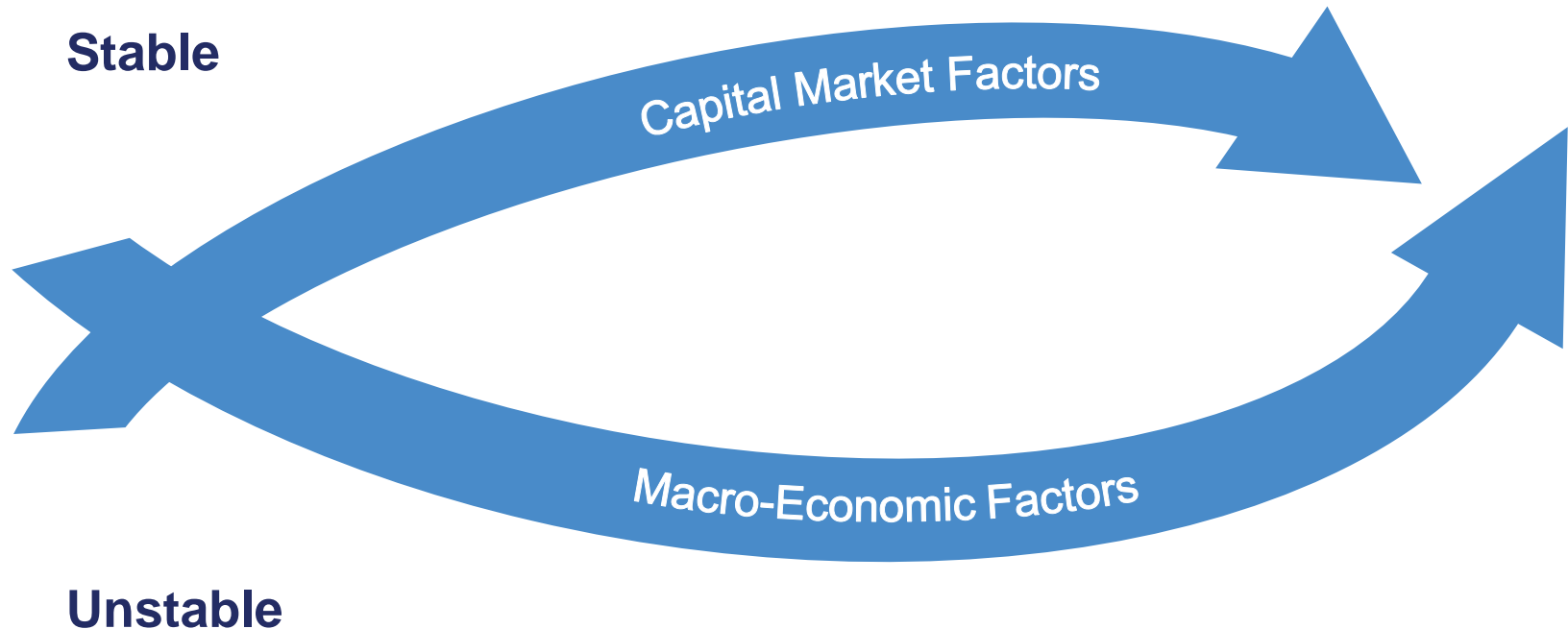
Conning's Relative Value Outlook



Prepared by Conning, Inc. Source: *Conning Capital Market Outlook* (March 2018).

Closing Thoughts

While challenges in the capital markets will continue to increase, we believe this is more of an opportunity than a risk, especially for fundamentally based, active investors.



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