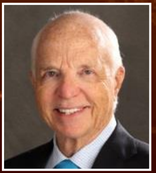
EPOCH | Epoch Investment Partners, Inc.

Epoch's Quarterly Capital Markets Outlook



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Thursday, April 4, 2019 | The webinar replay is available on our website: **www.eipny.com**

The Powell Pivot: What Usually Happens After Fed Finishes Tightening?

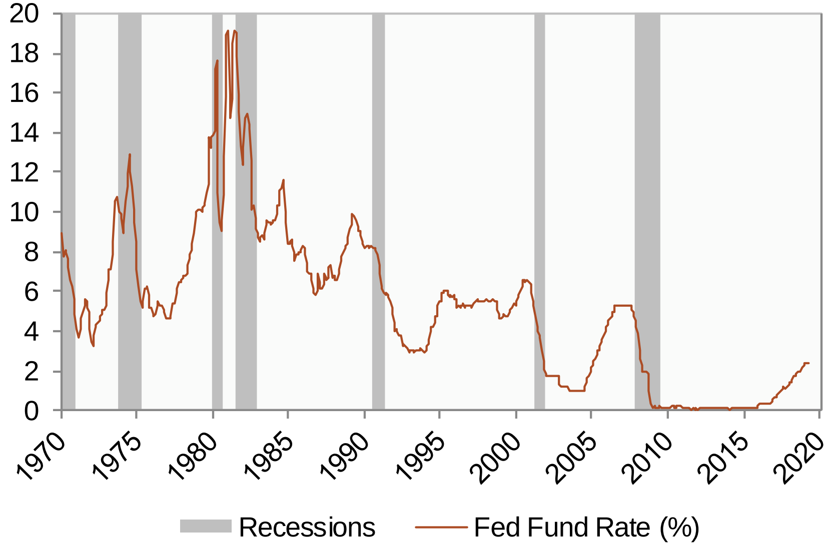
There were three main risks in 2018

- Fed & tightening financial conditions
- Trade tensions & China 2025
- Decelerating global growth

2019 off to a great start as first two recede

- "Back from the brink," but still late-cycle

Hiking cycle extremely mild relative to previous ones: Reflecting enormous debt build-up throughout the economy



Source: Bloomberg, Epoch Investment Partners

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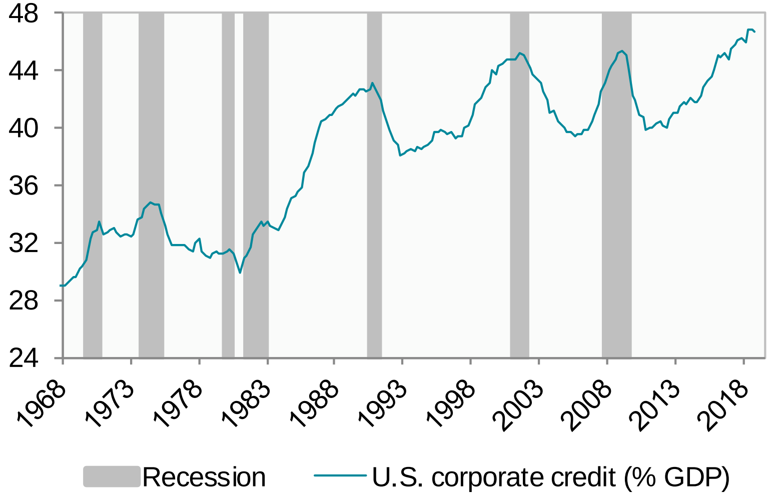
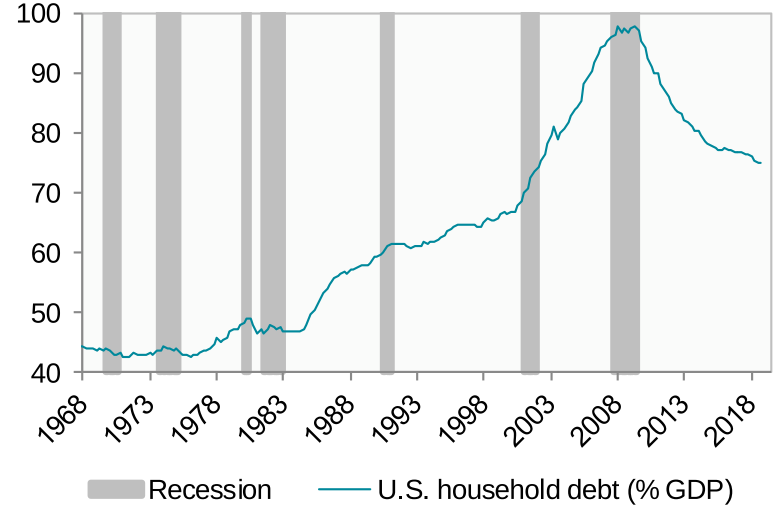
U.S. Corporate Debt as an Amplifier in the Next Slowdown

Corporate credit: Might not cause the next recession, but will certainly make it much worse once it arrives



Source: Bloomberg, Epoch Investment Partners

Household debt: Elevated, but less so than a decade ago. Housing and autos: Very sensitive to interest rate increases.



Source: Bloomberg, Epoch Investment Partners

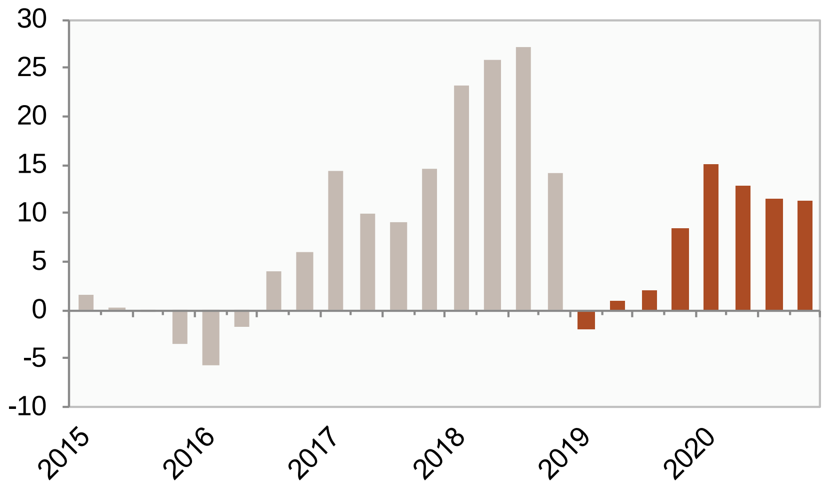
A decade of extraordinarily easy policy has created many risks and imbalances

- IG index dominated by BBBs
- HY index to be overwhelmed by fallen angels
- Upcoming wall of maturities
- Covenant-lite leveraged loans
- Excesses in private equity

Student debt is an additional concern and a major drag on housing.

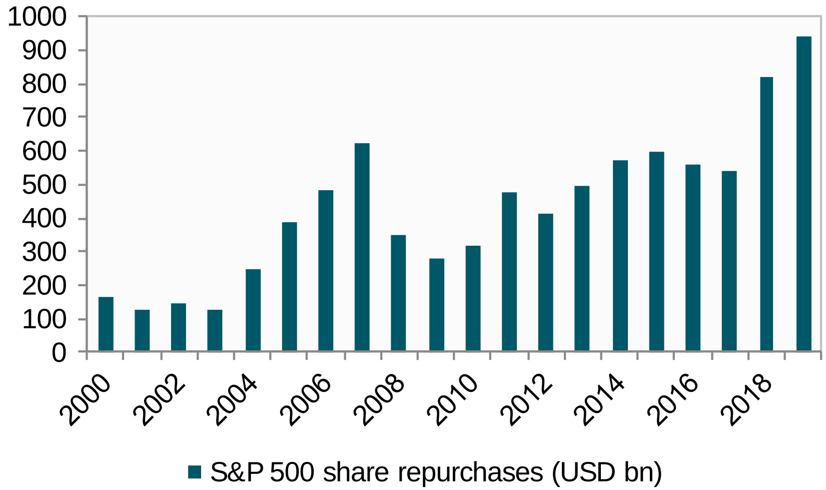
S&P 500 Earnings Growth Plummets, while Buybacks Soar

Consensus expects EPS growth of only 3% in 2019, followed by a robust 12% in 2020. We're skeptical and don't see margins increasing.



Source: Goldman Sachs

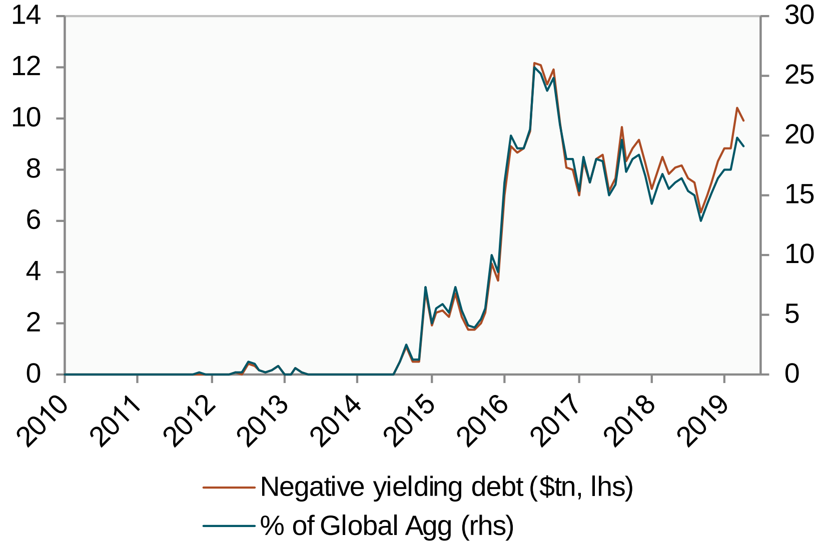
Share buybacks surged after the TCJA, up 52% in 2018, and expected to increase another 15% in 2019



Source: Goldman Sachs

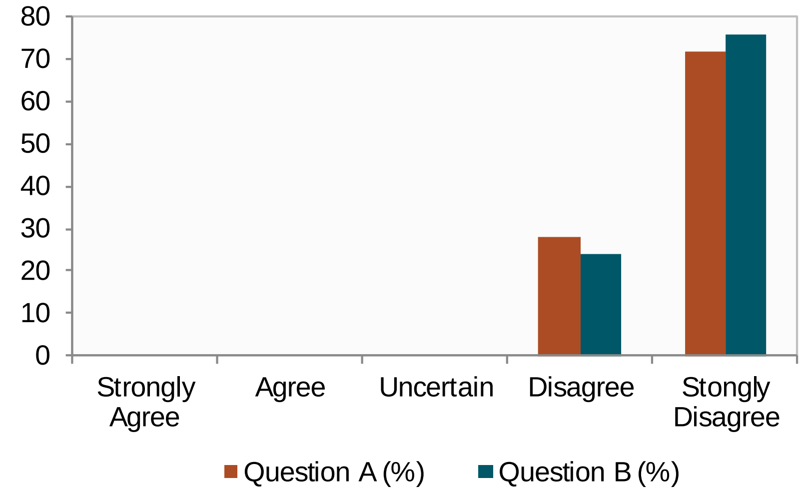
QE Partially Discredited: MMT to the Rescue?

Even with QE largely discontinued, there is $10 tn in negative yielding bonds, representing 20% of the global aggregate index



Source: Bloomberg, Epoch Investment Partners

During the next recession, MMT is unlikely to fill the void left by QE



Source: University of Chicago's Initiative on Global Markets
Based on a survey of 42 economic experts from Chicago, Stanford, MIT and others

Question A:
Countries that borrow in their own currency should not worry about government deficits because they can always create money to finance their debt.

Question B:
Countries that borrow in their own currency can finance as much real government spending as they want by creating money.

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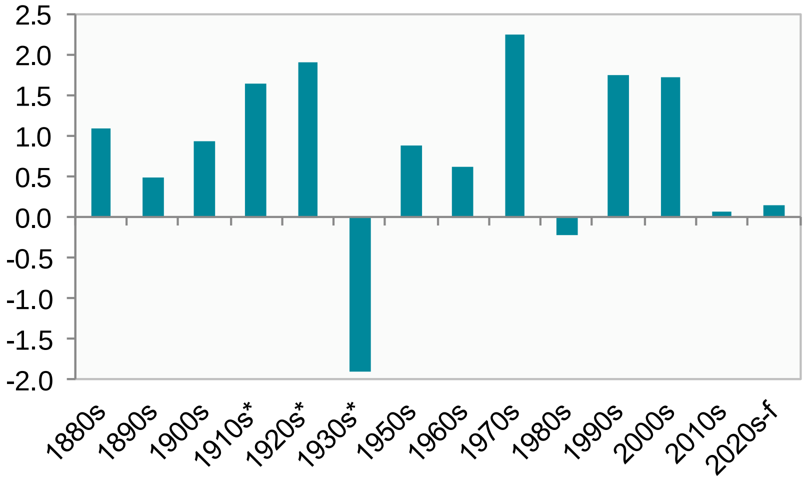
Slowbalization: Globalization has Faltered & is Now Being Reshaped

Emerging pattern of trade: More regional (Asian) and more focused on services and global supply chains

- Large and sustained increases in the cross-border flow of goods, money, ideas and people have been the most important factor in world affairs for the past three decades
- But now, most measures of global integration (trade, FDI, MNCs) are in retreat or stagnating.

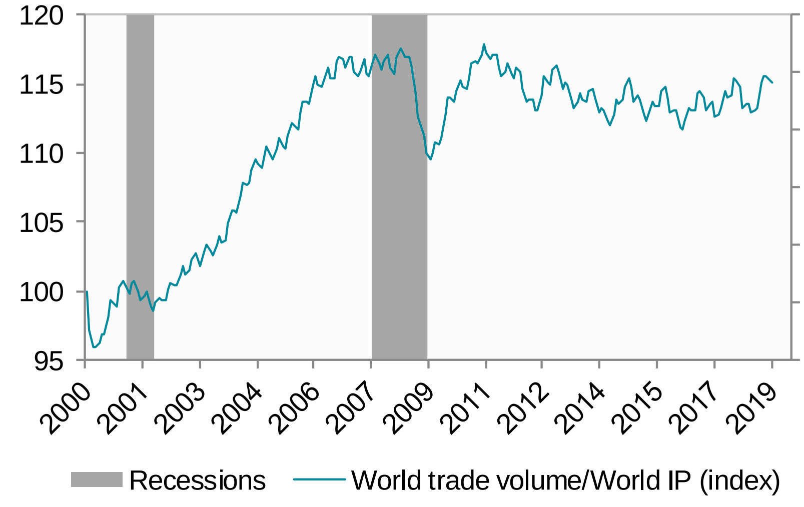
Negative for overall growth, as well as corporate margins

Change in openness 1880-2023 (average annual % change in world trade to world production ratio)



Source: World Bank, IMF, Vox EU (van Bergeijk)
* Limited data available for these decades, as well as for the 1940s.
Note: 2020s represents IMF forecast to 2023

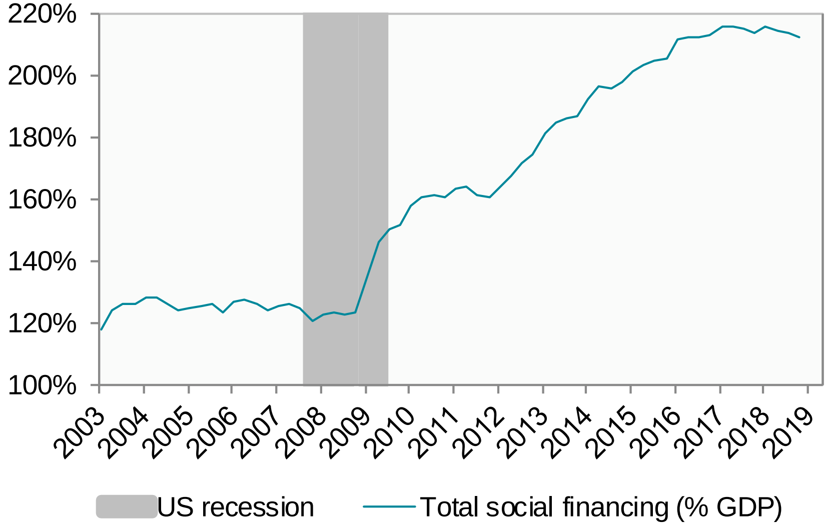
World trade: Stagnant since 2011



Source: Epoch, Bloomberg

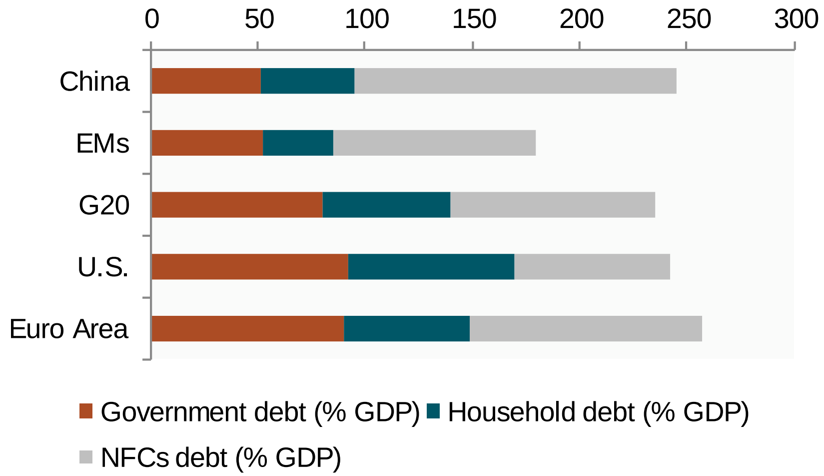
China's Excessive Leverage: Just One of Its Structural Headwinds

Since the GFC, TSF has turbo-charged growth



Source: Bloomberg, Epoch Investment Partners

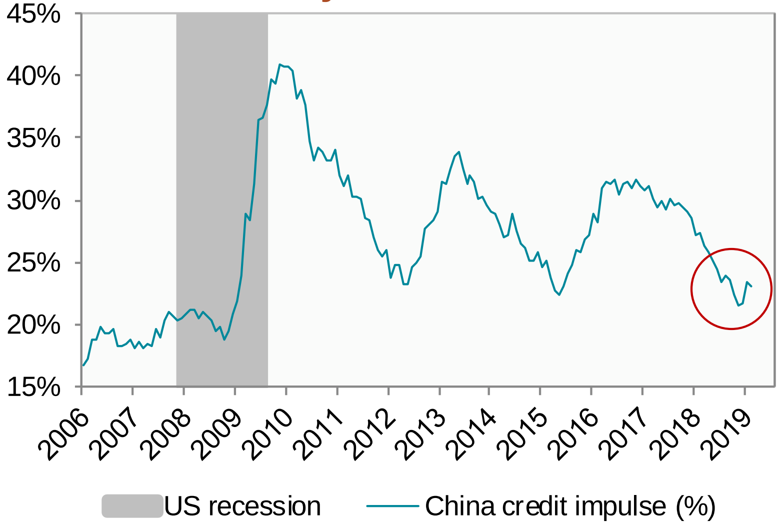
China's total debt already exceeds the G20 average. The corporate sector, especially SOEs, is particularly worrisome.



Source: Bloomberg, BIS, Mathews Asia, Epoch Investment Partners

China's Recent Inflection is Good News for Global Markets

Beijing tightened credit from late 2017, but has recently loosened the reins a bit



Source: Bloomberg, Epoch Investment Partners

Shadow lending declined dramatically from late-2017

- Resulted in slower GDP growth last year
- The impulse inflected recently: Setting a floor on growth for this cycle

Passing the growth baton to the consumer

- Capital spending: Still excessive, but a little less so
- Consumption: Is the key driver

Potential growth

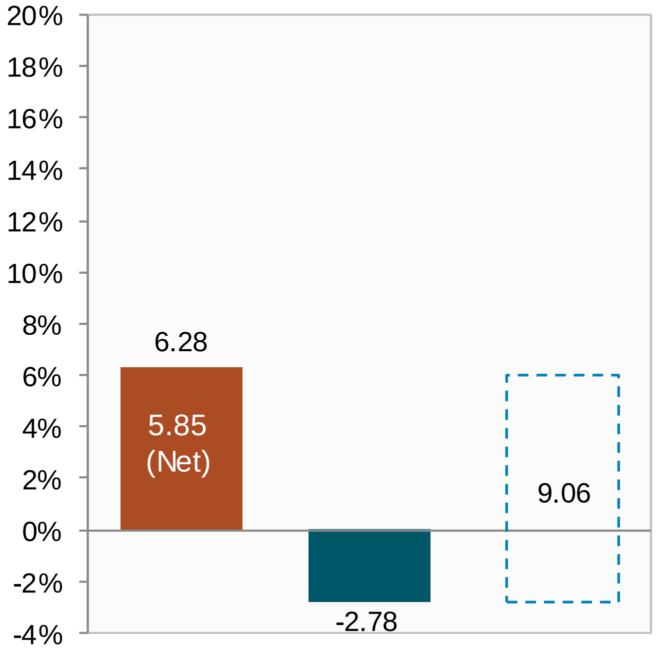
- Chinese GDP growth has been over-stated by 1.7 ppts/yr (due to skewed local statistics)
- Correctly measured growth: Likely 4.0 to 4.5%

While the Market Swings, We Aim for Steady Returns

Global Equity Shareholder Yield versus **MSCI World**

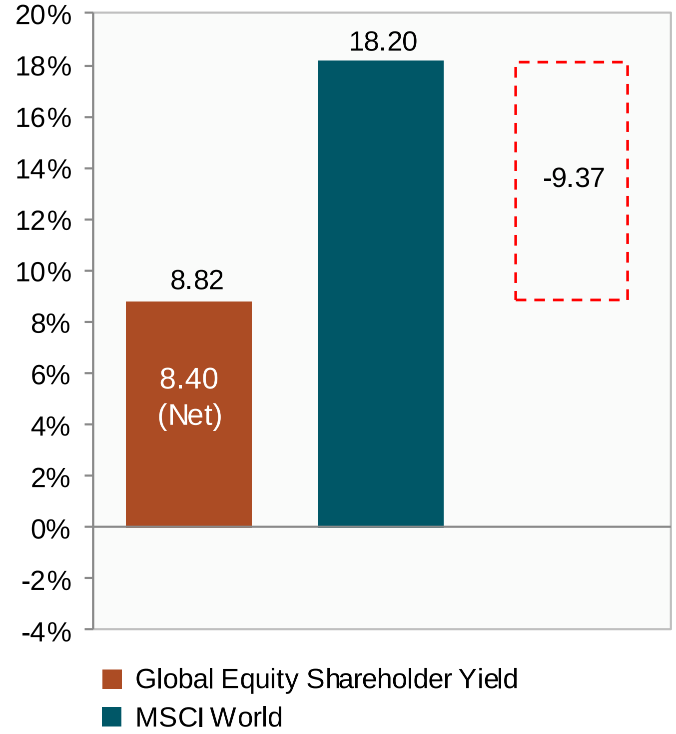
12 months to 6/30/2016: RISK OFF

- Falling commodity prices (oil falls below $30/bbl)
- Worries over China hard landing
- Global growth slowdown
- Looming Brexit vote



12 months to 6/30/2017: RISK ON

- Immediate Brexit aftermath quite benign
- Trump election and rally



The data shown for Global Equity Shareholder Yield reflects the composite and such data may vary for each client in the strategy due to market conditions, client guidelines and diversity of portfolio holdings.

While the Market Swings, We Aim for Steady Returns

Global Equity Shareholder Yield versus MSCI World

3Q 2018: RISK ON

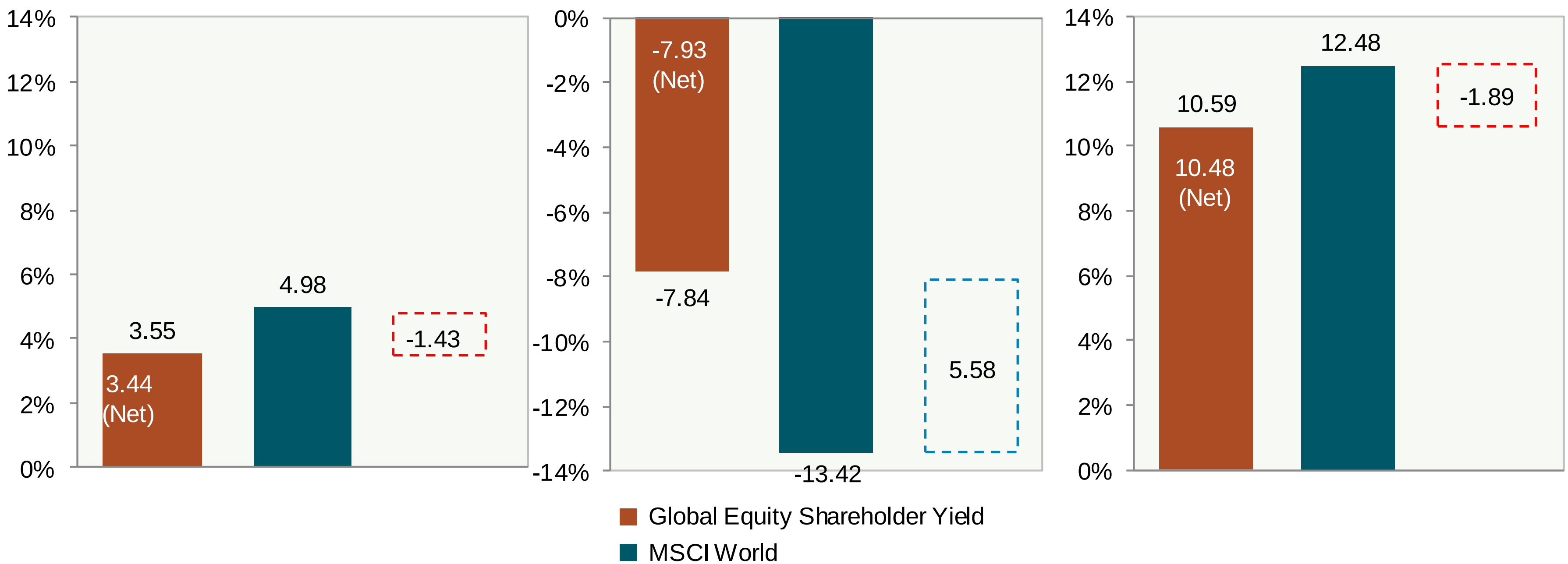
- Momentum/growth-driven
- Market led by FAANGs
- Economic acceleration from TCAJA
- "Defensive" stocks out of favor

4Q 2018: RISK OFF

- Fed worries (pace of rate hikes and QE to QT)
- Trade worries
- Prompt significant market correction

1Q 2019: RISK ON

- Fed pivot: QT on hold
- Recession fears ease



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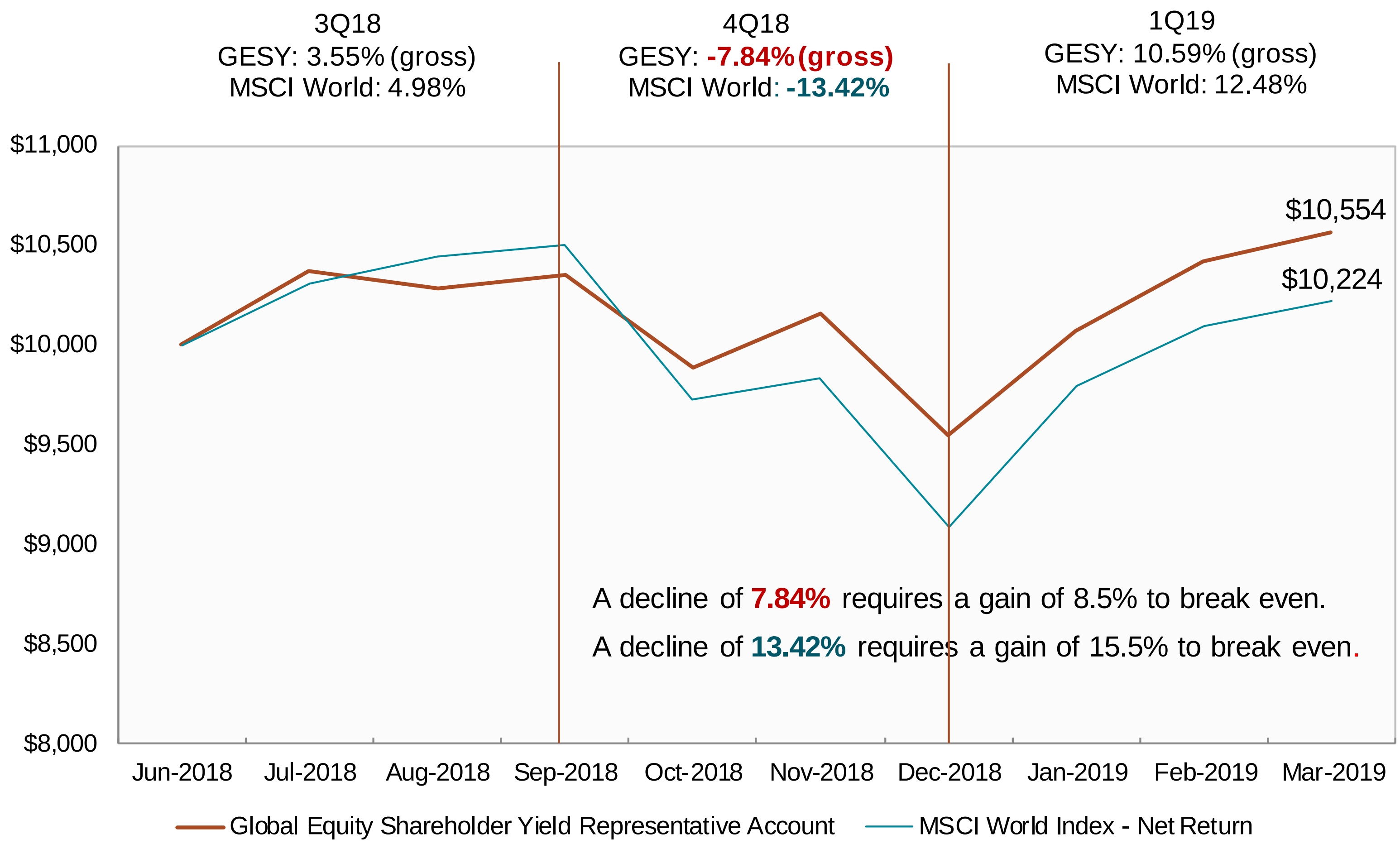
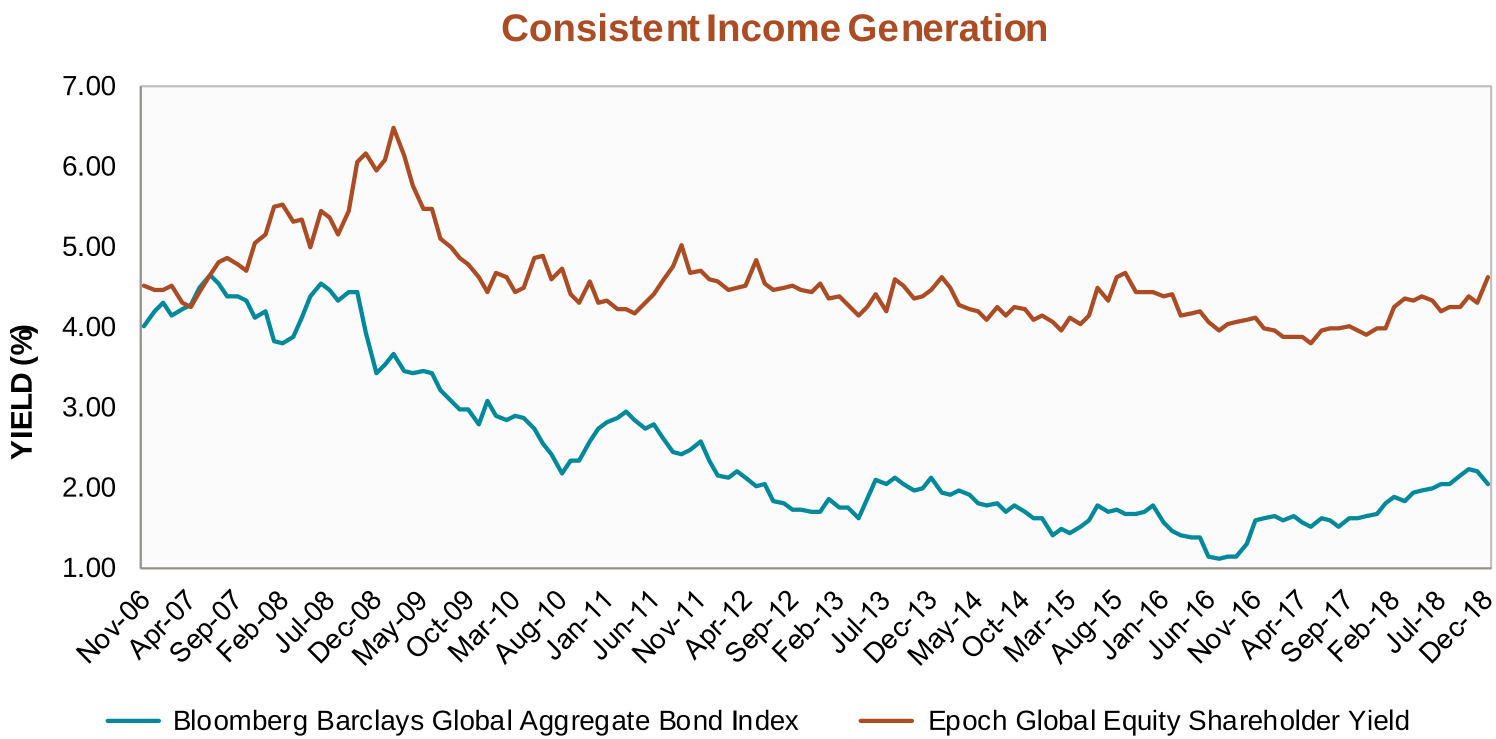
The Importance of Downside Protection



The data shown for Global Equity Shareholder Yield reflects the composite and such data may vary for each client in the strategy due to market conditions, client guidelines and diversity of portfolio holdings.

Long-Term Historical Benefits

FROM A DIVERSIFIED PORTFOLIO OF HIGH-QUALITY COMPANIES FOLLOWING GOOD CAPITAL ALLOCATION PRACTICES



Sources: Bloomberg, FactSet. As of December 31, 2018.

The data shown for Global Equity Shareholder Yield is of a representative account and such data may vary for each client in the strategy due to market conditions, client guidelines and diversity of portfolio holdings.

Long-Term Historical Benefits

NUMBER OF COMPANIES THAT INCREASED THEIR DIVIDENDS

2008	2009	2010	2011
62	69	72	88

2012	2013	2014	2015
82	73	79	83

2016	2017	2018
71	79	84

As of December 31, 2018.

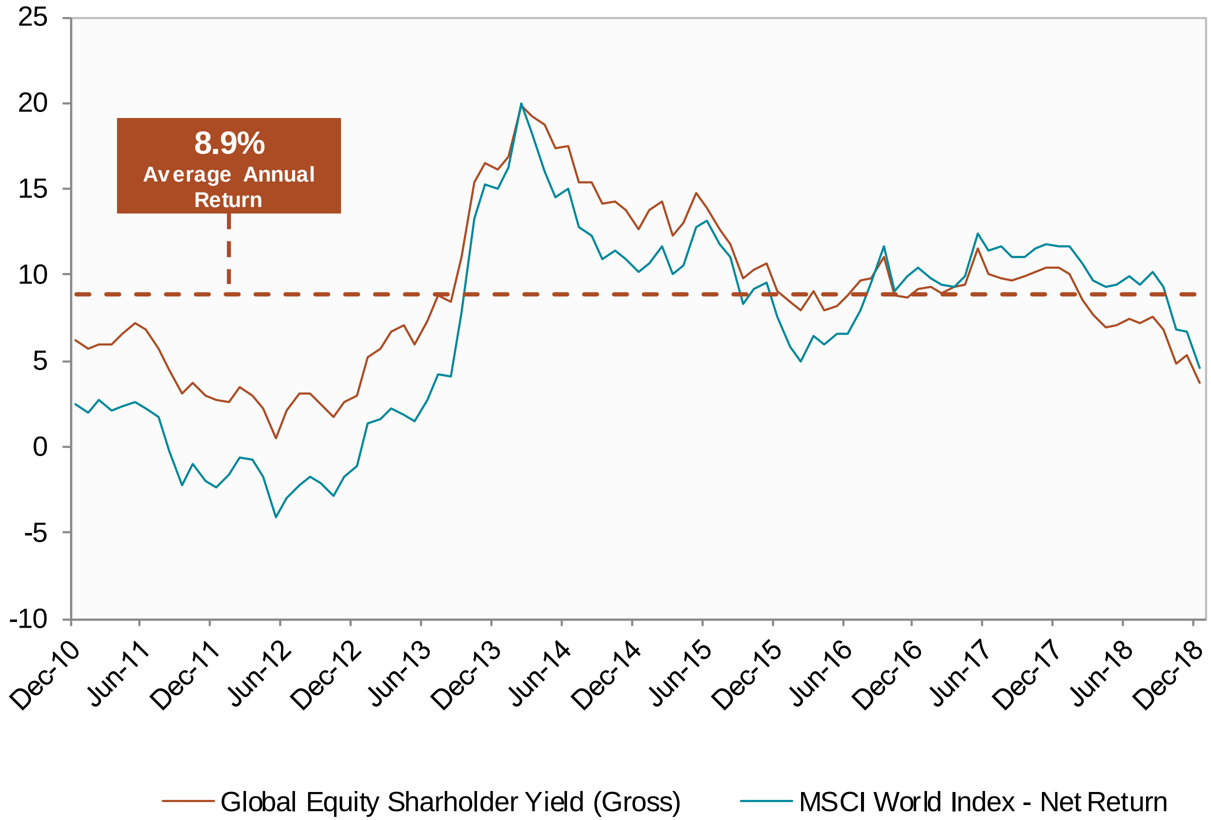
* Several companies increased their dividends more than once in each year.

Source: Epoch Investment Partners, Inc. The data shown above is for a representative account. Such data may vary for each client in the strategy due to market conditions, client guidelines and diversity of portfolio holdings. The data is unaudited and may change at any time. The data is supplemental to the composite presentation, is shown for informational purposes only, and is not indicative of future portfolio characteristics or returns.

Long-Term Historical Benefits

Reporting Currency: USD

ROLLING 5 YEAR ANNUALIZED RETURNS: COMPOSITE



Average* GESY
8.9% (Gross)
8.5% (Net)

Average MSCI World Index
7.1% (Net)

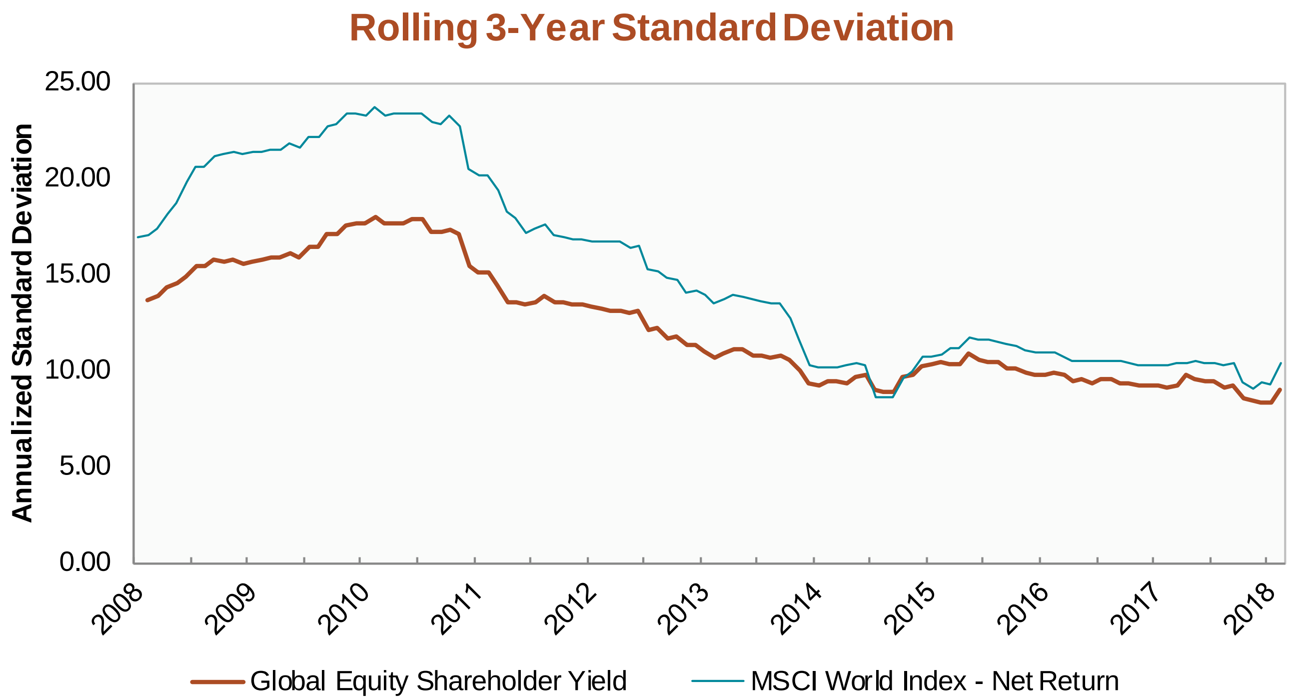
Source: FactSet

(From Inception through December 31, 2018)

* This value is an arithmetic average of a series of 5 year geometric average annualized returns at each month-end since inception.

Long-Term Historical Benefits

FROM A DIVERSIFIED PORTFOLIO OF HIGH-QUALITY COMPANIES FOLLOWING GOOD CAPITAL ALLOCATION PRACTICES



Sources: Bloomberg, FactSet. As of December 31, 2018.

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Long-Term Historical Benefits

Reporting Currency: USD

IN 154 ROLLING THREE-MONTH PERIODS SINCE THE PORTFOLIO'S INCEPTION

When Market Was Negative
(47 out of 154 periods)

Portfolio outperformed

81% (gross)

79% (net)

of the time

By an average of

3.6% (gross)

3.5% (net)

When Market Was Down >5%
(25 out of 154 periods)

Portfolio outperformed

96% (gross)

93% (net)

of the time

By an average of

4.1%

(gross and net)

As of December 31, 2018.

Market represented by the MSCI World Index Net. Strategy inception date is December 31, 2005.

Outlook

WHY WE EXPECT PAYOUT RATIOS TO REMAIN ROBUST

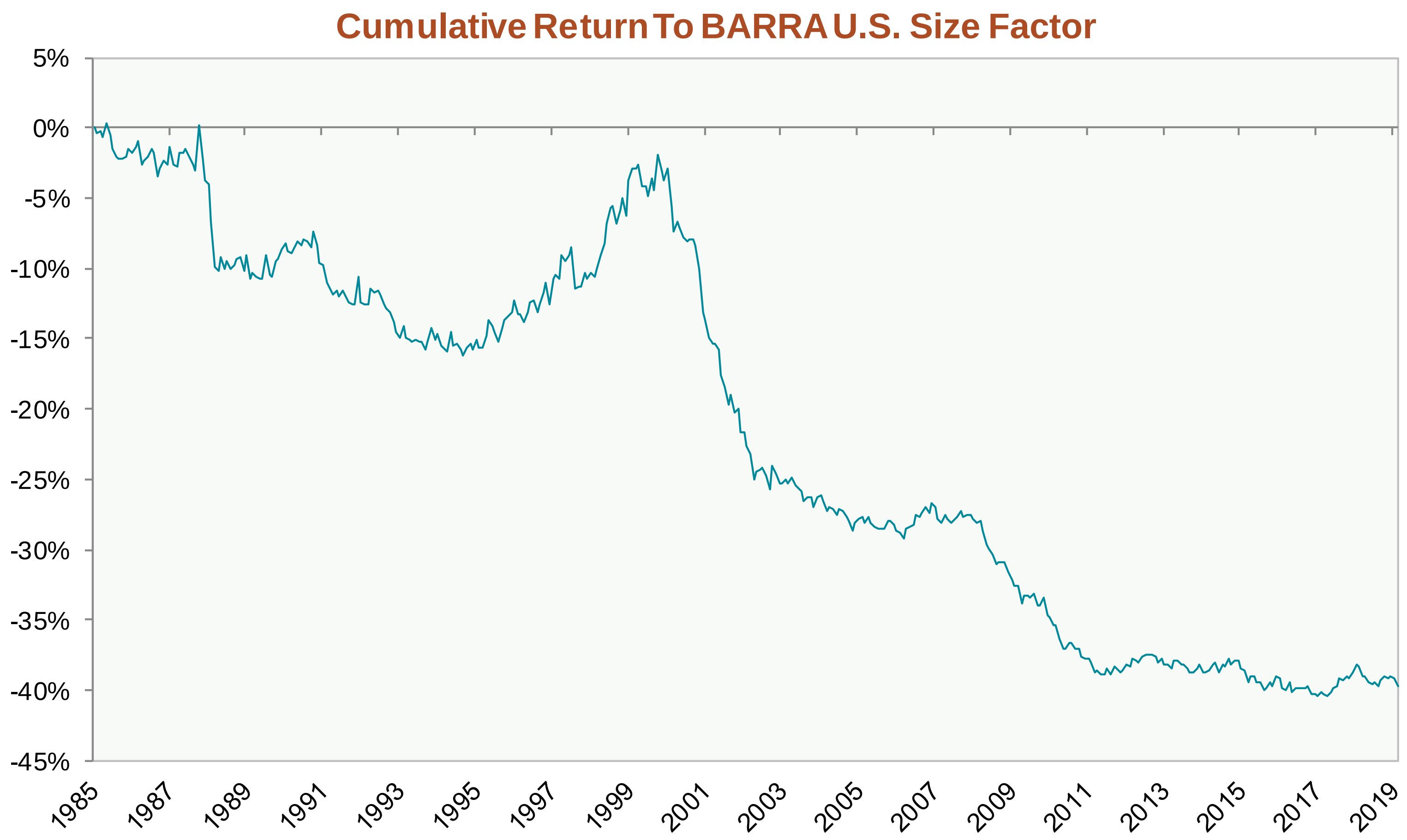
Companies continue to focus on appropriate capital allocation

- Invest when ROIC > WACC
- Otherwise, return capital to owners

Technology implies a "capital light" world with more free cash flow to distribute

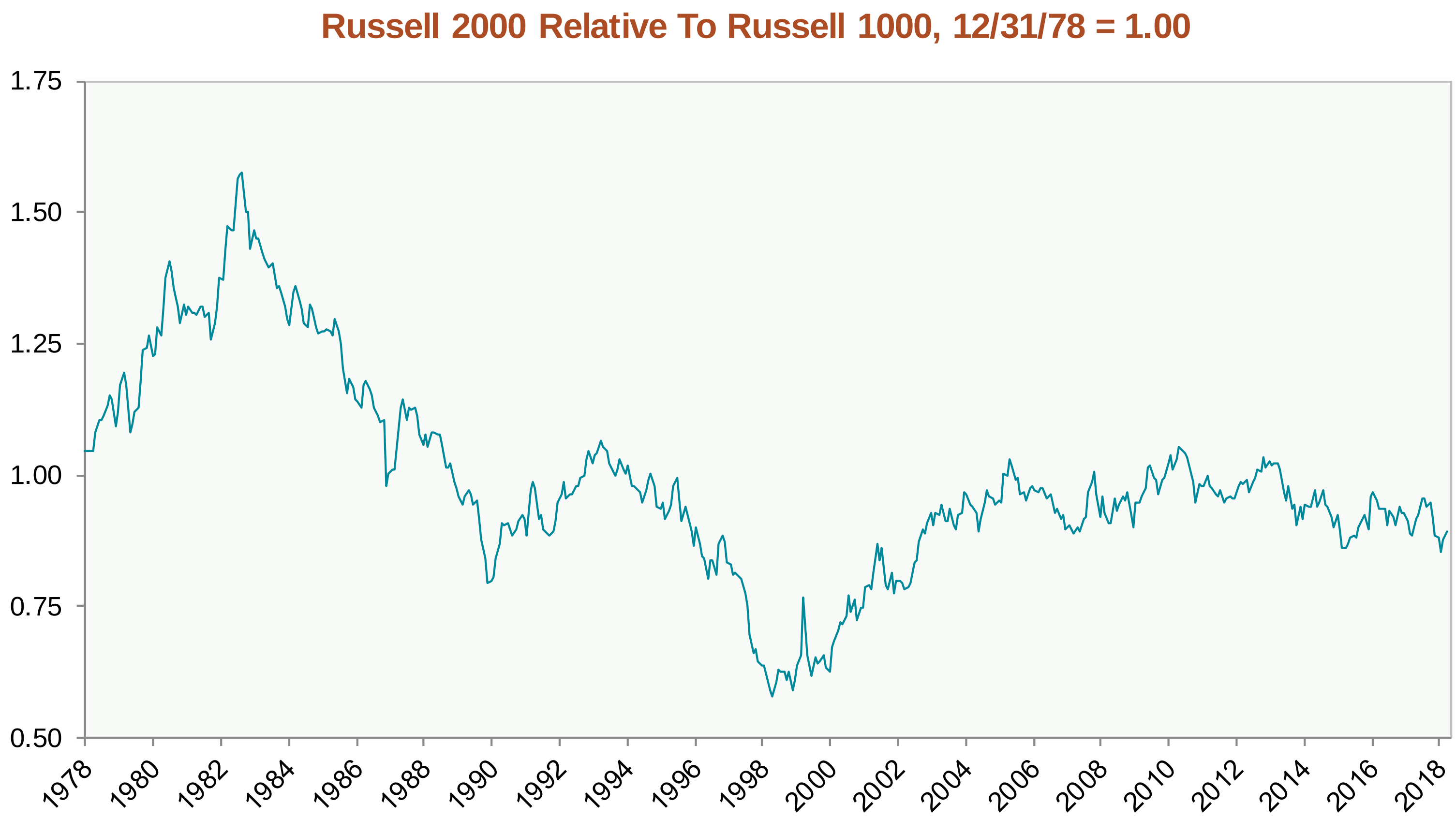
- "Tech is the New Macro"

BARRA Says Large Size Has Had Negative Return



Source: FactSet

So Why Hasn't The Russell 2000 Outperformed?



Source: Bloomberg

Why Do Some Companies Grow Large While Others Do Not?

EPOCH'S VIEW:

Companies create value (and grow larger) by earning high returns on invested capital (ROIC) compared to their cost of capital (WACC). If so, larger companies should exhibit higher ROIC than smaller companies.

TABLE 1

	Median ROIC	Percentage of Companies with Positive ROIC
Russell 1000	7.2%	87.8%
Russell 2000	4.4%	70.0%

TABLE 2

	Median ROIC	Percentage of Companies with Positive ROIC
Russell 1000 (Larger Half)	8.4%	89.9%
Russell 1000 (Smaller Half)	6.3%	85.7%
Russell 2000 (Larger Half)	4.9%	74.1%
Russell 2000 (Smaller Half)	3.7%	66.0%

Source: FactSet

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Why Do Some Companies Grow Large While Others Do Not?

BUT DO COMPANIES GROW LARGE BY HAVING HIGH ROIC, OR DO LARGE COMPANIES HAVE SOME ADVANTAGE THAT ENABLES THEM TO EARN HIGH ROIC?

- Membership in the Russell indices is not static, so looking at companies that have moved up or down from one index to the other can help us answer this question.

TABLE 3

	Median ROIC	Percentage of Companies with Positive ROIC
Stocks that moved up	5.5%	78.8%
Stocks that moved down	0.0%	49.4%

- Stocks that moved up had higher ROIC than the larger half of the Russell 2000;
- Stocks that moved down had lower ROIC than the smaller half of the Russell 2000.

Source: FactSet

The Small Cap Effect

THE SMALL CAP EFFECT DOES EXIST, BUT THE RUSSELL 2000 IS NOT THE PLACE TO LOOK FOR IT

The small companies that generate the small cap effect are precisely the ones that leave the Russell 2000 and move to the Russell 1000

The rest of the Russell 2000 index consists of small companies that have stayed small due to their poor ROIC, or formerly large companies which shrank (because of poor ROIC)

Trying to capture the small cap effect by passively owning the Russell 2000 is unlikely to work

Summary and Investment Implications

1. **U.S. Outlook – Back from the brink:** As the cycle matures, economic and earnings growth are slowing. However, the "Powell Pivot" has resulted in a significant loosening of financial conditions providing a nice, albeit temporary, tailwind for equities.
2. **Wage and price inflation:** Consumer prices are showing no signs of acceleration (due to the deflationary impact of technology), but U.S. wage growth is slowly increasing, reflecting the tight labor market. This is bad news for corporate margins.
3. **Equity multiples unlikely to increase further:** Multiples expanded on QE, but that phase of the cycle is now well behind us. Equity return drivers have shifted from broad multiple expansion to earnings growth, which is likely to be quite weak this year.
4. **The return of price discovery:** QE was designed to suppress volatility and acted as a rising tide, lifting all boats. However, we expect significantly higher volatility over coming quarters and believe it is becoming much more of a stock-pickers market.
5. **Corporate debt is likely to be at the epicenter of upcoming market dislocations**: Issuance soared with QE, spreads remain dangerously tight and the market faces a daunting wall of maturities. Associated imbalances (including those in leveraged loans and private equity) might not be the direct cause of the next recession, but they will certainly make it much worse once it arrives.
6. **Tech is the new macro:** Technology is positive for all three ROE components — profit margins, asset utilization, and leverage. Among other things, this implies corporate margins can remain high for a prolonged period and don't necessarily need to revert. Equally importantly, suggests companies returning a higher proportion of cash to shareholders.
7. **Trade tensions:** To remain a market theme, and a source of volatility. Although an outright trade war is unlikely, we're concerned about the impact on margins of a bifurcation in global supply chains (especially affecting tech hardware).
8. **Europe:** To continue underperforming as it grows earnings less quickly than the U.S. (reflecting a lower weighting in Tech and weaker top-line growth). Further, the Eurozone's reform agenda has stalled, undermining medium-term growth prospects.
9. **China**: Excessive leverage is just one of its structural headwinds. Total debt (% of GDP) already exceeds the G20 average, with segments of the corporate sector particularly worrisome. Shadow lending declined dramatically from late 2017, but has recently inflected, setting a floor on growth this cycle. Although infrastructure and capital spending remain excessive, the good news is that the key driver for both the economy and the equity market is now consumption, for which the outlook is very positive.
10. **Investment approach:** As a result of the above points, it is ever more important to favor companies with a demonstrated ability to produce FCF and allocate that cash flow wisely between return of capital options and reinvestment/acquisition opportunities.

Thought Leadership

RECENT PUBLICATIONS & WHITE PAPERS

"Trump, Tech and Trade"

"The Return of Price Discovery"

"The Size Paradox"

"Is e-Commerce a Bubble?"

"When 'Bits' Meet 'Atoms'"

Winning at Active Management

A REPLAY OF OUR QUARTERLY WEBINAR IS AVAILABLE AT: www.eipny.com