



ARGUS ECONOMIC COMMENTARY

August 12, 2024

Will the Fed Ride to the Rescue? Our Monthly Survey of the Economy, Interest Rates, and Stocks

The stock market is in correction mode and potentially on its way to a bear market. Several factors may be contributing to the selloff, including weak and below-consensus nonfarm payrolls and a 4.3% unemployment rate for July, softening indicators from the industrial economy, and overdue profit-taking in Magnificent Seven and AI names after an 18-month rally.

Despite the mid- to late-July selloff, a strong start to the month enabled the S&P 500 to end July barely changed for the month. August has been awful so far, with the stock market reacting to weak economic data from the industrial and jobs economy and concerns that the Fed remained in restrictive mode for too long. We do not expect the Fed to change interest-rate policy between FOMC meetings, but the environment is certainly dynamic.

The Economy, Interest Rates, and Earnings

The broadest measure of the U.S. economy, Gross Domestic Product, appeared to show a healthy and even accelerating economy as of mid-year. The advance report of second quarter GDP stepped up meaningfully from first-quarter levels, and in particular indicated a recovery in consumer spending. The market is not much for looking back, and third-quarter and monthly data will be key to restoring stability to the stock market. A review of the second quarter does appear to indicate a normally growing economy as of mid-year.

The advanced report of second-quarter GDP showed growth of 2.8%, double the 1.4% growth rate reported for 1Q24. Ahead of the advance report release, the consensus call was for low 2% growth in the first quarter.

The increase in second-quarter 2024 GDP primarily reflected increases in personal consumption expenditures, private inventory investment, non-residential fixed invest-

ment, and total government spending. These gains were offset partly by a decline in residential fixed investment. Imports, which are a subtraction in the calculation of GDP, increased and exceeded exports.

Personal consumption expenditures for 2Q24 increased 2.3%, up from 1.5% for 1Q24 and 2.2% for all of 2023. Spending on goods increased 2.5% in 2Q24, after falling 2.3% in 1Q24. Durable goods spending rebounded by a sharp 4.7% in 2Q24, after declining 4.5% in the prior quarter. Durable goods spending was up 4.2 % for all of 2023. Non-durable goods spending also bounced back, rising 1.4% for 2Q24 after declining 1.1% in 1Q24. The decline in annual inflation growth has mainly been concentrated in goods, while services inflation remains stubbornly elevated. Consumers may now be willing to buy goods at stable or even lower prices.

Consumer spending on services grew 2.2% in 2Q24, and was the one component of PCE that declined from the first quarter. Consumer spending on services grew 3.3% in 1Q24. Some of the growth in consumer services spending is being driven by rent equivalent and insurance, two costs consumers cannot control and many cannot avoid.

The very weak trend in 1Q24 consumer spending appeared to provide further evidence of the consumer under siege from multiple years of inflation. The bounce-back in second-quarter consumer spending could suggest that consumers have adapted to higher prices, or it could turn out to be a head-fake. We expect PCE within the GDP accounts to continue to send conflicting signals, with overall goods spending more volatile than services.

Non-residential fixed investment, the proxy for corporate capital spending, rose at a 5.2% annual rate in 2Q24, after

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ECONOMIC & MARKET COMMENTARY (CONT.)

rising at a 4.4% annual rate in 1Q24. This category was also healthy in 2023, rising 4.5%. Spending on equipment increased in low-double-digit percentages, while spending on intellectual property was up in low-single digits. Some of the growth in capital spending in 2023 and in the 2024 first half has been the result of corporations facing higher costs for everything.

PCE and non-residential fixed investment represent about four-fifths of gross domestic product in any quarter. In 2Q24, consumer spending added about 1.5 percentage point to GDP, while non-residential fixed investment added 0.7 percentage point. Residential fixed investment, which surprised with 16% growth in 1Q24, dropped back into negative territory, declining 1.5% in 2Q24.

The export-import balance heavily favored imports in 2Q24, as it did in 1Q24. Exports grew 2.0% in 2Q24, while imports were up 6.9%. Given the higher dollar value of imports, the net exports-imports balance subtracted about three-quarters of a percentage point (72 basis points, or bps) from overall 2Q24 GDP growth. We expect this category to remain volatile quarter over quarter.

Another volatile character has been the change in private inventories. This category added 82 basis points to GDP in 2Q24, after subtracting 42 bps from 1Q24 GDP growth. Disruptions in the distribution channel began with the trade and tariff wars of 2017-2020 and included the supply-chain crisis in 2021-2022 and the supply-chain glut in 2023. We look for private inventories to maintain the excessive volatility in this series that has prevailed since the pandemic.

Overall government spending was up 3.1% and added one-half of a percentage point to GDP growth. Federal spending increased 3.9% in 2Q24 after declining in 1Q24, while state and local government spending grew 2.6%.

The price index for gross domestic purchases increased 2.3% in 2Q24, compared with an increase of 3.1% in 1Q24. And the PCE price index advanced 2.6%, down from 3.4% in 1Q24. The core PCE index also came down from 1Q24. Higher GDP with lower price increases in 2Q24 marked a real improvement from 1Q24, yet the stock market in August 2024 is in the midst of its worse sell-off since 2022, when inflation was running wild.

Many of the concerns from investors are outside the GDP accounts. U.S. economic indicators generally suggest deceleration, although growth continues at a subdued level. The consumer economy continues to send mixed signals, with jobs and wages still growing – but at a meaningfully slower pace. The U.S. economy shocked with 114,000 new jobs in July, well below the consensus of 175,000. July was also well below the 12-month average of 215,000.

The unemployment rate rose to 4.3% for July 2024 from 4.1% for June, and was up sharply from 3.5% a year

earlier in July 2023. Average hourly earnings increased eight cents month to month for July and were 3.6% higher year over year. July annual wage growth represented a return to sub-4% growth; annual wage has mainly exceeded 4% since June 2021. Annual wage growth continues to run above inflation, but the premium has narrowed.

Retail sales in June were tepid for a third straight month. After declining in 0.2% in April and edging up just 0.1% in May, June retail sales were virtually unchanged from the prior month. On a year-over-year basis, retail sales were up 2.3% in June, similar to May annual growth; that is down from consistent mid- to high-single-digit annual growth across 2023.

Purchasing managers across the industrial economy have grown cautious. According to the Institute for Supply Management (ISM), the July manufacturing Purchasing Managers Index (PMI) remained in contraction territory -- below 50 -- for the fourth straight month and for the twentieth time in the past 21 months. ISM's manufacturing PMI came in at 46.8% for July 2024, down from 48% in June. This report reflected month over month declines in the production, order backlog, and employment indexes.

ISM's services PMI has been a bright spot in the economy but it too has slipped into contraction territory, falling to 48.8% in June. That reflected a sharp five-percentage-point stepdown from May's figure of 53.8%. Before April 2024, the U.S. services sector grew for 15 straight months. The services economy is significantly larger than the manufacturing economy, and further weakening in this category would continue fears of a developing economic slow-down.

Industrial production rose 0.6% in June, after rising 0.9% month over month in May. For the second quarter, industrial production increased 4.3% from the second quarter of 2023. June Capacity Utilization was 78.8%, edging up one tick from 78.7% in May. June capacity utilization was 0.9% below the long-run average.

Straddling the commercial and consumer economies is housing. Consistent with the negative residential fixed-investment data from 2Q24 GDP, the housing economy continues to struggle. Based on SAAR (seasonally adjusted annual rate), and both new and existing home sales are running at about 60% of peak pandemic levels.

At the same time, pent-up millennial demand for housing continues to intensify. Aging boomers have been locked into too-large homes by low mortgage rate. The plunge in interest rates accompanying the summer stock selloff could have a silver lining if it unlocks the housing market.

Given the realities in the present environment, Director of Economic Research Chris Graja, CFA, lowered the Argus forecast for 2024 GDP growth to 1.7%, from a prior 2.0%.

ECONOMIC & MARKET COMMENTARY (CONT.)

Looking at the cadence for the year ahead, Chris expects quarterly GDP to grow in the sub-2% range across all four quarters with some modest strengthening into 4Q24. Our expectations for 2025 GDP growth are in the 2% range.

Given the overhang of high prices and interest rates, and with the consumer weary from years of inflation, our GDP growth forecasts for 2024 and 2025 are likely to remain volatile. We also continue to believe the U.S. economy can avoid recession in 2024, as it did in 2023 and 2022.

The central bank started its rate-hiking campaign in March 2022 well behind the inflation curve. More than five percentage points later, the Fed halted in July 2023. At its mid-September 2024 FOMC meeting, the Fed voted to hold the fed funds rate steady at the 5.25%-5.50% tendency, as it has done for eight straight meetings since July 2023.

The market mood has certainly changed, however. Weariness with inflation has given way to fear of recession. At the beginning of the central-banking rate-hiking campaign, investors feared that the fed had “gotten behind the curve” in its fight against inflation. With inflation down to within a point of the Fed’s 2% target, that now seems like the last war. Investors once again fear that the Fed has “gotten behind the curve,” this time in its need to cut rates before the U.S. tips into recession.

In July, the FOMC statement pushed back against recession fears, noting that economic activity “continues to expand at a solid pace.” Although employment growth has moderated, the statement continued, unemployment has moved up but remains low. In May, the FOMC was concerned about “...lack of further progress toward the Committee’s 2 percent inflation objective.” The language in the June FOMC report, by contrast, noted “modest further progress toward the Committee’s 2 percent inflation objective.” In July, the Fed echoed its “further progress” commentary.

The statement did acknowledge uncertainty in the economic outlook, and stated the Fed was “attentive to risks on both sides of its dual mandate.” The Fed’s dual mandate is to keep inflation around 2% and prevent unemployment from spiking higher.

The Fed’s preferred inflation gauge, the core PCE price index, rose 0.2% in June and was up 2.6% year over year. That matched the May annual number, which was the lowest annual rate of change the core PCE price index since March 2021 (and also the first time in the current economic cycle that inflation topped the Fed’s 2% target).

The core PCE data confirmed inflation inputs from June CPI reported earlier in July. The June all-items CPI declined 0.1% on a month-over-month basis from May; on an annual basis, June all-items CPI was 3.0%. Core CPI was up 0.1%, and the annual change in core CPI was 3.3%; both beat the 3.5% consensus call while ticking down from May.

Goods inflation has come off markedly, while inflation in services is still stubbornly high. Overall improvement in inflation has been allowing market rates of interest to move down from spring peaks, but the selloff in stocks on recession fears has been the main rate driver this summer.

The 10-year Treasury yield was 3.75% as of the first week of August, down from 4.29% at the end of June and the 4.63% level as recently as the end of April. The two-year Treasury yield was 3.88% as of the first week of August, down from 4.70% as of end of June and the peak level of 4.96% as of end of April.

The two-year Treasury yield maintained its roughly 40 basis point (bps) premium to the 10-year yield for nearly two years. That premium has been whittled down to 12 bps in the current stock rout. Our forecasts continue to call for twos-10s inversion to end in the first quarter of 2025. We also see the potential for twos-10s inversion to end during 2024.

Fears of recession have prompted calls for the Fed to cut interest rates immediately. Argus Fixed Income Strategist Kevin Heal continues to model two quarter-point rate cuts in 2024: once at the September meeting prior to the election, and again at the December meeting post-election. Each cut is expected to be 25 basis points, bringing the Fed’s central tendency to the 4.75%-5.00% level by year-end. But the situation has become dynamic, to say the least.

As shown in the CME FedWatch tool, the probability of a 25-bps cut at the September FOMC meeting prior to July nonfarm payrolls was 70%; and the probability of a 50-bps cut at the September meeting was 30%. After the bleak jobs report, the probabilities flip-flopped to 70% for a 50-bps cut and 30% for a 25-bps cut. By August 5, 2024, the CME FedWatch tool indicated a 98% probability that the Fed would cut interest rates by 50 bps at its September meeting.

First-quarter 2024 earnings outpaced expectations, but were below the double-digit growth that prevailed in the pandemic and immediate post-pandemic era. Second-quarter 2024 earnings from continuing operations are up high-single-digit to low-double-digit percentages, according to our vendor survey. Along with GDP growth, second-quarter earnings represent a bulwark against growing recession concerns.

With about three-quarters of S&P 500 component companies having reported results, second-quarter 2024 earnings from continuing operations are up 11.5% compared with 2Q23 EPS, according to FactSet, and up 12.9% according to Refinitiv. According to Bloomberg, 2Q24 earnings are up 12.5% on a share-weighted basis and 16.5% on a market-cap-weighted basis. This premium of market-cap-weighted to share-weighted EPS growth is reflective of the earnings outperformance of large-capitalization companies compared with small- and mid-caps.

ECONOMIC & MARKET COMMENTARY (CONT.)

The average EPS decline for the negative-earnings group, which is heavily weighted in Energy, Materials, and Real Estate, is 16%. For the companies reporting positive EPS, average earnings growth is a robust 22%. A key reason investors are optimistic about second-half 2024 earnings growth is that the negative drag from Energy, Materials, and Real Estate is expected to diminish in 3Q24 and potentially reverse in 4Q24.

At the sector level, the strongest earnings growth is coming from Financial, Information Technology, and Utilities — all up in mid-teen percentages year over year. Other sectors reporting positive EPS growth include Communication Services, Healthcare, Consumer Discretionary, Consumer Staples, and Industrials, in descending order. As noted, Energy, Materials, and Real Estate are all down; Materials is off in high-single digits, while Energy and Real Estate earnings are down 20%-21% from a year earlier.

Second-quarter earnings are coming in about in line with Argus expectations. For 2Q24, Argus continues to model high-single-digit continuing-operations EPS growth for S&P 500 component companies. We see a higher likelihood that our forecast misses on the upside than on the downside. In other words, once all the component companies are tallied, we are more likely to see low-double-digit EPS growth for 2Q24 than we are to see mid-single-digit EPS growth.

According to Argus President John Eade, our stock-bond barometer is near equilibrium. Given declining inflation growth and interest rates along with our forecast for high-single-digit EPS growth for 2024 and 2025, coupled with the July-August selloff, stocks appear favorable at current levels.

A key risk to valuations would be earnings growth failing to meet the market's targets and/or inflation or interest rates ticking higher. Either of those factors would result in elevated valuations, but represent just modest risks at present.

Domestic and Global Markets

Growth stocks sectors began to pull away from the broad market in May and extended that leadership in June. That was all turned on its head late in July, and August has so far extended the severe rotation away from growth leaders and toward stocks seen as safer havens.

For the first quarter of 2024, the S&P 500 led the growth-heavy Nasdaq. But that changed in 2Q24 and, as of mid-year, the Nasdaq was three point ahead of the S&P 500. The indexes have flip-flopped once more, with the S&P 500 up 13% while the Nasdaq is up just over 12%.

In a clear sign of leadership change, Wilshire Large Cap Growth has seen its premium to Wilshire Large Cap Value shrink to just seven percentage points; in May and June, this premium was in double-digit percentage point.

With investors selling the giants, small-caps have narrowed their underperformance. The Russell 2000 was up about 5% in early August, after being up 2% at mid-year. The DJIA is also closing the gap and is up around 7% for the year.

The Barclays Bloomberg U.S. Bond Index has also had a remarkable turnaround, rising 3.1% year to date after being down 1.7% at mid-year. We believe stocks can rally from here, given positive fundamentals in GDP and earnings. We do not expect bond yields to rise much from current levels, given that the Fed is likely to cut interest rates several times by year-end.

Sector breadth had deteriorated at mid-year 2024 while remaining better than that at mid-year 2023. The July-August selloff has brought growth leadership down to earth while giving some formerly out of favor sectors room to catch up.

Communication Services and Information Technology were both up in the high-20% range at mid-year. Both sectors surrendered six to nine points of appreciation in July and early August. Multiple sectors -- including Financial, Utilities, and Staples -- are currently beating or matching the index's 2024 performance. Industrial, Materials and Energy are up in mid- to high-single digits year to date. No sector is negative, and that was not true for most of 2024.

The Consumer Discretionary sector, one of the top three performers in 2023, was tenth among 11 sectors in 2024 to date. Inflation has continued to weigh on consumer spending, although second-quarter GDP suggests that this pressure may be abating.

Sector weights as of the end of 1Q24 were meaningfully changed from one year earlier, when the shift from cyclical and defensive sectors into growth sectors was just getting underway. Growth returned to favor in 2Q24, and June ended with the Information Technology sector representing a highest-ever 32.4% weighting within the S&P 500.

In the third quarter, July started strong and multiple indices reached all-time highs at mid-month. In the second half of July, the market plunged with particular weakness in the growth sectors that had led the market for 18 months.

Notable sector losers in July were Information Technology, down 1.0 percentage point from its peak reading of 32.4% at the end of June; and Communication Services, down 0.4% at July-end from 9.3% at the end of June. Sectors that packed on the weight during turbulent July trading most notably included financial, up 0.7 percentage point in just a month as banks posted favorable earnings. Healthcare and Industrial sector weights also increased month over month in July. The rotation that was underway in July has intensified in August to date.

Our recommended sector weightings are as follows:

-- Overweight: Financial Services, Technology, Healthcare, and Communication Services.

ECONOMIC & MARKET COMMENTARY (CONT.)

-- Market Weight: Consumer Discretionary, Utilities, Industrials, Energy, and REITs.

-- Underweight: Consumer Staples and Materials.

Like the U.S. market, global stocks did better in 2023 than they did in 2022; and most carried that momentum into mid-year 2024. Global stocks have also been impacted by the summer 2024 sell-off. Asia has been particularly weak, but this region led the market at mid-year and still remains near the top. Compared to 2023, we continue to see some changes in international stock-market leadership in 2024.

On average, our composite of global bourses is up about 5% year-to-date in 2024, after being up 7% the first half of the year. Currently, the U.S. is leading in 2024; but negative performances by Brazil and Mexico are weighing on Americas performance.

In terms of our themes, mature economies are in front in 2024 with a 9% gain; this theme also won 2023 with a 22% gain. Asian markets are up 8%, as rising India and Japan are joined by China. Americas markets (including U.S., Brazil, Mexico and Canada) are up 2% in 2024 after rising 20% in 2023. BRICs-minus-Russia is up 2% in 2024 after also lagging in 2023. Resources economies (down 2%) have not lived up to last year's 18% gain.

Conclusion

Given its strong first-half start, the stock market is still up year to date. Recent turmoil is consistent with ongoing uncertainty. The nature of the presidential election changed dramatically over the past month. The Fed appears to be teeing up 50 bps or possibly even 75 bps of rate cuts by year-end. But no cuts appear likely until mid-September, leaving investors dangling.

A double-digit win as of mid-year has predicted a much better-than-average full-year gain for stocks. Such strength at mid-year is consistent with an the average full-year gain for the S&P 500 of more than twice the market's average gain in all years since 1980.

That statistic is little consolation at present, when everything that worked for the past year and a half suddenly seems to be falling. The distraction of the Olympics is ending, and the U.S. is about to go full-bore into election season. The jobs economy is notably decelerating.

Amid the uncertainty, we will continue to stress the so-far solid fundamentals in the economy and in corporate earnings. At the stock level, we would maintain our focus on high-quality, BUY-rated companies in Argus coverage with blue chip finances, seasoned leadership teams, and sustainable advantage in key end-markets.

Jim Kelleher, CFA,
Director of Research

ECONOMIC TRADING CALENDAR

Release: **PPI Final Demand**

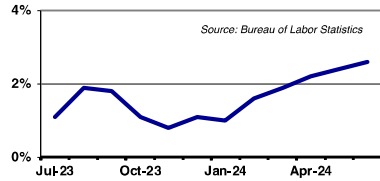
Date: 8/13/2024

Month: July

Previous Report: 2.6%

Argus Estimate: 1.8%

Street Estimate: NA



Release: **PPI ex-Food & Energy**

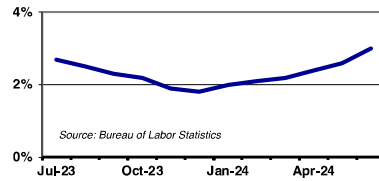
Date: 8/13/2024

Month: July

Previous Report: 3.0%

Argus Estimate: 2.4%

Street Estimate: NA



Release: **Consumer Price Index**

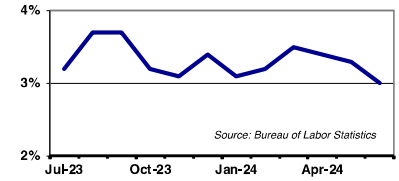
Date: 8/14/2024

Month: July

Previous Report: 3.0%

Argus Estimate: 3.0%

Street Estimate: NA



Release: **CPI ex-Food & Energy**

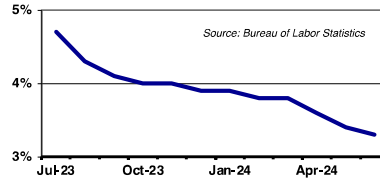
Date: 8/14/2024

Month: July

Previous Report: 3.3%

Argus Estimate: 3.3%

Street Estimate: NA



Release: **Industrial Production**

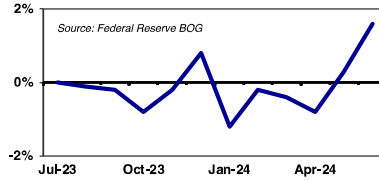
Date: 8/15/2024

Month: July

Previous Report: 1.6%

Argus Estimate: 0.3%

Street Estimate: NA



Release: **Capacity Utilization**

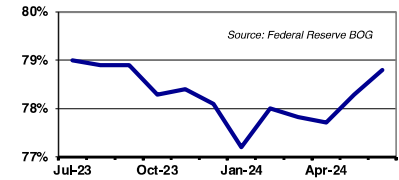
Date: 8/15/2024

Month: July

Previous Report: 78.8%

Argus Estimate: 78.6%

Street Estimate: 78.6%



Release: **Retail Sales**

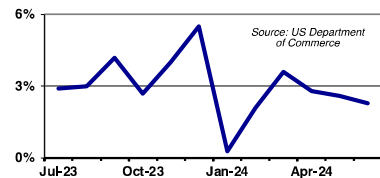
Date: 8/15/2024

Month: July

Previous Report: 2.3%

Argus Estimate: 2.4%

Street Estimate: NA



Release: **Retail Sales ex-autos**

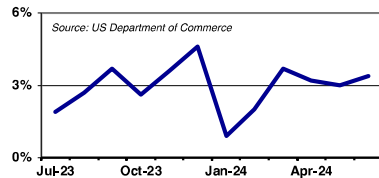
Date: 8/15/2024

Month: July

Previous Report: 3.4%

Argus Estimate: 1.8%

Street Estimate: NA



Release: **Business Inventories**

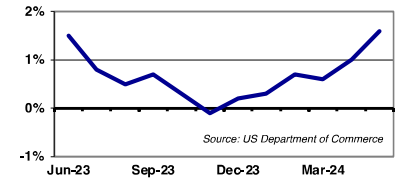
Date: 8/15/2024

Month: June

Previous Report: 1.6%

Argus Estimate: 1.3%

Street Estimate: NA



Previous Week's Releases and Next Week's Releases on next page.

ECONOMIC TRADING CALENDAR (CONT.)

Release: **Import Price Index**

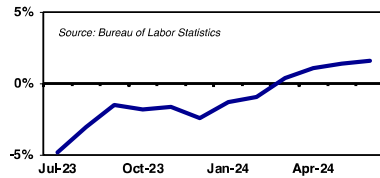
Date: 8/15/2024

Month: July

Previous Report: 1.6%

Argus Estimate: 1.2%

Street Estimate: NA



Release: **Housing Starts**

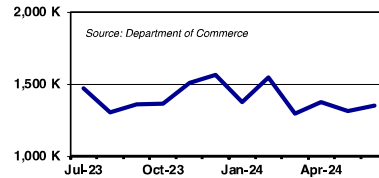
Date: 8/16/2024

Month: July

Previous Report: 1,353 K

Argus Estimate: 1,300 K

Street Estimate: 1,373 K



Release: **U. of Michigan Sentiment**

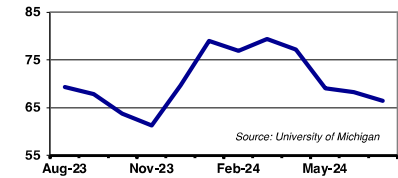
Date: 8/16/2024

Month: August

Previous Report: 66.4

Argus Estimate: 63.0

Street Estimate: NA



Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
5-Aug	ISM Services Index	July	48.8	50.0	NA	51.4
	Total Vehicle Sales	July	15.18 mln.	16.00 mln.	NA	15.82 mln.
6-Aug	Trade Balance	June	-75.1%	-71.0%	NA	NA
8-Aug	Wholesale Inventories	June	-0.5%	0.2%	NA	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
19-Aug	Leading Index	July	-0.2%	NA	NA	NA
22-Aug	Existing Home Sales	July	3.89 Mln.	NA	NA	NA
23-Aug	New Home Sales	July	617 K	NA	NA	NA

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