COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

LOOKING AHEAD | INSIGHTS FOR 2018

When I consider my 35 years in the industry, my favorite part has been spending time each year meeting with financial advisors and institutional investors. It's why I love what I do! After all, there is no better way to understand your challenges so we can design the solutions to help you meet your goals.

This past year we've heard a lot of the same questions and concerns from advisors and investors: You're concerned that financial markets have been too good for too long. You're not sure how to manage your portfolio because things feel uncertain. You have questions and the answers are rarely simple.

We're always listening and thinking about solutions to your most important investment goals. And we want to help you navigate the year ahead by analyzing the opportunities and challenges we expect from financial markets in 2018.

We do know one thing for certain: A consistent approach to investing through times of uncertainty will put you on a better path toward reaching your financial goals. And our global investment teams know that there are good opportunities out there.

On the following pages, some of our key thought leaders respond to some of your most common investment challenges. But because change is inevitable, the conversation doesn't pause here. We'll be out there gathering your thoughts and input throughout the year. And together, we'll use our insights and knowledge to invest with confidence.

William F. "Ted" Truscott

Chief Executive Officer

Ted is proud to continue his role as Chairman of the Investment Company Institute (ICI) in 2018

CHECK BACK THROUGHOUT THE YEAR TO GET OUR LATEST INSIGHTS: **COLUMBIATHREADNEEDLEUS.COM**

Q | IT SEEMS LIKE EVERY DAY SOMETHING NEW (AND UNUSUAL) IS HAPPENING IN THE WORLD, BUT FINANCIAL MARKETS HAVE BEEN PRETTY CALM. THE RESULT IS UNNERVING — HOW DO I INVEST IN THESE CONDITIONS?

"The financial markets may appear calm, but there's a lot going on under the surface and around the world. Many of the fundamental influences that drive investment returns are quite good. In this environment, a research-driven approach that focuses on reliable returns can get you closer to reaching your goals."

COLIN MOORE
Global Chief Investment Officer

The feedback that we get from advisors and investors is that consistency of income is really the big driver of long-term satisfaction, not the level of current income.

Stop chasing spectacular returns. Go for consistency.

Whether you're trying to save money for children to go to college or build income for retirement, it's the consistency of your return that is most important. It's far better to get 6% consistently than positive 10% one year, minus 2% the next year and then positive 4% after that. Using simple arithmetic, the compounding effect of a more consistent return is advantageous.

When it comes to generating income, people don't always consider that if they're getting a higher current income, it's because they're taking a higher level of risk — and stretching for yield has become one of the market's major themes. The feedback that we get from advisors and investors is that consistency of income is really the big driver of long-term satisfaction, not the level of current income.

Don't let behavioral investing cost you money.

Our work suggests that active management costs clients somewhere around 60–80 basis points (0.60%–0.80%) per year, whereas the behavioral trait of selling out of funds with high volatility (or selling low and buying high) is actually costing people around 200 basis points (2.0%) per year. If we can overcome this trend and help people invest in active strategies that deliver a more consistent return, it could have an enormous effect on their long-term outcomes.

Don't ignore external factors. But don't bet on them either.

Understanding potential geopolitical risks can help prepare portfolios for a range of possible outcomes. For instance, what will happen in the world's next big election? You can speculate that the underdog will win, and you may generate a lot of excess return if you make that bet. But ultimately, you're putting a lot of capital on something that has a low probability, and it's usually not a good tradeoff. What we try to do instead is give a more consistent experience to investors by providing the highest probability of a reasonable return over time.

Q | WE'VE EXPERIENCED ONE OF THE LONGEST EQUITY BULL MARKETS OF ALL TIME, AND I'M NERVOUS IT CAN'T CONTINUE. SHOULD I CHANGE MY ASSET ALLOCATION TO REDUCE EQUITIES?

"Stock market performance in 2017 was exceptional, both in the level and consistency of gains worldwide. While we do not expect the same unwavering pattern for equities in 2018, we still conclude that stocks offer an expected return advantage over other asset classes. We recommend an ongoing emphasis on equities as a source of growth for investors who are contemplating an asset allocation strategy in 2018."

Our five-year forecast reinforces the notion that equities should feature in an asset allocation as a driver of growth.

JEFFREY KNIGHT, CFA
Global Head of Investment Solutions

Look across the asset class landscape to make portfolio decisions.

Over the next five years, we expect returns across asset classes to be positive (including equities), although below their historical averages. Expected equity returns, even if they're lower than historical averages, would have a long way to fall before they stop looking good compared to bonds. So on a relative basis, our five-year forecast reinforces the notion that equities should feature in an asset allocation as a driver of growth.

A more conservative asset allocation strategy would make sense if you expect a recession. We don't.

Stocks tend to perform well in every phase of the economic cycle except a recession. But based on economic data, we don't a expect a recession in the near term — economic performance across the world continues to strengthen and gain pervasiveness. In addition, prevailing conditions present challenges for asset classes that would typically feature in a conservative strategy, such as government bonds, but may be favorable for other choices like commodities or inflation-linked bonds. Therefore, even with a stable allocation to equities, the strategic asset allocation should be flexible and evolve.

Expect returns across asset classes to become more balanced as the year progresses.

Our asset allocation tools continue to favor equities versus other asset classes, but these comparisons should evolve to be more balanced through 2018. We expect the Federal Reserve to raise interest rates several times, which could improve forward-looking returns for bonds of all maturities once they're priced in. Economic strength should bolster returns of real assets like commodities. Even a slight deterioration in equity returns, caused by, for example, a slowdown in corporate earnings growth, could contribute to a much more balanced return profile across asset classes as we move through 2018.

Keep in mind the adage: "Bull markets don't die of old age."

Q | EQUITY MARKET VALUATIONS ARE HIGH, MEANING THE PRICE OF BUYING STOCKS IS HIGH RELATIVE TO WHAT THEY SEEM TO BE WORTH. HAVE WE REACHED THE POINT OF "IRRATIONAL EXUBERANCE"?

"Even though the price of stocks is high, we do see good opportunities and solid fundamentals at the stock level. Finding these opportunities requires research into individual companies, not making bets on specific styles or sectors."

Like any attempt at market timing, trying to time sector investments will most likely leave you disappointed. Instead, focus on individual companies.

MELDA MERGEN, CFA
Deputy Global Head of Equities,
Head of U.S. Equities

Review your allocation to value and growth stocks. Focus on finding opportunities at the stock level.

Growth stocks have recently had a remarkable period of outperformance. For many investors this means their allocation to growth stocks has increased, leaving their portfolios underweight value. Now may be a good time to reassess your allocations, and make sure your exposure to value stocks is where you want it to be in the context of a balanced portfolio. The recent outperformance of growth stocks, combined with the current stage in the economic cycle, sets the stage for value stocks to outperform. But many value sectors are experiencing structural headwinds, so the answer isn't as simple as predicting a convincing winner between growth or value. We're staying focused on the fundamentals of stock-picking, and at a company level there are still growth companies with attractive valuations and value companies with earnings growth potential.

Consider that high valuations may be able to last longer than in the past.

Traditionally, there are two pressures that begin to eat into a company's profits: competitors take away market share, and workers ask for more money. But take a look at the companies included in the S&P 500 Index — many of them have complex business models with entrenched customer bases. Take Amazon for example: They're a dominant company whose business model crosses traditional sectors, and it would be nearly impossible for a competitor to launch tomorrow and compete at the same scale. At an economy-wide level, workers' negotiating power has eroded as technology continues to play a critical role. So, high valuations may be able to last longer than they would have 50 years ago and at higher multiples.

Look at individual companies. Winning sectors are constantly changing and difficult to accurately predict.

Since the financial crisis, the top performing sector has changed every year. We suspect the sector rotation is partly driven by flows in and out of passive ETF products as investors try to tactically adjust their portfolios. Large companies that make up a good portion of the S&P 500 Index also have developed more complex business models that cross sectors. Like any attempt at market timing, trying to time sector investments will most likely leave you disappointed. Instead, focus on individual companies.

TRYING TO TIME SECTOR BETS IS LIKELY TO DISAPPOINT

Top sector in the S&P 500 Index

SECTOR	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Consumer discretionary			●			●		●		
Consumer staples	●									
Energy									●	
Financials & REITS					●					
Health care										
Industrials										
Info tech		●								●
Materials										
Telecom										
Utilities				●			●			

Source: Columbia Threadneedle Investments as of 09/30/2017.

Q | ECONOMIC STRUGGLES IN EUROPE AND JAPAN HAVE BEEN LONGER AND MORE PRONOUNCED THAN IN THE U.S. ARE THEY OUT OF THE WOODS YET? SHOULD I BOTHER WITH INTERNATIONAL EQUITIES, WHEN IT SEEMS EASIER TO INVEST CLOSE TO HOME?

"We've seen positive economic indicators overseas, and we believe they're creating an environment where international companies with good fundamentals can continue to grow. Japan is a country with particularly good potential."

For investors who are concerned about high valuations in U.S. stocks, it may make sense to look abroad.

WILLIAM DAVIES
Global Head of Equities

Take advantage of synchronized economic growth in developed economies.

Global economic growth trends are positive, earnings estimates continue to rise and monetary policy is still supportive globally. What's more, major developed economies, including Europe, Japan and the U.S., are all growing at the same time. This synchronized growth is an opportunity for global portfolios that we haven't had in the last two decades. It's exciting, and we expect it to continue.

Invest in international stocks if you're concerned about high valuations in the U.S.

For investors who are concerned about high valuations in U.S. stocks, it may make sense to look abroad. Boasting some of the world's largest and most successful companies, the European equity market may prove to be too expensive for bargain-basement investors. But for those in search of a reasonable value compared to the U.S., Europe offers promising long-term opportunities. Political events in Europe in 2016 put a damper on European stock prices, so they haven't had as long a period of outperformance as the U.S. We believe they're still undervalued.

Look to Japan as an area of growth.

After a recent visit to Japan to do on-the-ground research, Daisuke Nomoto, Head of Japanese Equities, concluded that "There are various opportunities in the Japanese equity market that favor an active approach that allows concentrated investments in high-conviction areas." We see a number of positive trends in Japan, including:

- **Consistent growth in Japan's economy.** GDP has improved for more than seven consecutive quarters and deflation is finally over thanks to a combination of the accommodative monetary and fiscal policy.[1]
- **Strong corporate earnings growth.** Earnings grew more than 20% compared to the prior year, and we expect they will continue to grow.[2]
- **Japanese equity valuations are attractive relative to most major markets.** About 35% of stocks are trading below the book value of the company.[3]
- **A stable government.** This includes the reelection of Prime Minister Shinzo Abe and the positive results from policy changes, such as corporate governance reform, growth in the number of women in the workforce and a substantial increase in foreign tourists.

Sources: [1] Government of Japan as of 09/30/2017; [2] Quick, as of 11/14/2017; [3] Bloomberg as of 09/30/2017

Q | I'M NOT TOO FAMILIAR WITH EMERGING MARKETS, SO THEY SEEM RISKY. **WHAT'S WRONG WITH LIMITING MY INVESTMENTS TO DEVELOPED ECONOMIES?**

"Emerging markets do present a different set of investment risks compared to developed markets, but they also offer growth potential that established markets simply can't match."

ED KERSCHNER, CFA
Chief Portfolio Strategist

There are two factors that are driving economic growth in emerging markets: population growth and productivity growth.

Keep an open mind about emerging markets. They're too big to ignore.

Emerging markets are about 40% of the global economy, and that's doubled in the past 25 years. Today, emerging markets are the largest economy in the world — bigger than the U.S., bigger than Japan and bigger than all of Europe. And emerging market economies are expected to grow faster than developed markets every year through 2021.[1]

Take advantage of the rapid growth potential of emerging economies.

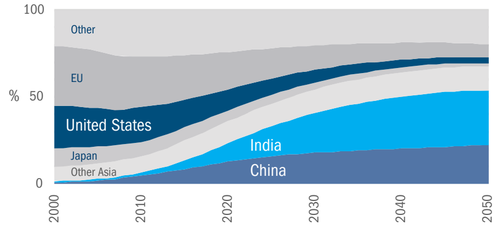
There are two factors that are driving economic growth in emerging markets: population growth and productivity growth. And for both of those factors, trends favor emerging markets. The demographic story in emerging markets tells us that there's rapid population growth compared to developed markets. When it comes to productivity, it's not that we're doing anything wrong in developed markets; it's simply that we're already so productive. So, creating more output per worker in an advanced economy requires ongoing investment in the latest equipment and technology to help do the job faster and better. Boosting productivity in the emerging markets might be as simple as installing some lights so employees can work when it gets dark.

Count on the numbers. Consumption is a key theme for emerging markets investors.

In 2000, only about 4% of the world's population was middle class living in emerging markets. By 2030, that's expected to increase to 15%.[2] China is projected to overtake the U.S. as the largest middle class by 2020, and India is projected to pass the U.S. a year later. It's not just the size of the middle class that's growing — it's also their discretionary income and spending. For investors, this translates to more opportunity for growth in consumer sector emerging market companies.

CHINA AND INDIA ARE PROJECTED TO BE DRIVERS OF GROWING MIDDLE CLASS.

Global middle class consumption[2]



Source: [1] International Monetary Fund as of 04/30/2017. [2] The OECD Development Center, published January 2010. Note: "Other Asia" reflects all Asian countries, excluding Japan, India and China, which are differentiated in the graph.

Q | FIXED-INCOME INVESTMENTS ARE NOT EXPECTED TO PROVIDE EXCITING RETURNS GOING FORWARD, AND THEY'RE NOT GENERATING THE AMOUNT OF INCOME I NEED. **WHERE SHOULD I FOCUS MY FIXED-INCOME INVESTMENTS?**

"The starting point for yields in 2018 is low, and investors aren't being adequately compensated for taking risk. A flexible, risk-sensitive approach that includes a diversified portfolio of bonds can still be a good source of income and capital preservation in this environment, although the focus in the next year may be more on the latter."

COLIN LUNDGREN, CFA
Global Head of Fixed Income

Even though inflation has been low, returns on money-market funds have been unable to keep up and investors have lost purchasing power.

Be cautious. Less risky fixed-income strategies may provide protection if you're risk-averse.

Fixed-income strategies that take less interest rate risk (by having a shorter duration) or focus on high-quality fixed-income securities are a prudent choice for cautious investors. They may have modest upside, and some of their ability to absorb market shocks has been worn down, but they will kick in to help preserve capital when you need it most.

Be flexible. Income seekers can take risk by using a nimble approach.

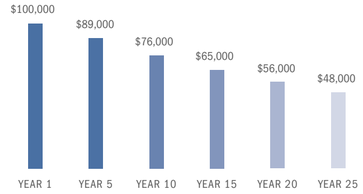
It's challenging to generate high income in today's low-yield world, so keep your expectations modest and don't stretch too far for yield. Investors are simply not being paid enough to invest in lower-quality, traditionally higher-yielding parts of the bond market (which tend to be the riskier sectors). There's opportunity to produce income in a more risk-sensitive way if you use a flexible strategy that includes a wider range of bond market sectors and can nimbly navigate those sectors as market conditions change. The right active manager with excellent research capabilities can identify individual bonds to help produce strong risk-adjusted returns.

Be invested. Turning to cash instead of bonds is a step too far.

Even though inflation has been low, returns on money-market funds have been unable to keep up and investors have lost purchasing power. We prefer strategies that are designed to preserve capital and produce returns that beat inflation, but in a risk-sensitive way. If you're not invested, and hold high levels of cash, you simply won't keep up.

SITTING IN CASH RESULTS IN "REAL" LOSSES.

Without any growth, cash will lose its purchasing power over time.



Source: Columbia Threadneedle Investments. Hypothetical example based on $100,000. Assumes 3% inflation annually and no growth of capital.

Q | I'LL MOST LIKELY BE AFFECTED BY TAX REFORM. BUT WHAT DOES TAX REFORM MEAN FOR MUNICIPAL BONDS?

"Investors rely on municipal bonds for tax-exempt income and low volatility. And we expect municipal bonds to continue to deliver on both fronts, even considering policy changes. Even at lower tax rates municipal yields are still compelling, and other aspects of tax reform could favorably affect supply and demand for municipal bonds. Because of this, we think municipal bonds will still play an important role in a diversified portfolio."

JAMES DEARBORN
Head of Municipal Bond Investments

We anticipate a much smaller supply of municipal bonds in 2018, and these technical conditions (supply and demand) may help tax-exempt bonds perform well during the year.

Invest in munis for higher taxable-equivalent yields.

Lower tax rates for millions of high-income earners would reduce the value of tax-exempt income. But we believe that even at lower tax rates, municipal bonds still make sense when you compare them on a taxable-equivalent basis to what you can earn from other fixed income asset classes. We compared the taxable-equivalent yield of the Bloomberg Barclays Municipal Bond Index (assuming a tax rate of 35%) to the Bloomberg Barclays Corporate Investment Grade Bond Index or the U.S. Treasury Index, and municipal bonds offer more yield than their taxable fixed-income counterparts.

Expect fewer municipal bonds will be issued, which can be a good thing for muni performance.

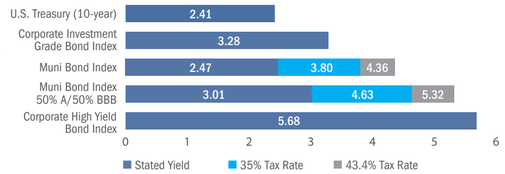
We anticipate a much smaller supply of municipal bonds in 2018 and that these favorable technical conditions (low supply and high demand) may help tax-exempt bonds perform well during the year. Tax reform may eliminate the ability of municipal issuers to lock in low interest rates by refinancing outstanding higher cost debt (referred to as pre-refunding). This has been a major portion of muni bond supply, so a change here would lower the supply of municipal bonds.

Avoid states and cities with pension and budget problems. Invest in the rest.

The credit quality of the vast majority of municipal issuers remains stable, benefitting from underlying economic growth and still positive revenue trends. Nonetheless, a few high-profile state and local issuers continue to struggle with rising pension funding requirements and stagnant revenue growth. We include the states of New Jersey, Pennsylvania, Connecticut and Illinois as well as some of their major cities (Hartford, Philadelphia and Chicago) in this group, and we anticipate that rating downgrades — potentially more than one notch — are likely in 2018. However, we believe you can take comfort in the overall stable fiscal health of most municipal issuers, and we encourage investors to work with professional asset managers to avoid potential credit pitfalls.

MUNICIPAL BONDS OFFER COMPETITIVE YIELD

Taxable-equivalent yields (%)



Source: Columbia Threadneedle Investments as of 11/30/2017. Asset classes represented with following indices: Bloomberg Barclays Treasury Index (U.S. Treasury), Bloomberg Barclays Corporate Investment Grade Index (Corporate investment grade bond), Bloomberg Barclays Municipal Bond Index (Muni bond index), Bloomberg Barclays U.S. Corporate High Yield Index (Corporate high yield). See disclosure section for additional information.

Columbia Threadneedle Investments is a leading global asset manager that provides a broad range of investment strategies for individual and institutional clients. With 450 investment professionals across 19 countries, we manage $484 billion* across asset classes. Our global investment team debates and challenges their best ideas to make better decisions, leading to better outcomes for you and your clients.

To find out more, call **800.426.3750**
or visit **columbiathreadneedle.com/us**

COLUMBIA THREADNEEDLE INVESTMENTS

Diversification and asset allocation does not assure a profit or protect against loss.

There are risks associated with fixed-income investments, including credit risk, interest rate risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer term securities.

The chart "Municipal bonds offer a competitive yield" on page 17 assumes a federal income tax rate of 43.4% (39.6% income tax rate + 3.8% Net Investment Income Tax rate) and a hypothetical tax rate of 35%. Other taxes are possible and as of this writing, tax reform proposals are not final and could impact the analysis. The effect of potential federal income tax phaseouts of personal exemptions and itemized deductions is excluded from this schedule. Had they been included, the reported tax rate would have been higher, which would then increase the municipal taxable-equivalent yield, for any given municipal stated yield. State income taxes may be applicable and can further reduce the after-tax returns of some municipal bond investments (depending on the state of residence). Income from certain tax-exempt securities may be subject to the federal and/or state alternative minimum tax for some investors. In addition, federal and state income tax rules will apply to any capital gain distributions and capital gains or losses on sales. When investing in municipal securities, investors in higher tax brackets can receive a greater tax benefit than those in lower tax brackets. Municipal bonds provide income exempt from federal and, in some cases, state income taxes.

The Bloomberg Barclays U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

The Bloomberg Barclays U.S. Treasury Index measures USD-denominated, fixed-rate, nominal debt issued by the U.S. Treasury.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index measures the USD-denominated, high-yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

The Bloomberg Barclays U.S. Investment-Grade Corporate Index includes dollar-denominated debt from U.S. and non-U.S. industrial, utility and financial institution issuers.

The Standard and Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks.

There are risks associated with foreign investments, including economic, market, social and others within a particular country, as well as to current instabilities and less stringent financial and accounting standards generally applicable to U.S. issuers. Risks are enhanced for emerging market issuers.

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* In U.S. dollars as of September 30, 2017. Source: Ameriprise Q3 Earnings Release. Contact us for more current data.

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