CHIEF INVESTMENT OFFICE

Capital Market Outlook

January 27, 2020

All data, projections and opinions are as of the date of this report and subject to change.

IN THIS ISSUE

- **Macro Strategy**—We think business investment spending could grow at a low- to mid-single-digit pace in the U.S. in 2020 despite headwinds from the retail, energy and air transportation sectors. Technology spending should likely continue to lead the way and gain share. Moderate growth in domestic consumer spending and housing plus a slight pickup in global growth should reinforce business confidence.
- **Global Market View**—The world is more disorderly than orderly. It's a jungle out there, in other words, giving fright to investors. Yet in the hierarchy of the jungle, investors must not forget that the U.S. is an economic silverback—or the older and dominate economic power of the planet. Stay long the American gorilla.
- **Thought of the Week**—Gold is at a technical crossroads, in our view. While a trifecta of bullish catalysts has reduced demand for the yellow metal, we see long-term reasons to maintain a position in this portfolio diversifier.
- **Portfolio Considerations**—We still remain underweight international developed equities overall but cut the large underweight approximately in half. We also raised emerging markets (EM) equities slightly to neutral from a slight underweight. On the back of these adjustments, we still remain overweight the U.S. and maintain our overall overweight in equities.

MACRO STRATEGY

Jonathan Kozy
Senior Vice President and
Senior Macro Strategy Analyst

GLOBAL MARKET VIEW

Joseph P. Quinlan
Managing Director and
Head of CIO Market Strategy

Lauren J. Sanfilippo
Vice President and
Market Strategy Analyst

THOUGHT OF THE WEEK

Rodrigo C. Serrano, CFA®
Director and
Senior Investment Strategist

Data as of 1/27/2020 and subject to change.

MACRO STRATEGY

2020 Outlook for U.S. Business Investment Spending

Jonathan Kozy, Senior Vice President and Senior Macro Strategy Analyst

Painting calendar year 2019 broadly as a year with weak capital expenditures (CAPEX) is misleading. Similarly, the blanket statement that U.S. CAPEX is likely to be weak in 2020 because of issues in the energy, retail and air transportation sectors, for example, ignores a major structural shift in U.S. business spending dynamics. More than half of business investment spending now comes from technology spending, including both information processing equipment and intellectual property products (IPP). The latter (IPP) has been consistently growing at a high-single-digit pace and makes up more than a third of total business spending (Exhibit 1). This has been at the expense of more traditional areas of CAPEX like retail and energy structures. For example, fixed investment in multimerchandise shopping is about one-quarter of what it was before the financial crisis. Nominal tech investment at around $1.5 trillion dollars is well over twice the size of structures investment in nominal terms. Shopping malls are out. The cloud is in.

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Are Not FDIC Insured	Are Not Bank Guaranteed	May Lose Value

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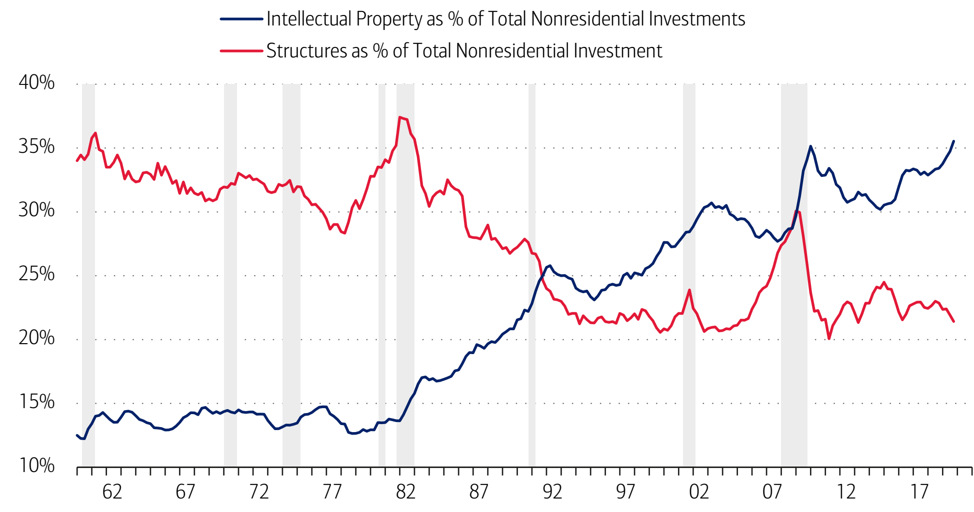
Exhibit 1: Not Your Grandma's CAPEX.



Sources: BEA/Haver Analytics. Data as of 11/27/2019.

A key reason for maintaining our mildly positive outlook for CAPEX in the U.S. is the Federal Reserve's (Fed's) pivot to lower-for-longer interest rates. The interest rate effect should work through a number of channels. Directly, firms are already seeing lower borrowing rates as policy rates have moved lower and spreads have narrowed. This was timely as nonfinancial corporate balance sheets look "late cycle" in terms of leverage ratios. From a corporate margin perspective, lower interest rates help to offset the pressure on margins from a tight labor market and moderate wage growth. More indirectly, lower rates have had a positive impact on housing and other interest rate sensitive sectors that should ultimately lead to higher levels of business spending via the "accelerator effect."

The stabilization and potential for a pickup in global growth is also a reason for optimism. Firms invest for the future in response to past demand but also in anticipation of future demand. For multinational firms, much of this demand comes from outside the U.S. According to BofA Global Research, 24 of the 39 central banks covered cut rates in 2019, a synchronized reflation effort. The lagged effects of this global monetary easing should support global growth and inflation in 2020. They also see a strong case for fiscal expansion in a number of countries. With both real global gross domestic product (GDP) growth and global inflation expected to pick up, the acceleration in global nominal GDP should mean multinational firms see stronger sales growth. This is a positive for CAPEX.

Surveys of capital spending expectations have been mixed but are showing some improvement. Specifically, small business surveys that are more domestically focused continue to show that businesses are poised to put money to work in 2020. The National Federation of Independent Business (NFIB) survey showed a net 25% of respondents are reporting that "now is a good time to expand." This is not far off the cycle high of 34% and is near the previous cycle high of 27%. Regional Federal Reserve survey data on CAPEX expectations have been weaker, but ticked higher in the last few months. Surveys of larger companies, such as the Duke/CFO Survey, were weak for much of 2019 as global growth was weak, but picked up in the fourth quarter. The Duke survey showed that expectations for growth in capital spending over the next twelve months rose from 0.6% in the third quarter to 4.6% in the fourth quarter. If global growth picks up as we expect, sentiment should improve.

That said, there are clear areas of CAPEX weakness in the U.S. that could likely keep overall growth rates muted. Airplanes are expensive and make a considerable contribution to U.S. economic growth and CAPEX. Boeing's decision to halt production of the 737 Max will weigh on CAPEX as aircraft sales are booked in GDP when they are shipped. No shipments of aircraft means no contribution to GDP. If the problem gets worse, the air transportation

drag from air transportation on overall CAPEX will be more significant. The issue should also create quarterly noise as aircraft orders, inventories and shipments become more volatile. Aircraft inventory has risen as shipments have stopped but, in an optimistic scenario, will likely be drawn on if shipments of the 737 Max resume. It is also difficult to discern whether the lease versus buy decisions will change for U.S. air carriers. If you throw trade issues and the potential for tariffs on the table, the aircraft industry will be a major source of uncertainty for the U.S. economy and CAPEX.

Business spending on energy equipment and structures like shopping malls is also likely to remain weak. While oil prices have risen some alongside geopolitical risk, the level of prices is not high enough to warrant U.S. producers investing heavily in future production. It is worth noting that energy is around 5% of total CAPEX in the U.S. While weakness in business spending in this sector is likely to make the headlines, its contribution to overall CAPEX pales in comparison to that of technology spending.

What about the impact of implemented tariffs and trade policy uncertainty more broadly? In the Institute for Supply Management's (ISM's) Semiannual Economic Forecast for 2020 (released in December 2019), they specifically asked companies, "What is the primary reason capital spending plans changed?" Perhaps surprising to some, 38.4% of the respondents answered that "Domestic economic conditions" were the primary reason. This compares with 3.4% of respondents choosing "Implemented tariffs" and 7.5% for "Uncertainty surrounding trade policy." Bottom line: The demand growth backdrop is most important. As long as housing and consumer spending remain on track in 2020 as we suspect they will, we think conditions are in place for business investment spending to register positive growth in 2020.

The Second Half of the Chessboard[1]

Importantly, tech spending will likely continue to garner a larger piece of the CAPEX pie, in our view. In Ray Kurzweil' 2000 book *The Age of Spiritual Machines: When Computers Exceed Human Intelligence*, he illustrates the power of exponential growth by telling the story of how chess was invented. In the story, an inventor tells the emperor he would like to be rewarded with rice to feed his family and proposed that the emperor put one grain of rice on the first square, two grains on the second square, four grains on the third square and so on, until each square receives twice as many grains as the previous square. Halfway through the chessboard, there are 4 billion grains of rice. While perhaps an exaggerated exercise for prognosticators of business investment spending, *we are in the second half of the chess board for technology innovation and processing*, where the numbers are getting too large for humans to register. Technology spending continues to be the driver of future productivity growth for the U.S. economy over the longer term as output increasingly depends less on physical equipment and structures and more on IPP. In short, technology spending is the freight train that will most likely continue to drive overall CAPEX growth.

GLOBAL MARKET VIEW

America: An Economic Silverback in a Jungle of a World

Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy

Lauren J. Sanfilippo, Vice President and Market Strategy Analyst

It's a jungle out there.

The liberal international order of the past seven decades is fading. Deglobalization is gaining traction. Global supply chains are fracturing, as is the global internet. The United States and China, once strategic competitors, are now ironclad foes. The Middle East is a

[1] Bynjolfsson, Erik and Andrew McAfee. *The Second Machine Age: Work, Progress, and Prosperity in a Time of Brilliant Technologies*. W.W. Norton & Company.

boiling cauldron of strife and instability. Populism, nationalism and authoritarianism—this triad is undermining the global post-WWII order that handsomely rewarded investors with solid long-term investment returns.

All of the above, of course, is anathema to the capital markets. Investors prefer open borders, free trade, unfettered capital flows, competition yet cooperation, and multilateralism. They prefer, quite naturally, the world as it used to be, not as it is: an unruly jungle that has caused a spike in geopolitical risks over the past few years, with the U.S.-Iran confrontation just the latest example.

But that said, and acknowledging that yes, it's a jungle out there, it's important for investors to realize where America stands amid the planet's wild habitat. In the hierarchy of the jungle, think of the United States as a silverback—or the older, stronger and domineering economic beast of the planet, challenged by up-starts but still top gorilla.

Here are some key characteristics of America as the world's dominant economic silverback.

First, America remains the largest and most productive economy in the world. With just 4.5% of the global population, the U.S. accounts for over 15% of global GDP on a purchasing power parity basis. In nominal dollars, the U.S. economy is more than $7 trillion larger than China's. Never have so few people produced so much output. Since the financial crisis of 2008/09, U.S. output has increased by roughly $7 trillion; according to the latest figures from the Department of Commerce, total U.S. GDP was over $21 trillion in the fourth quarter of last year. *The bottom line: No other economy in the world comes close to the productive capacity of the United States.*

Second, contrary to popular lore, the U.S. remains a global manufacturing superpower. According to recent data from the United Nation's Development Organization, of the 22 manufacturing categories outlined by the U.N., the United State ranked first in terms of global share of output in 12 categories. The top ranking of the U.S. runs the gamut from paper products to motor vehicles to aircraft. And that's not all: The U.S. tallied second in six other categories. Combined, America ranked first and/or second in 18 out of the 22 sectors, underscoring the manufacturing breadth and competitiveness of American manufacturing. *The bottom line: America's manufacturing base is currently alive and extremely well.*

Third, the U.S. remains among the largest exporters of goods and services in the world. Currently, U.S. monthly goods and services exports are clipping along at $209 billion (November 2019), a monthly tally only China comes close to. What the U.S. exports in a month is greater than what most countries export in a year. Whether it's soybeans or spacecraft, propane or plastics, accounting services or automobiles, the breadth of U.S. exports is virtually unparalleled. *The bottom line: Very few nations exhibit more export vigor than the United States.*

Fourth, the U.S. remains a magnet for foreign capital. Indeed, no country attracts as much overseas cash as the U.S. thanks to myriad attributes, including a vast and wealthy consumer market, a large skilled labor pool, a transparent rule of law, and, more recently, cheap energy costs and low corporate taxes. The upshot, the U.S. remains a magnet for other peoples' money. Foreign holdings of U.S. securities (U.S. Treasurys, corporate bonds, government agencies and equities) totaled $19.5 trillion in the third quarter of 2019, up over 75% from the start of 2009. Meanwhile, over the 2000–'19 period, the United States attracted over 17% of total global foreign direct investment, light years ahead of second place China (8%). *The bottom line: Global demand for U.S. assets remains strong and robust, reflecting, in large part, America's economic strengths.*

Fifth, America remains home to the world's top global brands. Despite intense global competition, America's global brand presence has become stronger over the past few

years. Of the top 10 global brands in 2019, eight of 10 were American, according to a report by BrandZ, which ranks the top 100 most valuable global brands. *The bottom line: Brands carry intangible value, with no country as brand savvy as America.*

Sixth, while China has made significant technological strides over the past decade, the U.S. remains the world's technology leader owing to the nation's risk-taking, not-afraid-to-fail entrepreneurial culture that underpins America's leadership in both technology and innovation. America is the largest market in the world for information technology (IT) spending on hardware, software and services, according to International Data Corporation estimates, and it remains the global leader in social media and content. *The bottom line: America remains a global innovation giant, which is one reason why the NASDAQ has posted returns in excess of 500% since March 2009 and is presently hitting all-time highs.*

Seventh, the top-ranked universities in the world are in the U.S.; indeed, 29% of the universities in the Quacquarelli Symonds World Rankings' top 100 universities for 2020 were located in America; five out of the top 10, and 10 out of the top 20, were American universities. *The bottom line: America remains a global leader in producing skilled/productive human capital.*

Eighth, while the "Made in America" financial crisis was touted by many as the death knell of the U.S. dollar, nothing of the sort has occurred over the past few years. The greenback remains king for now—the world's unchallenged world reserve currency, accounting for 61.8% of global central bank reserves as of the third quarter of 2019, according to the International Monetary Fund. For second-place euro, the currency's share of central bank holdings plunged from 28.0% in mid-2009 to 20% in Q3 2019. *The bottom line: The global economy still pivots around the greenback, an "exorbitant privilege" the United States should continue to enjoy over the medium term.*

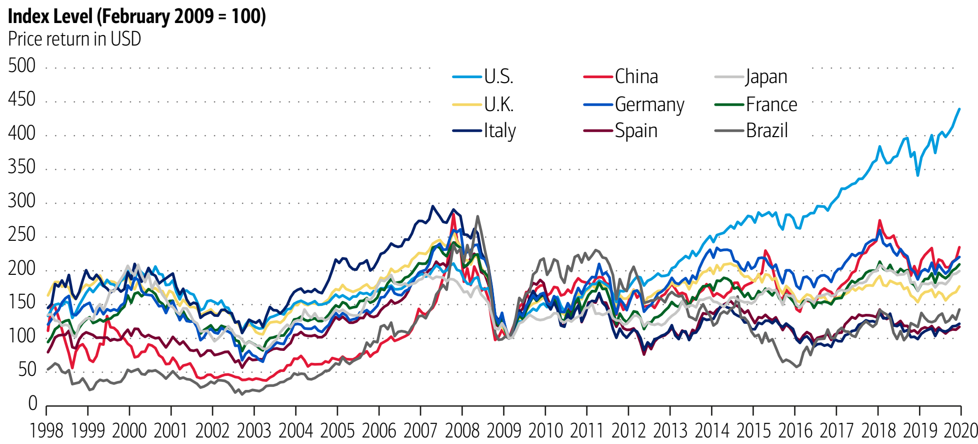
Ninth, the U.S. still ranks as one of the most competitive economies in the world. While America's competitiveness ranking slipped in the years following the financial crisis, the United States has found its way back into the global elite, ranking second in the latest competitiveness survey from the World Economic Forum. Only Singapore ranked higher. *The bottom line: Competitiveness matters—it drives and dictates economic development, prosperity and ingenuity on a relative and absolute basis; the U.S. is positioned to remain among the world's most competitive economies.*

Finally, there have been a few surprises in the post-crisis period but none bigger and more significant than America's energy revolution. And what a revolution. In late 2019, the United States emerged as the largest oil producer in the world, outproducing even Saudi Arabia and Russia thanks to the spike in production as a result of horizontal drilling and hydraulic fracturing, or fracking. The U.S. is also a leading producer of natural gas. *The bottom line: America is an energy giant, a dynamic that reflects the risk-taking entrepreneurial nature of the U.S. corporate sector and the technological prowess that sets the U.S. apart from the rest of the world.*

Investment summary

Betting against the U.S. corporate sector has been a losing proposition for nearly a decade (Exhibit 2). Distracted by divisive politics and a 24/7 negative news cycle, many investors have been blinded to the underlying strengths and pillars of the U.S. economy. Now they are fearful of a world without a leader, a planet without a hierarchy. The jungle.

Exhibit 2: Global Equity Markets: The U.S. Shines.



Source: Bloomberg. Data through December 2019.

While we are not oblivious to the multiple challenges in front of America—a crumbling physical infrastructure, burdensome entitlement expenditures, the rising cost to service America's debt, an unwieldy healthcare system, anti-trade and immigration sentiment—America's multiple strengths give it ample opportunity/ammunition to address its weaknesses. Stay long America—the economic silverback in a jungle of a world.

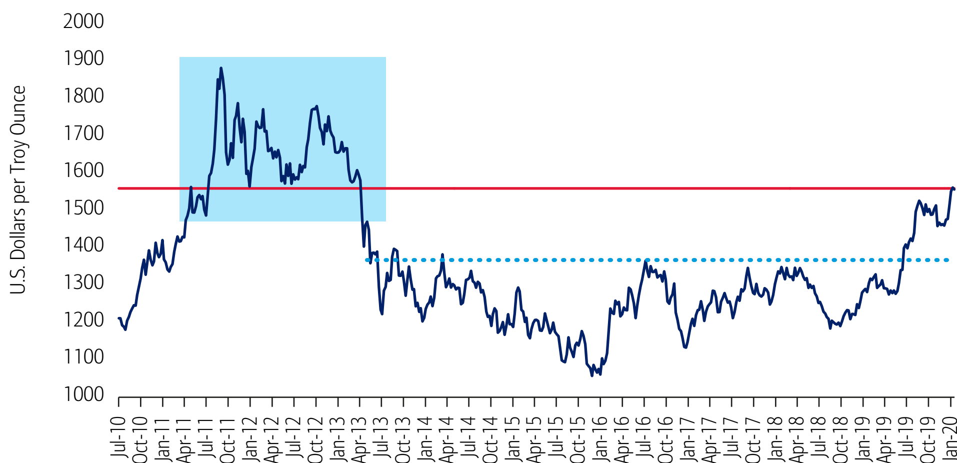
THOUGHT OF THE WEEK

At a Golden Crossroads

Rodrigo C. Serrano, CFA® Director and Senior Investment Strategist

Over the past three weeks, gold's price has straddled $1,560 per troy ounce, a notable technical battle zone. Marking a crossroads, this price area acted as resistance in May 2011, before the metal's final surge to its all-time high at around $1,900. It then acted as support until April 2013, when its violation triggered a fall of more than 30% (see shaded box in Exhibit 3).

Exhibit 3: After Breaking Through Initial Resistance (Dotted Line) Gold Stands at Another Crossroads.



Sources: Bloomberg; Chief Investment Office. Data as of January 24, 2020.

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Today, the yellow metal's struggle to clear this price band to the upside coincides with a bullish trifecta of developments. A U.S.-China "Phase I" trade deal has been signed. Decisive progress for the U.S.-Mexico-Canada trade accord has been made. The election of Prime Minister Boris Johnson in the United Kingdom has removed the concern of a near-term hard Brexit. Together these events have helped reduce uncertainty. Meanwhile, subdued inflation has afforded global central banks the leeway to stimulate. Recent new all-time highs in the MSCI All Country World Index indicate expectations for green shoots for global economic growth to germinate, in line with the Chief Investment Office's (CIO's) base case.

Versus the S&P 500 and 10-year U.S. government bond, gold sports a 30-year correlation[2] of -0.03 and +0.09 respectively. These stats underscore our view of the precious metal as a portfolio diversifier, a quality we favor, particularly in light of impressive performance in both equity and fixed income returns last year. Despite greater optimism and stretched valuations in certain equity markets, we remain cognizant of the risks that may upset the apple cart. Growing discords over Huawei, Taiwan, the South China Sea, Hong Kong and North Korea may wobble the U.S.-China trade truce. Tensions in the Middle East remain elevated. In the U.S., we expect election-related uncertainty to pick up, while a trade spat with the European Union (EU) can't be ruled out. Even wildcards, such as a prolonged bout of the recent Coronavirus in China, could trigger a return of uncertainty, dampening animal spirits, weighing on the global recovery, and benefitting relative safe havens such as gold.

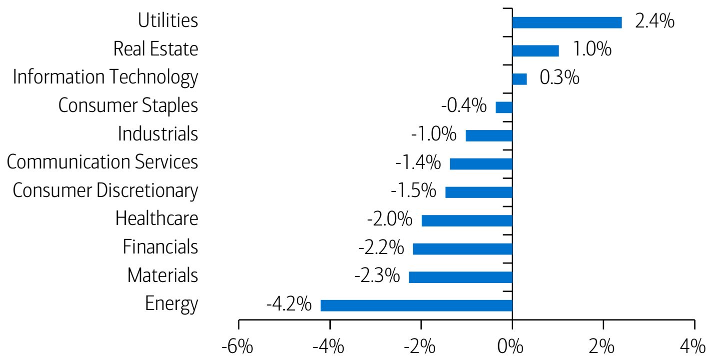
Notwithstanding extraordinary policy support in an adverse scenario, central banks are still contending with low inflation. Reviews of existing policy frameworks at the Fed and the European Central Bank may augur more unconventional measures to spur it. In the U.S., consider this alongside large U.S. fiscal and trade deficits. Gold may prove its worth as a store of value in this case.

[2] Correlation captures the performance relationship between one investment and another. A value of +1.00 or -1.00 indicates a perfect positive or negative correlation respectively, in line with or opposite the comparative security.

Equities

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
DJIA	28,989.73	-1.2	1.7	1.7
NASDAQ	9,314.91	-0.8	3.8	3.8
S&P 500	3,295.47	-1.0	2.1	2.1
S&P 400 Mid Cap	2,065.15	-1.4	0.2	0.2
Russell 2000	1,662.23	-2.2	-0.3	-0.3
MSCI World	2,395.31	-0.8	1.6	1.6
MSCI EAFE	2,044.92	-0.6	0.4	0.4
MSCI Emerging Markets	1,119.39	-2.4	0.5	0.5

S&P 500 Sector Returns



Fixed Income[1]

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
Corporate & Government	2.05	1.0	1.6	1.6
Agencies	1.76	0.6	0.9	0.9
Municipals	1.53	0.4	1.4	1.4
U.S. Investment Grade Credit	2.14	0.8	1.3	1.3
International	2.66	1.1	1.8	1.8
High Yield	5.29	-0.4	0.3	0.3

	Current	Prior Week End	Prior Month End	2019 Year End
90 Day Yield	1.49	1.51	1.49	1.49
2 Year Yield	1.49	1.56	1.57	1.57
10 Year Yield	1.68	1.82	1.92	1.92
30 Year Yield	2.13	2.28	2.39	2.39

Commodities & Currencies

		Total Return in USD (%)		
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	164.58	-3.1	-4.3	-4.3
WTI Crude $/Barrel[2]	54.19	-7.4	-11.3	-11.3
Gold Spot $/Ounce[2]	1,571.53	0.9	3.6	3.6

Currencies	Current	Prior Week End	Prior Month End	2019 Year End
EUR/USD	1.10	1.11	1.12	1.12
USD/JPY	109.28	110.14	108.61	108.61
USD/CNH	6.93	6.87	6.96	6.96

Source: Bloomberg, Factset.Total Returns from the period of 1/20/20 to 1/24/20. Bloomberg Barclays Indices.[1] Spot price returns.[2] All data as of the 1/24/20 close.
Past performance is no guarantee of future results.

Asset Class Weightings (as of 1/9/2020)

	Under-weight		Neutral		Over-weight
Global Equities	•	•	•	● (green)	•
U.S. Large Cap Growth	•	•	•	● (green)	•
U.S. Large Cap Value	•	•	•	● (green)	•
U.S. Small Cap Growth	•	•	•	● (green)	•
U.S. Small Cap Value	•	•	● (yellow)	•	•
International Developed	▶	● (orange)	•	•	•
Emerging Markets	•	▶	● (yellow)	•	•
Global Fixed Income	•	● (orange)	•	•	•
U.S. Governments	•	● (orange)	•	•	•
U.S. Mortgages	•	•	● (yellow)	•	•
U.S. Corporates	•	•	● (yellow)	•	•
High Yield	•	● (orange)	•	•	•
U.S. Investment Grade Tax Exempt	•	•	● (yellow)	•	•
U.S. High Yield Tax Exempt	•	● (orange)	•	•	•
International Fixed Income	● (red)	•	•	•	•
Alternative Investments*	see CIO Asset Class Views				
Hedge Funds			●		
Private Equity			|		
Real Assets			●		
Cash					

* Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to pre-qualified clients.

Economic and Market Forecasts (as of 1/24/20)

	Q2 2019A	Q3 2019A	Q4 2019A	2019A	Q1 2020E	2020E
Real global GDP (% y/y annualized)	–	–	–	2.9	–	3.2
Real U.S. GDP (% q/q annualized)	2.0	2.1	2.2*	2.3*	1.0	1.7
CPI inflation (% y/y)	1.8	1.8	2.0	1.8	2.4	2.4
Core CPI inflation (% y/y)	2.1	2.3	2.3	2.2	2.3	2.4
Unemployment rate (%)	3.6	3.6	3.5	3.7	3.5	3.6
Fed funds rate, end period (%)	2.40	1.90	1.55	1.55	1.63	1.63
10-year Treasury, end period (%)	2.01	1.66	1.92	1.92	1.80	1.80
S&P 500 end period	2942	2977	3231	3231	–	3300
S&P earnings ($/share)	41	42	41.5*	164.1*	40.5	177
Euro/U.S. dollar, end period	1.14	1.09	1.12	1.12	1.10	1.15
U.S. dollar/Japanese yen, end period	108	108	109	109	110	103
Oil ($/barrel, avg. of period, WTI**)	60	56	57	57	59	57

The forecasts in the table above are the base line view from BofA Global Research team. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts.

Past performance is no guarantee of future results. There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

A = Actual. E/* = Estimate. S&P 500 represents a fair value estimate for 2020. **West Texas Intermediate

Sources: BofA Global Research; GWIM ISC as of January 24, 2020.

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Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index.

Indexes are all based in dollars.

S&P 500 is a stock market index that tracks the stocks of 500 large-cap U.S. companies. It represents the stock market's performance by reporting the risks and returns of the biggest companies.

MSCI All Country World Index is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world.

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Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

It is not possible to invest directly in an index.

Asset allocation, diversification, dollar cost averaging and rebalancing do not ensure a profit or protect against loss in declining markets. Dollar cost averaging involves continual investment in securities regardless of fluctuating price levels; you should consider your willingness to continue purchasing during periods of high or low price levels.

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