We at Sterling Capital Management feel very privileged to partner with AE Wealth Management. As the outsourced Chief Investment Officer for the AE Wealth Management platform, our team is engaged in three key support areas for you and your clients: providing custom asset allocation frameworks, selecting high-quality investment managers and constructing well-diversified portfolios. Importantly, of course, we remain engaged every day with the ongoing monitoring and periodic rebalancing of those portfolios over time.

Today, we are pleased to provide a review of global financial markets during the second quarter of 2017, to reflect on changes we made to our portfolios during the quarter and to update our current positioning and outlook.

EQUITY MARKET REVIEW

Beginning with equity markets, recent positive momentum carried into the second quarter with key U.S. indexes setting new all-time highs. The Russell 3000 broad U.S. equity market index rose 3 percent in the second quarter, marking the 19th time in the last 20 quarters the index has posted a positive return. No meaningful pro-growth policy progress was made in the second quarter, and economic data releases during the quarter generally fell short of expectations, but strong first-quarter earnings reports helped propel equities higher. Approximately two-thirds of S&P 500 companies reported sales above estimates, and three-quarters came in ahead of earnings estimates. Further, S&P 500 earnings growth was 14 percent in the first quarter, which represented the highest quarterly growth rate since the third quarter of 2011.

Looking at size and style components of the U.S. market, large-cap stocks outperformed mid-cap and small-cap stocks during the quarter. Small-caps did experience resurgence, though, later in the quarter, led by a rotation into banks, REITs and biotechnology companies. On the style spectrum, growth continued to outperform value by a wide margin across all U.S. market capitalizations. Large-cap growth stocks were the top-performing segment of the U.S. equity market in the second quarter, driven by strength in technology, health care and consumer discretionary companies. Small-cap value was the worst-performing segment of the market during the quarter, partially driven by underperformance from energy companies.

On a sector basis, health care was the best-performing U.S. sector during the quarter, led by strength in biotechnology and managed care. Financials also outperformed during the quarter and were given a boost in June as the Fed cleared the way for several large banks to proceed with share repurchases and dividend increases. Technology, the best-performing sector year to date, continued to move higher during the quarter but experienced a pullback in June. Large technology stocks, such as Facebook, Apple, Microsoft and Alphabet, lost ground late in the quarter as fears over extended valuations in this group played a role in broader rotation out of the sector. Amazon, classified in the consumer discretionary sector, also fell in June. Still, year to date through June 30, the group of five aforementioned stocks was up over 22 percent and accounted for roughly a quarter of the S&P 500 Index's total return through the first six months of the year. On the other side of the coin, energy was the worst-performing sector during the quarter, dragged down in part by falling oil prices. The utilities and telecommunications sectors also declined during the second quarter.

Moving outside the U.S., international developed market and emerging market equities both outperformed U.S. equities in the second quarter. The U.S. dollar continued to weaken against the euro and pound sterling, which created a tailwind for international equity performance in U.S. dollar terms. Growth outperformed value in international developed markets and emerging markets. Mid-caps and small-caps outperformed in developed markets, while large-caps outperformed in emerging markets. China, South Korea and France were among the top-performing international equity markets, while commodity-centric countries such as Russia, Australia and Canada were among the worst. Key international developments during the second quarter included a somewhat unexpected hawkish tone from the European Central Bank meeting in June, French presidential election results that bucked the anti-European Union populist trend that was prevalent in 2016, and the announcement that MSCI will gradually add China A shares to the MSCI Emerging Markets and MSCI All Country World Indexes beginning in June 2018. In addition, U.K. snap election results, which resulted in Prime Minister Theresa May's Conservative Party losing seats in the House of Commons, could possibly complicate the Brexit negotiation process. The U.K., while posting positive returns over the past year, has been one of the worst-performing developed market countries since the Brexit vote in June of 2016.

PORTFOLIO POSITIONING

In terms of portfolio positioning, we made no net-of-benchmark asset allocation changes during the second quarter for the equity portion of portfolios. As of June 30, we continued to maintain an underweight to U.S. equities, primarily as a result of underweights to U.S. mid-cap value and U.S. large-cap growth segments. Conversely, we continue to favor international developed equities with an overweight to international developed growth. Emerging markets exposure remains in line with the benchmark. In terms of investment manager selection, we replaced the Salient International Small Cap Fund with the Goldman Sachs International Small Cap Insights Fund in April in an effort to reduce expenses and tracking error. The Goldman Sachs International Small Cap Insights Fund's expense ratio is roughly 40 basis points or 0.4 percent lower than the Salient International Small Cap Fund, and its sector and country neutral approach has led to lower levels of tracking error over time.

BOND MARKETS

The broad reflation trade that began following the U.S. presidential election slowed and ultimately reversed during the second quarter, headlined by delayed implementation of the administration's policies, slowing inflation and declining oil prices. While inflation measures fell short of expectations in consecutive months, along with a weaker-than-expected rebound in economic data, the fixed income markets, like the equity markets, marched higher. Notably, the Federal Reserve continued on its path of rate normalization and increased its target rate in June for the second time this year and for the fourth time since the 2008 financial crisis. The June rate hike, similar to previous rate increases, was well-telegraphed by the Fed and priced-in by investors.

The Fed also communicated it still plans to increase rates one more time in 2017 and hike again three times in both 2018 and 2019, though market participants remain somewhat skeptical of these projections. The Fed also provided additional information with respect to reducing the size of its balance sheet, though the timing of implementation is yet to be determined.

For the quarter, the Bloomberg Barclays Aggregate Bond Index, which is often used as a proxy for overall fixed income performance, returned 1.45 percent.

Looking at different segments of the fixed income markets, nominal Treasuries outpaced Treasury Inflation Protected Securities, or TIPS, as breakevens declined.

Municipal bonds returned nearly 2 percent for the quarter, as market technicals continued to provide support.

Corporate credit spreads continued to compress, helping investment grade corporates return 2.35 percent in the second quarter.

High yield continued its strong performance, up more than 2 percent for the quarter with BB-rated securities outperforming B-rated and CCC-rated bonds.

Within the structured space, Agency mortgage-backed securities returned 0.87 percent, lagging the broad market as concerns over the Federal Reserve unwinding its balance sheet and boosting net supply impacted the sector.

Finally, emerging market debt continued its strong momentum, returning 2.2 percent for the second quarter, as the asset class is seeing strong flows, improving fundamentals and pending positive structural reforms in several large countries.

During the second quarter, we made no changes to our Core Fixed Income portfolio.

Similar to last quarter, our taxable fixed income portfolios remain short duration relative to respective benchmarks. Yield curve positioning remains a focus. Our Core strategy, which has the flexibility to move throughout the yield curve, remains underweight at the front end of the curve in favor of the belly (and longer).

The Municipal Bond portfolio remains slightly short duration but maintains a higher allocation to the long end of the curve in favor of the short end. Additionally, the portfolio has an overweight to essential service revenue bonds and an underweight to general obligations.

SECOND-QUARTER REVIEW

For the second quarter overall, our balanced portfolio posted strong absolute returns of more than 3 percent and relative returns that compared favorably to both benchmark and peers. Asset allocation and manager selection decisions both added value during the quarter with manager selection decisions accounting for the majority of outperformance.

Leading contributors on the equity side for the second quarter included our U.S. mid-cap growth manager, global equity manager and international developed market large-cap value manager. Within the fixed income portion of portfolios, our unconstrained manager was the strongest contributor to returns.

Overall, we're pleased with second-quarter 2017 results and remain confident that we're well positioned for markets ahead.

Thank you very much as always for your interest, trust and support. We look forward to a continued strong and successful partnership.
